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Internal Revenue Bulletin

Cumulative Bulletin XI-2

JULY-DECEMBER, 1932

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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

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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 : 1933

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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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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-2, 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, and miscellaneous taxes, as indicated on the title-page of this Bulletin, published in the weekly Bulletins (Volume XI, Nos. 27 to 52, inclusive) for the period July 1 to December 31, 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 December 31, 1932.

Income Tax rulings are printed in three parts. Rulings under the Revenue Act of 1932 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 77. Rulings under the Revenue Act of 1928 are published as Part II, the section and article headings corresponding with the section and article headings of the Revenue Act of 1928 and Regulations 74, respectively. Rulings under the Revenue Act of 1926 and prior Acts are printed as Part III, the section and article headings corresponding with the section and article headings of the Revenue Act of 1926 and Regulations 69, respectively.

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.

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.

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.

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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 DECEMBER 31, 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 December 31, 1932, inclusive.]

[a] XI–52–5946

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

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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
Afremow, David, estate of	39593	25	1246
Afremow, Sarah, executrix	39593	25	1246
Albert Lea Packing Co., Inc	20765	24	376
Allen, Irene C	25414	25	834
Allied American Corporation	31704	25	1276
American Cigar Co	16229	21	464
American Feature Film Co	27623	24	18
American Security & Trust Co. et al., executors [1]	39167	24	334
Anderson, Gustave	36224	26	1208
B.			
Baldwin, Florence G	32387	23	512
Balfour, Sir Robert	40230	25	154
Bankers Dairy Credit Corporation	48329	26	886
Barber, Arthur	26747	25	513
Barber, Philip C	26755	25	513

[1] Estate tax decision.

[a] Ruling No. 5946 includes all acquiescence and nonacquiescence notices published in the Internal Revenue Bulletin service from January 1 to December 31, 1932.

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Bellows Falls Power Co	18592 29104	25	195
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
Boos Bros. Cafeteria Co	39200	25	651
Borg & Beck Co	24223 34964	24	995
Brown, Berenice	24667 36637	25	814
Buck, John A., estate of [1]	32584 44153 44684	25	780
Buck et al., Mary M., executors [1]	32584 44153 44684	25	780
Buena Vista Land & Development Co	2025	13	895
Bullock, George [2]	31209	23	710
Butler, U. H	46055	24	506
C.			
California Coast Oil Co	25018	25	902
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
Catlin, Daniel K	25421	25	834
Catlin, Theron E	25413	25	834
Central Market Street Co.[3]	24837	25	499
Central National Bank, trustee	28701	25	1123
Central Rendering Corporation	20776	24	376
Chapman & Dewey Land Co	37403 51059	25	1166
Chapman & Dewey Lumber Co	33466 37402 47130 50196 51058	25	1166

[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.

ACQUIESCENCES—Continued.

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Christopher, Rachel S.[1]	47704	26	292
City Bank Farmers Trust Co. et al., executors [1]	31869	23	663
Clark et al., James, executors	34499	24	1235
Clements, W. L	46058	24	506
Clinchfield Securities Co	40554	25	446
Colorado & Utah Coal Co	53799	26	588
Columbian Carbon Co.[2]	42743	25	456
Connecticut River Power Co	18591 29106	25	195
Cook, Elizabeth E.[3]	38579	25	1351
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 [4]	42619	24	461
Crouse, George N	43446 51419	26	477
Crowley, Joseph J., estate of [1]	35472	25	340
Crowninshield Shipbuilding Co	18987	24	925
Culver, Wilmer T	37574	24	1013
Cunard Coal Co.[5]	26874 26875 28792	26	234
D.			
Dahl, Andrew H., estate of	44845	24	1167
Dahl et al., Julia, executors	44845	24	1167
Daley, Eugene S., executor	26645	25	949
Davis, John A	20703	24	36
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
Dome Co	41887	26	967
Dominion National Bank	52165	26	421
Douglas Co., John	38726	23	1307
Drexel Packing Co	20775	24	376
Duff, Robert C.[6]	37552	23	1342
E.			
Eagle Pass & Piedras Negras Bridge Co	42460	23	1337
Elkins, Hallie D.[7]	39255	24	572
Elliott-Granite Linen Corporation	48212	26	936
Emery, Mary M., estate of [7]	40899	25	585
Enameled Metals Co	19011	25	186

[1] Estate tax decision.
[2] Nonacquiescence published in Bulletin XI-14, page 1, revoked.
[3] Acquiescence relates to issues regarding allocation of total cost between common and preferred stocks purchased.
[4] Estate tax decision; nonacquiescence published in Cumulative Bulletin X-2, pages 84, 88, revoked.
[5] Acquiescence relates to deductions for additional royalties and officers' salaries and directors' fees.
[6] Acquiescence relates to issue 1 of decision.
[7] Nonacquiescence published in Cumulative Bulletin XI-1, page 9, revoked.

ACQUIESCENCES—Continued.

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F.			
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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
First National Bank of Key West	45186	26	370
Florence Manufacturing Co	15383 26079	25	676
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.			
Gambill, A. A	47902	26	995
Gardner, Charles E.[2]	38575	25	1351
Garron et al., Isabel K. J., executors [1]	47705	26	292
George Machinery Co., R. B	61218	26	594
Ginsberg, Albert A	27628	24	18
Ginsberg, Nathan A	27629	24	18
Globe Construction Co	43438 51694 53310	25	146
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
Griffis, Stanton [2]	38577	25	1351
Griffiths, George W	42498	25	1292
Griffiths, John	43074	25	1292
Gulf Coast Irrigation Co.[4]	33694 40081 41343	24	958
Gurnee, Augustus Coe, estate of [5]	42619	24	461
H.			
Haberland, Paul	29289	25	1370
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

[1] Estate tax decision.
[2] Acquiescence relates to issues regarding allocation of total cost between common and preferred stocks purchased.
[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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Hartford-Empire Co	29958 41736 53600	26	134
Havard, Charles	32841	25	1161
Hay, W. H	37499	25	96
Hayman Co., B	16552	25	736
Hemphill, Clifford [2]	38573	25	1351
Hervey, W. R	46806	25	1282
Hess, Nathaniel J	33279	24	475
Hickman, Fannie Snyder	16253	24	438
Himelhoch Bros. & Co	41728 42769 45663	26	541
Hires Co., Charles E	47781	26	1351
Hobbs, Henry	27352	26	241
Hobbs, Teck	27351	26	241
Hoffer, Anita Owens	33374	24	22
Hoffer, T. B	33375	24	22
Houston Bros. [3]	12052	22	51
Houston, George T. [3]	13104 22008	22	51
Houston, Horace K. [3]	22009	22	51
Houston, Philip D. [3]	22007	22	51
Hunter, C. W., executor	45417	26	417
Hunter, George H., estate of	45417	26	417
Huyler's, Inc	28369 29154 39841	24	425
I.			
Ingalls, Charles C., estate of [1]	57835	25	773
Interstate Realty Co	46272 50981	25	728
Iten Biscuit Co	16429 20899	25	880
K.			
Kammerdiner, J	41643 46555	25	495
Kansas City Leasehold & Improvement Co. [4]	35718	17	213
Kansas City & Memphis Farms Co	51060	25	1166
Kasch, Ed	48293	25	284
Kasch, Theodora	48293	25	284
Kelley, John P	38233	26	212
Kent, Everett E	39576 42589 46064	26	482

[1] Estate tax decision.

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

[3] Acquiescence relates only to deduction for business expenses in 1920 and to number of feet of timber cut during 1919.

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

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L.			
Lake Charles Naval Stores	34630 36940	25	173
Landers, Douglas J., estate of [1]	35443	21	1347
Lawson, John	40232	25	154
Leamington Hotel Co	48413	26	1004
Leidesdorf, Samuel D	48305	26	881
Leonard Holding Corporation, George B., estate of	48871	26	46
Liberty Farms Co	26717 29899	22	1298
Lincoln, Robert Todd, estate of [1]	39167	24	334
Littauer, Eugene, estate of [2]	51858	25	21
Littauer et al., Lucius N., executors [2]	51858	25	21
Livingood, Charles J., executor [3]	40899	25	585
Loeb, jr., et al., William, trustees	34161	26	635
Logel, Joseph F	37762 40071	24	798
Longyear, Mary B., estate of	36438 46583	25	252
Lourie, David A	27630	24	18
Luhrig Collieries Co	40048	26	194
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
Marvin, Walter S.[5]	38578	25	1351
Matagarda Canal Co.[4]	40082 41345	24	958
Matthews, J. P	26250	22	858
Mauldin, I. M	26239	22	858
McCall, Florence [1]	47702	26	292
McCool, Bess	46059	24	506
McEwan, Anna B	25996	26	727
McEwan, et al., Anna B., executors	25997	26	727
McEwan, A. F	25995	26	727
McEwan, Lillian G	25994	26	727
McEwan, W. H., estate of	25997	26	727
McGrew, Elizabeth W	26753	25	513
McLennan, A. R	26730	25	1052
Mercantile-Commerce National Bank in St. Louis et al., executors and trustees [1]	35443	21	1347
Metropolitan Properties Corporation	45032	24	220
Milby & Dow Coal & Mining Co	22021 22022 26259 42184	24	40

[1] Estate tax decision.
[2] Estate tax decision; acquiescence relates to issues 4, 5, and 7 of decision.
[3] Nonacquiescence published in Cumulative Bulletin XI-1, page 10, revoked.
[4] Acquiescence relates to all issues except affiliation issue.
[5] Acquiescence relates to issues regarding allocation of total cost between common and preferred stocks purchased.

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Murtha & Schmohl Co	17911	17	442
Mutual Assurance Society of Virginia	43911	24	1102
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National Contracting Co.[3]	24520	25	407
National Mill Supply Co	37001	23	1362
National Packing Corporation	31668 33971	24	952
Netcher, Charles, estate of	38053	26	101
Netcher, Gladys Oliver, executrix	38053	26	101
Netcher, Irving	38052	26	101
Netcher, Townsend	38050	26	101
Newbury, Mollie Netcher	38049	26	101
Newbury, Mollie Netcher, trustee	38052	26	101
Newell et al., Sterling, executors [4]	57835	25	773
New England Power Co	18593 29105	25	195
New Market Investment Co.[5]	35719	17	213
Newton, Elizabeth K.[4]	47703	26	292
Newton, Joseph R., estate of [4]	47705	26	292
New York, Chicago & St. Louis R. R. Co	21047	23	177
Northern Coal Co.[6]	34945	24	307
Noyes, Jansen [7]	38574	25	1351
O.			
Oakley, Richard H	45778	24	1082
Ontario Realty Co.[5]	35721	17	213
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

[1] Acquiescence relates to issue 1 of decision.

[2] 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.

[3] 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.

[4] Estate tax decision.

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

[6] Acquiescence relates to inventory issue.

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

ACQUIESCENCES—Continued.

Taxpayer.	Docket No.	Board of Tax Appeals.	
		Volume.	Page.
Peavy-Moore Lumber Co	15823, 16355, 25986	25	223
Peavy-Wilson Lumber Co	15822, 16356, 25985	25	223
Pennsylvania Investors Co	20766	24	376
Perkins et al., Jacob	28701	25	1123
Pershouse, Alice E	26749	25	513
Pershouse, Mabel B	26748	25	513
Phillips, C. J	47901	26	995
Pictorial Review Co	43995	26	472
Pizitz Dry Goods Co., Louis	46585	22	161
P-M-K Petroleum Co.[1]	50576, 54779	24	360
Pope, Olive R	29274	25	1161
Powell, Benjamin I	50380	26	509
Price, Laura M	40659	24	216
Price, W. E	41072	24	216
Prophylactic Brush Co	32996, 47845, 47846	25	676
Prosser, Constance B	26752	25	513
Putnam Trust Co	34743	26	655
R.			
Rapp, John W., estate of	28618	24	1061
Rauh Realty Co	32822	26	48
Reardon & Sons Co., John	20773	24	376
Rialto Mining Corporation	48692, 56877	25	980
Richards & Hirschfeld, Inc	21715	24	1289
Robson, Clara P., estate of	26645	25	949
Rodeo-Vallejo Ferry Co.[2]	36411, 48528	24	936
Rosenberg, Louis	27626	24	18
Rosenbloom Finance Corporation [3]	35778, 40903	24	763
Roth, Gorton	22568	26	631
Roy & Titcomb, Inc	29138	24	969
Russell, C. C	46060	24	506
Russell, Mrs. C. C	46061	24	506
S.			
Sanders, W. C	26651	25	949
San Martinez Oil Co	37447, 43121	25	218
Sappington, G. Ridgely	51944	25	1385
Schepp Co., L	42908	25	419
Scovill Manufacturing Co	29854, 30238	25	265
Scruggs, Gross R	33610	24	1174
Scruggs Investment Co	46270	24	1174

[1] Acquiescence relates to third issue of decision.
[2] Acquiescence relates to deduction of contribution to Victory Highway Association.
[3] Acquiescence relates to holding of Board that distributions received from Joseph H. Finch & Co. were not partial liquidating dividends.

ACQUIESCENCES—Continued.

Taxpayer.	Docket No.	Board of Tax Appeals.	
		Volume.	Page.
Scruggs, Marian P	38711	24	1174
Seaconnet Coal Co.[1]	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
Simcoe Realty Co.[2]	35720	17	213
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
Smoot, Lewis E	32578	25	1038
Sprague & Son Co., C. H.[1]	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
Stegeman, A. V	26643	25	949
Stegeman, jr., Albert V	26650	25	949
Stegeman, Fannie L	26644	25	949
Stegeman, H. M	26647	25	949
Stegeman, H. R	26646	25	949
Stegeman, Mabel K	26649	25	949
Stegeman, William L	26648	25	949
Stevens, John H	29685	24	52
Stock Yards Bank of Cincinnati	41085	25	964
Stockham, Elijah	22569	26	631
Stone et al., Irving K., executors and trustees [3]	43830	26	1
Stone, Irving Lee, estate of [3]	43830	26	1
Stoneman, David	27627	24	18
Strong, Harold C. [4]	38576	25	1351
Sunburst Oil & Refining Co	45979	23	829
T.			
Talbot, J. A.[5]	36191	23	792
Texas Irrigation Co.[6]	40083 41346	24	958
Tifft, Charles	31029 33464 42340 45957	25	986

[1] Acquiescence relates to inventory issue.
[2] Acquiescence relates to March 1, 1913, value, for purposes of calculating gain or loss upon sale of land at Versailles, Mo.; whether the invested capital of the Simcoe Realty Co. should be increased for 1918; and the March 1, 1913, value for amortization purposes of a leasehold belonging to Kansas City Leasehold & Improvement Co.
[3] Estate tax decision; acquiescence relates to issue involving deductions from gross estate.
[4] Acquiescence relates to issues regarding allocation of total cost between common and preferred stocks purchased.
[5] Acquiescence relates to loss incurred in sale of a boat.
[6] Acquiescence relates to all issues except affiliation issue.

ACQUIESCENCES—Continued.

Taxpayer.	Docket No.	Board of Tax Appeals. Volume.	Page.
Tifft, Lewis E	31030, 33465, 42341, 45958	25	986
Tobey, Maurice	27624	24	18
Tolerton & Warfield Co.[1]	45320	23	892
Tracy, William R	45513	25	1055
Tricou, Sallie S	28093, 40258	25	713
Turrish, Henry	44742	24	913
Twin Bell Oil Syndicate	29518	26	165
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
V.			
Vaillant, Ethel Netcher	38051	26	101
W.			
Walker, George H., estate of [2]	31869	23	663
Ward Bros. Co	30992	24	989
Washington Market Co	43912	25	576
White Oak Transportation Co.[3]	18088	24	307
Whitney, Williard M	37927	26	212
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
Wilson Shipbuilding Co.[4]	34337	25	182
Wood Lumber Co., E. K	23605, 24156	25	1013
Wray, Eliza J	25881	24	94
Wright, George M	25854	22	858
Wright, Leonard Marshall	45508	26	21
Y.			
Young, Ethel P	38868	24	815
Yukon Alaska Trust	34161	26	635
Z.			
Zinsser & Co	5242	21	152

[1] Acquiescence relates to issue regarding deduction of loss sustained by petitioner during nonaffiliated period.
[2] Estate tax decision.
[3] Acquiescence relates to inventory issue.
[4] Acquiescence does not relate to issue 5 of decision.

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

Taxpayer.	Docket No.	Board of Tax Appeals. Volume.	Page.
A.			
Abelson Realty Co., Inc	53792	24	686
Abelson's, Inc	53793	24	686
Ackerman, Irving C	30311, 31634, 40948, 40949	24	512
Alameda Park Co	8355	25	850
Alker, Vera M. Kohler	36116	25	243
Allied Furriers Corporation	50059	24	457
American Brick & Tile Corporation	29994	22	1121
Apartment Corporation	42024	26	849
Arabol Manufacturing Co	50489	26	1068
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
Beebe, Junius, trustee	52707	26	190
Beebe, Marcus, estate of	52707	26	190
Belfast Investment Co.[2]	19128	17	213
Bell & Sons, Samuel	38056, 41647, 45616	22	793
Board of Fire Underwriters of the City of Duluth	43150	26	860
Boca Ceiga Development Co	40446	25	941
Brackman, J. W	45714	24	259
Bradbury, I. C	45780	23	1351
Brown, Frank A., estate of	47677	26	901
Brown, H. C	33343	25	631
Brown, Harry A	48136	26	901
Brown, Pearl B., executrix	47677	26	901
Buck, John A., estate of [3]	32584, 44153, 44684	25	780
Buck et al., Mary M., executors [3]	32584, 44153, 44684	25	780
Bullock, George [4]	31209	23	710
Burdette, Clara	37321	25	692
Burley, Blanche B., executrix	44909	26	615
Busche, F. C.[5]	9447, 10202, 10755	10	1345
Business Real Estate Trust of Boston	33469, 42684, 50305	25	191
Butler-Veitch Co	45169, 45170	23	953

[1] Estate tax decision.
[2] Nonacquiescence in issue as to whether petitioner is entitled to deduction for amortization of the Lee tract warehouse for 1918.
[3] Estate tax decision; nonacquiescence relates to deduction of amount of a claim filed against the estate and allowed by probate court.
[4] Nonacquiescence relates to issue 1 of decision.
[5] Acquiescence published in Cumulative Bulletin X-1 withdrawn.

NONACQUIESCENCES—Continued.

Taxpayer.	Docket No.	Board of Tax Appeals. Volume.	Page.
C.			
Carey Fibre Products Co., Emerson	36381	26	675
Carey Salt Co	36382	26	675
Central Market Street Co.[1]	24837	25	499
Central Union Trust Co. of New York, executor	31736	25	757
Chenowith, H. C	38349	26	301
Cobleigh, Margaret Edwards, estate of [2]	40765	24	176
Commercial Garage Co	41646	22	793
Cook, Elizabeth E.[3]	38579	25	1351
Cook, Sam	35014	25	92
Cooper, A. T.[4]	3144	7	798
Crile, Grace McBride	43136	26	1020
Cross, Maurice	32735	24	1079
Cunard Coal Co.[5]	26874 26875 28792	26	234
D.			
Davis, C. R.[6]	10299 32950	10 20	1233 931
Davis, Frederick H	37324	24	405
Davis, Thomas L	37395	24	405
Degener, John F., estate of [2]	38500	26	185
Degener, jr., et al., John F., executors [2]	38500	26	185
Delaware & Hudson Co	50553 50629	26	520
De Lisser, Horace, estate of [7]	2459	2	102
Dohrmann, Andrew B. C	20658 23969	19 19	507 466
Duff, Robert C.[8]	37552	23	1342
E.			
Eifert, Earl C	45781	23	1351
Everhart, James William	26675	26	318
F.			
Fairmount Cemetery Association	30925 42811	25	1272
Field, Marshall	36908	26	116
Fifth Street Building	16627 29264 45537	24	876
First National Bank of Boston, administrator [2]	44746	25	612
First Peoples Trust	45403	26	551
Fletcher, Salathiel R	33041	24	75
Foster, Caroline B., estate of [2]	46672	26	708
Foster et al., Charles H. W., executors [2]	46672	26	708

[1] Nonacquiescence relates to issue regarding Board's jurisdiction of subsidiaries.
[2] Estate tax decision.
[3] Nonacquiescence relates to value of common stock of American Chain Co., Inc., and the basis of allocation of cost between said common stock and preferred stock of said company acquired at the same time and under the same agreement.
[4] Acquiescence published in Cumulative Bulletin VII–1, page 1, withdrawn
[5] Nonacquiescence relates to expenditures for mine equipment.
[6] Acquiescence published in Cumulative Bulletin X–1 withdrawn.
[7] Estate tax decision; acquiescence published in Cumulative Bulletin X–2 recalled.
[8] Nonacquiescence relates to issue 2 of decision.

NONACQUIESCENCES—Continued.

Taxpayer.	Docket No.	Board of Tax Appeals. Volume.	Page.
G.			
G. M. & S. Co	16383	26	223
Garcin, Edward H	21657	22	1027
Gardner, Charles E.[1]	38575	25	1351
Garrie, Daniel T., estate of	31736	25	757
Garvan, John Joseph, estate of [2]	44746	25	612
Gassner, Louis [3]	4017	4	1071
Goetjen & Metson Co	17875	26	223
Goldberg, Harry S.[3]	5389	4	1073
Goldschmidt et al., Georgette, executors [4]	16138	14	1010
Goldschmidt, Henry P., estate of [4]	16138	14	1010
Graham, M. H	38335	26	301
Green, Robert D.[5]	53647	24	719
Greenleaf Textile Corporation	46746	26	737
Griffis, Stanton [1]	38577	25	1351
Gulf Coast Irrigation Co.[6]	33694 40081 41343	24	958
Gulf, Mobile & Northern R. R. Co. [7 8]	24887 42150	22	233
H.			
Hancock, G. Allan	36867	25	607
Hanson, Charles C	15398	23	590
Harris, Allen [3]	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
Hemphill, Clifford [1]	38573	25	1351
Henn, A. W	37102	20	1133
Hieronymus, Carl Richard, estate of	48930	24	269
Higley & Co., E. B	51003	25	127
Hill, D. F., estate of [2]	29399	24	1144
Hill et al., Paul F., executors [2]	29399	24	1144
Hodges, Agnes Wiley, executrix	38336	26	301
Hodges, W. L., estate of	38336	26	301
Hodges, W. L., trustee	38337	26	301
Household Products, Inc	44809	24	594
Houston Baseball Association	43985 45430	24	69

[1] Nonacquiescence relates to value of common stock of American Chain Co., Inc., and the basis of allocation of cost between said common stock and preferred stock of said company acquired at the same time and under the same agreement.
[2] Estate tax decision.
[3] Acquiescence published in Cumulative Bulletin X-1 withdrawn.
[4] Estate tax decision; acquiescence published in Cumulative Bulletin X-2 recalled.
[5] Nonacquiescence relates to transaction 5.
[6] Nonacquiescence relates to affiliation issue.
[7] Nonacquiescence relates to issues involving award of Interstate Commerce Commission in 1920 for transportation of United States mails in 1916 and 1917; and deduction in 1926 for depreciation on ways and structures.
[8] Nonacquiescence applies to the entire decision of the board in so far as it is adverse to the Commissioner. Partial acquiescence published in Bulletin XI-28, page 1, revoked.

NONACQUIESCENCES—Continued.

Taxpayer.	Docket No.	Board of Tax Appeals. Volume.	Page.
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
Hunter, G. W., estate of [2]	33564	25	1078
Hutchison Coal Co	34939	24	973
I.			
Imperial Elevator Co	35688	25	234
Imperial Investment Co	29291	23	1281
Indianapolis, Crawfordsville & Danville Electric Ry. Co	33859	24	197
Indianapolis & Northwestern Traction Co	33861	24	197
Iten Biscuit Co	43667, 45164	25	870
Ives Dairy, Inc	39873	23	579
J.			
Jackson & Eastern Ry. Co	38295, [3] 42149	22	233
Jackson, Wermich Trust	32307	24	150
Jamison Coal & Coke Co	31690, 34088	24	554
Jefferson Standard Life Insurance Co	43149	25	1335
K.			
Knapp, Kittie A.[4]	2775	7	790
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 [5]	16985	10	1096
L.			
Laun, Alfred A	45347	26	764
Laun, J. B	45348	26	764
Leetonia Furnace Co	32272	23	979
Levine, Hyman [6]	7435	8	298
Liebes & Co., H	28544, 35038	23	787
Littauer, Eugene, estate of [6]	51858	25	21
Littauer et al., Lucius N., executors [6]	51858	25	21
M.			
Manchester Coal Co	33392	24	577
Margay Oil Corporation	44891	26	199
Markham Irrigation Co.[7]	41344	24	958

[1] Nonacquiescence relates to March 1, 1913, value and to the basis for the deduction for depletion and for the computation of gain or loss upon subsequent sale of the timber.
[2] Estate tax decision.
[3] Nonacquiescence relates to issue involving deduction for depreciation on ways and structures.
[4] Acquiescence published in Cumulative Bulletin VII–1, page 17, withdrawn.
[5] Acquiescence published in Cumulative Bulletin X–1 withdrawn.
[6] 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.
[7] Nonacquiescence relates to affiliation issue.

NONACQUIESCENCES—Continued.

Taxpayer.	Docket No.	Board of Tax Appeals. Volume.	Page.
Marvin, Walter S.[1]	38578	25	1351
Matagarda Canal Co.[2]	40082, 41345	24	958
McCormick et al., Cyrus H., trustees	44139	26	1172
McCrory, Luke W., trustee	32444	25	994
Miglietta, Olga K	36379	25	243
Moore Bread Co	41645	22	793
Moore, G. H	38351	26	301
Morganite Brush Co., Inc	26369	24	776
Moro Realty Holding Corporation	37406, 44759, 50490	25	1135
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.[3]	24520	25	407
National Land & Construction Co	40126	25	562
National Pipe & Foundry Co.[4]	32997	19	242
Neal et al., J. Henry, trustees	45403	26	551
Neill, James[5]	9290	8	299
Newblock Oil Co. of Texas	28045	26	696
New York Life Insurance Co	38880	24	1217
Nichols & Cox Lumber Co	23601	24	54
Nicodemus, jr., F. C	52326, 62569	26	125
Nielsen Co., E. H	8899	26	223
North American Investment Co	30183	24	419
Northern Coal Co.[6]	34945	24	307
Noyes, Jansen[1]	38574	25	1351
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

[1] Nonacquiescence relates to value of common stock of American Chain Co., Inc., and the basis of allocation of cost between said common stock and preferred stock of said company acquired at the same time and under the same agreement.
[2] Nonacquiescence relates to affiliation issue.
[3] Nonacquiescence relates to issue 1 of decision and issue regarding deductibility of overhead costs in 1925.
[4] Acquiescence published in Cumulative Bulletin IX-2, 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.
[5] Acquiescence published in Cumulative Bulletin X-1 withdrawn.
[6] Nonacquiescence relates to statute of limitations issue.

NONACQUIESCENCES—Continued.

Taxpayer.	Docket No.	Board of Tax Appeals. Volume.	Page.
Omaha Coca-Cola Bottling Co	52641	26	1123
Oswego Falls Corporation	28301 32673 34352	26	60
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
Petaluma & Santa Rosa R. R. Co.[2]	13830	11	541
Phillips, William S	24446 31769	24	98
Plettner, Maude Brown	33345	25	631
P-M-K Petroleum Co.[3]	50576 54779	24	360
R.			
Richfield Oil Co	42921	25	101
Riffel, Henry [4]	3576	3	436
Riley Stoker Corporation	36584	26	749
Roberts, Walter B	37534	24	405
Rodeo-Vallejo Ferry Co.[3]	36411 48528	24	936
Rosenbloom Finance Corporation [5]	35778 40903	24	763
Rosser, E. M., executor [1]	40765	24	176
Roth, W. A.[6]	45065	22	587
S.			
St. Louis Southwestern Ry. Co	13319 27768 33938	24	917
Salomon, Leon [6]	3725	4	1109
	12231	8	979
San Carlos Milling Co., Ltd.[7]	39525	24	1132
Sand Springs Ry. Co	32438 32439	21	1291
Sather Lease—Thomas Sather & Co	31979	26	86
Schwartz-Kasser Improvement Co	36876	26	322
Seaconnet Coal Co.[8]	18089	24	307
Seatree, William Ernest	22094 33640	25	396
Selwyn Eddy Co	21612	25	1341
Small's, Inc	53791	24	686
Snyder, Inc., H. S. & M. W	36686	26	692

[1] Estate tax decision.
[2] Nonacquiescence relates to that part of decision concerning purchase of taxpayer's own bonds at less than par which were held as an investment. Acquiescence notice as to this issue published in Cumulative Bulletin VII-2, page 31, revoked.
[3] Nonacquiescence relates to first issue of decision.
[4] Estate tax decision; acquiescence published in Cumulative Bulletin X-2 recalled.
[5] Nonacquiescence does not relate to the Board's holding that distributions received from Joseph H. Finch & Co. were not partial liquidating dividends.
[6] Acquiescence published in Cumulative Bulletin X-1 withdrawn.
[7] Acquiescence as to issue 2 published in Cumulative Bulletin XI-1, page 6, and nonacquiescence as to issue 1 published in Cumulative Bulletin XI-1, page 11, withdrawn.
[8] Nonacquiescence relates to statute of limitations issue.

NONACQUIESCENCES—Continued.

Taxpayer.	Docket No.	Board of Tax Appeals. Volume.	Page.
Sprague & Son Co., C. H.[1]	34946	24	307
Spring City Foundry Co	21169	25	822
Stanley Co. of America	31516 33142 40023	26	705
Stearns, Marshall, administrator	48930	24	269
Stern et al., Samuel E. A., executors[2]	2459	2	102
Stockholms Enskilda Bank	55755	25	1328
Stone, H. C., estate of	38336	26	301
Stone, Mrs. H. C., executrix	38336	26	301
Stone et al., Irving K., executors and trustees[3]	43830	26	1
Stone, Irving Lee, estate of [3]	43830	26	1
Strong, Harold C.[4]	38576	25	1351
Sturgeon-Hubbard Trust	37095	25	368
Sturgeon et al, Rollin S., trustees	37095	25	368
Suncrest Lumber Co	33244	25	375
Swartz, Inc., Edward G	36650	25	1065
Swift, Mary Dodson, estate of	44909	26	615
Swisky, Toby W	42032	25	259
T.			
Talbot, J. A.[5]	36191	23	792
Tennessee Consolidated Coal Co	33383	24	369
Terre Haute, Indianapolis & Eastern Traction Co	33858	24	197
Terre Haute Traction & Light Co	33860	24	197
Texas Irrigation Co.[6]	40083 41346	24	958
Titus, C. Dickson	20705	24	36
Todd, Willis	37536	24	405
Tolerton & Warfield Co.[7]	45320	23	892
Towers & Sullivan Manufacturing Co	40508	25	922
Trojan Oil Co	33757	26	659
Twin Bell Oil Syndicate	45052	26	172
U.			
Union Trust Co., trustee	42917	24	84
United Oil Co	38082 42922 51622	25	101
V.			
Van Camp Packing Co., Inc	46131	26	256
Voelbel, Jacob, estate of [2]	6009	7	276
Voelbel, Walter W., executor [2]	6009	7	276

[1] Nonacquiescence relates to statute of limitations issue.
[2] Estate tax decision; acquiescence published in Cumulative Bulletin X-2 recalled.
[3] Estate tax decision; nonacquiescence relates to issue involving property transferred by trust agreement.
[4] Nonacquiescence relates to value of common stock of American Chain Co., Inc., and the basis of allocation of cost between said common stock and preferred stock of said company acquired at the same time and under the same agreement.
[5] Nonacquiescence relates to depreciation allowance in computing loss in sale of a boat.
[6] Nonacquiescence relates to affiliation issue.
[7] 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.
W.			
Waggoner, Ella	33517	24	657
Waggoner, W. T	33516	24	657
Wall, Frank E.[1]	7359	4	915
Wardman, Harry	22348	24	102
Warner Collieries Co. of Delaware	34679	26	1047
Wayne County & Home Savings Bank	49144	26	761
West Virginia-Pittsburgh Coal Co	20337 25030	24	234
White Oak Transportation Co.[2]	18088	24	307
White, Rita M. Kohler	36112	25	243
Williams et al., Frank G., executors	33564	25	1078
Wilson, Luke F., estate of	32444	25	994
Wilson Shipbuilding Co.[3]	34337	25	182
Wobber Bros	36875	26	322
Wobbers, Inc	36874	26	322
Wood Furniture Co., J. A	40565	21	564
Woodward, George [4]	42279	23	1258
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.
[3] Nonacquiescence relates to issue 5 of decision.
[4] Acquiescence published in Cumulative Bulletin X-2, page 78, withdrawn.

INCOME TAX RULINGS.—PART I.

REVENUE ACT OF 1932.

SUBTITLE B.—GENERAL PROVISIONS.

PART II.—COMPUTATION OF NET INCOME.

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

ARTICLE 81: Exclusions from gross income. XI-46-5850
I. T. 2655

REVENUE ACT OF 1932.

Pensions received from the United States by a veteran for services rendered to the United States in time of war, other than amounts paid under the World War Veterans' Act of 1924, are subject to Federal income tax.

Pensions received from the United States by the family of a veteran for services rendered by the veteran to the United States in time of war, are exempt, as gifts.

All types of compensation received by a veteran or his family under the World War Veterans' Act of 1924 are exempt from Federal income tax, and, to the extent that such compensation is paid under the provisions of that Act, exemption applies to all types of compensation received by a veteran or his family under the provisions of the War Risk Insurance and Vocational Rehabilitation Acts.

Information is requested relative to the taxability of amounts received as compensation, family allotments, and allowances under the provisions of the War Risk Insurance and the Vocational Rehabilitation Acts, and the World War Veterans' Act, 1924, or as pensions from the United States for service of the beneficiary or another in the military or naval forces of the United States in time of war.

Under section 22(b)6 of the Revenue Act of 1928 the items of income referred to received by a veteran or his beneficiary were not required to be included in gross income and were exempt from Federal income tax. The Revenue Act of 1932 in specifying the items of gross income which are to be excluded from gross income does not mention the items of gross income designated in section 22(b)6 of the Revenue Act of 1928. Attention has been directed to the fact that section 22 of the World War Veterans' Act, 1924, provides that the compensation, insurance, maintenance, and support allowances payable under Titles II, III, and IV of that Act are exempt from all taxation.

The specific question is whether such payments are subject to Federal income tax by reason of the fact that a provision similar to

section 22(b)6 of the Revenue Act of 1928 is not contained in the Revenue Act of 1932.

Section 22(b) of the Revenue Act of 1928 provides in part as follows:

Exclusions from gross income.—The following items shall not be included in gross income and shall be exempt from taxation under this title:

* * * * * * *

(6) *Pensions and World War compensation payments.*—Amounts received as compensation, family allotments and allowances under the provisions of the War Risk Insurance and the Vocational Rehabilitation Acts or the World War Veterans' Act, 1924, or as pensions from the United States for service of the beneficiary or another in the military or naval forces of the United States in time of war, or as a State pension for services rendered by the beneficiary or another for which the State is paying a pension * * *.

The World War Veterans' Act, 1924 (43 Stat., 607), is entitled as follows:

An Act to consolidate, codify, revise, and reenact the laws affecting the establishment of the United States Veterans' Bureau and the administration of the War Risk Insurance Act, as amended, and the Vocational Rehabilitation Act, as amended.

Section 601 of that Act provides in part as follows:

That the following Acts are hereby repealed. The sections of this codification herein applicable thereto shall be in force in lieu thereof, subject to the limitations contained in this title.

(1) The War Risk Insurance Act as amended.

(2) The Vocational Rehabilitation Act as amended.

It is evident, therefore, that the amounts payable to veterans under the provisions of the War Risk Insurance Act, as amended, and the Vocational Rehabilitation Act, as amended, are now being paid under the provisions of the World War Veterans' Act, 1924.

Section 22 of the World War Veterans' Act, 1924, provides as follows:

That the compensation, insurance, and maintenance and support allowance payable under Titles II, III, and IV, respectively, shall not be assignable; shall not be subject to the claims of creditors of any person to whom an award is made under Titles II, III, or IV; and shall be exempt from all taxation: *Provided*, That such compensation, insurance, and maintenance and support allowance shall be subject to any claims which the United States may have, under Titles II, III, IV, and V, against the person on whose account the compensation, insurance, or maintenance and support allowance is payable.

That the provisions of this section shall not be construed to prohibit the assignment by any person to whom converted insurance shall be payable under Title III of such Act of his interest in such insurance to any other member of the permitted class of beneficiaries.

The omission from the Revenue Act of 1932 of provisions similar to those of section 22(b)6 of the Revenue Act of 1928 had no effect on section 22 of the World War Veterans' Act, 1924. From the information available it appears that section 22 of the World War Veterans' Act, 1924, has not been amended, modified, or repealed. Therefore its provisions are still in effect.

Advice is requested specifically in the following types of payments:

(1) Pensions received from the United States by a veteran for services rendered to the United States in time of war.

Pensions received from the United States by a veteran for services rendered to the United States in time of war, other than amounts paid under the World War Veterans' Act, 1924, are subject to Federal income tax.

(2) Pensions received from the United States by the family of a veteran for services rendered by the veteran to the United States in time of war.

Pensions received from the United States by the family of a veteran for services rendered by the veteran to the United States in time of war are exempt, as gifts, from Federal income tax.

(3) All types of compensation received either by a veteran or his family under the provisions of the War Risk Insurance Act.

All types of compensation received either by a veteran or his family under the provisions of the War Risk Insurance Act, to the extent that such compensation is paid under the World War Veterans' Act, 1924, are exempt from Federal income tax.

(4) All types of compensation received either by a veteran or his family under the Vocational Rehabilitation Act.

All types of compensation received either by a veteran or his family under the Vocational Rehabilitation Act, to the extent that such compensation is paid under the provisions of the World War Veterans' Act, 1924, are exempt from Federal income tax.

(5) All types of compensation received either by a veteran or his family under the World War Veterans' Act, 1924.

All types of compensation received either by a veteran or his family under the World War Veterans' Act, 1924, are exempt from Federal income tax.

ARTICLE 81: Exclusions from gross income. XI–50–5912
I. T. 2660

REVENUE ACT OF 1932.

The emergency officers' retirement pay received under the Tyson-Fitzgerald Act of May 24, 1928, is subject to Federal income tax.

Advice is requested whether emergency officers' retirement pay received under the Tyson-Fitzgerald Act of May 24, 1928 (Public, No. 506, Seventieth Congress (S. 777, 45 Stat., 735)), is subject to Federal income tax under the provisions of the Revenue Act of 1932.

An exemption in a tax law must be clearly expressed and will not be implied. (*Bank of Commerce et al.* v. *State of Tennessee*, 161 U. S., 134.) An exemption from taxation is an extraordinary grace of the sovereign power, and is to be strictly construed. It must be made to appear plainly, either by the express words or necessary intendment of the statute. (A. R. R. 1122, C. B. I–2, 142.)

There is no provision in the Revenue Act of 1932, or in the Tyson-Fitzgerald Act of May 24, 1928, specifically exempting from income tax the emergency officers' retirement pay provided for in the latter Act. Therefore, such retirement pay is subject to Federal income tax under the Revenue Act of 1932.

As to exemption under the Revenue Act of 1928, see I. T. 2456 (C. B. VIII–1, 67).

ARTICLE 82: Proceeds of insurance—Compensation. XI-43-5803
G. C. M. 10843

REVENUE ACT OF 1932 AND PRIOR REVENUE ACTS.

The proceeds of the so-called "Family income policy—20-year period" issued by the M Company are wholly exempt from taxation as "amounts received under a life insurance contract paid upon the death of the insured," in accordance with the provisions of section 22(b)1 of the Revenue Act of 1932 and the corresponding provisions of prior Revenue Acts.

An opinion is requested relative to the taxability of the proceeds of an insurance policy issued by the M Company known as the "Family income policy—20-year period."

The policy provides that the company will pay the beneficiary $100 a month from date of death of the insured to the expiration of 20 years from the date the policy was *issued*, and $10,000 in cash at the end of the 20-year period. Thus, if the policy is issued in 1932 and the insured should die in 1937, five years after issuance, the company will pay the beneficiary $100 a month for 15 years (1937 to 1952), and $10,000 cash in 1952. If the insured should die in 1942, 10 years after issuance of the policy, the company will pay the beneficiary $100 a month for 10 years (1942 to 1952), and $10,000 cash in 1952. These payments are based on a guaranteed interest rate of 3 per cent. Should the company declare interest at a rate in excess of 3 per cent for any year, the beneficiary will receive excess interest in addition to the $100 a month which is guaranteed.

In order to accomplish this result, the company issues a policy containing two factors: (1) $10,000 of ordinary life insurance, and (2) decreasing term insurance. For example: On a $10,000 basis, as soon as the policy is issued it would have a commuted value in case of immediate death amounting to $23,680—that is, $10,000 of ordinary life insurance and $13,680 of term insurance. Therefore, if death occurred immediately the company would settle the policy as follows: (1) $10,000 would be held by the company and only the interest on that sum paid to the beneficiary for 20 years, the $10,000 being paid to the beneficiary in cash at the end of the 20-year period. Interest at 3 per cent would amount to $300 a year, and (2) $13,680 would be paid to the beneficiary in 240 monthly installments. At the guaranteed 3 per cent interest rate these monthly installments would amount to $900 a year. Combining the $300 of interest and the $900 of installments, the beneficiary would receive for 20 years $1,200 a year and $10,000 in cash at the end of the 20-year period. The company would also pay the beneficiary during the 20-year period excess interest on the $10,000 which is being held at interest, and also on the balance remaining under the installment settlement. This excess interest would be the difference between the interest rate as declared by the company and the guaranteed 3 per cent rate.

If the insured should die 10 years after the policy was issued, the commuted value would be $17,840—that is, $10,000 of ordinary life insurance and $7,840 of term insurance: In this case the company would settle the policy as follows: (1) $10,000 would be held by the company and only the interest on that sum paid to the beneficiary for 10 years, the $10,000 being paid to the beneficiary in

cash at the end of the 10-year period. Interest at 3 per cent would amount to $300 a year, and (2) $7,840 would be paid to the beneficiary in 120 monthly installments. At the guaranteed 3 per cent interest rate these monthly installments would amount to $900 a year. Combining the $300 of interest and the $900 of installments, the beneficiary would receive $1,200 a year for 10 years and $10,000 in cash at the end of the 10-year period. The company would also pay the beneficiary excess interest, as previously explained, during the 10-year period.

In Law Opinion 995 (C. B. 2, 90) it was concluded that where under a life insurance policy there is payable to the first beneficiary named 6 per cent per annum of the face value of the policy during life and, upon the death of the first beneficiary, the face value of the policy is payable to a second beneficiary, the payments to the first beneficiary are a part of the proceeds of the policy within the meaning of section 213(b)1 of the Revenue Act of 1918, and are not to be included in gross income for the purpose of the income tax. Law Opinion 995 reads in part as follows:

> While the amount of the face of the policy will earn income, although materially less than 6 per cent, in the hands of the company during the period ensuing between the death of the insured and the death of the first beneficiary, this fact is doubtless taken into consideration by the company in fixing the amount of additional premium charged to cover the risk. The withholding of the payment of the face of the policy during the lifetime of the first beneficiary is one of the things contracted for by the insured and constitutes as much a part of the consideration for the liability to pay income during the life of the first beneficiary, assumed by the company, as does the additional premium paid in cash. In view of these considerations it is impossible to escape the conclusion that the 6 per cent income payable to the first beneficiary during life under such a policy is not merely the payment of interest on the face value of the policy but is a part of the proceeds of the policy of insurance.

It is the view of this office that the reasoning and conclusion of that law opinion are equally applicable to the facts in the instant case. While the annual payments made under the policy represent, in part, earnings on the future or deferred payments to be made under the policy, the situation is not essentially different from the case where the proceeds of a policy are payable in periodic installments rather than in a lump sum upon the death of the insured. In either case the annual installments represent, in part, earnings on the deferred payments. However, the recent Revenue Acts have uniformly exempted from income tax the proceeds of a policy of life insurance payable upon death of the insured, whether paid in a single sum or in installments. The periodic payments under the policy here discussed represent installment payments.

It is, therefore, the opinion of this office that the proceeds of the so-called "Family income policy—20-year period" issued by the M Company are wholly exempt from taxation as "amounts received under a life insurance contract paid by reason of the death of the insured," in accordance with the provisions of section 22(b)1 of the Revenue Act of 1932 and the corresponding provisions of prior Revenue Acts.

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

160903°—33——3

ARTICLE 87: Interest upon United States obligations. XI-44-5817
I. T. 2651

REVENUE ACTS OF 1928 AND 1932.

Treasury bills issued subsequent to June 17, 1929, and beneficially owned by a nonresident alien individual not engaged in business in the United States, are, as to such individual, exempt, with reference to interest, from Federal income tax. Any gain from the sale or other disposition of Treasury bills issued subsequent to June 17, 1930, and beneficially owned by a nonresident alien individual not engaged in business in the United States, is, as to such individual, also exempt from that tax.

Advice is requested whether Treasury bills owned by a nonresident alien individual not engaged in business in the United States are exempt both as to principal and interest (discount at which issued) from Federal income tax the same as are Treasury notes and Treasury certificates of indebtedness.

Treasury bills are issued under the provisions of section 5 of the second Liberty Bond Act, approved September 24, 1917, as amended (Public, No. 11, Seventy-first Congress, June 17, 1929, and Public, No. 376, Seventy-first Congress, June 17, 1930). That section, as so amended, reads in part as follows:

SEC. 5. (a) That in addition to the bonds and notes authorized by sections 1 and 18 of this Act, as amended, the Secretary of the Treasury is authorized to borrow from time to time, on the credit of the United States, for the purposes of this Act, to provide for the purchase or redemption before maturity of any certificates of indebtedness or Treasury bills issued hereunder, and to meet public expenditures authorized by law, such sum or sums as in his judgment may be necessary, and to issue therefor (1) certificates of indebtedness of the United States at not less than par and at such rate or rates of interest, payable at such time or times as he may prescribe; or (2) Treasury bills on a discount basis and payable at maturity without interest. * * *

(b) All certificates of indebtedness and Treasury bills issued hereunder (after the date [June 17, 1929] upon which this subdivision becomes law) shall be exempt, both as to principal and interest, from all taxation (except estate and inheritance taxes) now or hereafter imposed by the United States, any State, or any of the possessions of the United States, or by any local taxing authority; and the amount of discount at which Treasury bills are originally sold by the United States shall be considered to be interest within the meaning of this subdivision.

(c) * * *

(d) Any gain from the sale or other disposition of Treasury bills issued hereunder (after the date [June 17, 1930] upon which this subdivision becomes law) shall be exempt from all taxation (except estate or inheritance taxes) now or hereafter imposed by the United States, any State, or any of the possessions of the United States, or by any local taxing authority * * *.

Under the provisions of section 5, as amended, supra, Treasury bills issued subsequent to June 17, 1929, and owned by any individual, are, as to interest, exempt from Federal income tax, and any gain from the sale or other disposition of Treasury bills issued subsequent to June 17, 1930, and owned by any individual, is, as to such individual, exempt from that tax.

Consequently, Treasury bills issued subsequent to June 17, 1929, and beneficially owned by a nonresident alien individual not engaged in business in the United States, are, as to such individual, exempt, with reference to interest, from Federal income tax, and any gain from the sale or other disposition of Treasury bills issued subsequent to June 17, 1930, and beneficially owned by a nonresident alien individual not engaged in business in the United States, is, as to such individual, exempt from that tax.

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

ARTICLE 121: Business expenses.

REVENUE ACT OF 1932.

Legal expenses incurred in securing a refund of customs duties or taxes, illegally or improperly collected. (See Mim. 3958, page 33.)

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

ARTICLE 151: Taxes. XI–48–5882
I. T. 2658

REVENUE ACT OF 1932.

The revenues derived from section 1001(a) of the Revenue Act of 1932 fall within the classification of postal receipts and not within the classification of internal revenue taxes, and the additional rate of postage is not deductible as a tax in Federal income tax returns.

Inquiry is made whether the increase in United States postage, namely, 1 cent for each ounce or fraction thereof in addition to the rate provided by existing law, is an emergency tax and deductible, as such, in Federal income tax returns.

Section 1001(a) of the Revenue Act of 1932 provides as follows:

On and after the thirtieth day after the date of the enactment of this Act and until July 1, 1934, the rate of postage on all mail matter of the first class (except postal cards and private mailing or post cards, and except other first class matter on which the rate of postage under existing law is 1 cent for each ounce or fraction thereof) shall be 1 cent for each ounce or fraction thereof in addition to the rate provided by existing law.

Although the section of the statute above quoted was incorporated in the Revenue Act of 1932 as a part of Title VIII, relating to postal rates, and became effective July 6, 1932, the revenues derived therefrom fall within the classification of postal receipts and not within the classification of internal revenue taxes. This increase in postage is not, therefore, deductible as a tax in Federal income tax returns.

ARTICLE 151: Taxes. XI–51–5930
Mim. 3988

Deductibility for Federal income tax purposes of the additional estate tax, gift tax, manufacturers' excise taxes, and miscellaneous taxes imposed by the Revenue Act of 1932.

TREASURY DEPARTMENT,
OFFICE OF COMMISSIONER OF INTERNAL REVENUE,
Washington, D. C., November 26, 1932.

Collectors of Internal Revenue, Internal Revenue Agents in Charge, and Other Officers and Employees of the Bureau of Internal Revenue Concerned:

Under section 23(c) of the Revenue Act of 1932, taxes paid or accrued within the taxable year are allowable deductions from gross income except—

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

(2) income, war-profits, and excess-profits taxes imposed by the authority of any foreign country or possession of the United States; but this deduction shall be allowed in the case of a taxpayer who does not signify in his return his desire to have to any extent the benefits of section 131 (relating to credit for taxes of foreign countries and possessions of the United States); and

(3) taxes assessed against local benefits of a kind tending to increase the value of the property assessed; but this paragraph shall not exclude the allowance as a deduction of so much of such taxes as is properly allocable to maintenance or interest charges.

The taxes referred to herein constitute allowable deductions from gross income for the year in which paid or accrued, provided they are not added to and made a part of the expenses of the business or the cost of articles of merchandise with respect to which they are paid, in which case they can not be separately deducted.

The titles and sections of the Act under which these taxes are imposed are arranged in the order in which they appear in the Act.

The person who is entitled to deduct the tax on the particular article or item to which the tax attaches is designated herein. The term "person" as used herein means an individual, a trust or estate, a partnership, or a corporation.

TITLE II.—ADDITIONAL ESTATE TAX.

The tax imposed by section 401 of this title, less any amount allowed under section 402 as a credit against such tax, is an allowable deduction from the gross income of the estate in computing the income thereof subject to the income tax. This deduction is in addition to the deduction allowable on account of the estate tax imposed by section 301(a) of the Revenue Act of 1926, less any amount allowed as a credit against such tax under sections 301(b) and 301(c) of that Act as amended by sections 801 and 802 of the Revenue Act of 1932. The tax is deductible for the year in which paid or accrued. Regulations relating to the imposition and application of the additional tax are in the course of preparation.

TITLE III.—GIFT TAX.

The tax imposed by section 501 of this title, computed in accordance with the gift tax rate schedule set forth in section 502, paid or accrued during the taxable year is an allowable deduction from the gross income of the donor of the property against whom such tax is assessed. If the tax is paid or is payable by the donee as a result of the statutory liability therefor, then, in such case, the tax paid or accrued constitutes an allowable deduction from the gross income of such donee. Regulations relating to the imposition and application of this tax are in the course of preparation.

TITLE IV.—MANUFACTURERS' EXCISE TAXES.

The taxes imposed under this title, with the exception of the import tax provided in section 601, are on certain articles sold, leased, or used by the manufacturer, producer, or importer on or after June 21, 1932, even though manufactured, produced, or imported before that date.

The tax imposed by section 601(a) applies to the articles specified in subsection (c), (2) to (7), inclusive, imported into the United

States on and after June 21, 1932 (unless treaty provisions of the United States otherwise provide), and will be administered by the Bureau of Customs under regulations promulgated by the Secretary of the Treasury.

The articles or items subject to the taxes imposed under this title are as follows:

Section—	Articles or items taxed.
601(c).	(1) Lubricating oils; (2) brewer's wort, liquid malt, malt sirup, and malt extract; (3) grape concentrate, evaporated grape juice, and grape sirup; (4) crude petroleum, gasoline, lubricating oil, and paraffin; (5) coal and coke; (6) lumber; (7) copper-bearing ores and concentrates.
602.	Tires and inner tubes.
603.	Toilet preparations, etc.
604.	Furs.
605.	Jewelry, etc.
606.	Automobiles, motor cycles, trucks, etc.
607.	Radio receiving sets and phonograph records.
608.	Mechanical refrigerators.
609.	Sporting goods, including games other than playing cards and children's games.
610.	Firearms, shells, and cartridges.
611.	Cameras.
612.	Matches.
613.	Candy.
614.	Chewing gum.
615.	Soft drinks.
616.	Electrical energy.
617.	Gasoline.

The taxes on lubricating oils (section 601(c)1), brewer's wort, liquid malt sirups, and malt extract (section 601(c)2), and grape concentrates, etc. (section 601(c)3), apply to the sale of these articles in the United States by the manufacturer or producer and are deductible from the gross income of such manufacturer or producer for the year in which paid or accrued. The taxes on brewer's wort, liquid malt sirups, and malt extract (section 601(c)2), grape concentrates, etc. (section 601(c)3), and lubricating oil (section 601(c)4), also apply with respect to the importation of such articles and are deductible from the gross income of the importer for the year in which paid or accrued.

The taxes on crude petroleum, etc. (section 601(c)4), coal and coke (section 601(c)5), lumber (section 601(c)6), and copper-bearing ores and concentrates (section 601(c)7), apply only with respect to the importation of these articles. These taxes constitute allowable deductions from the gross income of the person liable for the tax.

The taxes on all of the articles or items listed above under sections 602 to 615, inclusive, and section 617 are deductible from the gross income of the manufacturer, producer, or importer for the taxable year during which the manufacturer, producer, or importer pays or accrues such taxes. A jobber, dealer, or consumer who reimburses the manufacturer, producer, or importer for such taxes, even though billed to him as a specific item, is not entitled to deduct from gross income the amounts so reimbursed.

The tax imposed by section 616 applies to all payments made on or after June 21, 1932, for electrical energy for domestic or commercial consumption furnished after June 21, 1932, and before July 1, 1934, whether in the form of a minimum charge, a flat charge, or otherwise. The tax is payable by the person paying for the elec-

trical energy and is a proper deduction from the gross income of such person for the year in which paid or accrued.

In accordance with the provisions of section 625, if any person has, prior to May 1, 1932, made a bona fide contract for the sale, after the tax takes effect, of any article in respect of which a tax is imposed under this title of the Act, and such contract does not permit the adding to the amount to be paid thereunder of the whole of such tax, then (unless the contract prohibits such addition) the vendee shall, in lieu of the vendor, pay so much of the tax as is not permitted to be added to the contract price. It follows, therefore, that in such a case the tax, although collected by the vendor from the vendee, is actually levied against the vendee and consequently is deductible from the gross income of the vendee.

The provisions of the sections of the statute under which these taxes are imposed, the definitions, the provisions relating to the basis of such taxes, the manner of their application, collection, and return, the imposition of penalties, and other matters are contained in Regulations 42, 44, and 46. See also Regulations 47 (revised October, 1928) relating to the tax on pistols and revolvers under section 600(2) of the Revenue Act of 1926.

TITLE V.—MISCELLANEOUS TAXES.

The items subject to the taxes imposed under this title and the sections of the law which impose the taxes are as follows:

Section—	Items taxed.
701—	
	(a)(1)(A) Telephone conversations (for which the charge is 50 cents or more).
	(a)(1)(B) Telegraph dispatches and messages.
	(a)(1)(C) Cable and radio dispatches and messages.
	(a)(2) Leased wires and talking circuit special services.
711.	Admissions.
721.	(Stamp taxes.) Bonds, debentures, and certificates of indebtedness.
722.	(Stamp taxes.) Issues of capital stock and similar interests.
723.	(Stamp taxes.) Sales and transfer of stock and similar interests.
724.	(Stamp taxes.) Sales and transfer of bonds.
725.	(Stamp taxes.) Conveyances.
726.	(Stamp taxes.) Sales of produce for future delivery.
731.	Transportation of oil by pipe line.
741.	Leases of safe deposit boxes.
751.	Checks, etc.
761.	Use of boats.

The taxes imposed by sections 701, 741, and 761 are upon the use of the facilities, safe deposit boxes, and boats specified therein. All of these taxes constitute allowable deductions from the gross income of the person liable for the tax for the year in which paid or accrued. The provisions of sections 701 and 741 and the articles of the regulations applicable thereto are contained in Regulations 42. Regulations 72 cover the tax imposed under section 761 upon the use of boats.

The tax on admissions imposed by section 711 is on the amount paid on and after June 21, 1932, for admission to any place of a definite location. The tax in each case is to be paid by the person paying for such admission and such tax constitutes an allowable deduction from the gross income of the person liable therefor for the taxable year in which it is paid. Regulations covering this tax as well as the taxes on "Dues" and "Initiation fees" imposed by section 501 of the

Revenue Act of 1926, as amended by section 413(a) of the Revenue Act of 1928 (which continue in full force and effect), are published as Regulations 43.

The stamp taxes imposed by sections 721, 722, 723, 724, 725, and 726, effective June 21, 1932, constitute allowable deductions from the gross income of the purchaser of the stamps only to the extent of the total amount of the stamps actually affixed to the documents which are the subject of the tax and canceled during the taxable year. Regulations relating to the imposition and application of the stamp taxes are published in Regulations 71.

The tax imposed by section 731 on the transportation of oil by pipe line constitutes a proper deduction from the gross income of the person furnishing such transportation. The provisions of this section of the statute and interpretations thereof are contained in Regulations 42.

The tax imposed by section 751 on each draft, check, or order for the payment of money, drawn upon any bank, banker, or trust company and presented for payment on or after June 21, 1932, is payable by the maker or drawer of the instrument. The tax so imposed constitutes an allowable deduction from the gross income of the maker or drawer of the instrument for the taxable year in which the amount of the tax is charged to the maker's account by the bank.

Inquiries in regard to this mimeograph should refer to the number of the mimeograph and the symbols IT:E:RR.

DAVID BURNET, *Commissioner.*

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

ARTICLE 261: Contributions or gifts by individuals.

REVENUE ACT OF 1932.

Contributions to nonpartisan scientific agency of citizens' inquiries for promotion of better government. (See I. T. 2654, page 39.)

ARTICLE 261: Contributions or gifts by individuals. XI–49–5896 Mim. 3986

Discontinuance of procedure outlined in Mimeograph 3931, relating to 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., November 14, 1932.

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

Reference is made to Mimeograph 3931 [C. B. XI–1, 33], dated January 27, 1932, relating to the basis for computing the 15 per cent limitation on deductions for contributions by individuals having a "capital net gain" or a "capital net loss." Mimeograph 3931 was issued by reason of the decision of the United States Board of Tax

Appeals 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 from net income before computing the 15 per cent limitation on deductions for charitable, etc., contributions. The Board referred to I. T. 2104 (C. B. III–2, 152) as being apparently correct under the Revenue Acts of 1918 and 1921, but as not being sound with respect to the interpretation of section 208(c) of the Revenue Act of 1924. Inasmuch as the Board's decision was contrary to the position which the Bureau had consistently followed as announced in I. T. 2104, it was contemplated that the decision would be appealed, and it was stated in the mimeograph that in the audit of returns involving capital net losses, the Bureau would continue to follow I. T. 2104. It was further stated that in view of the decision of the Board, and pending the final decision of the courts on the question, it would 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." The audit of returns in which the question arose was governed by certain rules enumerated in the mimeograph and designated as paragraphs (1) to (8), inclusive. The purpose of the procedure outlined was to hold in abeyance the final audit of returns in such cases, and, in so far as possible, to protect the interests of both the Government and the taxpayer until the question could be finally adjudicated.

On August 29, 1932, the Board of Tax Appeals rendered a decision in the case of *Ralph W. Harbison* v. *Commissioner* (26 B. T. A., 896), in which it was held that in computing the 15 per cent limitation on deductions for charitable, etc., contributions, the taxpayer having realized a "capital net gain" during the taxable year and having elected to have that gain taxed at the rate provided in section 101(a) of the Revenue Act of 1928, the amount of the capital net gain should be excluded from the amount of the taxpayer's ordinary net income.

The nonacquiescence in the decision of the Board in the Hallie D. Elkins case [C. B. XI–1, 9] has been withdrawn.

In view of the foregoing, the audit of unclosed returns for all years involving the question of the basis for computing the 15 per cent limitation on deductions for contributions by individuals having a "capital net gain" should now be completed in accordance with the decision of the Board in the Ralph W. Harbison case. The audit of unclosed returns for 1924 and subsequent taxable years involving the question of the basis for computing the 15 per cent limitation on deductions for contributions by individuals having a "capital net loss" should also be completed now in accordance with the decision of the Board in the Hallie D. Elkins case.

As to cases covering taxable years prior to 1924 involving the question of the basis for computing the 15 per cent limitation on deductions for contributions by individuals having capital losses, I. T. 2104 should be followed until further notice.

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

H. F. Mires,
Acting Commissioner.

SECTION 23(r).—DEDUCTIONS FROM GROSS INCOME: LIMITATION ON STOCK LOSSES.

ARTICLE 272: Limitations on deductions for losses from sales and exchanges of stocks and bonds. XI–38–5696 I. T. 2641

REVENUE ACT OF 1932.

Where a taxpayer dealing for his own account sustains losses from the sale or exchange of stocks and bonds which are not capital assets under section 101 of the Revenue Act of 1932, such losses are not allowable as a deduction against "other income."

Advice is requested whether losses from sales of securities are deductible from "other income" in the case of a taxpayer whose sole business is trading in securities for his own account, and when the "other income" consists of dividends from securities purchased and held in the ordinary course of such business.

The losses in question resulted from the sale or exchange of stocks and bonds which were not capital assets within the meaning of section 101 of the Revenue Act of 1932, and the question relates to whether such losses are subject to the limitations provided in section 23(r) of the Revenue Act of 1932.

Section 23(r) of the Revenue Act of 1932 provides:

(r) *Limitation on stock losses.*—

(1) Losses from sales or exchanges of stocks and bonds (as defined in subsection (t) of this section) which are not capital assets (as defined in section 101) shall be allowed only to the extent of the gains from such sales or exchanges (including gains which may be derived by a taxpayer from the retirement of his own obligations).

(2) Losses disallowed as a deduction by paragraph (1), computed without regard to any losses sustained during the preceding taxable year, shall, to an amount not in excess of the taxpayer's net income for the taxable year, be considered for the purposes of this title as losses sustained in the succeeding taxable year from sales or exchanges of stocks or bonds which are not capital assets.

(3) This subsection shall not apply to a dealer in securities (as to stocks and bonds acquired for resale to customers) in respect of transactions in the ordinary course of his business, nor to a bank or trust company incorporated under the laws of the United States or of any State or Territory, nor to persons carrying on the banking business (where the receipt of deposits constitutes a major part of such business) in respect of transactions in the ordinary course of such banking business.

The limitations provided in section 23(r) do not apply to a dealer in securities as to stocks and bonds acquired for resale to customers in respect of transactions in the ordinary course of his business, but the limitations do apply to losses incurred by a taxpayer (whether or not a dealer in securities) from the sale or exchange of stocks and bonds in respect of transactions entered into for his own account. Since the losses in question resulted from the sale or exchange of stocks and bonds for the taxpayer's own account, such losses are not allowable as a deduction against his income from sources other than from the sale or exchange of stocks and bonds, although such income consists of dividends and interest received in respect of stocks and bonds dealt in by him in the course of his trading for his own account. The excess of the losses over the gains from such transactions for the current year may, however, in an amount not in excess of the taxpayer's net income for the current year, be carried forward and taken as a deduction against gains from similar transactions for the succeeding year.

ARTICLE 272: Limitations on deductions for losses from sales and exchanges of stocks and bonds.

XI-47-5866
I. T. 2656

REVENUE ACT OF 1932.

A capital net gain realized upon the sale of securities held for more than two years may not be reduced by losses sustained upon the sale of securities held for two years or less, in view of the express language contained in section 23(r) of the Revenue Act of 1932.

Reference has been made to I. T. 2641 (see on page 31) relating to the limitations on losses sustained through the sale of stocks and bonds under section 23(r) of the Revenue Act of 1932, and advice is requested whether the capital net gain realized upon the sale of securities held for more than two years may be decreased by losses sustained upon the sale of securities held for two years or less.

The ruling referred to holds that where a taxpayer dealing for his own account sustains losses from the sale or exchange of stocks and bonds which are not capital assets under section 101 of the Revenue Act of 1932, such losses are not allowable as a deduction against "other income." Section 101(c)8 defines the term "capital assets" as follows:

"Capital assets" means property held by the taxpayer for more than two years (whether or not connected with his trade or business), but does not include stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale in the course of his trade or business. * * *

Section 23(r)1 provides that losses from sales or exchanges of stocks and bonds which are not capital assets, as defined above, *shall be allowed only to the extent of gains from such sales or exchanges.* In respect of this provision the report of the Senate Committee on Finance (report No. 665, dated May 9, 1932, page 17) contains the following explanatory matter:

As now drafted the limitation that losses on stocks and bonds can only be taken to the extent of gains from similar transactions is confined to the sale of such securities which have been held for two years or less. Gains or losses arising from the sale for [of] stocks and bonds held for over two years are in all cases treated precisely as under present law * * *.

It is clear that Congress, in writing section 23(r) into the statute, intended that losses upon the sale of stocks and bonds which have been held for two years or less should be allowed only as an offset against gains from the sale of such securities held two years or less, and then only to the extent of such gains.

It is, therefore, held, in view of the express language of section 23(r) of the Revenue Act of 1932, that a capital net gain realized upon the sale of securities held for more than two years may not be reduced by losses sustained upon the sale of securities held for two years or less.

ARTICLE 272: Limitations on deductions for losses from sales and exchanges of stocks and bonds. XI-51-5931 I. T. 2663

REVENUE ACT OF 1932.

Insurance companies (other than life or mutual) taxable under section 204 of the Revenue Act of 1932, may deduct losses from the sale or other disposition of securities without reference to the limitation contained in section 23(r) of the Act.

SECTION 23(t).—DEDUCTIONS FROM GROSS INCOME: DEFINITION OF STOCKS AND BONDS.

ARTICLE 272: Limitations on deductions for losses from sales and exchanges of stocks and bonds. XI-42-5786 I. T. 2648

REVENUE ACT OF 1932.

Bonds issued by Federal land banks and joint stock land banks are not Government bonds within the meaning of section 23(t) of the Revenue Act of 1932.

PART IV.—ACCOUNTING PERIODS AND METHODS OF ACCOUNTING.

SECTION 42.—PERIOD IN WHICH ITEMS OF GROSS INCOME INCLUDED.

ARTICLE 331: When included in gross income. (Also Section 23(a), Article 121.) XI-30-5560 Mim. 3958

Taxable status of refunds of customs duties and taxes.

TREASURY DEPARTMENT,
OFFICE OF COMMISSIONER OF INTERNAL REVENUE,
Washington, D. C., July 2, 1932.

Collectors of Internal Revenue, Internal Revenue Agents in Charge, and Other Officers and Employees of the Bureau of Internal Revenue Concerned:

Consideration has been given the question whether a refund of customs duties collected over a number of years should be regarded as income for the year in which the refund is received, or whether the principal sum thereof should be allocated to the previous years in which the collections were made and income tax liability for those years adjusted accordingly.

The question above outlined was considered in the ruling published as O. D. 741, Cumulative Bulletin 3, page 115. It was therein held that excess customs duties, which were paid during the years 1915, 1916, and 1917 and for which a refund was received during the year 1919, were amounts which had been erroneously deducted in computing net income for the years 1915, 1916, and 1917, respectively, rather than an amount representing income for the year 1919. The reasoning underlying the ruling published as O. D. 741, supra, was apparently followed in the case of the *Inland Products Co.* v.

Commissioner (10 B. T. A., 235, affirmed by the Circuit Court of Appeals for the Fourth Circuit, 31 Fed. (2d), 867). This latter case involved the imposition of the soft drink tax upon sweet cider. The court in its opinion stated that inasmuch as the Revenue Acts in force in 1918 and 1919 did not impose the soft drink tax upon sweet cider, the regulations of the Department attempting to impose it were void. The court further held that the whole question involved was one of correction of mistake, and stated that readjustment of the returns for the years 1918 and 1919, by eliminating the deduction in question, would place both parties to the mistake exactly where they would have been if it had not occurred.

In the case of the *Chicago, Rock Island & Pacific Railway Co.* v. *Commissioner* (13 B. T. A., 988), one of the questions in issue was whether amounts represented by uncashed checks given in settlement of damage claims and for wages, for which deductions from gross income were taken in the years in which those checks were issued, should, after remaining unpaid for two years and then being credited to the profit and loss account, be restored to taxable income. The Board, while expressing doubt as to whether, in a strict legal sense, the sums so restored constituted income at all, held, upon consideration of all the factors involved, that the practice of the company in crediting the amounts of the uncashed checks to profit and loss had the sanction of common sense and that such amounts might be included in the computation of taxable income for the years in which the credits were made rather than in the previous years in which the deductions were taken. On this point the Board was sustained in *Chicago, Rock Island & Pacific Railway Co.* v. *Commissioner* (47 Fed. (2d), 990, cert. denied, 284 U. S. 618).

Reference is also made to the taxability as income of awards made by the Mixed Claims Commission to certain insurance companies. During the World War period these companies wrote marine insurance and were obliged to pay claims resulting from the loss of hulls and cargoes occasioned by war operations. The amounts paid on these claims were allowed as deductions in the income tax returns of the companies for the years in which they were paid. The Mixed Claims Commission, upon the filing of claims for recovery of the amounts so paid, made awards to the insurance companies with respect to certain of the losses. In the particular cases considered in the memorandum referred to the awards were made by the commission in 1924, but it was not until 1928 that Congress passed the Settlement of War Claims Act, which authorized the payment of such awards. The Bureau held that the awards constituted income to the companies when realized.

A distinction should be made between (1) the ruling published as O. D. 741, supra, and (2) the decisions in the cases of the Chicago, Rock Island & Pacific Railway Co., supra, and the Mixed Claims Commission awards. In the former case the customs duties were illegally collected and were, therefore, void from the beginning. It follows that the deductions from gross income were improperly taken and the income tax liability erroneously computed. When the illegality of these payments was later established the refunds made did not constitute income, since the original payments were payments made to the collector under mistake. Readjustment of the returns for the years in which the mistakes were made was the

logical method for remedying the situation. In the latter cases, when the railroad company took deductions for the damage claims and wages and the insurance companies took deductions for the losses, they were strictly within their rights in so doing. The legality of those transactions and the deductions based thereon have never been questioned. There was involved in those cases no element constituting the correction of a mistake.

It is now held that application of the ruling published as O. D. 741, supra, should be restricted to cases in which collections of customs duties and taxes were illegally or improperly made. It sometimes happens that duties or taxes are legally or properly collected, but by reason of some subsequent event are refunded. An example of this type of case is the refund under the drawback provisions of the law where the importer pays the customs duties but later secures a refund by showing that the goods imported on which the duties were paid have gone into a manufactured article which was later exported. In such a case the collection of the customs duties was entirely legal and the refund thereof did not constitute the correction of a mistake because no mistake had been made. Therefore, legal and proper collections of customs duties and taxes should be distinguished from those illegally or improperly made. Refunds of customs duties or taxes, the collection of which was legally or properly made, should be treated as income for the year in which refunded.

It is further held that legal expenses incurred in securing a refund of customs duties or taxes illegally or improperly collected are proper deductions from income for the year in which paid or accrued, as ordinary and necessary expenses, when incurred in carrying on a trade or business.

Inquiries in regard to this mimeograph should refer to the number of the mimeograph and the symbols IT:E:RR.

DAVID BURNET, *Commissioner.*

PART V.—RETURNS AND PAYMENT OF TAX.

SECTION 53.—TIME AND PLACE FOR FILING RETURNS.

ARTICLE 401: Time for filing returns. XI-36-5658
T. D. 4350

Income tax—Revised income tax returns to be made for fiscal years ended in 1932.

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

To Collectors of Internal Revenue and Others Concerned:

Revised forms prescribed for use in making returns of income under the Revenue Act of 1932 for fiscal years ending in 1932 are available in the offices of collectors of internal revenue as follows:

Individual income tax return Form 1040FY.
Corporation income tax return Form 1120A.
Partnership return of income Form 1065.

As used in the Revenue Act of 1932, the term "partnership" includes a syndicate, group, pool, joint venture, or other unincorporated organization, through or by means of which any business, financial operation, or venture is carried on, and which is not, within the meaning of the Act, a trust or estate, or a corporation. Such organizations shall in making a return for a fiscal year ending in 1932 make such return on the revised Form 1065A prescribed for use by partnerships.

Any individual, corporation or partnership which has heretofore made a return under the Revenue Act of 1928 for a fiscal year ended in 1932 and computed the tax on such return in accordance with the provisions of the Revenue Act of 1928 and not in accordance with the provisions of the Revenue Act of 1932 (or in the case of a partnership which has made such a return and computed the net income thereon in accordance with the provisions of the Revenue Act of 1928 and not in accordance with the provisions of the Revenue Act of 1932), shall make a new return on the appropriate revised form under the Revenue Act of 1932 for such fiscal year. Such new return shall be made on or before October 15, 1932. If the tax shown by the taxpayer upon the new return exceeds the tax shown by the taxpayer upon the return filed under the Revenue Act of 1928, such excess shall be paid at the time the new return is required to be made, unless the taxpayer elects to pay the excess in installments, in which event such installments will be due on the same dates on which the installments of the tax shown by the taxpayer upon the return made under the Revenue Act of 1928 would be due had the taxpayer shown a tax upon such return and elected to pay such tax in four equal installments. All installments of the excess tax due on or before the date such new return is required to be made shall be paid on or before that date.

All individuals and partnerships having an annual accounting period which is a fiscal year ending on or before June 30, and who were not required to make a return under the Revenue Act of 1928 for the fiscal year 1932, but who are required to make a return for such fiscal year under the Revenue Act of 1932, shall make such return on the appropriate revised form on or before October 15, 1932. The tax shown to be due by the taxpayer on such return, in the case of an individual, shall be paid at the time the return is required to be made, unless the taxpayer elects to pay the tax in installments, in which event all installments of the tax due on or before October 15, 1932, shall be paid on or before that date.

Where the tax shown to be due on a return filed under the Revenue Act of 1932 is paid as provided in this Treasury decision, no interest will be collected on the tax so paid. If the tax is not so paid, interest will be collected at the rate of 1 per cent a month from the date prescribed in this Treasury decision for its payment until it is paid.

DAVID BURNET,
Commissioner of Internal Revenue.

Approved August 30, 1932.

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

ARTICLE 401: Time for filing returns. XI–42–5787
I. T. 2649

REVENUE ACT OF 1932.

In those cases where an individual, a corporation, or a partnership, prior to the issuance of the revised forms prescribed for making returns under the Revenue Act of 1932 for fiscal years ending in 1932, has made a return on the old form for such a fiscal year and computed thereon the net income and the tax in accordance with the Revenue Act of 1932, and such return contains all the information necessary for such computation, a new return on a revised form is not required by Treasury Decision 4350 (see on page 35).

It appears that returns have been filed by taxpayers for fiscal years ended in 1932 which were prepared on the old forms prescribed for the use of taxpayers in making their returns under the Revenue Act of 1928, and that in practically all these cases the computation of both the income and the tax was made in accordance with the provisions of the Revenue Act of 1932. Inquiry is made whether new returns prepared on the revised forms are required to be filed by such taxpayers.

In those cases where an individual, a corporation, or a partnership, prior to the issuance of the revised forms prescribed for the use of such taxpayers in making returns under the Revenue Act of 1932 for fiscal years ending in 1932, has made a return on the old form for such a fiscal year and computed the net income and the tax, if any, on such return in accordance with the provisions of the Revenue Act of 1932, and such return contains all the information necessary to determine the net income and the tax, if any, under the Revenue Act of 1932, a new return on a revised form for such fiscal year is not required by Treasury Decision 4350.

SECTION 55.—PUBLICITY OF RETURNS.

ARTICLE 421: Inspection of returns.

REVENUE ACT OF 1932.

Regulations governing the inspection of returns. (See T. D. 4359, page 305.)

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

ARTICLE 451: Examination of return and determination of tax by the Commissioner. XI–33–5605
Mim. 3965

Examination of income tax returns—Change in procedure.

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

Collectors of Internal Revenue and Internal Revenue Agents in Charge:

The Revenue Act of 1932, which, among other things, lowers the exemption of individual income taxpayers, will result in the filing of

numerous new returns on Form 1040A. The Revenue Act also imposes many new miscellaneous taxes, with the result that a greatly increased number of miscellaneous tax returns will also be filed.

In view of the additional burdens placed upon the collectors incident to the receiving and recording of these new returns and the investigative work which will be required in connection therewith, and in view of the necessity for economy in the employment of personnel, it is deemed essential to relieve collectors' offices of some of the work they are now performing. Therefore, as a temporary emergency measure, all Forms 1040 will, until further notice, be referred to the offices of the internal revenue agents in charge for examination.

Collectors' offices will continue to perform the preliminary examination in accordance with the established procedure, except that, effective immediately, the classification of 1040 returns into those which collectors wish returned and those which are recommended for acceptance will be discontinued. Beginning with the income tax lists for the month of January, 1933, no segregation of the 1040 or 1120 returns will be made on the basis of gross income.

Until further notice the following rules will be observed by the Bureau in the audit of income tax returns:

1. All Forms 1040A will be audited by collectors of internal revenue.

2. All Forms 1040 showing a gross income in excess of $25,000 will be forwarded by the Bureau in Washington to the appropriate internal revenue agents in charge for examination.

3. All taxable Forms 1120 having gross income in excess of $75,000 and all nontaxable Forms 1120 having gross income in excess of $125,000 will be forwarded by the Bureau in Washington to the appropriate internal revenue agents in charge for examination.

4. All other 1040 and 1120 returns showing gross income less than that stated in paragraphs 2 and 3, above, will be given a preliminary review in Washington for the purpose of determining whether or not a field examination is warranted.

5. The procedure for the handling of returns on Forms 1041 and 1065 contained in Mimeograph 3937 [C. B. XI–1, 61] will remain in effect.

A number of Forms 1040 for the taxable year 1931, disclosing gross income of $25,000 or less, have already been referred to collectors of internal revenue. Collectors having in their possession such returns for 1931, which have not been closed as the result of a survey or investigation, are requested to transfer them to the appropriate internal revenue agents in charge. It will not be necessary to prepare cards (Form 7935) indicating the transfer of these returns, but a letter should be addressed to the Bureau for the attention of IT:R when the transfer of these returns is completed.

A few 1040 returns for the taxable year 1930, showing gross income of $25,000 or less, are still in collectors' offices undergoing the process of audit or investigation. Collectors should make it a point to promptly dispose of these few remaining returns. If the condition of the work in collectors' offices is such that they can not bring the audit of these returns to a prompt conclusion, the collectors are authorized to transfer these 1930 returns to the appropriate internal revenue agents in charge. This is a matter that is left to the discre-

tion of the collectors. In the event that it is necessary to transfer these returns to the internal revenue agents in charge, it is requested that such action be taken promptly in order that there may be ample time to close the cases well in advance of the running of the statute of limitations. Cards (Form 7935) should be prepared for all transfers of 1930 returns to internal revenue agents in charge.

Previous instructions inconsistent with the foregoing are hereby revoked.

Correspondence from collectors in regard to the procedure outlined herein should refer to the number of this mimeograph and to the symbols A&C. Correspondence from internal revenue agents in charge relative to 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 101.—CAPITAL NET GAINS AND LOSSES.

ARTICLE 501: Definition and illustration of capital net gain. XI–50–5913 I. T. 2661

REVENUE ACT OF 1932.

The gain realized from the surrender of a combined annuity and life insurance contract held for more than two years may not be treated as capital gain and taxed under section 101 of the Revenue Act of 1932, but must be treated as ordinary income.

SECTION 103.—EXEMPTIONS FROM TAX ON CORPORATIONS.

ARTICLE 527: Religious, charitable, scientific, literary, and educational organizations and community chests. XI–45–5835 I. T. 2654
(Also Section 23, Article 261.)

REVENUE ACTS OF 1926, 1928, AND 1932.

Where an organization, the purposes of which are to serve a city and county as a nonpartisan scientific agency of citizens' inquiries for the promotion of better government, etc., engages in making research and publishing the results of such investigation for the benefit of the State and county, it is exempt under section 103(6) of the Revenue Act of 1932 and the corresponding provisions of prior Revenue Acts. Contributions made to it by individuals are deductible in the manner and to the extent provided in section 23(n) of the Revenue Act of 1932 and the corresponding provisions of prior Revenue Acts.

A ruling is requested relative to the status of the M organization for Federal income tax purposes.

The organization was incorporated as a membership corporation in 1927 under the laws of the State of X. Its purposes are to serve the city of Y and county of Z, State of X, as a nonpartisan scientific agency of citizens' inquiries for the promotion of better government, etc. It is actually engaged in making research and publishing the results of such investigation for the benefit of the State and county. The income is derived from contributions by members and is expended solely in carrying out the purposes of aiding the city of Y and county of Z. No part of the income inures to the benefit of any private shareholder or individual.

In view of the foregoing, it is held that the organization comes within the exempting provisions of section 103(6) of the Revenue Act of 1932 and the corresponding provisions of prior Revenue Acts. It will, accordingly, be relieved of the duty of filing returns of annual income so long as its purposes and actual activities remain unchanged. Any changes, however, in its purposes or actual activities must be reported immediately to the collector of internal revenue for its district in order that the effect of such changes upon its present exempt status may be determined.

The exemption referred to in this letter does not apply to taxes levied under other titles or provisions of the Revenue Act of 1932 and the corresponding provisions of prior Revenue Acts, except in so far as the exemption is expressly granted under those provisions to corporations enumerated in section 103 of the Revenue Act of 1932 and the corresponding provisions of prior Revenue Acts.

Since it is organized and operated exclusively for one or more of the purposes enumerated in section 103(6) of the Revenue Act of 1932, it follows that contributions made to it by individuals are deductible for Federal income tax purposes in the manner and to the extent provided in section 23(n) of the Revenue Act of 1932 and the corresponding provisions of prior Revenue Acts.

SECTION 105.—TAXABLE PERIOD EMBRACING YEARS WITH DIFFERENT LAWS.

ARTICLE 551: Fiscal years ending in 1932.

REVENUE ACT OF 1932.

Computation of tax liability for fiscal year beginning in 1931 and ending in 1932 where net losses were sustained for the fiscal years 1930 and 1931. (See I. T. 2652, page 45.)

SECTION 113.—ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS.

ARTICLE 598: Property acquired in reorganization after December 31, 1917. XI–50–5914 I. T. 2662

REVENUE ACT OF 1932.

Under the facts in the instant case the basis for determining gain or loss and depreciation of the transferred properties and assets in the hands of the transferee corporation is held to be the same as the basis such properties and assets had in the hands of the transferor corporation, properly adjusted to the date of transfer as required by section 113(b)2 of the Revenue Act of 1932.

Advice is requested relative to the basis for determining gain or loss and depreciation for the year 1932 and subsequent years, of the properties and assets acquired by the M Company on October 1, 1928, from the N Company under the following circumstances:

The transaction originated with the proposal made on July —, 1928, by the M Company, the name of which was later changed to the O Company and which is herein referred to for convenience as the transferee corporation. Such proposal was made to the N Company, which is herein referred to as the transferor corporation, and was for the acquisition by the transferee corporation of the entire properties and assets, including good will of the transferor corporation. The proposal is shown to have been accepted at a meeting of the stockholders of the transferor corporation on September —, 1928. The transfer of such properties and assets was made on October 1, 1928.

The transferor corporation at the time of entering into the transaction had outstanding $3y$ shares of common stock and $1.2y$ shares of cumulative preferred stock. Of such amount of common stock $1.53y$ shares were held at the time by the transferee corporation, leaving $1.47y$ shares held by other stockholders. The preferred stock was redeemable at a price of $—— a share, plus accumulated unpaid dividends. The transferee corporation, in addition to preferred stock, had outstanding at the time $14.40y$ shares of common stock.

As a part of the plan the preferred stock of the transferor corporation was redeemed or retired at the price above specified, and for that purpose cash was supplied by the transferee corporation in the amount of $3.87x$ dollars. As additional consideration for such transfer of properties and assets the transferee corporation surrendered for cancellation the common stock held by it in the transferor corporation, and in addition thereto it issued $.3675y$ shares of its own common stock to the transferor corporation to be exchanged for the remaining outstanding common stock of the latter on the basis of 1 share for 4.

The properties and assets in question were carried at the time on the books of the transferor corporation at a combined or aggregate basis on which to compute gain or loss and depreciation of $4.26x$ dollars. As measured by the amount of the consideration, including the amount in cash plus the market value of the stock involved, the value of such properties and assets is shown to have been fixed at $6.82x$ dollars. The question involved is whether, under the circumstances, the transferee corporation is entitled to use the greater amount as the combined or aggregate basis on which to compute gain or loss and depreciation of the properties and assets so acquired for the year 1932 and subsequent years, or whether it is limited to the basis of $4.26x$ dollars which the properties and assets had at the time in the hands of the transferor corporation.

It is held that, as the transferee corporation acquired all the properties and assets of the transferor corporation, the transaction constituted a reorganization within the meaning of section 112(i)1(A) of the Revenue Act of 1932, such provision being the same as the corresponding provision of the Revenue Act of 1928. The properties and assets having been acquired in connection with a reorganization after December 31, 1917, the question relative to the basis for determining gain or loss and depreciation in the hands of the transferee corporation for the year 1932 and subsequent years involves the applicability of section 113(a)7 of the Revenue Act of 1932 reading as follows:

SEC. 113. ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS.

(a) *Basis (unadjusted) of property.*—The basis of property shall be the cost of such property; except that—

* * * * * * *

(7) *Transfers to corporation where control of property remains in same persons.*—If the property was acquired after December 31, 1917, by a corporation in connection with a reorganization, and immediately after the transfer an interest or control in such property of 50 per centum or more remained in the same persons or any of them, then the basis shall be the same as it would be in the hands of the transferor, increased in the amount of gain or decreased in the amount of loss recognized to the transferor upon such transfer under the law applicable to the year in which the transfer was made. This paragraph shall not apply if the property acquired consists of stock or securities in a corporation a party to the reorganization, unless acquired by the issuance of stock or securities of the transferee as the consideration in whole or in part for the transfer.

The answer to the question presented as applied to 1932 and subsequent years, therefore, depends upon whether "* * * an interest or control in such property of 50 per centum or more remained in the same persons or any of them * * *."

The corresponding provision of the Revenue Act of 1926 is contained in section 204(a)7 of that Act and, so far as is here material, is the same as the above-quoted provision of the Revenue Act of 1932, except that the limitation provided in section 204(a)7 of the Revenue Act of 1926 was applicable only in case an interest or control of "80 per centum" or more remained in the same persons or any of them. The meaning of the words "interest or control" in such connection is set out at length in General Counsel's Memoran-

dum 7472 (C. B. IX–1, 184), and the same meaning is, of course, applicable in the instant case with the exception, or difference, as to the percentage of such interest or control.

The interests of the minority holders of the common stock of the transferor corporation in the transferred properties continued after the transfer by reason of their becoming stockholders in the transferee corporation pursuant to the reorganization plan. The interest of the holder of the majority of the common stock of the transferor corporation (the M Company) in the transferred properties obviously continued after the transfer, since it then owned such properties outright. The interest of the preferred stockholders of the transferor corporation had prior to the transfer been shifted from the transferred properties by reason of that portion of the reorganization plan which provided for the retirement of the preferred stock for cash; otherwise stated, upon the acceptance by the transferor corporation and its common stockholders of the reorganization plan offered by the transferee corporation, the right to receive in cash $—— per share plus unpaid dividends to July 1, 1928, immediately accrued to the preferred stockholders, and they no longer retained their stockholders' interest in the transferred properties. The preferred stockholders, immediately upon the acceptance and adoption of the plan, in effect became creditors of the transferor corporation holding a preferred claim in and to the cash consideration. This view is supported by the fact that in the "plan of reorganization" addressed to the stockholders of the transferor corporation on September 1, 1928, the preferred stockholders were informed of the proposed redemption of their stock under the plan and were advised that they were not entitled to vote relative thereto. It follows, therefore, that the interest of the common stockholders in the transferred properties prior to the transfer was complete to the extent of 100 per cent, and that such interest remained in the same persons immediately after the transfer to the extent of 100 per cent, within the meaning of "interest" as set forth in, and within the scope of the ruling contained in, General Counsel's Memorandum 7472, supra, pages 191, 192, and 193.

Accordingly, in the instant case the basis for determining gain or loss and depreciation of the transferred properties and assets in the hands of the transferee corporation is held to be the same as the basis such properties and assets had in the hands of the transferor corporation, properly adjusted to the date of transfer as required by section 113(b)2 of the Revenue Act of 1932.

ARTICLE 605: Adjusted basis for determining gain or loss. XI–51–5932 I. T. 2664

REVENUE ACT OF 1932.

The term "carrying charges" as used in section 113(b)1(A) of the Revenue Act of 1932 includes interest on unimproved and unproductive real property.

SECTION 115.—DISTRIBUTION BY CORPORATIONS.

ARTICLE 621: Dividends.

REVENUE ACT OF 1932.

Dividend received under employees' stock purchase plan. (See I. T. 2657, page 55.)

SECTION 116.—EXCLUSIONS FROM GROSS INCOME.

ARTICLE 643: Compensation of State officers and employees. XI–38–5697 I. T. 2642

REVENUE ACT OF 1932.

Where a State or a political subdivision thereof conducts a hospital in such manner as to compete with the business of operating hospitals as carried on by private persons—that is, by taking all classes of patients regardless of their financial condition and requiring all patients able to do so to pay for the care and treatment received by them—the State or political subdivision will be regarded as performing a proprietary function. Where, however, a State or political subdivision conducts a hospital for the benefit of the indigent sick and paupers, it will be regarded as performing an essential governmental function. The compensation received by officers and employees of a hospital conducted by a State or a political subdivision thereof in its proprietary capacity is subject to Federal income tax.

A ruling is requested concerning the taxable status of the compensation received by officers and employees of a general hospital operated by a State or a political subdivision thereof.

For 1925 and subsequent years there is no statutory exemption for compensation paid to officers or employees of a State for services rendered to a State. Such exemption as exists results from the implied constitutional inhibition against the interference by the Federal Government with the means and instrumentalities employed by a State government in the exercise of an essential governmental function. The Treasury Department has recognized the implied constitutional exemption by providing, in the regulations applicable to the various Revenue Acts covering the years referred to above, that compensation paid to its officers and employees by a State or political subdivision thereof for services rendered in connection with the exercise of an essential governmental function is not taxable. Such regulations further provide that compensation received for services rendered to a State or political subdivision thereof is included in gross income unless (a) the person receives such compensation as an officer or employee of a State or political subdivision and (b) the services are rendered in connection with the exercise of an essential governmental function.

In I. T. 2357 (C. B. VI–1, 52) the Bureau of Internal Revenue ruled that the operation by a county of a hospital in which all patients, except such as were found to be indigent and entitled to free care and treatment, were required to pay the board of trustees reasonable compensation for care and treatment constituted the exercise

of a proprietary rather than a governmental function, and that the compensation of officers and employees of such hospitals was not exempt from income taxation. On the other hand, the Bureau has recognized that a hospital operated by a State or a political subdivision thereof solely for the benefit of indigent persons, without the payment by such persons of anything for their care and treatment, fell within the term "essential governmental function" as used in the regulations, and that compensation received by officers and employees of such hospital for services rendered thereto was exempt from Federal income tax. In a very recent ruling the Bureau held that the compensation of employees of a hospital operated by a county under the State law in which only the indigent sick and paupers were admitted as patients, only a small percentage of the patients paying not in excess of their actual expenses and the balance paying nothing, was exempt, upon the theory that the care of the indigent sick and dependent poor constituted the exercise of an essential governmental function. (See G. C. M. 10814, page 113, this Bulletin.)

The general rule of the Bureau relative to hospitals is that where a State or a political subdivision thereof conducts a hospital in such manner as to compete with the business of operating hospitals as carried on by private persons—that is, by taking all classes of patients regardless of their financial condition and requiring all patients able to do so to pay for the care and treatment received by them—the State or political subdivision will be regarded as performing a proprietary function, whereas when the State or political subdivision conducts a hospital solely for the benefit of the indigent sick and paupers it will be regarded as performing an essential governmental function.

The compensation received by officers and employees of a hospital conducted by a State or a political subdivision thereof in its proprietary capacity is subject to Federal income tax.

SECTION 117.—NET LOSSES.

ARTICLE 654: Net loss for taxable year 1931 and for the fiscal year 1932. (Also Section 105, Article 551.) — XI-44-5818, I. T. 2652

REVENUE ACT OF 1932.

Computation of tax liability for the fiscal year ending June 30, 1932, where the taxpayer sustained net losses for the fiscal years ending June 30, 1930, and June 30, 1931.

Advice is requested relative to the deductibility in a Federal income tax return for a fiscal year ending in 1932 of net losses sustained for the taxable years 1930 and 1931.

In the case submitted the taxpayer had a net income of $12,000 (without deducting net losses) for the fiscal year ended June 30, 1932, a net loss of $5,000 for the fiscal year ended June 30, 1931, and a net loss of $10,000 for the fiscal year ended June 30, 1930.

The only question presented relates to the extent to which the net losses for 1930 and 1931 may be deducted in the return of the taxpayer for the fiscal year ended June 30, 1932.

Section 117(a)6 of the Revenue Act of 1932 provides as follows:

(a) *Definition of "net loss."*—As used in this section the term "net loss" means the excess of the deductions allowed by this title over the gross income, with the following exceptions and limitations:

* * * * * * *

(6) *Net loss not to produce net loss.*—In computing the net loss for any taxable year a net loss for a prior year shall not be allowed as a deduction.

An identical provision is contained in section 117(a)6 of the Revenue Act of 1928. Section 117(d) of the Revenue Act of 1932 reads as follows:

(d) *Net losses for 1930 or 1931.*—If for the taxable year 1930 a taxpayer sustained a net loss within the provisions of the Revenue Act of 1928, the amount of such net loss shall not be allowed as a deduction in computing net income under this title. If for the taxable year 1931 a taxpayer sustained a net loss within the provisions of the Revenue Act of 1928, the amount of such net loss shall be allowed as a deduction in computing net income for the taxable year 1932 to the same extent and in the same manner as a net loss sustained for one taxable year is, under this Act, allowed as a deduction for the succeeding taxable year.

Section 117(b) of the Revenue Act of 1932 provides in part as follows:

(b) *Net loss as a deduction.*—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") * * *.

Section 117(b) of the Revenue Act of 1928 provides in part as follows:

(b) *Net loss as a deduction.*—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") * * *

Section 105 of the Revenue Act of 1932 provides as follows:

SEC. 105. *Taxable period embracing years with different laws.*

If it is necessary to compute the tax for a period beginning in one calendar year (hereinafter in this section called "first calendar year") and ending in the following calendar year (hereinafter in this section called "second calendar year") and the law applicable to the second calendar year is different from the law applicable to the first calendar year, then the tax under this title for the period ending during the second calendar year shall be in the sum of: (1) the same proportion of a tax for the entire period, determined under the law applicable to the first calendar year and at the rates for such year, which the portion of such period falling within the first calendar year is of the entire period; and (2) the same proportion of a tax for the entire period, determined under the law applicable to the second calendar year and at the rates for such year, which the portion of such period falling within the second calendar year is of the entire period.

The tax for any fiscal year beginning in 1931 and ending in 1932 is to be computed under section 105 of the Revenue Act of 1932, and as so computed is the sum of the following:

(a) The tax attributable to the calendar year 1931, found by computing the tax upon the income of the taxpayer for the fiscal year under the provisions of the Revenue Act of 1928, and by taking the proportion of such tax which the portion of the period falling within the calendar year 1931 is of the entire period;

(b) The tax attributable to the calendar year 1932, found by computing the tax upon the income of the taxpayer for the fiscal year under the provisions of the Revenue Act of 1932, and by taking the proportion of such tax which the portion of the period falling within the calendar year 1932 is of the entire period.

In the instant case, the taxpayer may, in computing the tax attributable to the calendar year 1931, deduct both the net loss of $10,000 sustained for the fiscal year ended June 30, 1930, and the net loss of $5,000 sustained for the fiscal year ended June 30, 1931. In computing the tax attributable to the calendar year 1932, the taxpayer may deduct only the net loss of $5,000 sustained for the fiscal year ended June 30, 1931.

In computing the tax attributable to the calendar year 1931, section 105 of the Revenue Act of 1932 is to be considered in the nature of an exception to the rule stated in section 117(d) of that Act. On the basis of the computation under section 105, the taxpayer did not have a statutory net loss for the fiscal year ended June 30, 1932.

SUPPLEMENT D.—RETURNS AND PAYMENT OF TAX.

SECTION 141.—CONSOLIDATED RETURNS OF CORPORATIONS.

ARTICLE 711: Consolidated returns of affiliated corporations for 1932 and subsequent taxable years. XI-35-5634 I. T. 2639

REVENUE ACT OF 1932.

Instructions relative to the making of separate or consolidated returns by an affiliated group for the taxable year 1932 and subsequent taxable years.

Inquiry is made relative to the making of Federal income tax returns by the M Corporation and the corporations with which it is affiliated, the entire group having a fiscal year ended April 30, 1932. An extension of time has been granted by the collector of internal revenue within which to file such returns. The following questions are presented:

(1) Whether for the taxable year 1932 and each subsequent taxable year the affiliated group has the option under the Revenue Act of 1932 of making separate returns or a consolidated return.

(2) Whether by reason of having properly made a consolidated return under the Revenue Act of 1928 for the fiscal year ended April 30, 1931, the affiliated group is required to make a consolidated

return under the Revenue Act of 1928 for the fiscal year ended April 30, 1932, compute the tax thereon at the rate of 12 per cent and pay 8/12ths of the tax so computed, and, in addition, to make a consolidated return under the Revenue Act of 1932 for the fiscal year ended April 30, 1932, compute the tax on such return at the rate of 14½ per cent and pay 4/12ths of the tax so computed, or to make separate returns under the Revenue Act of 1932 for such fiscal year, compute the tax on the returns at the rate of 13¾ per cent and pay 4/12ths of the tax so computed in addition to 8/12ths of the tax shown on the consolidated return under the Revenue Act of 1928.

(3) Whether in making a return under the Revenue Act of 1932 for the fiscal year ended April 30, 1932, the income of the M Corporation for the entire fiscal year may be segregated and the actual income for the eight months ended December 31, 1931, taxed at the rates for the calendar year 1931, and the actual income for the four months ended April 30, 1932, taxed at the rates for the calendar year 1932.

The three questions presented are so closely related that they will be considered together. It may be said at the outset that the entire tax for any fiscal year ended in 1932 is imposed by the Revenue Act of 1932. Therefore, the affiliated group is required under the Revenue Act of 1932, irrespective of whether a consolidated return was made under the Revenue Act of 1928 for the fiscal year ended April 30, 1931, to make either separate returns or a consolidated return for the entire fiscal year ended April 30, 1932. Whether separate returns or a consolidated return is made for such fiscal year, the tax can not be computed upon the basis of segregating the income as suggested (i. e., on the basis of the actual income earned during the portion of each calendar year), but must be computed as provided in section 105 of the Revenue Act of 1932. As so computed, the tax for the taxable year 1932 is the sum of the following:

(a) The tax attributable to the calendar year 1931, found by computing the tax upon the income for the entire fiscal year ended April 30, 1932, under the provisions of the Revenue Act of 1928, and by taking the proportion of such tax which the portion of the period falling within the calendar year 1931 is of the entire period;

(b) The tax attributable to the calendar year 1932, found by computing the tax upon the income for the entire fiscal year ended April 30, 1932, under the provisions of the Revenue Act of 1932, and by taking the proportion of such tax which the portion of the period falling within the calendar year 1932 is of the entire period.

If separate returns are made for the fiscal year ended April 30, 1932, the affiliated group may continue to make separate returns for succeeding taxable years. If a consolidated return is made for such fiscal year prior to the promulgation of the regulations under section 141(b) of the Revenue Act of 1932, such return will be considered as constituting a consent to the provisions of Regulations 75, in so far as not inconsistent with the Revenue Act of 1932, and thereafter neither separate returns nor a consolidated return consenting to the regulations to be promulgated under section 141(b) of the Revenue Act of 1932 may be made for such fiscal year. For subsequent taxable years, however, each of the affiliated corporations

must make a separate return unless the affiliated group makes a consolidated return consenting to the provisions of the regulations to be promulgated under section 141(b) of the Revenue Act of 1932.

If a consolidated return is made for the fiscal year ended April 30, 1932, or any subsequent taxable year after the promulgation of the regulations under section 141(b) of the Revenue Act of 1932, a consolidated return must be made for each subsequent taxable year during which the affiliated group remains in existence unless (1) a corporation (other than a corporation created or organized, directly or indirectly, by a member of the affiliated group) has become a member of the group during such subsequent taxable year, or (2) one or more provisions of such regulations, which have previously been consented to, have been amended, or (3) the Commissioner, prior to the time of making the return, upon application made by the common parent corporation and for good cause shown, grants permission to change.

SECTION 143.—WITHHOLDING OF TAX AT SOURCE.

ARTICLE 761: Withholding tax at source. XI–32–5591
(Also Section 144, Article 781.) Mim. 3967

Withholding under the Revenue Act of 1932.

TREASURY DEPARTMENT,
OFFICE OF COMMISSIONER OF INTERNAL REVENUE,
Washington, D. C., July 25, 1932.

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

The Revenue Act of 1932 was approved by the President at 5 p. m., eastern standard time, June 6, 1932. The following provisions provide for the withholding of tax at the source:

SECTION 143.

(a) TAX-FREE COVENANT BONDS.—

(1) *Requirement of withholding.*—In any case where bonds, mortgages, or deeds of trust, or other similar obligations of a corporation contain a contract or provision by which the obligor agrees to pay any portion of the tax imposed by this title upon the obligee, or to reimburse the obligee for any portion of the tax, or to pay the interest without deduction for any tax which the obligor may be required or permitted to pay thereon, or to retain therefrom under any law of the United States, the obligor shall deduct and withhold a tax equal to 2 per centum of the interest upon such bonds, mortgages, deeds of trust, or other obligations, whether such interest is payable annually or at shorter or longer periods, if payable to an individual, a partnership, or a foreign corporation not engaged in trade or business within the United States and not having any office or place of business therein: *Provided*, That if the liability assumed by the obligor does not exceed 2 per centum of the interest, then the deduction and withholding shall be at the following rates: (A) 8 per centum in the case of a nonresident alien individual, or of any partnership not engaged in trade or business within the United States and not having any office or place of business therein and composed in whole or in part of nonresident aliens, (B) 13⅓ per centum in the case of such a foreign corporation, and (C) 2 per centum in the case of other individuals and partnerships: *Provided further*, That if the owners of such obligations are not known to the withholding agent

the Commissioner may authorize such deduction and withholding to be at the rate of 2 per centum, or, if the liability assumed by the obligor does not exceed 2 per centum of the interest, then at the rate of 8 per centum.

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

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

(b) *Nonresident aliens.*—All persons, in whatever capacity acting, including lessees or mortgagors of real or personal property, fiduciaries, employers, and all officers and employees of the United States, having the control, receipt, custody, disposal, or payment of interest (except interest on deposits with persons carrying on the banking business paid to persons not engaged in business in the United States and not having an office or place of business therein), rent, salaries, wages, premiums, annuities, compensations, remunerations, emoluments, or other fixed or determinable annual or periodical gains, profits, and income, of any nonresident alien individual, or of any partnership not engaged in trade or business within the United States and not having any office or place of business therein and composed in whole or in part of nonresident aliens (other than income received as dividends of the class allowed as a credit by section 25(a)), shall (except in the cases provided for in subsection (a) of this section and except as otherwise provided in regulations prescribed by the Commissioner under section 215) deduct and withhold from such annual or periodical gains, profits, and income a tax equal to 8 per centum thereof: *Provided*, That the Commissioner may authorize such tax to be deducted and withheld from the interest upon any securities the owners of which are not known to the withholding agent.

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

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

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

(f) *Refunds and credits.*—Where there has been an overpayment of tax under this section any refund or credit made under the provisions of section 322 shall be made to the withholding agent unless the amount of such tax was actually withheld by the withholding agent.

(g) Notwithstanding the provisions of subsections (a) and (b), the deduction and withholding for any period prior to the date of the enactment of this Act shall be at the rates of 12 per centum and 5 per centum in lieu of the rates of 13¾ per centum and 8 per centum prescribed in such subsections.

SECTION 144.

In the case of foreign corporations subject to taxation under this title not engaged in trade or business within the United States and not having any office or place of business therein, there shall be deducted and withheld at the source in the same manner and upon the same items of income as is

provided in section 143 a tax equal to 12 per centum thereof in respect of all payments of income made before the enactment of this Act, and equal to 13¾ per centum thereof in respect of all payments of income made after the enactment of this Act, and such tax shall be returned and paid in the same manner and subject to the same conditions as provided in that section: *Provided*, That in the case of interest described in subsection (a) of that section (relating to tax-free covenant bonds) the deduction and withholding shall be at the rate specified in such subsection.

The following table shows the rates of withholding of tax at the source applicable to income payments made after 5 p. m., eastern standard time, June 6, 1932, the effective date of the Revenue Act of 1932:

Interest on bonds and similar obligations of corporations containing a tax-free covenant.

Taxpayer.	Type of interest.	Rate.
		Per cent.
Citizen or resident of the United States	Interest on corporate bonds containing a tax-free covenant in which the liability assumed by the obligor exceeds 2 per cent.	2
Do	Interest on corporate bonds containing a tax-free covenant in which the liability assumed by the obligor does not exceed 2 per cent.	2
Nonresident alien individual	Interest on corporate bonds containing a tax-free covenant in which the liability assumed by the obligor exceeds 2 per cent.	2
Do	Interest on corporate bonds containing a tax-free covenant in which the liability assumed by the obligor does not exceed 2 per cent.	8
A partnership not engaged in trade or business within the United States and not having any office or place of business therein, composed in whole or in part of nonresident aliens.	Interest on corporate bonds containing a tax-free covenant in which the liability assumed by the obligor exceeds 2 per cent.	2
Do	Interest on corporate bonds containing a tax-free covenant in which the liability assumed by the obligor does not exceed 2 per cent.	8
A foreign corporation not engaged in trade or business within the United States and not having any office or place of business therein.	Interest on corporate bonds containing a tax-free covenant in which the liability assumed by the obligor exceeds 2 per cent.	2
Do	Interest on corporate bonds containing a tax-free covenant in which the liability assumed by the obligor does not exceed 2 per cent.	13¾
Unknown owner	Interest on corporate bonds containing a tax-free covenant in which the liability assumed by the obligor exceeds 2 per cent.	2
Do	Interest on corporate bonds containing a tax-free covenant in which the liability assumed by the obligor does not exceed 2 per cent.	8

Fixed or determinable annual or periodical income from sources within the United States (other than interest on corporate bonds containing a tax-free covenant and dividends of the class allowed as a credit by section 25(a)), including compensation for personal services rendered within the United States, royalties, interest on bonds of corporations not containing a tax-free covenant, and interest on bonds issued by partnerships and individuals.

Taxpayer.	Rate.	Taxpayer.	Rate.
	Per cent.		*Per cent.*
Nonresident alien individual	8	A foreign corporation not engaged in trade or business within United States and not having any office or place of business therein	13¾
A partnership not engaged in trade or business within United States and not having any office or place of business therein, composed in whole or in part of nonresident aliens	8	Unknown owner	8

Section 211 of the Act provides, in part, as follows:

(a) *General rule.*—In the case of a nonresident alien individual who is not a resident of a contiguous country, the normal tax shall be 8 per centum of the amount of the net income in excess of the credits against net income allowed to such individual.

(b) *Aliens resident in contiguous countries.*—In the case of an alien individual resident in a contiguous country, the normal tax shall be an amount equal to the sum of the following:

(1) 4 per centum of the amount by which the part of the net income attributable to wages, salaries, professional fees, or other amounts received as compensation for personal services actually performed in the United States, exceeds the personal exemption and credit for dependents; but the amount taxable at such 4 per centum rate shall not exceed $4,000; and

(2) 8 per centum of the amount of the net income in excess of the sum of (A) the amount taxed under paragraph (1) of this subsection plus (B) the total credits against net income allowed to such individual. * * *

Section 216(b) provides:

(b) *Tax withheld at source.*—The benefit of the personal exemption and credit for dependents, and of the reduced rate of tax provided for in section 211(b), may, in the discretion of the Commissioner and under regulations prescribed by him with the approval of the Secretary, be received by a nonresident alien individual entitled thereto, by filing a claim therefor with the withholding agent.

A nonresident alien individual, a resident of Canada or Mexico, who files with his employer a claim (Form 1115) in order to obtain the benefit of the credits for personal exemption and dependents, as well as the reduced rates of normal tax, will have tax withheld at the rate of 4 per cent from the first $4,000 of the net income attributable to compensation for personal services actually performed in the United States in excess of the personal exemption of $1,000 (allowable under section 214) and the credit of $400 for each dependent (allowable under sections 214 and 25(d)). The amount of such compensation in excess of the sum of (1) the amount taxed at 4 per cent and (2) the personal exemption and credit for dependents will be subject to withholding at the rate of 8 per cent. In the case of compensation paid prior to the enactment of the Revenue Act of 1932 to a nonresident alien individual, a resident of Canada or Mexico, who filed Form 1115 with his employer in order to obtain the benefits of the reduced rates of normal tax provided in section 211(b) of the Revenue Act of 1928, withholding of the tax was required at the rates of 1½ per cent, 3 per cent, and 5 per cent, instead of the rates of 4 per cent and 8 per cent.

DIVIDENDS.

No withholding from dividends distributed by a corporation subject to taxation under Title I of the Act is required, except dividends treated as income from sources within the United States under section 119(a)2(A) of the Act and distributed by a corporation organized under the China Trade Act, 1922, to—

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

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

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

Tax at the following rates is required to be withheld from dividends which are income from sources within the United States distributed by China Trade Act corporations to persons not resident in China (such dividends being subject to normal tax, as well as to surtax):

Taxpayer.	Rate.	Taxpayer.	Rate.
	Per cent.		*Per cent.*
Nonresident alien individual	8	A foreign corporation not engaged in trade or business within the United States and not having any office or place of business therein	13¾
A partnership not engaged in trade or business within the United States and not having any office or place of business therein, composed in whole or in part of nonresident aliens	8		

Dividends distributed by a corporation not subject to taxation under Title I of the Act are subject to withholding when such dividends are treated as income from sources within the United States as determined under section 119 and distributed to—

(a) A nonresident alien individual;

(b) A partnership not engaged in trade or business within the United States and not having any office or place of business therein, composed in whole or in part of nonresident aliens; or

(c) A foreign corporation not engaged in trade or business within the United States and not having any office or place of business therein.

Tax at the following rates is required to be withheld from such dividends, since they are subject to normal tax as well as to surtax:

Taxpayer.	Rate.	Taxpayer.	Rate.
	Per cent.		*Per cent.*
Nonresident alien individual	8	A foreign corporation not engaged in trade or business within the United States and not having any office or place of business therein	13¾
A partnership not engaged in trade or business within the United States and not having any office or place of business therein, composed in whole or in part of nonresident aliens	8		

Withholding of the tax at the rates of 8 per cent and 13¾ per cent, as set forth in the tables contained herein, is applicable only to payments of income made after the enactment of the Revenue Act of 1932, 5 p. m., eastern standard time, June 6, 1932. In the case of payments of income made prior to the enactment of the Revenue Act of 1932, withholding of the tax is at the rates of 5 per cent and 12 per cent (as provided in the Revenue Act of 1928) in lieu of the rates of 8 per cent and 13¾ per cent provided in the Revenue Act of 1932. In the case of interest on corporate bonds, containing a tax-free covenant, paid to a citizen or resident of the United States, the rate of withholding is 2 per cent, whether such interest is paid before or after the enactment of the Revenue Act of 1932.

Nonresident alien individuals and foreign corporations not engaged in trade or business within the United States and not having

any office or place of business therein, are required to file, or cause to be filed in their behalf, individual income tax returns, Form 1040B, and corporation returns, Form 1120, respectively, for the year 1932, including therein their total income from all sources within the United States. The tax thereon should be computed at the rates provided in sections 211 and 12 in the case of nonresident alien individuals and section 13 in the case of corporations, which are as follows:

In the case of a nonresident alien individual who is not a resident of a contiguous country, the normal tax is 8 per cent on the amount of the net income in excess of the credits against the net income allowed to such individual.

In the case of an alien individual resident in Canada or Mexico, the normal tax shall be an amount equal to the sum of the following:

(1) 4 per cent of the amount by which the part of the net income attributable to wages, salaries, professional fees, or other amounts received as compensation for personal services actually performed in the United States exceeds the personal exemption and credit for dependents, but the amount taxable at such 4 per cent rates shall not exceed $4,000.

(2) 8 per cent of the amount of the net income in excess of the sum of (a) the amount taxed under (1), plus (b) the total credits against net income allowed to such individual.

In the case of a nonresident alien individual, whether or not he is a resident of Canada or Mexico, his net income from sources within the United States is subject to the graduated surtax provided in section 12, ranging from 1 per cent on net incomes in excess of $6,000 and not in excess of $10,000, to 55 per cent on net incomes in excess of $1,000,000.

In the case of a foreign corporation, its net income from sources within the United States is subject to tax at the rate of 13¾ per cent.

Forms 1000, 1001, and 1012 are being revised. Forms 1000 and 1001, revised January, 1929, and Form 1012, revised March, 1931, should be used until the new forms are distributed.

All inquiries concerning this mimeograph letter should refer to the number thereof and the symbols IT:E:RR.

DAVID BURNET, *Commissioner.*

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

ARTICLE 781: Withholding in the case of nonresident foreign corporations.

REVENUE ACT OF 1932.

Rates of tax applicable. (See Mim. 3967, page 49.)

SECTION 165.—EMPLOYEES' TRUSTS.

(Also Section 115, Article 621.) XI-47-5867
I. T. 2657

REVENUE ACT OF 1932.

Under an employees' stock purchase plan, the mere fact that due to a shrinkage in value the stock is worth less at the time of distribution to the employee than the amount contributed by him toward its purchase is not sufficient to establish a deductible loss for income tax purposes. Any amount allocated to the account of the employee as a dividend is taxable to him at surtax rates when the cash becomes available to him or subject to his order.

Advice is requested relative to the second stock purchase plan of the M Corporation under which distribution was made to participants as of September —, 1932.

The provision of the Revenue Act of 1932 which is applicable reads as follows:

SEC. 165. EMPLOYEES' TRUSTS.

A trust created by an employer as a part of a stock bonus, pension, or profit-sharing plan for the exclusive benefit of some or all of his employees, to which contributions are made by such employer, or employees, or both, for the purpose of distributing to such employees the earnings and principal of the fund accumulated by the trust in accordance with such plan, shall not be taxable under section 161, but the amount actually distributed or made available to any distributee shall be taxable to him in the year in which so distributed or made available to the extent that it exceeds the amounts paid in by him. Such distributees shall for the purpose of the normal tax be allowed as credits against net income such part of the amount so distributed or made available as represents the items of dividends and interest specified in section 25 (a) and (b).

The foregoing section was commented upon in the report of the Senate Committee on Finance (report No. 665, dated May 9, 1932, page 33) as follows:

SECTION 165.—EMPLOYEES' TRUSTS.

The House bill retained the provisions of existing law under which an employee who receives a distribution from a trust created by an employer as part of a stock bonus, pension, or profit-sharing plan is taxed upon the amount contributed to such fund by the employer plus all earnings of such fund in the year in which distributed or made available to him. In recent years situations have arisen in which the amount contributed to such fund by the employer and all earnings of such fund, together with the amounts contributed to the fund by the employees, have been invested by the trustee in stock of the employer corporation, and at the time of distribution to the employee the market value of the stock was less than the amount contributed to the fund by the employer plus the earnings of the fund.

Your committee believes that it is a distinct hardship to an employee to be taxed under such circumstances as the existing law requires, and corrects the situation by amending section 165 to provide that only the excess of the market value of the stock distributed or made available to the employee over the amounts paid in by him to the trust should be taxable in the year of distribution. This plan renders the employee taxable at the time of distribution upon the excess of the fair market value of the stock received by him over his contributions to the trust regardless of the amount contributed to the trust by

the employer. In the case of cash distributions, of course, the present rule is unchanged.

It would appear, therefore, that in the case of a distribution to employees under a stock purchase plan that falls (as in the instant case) within the scope of this section of the Revenue Act of 1932, the gain, if any, must be determined upon the basis of "the fair market value of the stock received by him," the excess of such fair market value over the amount of his contributions to the trust being treated as gain to be included in his gross income. (See *Schaefer* v. *Bowers*, 50 Fed. (2d), 689, certiorari denied 284 U. S., 668.)

In the instant case the total contributions of the employee amount to $25x$ dollars. The contributions of the company amount to $12.5x$ dollars. Other amounts allocated to the account of the employee by the company include dividends, x dollars, and other earnings, $2.5x$ dollars. Thus, the total amount contributed in the stock purchase plan is $41x$ dollars. The company proposes to distribute to the employee as of September —, 1932, 10 shares of stock having a present fair market value of $2x$ dollars a share and a cash dividend of x dollars. The employee, therefore, will receive shares of stock worth $20x$ dollars, which amount is $5x$ dollars less than the aggregate amount of his contributions, and in addition will receive a cash dividend of x dollars.

The questions presented are:

(1) Whether the employee has sustained a deductible loss of $5x$ dollars for the year 1932?

(2) Whether the x dollars of dividends shall be treated as dividend income rather than as a reduction of the loss indicated?

Although section 165, quoted above, is authority for treating as taxable gain to the employee for the year in which the stock is distributed, the amount by which the fair market value of stock received by the employee (under a stock purchase plan such as here involved) exceeds the amount of the employee's contribution, there is nothing in the statute which warrants treating as a deductible loss to the employee the excess of the amount of his contributions over the fair market value of the stock when distributed or made available to him. A deduction from gross income can be claimed only as authorized by statute. (See *Pugh et al.* v. *Commissioner of Internal Revenue*, 49 Fed. (2d), 76.) In the instant case the shrinkage in value of the stock occurred while it was in the hands of the trustee, at which time the employee held nothing more than contingent equitable title. Contingencies might arise under which the employee would never receive the stock. The shrinkage in value prior to the transfer of the stock to the employee has the effect of defeating the purpose of the plan, and leaves the employee as a purchaser of stock at a cost of $25x$ dollars which had a market value of only $20x$ dollars. The purchase of property at a price greater than its market value does not result in a deductible loss for income tax purposes. (See *M. J. Hellmers* v. *Commissioner*, 5 B. T. A., 198; *Schuman Piano Co.* v. *Commissioner*, 10 B. T. A., 118; O. D. 851, C. B. 4, 179; A. R. R. 906, C. B. I–1, 143.) The stock here involved was acquired by the employee in a going concern, and the mere fact that due to a shrinkage in value the stock is worth less at the time of its receipt by the em-

ployee than the amount contributed by him toward its purchase is not sufficient to establish a deductible loss within the meaning of the statute. (See *Edward J. Slater* v. *Commissioner*, 12 B. T. A., 60, and cases cited therein; also, *White Star Line* v. *Commissioner*, 20 B. T. A., 111.)

It is, therefore, held (1) that the employee has not sustained a deductible loss during the taxable year within the meaning of section 23(e) of the Revenue Act of 1932, relating to losses by individuals; and (2) that the dividend of x dollars is taxable to him at surtax rates as a dividend when the cash becomes available to him or subject to his order, in accordance with sections 22(d), 25(a), and 115(a) of the Revenue Act of 1932, relating to dividends.

INCOME TAX RULINGS.—PART II.

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–33–5606
G. C. M. 10798

REVENUE ACT OF 1928.

Amounts returned to policyholders by a mutual marine insurance company are to be treated for income tax purposes as rebates on premiums, except to the extent they are paid out of earnings exclusive of premiums. In case the premiums have been charged off by the insured as a business expense, a rebate of any portion thereof is considered income.

An opinion is requested whether amounts paid to the policyholders of a mutual marine insurance company are to be treated by the policyholders as dividends (which in case the insured is a corporate taxpayer would not be reflected in its net income), or are to be treated as rebates on premiums and returned as such for income tax purposes.

In discussing the nature of the so-called dividend of a mutual life insurance company the court, in the case of *Fuller* v. *Metropolitan Life Insurance Co. of New York* (70 Conn., 647, 41 Atl., 4), said:

* * * It [the insurer] has a sum which is not needed for the purpose for which it was paid. This sum is called "profits." It is in fact a surplus resulting from overpayments by policyholders. This surplus is derived from money paid by the insured and received by the company for a particular purpose, i. e., providing for cost of insurance and expense of management. If not needed for that purpose, it should, in equity, be returned to the policyholders. They do not, however, own it, or have any legal control over its distribution. Part of it, indeed, is derived from contributions of policyholders who are dead; but the equity is recognized, and it is the duty of the company, when a surplus is ascertained, to return such portion as it does not deem proper to keep as a guaranty fund to the existing policyholders in equitable (i. e., as nearly as practicable) proportion to their overpayments or contributions. Such return of overpayments, whether in cash or by application on future premiums, or by increase of the amount insured, is a dividend. This is the meaning of "dividend," and the only meaning it has or can have in connection with mutual insurance.

The opinion of the court in the case of the *New York Life Insurance Co.* v. *Styles* (59 L. J. Q. B., 291, L. R. 14 App. Cas., 381) is to the same effect. The foregoing cases were cited, with approval, by the Federal District Court, New Jersey, in the case of *Mutual Benefit Life Insurance Co.* v. *Herold* (198 Fed., 199), in which the court said:

The above cases furnish a clear exposition of the nature and character of the dividends considered in this case. Not only is their reasoning inherently persuasive, but their authority is enhanced by the fact that there are no conflicting decisions, or at least none have been brought to the court's attention. * * * [Affirmed, *Herold* v. *Mutual Benefit Life Insurance Co.*, 201 Fed., 918, cert. denied, 231 U. S., 755.]

It is true that in these cases the court had under consideration the nature of the so-called dividend paid by life insurance companies. However, in the case of the *Penn Mutual Life Insurance Co.* v. *Lederer* (252 U. S., 523, T. D. 3046, C. B. 3, 249), the Supreme Court said:

* * * In a mutual company, whatever the field of its operation, the premium exacted is necessarily greater than the expected cost of the insurance, as the redundancy in the premium furnishes the guaranty fund out of which extraordinary losses may be met, while in a stock company they may be met from the capital stock subscribed. It is of the essence of mutual insurance that the excess in the premium over the actual cost as later ascertained shall be returned to the policyholder. Some payment to the policyholder representing such excess is ordinarily made by every mutual company every year; but the so-called repayment or dividend is rarely made within the calendar year in which the premium (of which it is supposed to be the unused surplus) was paid. * * *

The Bureau of Internal Revenue, following the decision of the court in the case of *Niles* v. *Central Manufacturers' Mut. Insurance Co.* (252 Fed., 564), has uniformly held with respect to mutual fire and mutual casualty insurance companies that it would be presumed that losses and expenses have been paid out of earnings and profits, other than premiums, to the extent of such earnings and profits. In this connection see Law Opinion 1050 (C. B. 3, 279), article 1014, Regulations 74, and the corresponding articles of prior regulations. It necessarily follows that if the earnings, other than premiums, of a mutual insurance company exceed the losses and expenses in a given year, the amount returned to its policyholders for that year would represent a true dividend to the extent that it was paid out of earnings in excess of losses and expenses. It is apparent, therefore, that the so-called dividend of a mutual property insurance company, except under the circumstances noted, does not represent a distribution of earnings as in the case of an ordinary corporation.

It is accordingly the opinion of this office that amounts returned to policyholders by a mutual marine insurance company are to be treated for income tax purposes as rebates on premiums, except to the extent they are paid out of earnings exclusive of premiums. In case the premiums have been charged off by the insured as a business expense, a rebate of any portion thereof is considered income.

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

ARTICLE 51: What included in gross income. XI–41–5766
I. T. 2646

REVENUE ACT OF 1928.

General Counsel's Memorandum 10798 (see on page 58), relating to the treatment of amounts returned to policyholders by a mutual marine insurance company, is applicable to amounts returned

to policyholders by all classes of mutual insurance companies where the premium originally paid by the policyholder has been previously deducted as a business expense, in determining the net income of the policyholder.

ARTICLE 52: Compensation for personal services. XI–41–5767
(Also Section 22(b), Article 83.) G. C. M. 11010

REVENUE ACT OF 1928.

The majority stockholders of the M Company agreed to exchange the stock of that company for the stock of two other companies. After the terms were fully agreed upon the board of directors of the M Company appropriated a sum of money from the company's surplus to be distributed among its officers and employees who were not to be employed by the other companies after completion of a reorganization. The purchasing corporations agreed to this arrangement.

Held, that the payment to the taxpayer represented taxable income rather than a gift.

An opinion is requested whether an amount of $11x$ dollars received by the taxpayer in the year 1929 constituted taxable income or a gift.

The taxpayer was president of the M Company and had been instrumental in making this company a successful organization. In 1929 the N Company and the O Company desired to acquire the business of the M Company through an exchange of stock of the former for that of the latter corporations. A opposed the exchange of stock but a large majority of the stockholders were in favor of it, with the result that such an exchange took place in July, 1929.

After extended negotiations the principal stockholders agreed to exchange — shares of stock of the M Company for — shares of the N Company and — shares of the O Company. After these terms were fully agreed upon the board of directors of the M Company requested that it be permitted to appropriate $20x$ dollars from that company's surplus and distribute it among those officers and employees who were not to be employed by the N and O Companies after completion of the reorganization. The purchasing corporations assented to this request. A received $11x$ dollars of the $20x$ dollars so appropriated and reported it as income for the year 1929. The M Company claimed the amount of $20x$ dollars as a deduction in its return for that year.

It is now contended by the taxpayer that the amount of $11x$ dollars received by him out of the special appropriation from the surplus of the M Company represented a gift; that there was in fact no consideration for the payment in question; that the terms of exchange had already been agreed upon before any request was made for the distribution of this amount by the M Company; that this payment was in effect a gift to the taxpayer by the purchasing corporations which were in no way obligated to him; and that, under the existing agreements, the board of directors of the M Company could not have authorized this payment without receiving in advance the permission of the controlling interests of the N and O Companies. It is also pointed out that as a result of the transaction A was deprived of his salary amounting to $10x$ dollars per annum from the M Company and a share of the profits of that company.

The first question which naturally presents itself is whether there was any consideration for the payment to the taxpayer, and exactly what was the motivating influence behind it. In a letter of June —, 1929, addressed to the board of directors of the M Company by the chairmen of the boards of the N and O Companies, the following statements were made:

It is further agreed, if and when such exchange is completed, the board of directors of the M Company may appropriate from the funds of said company a sum not to exceed $20x$ dollars for distribution in its discretion among present officers of the M Company who may not be satisfactorily placed in these companies. In consideration of the above it is agreed that we shall receive an agreement signed by A, president, and B, vice president, releasing the M Company of any and all claims which they may have to any share of the profits of the company on and after June —, 1929, and submitting their resignation from office effective at the pleasure of the board of directors of the M Company. It is understood that such agreement is only to become effective if and when such exchange is completed. We shall also be furnished with a letter signed by A to the effect that no officer or employee, except himself and B have any interest in the profits of the company or any claim against the company other than for current salary.

At a meeting of the M Company board on June —, 1929, a resolution was passed providing for the appropriation of $20x$ dollars to be distributed among the officers and employees of that company "who may not be satisfactorily placed in N-O Company, if and when contemplated exchange of stock is completed."

In connection with the letter of June —, 1929, it is contended that such an agreement was in fact superfluous; that A's cooperation was not required to consummate the exchange; that he and all other officers were subject to discharge at any and all times by the board of the M Company in accordance with the by-laws of that corporation; and that the profit-sharing agreement under which A worked specifically provided that any right to participate in the profits should terminate when he ceased to occupy the office of president. In other words, it is contended that the agreement incorporated in the letter of June —, 1929, was unnecessary because the exchange would have been effected regardless of the execution of the agreement proposed in that letter. The taxpayer relies upon the decision of the United States Circuit Court of Appeals, Third Circuit, in the case of *Jones* v. *Commissioner* (31 Fed. (2d), 755), and the decision of the United States Circuit Court of Appeals, Ninth Circuit, in the case of *Blair* v. *Rosseter* (33 Fed. (2d), 286), in support of his position.

In the opinion of this office the facts in the cases relied upon by the taxpayer are such as to distinguish them from the instant case. In *Jones* v. *Commissioner*, supra, the amount in question was paid, without consideration, from a fund voluntarily created by the stockholders of the corporation from proceeds of the sale of their stock with no diminution of corporate assets. No deduction was claimed by the corporation in that case for the payment made to Mr. Jones.

In *Blair* v. *Rosseter*, supra, a payment of $50,000 was made to the president of the Sperry Flour Co., by unanimous instruction of the stockholders to the board of directors, as a gift in recognition of his able and successful direction of the affairs of the corporation during the preceding 10 years. This amount was charged to the surplus account of the corporation. The Circuit Court of Appeals sustained the Board of Tax Appeals in holding that the payment

was a voluntary one without consideration or compensation therefor, and made with no obligation on the part of the corporation or its stockholders. As previously stated, the facts in the cases relied upon by the taxpayer are clearly such as to distinguish them from the instant case.

The United States Circuit Court of Appeals for the Fourth Circuit in the case of *Noel* v. *Parrott* (15 Fed. (2d), 669, T. D. 3908, C. B. V–2, 149) held that a distribution of surplus to officers of a corporation, pursuant to resolutions and a sale by stockholders of their stock, resulted in taxable income rather than a gift. In that case, where the corporation treated the distribution as compensation, the court held that there was a consideration for the payment.

In the case of *Schumacher* v. *United States* (55 Fed. (2d), 1007) the Court of Claims held that the amount of $100,000 received by the former president of the El Paso & Southwestern Co. at the time of the termination of his employment because of reorganization with another railroad, as a part of a sum set aside for officers and employees of the former company as additional compensation for long and faithful services, represented income and not a gift. It was pointed out that it was evident in that case that there was no intent to make a gift.

In a recent case decided by the United States Circuit Court of Appeals for the Second Circuit on June 6, 1932 (*Edward F. Fisher* v. *Commissioner*, 59 Fed. (2d), 192), it was held that an amount received in 1924 by the taxpayer from his employer (a corporation) was taxable income rather than a gift, where he had been in the employ of the corporation for many years prior to his resignation in 1924 and where the corporation charged the payment on its books to salary account and reported it as salary in its income tax return. The court in its opinion used the following language:

> * * * But the mere fact that the employer was under no legal duty to pay is not conclusive that the payment was a nontaxable gift * * *. In *Old Colony Trust Co.* v. *Commissioner* (279 U. S., 716, 730, 49 S. Ct., 499, 504, 73 L. Ed., 918), the Supreme Court said that "the payment for services, even though entirely voluntary" may nevertheless be "compensation within the statute, * * *." The doctrine that bonus payments and gratuitous "additional compensation" for past services may constitute taxable income has been frequently recognized in decisions of the lower Federal courts and of the Board of Tax Appeals. [Citing cases.] Whether a payment in a given case shall be deemed taxable compensation or a gift exempt from tax *depends upon the intention of the parties*, and particularly that of the employer, to be determined from the facts and circumstances surrounding the transaction. [Italics supplied.]

(See also *Weagant* v. *Bowers*, 57 Fed. (2d), 679, Ct. D. 526, page 237, this Bulletin; *Arthur L. Lougee* v. *Commissioner*, 26 B. T. A., 23; *Willis L. Garey* v. *Commissioner*, 16 B. T. A., 274; *Robert E. Binger* v. *Commissioner*, 22 B. T. A., 111, C. B. X–1, 6; and *Margaret A. Lunsford, Administratrix, Estate of Abner Lunsford*, v. *Commissioner*, 22 B. T. A., 881.)

This office is of the opinion, after a careful consideration of the facts and circumstances in the instant case, that the payment of 11x dollars to the taxpayer in the year 1929 represented taxable income rather than a gift. The payment does not meet the test of a gift since it was clearly not a voluntary payment without consideration, nor does the evidence indicate that the intent to make a gift existed.

The amount was, therefore, properly included as taxable income in the taxpayer's return for the year 1929.

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

ARTICLE 62: Annuities and insurance policies. XI–31–5576
I. T. 2635

REVENUE ACTS OF 1926 AND 1928.

Treatment for income tax purposes of amounts received in settlement of an endowment insurance policy where the insured survives the maturity of the policy. The ruling published as Solicitor's Opinion 160 (C. B. III–2, 60) does not apply under section 213(b)2 of the Revenue Act of 1926 and section 22(b)2 of the Revenue Act of 1928.

The questions presented involve the status for income tax purposes of the payments made by the M Insurance Co. in settlement of an endowment insurance policy issued by it under the optional settlements provided for in the policy. By the terms of the policy the insured may have settlement made of the proceeds under one of three optional methods designated as Options A, B, and C. Under Option A the amount of the proceeds payable upon the death of the insured is left with the company, with provision for the payment of interest thereon to the designated beneficiary for life, with the right to the beneficiary of withdrawing the amount of such proceeds upon giving the required notice. Under Option B the insured may have the amount of the proceeds paid to the designated beneficiary in periodic installments over a designated period of time not to exceed 30 years. Under Option C the insured may have settlement made by the payment of monthly or other periodic installments over a designated period of time, or during the remaining life of the beneficiary, whichever is greater.

The questions presented pertain to the various methods of settlement made under an endowment policy where the insured survives the maturity of the policy and where the insured, prior to the maturity of the policy, irrevocably designates a beneficiary other than himself with whom settlement is made, in accordance with one of the optional methods provided for in the policy. In the instant case the designation of the beneficiary was made without any valuable consideration to the insured. The first question presented involves the applicability to such situation of the ruling published as I. T. 2380 (C. B. VI–2, 32), whether the insured is to be considered as having constructively received the amount of the proceeds upon the maturity of the policy.

By irrevocably designating another person as beneficiary prior to the maturity of the policy, the insured thereby divests himself of the right to receive the payment of the proceeds and I. T. 2380, supra, is, therefore, not applicable to that situation, there being no constructive receipt of the proceeds by the insured in such case. The effect or result to the beneficiary in such case depends upon the method of settlement designated by the insured.

The first question, therefore, pertains to the situation where payment of the amount of the proceeds is made to a designated beneficiary in a lump sum upon the maturity of the policy. Under section 22(b)2 of the Revenue Act of 1928 no taxable income results

to the insured in such case but a taxable gain is realized by the beneficiary to the extent of the excess of such proceeds over the amount of the premiums or consideration paid for the policy by the insured.

The second question pertains to a situation where the amount of the proceeds is retained by the insurance company to pay interest thereon for life to one beneficiary, referred to for convenience as the first beneficiary, and upon the death of such first beneficiary the amount of the proceeds is payable to another beneficiary, referred to as the second beneficiary. When payment is made to such second beneficiary a taxable gain thereby results to him in the amount of the excess of such proceeds over the amount of the premiums or consideration paid for the policy by the insured as in the preceding instance. As to the first beneficiary, the arrangement amounts to an agreement whereby the insurance company retains the amount of the proceeds and pays interest thereon during the lifetime of the first beneficiary. The amount of such interest, therefore, constitutes taxable income to the first beneficiary in accordance with article 82 of Regulations 74.

The third and fourth questions pertain to a situation where payment of the amount of the proceeds is to be made to the designated beneficiary in installments over a period of not to exceed 30 years, or in lieu thereof over such period of years or the lifetime of the beneficiary, whichever is greater. The effect of this arrangement is to convert the policy into an annuity contract and involves the applicability of the ruling published as Solicitor's Opinion 160. As will be observed, the statutes under which that ruling was promulgated exclude from gross income the amount received "by the insured" as a return of premium or consideration paid. It was held in that ruling that such exemption or exclusion did not extend to the beneficiary of such annuity. Such limitation is not contained in section 213(b)2 of the Revenue Act of 1926 and section 22(b)2 of the Revenue Act of 1928, however, and it is therefore held that the ruling in question is not applicable under those provisions. Accordingly, taxable gain will result to the donee beneficiary of such annuity only when the aggregate of the annuity payments received exceeds the amount of the premiums or consideration paid by the insured from whom the right to receive the annuity payments is acquired by the beneficiary.

ARTICLE 63: Improvements by lessees. XI-40-5743
G. C. M. 10969

REVENUE ACT OF 1928.

The phrase "in pursuance of an agreement" in article 63, Regulations 74, as amended by Treasury Decision 4282 (C. B. VIII-2, 82), does not exclude improvements made on leased realty under a lease which, although not requiring improvements, nevertheless permitted the lessee to make such improvements. The lessor in the instant case should report as income the value thereof upon one or the other of the bases prescribed by that article, as amended.

An opinion is requested with respect to the application of article 63, Regulations 74, as amended by Treasury Decision 4282, to a situation where improvements are made voluntarily by a lessee upon leased premises under a lease that contains no covenant requiring such improvements to be made.

In the instant case the tenant was given the right under the lease to alter, tear down, and demolish buildings upon the premises at the time of the making of the lease, and to erect a new building upon properly indemnifying the lessor in the form of a building bond. The lease provided that the tenant must hold, maintain, and keep in good order, repair, and condition any building which at any time might be upon the land; and further that upon the expiration of the lease or any renewal lease, all buildings and structures upon the demised premises should belong to the landlord. Title to any such improvements was not reserved to the lessee until the termination of the lease. Consequently, the title thereto vested in the lessor immediately upon their completion.

Although the lessee in this case was not required to place improvements upon the leased premises, it is obvious from the provisions of the lease, referred to above, that both the lessor and the lessee contemplated the placing of improvements upon the property by the lessee. While it is true that such improvements were not made in pursuance of an agreement requiring them to be made, they were made in pursuance of an agreement which permitted them to be made. The agreement contains no covenant for their removal by the lessee, but expressly provides that they shall belong to the lessor. Under such circumstances they were just as much income to the lessor as if the lease had contained a covenant expressly requiring them to be made. There appears to be no reason for making a distinction between the two types of cases. (See *Appeal of Henry I. Brown*, 4 B. T. A., 1129, C. B. VI–1, 1; *Appeal of Everett U. Crosby*, 4 B. T. A., 1147, C. B. VI–1, 2.)

It is, therefore, the opinion of this office that the use of the phrase "in pursuance of an agreement" in Treasury Decision 4282, supra, does not exclude improvements made on leased realty under a lease which, although not requiring improvements, nevertheless permitted the lessee to make such improvements. The lessor in the instant case should report as income the value thereof upon one or the other of the bases prescribed by that article, as amended.

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

ARTICLE 68: Sale and retirement by corporation of its bonds. XI–31–5577
G. C. M. 10739

REVENUE ACT OF 1928 AND PRIOR REVENUE ACTS.

Bonds purchased by the issuing corporation for a sinking fund or for investment purposes are "retired" at the time of purchase within the meaning of the regulations.

An opinion has been requested relative to when bonds are retired within the meaning of article 68(1) of Regulations 74 and the corresponding article of prior regulations, where a corporation purchases its own bonds for purposes of investment or for a sinking fund in accordance with mortgage obligations.

For convenience the provisions of Regulations 74 referred to are quoted below:

ART. 68. *Sale and retirement by corporation of its bonds.*—(1) (*a*) If bonds are issued by a corporation at their face value, the corporation realizes no gain

or loss. (*b*) If thereafter the corporation purchases and retires any of such bonds at a price in excess of the issuing price or face value, the excess of the purchase price over the issuing price or face value is a deductible expense for the taxable year. (*c*) If, however, the corporation purchases and retires any of such bonds at a price less than the issuing price or face value, the excess of the issuing price or face value over the purchase price is gain or income for the taxable year.

In the case of bonds purchased by the issuing company for purposes of investment, this office considers it immaterial whether such bonds are "retired" in the technical sense of the term. It does not appear that for the purposes of income tax the term "retires" necessarily imports a technical meaning. Funk & Wagnall's Standard Dictionary defines "retire" as "to pay up and withdraw from circulation; as, to retire the bonds of a city." When a corporation purchases its own bonds at a price less than the issuing price or face value, it discharges a liability for less than the amount which it was legally obligated to pay at the date of the maturity of the bonds. So long as the issuing company holds the bonds there is no liability to pay any part thereof. A corporation purchasing outstanding bonds may reissue them. (*Pruyne* v. *Adams Furniture & Mfg. Co.*, 36 N. Y. S., 361, affirmed, 155 N. Y., 629, 49 N. E., 1103.) However, it is considered that bonds purchased by the issuing company are "retired" even though they are purchased for reissue. The common meaning of the word investment implies a certain measure of permanence. (Words and Phrases.) It is clear that the purchase of bonds under such circumstances constitutes a withdrawal or retirement from circulation. There seems to be no logical distinction, in so far as the realization of income is concerned, between a purchase which does not involve a technical retirement and one which does. Whether the bonds have been retired within the technical meaning of the term does not preclude the fact that income from such transaction has been realized, that is, when the purchase price is less than the issuing price or face value. The purchase constitutes a closed transaction for income tax purposes regardless of the intent to resell, and gain or loss is determined accordingly. The purpose or intent of the purchaser has no bearing on the question.

In *Woodward Iron Co.* v. *Commissioner* (24 B. T. A., 1050) it was stipulated that certain bonds purchased by the corporation were marked "held for the sinking fund and not transferable," as provided in the mortgage. In its decision the Board said, in part, as follows:

> In *United States* v. *Kirby Lumber Co.* (284 U. S., 1 (November 2, 1931) [Ct. D. 420, C. B. X–2, 356]), the Supreme Court held that the taxpayer realized income upon the purchase of some of its bonds at a price less than the amount received upon the issuance of such bonds. * * *
>
> The stipulated facts of the instant case do not distinguish it from *United States* v. *Kirby Lumber Co.*, supra, which controls the issue here.

This Board case is authority for holding that bonds purchased for a sinking fund, whether canceled or not, are "retired" within the meaning of the regulations. It is, therefore, the opinion of this office that bonds purchased for investment or sinking fund purposes are "retired" at the time of purchase.

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

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

ARTICLE 82: Proceeds of insurance—Compensation—Pensions.

REVENUE ACT OF 1928.

Proceeds of so-called "Family income policy—20-year period." (See G. C. M. 10843, page 22.)

ARTICLE 83: Gifts and bequests.

REVENUE ACT OF 1928.

Distribution out of surplus to officer of purchased company by that company upon reorganization. (See G. C. M. 11010, page 60.)

ARTICLE 84: Interest upon State obligations. XI-41-5768
Ct. D. 580

INCOME TAX—REVENUE ACTS OF 1926 AND 1928—DECISION OF COURT.

EXEMPTION—INTEREST—CONSTITUTIONALITY—AWARD IN EMINENT DOMAIN PROCEEDINGS.

The obligation of a municipality to pay just compensation for property taken by it in the exercise of the power of eminent domain is not an obligation of a political subdivision of a State within the meaning of section 213(b)4 of the Revenue Act of 1926 and section 22(b)4 of the Revenue Act of 1928, and interest paid by a municipality on the principal awarded as compensation for property so taken is not exempt from tax. An income tax on such interest is constitutional.

UNITED STATES DISTRICT COURT, SOUTHERN DISTRICT OF NEW YORK.

United States Trust Co. of New York, as Executor of the Will of William Burhans Isham, plaintiff, v. Charles W. Anderson, Collector of Internal Revenue for the Third Collection District of New York, defendant.

[June 13, 1932.]

OPINION.

BONDY, District Judge: This is a motion to dismiss the complaint upon the ground that it fails to state a cause of action.

The complaint alleges that plaintiff's testator had an interest in two pieces of real property which were condemned by the city of New York, one in 1925 and the other in 1926; that there was awarded to the plaintiff's testator in each case the value of his interest in the property at the time of the taking of title by the city and interest thereon to the date of the award; that plaintiff's testator included in his Federal income tax returns for the years 1927 and 1928 as gross income, the amounts representing interest on the awards; that by reason thereof there was paid an amount of tax in excess of his tax liability during these years; and that claims for refunds were disallowed by the Commissioner of Internal Revenue. The complaint demands judgment for the amounts which it is claimed were overpaid.

The Greater New York charter provides that in case title to property required for improvement shall vest in the city prior to the entry of the final decree, interest on the entire amount due to the owner for the real property acquired for the improvement from the date of the vesting of title to the date of the final decree shall be awarded as part of such owner's compensation. (Sections 970(a), 976.)

The plaintiff contends that upon the taking of title to the property by the city of New York an obligation arose to pay just compensation under the constitution of the State of New York, Article I, section 6, and the provisions of the city charter, and that interest allowed on the amount found by the award to be the fair market value of the property on the day title passed is interest paid on an obligation of the city of New York, a political subdivision of a State, and therefore exempt by express provision of the Revenue Act; and that if the interest is not so exempted by statute, then the tax is unconstitutional because it is a tax imposed upon the exercise of a governmental function.

The statute designates as tax-free, interest upon "the obligations of a State, Territory, or any political subdivision thereof, * * *." (Revenue Act of 1926, section 213(b); Revenue Act of 1928, section 22(b); 26 U. S. C., section 2022.)

Though the constitution of the State of New York and the charter of Greater New York imposed upon the city the obligation to make just compensation for the property taken, such obligation is not an obligation within the meaning of this provision of the Revenue Act.

The word "obligation" does not necessarily include every duty imposed by law, as plaintiff seems to contend. It is generic, having many meanings. When used in a statute its meaning depends upon the context and the purpose of the enactment. (See *Hibernia Savings & Loan Society* v. *San Francisco*, 200 U. S., 310.)

It is fundamental that Congress can not impose a tax on any obligation, or on the interest on any obligation, issued by a State in order to borrow money. (See *Willcuts* v. *Bunn*, 282 U. S., 216 [Ct. D. 280, C. B. X–1, 309].)

There is no reason to suppose that this statutory exemption was intended to be otherwise than declaratory of the constitutional limitation upon the power of Congress to impose a tax upon an obligation of a State. The court has not been referred to any case in which the exemption has been extended to any obligation other than one to repay money borrowed by a State or a subdivision thereof. The reason for the exemption does not apply except in cases which involve the power of the Government to borrow money, as a means of carrying on its governmental functions. It has never, so far as the court knows, been extended to include interest paid by a State government on a judgment against it.

In *Hibernia Savings & Loan Society* v. *San Francisco* (supra), the reasoning in which applies to this case, though the facts are clearly distinguishable, it was held that checks or orders issued by the United States Treasury for interest accrued upon registered bonds of the United States, which represented obligations to pay money previously borrowed, might be taxed by a State in the hands of the owner without violating section 3701 of the Revised Statutes, which provided that "all stocks, bonds, Treasury notes, and other obligations of the United States, shall be exempt from taxation by or under State or municipal authority." A ground for the decision was that the statute was one of those directed against intergovernmental taxation enacted pursuant to the constitutional immunity of State and Federal instrumentalities, and that, since in this case the borrowing power of the Treasury was not affected by the tax, the statute did not prohibit the tax in question.

Mr. Justice Stone, in *Metcalf & Eddy* v. *Mitchell* (269 U. S., 514, 522 [T. D. 3824, C. B. V–1, 218]), in enumerating instances of State and Federal exemptions, speaks of "obligations sold to raise public funds."

The word "obligation" as used in section 213(b)4 of the Revenue Act of 1918 was likewise held not to include all legal duties, but rather to be confined to securities, the purpose of the exemption in question being "to facilitate the flotation of low-interest bearing Government securities." See *Kansas City Southern Railway* v. *Commissioner of Internal Revenue* (16 B. T. A., 655, 692, affirmed 52 Fed. (2d), 372).

A similar decision was reached as to interest received from the Federal Government upon a refund of overpaid income and profit taxes. (*American Viscose Corporation* v. *Commissioner of Internal Revenue*, 56 Fed. (2d), 1033, affirming 19 B. T. A., 937.)

The dissatisfaction of Congress with the exemption of State obligations, the suggestions made in Congress on various occasions with reference to amending the Constitution in so far as it limits the power to tax such obligations, and its failure to attempt to amend the Revenue Act are some evidence of the improbability of an intention to exempt more than was obligatory, and of the fact that it understood the exemption to be no wider in scope

than the constitutional limitation. (See Holmes, Federal Taxes (6th Ed.), page 754 n. 47; Congressional Record, volume 57, pages 553, 775, 2988.)

In a letter dated January 26, 1931, the Commissioner of Internal Revenue held that interest received on awards in condemnation proceedings is taxable, thereby reversing a Treasury Department office decision to the contrary, rendered in 1920. (O. D. 591 (T. B. 29–20–1071), C. B. 3, 113.)

It does not appear that the original decision has been followed continuously. Though the administrative practice is persuasive, it is not conclusive, especially in view of the fact that the Department has reversed its decision. (See *Merritt* v. *Cameron*, 137 U. S., 542; *Houghton* v. *Payne*, 194 U. S., 88; *Swift & Courtney and Beecher Co.* v. *United States*, 105 U. S., 691.) The absence of any uniform interpretation by the Treasury Department is further emphasized by article 84 of the Income Tax Regulations of 1928 in which the word "issued" used in connection with the word "obligations" indicates a construction to the effect that the latter was used in the more restricted sense of "securities."

The borrowing power of a State or subdivision is not affected, for it is not involved in condemnation proceedings. Nothing is borrowed.

Any theoretical effect of such tax upon the exercise of the power of eminent domain seems so remote as to fall outside the field recognized by the constitutional doctrine. (See *Group No. 1 Oil Corporation* v. *Bass*, 283 U. S., 279, 282 [Ct. D. 330, C. B. X–1, 153]; *Fox Film Corporation* v. *Doyal*, United States Supreme Court, October term, No. 118, decided May 16, 1932, at pages 2–3.)

Counsel urge the unconstitutionality of the tax upon the further ground that it deprives plaintiff of the just compensation to which it is entitled. The provision of the fifth amendment of the Constitution of the United States that private property shall not be taken for public use without just compensation, the only one applicable to the Federal Government in any event, is a limitation upon that Government in the exercise of the power of eminent domain, and not of the taxing power. (See also *Kansas City Southern Ry. Co.* v. *Commissioner of Internal Revenue*, 52 Fed. (2d), 372, 381.)

Accordingly the motion to dismiss the complaint is granted.

ARTICLE 84: Interest upon State obligations. XI–52–5947
I. T. 2666

REVENUE ACTS OF 1926 AND 1928.

Interest on bonds issued by corporations formed under the act of the Legislature of Indiana, approved on March 10, 1927, for the purpose of financing the acquisition of school sites and the erection of school buildings in the case of a specified class of private school corporations of the State, is exempt from income tax. I. T. 2374 (C. B. VI–2, 36) revoked.

Reconsideration is requested of I. T. 2374, which held that interest on bonds issued by corporations formed under the act of the Legislature of Indiana, approved on March 10, 1927, for the purpose of financing the acquisition of school sites and the erection of school buildings in the case of a specified class of private school corporations of the State, is not exempt from the income tax.

In I. T. 2374 it is stated that the purpose intended to be served by the statute is to provide means to meet the needs of private school corporations which, by reason of statutory or constitutional limitations, are precluded from incurring additional indebtedness to obtain funds for school purposes. The corporations so provided for are authorized to obtain through the issuance of bonds such funds as may be needed in order to acquire the sites and erect the necessary school buildings. These buildings are leased to the school corporations with the provision that the school corporation shall have the option at any time prior to the expiration of the lease to purchase the property at such a figure as will enable the finance corporation to redeem its outstanding obligations and to liquidate.

Section 2 of the Indiana statute, approved March 10, 1927, provides in part as follows:

No such contract of lease shall be entered into by such school corporation except with a corporation organized under the laws of the State of Indiana solely for the purpose of acquiring a site, erecting thereon a school building, leasing the same to such school corporation and collecting the rentals therefor, all without profit to said corporation, its officers, directors and stockholders, other than the return of capital actually invested, plus interest or dividends thereon not to exceed 6 per cent per annum. Such lease contract shall also provide that any amount of rental received by the corporation over and above the amount necessary to meet its incidental corporate expenses and to pay dividends or interest on its securities shall be applied in the redemption and cancellation of its outstanding securities.

In the case of *Burnet* v. *Coronado Oil & Gas Co.* (52 S. Ct., 443, Ct. D. 485, C. B. XI–1, 265), the Supreme Court of the United States held that the income received by an oil and gas lessee from a lease of public school lands of the State of Oklahoma was exempt from Federal income tax. The court in its opinion stated in part as follows:

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.

It appears that the same reasoning is applicable in the case of the bonds issued by Indiana school building corporations created in accordance with the provisions of the statute approved March 10, 1927, referred to above. To tax the interest on those bonds would result in an imposition upon the instrumentality of the State of Indiana used for the purpose of carrying out a function strictly governmental in character. It is held, therefore, in view of the decision 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. I. T. 2374, supra, is hereby revoked.

ARTICLE 87: Interest upon United States obligations.

REVENUE ACT OF 1928.

Exemption of Treasury bills. (See I. T. 2651, page 24.)

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

ARTICLE 102: Valuation of inventories. XI–39–5718
(Also Section 611.) Ct. D. 572

INCOME TAX—REVENUE ACTS OF 1916, 1917, AND 1928—DECISION OF COURT.

1. VALUATION OF INVENTORIES—INTERMINGLED GOODS—BURDEN OF PROOF.

In the valuation of inventories for the year 1917 the rule provided in article 1582 of Income Tax Regulations 45 that "goods taken in the inventory which have been so intermingled that they

can not be identified with specific invoices will be deemed to be the goods most recently purchased " is sustained where the taxpayer, a dealer in hardware and related merchandise, does not sustain its burden that this method did not correctly reflect income and was not in accord with good accounting practice and where it has not been shown that an arbitrary or capricious result has followed from the use of that method.

The claim of the taxpayer for a revised income is denied, the same being based upon inventories used in its original return which were valued at a figure or value that would in the taxpayer's opinion be realizable under any conditions foreseeable based on the theory that the stock on hand was practically the same as had been on hand for several years and therefore the cost of such goods would be their cost when acquired regardless of the fact that many times that amount had been purchased and sold in the meantime.

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 claim in abatement filed was rejected before the expiration of the statutory period of limitation for collection. The facts show that the collection was stayed by a claim for abatement filed by the taxpayer.

COURT OF CLAIMS OF THE UNITED STATES. No. H-513.

Marshall-Wells Co. v. *The United States.*

[May 31, 1932.]

OPINION.

LITTLETON, Judge, delivered the opinion of the court.

The first question is whether the plaintiff is entitled to recover the amount of $456,896.67 sued for on the ground that the 1917 tax in that amount was collected after the expiration of the statute of limitation. It contends that the total amount sued for constitutes an overpayment for 1917, as defined in section 607 of the Revenue Act of 1928, and bases this claim upon the contentions, first, that the abatement claim filed by it did not stay the collection of the additional tax for 1917; that the additional assessment was premature and, in order to avoid the effect of the assessment upon the plaintiff, the collector filed his claim in abatement which had the effect of canceling the plaintiff's abatement claim and that it was the collector's claim that stayed the collection and was the claim which the Commissioner considered and rejected; and, secondly, that as to the additional tax for 1917, in the amount of $24,475.35 assessed February 19, 1924, and collected April 15, 1924, no abatement claim was filed which stayed collection.

The plaintiff insists therefore that under these circumstances section 611 of the Revenue Act of 1928 is inapplicable. It further contends that its appeal from the decision of the Income Tax Unit was decided by the Committee on Appeals and Review, June 26, 1923; that it did nothing further which stayed collection of the tax assessed or assessment of a further additional tax; that the statute in force at the time prohibited further delay by the taxpayer after decision on appeal and that the delays in collecting the additional assessments of $433,398.61 and $24,475.35 for 1917, until after April 1, 1924, were due to the delay of the Commissioner in proceeding promptly in the matter.

We are unable to agree with the claim of the plaintiff that the provisions of section 611 of the Revenue Act of 1928 are not applicable to the tax of $456,896.67, represented by the additional assessments of $433,398.61 made June 2, 1924, and $24,475.35 made February 19, 1924. Both of these assessments were made within the period of limitation properly applicable thereto and the facts show that collection thereof was stayed by the claim for abatement filed by plaintiff against the additional assessment of $433,398.61.

The ground of plaintiff's claim for abatement of the additional assessment was that the corporation was entitled to have its profits tax for 1917 determined and computed under the provisions of section 210 of the Revenue Act of 1917.

The facts establish that it was the plaintiff's abatement claim that caused the delay in collecting the additional assessment and the delay in collecting the further additional tax beyond the limitation period. The facts further show that it was the plaintiff's abatement claim the Commissioner considered and finally rejected. The collector's abatement claim was prepared pursuant to the instructions of the Commissioner only for the purpose of relieving the plaintiff from the payment of the interest imposed by the statute upon the delayed payment of such portion of the additional tax for 1917 finally determined to be due. But for the filing of plaintiff's abatement claim, the additional tax of $433,398.61, assessed June 2, 1922, would have been collected on or before July 7, 1922, and the further additional tax of $24,475.35 proposed in the Bureau letter of January 5, 1923, would have been assessed and collected prior to the expiration of the statute of limitation on April 1, 1924. The fact that no claim in abatement was filed by the plaintiff directed specifically against the additional tax of $24,475.35, after it was proposed or assessed, is immaterial in view of the language, and the evident purpose and intent of section 611. The claim in abatement which the plaintiff filed in fact delayed the collection of this item for 1917, and the appeal by the plaintiff to the Commissioner from the decision of the Income Tax Unit denying its application for relief, as claimed in its abatement claim, was directed as well to the proposed additional assessment of $24,475.35 as to the additional assessment of $433,398.61 theretofore made.

We are of opinion that there is no merit in the claim of the plaintiff that section 611 is not applicable, on the ground that the delay in collecting the entire additional tax of $456,896.67 was the result of the failure of the Commissioner promptly to act after the Committee on Appeals and Review had made its decision on the appeal. The Commissioner approved the recommendation of the committee on or about October 9, 1923. So far as appears the matter of officially notifying the taxpayer of the action taken on its abatement claim, the preparation of the assessment list, the making of the assessment of the further additional tax of $24,475.35 and the preparation of the schedule of rejection of the abatement claim proceeded through the Bureau of Internal Revenue in the usual way. The fact that the decision to reject plaintiff's abatement claim was reached some time before the expiration of the period within which collection of the additional tax could be made does not render the provisions of section 611 inapplicable. In *Graham & Foster* v. *Goodcell* (282 U. S., 409 [Ct. D. 287, C. B. X–1, 191]), the court said "In No. 36, *Graham* v. *Goodcell*, however, the claim in abatement was rejected in December, 1922, and the period of limitation did not expire until March, 1923. It is urged that, for this reason, that case falls outside the purview of section 611. The statute makes no such exception, and we are not warranted in implying one. The claim in abatement had been filed and was pending for nearly three years. *There is room for the inference that, had it not been for this delay, the tax would have been collected before the statute ran. The tax was collected later and the statute, by its terms, is applicable.*" [Italics ours.]

In the case of this plaintiff the Commissioner officially rejected the claim for abatement March 19, 1924, and the tax in question was collected on different dates between April 15 and June 25, 1924. The plaintiff is therefore not entitled to recover on its claim that the additional tax of $456,896.67 collected and paid in 1924 constituted an overpayment within the meaning of section 607 of the Revenue Act of 1928.

The next question is whether the plaintiff is entitled to recover on the ground that its inventories at January 1 and December 31, 1917, were correctly stated in its original return filed for 1917 and that the Commissioner was in error in requiring the plaintiff to state its inventories in accordance with the method prescribed in article 1582, Regulations 45, which provided in part that "Goods taken in the inventory which have been so intermingled that they can not be identified with specific invoices will be deemed to be the goods most recently purchased."

When the plaintiff filed its original return for 1917 the inventories used in determining its income for that year were priced "at a figure or value that would in its opinion be realizable under any conditions foreseeable." The exact manner in which this was done does not definitely appear, other than that it was based on the theory that the stock on hand was practically the same as had been on hand for several years and therefore the cost of such goods would be their cost when acquired regardless of the fact that many times that amount had been purchased and sold in the meantime. Plaintiff kept on hand about a

four months' supply of a given article. The trend of the market was upward and therefore, if recent purchases had been considered, the inventory values would have been greater than those used. Plaintiff contends, however, that the replenishing of its supply did not affect its normal supply, since the goods most recently purchased were first sold, thus leaving the old goods on hand.

Subsequent to the filing of the original return for 1917, the Commissioner in the latter part of October or the first of November, 1919, rendered a decision which was adopted as the ruling of the Bureau of Internal Revenue in which methods similar to that followed by the plaintiff in the original return were disapproved. This decision and ruling was published in 1919, being T. B. R. 65 [C. B. 1, 51]. After the publication of this ruling and after the plaintiff's attention had been called to the fact that the Government regulations required a different method of preparing its inventories from that which it had pursued, the plaintiff on January 20, 1922, voluntarily filed an amended return for 1917 in which the inventories were prepared in accordance with article 1582, Regulations 45 (1920 edition), which provides, so far as material here, that "Inventories must be valued at (*a*) cost or (*b*) cost or market, as defined in article 1584 as amended, whichever is lower. * * * Goods taken in the inventory which have been so intermingled that they can not be identified with specific invoices will be deemed to be the goods most recently purchased."

The foregoing regulation, which was promulgated pursuant to the authority granted in section 203 of the Revenue Act of 1918, merely provides for the pricing of inventories in a manner generally recognized in good accounting practice, that is, the inventories may be priced at either "cost" or "cost or market, whichever is lower," and in carrying out whichever method is adopted, where fungible goods are involved which can not be identified by specific invoices, the cost of such goods will be computed upon the basis of the most recent purchases. The Revenue Act of 1916, as amended by the Revenue Act of 1917, did not specifically contain the authority granted by section 203 of the Revenue Act of 1918, but the same rule as to pricing inventories was applicable to 1917. (*Chicago Frog & Switch Co.* v. *United States*, 68 C. Cls., 186.)

The contention of plaintiff is that the method prescribed by the regulations and followed by it in its amended return leads to an arbitrary and capricious result, and that the inventories as reflected in the original return should be accepted. More specifically, the plaintiff objects to the use of inventories which place thereon costs on the principle that the first goods purchased were the first goods sold and therefore the goods on hand at a given inventory date were those most recently purchased.

It insists that the principle should be reversed and that the inventories should be prepared on the basis that the sales were always made from the most recent purchases and therefore the goods on hand at a given date were those first purchased. How far back the plaintiff would go in having us arrive at the "first purchases" does not definitely appear, though a witness for plaintiff testified that "We considered our stock was practically the same stock we had for several years." This is little more than another way of expressing the idea of a "base stock" method of inventories where a given quantity of goods on hand at all times is assigned the same price year after year. The reasons for rejecting such a system of valuing or pricing inventories is sufficiently stated in the Commissioner's ruling referred to above, T. B. R. 65, as well as in *Lucas* v. *Kansas City Structural Steel Co.* (281 U. S., 264 [Ct. D. 223, C. B. IX–2, 299]), and *Chicago Frog & Switch Co.* v. *United States*, supra. But even if we should examine plaintiff's inventories, as it urges we should, in an attempt to fix inventories based on actual cost, we are unable to see wherein it avails the plaintiff anything. The testimony of one of its witnesses shows that it had no accounting system which would enable it to identify particular goods and affix thereto their particular cost. To meet this deficiency in its system, the plaintiff introduced proof to show that its sales were made from the top of bins in which the articles were stored and that when it became necessary to replenish its supply, new articles were placed on top or in front of the old stock. Plaintiff therefore contends that the goods on hand in 1917 were those purchased long prior to 1917, and that it should have its inventories priced at these old costs. We find little merit in this position.

The plaintiff was a dealer in hardware and related merchandise of various kinds, including builders' hardware, mechanics' tools, stoves, mining and

railway supplies, cutlery, sporting goods, automobile supplies, and heating and plumbing supplies. The number of items was from 45,000 to 60,000. It was necessary to replenish the stock about three times each year, the average stock being sufficient for approximately four months' business. It may be that in some isolated instances the old stock remained on hand to the extent that the sales were made entirely from new purchases, but in large inventories, such as that with which we are here concerned, it would be going further than we think we would be justified to say that any substantial part of the original supply remained undisturbed over a long period of years. That some part of the original goods remained unsold is not equivalent to saying that the entire stock of goods on hand at a given inventory date represented purchases made many years prior thereto where the equivalent of such stock had been replenished over and over again. Such a situation is not comparable with that considered in *Ozark Mills, Inc.* (6 B. T. A., 1179), in which the actual cost of goods on hand were shown and therefore it was unnecessary to resort to a principle of presumption as to what goods were on hand. In the present case the original inventories which we are asked to accept do not purport to represent actual costs, but rather some kind of an approximation based on the cost of the original supply of the various articles sold.

In these circumstances we can not adopt the inventories used in the original returns for 1917 as representing inventories acceptable for income tax purposes. The plaintiff has the burden of showing that the method prescribed by the Commissioner's regulation and followed by him in the inventories accepted and used did not correctly reflect income and was not in accordance with good accounting. (*Chicago Frog & Switch Co.* v. *United States*, supra.) We are of opinion that this burden has not been sustained by plaintiff and that it has not been shown that an arbitrary or capricious result has followed from the Commissioner's action. The claim of plaintiff for a revised income based upon the inventories used in its original return is therefore denied. The petition is dismissed. It is so ordered.

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

ARTICLE 121: Business expenses.

REVENUE ACT OF 1928.

Legal expenses incurred in securing a refund of customs duties, or taxes, illegally or improperly collected. (See Mimeograph 3958, page 33.)

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

ARTICLE 151: Taxes. XI-27-5533
I. T. 2632

REVENUE ACT OF 1928.

Under Ohio Senate bill No. 323, approved June 29, 1931 (Laws of Ohio, 1931), personal property taxes should, in general, be accrued as of the 1st day of January. The adjustments for Federal income tax purposes occasioned by the change in the State law set out.

General Counsel's Memorandum 8218 (C. B. IX-2, 106) is modified in so far as it is inconsistent herewith.

Advice is requested relative to the proper accrual date of real and personal property taxes in the State of Ohio under Ohio Senate bill No. 323, approved June 29, 1931 (Laws of Ohio, 1931, page 714), providing for the levying of taxes on intangible property at classified rates, and for the assessment of tangible personal property for

taxation. That section of law amends, repeals, and supplements the preexisting law relating to the taxes imposed upon personal property in the State of Ohio.

In General Counsel's Memorandum 8218 it was held that real and personal property taxes imposed by the State of Ohio accrue for income tax purposes as of the day preceding the second Monday of April. The provisions of law upon which that memorandum was based were sections 5328, 5366–1, 5548, 5548–1, and 5671 of Page's Annotated Ohio General Code, 1926 edition. Section 5366–1 of that code specifically provided for the listing and valuation of personal property for taxation purposes as of the day preceding the second Monday of April. That section, however, has been repealed by section 4 of senate bill No. 323. (See page 776 of the Laws of Ohio, 1931.) There is no amendment of the law in the above-mentioned senate bill which will affect the accrual date of real property taxes.

Under the Ohio tax law as amended, it is provided, in general, that all taxable personal property shall be listed with respect to the ownership or control, valuation, and taxing districts as of the beginning of the 1st day of January, annually, and deposits not taxed at the source shall be listed as of the day fixed by the commission for the listing of deposits in financial institutions taxed at the source, pursuant to section 5411–1 of the General Code. (Section 5368, page 734, Laws of Ohio, 1931.) A taxpayer having a fiscal year may, if authorized by the tax commission of Ohio, list his taxable property "as of the close of business at the end of his fiscal year." (Section 5372–2, pages 737, 738, Laws of Ohio, 1931.)

Under the provisions of section 5 of senate bill No. 323 (see page 776, Laws of Ohio, 1931) it is provided on page 777 that—

> The first assessment of taxable property of the kinds and classes mentioned in this act shall take place in the year 1932 at the times and in the manner provided in this act. * * *

The question of the administrative effect of the law as changed was taken up with the tax commission of Ohio and the following information was received:

> With the exception of public utilities, the returns of personal property (tangible and intangible) made in the year 1931 are canceled and annulled and no tax will be collected with respect thereto. In such instances the only property which will be taxed for the year, 1931, will be real estate. The taxes on public utilities for the year, 1931, are to be levied only upon real and tangible personal property and no intangibles will be included in the assessment so made.
>
> Under amended senate bill No. 323, the first returns and assessments are to be made in the year, 1932, with the exception that the tax on bank deposits in Ohio financial institutions become a lien on November 24, 1931. The return of such deposits will be made by the financial institutions at the source between the first and second Mondays of March, 1932. Generally all returns will be made as of the beginning of January 1, 1932, with the exception as heretofore noted of bank deposits, and a further exception in the case of those taxpayers who return as of the close of their fiscal year with our permission. Real estate will continue to be taxed as in the past and the lien will attach as heretofore on the day preceding the second Monday of April in each year.

In view of the foregoing it is necessary to modify the rule set forth in General Counsel's Memorandum 8218 for accruing personal property taxes so as to conform to the State law as amended. It is, therefore, the opinion of this office that, under the Ohio tax law as amended in 1931, in general, personal property taxes should be

accrued as of the 1st day of January. For any taxable year embracing January 1, 1932, personal property taxes should be accrued as of that date, with the following exceptions: (1) Taxes on deposits in financial institutions (whether or not taxed at the source) should be accrued as of the date fixed by the tax commission of Ohio for the listing and assessment of deposits taxed at the source; and (2) taxes imposed in the case of taxpayers who have been authorized by the tax commission of Ohio to list their personal property as of the end of their fiscal year should be accrued as of the last day of such fiscal year. Inasmuch as the accrual date of real property taxes is not affected by senate bill No. 323, taxpayers in Ohio should continue to accrue such taxes as of the day preceding the second Monday of April, as provided in General Counsel's Memorandum 8218.

It is evident that in Ohio the personal property taxes (other than tangible personal property taxes imposed against public utilities), which have been accrued as of the day preceding the second Monday of April, 1931 (namely, April 12, 1931), in accordance with General Counsel's Memorandum 8218, will not be paid, as they are canceled and annulled by senate bill No. 323, approved June 29, 1931. Although under the law of Ohio before it was amended ownership of personal property on April 12, 1931, was the event which determined the taxpayer's liability for personal property taxes and fixed the amount thereof within the rule laid down in *United States* v. *Anderson* (269 U. S., 422, T. D. 3839, C. B. V–1, 179), the act of June 29, 1931, so changed the State law as to extinguish the liability. It follows that taxpayers in Ohio whose taxable year began before April 12, 1931, and ended after June 29, 1931, and whose books are kept on the accrual basis, must exclude as a deduction in computing net income the amount of the canceled personal property taxes. This is upon the theory that both the event which permitted the accrual of the taxes (ownership of property on April 12, 1931) and the event which extinguished the liability (the enactment into law of senate bill No. 323 on June 29, 1931) occurred in the same taxable year.

Where, however, the accrual date of the liability for personal property taxes and the effective date of the act which extinguished the liability occurred in separate taxable years, the situation must be treated differently. A taxpayer keeping his books on an accrual basis whose taxable year began before April 12, 1931, and ended before June 29, 1931, may accrue such taxes as of the former date for the reason that at the end of his taxable year senate bill No. 323 had not been enacted, and the accrual may properly be made in accordance with the law and facts as they then existed. The enactment into law of senate bill No. 323 and its approval on June 29, 1931, extinguished the accrued liability and it is necessary for the taxpayer to take cognizance of this change by proper bookkeeping entries. In such cases (i. e., where the taxpayer's taxable year began before April 12, 1931, and ended before June 29, 1931), the accrued liability for personal property taxes is an allowable deduction for that year, but the taxpayer's books should be adjusted by adding to the profit and loss account for the succeeding taxable year the amount of property taxes which have been extinguished by operation of law, and such amount must be included in taxable income. (G. C. M. 6075, C. B. VIII–1, 76.) This treatment is in accord

with the theory recognized by the courts that where an accrued liability is used to reduce income for one taxable year, and the events occurring in a subsequent taxable year extinguish the liability, the amount thereof should be treated as taxable income. (See *Burnet* v. *Sanford & Brooks Co.*, 282 U. S., 359, Ct. D. 277, C. B. X–1, 363; *Putnam National Bank* v. *Commissioner*, 50 Fed. (2d), 158, Ct. D. 415, C. B. X–2, 249; *Nott-Atwater Co.* v. *Poe*, 33 Fed. (2d), 1000, affirmed 42 Fed. (2d), 1018; *Chicago, Rock Island & Pacific Ry. Co.* v. *Commissioner*, 47 Fed. (2d), 990, cert. denied, 284 U. S., 618; *Charleston & Western Carolina Ry. Co.* v. *Burnet*, 50 Fed. (2d), 342.) (Cf. articles 191 and 331 of Regulations 74; *Excelsior Printing Co.* v. *Commissioner*, 16 B. T. A., 886, relating to recovery of bad debts which have been charged off and used to reduce income of a previous year.)

General Counsel's Memorandum 8218 is modified in so far as it is inconsistent herewith.

ARTICLE 151: Taxes.

XI–28–5541
I. T. 2633

REVENUE ACT OF 1928.

Under the Wisconsin statutes of 1927, ownership of real property on the date (falling between May 1 and the first Monday in July of each year for cities, and between May 1 and the last Monday of June elsewhere in the State) as of which such property is actually valued for assessment purposes is the "event" which determines the liability for the tax.

In the instant case the tax had accrued prior to the purchase of the property on August 1, 1929, and should be treated as part of its cost.

The taxpayer purchased certain real estate on August 1, 1929, and contends that real property taxes under the Wisconsin statutes of 1927 (applicable to this case) do not accrue or become a lien on the property until the tax is extended on the tax rolls, relying on the decision in *Spear* v. *Door County* (65 Wisc., 298, 27 N. W., 60). The specific question is should the real property taxes in the instant case be added to the cost of the property, or allowed as a deduction in computing net income. If the Wisconsin real property taxes accrued prior to August 1, 1929, the amount of the taxes in question should be capitalized and treated as a part of the cost of the property; if not, the amount is an allowable deduction in the computation of net income.

The taxes concerning which the question arises are taxes levied for the year 1929. The taxpayer purchased the property, located in ———, Wis. (a city of the first class), on August 1, 1929. The statutes in force at the time of the purchase and when the taxing officials began the work of listing and valuing property on the assessment roll were the statutes of 1927. The pertinent sections of the law are quoted below and the references to the numbered sections are from Wisconsin statutes of 1927.

70.07. *What property taxable.*—Taxes shall be levied upon all property in this State except such as is exempted therefrom. * * *

70.08. *Assessment, when made.*—The assessor of each assessment district shall begin on the 1st day of May in each year, or as soon thereafter as prac-

ticable, and proceed to make an assessment of all the real and personal property liable to taxation in such district. All personal property shall be assessed as of the 1st day of May in such year * * *. Real property may be assessed at any time between the 1st day of May and the time of the sitting of the board of review for such district.

(NOTE.—This section has been amended by an act approved September 3, 1929, chapter 461, Laws of Wisconsin, 1929.)

70.46. *Boards of review; members; organization.*—(1) The supervisors and clerk of each town, the mayor, clerk, and such other officer or officers, other than assessors, as the common council of each city shall, by ordinance determine, the president, clerk, and such other officer or officers, other than the assessor, as the board of trustees of each village shall, by ordinance determine, shall constitute a board of review for such town, city, or village. In cities of the first class, the mayor, clerk, tax commissioner and assessors shall constitute the board of review. * * *

(2) Such board shall meet annually on the last Monday of June * * *. In cities the board shall meet on the first Monday of July in each year. * * *

Section 70.50 provides that, except in cities of the first class, the assessor shall, on or before the first Monday in August annually, deliver the assessment roll so completed and all the sworn statements and valuations of personal property to the clerk of the town, city, or village, who shall file and preserve the same in his office.

With respect to cities of the first class, the assessment or valuation by assessors in the preparation of the assessment roll is covered by section 70.06, supra. Section 70.03 provides that in all cities of the first class, the several assessors shall deliver their respective assessment rolls to, and file them with, the tax commissioner on the last Monday of June in each year, or as soon as practicable thereafter. The tax commissioner shall give notice by publication in the official papers of said city that on a day therein named for each assessment district, the assessment roll for said district will be open for examination by the taxable inhabitants thereof. On the last Monday of June the tax commissioner shall call together all of the assessors, and said tax commissioner together with such assessors shall constitute an assessment board. This board is empowered to make all necessary corrections and changes and after they are made the tax commissioner shall submit the corrected assessment roll to the board of review.

As previously stated in section 70.46, the board of review in cities shall meet on the first Monday in July each year and may adjourn from day to day or from time to time until its business is completed. Section 70.51 provides that the board of review shall complete the assessment roll of the city within the time prescribed by law and deliver the assessment roll to the tax commissioner, who shall make out therefrom a complete roll. While the tax commissioner may make out a tax roll from the assessment roll, the tax roll can not be completed until after the levy of taxes by the proper authorities in the respective taxing districts, including the State levy for State purposes, the county levy for county purposes, and the town, city, or village levy for local purposes.

The State levy does not become available until some time in October and is not certified to the county clerk until on or before the fourth Monday in October. (Section 70.59.) The county levy and rate are not determined until the annual meeting of the county board and after the second Tuesday in November of each year. (Sections 70.61 and 70.62.) The common council can not make its levy until

after the meeting of the board of estimates in August of each year, and, as a matter of practice, does make the levy in the latter part of October.

The levies must be available to the tax commissioner in order to complete the tax roll for delivery to the city treasurer on the second Monday in December. (Section 70.51.)

The taxpayer refers to the general principle, with respect to the accrual of taxes for Federal income tax purposes, stated by the United States Supreme Court in *United States* v. *Anderson et al.* (269 U. S., 422, T. D. 3839, C. B. V–1, 179), as follows:

> * * * 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. * * *

The taxpayer contends that not until the tax roll is completed is liability fixed upon the taxpayer, and cites *Spear* v. *Door County* (65 Wisc., 298, 27 N. W., 60) in support of its view that a tax is not a lien under the Wisconsin law until extended on the tax roll. In that case, the owner in fee of the real estate on November 15, 1875, covenanted in a mortgage to pay "all taxes subsequently levied" on the mortgaged premises. The mortgaged premises, upon foreclosure were sold on April 8, 1880, one consideration being a promise to protect the premises from all prior taxes. The court said:

> * * * In the mortgage the plaintiff covenanted to pay *all taxes subsequently levied* on said mortgaged premises. This mortgage was executed November 15, 1875, and must have been before the taxes for the year 1875 had been extended on the tax roll for that year. We think this was a covenant to pay all taxes which thereafter became a specific lien upon said lands by being extended upon the tax roll of the town in which they were situate. The rule fixed by statute as to who shall pay the taxes for the current year, as between grantor and grantee, when no agreement is made in respect to the same, goes upon the theory that the taxes are not a specific lien upon real estate until the tax roll is completed and the taxes extended on such roll. * * * The grantor is not liable, on his convenant against incumbrances, for the taxes of the current year unless they have been extended on the tax roll at the date of his conveyance. At the date of the plaintiff's mortgage had he conveyed the lands by warranty deed, he would not have been liable for the payment of the taxes for the current year, unless upon special agreement. * * * (Italics in original.)

It does not follow, however, that there was no liability for the taxes prior to the date when the lien attached. The court merely states that the grantor is not liable "on his covenant," and his covenant was to pay all taxes "subsequently levied." Liability for taxes may accrue for Federal income tax purposes prior to the determination of a specific rate or ascertainment of the amount of tax against the property.

It is held that, in the case of real estate under the Wisconsin statutes of 1927, the ownership of property on the date (falling between May 1 and the first Monday of July in each year for cities, and between May 1 and the last Monday of June elsewhere in the State) as of which such property is actually valued for assessment purposes is the "event" which determines the liability for the tax.

In the instant case the tax had accrued prior to the purchase of the property on August 1, 1929, and should be treated as a part of the cost of the property. (See G. C. M. 7235, C. B. VIII–2, 197.)

ARTICLE 151: Taxes. XI-34-5621
I. T. 2638

REVENUE ACT OF 1928.

Under the laws of the State of Wyoming inheritance taxes accrue on the date of death of the decedent. Where the estate's books of account are kept on the accrual basis, such taxes are deductible for the year in which the death occurred, regardless of when paid.

Inquiry is made relative to the year for which the estate of A is entitled to deduct Wyoming inheritance taxes paid during the years 1930 and 1931.

It is shown that A died testate in 1929, that the executor for the estate kept the books of account on the accrual basis, and that Federal income tax returns were filed on that basis. The executor elected to report income on the calendar-year basis and as a result filed a return for the period from the date of death to December 31, 1929, and a return for the calendar year 1930. Wyoming inheritance taxes were paid in 1930 and additional Wyoming inheritance taxes were paid in 1931.

No inheritance taxes were deducted in the return for 1929, which included income from date of death to December 31, 1929. In the return for 1930 the executor for the estate deducted Wyoming inheritance taxes paid during the year 1930 on the theory that the taxes accrued during that year. The claim for refund is based on the theory that additional inheritance taxes paid in 1931 also represent taxes which accrued in 1930 and which should be allowed as a deduction for the year 1930. The examining officer contends that inheritance taxes may not be allowed as a deduction to the estate for the year 1930 for the reason that Wyoming inheritance taxes accrue upon the death of the decedent, which in the instant case occurred in 1929.

Section 23(c) of the Revenue Act of 1928 provides that in computing net income there shall be allowed as a deduction taxes paid or accrued within the taxable year, with certain exceptions not here material. It is also stated in that section that estate, inheritance, legacy, and succession taxes accrue on the due date thereof, except as otherwise provided by the law of the jurisdiction imposing such taxes, and shall be allowed as a deduction only to the estate.

Section 4 of the inheritance tax laws of the State of Wyoming, chapter 78 (original house bill No. 96), Session Laws of Wyoming, 1925, provides in part as follows:

SEC. 4. All taxes imposed by this act shall take effect at and *accrue upon the death* of the decedent, or donor, and shall be due and payable at the expiration of sixteen (16) months from such death, except as otherwise provided in this act * * *. [Italics supplied.]

In view of the fact that the above-quoted provision of the law of the State of Wyoming, which is the law of the jurisdiction imposing the inheritance taxes, specifically provides that the inheritance taxes shall accrue upon the death of the decedent, it is held that the inheritance taxes accrued in the instant case on ———, 1929, the date of A's death. Inasmuch as the executor of the estate adopted the accrual method of accounting and filed returns on the calendar-year basis, the entire amount of the inheritance taxes is deductible for the taxable year 1929, regardless of when paid. The taxpayer's contention that such taxes accrued in 1930 should, therefore, be denied.

ARTICLE 151: Taxes. XI-39-5719
I. T. 2643

REVENUE ACT OF 1928.

Ownership of property in Louisiana on January 1 is the event which determines the liability for both real estate and personal property taxes and fixes the amount, though not ascertainable on that date. Real and personal property taxes in Louisiana accrue, therefore, for Federal income tax purposes, on January 1 of each year.

A ruling is requested relative to the date on which real and personal property taxes accrue in the State of Louisiana.

The law under which such taxes are imposed is contained in Marr's Annotated Revised Statutes of Louisiana, volume 3. The applicable provisions of the State law are as follows:

6202. [Section 1, act 170, 1898, page 346.] For the calendar year A. D. 1914 * * *, and for each succeeding calendar year, there are hereby levied annual taxes amounting in the aggregate to * * * mills on the dollar of the assessed valuation of all property situated within the State of Louisiana * * *.

The foregoing section further defines real property and concludes with a long list of personal property which is taxable.

6219. [Sec. 10.] Each tax assessor, parish of Orleans excepted, on and after the 1st day of January of each year, shall diligently examine the records in the offices of mortgages and conveyances and abstracts of land entries, * * * and shall otherwise make faithful inquiry and investigation to ascertain what taxable property in his district or parish belongs to residents and to absent owners, and to unknown owners; and he shall make a separate list describing each tract of land and other items of taxable property belonging to any absent owner whose name is unknown, and shall affix the valuation thereof * * * unless said absent owner * * * shall have delivered to him a correct and complete tax list * * * on or before the 1st day of June * * *.

6238. [Sec. 22.] Immediately after listing and estimation of the valuation of all real and personal property shall have been completed by the assessors (parish of Orleans excepted), which shall in all cases be done on or before the 1st day of June in each and every year, the said assessors shall give notice by publication * * * that the listing of the property has been completed, and the estimated valuation made therein by the said assessor in accordance with law, and that the said list shall be exposed in the office of the said assessor for inspection and correction for a term of twenty (20) days, beginning next after the ten (10) days required for notice herein provided shall have expired.

6239. [Act 164, 1904, page 341.] In the parish of Orleans all the assessors in and for said parish shall meet on the 2d day of January in each year, or if a holiday then the next succeeding day not a holiday and daily thereafter (Sundays and legal holidays excepted) until the assessments shall have been completed, which shall, in all cases be done on or before the 15th day of March of each year.

The said assessors for said parish shall give notice by publication, as now provided by law, of the completion of the assessment of property in said parish, and the estimated valuation made therein, and that the said lists will be exposed in the office of the board of assessors for inspection and correction * * * from the 16th of March to the 31st of March, both inclusive, of each year * * *.

6211. [Sec. 4, act 78, 1906, page 124.] The tax assessors herein provided for shall have all the powers and discharge all the duties given to and prescribed for tax assessors by existing laws, except they shall not be registrars of voters. They shall enumerate and list and assess property as now directed by law, and be subject to all the obligations prescribed by law. They shall prepare and have ready their rolls showing the valuations or assessments made by them, and lay the same before the boards of review within the time and in the manner prescribed by law.

6215. [Sec. 7, act 170, 1898, page 350.] It is made the duty of the tax assessors throughout the State to place upon the assessment list all property subject to taxation, including merchandise or stock in trade on hand at the date of listing, within their respective district or parishes * * *.

Tax assessors in Louisiana are elected at the general election and hold office for a term of four years from and after December 31 of the year in which they are elected. The auditor of public accounts is required to prepare and have forwarded to the several assessors in the State (parish of Orleans excepted), prior to the 1st day of January of each year, tax lists sufficient to secure the listing of all property subject to taxation. The property owner is required to prepare a list of his property in accordance with the prescribed form, and to return the list to the assessor before the 1st day of May of each year. The lists have columns for valuation to be filled in by the assessor.

In the parish of Orleans the several assessors comprise a board of assessors and the auditor of public accounts furnishes them such lists as they require. The taxpayer is required to make a return of his property within 20 days after the list has been left at his domicile or place of business.

Except as indicated by the requirements stated and the sections of the law quoted, there is nothing to indicate when the tax assessors (parish of Orleans excepted) shall distribute the tax lists or shall begin the work of assessment. The courts have held, however, that for the purpose of assessment the status of property is to be taken as of the 1st of January of the year in which the assessment is made. (*Palfrey et al.* v. *Connelly*, 106 La., 699, 31 So., 148; *Southern Insurance Co.* v. *Board of Assessors*, 49 La., 401, 21 So., 913; *Home Insurance Co.* v. *Board of Assessors*, 48 La., 451, 19 So., 280.) Hence, buildings and improvements constructed after January 1 are not subject to tax for that calendar year. (*Bunkie Brick Works, Ltd.*, v. *Police Jury of Aroyelles*, 113 La., 1062, 37 So., 970.) But the average stock in trade carried during the year is the basis of assessment. Movables brought into the State after January 1 are assessable (*Hammond Lumber Co., Ltd.*, v. *Smart*, 129 La., 945, 57 So., 277), even though taxes may have been paid on the same in another State (*Griggsby Construction Co.* v. *Freeman, Tax Collector*, 108 La., 435, 32 So., 399); and movables brought from one taxing district of the State into another taxing district are assessable in the latter if not already assessed in the former. The fact that the property was only acquired after January 1 does not make it nontaxable from date of acquisition to the end of the year. (*Citizens' Bank & Trust Co.* v. *Board of Assessors*, 129 La., 1091, 57 So., 528.) Real estate in annexed territory owes taxes to that political subdivision in which it was situated January 1. (*City of New Iberia* v. *Police Jury of Iberia Parish*, 135 La., 769, 66 So., 193.)

In *Southern Insurance Co.* v. *Board of Assessors* (49 La. Ann., 401, 21 So., 913), the court said:

* * * that there should be some fixed date determining the rights of the parties, but they contend that that date is fixed as of the 1st of March, when the assessments are closed. We are not of that opinion. It is true that there is a period of time between that when the business of assessment commences and that when it is ordered to be closed, but that is because, in the nature of things, the assessors can not make the assessment over an extended

territory in one day; and it is true that during that open period the taxpayer may make his return for assessment purposes, but, when he does so, he is expected to make it on the basis of the condition of things existing on the 1st of January. * * *

It was concluded, therefore, that the levying of taxes is for the "calendar years," and the "assessment" of property for the "purpose of levying" the "annual taxes" is likewise for the calendar year. So, when the law provides that assessment must begin on the 2d of January and be completed on the 1st day of March, it contemplates an assessment on the basis of the condition of things existing on the 1st day of January.

The rule in regard to ownership of property for taxation is stated in 37 Cyc. at page 788, as follows:

Ordinarily and in the absence of statute to the contrary, property is taxable only to the person who is the owner thereof at the date for its listing or assessment, or the date fixed by statute as of which its ownership for purposes of taxation is to be determined; * * *.

Ownership of property in the State of Louisiana on January 1 is the event which determines the liability for both real estate and personal property taxes and fixes the amount, though not ascertainable on that date. Real and personal property taxes in Louisiana accrue, therefore, for Federal income tax purposes, on January 1 of each year.

ARTICLE 151: Taxes.

XI-41-5769
I. T. 2647

REVENUE ACT OF 1928.

Ownership of property in the State of Montana on the first Monday of March is the event which determines the liability for both real and personal property taxes. Such taxes accrue, therefore, for Federal income tax purposes on that date.

Inquiry is made whether A, a taxpayer, residing in Montana, is entitled to deduct in his return filed for the calendar year 1930 the amount of taxes accrued on certain real property disposed of on November 1, 1930.

The books of the taxpayer are kept on the accrual basis and his returns are filed for the calendar year. On December 1, 1930, the first half of the taxes for that year was paid, and on May 31, 1931, the second half was paid. The total amount of such taxes was accrued, however, on the books of account maintained by the taxpayer for 1930.

Section 2002 of volume 1 of the Revised Codes of Montana, 1921, provides as follows:

2002. *When assessment to be made—Credits must be assessed, how.*—The assessor must, between the first Monday of March and the second Monday of July in each year, ascertain the names of all taxable inhabitants, and all property in his county subject to taxation * * * and must assess such property to the persons by whom it was owned or claimed, or in whose possession or control it was at 12 o'clock m., of the first Monday of March next preceding * * *.

In 1927 the foregoing provision was modified as to the time of assessment of real estate. The modifying provisions are set forth as

sections 2002.1 and 2002.2 in the Revised Codes of Montana, Supplement, 1923–1927, as follows:

2002.1. *Valuation of real estate for assessment in 1927.*—All real estate and all improvements on real estate, in this State, subject to taxation * * * shall be separately valued for assessment and taxation purposes in the year 1927, and biennially thereafter in each odd-numbered year, with reference to the value thereof at 12 o'clock noon on the first Monday of March preceding the assessment, and such valuation in each such odd-numbered year shall constitute the assessed valuation thereof until the next biennial assessment * * *.

2002.2. *Valuation by assessor—Effect destruction improvements.*—Each assessor shall annually value and assess all real estate that shall have become subject to taxation since the last previous valuing and assessing of real estate in the county, or which has escaped taxation the preceding year, and he shall also annually value and assess all buildings, structures and other improvements on real estate which shall not have been previously valued and assessed. * * *

Section 2050 of the Revised Codes of Montana, 1921, provides that the assessor must complete his assessment book on or before the second Monday in July. Section 2052 states that the assessment book must be delivered to the county clerk as soon as completed. Section 2161 of the Revised Codes of Montana, Supplement, 1923–1927, provides that on or before the third Monday of October he must deliver the original assessment book to the county treasurer. Section 2169 makes the requirement that within 10 days after the receipt of the assessment book the county treasurer must publish a notice specifying:

1. That one-half of all taxes levied and assessed will be due and payable before 6 o'clock p. m. on the 30th day of November next thereafter, and that unless paid prior thereto the whole amount of said taxes will be delinquent and will draw interest at the rate of 1 per cent per month from and after such delinquency, and 10 per cent will be added to the amount thereof as a penalty, and that one-half of all taxes levied and assessed will be due and payable on or before 6 o'clock p. m., on the 31st day of May next thereafter, and that unless paid prior to said date said taxes will be delinquent * * *.

Chapter 67 of the Laws of Montana, 1931, has altered the requirements under section 2169 to some extent but not so as to change the dates on which the taxes become due and payable. Inasmuch as the case in question comes under the provisions of the law in existence in 1930, the provisions of chapter 67 are not further discussed.

It thus appears that the tax on both real and personal property in the State of Montana in 1930 was assessed as of the first Monday of March of that year and that it was due and payable on November 30, 1930. A taxpayer, however, was required to pay only one-half of the total tax on that date, and one-half on May 31, 1931.

The general rule in regard to the taxation of property is stated in 37 Cyc., page 788, as follows:

Ordinarily and in the absence of statute to the contrary, property is taxable only to the person who is the owner thereof at the date for its listing or assessment, or the date fixed by statute as of which its ownership for purposes of taxation is to be determined; * * *.

Ownership of property in the State of Montana on the first Monday of March in each year is the event which determines the liability for both real and personal property taxes. (See *United States* v. *Anderson*, 269 U. S., 422, T. D. 3839, C. B. V–1, 179.) Real and personal property taxes in Montana accrue, therefore, for Federal income tax purposes on that date.

Inasmuch as the taxpayer kept his books on the accrual basis and filed his return for the calendar year, he is entitled to deduct the entire tax assessed for 1930 in his return for that year.

ARTICLE 151: Taxes.

REVENUE ACT OF 1928.

New York State franchise tax. (See Ct. D. 581, page 141.)

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

ARTICLE 171: Losses.

XI–37–5675
G. C. M. 10873

REVENUE ACTS OF 1926 AND 1928.

Gambling losses incurred by a citizen of the United States in legalized foreign gambling casinos should be treated as allowable deductions from gross income if (a) the transactions producing those losses were entered into for profit and (b) the taxpayer submits sufficient evidence that the gambling transactions were entered into for profit to warrant the Bureau's allowance of the losses.

An opinion is requested relative to proposed certificates of overassessment in favor of the taxpayer for the years 1927 and 1928 in the amounts of 2.75x dollars and 3.41x dollars, respectively.

The issue in the case is the deductibility from income of gambling losses aggregating 14.40x dollars for 1927 and 13.65x dollars for 1928, incurred by the taxpayer, a citizen of the United States, in certain legalized gambling casinos in the Republic of France.

Section 214(a)5 of the Revenue Act of 1926 and section 23(e)2 of the Revenue Act of 1928 provide 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."

It appears that the taxpayer's agent filed original returns for 1927 and 1928 for the taxpayer without knowing that losses had been sustained through gambling in French casinos and, accordingly, did not take any deductions therefor. Consequently, upon the disclosure of the losses, amended returns were filed, accompanied by claims for refund in the amounts of 3.31x dollars for 1927 and 3.43x dollars for 1928.

These claims were audited by the Bureau upon the basis of allowing the losses as deductions resulting in proposed certificates of overassessment in favor of the taxpayer for 1927 and 1928 in the respective amounts of 2.75x dollars and 3.41x dollars. Such certificates were then submitted to this office for review, but were returned without approval for the reason that there was no proof that the losses sustained were incurred in transactions "entered into for profit." In returning the certificates this office cited *Louis D. Beaumont* v. *Commissioner* (25 B. T. A., 474, C. B. XI–1, 1), and

suggested that the taxpayer be given an opportunity to submit such proof.

In *Beaumont* v. *Commissioner*, supra, promulgated February 9, 1932, the Board of Tax Appeals disallowed similar losses from legalized gambling at Monte Carlo, within the Principality of Monaco, for lack of proof that the losses were incurred in any transactions entered into for profit. In its opinion the Board stated in part as follows:

* * * Even though the gambling was legal, as contended by the petitioner, we are of the opinion that the petitioner's case is not aided thereby. *The deduction allowed by the statute is of losses incurred in any transactions entered into for profit. The question whether the gambling transactions under consideration were entered into for profit is a question of fact, upon which the evidence before us in these proceedings is entirely silent.* We can not proceed upon a presumption that all gambling transactions are entered into for profit within the meaning of the statute. The petitioner was a wealthy man living abroad at fashionable resorts, apparently as a matter of choice. He was not a professional gambler and was not dependent upon the success of his gambling ventures for a livelihood. It may well be that he indulged in games of chance for sport and recreation and without serious concern as to the financial results. Upon the evidence the respondent is sustained in disallowing the deductions. [Italics supplied.]

As the evidence in the instant case was "entirely silent" on the point, the taxpayer was given an opportunity to submit additional facts tending to establish her claim that her transactions in the French gambling casinos were entered into for profit. Through her attorney she has submitted further evidence which may be summarized as follows:

The losses described in the claims for refund and the protest were sustained during the taxable years 1927 and 1928, and were not compensated for by insurance or otherwise. The amounts lost on the various dates set out in the claims for refund and the protest were not the gross amounts of losses but were the amounts of losses, reduced by the amounts of gains, on a series of separate transactions extending frequently over a number of days and sometimes over a number of months. Each transaction was entered into with the expectation and belief that, in accordance with the laws of chance, or mathematical probability, and the rules of the particular transaction, a profit would result, and in many instances a profit did result. The taxpayer made a study of the laws of chance affecting the conduct of the transactions into which she entered, and believed that she was conducting the transactions in such a way that they would ultimately result in a profit to her. She frequently succeeded in conducting her gambling transactions at a profit over a considerable period of time, and engaged in the particular transactions involved with the hope and expectation of doing so again. The so-called games of chance in which the taxpayer engaged in the years 1927 and 1928 were chemin de fer and baccarat. These games the taxpayer played with the belief that they are not capable of being so conducted as to disturb the operation of the applicable laws of chance or mathematical probability.

The taxpayer also bought and sold shares of stock, bonds, and other property on the M Stock Exchange and other exchanges during the years 1927 and 1928, resulting in respective profits of $5.89x$ dollars and $39.88x$ dollars, which were returned by her as income.

These stock transactions of purchase and sale were entered into with the same previous study of the factors affecting the likelihood

of profit, and with the same hope and expectation of profit as in the case of the gambling transactions. In this respect the taxpayer did not differentiate between transactions at the various casinos where losses were sustained and transactions in corporate stocks in which profits were realized.

The record shows that the taxpayer was the recipient of a very large annual income derived principally from trusts, that she lived abroad, that her losses were not excessive in proportion to her income, that her gambling was not done as a means of livelihood, that such gambling was prohibited in France except in a few watering resorts for the rich, that she traveled a great deal, and had interests in other parts of the world, from all of which it might be argued that the taxpayer's gambling was done for sport and amusement, or for recreation and entertainment, or for the thrill of it, and not for "profit" within the meaning of the statute. It is of course a matter of common knowledge that the odds are heavily against the participant in such gambling.

The question then occurs whether such facts of record could reasonably be regarded as sufficient to overcome the evidence submitted by the taxpayer. The comments of the Board in the quoted portion of the Beaumont case give some color to the answer that they might be so considered, but on the other hand the Board did not have before it evidence of the same weight and sufficiency as has been presented to the Bureau in the instant case. In *Edgar N. Carnrick* v. *Commissioner* (21 B. T. A., 12) the Board said:

> * * * 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. * * *

If "reasonableness" were the test—that is, if the question were whether the taxpayer "reasonably" entered into the gambling transactions for profit—there might be good ground for holding that her losses were not deductible; but the statute does not appear to provide such a test, and the Board's use of the word "reasonably" in the Carnrick case is believed to relate to the particular case which the Board had under consideration.

In the Beaumont case the Board said that "the question whether the gambling transactions under consideration were entered into for profit is a question of fact." Therefore, in order to sustain a disallowance of gambling losses as deductions the Bureau would have to overcome the taxpayer's testimony or other evidence that such transactions were in fact entered into for profit.

According to the evidence submitted, the transactions entered into were not isolated, but frequent, with varying results, and were based on a study of the laws of chance, if not on a plan. It seems to be the fact that players do devise plans for play in the belief, whether sound or not, that these gambling establishments can be "broken," and also that players do actually play "for profit." In the light of such evidence as the taxpayer has produced, the Bureau would need something more than presumption to warrant a conclusion to the contrary.

Consideration must also be given to the fact that the question whether such gambling losses are properly deductible within the

meaning of the statutes is not fully an open question. Although losses in illegal transactions are disallowed as deductions to the extent that they exceed the gains during the taxable year from similar transactions (*Appeal of Mitchell M. Frey, jr., et al.*, 1 B. T. A., 338, C. B. X–2, 25; *Appeal of James P. McKenna*, 1 B. T. A., 326, C. B. X–2, 46; and I. T. 1854, C. B. II–2, 125), losses on election bets where legal have been held to be allowable deductions as losses sustained in transactions entered into for profit (I. T. 1865, C. B. II–2, 125), and losses incurred in betting on horse races where legal have likewise been held so deductible (S. M. 2680, C. B. III–2, 110). It is the opinion of this office that no logical distinction can be made between losses at legalized foreign gambling casinos and losses sustained through betting on horse races and elections where such transactions are legal, nor would the fact that the transactions took place in a foreign country be material in the case of a citizen of the United States.

In view, therefore, of the Bureau's position with respect to losses sustained through betting on horse races and elections, it is concluded that gambling losses incurred in legalized foreign gambling casinos should be treated as allowable deductions from gross income if (a) the transactions producing those losses were entered into for profit, and (b) the taxpayer submits sufficient evidence that the gambling transactions were entered into for profit to warrant the Bureau's allowance of the losses. As the taxpayer in the instant case has submitted evidence substantiating the fact that her gambling transactions were entered into for profit, the losses should be allowed as deductions.

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

SECTION 23(k).—DEDUCTIONS FROM GROSS INCOME: DEPRECIATION.

ARTICLE 203: Depreciation of intangible property. XI–36–5657 G. C. M. 10845

REVENUE ACT OF 1928 AND PRIOR REVENUE ACTS.

The taxpayer, a smelting company, made a contract with a mining corporation in which it held the majority of the outstanding stock, the smelting company to buy and the mining company to sell all of the —— ores mined upon or coming from any or all the properties owned or leased by the mining company within a certain district.

Held, the contract in the instant case was valid and enforceable on March 1, 1913, and the taxpayer is entitled to a determination of the March 1, 1913, value of the contract in order that the value determined upon may be amortized or exhausted over the remaining useful life of the contract.

An opinion is requested whether the M Company (hereinafter referred to as the "Smelting company") is entitled to a valuation as of March 1, 1913, on an ore purchase agreement made between it and the N Company (hereinafter referred to as the "Mining com-

pany") to support its claim for amortization of the contract over the period from March 1, 1913, to August 31, 1930.

Prior to 1913 the Smelting company and the Mining company (the majority of whose stock was owned by the Smelting company) entered into an agreement by the terms of which the Mining company agreed to sell and the Smelting company agreed to purchase all of the —— ores mined upon or coming from any or all the properties owned or leased by the Mining company in a certain district. The material parts of the contract read as follows:

> The Mining company agrees * * * to sell to the Smelting company all the —— ores mined upon or coming from any and all properties owned or leased by the Mining company in the —— District in the State of R * * *.
>
> The Smelting company agrees to buy, and accept delivery of, all the ores of the description mentioned in the foregoing article which the Mining company shall tender for delivery in accordance with this contract, as and when the same shall be so tendered, and to pay therefor as hereinafter provided. * * *
>
> This agreement shall be binding upon and inure to the benefit of the successors and assigns of the respective parties hereto, and all its provisions relating to the sale of ore shall, as to the Mining company, be deemed to be and considered as a covenant running with the land. The Mining company, in further consideration of the premises, undertakes and agrees that in the event that it shall sell, lease, or otherwise dispose of any or all of its mining property or dispose of its stock in a company or companies owning or leasing mining property producing the ore covered by this agreement during the period covered by this agreement, it will at its option obtain the previous written consent of the Smelting company to such sale, lease, or disposal, or will cause its successors and assigns in interest in such mining property or stock to agree with the Smelting company to assume, fulfill, and carry out each, every and all of the covenants and agreements with respect to the sale of products herein set forth, to be kept and performed by the Mining company, and to make a covenant with the Smelting company which shall require similar agreements, assumptions, and covenants to those in this article provided for on any subsequent transfers of any such property. And in the event that the Mining company shall not obtain the previous written consent of the Smelting company to such sale, lease, or disposition, the Mining company, notwithstanding any such sale, lease, or other disposition of any mine or stock, shall be and remain responsible and liable to the Smelting company for the due sale and delivery, according to the provisions of this contract, of all products therein contracted to be sold to the Smelting company and agrees that such sale and delivery shall be so made.

The Income Tax Unit has denied the claim for allowance for amortization on the contract over the period March 1, 1913, to August 31, 1930, for the following reasons:

1. The contract is for the purchase of ores after the production by the Mining company, without specific provision as to the total quantity of ores to be purchased over the life of the contract, or for any specific amounts to be purchased yearly.

2. The contract discloses no elements of a lease or other contractual provisions which convey to the purchasing company any equities in unmined ores or any other tangible property.

3. No provision appears in the contract that carries any assurance or guaranty, or provides any other basis, for the determination of the future profits, all or any part of which actually accrued or was determinable as of March 1, 1913.

The unit takes the position that any potential value it may have had on March 1, 1913, is attributable mainly to improved methods in the mining and the refining of ores which influenced the margin of profits.

It seems evident from the foregoing that the action of the unit in denying that the agreement had any value as of March 1, 1913, is based upon the belief that the agreement was void, either for want of mutuality of obligation or for indefiniteness, in that it did not bind the Mining company to produce any specified quantity of ore either by a maximum or minimum clause, and that the Mining company could have ceased operations or gone out of business at any time it chose to do so. In other words, the contract has been regarded as having no value because it apparently was believed that the measure of the product to be sold was left to the uncontrolled wish or desire of the vendor.

An examination of the contract clearly shows that the Smelting company was required to purchase all ores which the Mining company produced. In other words, it would appear that the Smelting company agreed to purchase the total output of the mines owned or controlled through lease or other arrangement by the Mining company. At the outset it should be noted that a distinction must be drawn between contracts which, without specifying exact quantities, provide for the sale or purchase of all or a specified part of the output of an established plant or business and contracts which by their terms leave the amount to be sold or purchased subject to the uncontrolled wish, desire, or need of one of the parties.

In *Miller* v. *Robertson* (266 U. S., 243) the United States Supreme Court had for consideration the validity of a contract for the sale of the entire zinc product of a certain mine. In sustaining the validity of the contract and in affirming the judgment of the lower courts for damages for breach of the contract, the court said:

> Was there a lack of mutuality and want of consideration?
>
> Appellants contend that the parties failed to make a contract, and assert the seller promised only such ore as it might ship from the mine and was not bound to ship all the ore produced or to mine or ship any ore. * * *
>
> * * * The buyers had a large business in the smelting of zinc ore in the United States. The seller had been engaged for a long time in the mining of copper ore from the Mammoth Mine. Early in 1914, there was discovered in that mine a large body of zinc ore, containing about 40,000 tons. The sellers desired to dispose of, and the buyers wanted, zinc ore. While there had been no regular weekly or monthly production or shipments prior to the signing of the writing, the seller had made a number of shipments to the buyers. The work of developing the ore body in preparation for production was in progress. The mine was already equipped and capable of producing ore. The writing shows that the completion of a picking plant was contemplated. The year covered was to commence on the date of the first shipment after its completion. When the instrument was executed, September 29, 1914, both parties knew the quality of the ore and that the quantity was substantial.
>
> The parties intended to make a contract—one to sell, and the other to buy, zinc ore. By plain statements and manifest implications, the seller was bound for a definite time not otherwise to dispose of its ore; the buyers were given an option on the lower grade ore; the seller was bound at all times, when not prevented or delayed by some cause beyond its control, to mine and to ship to the buyers the total production of zinc ore of the specified grade; and the buyers were bound to take and pay for all such ore when not prevented or delayed by causes beyond their control as specified in the contract. The quantities of ore to be mined and shipped were not limited to those to be produced by the equipment and methods employed at the time of the execution of the contract. The proposed picking plant was to be added, and increased output was expected and bargained for.
>
> * * * The writing did not give the seller the option to ship or to refrain from shipping as it saw fit, or leave the quantity to be delivered to its choice. There was no want of consideration or lack of mutuality.

In *Transcontinental Petroleum Co.* v. *Interocean Oil Co.* (262 Fed., 278) the court had occasion to consider a contract substantially similar to the contract here involved, and in the course of its opinion the court used the following language:

> At the threshold of the case is defendant's contention that the contract is void for want of mutuality of obligation. This involves a construction of the first three paragraphs of the contract. By the first paragraph plaintiff agreed to sell and deliver to defendant 1,200,000 barrels of Mexican crude petroleum oil upon terms and conditions specified, "provided, however, that deliveries in said quantity or in any quantity are limited to the actual production of the oil wells owned by the vendor and the production of other wells which may be from time to time controlled by the vendor." The second paragraph provides for deliveries by plaintiff at the rate of not less than 50,000 barrels per month from January 1, 1914, to December 31, 1915, in cargo lots into defendant's vessels of stated capacities, failure of the latter to take the specified quantity in any month to be made up the next. The defendant was given the right to require plaintiff, by notice, to commence the monthly deliveries before January 1, 1914. By the third paragraph defendant agreed "to take said oil as above provided, and pay for the same at the rate" specified.
>
> The argument of defendant is that the proviso of the first paragraph limiting plaintiff's undertaking to the production of wells owned or controlled by it made it entirely optional with plaintiff to deliver any oil at all. There is no merit in the argument. In effect, the contract bound the plaintiff to deliver the entire output of its wells, up to the quantities specified. No such personal choice or option was given to withhold or refuse deliveries of oil produced by its wells as is sometimes held to destroy the requisite mutuality of contract obligations. The limitation is a physical one, of a kind common in business affairs. When the quantity of a commodity to be delivered or received under a contract of sale rests in the uncontrolled will or desire of one of the parties, mutuality is lacking. It is otherwise when the quantity is measured by the output or requirements of an established plant or business during a limited time. (*Cold Blast Transp. Co.* v. *Kansas City Bolt & Nut Co.*, 52 C. C. A., 25, 114 Fed., 77, 57 L. R. A., 696.) This latter rule is an adjustment of legal principles to necessary and reasonable business usages. It appears plaintiff owned and controlled about 20 oil wells in the Panuco field, with extensive structural equipment, and though the life of any particular well might not be forecast with certainty, it is idle to say plaintiff did not have an established plant, the actual product of which it could bind itself to sell and deliver in whole or in part during the time limited. The plaintiff could not, without violating its contract, have capped its wells or choked their production to escape deliveries. In that respect a correlative duty on its part would be implied.

In *Imperial Refining Co.* v. *Kanotex Refining Co.* (29 Fed. (2d), 193) the court, after a very careful review of the cases, in which it pointed out the distinction between the two types of contracts above referred to, decided the issue in that case in favor of the validity of the contract.

In *Kentucky Tobacco Products Co.* v. *Lucas* (5 Fed. (2d), 723) the court, in an income tax case, had occasion to determine the validity of a contract for the sale of the entire output of tobacco stems by one of the parties to a contract. In that case the court held that the contract was not unilateral; that it was not void for indefiniteness or for lack of mutuality; and that it could not be voided through the medium of one of the contracting parties going out of business. In addition to the cases cited and relied upon in the opinions above referred to, see also *Fayette-Kanawha Coal Co.* v. *Lake & Export Coal Corporation* (91 W. Va., 132, 112 S. E., 222, 23 A. L. R., 565 and note).

It is evident from the foregoing decisions that the contract here involved is not void for want of mutuality because the promise on the

one hand to sell was supported by the promise on the other hand to purchase, and that the contract was not indefinite in that it called for the entire output of an established mining and smelting company. It also is evident from the foregoing cases that the Mining company could not have ceased its mining operations nor gone out of business without having subjected itself either to an action to compel performance or for damages for violation of the contract.

The foregoing would appear to dispose of the specific questions raised. However, subsequent to the time the case was transmitted to this office the question arose as to what effect, if any, the decision of the United States Supreme Court in *Burnet* v. *Logan* (283 U. S., 404, Ct. D. 351, C. B. X–1, 345) had upon the instant case. The facts in that case are that prior to 1913 the taxpayer (Mrs. Logan) was one of the stockholders in the Andrews & Hitchcock Iron Co. The Andrews & Hitchcock Iron Co. owned 12 per cent of the stock of the Mahoning Ore & Steel Co., an operating company, which owned a lease on a valuable iron ore mine. All of the stock of the Mahoning company was owned by steel manufacturing companies and through an agreement of such stockholders the Mahoning company was obligated to apportion the extracted ore among the corporate stockholders according to their holdings. Under this agreement the Andrews & Hitchcock Iron Co. was entitled to 12 per cent of the extracted ore. In 1916 the owners of stock in the Andrews & Hitchcock Iron Co. sold their entire holdings to the Youngstown Sheet & Tube Co., which company acquired among other things 12 per cent of the Mahoning company's stock and the right to receive the same percentage of ore thereafter taken from the leased mine. For the shares so acquired the Youngstown company paid the holders $2,200,000 in money and agreed to pay annually thereafter, for distribution among the selling stockholders, 60 cents for each ton of ore apportioned to it. Mrs. Logan's mother had also owned stock in the Andrews & Hitchcock Iron Co. She died in 1917 leaving Mrs. Logan one-half of her interest in the future payments by the Youngstown company. This bequest was appraised for Federal estate tax purposes at $277,164.50.

The question in the case was whether the amounts received by the taxpayer by reason of the 60 cents per ton payments in years subsequent to 1916 constituted taxable income to her.

The Commissioner ruled that the obligations of the Youngstown company to pay 60 cents a ton had a market value of $1,942,111.46 on the date of the sale; that this value should be treated as so much cash, and the sale of the stock regarded as a closed transaction with no profit in 1916. On the basis of the value attributed to the contract the Commissioner undertook to apportion the subsequent annual payments between income and capital and to tax the income portion each year. This view was sustained by the Board (*Edith Andrews Logan et al.* v. *Commissioner*, 12 B. T. A., 586). It was also sustained by the Circuit Court of Appeals for the Sixth Circuit in *Hitchcock* v. *Commissioner* (44 Fed. (2d), 756). It was reversed by the Circuit Court of Appeals for the Second Circuit in *Logan* v. *Commissioner* (42 Fed. (2d), 193), on the ground that the payments under the contract were so contingent and uncertain that it was impossible to determine the fair market value of the contract of the

Youngstown company to pay 60 cents per ton, and that the taxpayer was entitled to a return of capital before she was subject to tax. The Supreme Court agreed with the second circuit and held that the contract had no ascertainable value and that the taxpayer could not be taxed upon the receipts from the contract until her capital (March 1, 1913, value in the case of her own shares and date of death value in the case of the inherited payments) had been fully returned to her.

If the Supreme Court's decision in the Logan case applies to the instant case, the result will be either to deny the taxpayer the right to claim any value on account of the contract here involved, or else to require the taxpayer to accelerate the amortization of its contract by applying the entire receipts under the contract to capital and hence deny the right to any deduction for amortization in the latter years of the contract—the years here under consideration.

Although the contract involved in the instant case and the contract involved in the Logan case have some points in common, the two contracts are dissimilar in some important particulars. As pointed out above, the contract in the instant case was a valid and enforceable obligation between two competent contracting parties, either of which could have compelled performance or could have recovered damages for failure to perform. The subject matter of the contract was clearly within the sole control of the contracting parties, and, because of its majority stock ownership, the taxpayer was in a position to assure itself that the contract would be carried out by the Mining company. In the Logan case the contract related to a subject matter over which the two contracting parties had no absolute control either jointly or separately. The contract itself was subject to many uncertainties and contingencies. This fact was pointed out by the Circuit Court of Appeals for the Second Circuit in its opinion, as follows:

> There were many uncertainties involved in the future receipt of 60 cents a ton by this petitioner. She, a minority stockholder, was not in control. The right to continue to receive ore was dependent on the continuance in force of the contract of December 16, 1914, between the stockholders of the Mahoning company. That contract might be abrogated or changed. No maximum or minimum payment is provided for by the contract. The tonnage mined each year was subject to the discretion of the board of directors of the Mahoning company.
>
> * * * * * * *
>
> * * * The Commissioner may not create income by spelling out paper profits with all the attending uncertainties which exist here and which might prevent the return of capital. The statute and the regulation referring to depletion of the mines, we think, have no application to this petitioner.

It is evident from the foregoing that the contract in the instant case is not subject to any of the uncertainties which influenced the courts in holding that the contract in the Logan case was incapable of valuation and that even when the right to receive the annual payments was valued (as in the case of the inherited payments) the amounts received should first be treated as a return of capital. It is also evident that, with respect to the treatment of the inherited payments, the courts were influenced not only by the uncertainties but also by the fact that the value of property acquired by bequest is to be excluded from gross income and by the rules therefor announced in the case of annuities. The instant case involves none of

the factors upon which the courts based their decisions in the Logan case.

This office is, therefore, of the opinion that the Logan case does not apply to the situation here presented; that the contract in the instant case was valid and enforceable on March 1, 1913; and that the taxpayer is entitled to a determination of the March 1, 1913, value of the contract, in order that the value determined upon may be amortized or exhausted over the remaining useful life of the contract.

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

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

ARTICLE 261: Contributions or gifts by individuals.

REVENUE ACT OF 1928.

Contributions to nonpartisan scientific agency of citizens' inquiries for promotion of better government. (See I. T. 2654, page 39.)

ARTICLE 262: Donations by corporations. XI-44-5819
I. T. 2653

REVENUE ACT OF 1928.

Deductibility by corporations of contributions to unemployment emergency funds.

Advice is requested relative to the attitude of the Bureau with respect to the deductibility by corporations of contributions to unemployment emergency funds during the taxable year 1931.

There is no provision in any of the Revenue Acts which permits corporations in computing net income to deduct contributions to community chests, welfare leagues, and similar organizations except the provision which authorizes the deduction of "all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business." (See section 23(a) of the Revenue Act of 1928 and the corresponding provisions of prior Revenue Acts.) Before a deduction may be allowed it must be shown that the payment had a business significance to the taxpayer making the payment. That is, the taxpayer must reasonably contemplate a financial return commensurate with the payment and must be influenced by such expectation. The United States Board of Tax Appeals in several cases where such payments have been allowed as deductions has referred to evidence showing that increased business did result. In the case of the *Yamhill Electric Co.* v. *Commissioner* (20 B. T. A., 1232), the Board allowed as a deduction a contribution to an endowment fund of a local college. It was there held that "Whether an item such as the one here is deductible as an ordinary and necessary expense of carrying on a trade or business depends largely upon the facts of each individual case." The Board also

approved its prior ruling in the *Appeal of The Thomas Shoe Co.* (1 B. T. A., 124), that the payment to be deductible "must have in a direct sense some reasonable relation to the taxpayer's business." In the case of the *American Rolling Mills Co.* v. *Commissioner* (41 Fed. (2d), 314), the court stated:

> The question always is whether balancing the outlay against the benefits to be reasonably expected, the business interest of the taxpayer will be advanced. The answer must depend, among other things, upon the nature and size of the industry, its location, the number of its employees as compared to the entire community, the type of its employees, and what other employers similarly situated are doing.

All the Board cases referred to have been acquiesced in.

The character of payments of this nature and their significance for income tax purposes will, of course, depend primarily upon facts existing at the time the payment is made. Some of the elements to be considered are the size of the contribution as compared with the taxpayer's business, and whether such contribution or payment bore a reasonable relationship to the taxpayer's enterprise. Every case will involve a question of whether the payment had a practicable business significance to the particular taxpayer, and whether a financial return in proportion to the outlay could be reasonably contemplated at the time of making such payment. Very careful consideration will be given the facts in each case, since it is the desire of the Bureau that its policy with respect to the treatment of such contributions be as liberal as possible consistent with the statute.

SECTION 25.—CREDITS OF INDIVIDUAL AGAINST NET INCOME.

ARTICLE 295: Date determining exemption. XI–29–5551
I. T. 2634

REVENUE ACT OF 1928.

> Method of computing personal exemption in the case where a married person dies and the surviving spouse remarries during the same taxable year.

The collector refers to General Counsel's Memorandum 10129 (C. B. XI–1, 38), and requests a ruling relative to the amount of personal exemption allowable to the surviving spouse and the person whom the surviving spouse marries under the following circumstances:

A, the husband of B, died April 1, 1931, and B married C, who was not the head of a family, on September 28, 1931. B and C were living together on December 31, 1931, and neither individual had dependents for which credit could be claimed under section 25(d) of the Revenue Act of 1928.

Section 25 of the Revenue Act of 1928 provides in part:

> There shall be allowed for the purpose of the normal tax, but not for the surtax, the following credits against the net income:
>
> * * * * * * *
>
> (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.

(d) *Credit for dependents.*—$400 for each person (other than husband or wife) dependent upon and receiving his chief support from the taxpayer if such dependent person is under 18 years of age or is incapable of self-support because mentally or physically defective.

(e) *Change of status.*—

(1) The credit for dependents shall be determined by the status of the taxpayer on the last day of his taxable year.

(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.

(3) In the case of an individual who dies during the taxable year, the personal exemption and the credit for dependents shall be determined by his status at the time of his death, and in such case full credits shall be allowed to the surviving spouse, if any, according to his or her status at the close of the taxable year.

General Counsel's Memorandum 10129, supra, involved the question as to the amount of personal exemption to which two individuals were entitled where each was the head of a family at the time of their marriage. The instant case is quite different. Here there was a death of one spouse and the remarriage of the survivor during the same taxable year to a single man who was not the head of a family.

It has been held in General Counsel's Memorandum 6275 (C. B. VIII–1, 86) that section 25(e)3, in so far as it relates to the personal exemption of a married individual who dies during the taxable year, is exclusive in its terms and can not be applied in conjunction with section 25(e)2, and that where there is both a change of status and death within the taxable year section 25(e)3 must govern. The rule announced in General Counsel's Memorandum 6275 is also applicable in determining the personal exemption of the surviving spouse. This does not mean that in a case where a married individual dies and the surviving spouse remarries during the taxable year section 25(e)3 is to be applied independently of section 25(c) in determining the personal exemption to which the surviving spouse is entitled. Furthermore, section 25(e)3 is not to be applied independently of section 25(e)2 in determining the personal exemption of the individual whom the surviving spouse marries.

In view of the foregoing, this office holds that in a case where a married individual dies and the surviving spouse remarries during the same taxable year, and the surviving spouse and the individual whom the surviving spouse marries are living together at the close of the taxable year, the "full credits" for the personal exemption to be allowed to the surviving spouse because of such marital status are $3,500, less the portion of the joint personal exemption, determined as provided in section 25(e)2, to which the individual whom the surviving spouse marries is entitled. This office further holds that in such a case the individual whom the surviving spouse marries is also entitled (in addition to his or her portion of the $3,500 joint personal exemption) to the portion of the personal exemption allowable in respect of the single status occupied during the taxable year, determined as provided in section 25(e)2. Applying these rules to

the case referred to, the amount of C's personal exemption is 9/12ths of $1,500, or $1,125, for the period during which he had the status of a single person, plus ½ of 3/12ths of $3,500, or $437.50, for the period during which he was married and living with B, or a total personal exemption of $1,562.50. The amount of B's personal exemption is $3,500 less $437.50, or $3,062.50. The combined personal exemption allowable to both B and C is $3,062.50 plus $1,562.50, or $4,625. If B and C make separate returns, the portion of the $3,500 personal exemption to which they are entitled for the period during which they were married and living together, that is, 3/12ths of $3,500, or $875, may be taken by either or divided between them.

PART IV.—ACCOUNTING PERIODS AND METHODS OF ACCOUNTING.

SECTION 41.—GENERAL RULE.

ARTICLE 321: Computation of net income. XI–27–5534
G. C. M. 10630

REVENUE ACT OF 1928.

Treatment for income tax purposes of amount received from award for loss incurred in respect of certain accounts with German banks in 1917.

The opinion of this office is requested whether a loss is allowable for the taxable year 1928 in respect of certain accounts of the taxpayers with German banks.

The taxpayers, doing business as copartners under the firm name of M Company, had sundry accounts with German banks prior to April 6, 1917. The declaration of war on April 6, 1917, rendered further dealings between the copartners and the German banks impossible. On August 4, 1914, Germany had by law authorized the Federal Council to adopt during the duration of the war "such economic measures as may be necessary in order to avert economic damage." The decrees and ordinances so issued had the force and effect of law. By decree of September 30, 1914, all payments, directly or indirectly, to Great Britain and Ireland, or to the British colonies or foreign possessions, as well as the removal or transfer of moneys or securities thereto, were prohibited. By decree of October 7, 1915, all persons having possession of property of nationals of enemy States were required to give notice thereof to specified German authorities ("Central State Authorities"). Detailed regulations for carrying out the provisions of this decree were prescribed. By decree of April 19, 1917, the administration of such property was vested in a "Treuhander fur das feindliche Vermogen" (Custodian for Enemy Property). These decrees and regulations thereunder permitted the "treuhander," in his discretion, either to take physical possession of the foreign property (or to require the accounts to be liquidated and paid to him), or to permit the person in possession to continue to hold the property, but to hold it, not for the enemy owner, but for the "treuhander." Property thus held for the "treuhander" was in all respects subject to the control and

direction of the "treuhander." Even in this class of cases the income from the property was required to be paid to the "treuhander."

By decree of August 9, 1917, the provisions of the ordinance or decree of September 30, 1914, were "applied correspondingly to the United States of America." By decree of November 10, 1917, effective November 17, 1917, and/or November 20, 1917, the provisions of the ordinance of October 7, 1915, were made applicable to the property of American nationals. The accounts with German banks of these taxpayers were reported to the appropriate German authorities and throughout the duration of the war the authorities exercised complete control over them, receiving the payments of income as they arose, supervising and in all respects directing the entire management of these accounts (prescribing specifically what claims on the fund should be paid or not paid, what investments should be made, etc.). The accounts themselves were converted into accounts with the "treuhander."

The taxpayers filed with the Mixed Claims Commission, United States and Germany, claims against Germany in respect of these accounts. Awards were made under these claims and 27.89x dollars on account of them became payable under section 2(b), Settlement of War Claims Act of 1928, approved March 10, 1928 (45 Stat., 254). During the taxable year 1928 there was paid on account of this sum 9.72x dollars.

The loss in respect of these accounts occurred when the property in question was seized by the authorities of the German Government in 1917, and the seizure was no less effective because it was not physical. The seizure was within the rights of the German Government as a belligerent power and left the taxpayers without the right to demand release or compensation, at least until the declaration of peace. "What would ultimately come back to it, as the event proved, might be secured not as a matter of right, but as a matter either of grace to the vanquished or exaction by the victor. In any case the amount realized would be dependent upon the hazards of the war then in progress. * * * It was none the less a deductible loss then, although later the German Government bound itself to repay and an award was made by the Mixed Claims Commission which * * * [did] result in a recovery." (*U. S.* v. *S. S. White Dental Mfg. Co.*, 274 U. S., 398, 47 S. Ct., 598 [T. D. 4059, C. B. VI–2, 198].) (See also *Hector Fezandie, Executor*, v. *Commissioner*, 12 B. T. A., 1325; *Appeals of Emil Stern* and *Jules Stern*, 5 B. T. A., 89, acquiescence, C. B. VIII–1, 43; and *Commissioner* v. *Brown*, 54 Fed. (2d), 563.)

The loss having occurred in 1917, there was no loss in 1928, and, hence, no deduction may be allowed for 1928. (*Darling* v. *Commissioner*, 49 Fed. (2d), 111, cert. denied, 283 U. S., 866; *Putnam National Bank* v. *Commissioner*, 50 Fed. (2d), 158; and *Excelsior Printing Co.* v. *Commissioner*, 16 B. T. A., 886.) The loss occurred and was allowable as a deduction in 1917; the circumstance that in 1928 there was a recovery, in whole or in part, in respect of that which was lost in 1917 does not result in a loss deduction becoming allowable again in 1928, although it may result in taxable income. (See G. C. M. 9210, C. B. X–1, 129.)

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

SECTION 42.—PERIOD IN WHICH ITEMS OF GROSS INCOME INCLUDED.

ARTICLE 331: When included in gross income.

REVENUE ACT OF 1928.

Taxable status of refunds of customs duties and taxes. (See Mim. 3958, page 33.)

PART V.—RETURNS AND PAYMENT OF TAX.

SECTION 51.—INDIVIDUAL RETURNS.

ARTICLE 381: Individual returns. XI-35-5635
G. C. M. 10759

REVENUE ACT OF 1928.

Where the status of a taxpayer for the first part of the year was that of a citizen of the United States, but for the balance of the year was that of a nonresident alien, only one return need be filed. Method of computing the tax stated.

An opinion is requested relative to the method to be employed in computing the income tax liability in the case of a taxpayer in whose behalf a return for the year 1929 was filed March 15, 1930, on Form 1040, as a citizen and resident of the United States, but whose status as of December 31, 1929, was that of a nonresident alien.

The taxpayer was a citizen of the United States. On or about August 17, 1929, she filed an application with the French Government for reinstatement as a French citizen, which application was approved and such citizenship granted on September 22, 1929. The taxpayer contends that under General Counsel's Memorandum 9064 (C. B. X-1, 314), she should have filed two separate returns, one covering the period from January 1, 1929, to the date when her status changed to that of a nonresident alien, and the other covering the period from such date to December 31, 1929. Although her status changed on September 22, 1929, when French citizenship was granted, she has treated the date her status changed as August 17, 1929, when reinstatement as a French citizen was applied for. It is further contended that for the period during which the taxpayer was a nonresident alien she is taxable only on income from sources within the United States.

Section 51 of the Revenue Act of 1928 requires that the following individuals shall each "make under oath a return," etc.:

(1) Every individual having a net income for the taxable year of $1,500 or over, if single, or if married and not living with husband or wife;
(2) Every individual having a net income for the taxable year of $3,500 or over, if married and living with husband or wife; and
(3) Every individual having a gross income for the taxable year of $5,000 or over, regardless of the amount of his net income.

Section 212 of the Revenue Act of 1928 provides that "in the case of a nonresident alien individual gross income includes only the gross income from sources within the United States." Under H. J. Res.

133 (Public, No. 23, Seventy-first Congress, U. S. C. Sup. III, title 26, ch. 24) (C. B. IX–1, 411), the normal tax rate for the year 1929 in the case of a nonresident alien (who is not a citizen of a contiguous country) is 4 per cent, whereas in the case of an American citizen the normal tax rates are ½ of 1, 2, and 4 per cent. Therefore, where, as in the instant case, a change of status has occurred, the income must be segregated for normal tax purposes but combined for surtax purposes.

It is the opinion of this office that the provisions of law referred to above do not require two separate returns to be filled by an individual whose status at the beginning of the year was that of a citizen or resident of the United States, but whose status at the end of the taxable year was that of a nonresident alien. The law requires that every individual within the income classes specified shall each "make under oath a return." There is no basis for construing this to mean that an individual whose status has changed during the taxable year must be considered two taxpayers from whom separate returns are required. Furthermore, 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 an individual's income, merely because different rates of tax apply by reason of a change in the status of such individual from that of a citizen to a nonresident alien.

In General Counsel's Memorandum 9064, supra, this office reached the conclusion that the change in status from that of a citizen to that of a nonresident alien, or vice versa, appears to be governed by the same rule as that applicable to a change in status from that of a resident alien to that of a nonresident alien, or vice versa. That memorandum cited the case of *John C. Lee et al.* v. *Commissioner* (6 B. T. A., 1005, C. B. VI–2, 4), in which the Board of Tax Appeals held that income received by a nonresident alien from sources without the United States is not taxable even though such person may become a resident alien subsequent to its receipt and prior to the close of the taxable year.

Since a single return is all that is required in the instant case, it is the opinion of this office that the return filed March 15, 1930, on Form 1040, covering the entire gross income for the year 1929, was valid for purposes of assessment and the statute of limitations. In computing the tax liability the taxable income should be segregated for the two periods involved, January 1, 1929, to September 21, 1929, inclusive, and September 22, 1929 (the date French citizenship was granted), to December 31, 1929, inclusive, for normal tax purposes and combined for surtax purposes, except that gross income for the period September 22, 1929, to December 31, 1929, during which the taxpayer was a nonresident alien, should include only gross income from sources within the United States.

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

ARTICLE 381: Individual returns. XI–12–5788
I. T. 2650

REVENUE ACT OF 1928.

On April 1, 1929, by decree of court the taxpayer was divorced from his wife and a division was made of all the community property. On March 6, 1930, the taxpayer filed a joint return for the calendar year 1929, in which was reported the income of himself and his divorced wife. On February 1, 1932, he filed a claim for refund covering the year 1929, accompanied by amended separate returns.

Held, that the taxpayers did not exhaust their statutory right to file separate returns subsequent to March 15, 1930. The decision of the Circuit Court of Appeals for the Fifth Circuit in the case of *Rose* v. *Grant* (39 Fed. (2d), 340) is not applicable to this case, as husband and wife were not living together at the close of the taxable year 1929 and could not legally file a joint return.

Inquiry is made whether under the decision of the Circuit Court of Appeals for the Fifth Circuit in *Rose* v. *Grant*, the taxpayer is precluded from filing amended separate returns dividing the income received by him up to the date of the granting of a divorce.

On April 1, 1929, by decree of the proper State court in Texas, the taxpayer was divorced from his wife and under the decree a division was made of all the community property. On March 6, 1930, the taxpayer filed what purported to be a joint return for the calendar year 1929 in which was reported the income of himself and his divorced wife. On February 1, 1932, the taxpayer filed a claim for the refund of x dollars covering the year 1929 in which it was stated that since the wife had a statutory right under the State law to one-half of the community income to the date of the divorce, and since under article 381 of Regulations 74 a joint return may be filed only if the husband and wife are living together at the close of the taxable year, the joint return was erroneous. The claim for refund was accompanied by amended separate returns. In the amended return filed in behalf of Mrs. A for the calendar year 1929 there has been reported one-fourth of all the income received by A during the whole of the calendar year 1929, less one-fourth of all deductions for that year.

After careful consideration of all the facts in the case, it is held that the taxpayers did not exhaust their statutory right to file separate returns subsequent to March 15, 1930, since under the provisions of article 381 of Regulations 74 a joint return of husband and wife may be filed only if they were living together at the close of their taxable year. The return filed and designated as a "joint return" was, therefore, erroneous. The decision by the Circuit Court of Appeals for the Fifth Circuit in the case of *Rose* v. *Grant*, supra, is not applicable to the instant case, because here the husband and wife had no election whether they should file a joint return or separate returns.

It appears from the statement attached to the claim for the refund that the taxpayer in determining the community income of the wife up to April 1, 1929, the date of the divorce, computed such income as follows: ¼ of all income less ¼ of all deductions was treated as net community income—¾ of all income less ¾ of all deductions was

treated as the individual income of A—or, in other words, 1/8 of the net income for the year was treated as the income of Mrs. A and 7/8 as the income of A.

On this basis the sum of $10x$ dollars has been reported as the net income of the divorced wife in the separate return of that individual. Such method of computation is incorrect and can not be accepted as reflecting the true income of the individuals concerned. The total amount of community income received by the taxpayers up to and including April 1, 1929, should be ascertained and one-half thereof treated as the community income of each spouse. (See G. C. M. 10941, page 223.)

In other words, the tax liability on the separate return filed in the name of the divorced wife should be computed on one-half of the gross community income up to and including April 1, 1929, less one-half of the deductions properly chargeable to such gross community income for the same period. There is no authority of law or regulations under which the taxpayer could be permitted to report as the community income of the wife for the 3-month period ended April 1, 1929, one-eighth of his total net income as of the close of the calendar year 1929.

SECTION 55.—PUBLICITY OF RETURNS.

ARTICLE 421: Inspection of returns.

REVENUE ACT OF 1928.

Regulations governing the inspection of returns. (See T. D. 4359, page 305.)

ARTICLE 424: Examination of returns by shareholder. XI-40-5744 I. T. 2645

REVENUE ACT OF 1928.

A claim for refund filed by a corporation comes within the provisions of paragraph 3 of the regulations for inspection of returns embodied in article 421, Regulations 74, and a stockholder meeting the requirements of article 424, Regulations 74, is entitled to inspect such claim.

SUBTITLE C.—SUPPLEMENTAL PROVISIONS.

SUPPLEMENT A.—RATES OF TAX.

SECTION 103.—EXEMPTIONS FROM TAX ON CORPORATIONS.

ARTICLE 527: Religious, charitable, scientific, literary, and educational organizations and community chests. XI-32-5592 I. T. 2636

REVENUE ACT OF 1928 AND PRIOR REVENUE ACTS.

The M Store was incorporated without capital stock for the purpose of promoting the interests of the student body and faculty of the R University, and to provide without profit and at lowest

costs supplies for students. It was provided that any accumulations of funds above the needs of the store should be paid into a general fund to be used for athletic and social activities. It conducts a students' store which has a salaried manager and necessary clerks. Profits have mostly been put back into the business, some into the purchase of an additional athletic field and some into building and loan stock.

Held, the taxpayer is engaged in a business ordinarily carried on for profit and is not operated exclusively for any of the purposes specified under section 103(6) of the Revenue Act of 1928 and similar provisions of prior Acts.

Advice is requested relative to whether the M Store is entitled to exemption from income tax under section 103(6) of the Revenue Act of 1928.

The evidence on file in the case discloses that the M Store was incorporated without capital stock. The articles of incorporation provide that its purposes, among others, shall be to promote and foster the educational, intellectual, social, and athletic interests of the student body and faculty of the R University; to provide textbooks, stationery, confectionery, and other student supplies and commodities; and to distribute periodicals, student publications, and tickets to athletic contests and social functions. The articles of incorporation provide further that pecuniary profit to its members shall not be an object of the corporation; that dividends shall not be distributed to members; and that any accumulation of funds over and above the needs of the store shall be paid into the general fund of the students' association to be used for the furtherance of athletic and social activities among the students of the university. All regularly registered students and members of the faculty of the university are members of the corporation.

The corporation is actively engaged in conducting a students' store on the campus of the university. Books, stationery, and other commodities are supplied to the students at prices as low as are consistent with the welfare of the store. No dividends have ever been declared and no funds have been distributed to any member of the organization. A manager is employed, who receives a salary plus a commission on stated conditions. The manager in turn employs the necessary clerks and pays them a fixed wage for their services. It appears that most of the profits of the store have been put back into the business as they accumulated; that some of the profits have been used for the purchase of additional campus, which is being used as an athletic field at the present time; and that a small investment has been made in building and loan stock which will be paid up in 10 years. Both investments are treated as a part of a sinking fund program for the erection of a students' association building on the campus.

Section 103(6) of the Revenue Act of 1928 and the corresponding sections of prior Revenue Acts provide for the exemption of "Corporations * * * organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes * * * no part of the net earnings of which inures to the benefit of any private shareholder or individual."

In order to be exempt under this provision of law an organization must be organized and operated exclusively for one or more of the

specified purposes. The M Store is engaged in conducting a store where books, stationery, and other commodities are sold to students. It is, therefore, engaged in a business of a kind ordinarily carried on for profit and is not operated exclusively for religious, charitable, scientific, literary, or educational purposes.

Accordingly it is held that the M Store does not come within the provisions of section 103(6) of the Revenue Act of 1928 and the corresponding sections of prior Revenue Acts, and hence is not entitled to exemption from Federal income tax.

ARTICLE 527: Religious, charitable, scientific, literary, and educational organizations and community chests.

REVENUE ACT OF 1928.

Nonpartisan scientific agency of citizens' inquiries for promotion of better government. (See I. T. 2654, page 39.)

ARTICLE 529: Civic leagues and local associations of employees.

XI-31-5578
G. C. M. 10232

REVENUE ACT OF 1928.

The M Corporation was organized for the purpose of promoting and encouraging the efficiency and activity of all officers and departments of its city, county, and State charged with the duty of preventing, suppressing, and punishing crime. It has no capital stock and anyone interested may become a member on approval of its board. It cooperates with Federal and local officials. Its income is derived from donations and no part inures to the benefit of any private individual.

This corporation is entitled to exemption as an organization operated for the promotion of social or public welfare under section 103(8) of the Revenue Act of 1928.

The M Corporation was organized for the purpose of promoting and encouraging the efficiency and activity of all officers and departments of the city of ——, and of —— County, and of the State of R, charged with the duty of preventing, suppressing, and punishing crime. The corporation has no capital stock and any person interested in its work may become a member of it upon the approval of its board of directors. The corporation has also cooperated and is cooperating with officials of the United States, as well as local officials, in assisting in the prevention and punishment of crime. A record of crimes committed and of criminals is maintained by the corporation, which is used in furthering the purposes for which it was incorporated. Its income is derived exclusively from donations and none of such income inures to the benefit of any private member or individual.

It is contended that exemption extends to this corporation on the ground that it is organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, within the scope of section 103(6) of the Revenue Act of 1928. This office does not agree with the contention. The corporation is performing work that is auxiliary to the police departments of the State of R

and of the city of —— and of —— County, and incidentally aiding the United States in preventing, suppressing, and punishing crime. These activities are of such a nature as to benefit society in general and are for social welfare. But such activities are not religious, charitable, scientific, or educational. If allowed exemption at all such exemption should be accorded the organization by virtue of the provisions of section 103(8) of the Revenue Act of 1928, and similar provisions contained in prior Revenue Acts, since the corporation may, in view of the nature of its activities, properly be said to be organized and operated for the promotion of social welfare. It is concluded that the corporation is not organized and operated exclusively for religious, charitable, scientific, or educational purposes, within the meaning of section 103(6) of the Revenue Act of 1928, but that it is operated for the promotion of social or public welfare. The corporation is, therefore, exempt from taxation under section 103(8) of the Revenue Act of 1928.

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

SUPPLEMENT B.—COMPUTATION OF NET INCOME.

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

ARTICLE 561: Determination of the amount of gain or loss. XI–37–5676 G. C. M. 10857

REVENUE ACT OF 1928.

Where an organization derived taxable gain from the sale of its property, the basis should not be reduced by the amount of depreciation sustained with respect to the property for the period during which the taxpayer occupied the status of an exempt organization.

The question is presented whether a taxpayer which derived taxable gain from the sale of its assets in 1931 should, in computing the gain derived from the sale, reduce the basis on account of depreciation sustained for the period during which the taxpayer occupied the status of an exempt organization.

It appears from the internal revenue agent's report that the taxpayer acquired the property in question prior to March 1, 1913, and that the March 1, 1913, value of the property was the basis to be used in computing the gain derived from the sale of the property. Accordingly, it is not necessary to consider depreciation sustained prior to March 1, 1913. In computing the gain the internal revenue agent did not reduce the basis on account of depreciation, upon the theory that no depreciation was allowable with respect to the property, since the taxpayer was an exempt organization under the Revenue Act of 1928 and all prior Revenue Acts.

Under sections 111 (a) and (b) and 113(b) of the Revenue Act of 1928, the basis of the property in this case is the March 1, 1913, value thereof, diminished by the amount of 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 the Revenue Act of 1928 and prior Revenue Acts. It is obvious that for the period during which the taxpayer occupied the status of an exempt organization no deduction with respect to the property on account of depreciation was allowable for income tax purposes. Consequently, there was no return of capital to the taxpayer in the form of depreciation allowances.

Examination of the various Revenue Acts, beginning with the Revenue Act of 1913, shows that each Act has provided for a deduction for depreciation with respect to property used in trade or business. In the instant case the file discloses that the taxpayer occupied the status of an exempt organization under all those Revenue Acts. It is, accordingly, the opinion of this office that for the purpose of computing gain or loss from the sale thereof the basis of the property in question should not be diminished by the amount of depreciation sustained with respect to the property since March 1, 1913.

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

SECTION 113.—BASIS FOR DETERMINING GAIN OR LOSS.

ARTICLE 596: Property transmitted at death. XI–28–5542
G. C. M. 10698

REVENUE ACT OF 1928.

In deciding the question presented in the last paragraph on page 24 of General Counsel's Memorandum 10260 (C. B. XI–1, 79) the fact was not taken into consideration that it had been decided in the preceding paragraph that the value of the stock itself at the basic date must be reduced to reflect the value of the widow's life estate. Obviously, if an adjustment of the basis on account of the life estate is made where the original trust corpus is delivered to the sons, an adjustment must also be made where the trustees, during the existence of the life estate, have sold the original corpus, reinvested the proceeds in other property, and delivered the substituted property to the sons, and in so far as the last paragraph on page 24 of General Counsel's Memorandum 10260, supra, appears to state the contrary, it does not represent the view of the General Counsel. General Counsel's Memorandum 10260, supra, modified.

Reference is made to General Counsel's Memorandum 10260, supra. Beginning with the second full paragraph on page 101 of Cumulative Bulletin XI–1 the following statements appear:

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 deciding the question presented in the second paragraph above quoted, this office did not take into consideration the fact that it had been decided in the preceding paragraph that the value of the stock itself at the basic date must be reduced to reflect the value of the widow's life estate. Obviously, if an adjustment of the basis on account of the life estate is made where the original trust corpus is delivered to the sons, an adjustment must also be made where the trustees, during the existence of the life estate, have sold the original corpus, reinvested the proceeds in other property, and delivered the substituted property to the sons, and in so far as the second paragraph above quoted appears to state the contrary, it does not represent the view of this office.

The general principle in the second paragraph above quoted is nevertheless entirely correct, namely, that the cost or other basis of substituted property in the hands of the trustees must be taken into account in fixing the basis of the property in the hands of the beneficiaries. For example, let it be assumed that the value of the physical property, when distributed to testamentary trustees in 1914, is $100,000 and that the value of the interests of certain vested remaindermen beneficiaries at that time is $75,000. If the trustees, during the existence of the life estate, sell the property of the trust for $200,000, reinvest the proceeds in other property costing that amount, and deliver the substituted property to the remaindermen after the termination of the life estate, the basis of such property in the hands of the former remaindermen will be $150,000 instead of $75,000. In other words, in computing the basis of the property in the hands of the former remaindermen, the same proportionate reduction from the trustees' basis will be made with respect to the substituted property as would have been made with respect to the original property had the latter been retained by the trustees and delivered in kind to the former vested remaindermen after the termination of the life estate.

General Counsel's Memorandum 10260, supra, is modified to accord with the views herein expressed.

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

ARTICLE 596: Property transmitted at death. XI-45-5836
Ct. D. 595

INCOME TAX—REVENUE ACT OF 1928—DECISION OF COURT.

GAIN OR LOSS—SALE—BASIS—PROPERTY TRANSMITTED AT DEATH—DEVISE IN TRUST.

Where property is devised in trust for the duration of the lives of the beneficiaries, the will providing that the trustees could terminate the trust at any time and distribute the corpus to the beneficiaries, the property, the legal title to which was conveyed to them by the trustees in 1928, is acquired by the beneficiaries by devise, within the meaning of section 113(a)5 of the Revenue Act of 1928, at the death of the testatrix, and where her death occurs on or after March 1, 1913, the basis for determining gain or loss from the sale of the property by the beneficiaries in 1928 is the fair market value of the property at the time of her death, as provided by that paragraph.

UNITED STATES DISTRICT COURT, EASTERN DISTRICT OF NEW YORK. No. L-4972.

George Bliss Lane, plaintiff, v. *Walter E. Corwin, Collector of Internal Revenue for the First District of New York, defendant.*

[July 5, 1932.]

OPINION.

MOSCOWITZ, D. J.: This is a motion for judgment on the pleadings in an action brought for the recovery of $14,247.51 with interest, alleged to have been illegally collected from the plaintiff by the defendant, who is collector of internal revenue of the United States for the first district of New York, as income tax for the calendar year 1928.

A similar motion has been made in the action entitled, *James W. Lane, jr., plaintiff*, v. *Walter E. Corwin, Collector of Internal Revenue for the First District of New York, defendant*, No. L-4973. The action in that case is to recover the sum of $14,167.60.

The facts in each case are the same, the only difference is in amounts. The motion is based upon the complaint and answer; the facts are not in dispute.

For convenience the court will refer to the plaintiff in this action and the plaintiff in the action of *James W. Lane, jr.*, v. *Walter E. Corwin, Collector of Internal Revenue for the First District of New York*, L-4973, in which action a similar motion is made, as the plaintiffs.

On October 29, 1922, Eva B. Lane, a resident of Suffolk County, N. Y., and mother of the plaintiffs, died leaving a will wherein, among other things, she devised to certain trustees named in the will, for the benefit of the plaintiffs and two other sons, a certain piece of property described as lot 2, section 10, block 5832, Borough of Brooklyn, and commonly known as "Owls Head Park," at Sixty-eighth Street and Colonial Road. The trust was for the duration of the lives of the plaintiffs. It was further provided that the trustees, acting unanimously and in their discretion could terminate the trust in whole or in part at any time and distribute the corpus thereof to the beneficiaries, and also, if it was decided to terminate the trust, the trustees should immediately convey the legal title of the real property equally to all of the sons of the testatrix.

The value of the tract in question at the date of death of the testatrix was $379,500, at which value it was returned for Federal estate tax purposes.

On June 8, 1928, the trustees conveyed the property to the four sons of the decedent by appropriate deed. Subsequently and on August 20, 1928, the plaintiffs and the two other sons duly conveyed the tract to the city of New York for park purposes in consideration of a purchase price of $835,000. On their income tax returns filed for the year 1928, the plaintiffs, in reporting their income derived from the sale of the property, treated their interest as having been acquired on June 8, 1928, and as having a value on that date of $208,750, or one-fourth of $835,000, the price for which it was sold about two months later, and reported no gain or loss from the transaction.

Subsequently, and upon an audit of the returns so filed, the Commissioner of Internal Revenue determined that the plaintiffs had acquired their interest in the property in question upon the death of their mother, on October 29, 1922, and that their respective interests had a value on that date of $94,875, or one-fourth of $379,500, the value of the entire tract on that date. As a result the Commissioner of Internal Revenue assessed against the plaintiff the additional taxes sought to be recovered, which were duly paid to the defendant, as collector of internal revenue. Proper claims for refund of the amounts so paid were timely filed and rejected in full by the Commissioner of Internal Revenue, whereupon these actions were begun.

The pertinent parts of the decedent's will are as follows:

"C. (a) I give, devise and bequeath to my trustees hereinafter named, all of the pieces and parcels of real estate now owned by me in the Borough of Brooklyn, County of Kings, State of New York, and belonging to me at the time of death, wheresoever situated therein, and whether contiguous or not, and whenever and however the same have been acquired by me, with all buildings, improvements, easements and appurtenances of every nature and description relating to or connected with the same.

* * * * * * *

"(b) All of the foregoing assets shall be held and disposed of by my trustees, their successors and assigns, upon the trusts, and with the powers set forth in this clause second, subdivision E, paragraphs a to i, inclusive, of this will * * *.

"(c) The duration of the said trust shall be the lives of my sons, James W. Lane, jr., and George Bliss Lane, or if either of them predecease me, then the lives of the youngest two of my sons who shall survive me, provided, however, that my individual trustees hereinafter named and their successors (including the corporate trustee if it shall act as sole trustee as hereinafter provided), shall, in case they have sold all or any portion of the said real estate, have power in their unrestricted discretion, to distribute at one time or from time to time the proceeds of any such sale or sales among the persons entitled thereto as stated in this subdivision C, paragraph (e), and to terminate the trust as to all amounts thus distributed. * * *

"(d) I direct my trustees to receive all of the net rents, income, profits and increment from and of any and all securities, assets and property now or hereafter held in trust hereunder, and to pay over the balance in equal parts and at quarterly periods during the existence of the trust to each of my sons, Mortimer Bliss Lane, Arthur Bliss Lane, James W. Lane, jr., and George Bliss Lane, * * *.

* * * * * * *

"E. I give, devise and bequeath unto my executors and trustees hereinafter named those parts of the respective shares or portions of my said sons which they will not be entitled to receive immediately upon death.

"In trust, however, to hold, manage and dispose of the same as hereinafter authorized, to wit:

* * * * * * *

"(i) I further direct my said trustees to receive the rents, profits, income and interest from the various portions thus held pursuant to the respective trusts created hereunder, and to pay the same to the beneficiaries of said trusts during the respective periods thereof."

The only question for determination is the value to be used in determining the gain or loss upon the sale of the property, whether the value should be fixed at the date of death of the testatrix, or its value at the date of distribution to the plaintiffs.

The statute and regulations involved are as follows:

Revenue Act of 1928 (45 Stat., 791):

"SEC. 113. BASIS FOR DETERMINING GAIN OF LOSS.

"(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. In the case of property transferred in trust to pay the income for life to or upon the order or direction of the grantor, with the right reserved to the grantor at all times prior to his death to revoke the trust, the basis of such property in the hands of the persons entitled under the terms of the trust instrument to the property after the grantor's death shall, after such death, be the same as if the trust instrument had been a will executed on the day of the grantor's death;

* * * * * * *

Regulations 74—Bureau of Internal Revenue:

"ART. 596. *Property transmitted at death.*—In the following cases the basis for determining gain or loss from the sale or other disposition of property acquired after February 28, 1913, shall be the fair market value of the property at the time of the death of the decedent:

"(1) Personal property acquired by specific bequest;

"(2) Real property acquired by general or specific devise or by intestacy; and

"(3) Property, whether real or personal, in the hands of a decedent's estate, acquired by the estate from the decedent (see article 863).

"In all other cases where property was acquired either by will or by intestacy after February 28, 1913, the basis shall be the fair market value of the property at the time of its distribution to the taxpayer.

* * * * * * *

"For the purposes of this article, the value of property as appraised for the purpose of the Federal estate tax or in the case of estates not subject to that tax, its value as appraised in the State court for the purpose of State inheritance taxes shall be deemed to be its fair market value at the time of the death of the decedent."

If the value to be used in determining the gain or loss upon the sale of the property in question is the date of the death of the testatrix, plaintiffs are not entitled to recover.

The decedent died in 1922, at which time the property in question had a value of $379,500, of which the plaintiffs received one-fourth interest each. The property was distributed to the plaintiffs and two other brothers by having the legal title conveyed to them in 1928. Two months later, and in the same year, the property was sold for $835,000.

A reading of the will, the pertinent portions of which have been set forth in the opinion, indicates that the property was conveyed to the trustees to be held for the benefit of the decedent's sons and that upon a termination of the trust they were each to become seized of an undivided one-fourth interest in the real estate, therefore, at the time of the decedent's death although the legal title did not vest in the decedent's sons, they acquired a beneficial interest in the property, which beneficial interest creates an equitable interest.

Although the legal title was devised to the trustees, the beneficiaries acquired their equitable interest by the same devise and the trust need not be considered as it does not affect the interest acquired by the beneficiaries at their mother's death.

The interest acquired by the plaintiffs in the property is not a contingent remainder as there was no contingency upon which the vesting of their interest depended or by which it could be delayed. This court is not bound by the ruling of the New York Tax Commission which held that under the New York State income tax laws, the applicable sections of which are almost identical with the Federal law, that the plaintiffs did not realize any income from the transaction.

In the case of *Brewster* v. *Gage* (30 Fed. (2d), 604 [Ct. D. 50, C. B. VIII–1, 229]), the Circuit Court of Appeals, Second Circuit, decided:

"It surely was not the intent of Congress that the acquisition of a mere legal title should completely wipe out or render untaxable the gain which had been acquired by the equitable ownership and which was, in fact, realized upon the sale made when the date of distribution arrived. Moreover, it would be an

unfortunate construction, which is not demanded by the statute, that would place it within the power of personal representatives and the real owners, namely, the legatees or distributees, to defer distribution in order to escape tax. This should be avoided."

This decision was affirmed by the Supreme Court (*Brewster* v. *Gage*, 280 U. S., 327 [Ct. D. 148, C. B. IX–1, 274]). That court in affirming the decision of the circuit court said:

"Upon the death of the owner, title to his real estate passes to his heirs or devisees. A different rule applies to personal property. Title to it does not vest at once in heirs or legatees. (*United States* v. *Jones*, 236 U. S., 106, 112; 35 S. Ct., 261, 69 L. Ed., 488, Ann. Cas. 1916A, 316.) But immediately upon the death of the owner there vests in each of them the right to his distributive share of so much as shall remain after proper administration and the right to have it delivered upon entry of the decree of distribution. (*Sanders* v. *Soutter*, 136 N. Y., 97, 32 N. E., 638; *Vail* v. *Vail*, 49 Conn., 52; *Cook* v. *McDowell*, 52 N. J. Eq., 351, 30 A., 24.)

"Upon acceptance of the trust there vests in the administrators or executors, as of the date of the death, title to all personal property belonging to the estate; it is taken, not for themselves, but in the right of others for the proper administration of the estate and for distribution of the residue. The decree of distribution confers no new right; it merely identifies the property remaining, evidences right of possession in the heirs or legatees, and requires the administrators or executors to deliver it to them. The legal title so given relates back to the date of the death. (*Foster* v. *Fifield*, 20 Pick. (Mass.), 67, 70; *Wager* v. *Wager*, 89 N. Y., 161, 166; *Thompson* v. *Thomas*, 30 Miss., 152, 158.)

* * * * * * *

"Undoubtedly the basis for the ascertainment of gain or loss on the sale of real estate by an heir or devisee is its value at the time of decedent's death. That is 'the time of such acquisition.' The decree of distribution necessarily is later than, and has no definite relation to, the time when the real estate passes. And generally specific bequests are handed over to the legatees soon after the death of the testator and such property may be and often is sold by them prior to the entry of the decree for final distribution. In such cases gains or losses are to be calculated under these acts on value at the time of death. No other basis is or reasonably could be suggested. * * *"

In the case of *Chandler* v. *Field, Collector*, decided by the United States District Court for the District of New Hampshire, April 13, 1932, which has not yet been reported [Ct. D. 517, page 190, this bulletin], the plaintiff was a beneficiary under a testamentary trust created by the will of his mother, who died October 25, 1915. Pursuant to the trust, the trustees in 1920 and 1925, delivered to him a certain number of stocks which he sold in 1925. The collecter of internal revenue in determining the gain or loss from the sale of the stock used as a basis its value at the date of death of the testatrix, and assessed and collected additional taxes accordingly. The district court in that case decided against the taxpayer; the court said:

"The plaintiff seeks to distinguish the Brewster case from the case at bar and calls attention to the fact that in the Brewster case the stock passed at once upon the settlement of the estate to the residuary legatee while in the case at bar there was an intervening trust under which the stock was held by trustees in trust to pay the income to a life tenant. Plaintiff further seeks to distinguish the two cases, pointing out that in the Brewster case the residuary legatee took the entire title to the property subject to administration expenses and if he died before receipt of the same it passed to his heirs, whereas in the instant case the plaintiff took a vested remainder subject to be divested if he died without issue before reaching the specified age.

"The court can see that the facts in the two cases are easily distinguishable but to my mind the distinguishable features are not of such a character as to make the holdings of the Supreme Court in the Brewster case inapplicable. It is true that the plaintiff in the case at bar might never have received his share of the property. What then would have been the situation presents another question. He did receive it and that is the fact with which we are dealing. Whatever rights he finally acquired date back to the death of his mother. That was the date of their inception. Those rights continued uninterruptedly from the date of her death until the stocks were physically delivered to the plaintiff.

"In the Brewster case, Mr. Justice Butler says:

"'Petitioner's right later to have his share of the residue vested immediately upon testator's death. At that time petitioner became enriched by its worth which was directly related to and would increase or decline correspondingly to the value of the property. And, notwithstanding the postponement of transfer of the legal title to him, Congress unquestionably had power and reasonably might fix value at the time title passed from the decedent as the basis for determining gain or loss upon the sale of the right or of the property before or after the degree of distribution. And we think that in substance it would not be inconsistent with the rules of law governing the descent and distribution of real and personal property of decedents to construe the words in question to mean the date of death.' * * *."

Prior to the enactment of the Revenue Act of 1928, the basis in determining the gain or loss from the sale of property acquired by bequest, devise or inheritance, was the fair market value of such property at the time of acquisition. The time of acquisition was the date of death. (*Brewster* v. *Gage*, supra.)

The Court of Claims decided the case of *McKinney et al.* v. *United States* (62 C. Cls., 180), and the Supreme Court denied application for writ of certiorari (273 U. S., 716). The Court of Claims in that case, in construing the Revenue Act of 1918, is silent as to the basis for determining gain or loss on the sale of property transmitted by death, deciding that the basis for determining the gain or loss on the sale of stock by the executor of an estate is the cost of the property to the decedent, or, where acquired prior to March 1, 1913, its value as of that date, and that when the stock was acquired by a decedent before March 1, 1913, and sold by the executor for less than cost or March 1, 1913, value, but for more than its appraised value at date of death, no taxable gain resulted. Prior to the decision of *McKinney et al.* v. *United States*, supra, the Department has held that the value at date of death was the correct basis in all cases.

There were hearings had before the Ways and Means Committee of the House of Representatives and the Finance Committee of the Senate, on the proposed Revenue Act of 1928. Such hearings may be considered by the court in construing the intent of Congress. The following are excerpts from the committee reports:

Report of the Ways and Means Committee of the House on the revenue bill of 1928, Report No. 2, at page 18:

"SEC. 113. BASIS FOR DETERMINING GAIN OR LOSS.—*Executor's sale.*

"In view of the decision of the Court of Claims in *McKinney* v. *United States*, it is desirable specifically to provide what basis shall be used in determining gain or loss on the sale of property by an estate. It is believed that the basis should be the value of the property on the date of the decedent's death, and this rule is incorporated in section 113(a)5.

"It is also provided, in the same paragraph, that the basis in case of a sale by a beneficiary shall be the value of the property on the date of the decedent's death. Under existing law, the basis in such a case is the value at the date of 'acquisition,' which is indefinite and has given rise to controversy. The value on the date of death affords an equitable and more readily determinable basis."

Report of the Committee on Finance of the Senate on the internal revenue bill of 1928, No. 960, at page 26:

"SEC. 113.—BASIS FOR DETERMINING GAIN OR LOSS.—*Executor's sale.*

"The decision by the Court of Claims in *McKinney* v. *United States* has caused confusion in the existing law as to the basis on which an executor must determine gain or loss on the sale by him of property of the estate. The House bill in section 113(a)5 provides that in such cases the basis shall be the fair market value of the property at the time of the death of the decedent. In the same section the House bill provides the same basis shall be used where the property is sold by the beneficiary.

"It appears that the House bill is inadequate to take care of a number of situations which frequently arise. For example, the executor, pursuant to the terms of the will, may purchase property and distribute it to the beneficiaries, in which case it is impossible to use the value at the decedent's death as the basis for determining subsequent gain or loss, for the decedent never owned the property. Moreover, the fair market value of the property at the decedent's death can not properly be used as the basis, in the case of property transferred in contemplation of death where the donee sells the property while the donor is living.

"Accordingly, the committee has revised section 113(a)5 and certain related sections, so as to provide that in the case of a specific bequest of personalty or a general or specific devise of realty, or the transmission of realty by intestacy, the basis shall be the fair market value at the time of the death of the decedent. 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. The same rule is applied to real and personal property transmitted by the decedent, where the sale is made by the executor. In all other cases the basis is the fair market value of the property at the time of the distribution to the taxpayer. The latter rule would obtain, for example, in the case of personal property not transmitted to the beneficiary by specific bequest, but by general bequest or by intestacy. It would also apply in cases where the executor purchases property and distributes it to the beneficiary."

These reports indicate that the "other cases" referred to in section 113(a)5 are those where it is impossible to use the date of death as the basis. The cases at bar do not seem to come within the exception contained in the report of the Committee on Finance of the Senate.

The conclusion which has been reached is, that the value of the property at the date of the death of the testatrix governs in determining the gain or loss upon the sale of the property.

The motion made by the plaintiff for judgment is denied.

Settle order on notice.

SECTION 116.—EXCLUSIONS FROM GROSS INCOME.

ARTICLE 643: Compensation of State officers and employees.

XI-38-5698
G. C. M. 10814

REVENUE ACT OF 1928 AND PRIOR REVENUE ACTS.

The taxpayer was superintendent of the M County Hospital, which was established and is maintained under statutes which provide that the counties of the State through their board of supervisors shall have jurisdiction and powers to provide for the care and maintenance of the indigent sick or dependent poor of the county, and levy taxes for such purposes. Collections from patients from 1915 to 1931 were only 3.1 per cent of expenses, and the facilities of the hospital are not available to those able to pay reasonable compensation.

Held, the M County Hospital is an instrumentality of the State engaged in the exercise of an essential governmental function, and the taxpayer as an employee is exempt from taxation with respect to his salary.

The opinion of this office is requested whether the taxpayer is exempt from taxation with respect to compensation received by him as an officer of the M County Hospital.

The facts in the case are as follows: The M County Hospital was established and is maintained by the authority of the California Political Code, section 4041.16 (see section 17, chapter 755, page 1458, Statutes of California, 1929), which provides that the boards of supervisors, in their respective counties, shall have the jurisdiction and powers to provide for the care and maintenance of the indigent sick or dependent poor of the county, and for that purpose to levy the necessary property or poll taxes, or both. It is further provided that graduates in medicine shall be appointed to attend to such indigent sick or dependent poor in the county hospitals and almshouses. The law also provides that the board shall not let the care,

maintenance, or attendance of such indigent sick or dependent poor by contract to any person; except, that the board shall be authorized and empowered to secure by agreement for the needy sick and dependent and partially dependent citizens, in cases of emergency, hospital care, including medical, surgical, X-ray, laboratory, nursing, and general hospital service, at cost from persons, firms, and corporations then and there maintaining and operating hospitals in the county or city and county. (See also section 4041(7) of Deering's Political Code, 1923.)

The taxpayer's office in the M Hospital was created by ordinance enacted by the board of supervisors of M County in 1924. The taxpayer is a graduate of the University of ——, with degree of M. D., and a graduate of the —— Medical School. He was appointed to the office in the M County Hospital by the board of supervisors upon its creation, and held that position until July, 1931.

The "pauper act" (Statutes of California, 1901, page 636) provides, *inter alia*, that every county shall relieve and support all pauper, incompetent, poor, indigent persons, and those incapacitated by age, disease, or accident, lawfully resident therein, when such persons are not supported and relieved by their relatives and friends, or by their own means, or by State hospitals or other State or private institutions. It is also provided that it is the duty of any superintendent of any county hospital or almshouse, or his subordinates, immediately upon receiving any person into such hospital or almshouse as a public charge, such person being poor, indigent, incapacitated, or incompetent as therein defined, to make diligent inquiry into the ability of such person or of his relatives to bear the actual charges and expenses of the maintenance and support of such person, and to forthwith notify the district attorney of such county thereof, and the board of supervisors of such county, of the result of such inquiry.

The moneys collected on the account of the patients are, in accordance with the provisions of the "pauper act," used for the support of, and furtherance of the care of, the patients in the hospital. During the years 1915 to 1931 the percentage of total expense collected from patients was only 3.1 per cent. The facilities of the hospital are not available to anyone who is in a position to pay reasonable compensation for hospital care and treatment, and such persons are refused admittance to the hospital, as it was never intended for this class of patients. The attending physicians and surgeons give their services free and entirely without financial remuneration from any source.

There is no express provision of law which prohibits taxation by the Federal Government of the compensation received by an employee of a State, but the courts have held that under the Constitution of the United States the Federal Government may not tax the means, agencies, or instrumentalities by which the States exercise their sovereign powers or discharge their strictly governmental functions. (*The Collector* v. *Day*, 11 Wallace, 113; *South Carolina* v. *U. S.*, 199 U. S., 437; *Flint* v. *Stone Tracy Co.*, 220 U. S., 107; *Pollock* v. *Farmers' Loan & Trust Co.*, 157 U. S., 429.) Just what instrumentalities of a State are exempt from taxation by the Federal Government can not be stated in terms of universal application. (*Metcalf & Eddy* v. *Mitchell*, 269 U. S., 514, T. D. 3824, C. B. V–1,

218.) But it is recognized in article 643 of Regulations 74 that compensation received for services rendered to a State or political subdivision thereof is included in gross income, unless (a) the person receives such compensation as an officer or employee of a State or political subdivision, and (b) the services are rendered in connection with the exercise of an essential governmental function.

There seems to be no doubt that the taxpayer is an employee of the county of M. He was appointed an officer of the M County Hospital by the board of supervisors of that county and his compensation is paid by the county out of taxes levied by the board as provided by law. In connection with the operation of a county hospital in California and the appointment of attending physicians, the following is quoted from *Sacramento County* v. *Chambers* (33 Cal. App., 142 (1917), 164 Pac., 613):

* * * The constitution nowhere places the burden of maintaining, supporting, caring for, and treating the indigent sick upon the counties of the State. The legislature, however, in the exercise of its duty and power to establish a system of county governments (section 4, article 11, Const.), has, in fixing and enumerating the powers of boards of supervisors of the counties, authorized said boards to establish and maintain county hospitals, prescribe rules for the government and management thereof, *and appoint county physicians and the necessary officers and employees thereof*, who shall hold office during the pleasure of the board (Pol. Code, section 4223), to build or rebuild, furnish, or refurnish hospitals and almshouses (Pol. Code, section 4041, subdivision 7), *and has further provided that the necessary expenses incurred in the support of the county hospitals, almshouses, and the indigent sick and otherwise dependent poor, whose support is chargeable to the county, constitute county charges.* (Pol. Code, section 4307, subdivision 7.)

* * * There is no doubt that the legislature, by the legislation above referred to, intended to and did transfer from its own shoulders, and so placed upon the counties, the duty and burden of caring for, supporting, and treating the classes of persons mentioned. * * * The State may, through its legislature, and in the exercise of its sovereign power and will, in all cases where the people themselves have not restricted or qualified such exercise of that power, apportion and delegate to the counties any of the functions which belong to it. * * * [Italics supplied.]

The principal question in the instant case is whether the county of M in operating a general hospital for the indigent sick and the dependent poor is exercising an essential governmental function. The "pauper act" referred to above places the care and support of "all paupers, incompetent poor, indigent persons" and those incapacitated by "disease or accident" upon the county, except where such persons are supported by relatives in State institutions. Under section 4041.16 of the California Political Code the care and maintenance of these unfortunates are placed under the supervision of the county board of supervisors. The care of the indigent sick and dependent poor, where there are no relatives to care for them, is the profound duty of the State and/or its political subdivisions. It is essentially a governmental function, for there is no other method of caring for such class of individuals. The State alone must assume the burden where there are no relatives which may be charged with their support. On this point the following comment in *Sacramento County* v. *Chambers*, supra, is of especial interest:

It has never been, nor will it ever be, questioned that among the first or primary duties devolving upon a State is that of providing suitable means and measures for the proper care and treatment, at the public expense, of the indigent sick, having no relatives legally liable for their care, support, and

treatment, those who are infirm and helpless from the ravages of advancing years and without means of their own or relatives upon whom the law places responsibility for their care and support, and the insane, likewise situated as to means necessary for their care, support, and safe-keeping. (Cooley on Taxation, page 204.) * * *

That the care of the dependent poor is a governmental function was recognized in *Chafor* v. *City of Long Beach* (174 Cal., 478, 163 Pac., 670), wherein the California Supreme Court stated as follows:

Nor is it difficult to set forth the definition of governmental functions as applied to a city. Under the theory of the common law, that the municipality is protected from liability only while exercising the delegated functions of sovereignty, the governmental powers of a city are those pertaining to the making and enforcing of police regulations, to prevent crime, to preserve the public health, to prevent fires, *the caring for the poor*, and the education of the young. And in the performance of these functions all buildings and instrumentalities connected therewith come under the application of the principle. (*City of Kokomo* v. *Loy* (Ind.), 112 N. E., 994.) [Italics supplied.]

In *Jensen* v. *McCullough* (271 Pac., 568) the court stated as follows:

* * * Thus, in the absence of a limitation, and without an express grant, the legislature has the inherent right to subdivide the State into political subdivisions and to prescribe the mode of government, the powers, duties, and obligations of each of such subdivisions and of the officers and employees created for the purpose of exercising, on behalf of the State, *the governmental functions of such subdivisions.* Having heretofore discussed the limitations which surround the power of the legislature in matters of this kind, and having found none of them applicable to the case in hand, we are left with the inherent power of the legislature, in the exercise of its police power, and for the general welfare of the State at large, to provide for the *care and maintenance of its citizens.* Without specifying the particular acts, we know that *the State has provided for the care and maintenance of the indigent, the orphans and half orphans, the blind, the insane, the feeble-minded, the juvenile delinquents, the criminal, and other dependent persons.* * * * [Italics supplied.]

The hospital in the instant case may be distinguished from that referred to in I. T. 2357 (C. B. VI–1, 52), where it was held that the compensation received by the medical director of the county hospital, operated under the laws of another State, was not exempt for the year 1925, and subsequent years, because the hospital was engaged in a proprietary rather than a governmental function. (Cf. Mim. 3838, C. B. IX–2, 137.) In that case it appeared that the attending physicians, including the leading tuberculosis specialists, received compensation for their services, whereas in the instant case the attending physicians gave their services free of charge. It did not appear in that case that the hospital was operated for the benefit of the indigent sick and paupers, but that it was an ordinary hospital controlled by the county where reasonable compensation was paid for care and treatment, although that hospital like all hospitals did have some charity patients. In the instant case, however, the hospital was organized and operated for the purpose of taking care of the indigent sick or dependent poor, a function which is recognized by the courts as essentially governmental, and which is a burden specifically placed upon the respective counties of the State of California. As indicated above, those who are able to pay a reasonable compensation for medical attendance are not admitted. Clearly, such patients could not be classed as indigent sick, dependent poor, or paupers, referred to in the statutes under which the hospital is organized and maintained.

In view of the foregoing, this office is of the opinion that the M County Hospital is an instrumentality of the State engaged in the exercise of an essential governmental function. It follows that the taxpayer as an employee of the institution is exempt from taxation with respect to his salary.

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

SECTION 117.—NET LOSSES.

ARTICLE 651: Net losses, definition and computation. XI-34-5631 T. D. 4349

INCOME TAX.

Net losses; deductions; article 1601 of Regulations 62, article 1621 of Regulations 65, article 1621 of Regulations 69, and article 651 of Regulations 74 amended.

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

To Collectors of Internal Revenue and Others Concerned:

Article 1601 of Regulations 62, approved February 15, 1922, is amended by striking out the third sentence and changing the first sentence to read as follows:

The term "net loss" as used in the statute means only a net loss sustained during the taxable year and resulting from the operation of any trade or business regularly carried on by the taxpayer during the taxable year or any prior taxable year.

Article 1621 of Regulations 65, approved October 6, 1924, is amended by striking out the fourth sentence and changing the first sentence to read as follows:

The term "net loss" as used in the statute applies to a net loss sustained during the taxable year and resulting from the operation of any trade or business regularly carried on by the taxpayer during the taxable year or any prior taxable year.

Article 1621 of Regulations 69, approved August 28, 1926, is amended by striking out the fourth sentence and changing the first sentence to read as follows:

The term "net loss" as used in section 206 applies to a net loss sustained during the taxable year and resulting from the operation of any trade or business regularly carried on by the taxpayer during the taxable year or any prior taxable year.

Article 651 of Regulations 74, approved February 15, 1929, is amended by striking out the fourth sentence and changing the first sentence to read as follows:

The term "net loss" as used in section 117 applies to a net loss sustained during the taxable year and resulting from the operation of any trade or business regularly carried on by the taxpayer during the taxable year or any prior taxable year.

DAVID BURNET,
Commissioner of Internal Revenue.

Approved August 15, 1932.

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

SUPPLEMENT C.—CREDITS AGAINST TAX.

SECTION 131.—TAXES OF FOREIGN COUNTRIES AND POSSESSIONS OF UNITED STATES.

ARTICLE 691: Analysis of credit for taxes. XI-45-5837
G. C. M. 11039

REVENUE ACT OF 1928.

The film-hire tax imposed by the New Zealand finance act of 1930 is not a part of the income tax law of that country and is levied on mere receipts from the use of films by those who have obtained a renter's license under the cinematograph films act of 1928. It is considered in the nature of an excise tax rather than an income tax. The amount of the film-hire tax paid to the New Zealand Government may not, therefore, be claimed as a credit against United States income tax.

An opinion is requested whether "film-hire tax," paid to the Government of New Zealand under the provisions of the finance act of 1930, may be allowed as a credit for income tax purposes under section 131 of the Revenue Act of 1928. Subdivision (a) of that section provides in part that the tax imposed by the United States Government 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. * * *

From an examination of the laws of New Zealand it is found that that country imposes an income tax by the "Land and income tax act, 1923," which was amended in 1924, 1925, 1926, 1927, and 1928. The original income tax law and the amendments thereto do not contain a "film-hire tax." The latter tax is imposed by the finance act of 1930, which is separate and distinct from the New Zealand income tax law. The finance act of 1930 is divided into six parts, designated as follows: Part I—Stamp duties; Part II—Death duties; Part III—Amusements-tax; Part IV—Main highways; Part V—Cinematograph films; Part VI—Miscellaneous. The film-hire tax is levied under Part V. That part of the finance act of 1930 provides that a film-hire tax shall be levied in respect of the proceeds derived from renting sound-picture films. The film-hire tax is payable by every person who is the holder of a renter's license under cinematograph films act, 1928. Section 45 of the finance act of 1930 reads as follows:

45. (1) The film-hire tax payable by any renter shall be assessed on the net monthly receipts derived by him from renting sound-picture films, or, in the case of an exhibitor who is also a licensed renter, shall be assessed on the net monthly receipts deemed, in accordance with the provisions hereinafter set forth, to have been derived by him from renting sound-picture films.

(2) Film-hire tax shall be levied at the following rates, namely:

(a) In respect of British sound-picture films, at the rate of 10 per centum of the net receipts aforesaid;

(b) In respect of foreign sound-picture films, at the rate of 25 per centum of such net receipts.

In ascertaining net receipts there are deducted therefrom certain expenses which are enumerated in the act, as well as an amount equal to 12½ per cent of the gross receipts derived from the renting of sound-picture films.

This office has previously held that an income tax within the meaning of section 131 of the Revenue Act of 1928 has reference to a tax on "income" within the meaning of that term as used and understood by the Federal income tax law and court decisions. (See I. T. 2596, C. B. X-2, 184; I. T. 2620, C. B. XI-1, 44.) A tax on net receipts from business is not an income tax but has been held to be an excise tax. (See Cooley on Taxation, fourth edition, section 845; Judson on Taxation, second edition, section 256.) As the film-hire tax imposed by the New Zealand finance act of 1930 is not a part of the income tax law of that country, and is levied on mere receipts from the use of films by those who have obtained a renter's license under the cinematograph films act, 1928, the tax in question is considered in the nature of an excise tax rather than an income tax. The amount of film-hire tax paid to the New Zealand Government may not, therefore, be claimed as a credit against United States income tax.

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

ARTICLE 692: Meaning of terms. XI-34-5630
T. D. 4348

Income tax—Article 382 of Regulations No. 45, 45 (1920 Edition), 62, 65, and 69, and article 692 of Regulations No. 74, amended.

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

To Collectors of Internal Revenue and Others Concerned:

The second sentence of article 382 of Regulations No. 45, approved April 17, 1919; No. 45 (1920 Edition), approved January 28, 1921; No. 62, approved February 15, 1922; No. 65, approved October 6, 1924; No. 69, approved August 28, 1926, and the second sentence of article 692 of Regulations No. 74, approved February 15, 1929, are hereby amended to read as follows:

"Foreign country" means any foreign state or political subdivision thereof, or any foreign political entity, which levies and collects income, war-profits, or excess-profits taxes.

DAVID BURNET,
Commissioner of Internal Revenue.

Approved August 15, 1932.

JAMES H. DOUGLAS,
Acting Secretary of the Treasury.

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SECTION 144.—WITHHOLDING OF TAX AT SOURCE.

ARTICLE 768: Return and payment of tax withheld. XI–39–5720 I. T. 2644

REVENUE ACT OF 1928.

The Act of March 1, 1879 (20 Stat., 351, 12 U. S. C. A., 570), is limited in its application to cases involving taxes directly imposed upon a bank. It has no reference to a case which involves the liability of a withholding agent for the payment of taxes imposed upon the owners of bonds containing a tax-free covenant clause.

A ruling is requested whether the M Bank, which is now insolvent, is required to pay to the United States Government sums representing income taxes received by it as withholding agent.

The superintendent of banks of the State of X is in charge of the liquidation of the M Bank, which passed into his hands on August —, 1931. The bank has been acting as withholding agent in connection with interest payments upon tax-free covenant bonds of a domestic corporation, and at the time the bank was taken over in liquidation it had on hand the sum of $1.02x$ dollars, representing income tax required to be withheld at the source under the provisions of section 144(a) of the Revenue Act of 1928. In addition to this the bank, as withholding agent, received the sum of $.44x$ dollars subsequent to its closing. The assets of the bank are not sufficient to pay the depositors of the bank in full, and the question arises whether section 22 of the Act of March 1, 1879, is applicable.

The Act of March 1, 1879 (20 Stat., 351, 12 U. S. C. A., 570), provides as follows:

Insolvent banks as exempt from tax.—Whenever and after any bank has ceased to do business by reason of insolvency or bankruptcy, no tax shall be assessed or collected, or paid into the Treasury of the United States, on account of such bank, which shall diminish the assets thereof necessary for the full payment of all its depositors; and such tax shall be abated from such national banks as are found by the Comptroller of the Currency to be insolvent; and the Commissioner of Internal Revenue, when the facts shall so appear to him, is authorized to remit so much of said tax against insolvent State and savings banks as shall be found to affect the claims of their depositors. (March 1, 1879, ch. 125, section 22, 20 Stat., 351; March 3, 1883, ch. 121, section 1, 22 Stat., 488.)

The statute above quoted is limited in its application to cases involving taxes directly imposed upon a bank. It has no reference to a case, such as the one here under consideration, which involves the liability of a withholding agent for the payment of taxes imposed upon the owners of bonds containing a tax-free covenant clause. The bank's liability for the taxes in question arises as the result of the burden placed upon the debtor corporation (obligor) by sections 144(a) and 144(c) of the Revenue Act of 1928, namely, to "deduct and withhold" the tax at the source and to "pay the tax to the official of the United States Government authorized to receive it."

The bank, as withholding agent of the debtor corporation, is liable to the United States on account of the income taxes collected by it whether such taxes were received before or after the bank was taken over by the superintendent of banks. (Cf. section 3466 of the Revised Statutes, which creates a priority for debts due to the United States by an insolvent debtor.)

ARTICLE 768: Return and payment of tax withheld. XI-49-5897 I. T. 2659

REVENUE ACT OF 1928.

The liability to collect income tax at the source and pay the amount thereof to the United States Government is primarily that of the debtor corporation. In case it has designated a bank to act for it as withholding agent, and the bank has not collected any tax from the bondholders nor received any funds from the debtor corporation to pay the tax which the debtor corporation assumed in connection with its tax-free covenant bonds, the bank can not be held liable for the tax merely by reason of its appointment as withholding agent.

Advice is requested relative to the liability of the M Bank as withholding agent, with respect to an outstanding assessment against the O Company representing income tax required to be withheld at the source during 1931 from interest payments upon bonds issued by the latter company.

The M Bank states that it has been unable to collect from the debtor corporation the amount of tax assessed, and that it knows of no provision of law under which the Government can compel a bank acting as withholding agent to pay the tax required to be withheld where the bank is unable to make collection.

An examination of the returns filed upon which the assessment was based indicates that the M Bank was acting only as a "duly authorized agent" for the debtor corporation with respect to interest paid upon tax-free covenant bonds, as provided by article 761 of Regulations 74. The liability to collect income tax at the source and pay the amount thereof to the United States Government is primarily that of the debtor corporation. (See sections 144(a) and 144(c) of the Revenue Act of 1928.) In case it has designated a bank to act for it as withholding agent, and the bank has not collected any tax from the bondholders nor received any funds from the debtor corporation to pay the tax which the debtor corporation assumed in connection with its tax-free covenant bonds, the bank can not be held liable for the tax merely by reason of its appointment as withholding agent. Inasmuch as it appears in the instant case that the M Bank, as withholding agent of the O Company, has not collected any income tax at the source and has been unable to obtain from the debtor corporation the amount of tax which the debtor corporation covenanted to pay for its bondholders, the M Bank can not be held liable for the tax. (Compare I. T. 2644 (page 120).)

SECTION 148.—INFORMATION AT SOURCE.

ARTICLE 811: Return of information as to payments of $1,500. XI–46–5851 G. C. M. 11115

REVENUE ACT OF 1928.

An insurance company paying insurance commissions to agents should furnish information returns in accordance with section 148 of the Revenue Act of 1928 and article 811 of Regulations 74.

An opinion is requested relative to the liability of the M Company to file information returns under section 148 of the Revenue Act of 1928.

The M Company is engaged in accepting insurance and executing bonds in connection with accident insurance, health insurance, and numerous types of property insurance. The question has arisen in connection with the investigation of the tax liability of the insurance company, whether it is required to file information returns on Forms 1096 and 1099, showing commissions paid during the years 1929, 1930, and 1931 to its agents for procuring insurance and writing fidelity and surety bonds.

Section 148 of the Revenue Act of 1928 provides in part as follows:

(a) *Payments of $1,500 or more.*—All persons, in whatever capacity acting, including lessees or mortgagors of real or personal property, fiduciaries, and employers, making payment to another person, of interest, rent, salaries, wages, premiums, annuities, compensations, remunerations, emoluments, or other fixed or determinable gains, profits, and income (other than payments described in section 149(a) or 150), of $1,500 or more in any taxable year, or, in the case of such payments made by the United States, the officers or employees of the United States having information as to such payments and required to make returns in regard thereto by the regulations hereinafter provided for, shall render a true and accurate return to the Commissioner, under such regulations and in such form and manner and to such extent as may be prescribed by him with the approval of the Secretary, setting forth the amount of such gains, profits, and income, and the name and address of the recipient of such payment.

Article 811 of Regulations 74 provides that all persons making payment to another person of fixed or determinable income of $1,500 or more in any calendar year must render a return thereof to the Commissioner. The return is required to be made on Form 1099, accompanied by transmittal Form 1096, showing the number of returns filed.

Section 148 of the Revenue Act of 1928 and the corresponding sections of prior Revenue Acts were incorporated into the income tax law for the purpose of enabling the Department to reach and impose a tax upon certain items of income, the existence of which might otherwise remain undisclosed. (I. T. 2560, C. B. X–1, 173.) The law is mandatory in its requirement that returns of information be filed where the amount paid during the taxable year is $1,500 or more. No exception is made in the case of insurance companies. The fact that a large sum in commissions was paid each year by the M Company would indicate the necessity for the Government having information from which to verify properly the income tax returns filed by the recipients.

From the file in the case it appears that the insurance company has contracts which it enters into with general agents, agents, and subagents. The company will be required to file information returns, under section 148 of the Revenue Act of 1928, of the amount of

commissions paid to all its agents where such commissions paid to any individual during the calendar year amounted to $1,500 or more. The fact that the general agent, or agent, has expenses connected with the carrying on of his business is not sufficient reason for relieving the insurance company of the burden imposed upon it by the statute to file information returns. Such expenses of operation are allowable deductions to the agent in computing net income, but information returns must be filed by the insurance company. Should a general agent pay a part of his commissions to an agent or subagent in consideration of business secured, the general agent should also render returns of information as required by law.

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

SUPPLEMENT E.—ESTATES AND TRUSTS.

SECTION 161.—IMPOSITION OF TAX.

ARTICLE 861: Estates and trusts. XI–48–5883
G. C. M. 11221

REVENUE ACT OF 1928.

The interest on Liberty bonds, beneficially owned by a nonresident alien individual, is exempt from income tax when accumulated by a resident trustee for the benefit of nonresident alien beneficiaries.

The interest on foreign bonds, when accumulated by a resident trustee for future distribution to nonresident aliens under the terms of a trust, is the income of a resident trust and taxable to the trustee under section 161 of the Revenue Act of 1928.

An opinion is requested whether interest on certain Liberty bonds and foreign bonds is taxable to a resident trustee when accumulated for the benefit of nonresident alien beneficiaries.

It appears that a trust deed was executed in 1916 by A, who was a nonresident alien, for the benefit of his relatives, also nonresident aliens. The M Company, a domestic corporation, was appointed trustee. The deed, as modified by supplemental indenture, provided that at the death of the grantor a certain portion of the trust property should go in equal shares to such grandsons of the grantor (by a certain named son) as were living at the grantor's death; provided, however, that in the case of any such grandson who was under 21 years of age at the grantor's death, the trustee should continue to hold the share of such infant in trust during his minority, collecting the income and applying to the use of said infant so much of the income as the trustee might deem proper for the infant's education, maintenance, and support, accumulating the remainder during his minority and paying the corpus and accumulated income to the grandson upon his attaining 21 years; provided, that if the said infant should die under the age of 21 years leaving issue, then the trustee should deliver said grandson's share and accumulations to his issue living at his death, and if the said grandson should die before attaining 21 years without leaving issue, then his share and accumulations should be treated as though he had died without issue in the

lifetime of the grantor, and as if every person predeceasing the said grandson had predeceased the grantor.

Under the terms of this instrument the trustee, in 1929, paid and distributed to the infant grandson, B, a nonresident alien, through his guardian, the sum of x dollars of trust income, part of which was interest on Liberty bonds and foreign bonds, the remainder of the income of his share being accumulated in accordance with the terms of the trust. The sum so accumulated included interest on Liberty bonds in the sum of $2.82x$ dollars and interest on foreign bonds in the sum of $.42x$ dollars. In the same year the trustee distributed and paid to the infant grandson, C, also a nonresident alien, through his guardian, the sum of x dollars, part of which was interest on Liberty bonds and foreign bonds, and accumulated the remainder of his share of income. The sum so accumulated included interest on Liberty bonds in the sum of $2.78x$ dollars and interest on foreign bonds in the sum of $.44x$ dollars.

With respect to the Liberty bond interest, it appears that section 4 of the Victory Liberty Loan Act (40 Stat., 1309) provides in part as follows:

SEC. 4. That section 3 of the Fourth Liberty Bond Act is hereby amended to read as follows:

"SEC. 3. That, notwithstanding the provisions of the Second Liberty Bond Act or of the War Finance Corporation Act or of any other Act, bonds, notes, and certificates of indebtedness of the United States and bonds of the War Finance Corporation shall, *while beneficially owned by a nonresident alien individual, or a foreign corporation, partnership, or association, not engaged in business in the United States, be exempt both as to principal and interest from any and all taxation now or hereafter imposed by the United States, any State, or any of the possessions of the United States or by any local taxing authority.*" [Italics supplied.]

The beneficiaries, B and C, in the instant case come within the classification of nonresident aliens not engaged in business in the United States.

In the opinion of this office the fact that the holder of legal title to the bonds is a resident trustee can not alter the express exemption granted by the Liberty Bond Act, as amended, for the equitable and beneficial ownership of such bonds is in nonresident aliens not engaged in business in the United States, and this is true regardless of whether the interest is distributed to them or is accumulated for their benefit.

The situation is different, however, with respect to the foreign bond interest. The Bureau has conceded that with respect to foreign bond interest currently distributed to the beneficiaries the trustee may be regarded as a mere conduit, with the result that the character of such interest is not changed by passing through the trustee's hands. Since section 212(a) of the Revenue Act of 1928 provides that "In the case of a nonresident alien individual gross income includes only the gross income from sources within the United States," it follows that currently distributed foreign bond interest, passing unchanged through a resident trustee to a nonresident alien, is not taxable, the *taxpayer* in question in such a case being the nonresident alien and not the resident trust or trustee. (A. R. M. 37, C. B. 2, 172; I. T. 1642, C. B. II-1, 81.)

But foreign bond interest accumulated by a resident trustee is in a different category, for the *taxpayer* in question is then the resident

trust or trustee and not the nonresident alien. Section 161(a) of the Revenue Act of 1928 provides that "The taxes imposed by this title *upon individuals* shall apply to the income of estates or of any kind of property held in trust," and section 162 provides that "The net income of the estate or trust shall be computed *in the same manner* and on the *same basis* as in the case of an *individual*, except that"—(naming exceptions that do not mention nonresident aliens). Section 161(b) provides that "The tax shall be computed upon the net income of the estate or trust, and shall be paid by the *fiduciary* * * *." Such income as is "to be distributed currently" (or in the case of a discretionary trust, such income as is "properly paid or credited" during the year to the beneficiary) is not included in the statutory "net income" of the trust but is allowed as a deduction in computing such "net income," and with respect to the amount so allowed as a deduction, the taxpayer in question is the beneficiary. But "income accumulated or held for future distribution under the terms of the * * * trust" is included in computing the "net income" of the trust, and with respect to such statutory "net income" the trust is clearly a separate taxable "person" from the beneficiary. Section 701(a)1 provides that "The term '*person*' means an individual, a *trust* or estate, a partnership, or a corporation," and section 701(a)13 provides that "The term '*taxpayer*' means any *person* subject to a tax imposed by this Act." The individual designated by the statute to pay the tax upon the statutory "net income" of the trust is of course the "fiduciary" (section 161(b)).

In the case of *Estate of A. F. T. Cooper* v. *Commissioner* (9 B. T. A., 21, C. B. VII–1, 7) the Board held that a decedent's estate is a separate taxable entity from the decedent and from the beneficiaries, and that consequently if such an estate is being administered by a domestic fiduciary it is a domestic *taxpayer*, entitled to a credit of $1,000 as such, even though the decedent and beneficiaries are nonresident aliens. The Board said that "We have no doubt that the Revenue Act of 1918 * * * indicates a clear intent by Congress to treat an estate as a separate taxable entity," and "diversity of citizenship has been held uniformly to depend upon the status of the trustee, executor, administrator, guardian, etc., rather than upon the status of their principals, whether decedents, heirs, or other beneficiaries * * *." In other words, if the trustee is a resident the *trust* is a resident entitled to the personal exemption or credit of a resident, regardless of where the beneficiaries live, and the trust, as a separate taxpayer, is to be treated as *any other resident taxpayer is treated*. As an ordinary resident taxpayer who receives interest on foreign bonds is not exempt from tax on such income, it follows that a resident trust is likewise not exempt from tax on such income where it is the taxpayer.

There is no room for the conduit theory in the case of accumulated income, because such income is not passed on by the trustee during the taxable year but is held and accumulated. The fact that such income will eventually be passed on to the beneficiaries is immaterial in this connection, for the scheme of the Revenue Act is based on annual accounting periods, not on the basis of the finally ascertained results of particular transactions extending over more than one year. (*Burnet* v. *Sanford & Brooks Co.*, 282 U. S., 359; *Burnet* v. *Thomp-*

son Oil & Gas Co., 283 U. S., 301; *Buffalo Union Furnace Co.* v. *Commissioner*, 23 B. T. A., 439.) The very purpose of the trust sections is to set up the trust as a separate and independent taxable entity from the beneficiaries with respect to accumulated income, so that the separate entity thus created may pay the tax *each year* on such income, regardless of what becomes of the income after the taxable year is ended. Accordingly, a trust, as a separate taxpayer from the beneficiary, is entitled to the same personal exemption as is allowed to a single person, and a beneficiary is likewise entitled to his own personal exemption in addition. A trust, as a separate taxpayer from the beneficiary, computes its *own* statutory net income and pays no surtax on accumulated income unless such income is itself large enough to be in the surtax brackets, regardless of the fact that the income may be accumulated for the sole benefit of a beneficiary who has an indefeasibly vested interest in the income and who is himself in very high brackets.

There is nothing in the *character* of foreign bond interest which is alone sufficient to exempt it from taxation. It is only when such interest is the income of a nonresident alien that it is exempt. In the instant case the accumulated foreign bond interest is not the income of a nonresident alien but is the income of a *resident* taxpayer (the trust), and such taxpayer is no more entitled to the advantages that would occur if the cestui were treated as the taxpayer than it is compelled to assume the disadvantages that would flow from such treatment.

In Appeals and Review Memorandum 37, supra, it was in effect held that foreign bond interest accumulated by a resident trustee is taxable to the trust, regardless of the fact that the beneficiaries are nonresident aliens. This ruling was supported in the later Office Decision 743 (C. B. 3, 203), which held that the net income of a discretionary trust which was created by a nonresident alien for the benefit of another nonresident alien is taxable in the hands of a resident fiduciary, notwithstanding such income is derived from interest on foreign bonds, unless the income is of a character to make it exempt in the hands of any ordinary resident. At the time this office decision was promulgated, the regulations provided that where under the terms of the will or deed the trustee may in his discretion distribute the income or accumulate it, the income is taxed to the trustee, irrespective of the exercise of his discretion. (Article 342 of Regulations 45.) Office Decision 743 is, therefore, but another illustration of the Bureau's position that income which would otherwise be taxed to the trust as an entity is not rendered nontaxable simply because the beneficiary is a nonresident alien and the income is from sources without the United States.

The taxpayer argues that under the State of R law the accumulated income in the instant case is absolutely and indefeasibly vested in the two beneficiaries in question; that if they die before reaching 21, such accumulated income will pass to their individual estates and will not be governed by the provisions of the trust instrument which appear to give the accumulations, in such an event, to others. From this the taxpayer concludes that the accumulated income has been irrevocably set aside by the trustee for the benefit of the two beneficiaries, and that in effect, therefore, the income has been "properly * * * credited" each year to the beneficiaries. If it be admitted for the

sake of argument that the accumulated income is in fact indefeasibly vested in the two grandsons, the results claimed by the taxpayer do not follow. The trust sections of the statute plainly show that the trust is an entirely separate taxable entity from the beneficiaries with respect to income which is "accumulated or held for future distribution under the terms of the * * * trust" regardless of whether the beneficiaries have indefeasibly vested equitable interests or not. It is not simply income which the trustee accumulates "for the benefit of unborn or *unascertained* persons or persons with *contingent* interests" that is taxable to the trust as an entity, but there is also taxable to the trust as an entity such income as is simply "accumulated or *held for future distribution* under the terms of the will or trust." These additional words in section 161(a)1 plainly imply that Congress did not intend that the question of whether the income of a trust is taxable to the fiduciary or to the beneficiary should depend on whether the beneficiary has a contingent interest or an indefeasibly vested interest. Regardless of how completely vested a beneficiary's equitable interest may be, the income is nevertheless taxable to the trust as an entity if it is simply "held for future distribution under the terms of the will or trust," as distinguished from income "which is to be distributed currently," or, in the case of a discretionary trust, from income which "is properly paid or credited" to the beneficiary during the taxable year.

In the opinion of this office, therefore, the taxpayer with respect to the foreign bond interest withheld by the trustee is the resident trust, and such income is as subject to tax in the hands of the trust as it would be in the hands of any other resident taxpayer. Such income has not been "properly paid or credited" to the beneficiaries, nor does it constitute income "which is to be distributed currently." The accumulated Liberty bond interest escapes tax, not because it is included in either of those classifications, but because the Liberty Bond Act, as amended, exempts such interest from tax (if the bonds are beneficially owned by nonresident aliens), in spite of the fact that the interest may be accumulated by a resident trustee.

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

SECTION 162.—NET INCOME.

ARTICLE 862: Method of computation of net income and tax.

XI-35-5636
G. C. M. 10423

REVENUE ACT OF 1928.

A, in his will, made specific bequests and directed that the residue of his estate be placed in trust, the income to be paid to his widow during her life, with remainder over to charitable institutions. In 1928, in order to pay taxes and the specific bequests, the executors sold securities of the estate, which sale resulted in a profit.

Held, the profit from the sale of securities is allowable as a deduction under section 162(a) of the Revenue Act of 1928, as having been permanently set aside or to be used exclusively for charitable purposes.

I. T. 1678 (C. B. II-1, 129) and Appeals and Review Recommendation 3293 (C. B. II-2, 165) were overruled by Treasury Decision 4122 (C. B. VII-1, 247).

An opinion is requested whether the profit from the sale of securities of the estate of A, which was not distributed to the beneficiaries, may be considered as permanently set aside for charitable purposes.

A died testate on July —, 1927. In his last will and testament, and codicils thereto, he made several specific bequests, aggregating approximately 6.165x dollars, to certain individuals and charitable institutions, created two trusts, and directed that the residue of his estate be placed in trust, the income therefrom to be paid to his widow during her life, with remainder over to certain charitable institutions.

During part of the year 1928 the estate was in process of administration. In order to pay the estate and inheritance taxes, and the various specific bequests, the executors sold securities of the estate, which sale resulted in a profit of 1.233x dollars. The estate also received during 1928 other income, consisting of interest and dividends, in the amount of .91x dollars. Under paragraph eighth of the will, the executors were empowered to satisfy the bequests by delivering securities of the estate at fair valuations determined by them.

There was a large residuary estate, after satisfying all charges and expenses.

Section 162 of the Revenue Act of 1928 provides, in part, as follows:

> The net income of the estate or trust shall be computed in the same manner and on the same basis as in the case of an individual, except that—
>
> (a) There shall be allowed as a deduction (in lieu of the deduction for charitable, etc., contributions authorized by section 23(n)) any part of the gross income, without limitation, which pursuant to the terms of the will or deed creating the trust, is during the taxable year paid or permanently set aside for the purposes and in the manner specified in section 23(n), or is to be used exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals, or for the establishment, acquisition, maintenance or operation of a public cemetery not operated for profit.

As stated in General Counsel's Memorandum 423 (C. B. V–2, 53):

> The general rule is that gain derived through the sale of assets which constitute a part of the corpus of a trust inures to the benefit of the remaindermen, if any, and not to the life tenant. This is true for the reason that such gain is not income in a probate sense, but becomes part of the capital or corpus of the trust. * * *

The Supreme Court of the United States in *Lederer* v. *Stockton* (260 U. S., 3 [T. D. 3407, C. B. I–2, 156]) held that income accumulated in the hands of a trustee, which on the death of an annuitant would immediately pass to a tax-exempt corporation, was not taxable under the Revenue Act of 1916.

In *Slocum et al.* v. *Bowers* (15 Fed. (2d), 400) the District Court for the Southern District of New York held that income of the estate of the deceased, which would ultimately pass to religious, charitable, scientific, or educational corporations which were residuary legatees, was not subject to income tax under the 1918 Act. In the course of its opinion, the court said:

> * * * it is hard to believe that in the one case of administration of an estate the exemption should turn on the technical question of whether

the corporations seeking it have the legal or equitable title to the income. * * * There is no doubt that the executors held the legal title, but it does not necessarily follow because they can sell assets, pay debts and distribute, that the portion of the property which they hold, though ultimately distributable to tax-exempt persons, is taxable in their hands. * * *

The Circuit Court of Appeals for the Second Circuit sustained the decision of the district court. (*Bowers* v. *Slocum et al.*, 20 Fed. (2d), 350, T. D. 4122, C. B. VII–1, 247.) In the course of its opinion, the Circuit Court of Appeals said:

* * * the income in question, in the case at bar, reaches the beneficiaries of the bounty of the testatrix through the executors, and, if that income should be lost or reduced in amount, the loss occasioned thereby would be that of the residuary legatees, and therefore the income which the Government is proposing to tax is the income of the residuary legatees. * * *

The Slocum case was considered by the Board of Tax Appeals for the year 1921, *Appeal of Herbert Jermain Slocum et al.* (6 B. T. A., 36). The Board followed the decision of the district court as to the prior year, and held that income received by the estate during administration and settlement was, pursuant to the terms of the will, permanently set aside for charitable, religious, and educational purposes and was a proper deduction in the return filed by the estate. That Board decision was nonacquiesced in (C. B. VII–1, 40) for the reason that the same issue for prior years was then pending before the Circuit Court of Appeals. When the decision of the Circuit Court of Appeals was accepted it was published as Treasury Decision 4122, supra, and the Board case was closed without an appeal being filed. That Treasury decision therefore takes precedence over the nonacquiescence in the Board case.

To the same general effect as the court and Board decisions in the Slocum cases, see *Hartford-Connecticut Trust Co.* v. *Eaton* (29 Fed. (2d), 840); *E. Sohier Welch et al.* v. *Commissioner* (9 B. T. A., 1370, C. B. X–1, 69); *Peoples Trust Co.* v. *Commissioner* (10 B. T. A., 1385, C. B. X–1, 51); and *E. C. Johnson* v. *Commissioner* (13 B. T. A., 850, C. B. X–1, 32).

In I. T. 1678 (C. B. II–1, 129), where a testator left the residue of his estate to exempt charitable corporations and provided that certain stocks should be sold in the event there were not sufficient funds to pay the pecuniary legacies, it was held that the gain derived from the sale constituted taxable income accruing to the estate.

The Bureau held in Appeals and Review Recommendation 3293 (C. B. II–2, 165) that the portion of the income of an estate of a deceased person, received during the period of administration, which accrued to an exempt corporation, the residuary legatee, was not exempt from income tax. These two rulings, however, were superseded and overruled by the Bureau's acceptance of the decision of the Circuit Court of Appeals in the Slocum case.

After careful consideration of the facts in the instant case, and the law and decisions cited, this office is of the opinion that the profit from the sale of securities in this case is allowable as a deduction under section 162(a) of the Revenue Act of 1928, as having been permanently set aside or to be used exclusively for charitable purposes.

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

SECTION 165.—EMPLOYEES' TRUSTS.

SECTION 165. XI-32-5593
I. T. 2637

REVENUE ACT OF 1928.

Under an agreement entered into in 1929 between each of certain employees and the corporation, the corporation agreed to allot a certain number of shares of its common stock to the employee and apply a certain portion of its annual net earnings toward payment therefor in his behalf. If he exercises a privilege of contributing an annual amount toward the payment the corporation will credit him with a further amount. Dividends are credited toward payment. Upon execution of the agreement the corporation set aside the shares and at the close of accounting periods certificates, so far as paid for, are issued in the employee's name, who is required immediately to execute a transfer in blank and redeliver to the corporation or to a designated trustee. He can not transfer or assign the stock prior to its unconditional delivery to him at termination of the agreement.

The contract constitutes a trust created as a part of a stock bonus or profit-sharing plan within the meaning of section 165 of the Revenue Act of 1928. The amount contributed toward the purchase of the stock by the corporation and the earnings attributable to the stock or the fund are, therefore, taxable to the employee in the year in which the stock is made available to him.

A ruling is requested relative to the Federal income tax liability of certain employees of the M Corporation for 1929 and subsequent years.

The cases of the employees referred to involve the question of the taxable year or years in which the employees are required to report in their income tax returns certain amounts credited to them annually on the books of the corporation, pursuant to an agreement entered into during 1929 between each of the employees and the corporation.

The provision of law involved is section 165 of the Revenue Act of 1928, which reads as follows:

SEC. 165. EMPLOYEES' TRUSTS.—
A trust created by an employer as a part of a stock bonus, pension, or profit-sharing plan for the exclusive benefit of some or all of his employees, to which contributions are made by such employer, or employees, or both, for the purpose of distributing to such employees the earnings and principal of the fund accumulated by the trust in accordance with such plan, shall not be taxable under section 161, but the amount contributed to such fund by the employer and all earnings of such fund shall be taxed to the distributee in the year in which distributed or made available to him. Such distributees shall for the purpose of the normal tax be allowed as credits against net income such part of the amount so distributed or made available as represents the items of dividends and interest specified in section 25 (a) and (b).

Under the terms of the agreement the corporation agreed to continue the employment of the employee, and the employee agreed to continue to work for the corporation, for a period of five years from January 1, 1928, in consideration of which the corporation further agreed to pay the employee a stated sum annually in cash, to allot a certain number of shares of its common stock to the employee, and to apply a portion of the annual net earnings of the corporation toward the payment by or on behalf of the employee for the allotted shares. The employee has the privilege of contributing an amount annually toward payment for the stock, and, if such payment is made, the corporation credits him with a further equal amount not exceed-

ing x dollars for each allotted share. Dividends on any of the allotted shares, which are paid for when the dividends are declared, are credited toward the payment for the stock. Upon execution of the agreement the corporation set aside or allotted the shares, and at the close of each accounting period of the corporation a certificate for such number of shares of stock as can be paid for with the amount available for the purpose, determined in accordance with the agreement, is issued in the name of the employee, who is required by the agreement to immediately indorse the certificate in blank and deliver it, either to the corporation or to a designated trustee. The provisions of the agreement respecting the rights of ownership and control by the employee of the shares of stock as paid for and issued are as follows:

Twelfth: This agreement is strictly personal as regards the employee and shall not confer any rights or benefits upon any other person, except as hereinafter provided in respect of the legal representatives of the employee in case of his death. Neither this agreement nor any interest herein or right hereunder shall be subject to sale, pledge, assignment, or transfer by the employee, whether by his voluntary act or otherwise, and the employee will not sell, pledge, assign, transfer, or otherwise encumber any interest herein or in the allotted shares or in any common shares at the time held by the trust company pursuant to the provisions hereof; nor shall this agreement or any such interest or right be subject in any manner to attachment, execution, or sale for any debts or liabilities of the employee; and if any sale, pledge, assignment, or transfer hereof or thereof shall be attempted or any attachment or execution shall be issued in respect hereof or thereof, the corporation may at its option terminate this agreement.

* * * * * * *

Sixteenth: As security for the performance by the employee of all his obligations under this agreement, he hereby pledges with the trust company all of the allotted shares certificates for which shall have been issued and shall be issuable to him under the provisions of this agreement, the certificates for such shares to be held by said trust company as such security until the corporation shall have notified it that the obligations of the employee under this agreement shall have been fully performed, or that the employee shall have been released from further performance thereof.

In view of the foregoing and all the other provisions of the contract, it is held that the contract constitutes a trust created as a part of a stock bonus or profit-sharing plan within the meaning of section 165 of the Revenue Act of 1928. The amount contributed toward the purchase of the stock by the corporation and all the earnings attributable to the stock or the fund with which it was acquired are, therefore, taxable to the employee in the year in which the stock is distributed or made available to him.

It is contended that the decision of the Board of Tax Appeals in the case of *Lyle H. Olson et al.* v. *Commissioner* (24 B. T. A., 702) is applicable and controlling in the instant case, but it has been suggested that the decision of the Circuit Court of Appeals for the Second Circuit, in the case of *Rodrigues* v. *Edwards* (40 Fed. (2d), 408), may be applicable and controlling. The respective pertinent facts and the decisions in the two cases referred to may be summarized as follows:

In the Olson case, the bonus stock was acquired pursuant to a resolution passed by the board of directors of the corporation on March 13, 1917, and subscribed to by the employees concerned. The opening paragraph of the resolution provided that in consideration of the employees agreeing to remain continuously in the employ of

the company for a period of five years from March 1, 1917, specified amounts would be credited to their accounts each month toward the purchase of shares of stock in the company.

The resolution further provided that the shares of stock thus paid for during each of the five years would be issued to a trustee at the end of each year to be held for and on behalf of the employees, and that when the employees "shall have been continuously in the employ of the company for a period of five years" the trustee should assign to the employees all the shares then issued under the resolution. There was no provision in the resolution under which the employees might have sold or otherwise assigned the shares for value prior to the expiration of the 5-year period. For the years up to and including the calendar year 1922, the employees filed their returns on the cash receipts and disbursements basis. During 1922 each of the employees received unconditionally 200 shares of stock of a total par value of $20,000, and reported that amount in their returns for that year. The Bureau determined the taxable income on the basis of a fair market value of the stock of $80,000, and proposed a deficiency in tax against each employee for the year 1922. Several issues were presented on petitions to the Board of Tax Appeals, one of which was whether the value of the stock issued to the trustee at the end of each year was taxable to the employees in the year for which issued, or the value of all the 200 shares was taxable in the year 1922 when they were unconditionally received by the employees. The Board in deciding that the total fair market value of all the shares of stock was taxable to the employees in 1922 stated, in effect, that as there was no evidence that the returns of the employees were made on other than a receipts and disbursements basis, it must be held that the additional compensation paid to the employees was income to them in the year in which they received the shares of stock, and that the shares of stock were received by the employees at the time they were turned over to them and made subject to their disposal.

In the Rodrigues case the corporation and the employee entered into a contract of employment, which ran for a period of three years from January 1, 1918. The employee was to receive annual compensation of $3,600, plus a sum equal to 2 per cent of the annual net profits of the corporation. It was agreed that the employee would purchase treasury common stock of the corporation with two-thirds of the 2 per cent of net profits, and the company was authorized to apply the two-thirds of the 2 per cent for that purpose. The contract provided that the employee, upon receiving the stock, would place it in trust and receive in return trust certificates. The certificates were assignable by the employee at any time during the employment with the consent of the corporation or the chief stockholder. At the termination of the contract the corporation could, within a brief option period, purchase the stock, and if the option was not exercised the employee could sell or otherwise dispose of the stock without restriction. There was no provision in the contract requiring the employee to continue in the employ of the company for the full period of three years in order to receive the stock. For the year

1919 the employee received stock of the corporation of a value of $13,478.91, representing two-thirds of 2 per cent of the net profits of the corporation. The value of the stock was included in the employee's gross income for that year and the tax thereon was assessed and collected. The employee (Rodrigues) filed a claim for refund of the tax on the value of the stock and, upon rejection of the claim, suit was brought in the district court for the recovery of the amount.

The verdict was for the defendant, and the plaintiff appealed. The circuit court of appeals, after reviewing the facts in the case and noting that the employee conceded that the receipt of something of exchangeable value, or of which he could dispose, would constitute income, stated that in its judgment "the contract not only did not prevent plaintiff from disposing of the trust certificates, but, on the contrary, it evidenced a clear intention that he should have a right of immediate disposition thereof." The court further stated:

> The express restriction against any sale was limited to the brief option periods; at other times the certificates might have been freely sold subject, of course, to the options and, during the employment, to Meyer's or the company's consent.

In the instant case the employee not only can not transfer or assign the stock prior to its unconditional delivery to him at the termination of the agreement, but he has pledged the stock with the trustee to be held until the corporation notifies the trustee that the employee has fully performed all his obligations under the agreement. Therefore, the employee did not or will not receive anything of exchangeable value, or of which he could dispose, until the stock was or is distributed or made available to him.

After careful consideration of the material provisions of the agreement in the instant case, it is concluded that the practical intent and effect of the agreements in the instant case and the Olson case are substantially the same and are distinguishable from the practical intent and effect of the agreement in the Rodrigues case. This being true, it follows that the portion of the decision of the Board of Tax Appeals in the Olson case which held, in effect, that the shares of stock were "received" by the employees at the time the shares were turned over to them and made subject to their disposal, is applicable to the instant case. It is, accordingly, held that the amount contributed toward the fund by the corporation for the purchase of the stock, and all the earnings attributable to the stock or the fund, were or will be "distributed or made available" to the employees in the year in which the stock was or will be unconditionally turned over to them by the trustee, pursuant to the provisions of the agreements creating the trust.

Since the agreements between the employees and the corporation constitute a trust created by the corporation as a part of a stock bonus or profit-sharing plan, within the meaning of section 165 of the Revenue Act of 1928, the total of the amount contributed toward the fund by the corporation for the purchase of the stock and all the earnings attributable to the stock or the fund are or will be taxable to the employees, in accordance with the provisions of that section, for the year in which the stock is distributed or made available to them.

SUPPLEMENT G.—INSURANCE COMPANIES.

SECTION 203.—NET INCOME OF LIFE INSURANCE COMPANIES.

ARTICLE 971: Tax-exempt interest and reserve funds. XI–51–5933 I. T. 2665

(Also Section 204, Article 992.)

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

All insurance companies are required to use the highest aggregate reserve, after deduction for reinsurance placed with both authorized and unauthorized companies, called for at the beginning and end of the taxable year by any State in which they transact business, but the reserve must have been actually held as shown by the annual statement approved by the National Convention of Insurance Commissioners.

SECTION 204.—INSURANCE COMPANIES OTHER THAN LIFE OR MUTUAL.

ARTICLE 992: Gross income of insurance companies other than life or mutual.

REVENUE ACT OF 1928.

Deductions of net additions to reserve funds of insurance companies. (See I. T. 2665, above.)

SUPPLEMENT L.—ASSESSMENT AND COLLECTION OF DEFICIENCIES.

SECTION 274.—BANKRUPTCY AND RECEIVERSHIPS.

ARTICLE 1191: Bankruptcy and receiverships. XI–30–5561 Ct. D. 521

FEDERAL TAXES—BANKRUPTCY—DECISION OF COURT.

ORDER BARRING FILING CLAIM FOR TAXES DUE THE UNITED STATES.

An order of a referee in bankruptcy barring the United States from participating in the assets of the estate of a bankrupt except as to claims filed on or before a specified date is valid and an order expunging the claim of the United States for taxes assessed after that date on the ground that the claim had not been filed on or before the specified date is affirmed, but without prejudice to the right of the United States to make application for modification of the bar order so that it may file proof of claim for such taxes, which application the referee is bound to grant if there are assets on hand available to pay the taxes.

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

In the Matter of Morgenstern & Co., Bankrupt, ex parte Walter F. Carter, Trustee, appellee, v. *United States of America, appellant.*

Appeal from United States District Court for the Eastern District of New York.

[April 4, 1932.]

OPINION.

Per curiam: Morgenstern & Co. was adjudicated a bankrupt by the United States District Court for the Eastern District of New York, on April 11, 1930,

and Walter F. Carter was appointed trustee on May 6 of the same year. Upon the trustee's petition, Referee O'Connor made an order that the United States file all claims it might have against the bankrupt on or before October 11, 1930, and that it should be barred from participating in the assets of the estate except as to claims filed before that date and subsequently allowed by the referee. No claims were filed during the period provided in this order, but, on April 2, 1931, the collector of internal revenue filed with the referee a proof of claim for $3,876.31. representing income taxes for the year 1928, alleged to be due the United States from the bankrupt, and to be entitled to a preference. The United States at no time applied for the removal of the bar order or sought to open its default in failing to file the claim for income taxes on or before October 11, 1930, as provided in the order. It did allege that the order had no effect on the claim for income taxes "the origin and assessment of said liability having arisen subsequently to said bar order." In such a state of the record the trustee moved for an order expunging the claim on the ground that it had not been filed within the time provided by the order of June 16, 1930. This motion was granted by the referee and his order was affirmed by the district court upon a petition to review. From the order of affirmance, this appeal is taken.

We held *In re Anderson* (279 Fed., 525), that because of the provisions of section 64–a of the Bankruptcy Act directing the court to order trustees in bankruptcy to pay all taxes in advance of the dividends to creditors, the Government may be required to file its claim for taxes within a time fixed or otherwise to be barred from sharing in distribution of the assets in the hands of a trustee in bankruptcy. By *In re J. Menist & Co., Inc.* (294 Fed., 532 [T. D. 3563, C. B. III–1, 321]), we again approved of this practice for expediting administration. Judge Thatcher, *In re Starin* (12 Fed. (2d), 471), adverted to the rule that the liquidation of tax claims is governed by section 64–a and stated that in aid of such liquidation presentation of these claims may be required within a period even less than that allowed for ordinary claims under section 57–n, which he said has "no relation to the procedure required under section 64–a." In view of *In re Anderson*, supra, the order of the referee in the present estate barring the United States from participating in the assets except as to claims for taxes filed before October 11, 1930, was entirely valid and the motion to expunge the claim for income taxes which had not been filed within the time limited was properly granted.

It is true that under sections 274 and 275 of the Revenue Act of 1928, the Commissioner of Internal Revenue had until May 15, 1931, to make the assessment for income taxes for the year 1928. Because of this the Government says that the order requiring it to present its claim for taxes on or before October 11, 1931, could not affect its rights. But, under our construction of section 64–a of the Bankruptcy Act, the bankruptcy court, in aid of speedy administration, might limit the time within which the Government might prove its claim against the estate. If the Commissioner, because of existing exigencies, required more time to make his assessment, application should have been made to the court to modify its order so as to extend the time to file proof of claim. In default of such extension the order barring claims would protect the trustee in distributions of assets made while it stood. Any other interpretation of its effect would enable the Government to take its time in presenting claims for taxes and would thus destroy the very advantages which orders limiting the time to file tax claims have been designed to prevent.

The Government also contends that the order barring it from filing claims for taxes after October 11, 1930, and from sharing in the assets of the estate except as to claims so filed, does not affect assets still undistributed. But we know nothing about the extent or even the existence of such undistributed assets. It may be that assets have already been distributed to creditors by way of dividends which ought to have been retained for other purposes if the estate was to be subject to the deduction of the income taxes in question. While counsel say that there are still undistributed assets, we ought not to go on mere general statements which are not of record and, without definite facts ought not to treat the proof of claim as an application for a modification of the so-called "bar order."

In *Employers Liability Assur. Corp.* v. *Astoria Mahogany Co.* (6 Fed. (2d), 945) we held that the refusal to permit the filing of a claim in an equity receivership after the termination of the period fixed by a general order for

the filing of claims must be based on some prejudice arising not from the claim itself, but from the delay in presenting it. In *People* v. *Hopkins* (18 Fed. (2d), 731), where also the administration was in equity, and not in bankruptcy, we held that an order limiting the time within which to present claims should be modified so as to allow the State of New York to present a claim for taxes after the original time prescribed in the bar order. Judge Swan, who wrote the opinion, said that:

"The effect of such so-called bar order is merely to protect the receiver in making the distribution without regard to possible claims of creditors who have failed to file them. If before distribution is actually made, a creditor appears and satisfies the court that he is justly entitled to share in the assets on hand, his delay in presenting the claim should not bar him unless some one has been injuriously misled thereby * * *. Particularly should this be true with respect to taxes. The assets are still in custodia legis and should bear their share of the public dues despite the State's delay in asserting its claim."

Similar reasoning ought to govern the administration of estates in bankruptcy.

From the foregoing, it is evident that if an application had been made for leave to prove the tax claim here under consideration, the referee would have been bound to grant the application if there were assets on hand available to pay taxes. The right of the Government to share in any assets that may be available to pay taxes may be preserved if the order below is affirmed without prejudice to the right of the United States to apply to the bankruptcy court for modification of the order of June 16, 1930, so that it may file proof of claim and receive payment so far as any assets remaining undistributed may be properly applicable.

The order is affirmed but without prejudice to the right of the United States to apply to the district court for its modification of the order of June 16, 1930.

ARTICLE 1191: Bankruptcy and receiverships.

XI–41–5765
Ct. D. 583

FEDERAL TAXES—REVISED STATUTES—DECISION OF COURT.

RECEIVERSHIP—TAXES—PRIORITY OVER STATE TAXES.

Under section 3466, Revised Statutes, the United States is entitled to priority in the payment of Federal taxes over claims of the State of New York for taxes even though the latter were a general lien, provided by a State statute, upon the property of the insolvent at the time receivers were appointed.

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

North River Coal & Wharf Co., complainant, v. *McWilliams Bros., Inc., defendant.*

Ex parte The People of the State of New York, appellant, v. *Mark W. Maclay and Charles E. McWilliams, Receivers of McWilliams Bros., Inc., and United States of America, appellees.*

[June 13, 1932.]

OPINION.

AUGUSTUS N. HAND, Circuit Judge: The question raised by this appeal is whether under section 3466 of the United States Revised Statutes claims of the United States for unpaid income taxes and for damages are entitled to priority over claims of the State of New York for franchise taxes and taxes for gross earnings. The United States and the State of New York each presented its claims to receivers who had been appointed upon the filing of a creditors' bill alleging that the assets of McWilliams Bros., Inc., exceeded its liabilities and praying for the appointment of a receiver, and upon an answer admitting the allegations of the bill and joining in the prayer for relief. The district court awarded priority to the United States.

The "consent receivership" in this case was in effect a "voluntary assignment." Under the decisions, the order appointing the receivers gave the United

States priority over general creditors of the insolvent estate by virtue of section 3466 of the Revised Statutes. (*Price* v. *United States*, 269 U. S., 492 [T. D. 3820, C. B. V–1, 318]; *United States* v. *Butterworth Corporation*, 269 U. S., 504 [T. D. 3825, C. B. V–1, 321].) This priority attached when the receivers were appointed. (*United States* v. *Oklahoma*, 261 U. S., 260.) The question is whether section 3466 gives priority not only over the claims of general creditors but over the claims of the State of New York for taxes even though the taxes were liens upon the property of the insolvent at the time when the receivers were appointed. This section is in terms very sweeping. It provides that:

"Whenever any person indebted to the United States is insolvent * * * the debts due to the United States shall be first satisfied * * *."

The word "debts" has long been held to include taxes.

The State of New York relies upon the decision of the Supreme Court in *Marshall* v. *New York* (254 U. S., 380), which gave the State, by virtue of its sovereign prerogative, a priority over the general creditors of an insolvent that had been placed in the hands of a receiver. It says that, as this prerogative right was never ceded to the Federal Government by the Constitution, it avails as much against the United States as against private creditors. But the right of the United States depends upon its delegated power under the Constitution "to pass all laws necessary for carrying into execution the express power to levy and collect taxes and duties." (*Price* v. *United States*, 269 U. S., 492.) It is consequently paramount whenever exercised by statute.

The question of the extent of the State's prerogative recently came before the Supreme Court in *Spokane County* v. *United States* (279 U. S., 80). There taxes had been assessed against the personal property of a corporation by two counties in the State of Washington and afterwards a receiver of its assets was appointed who sold the property and reduced it to cash. The Supreme Court of Washington, from which the appeal lay, had held that under the law of that State the liens of the counties for the taxes assessed before the receiver was appointed had not been made specific. After the appointment of the receivers the Commissioner of Internal Revenue assessed income taxes against the corporation for years prior to the date of the receivership. The funds in the hands of the receivers were, as in the present case, insufficient to pay in full the claims of the United States and those of the counties. The court, per Taft, C. J., held that the taxes due the United States were entitled to payment by the receiver in priority to claims for county taxes that were not supported by a specific lien acquired prior to the appointment of the receiver. But he expressly reserved the question as to whether the taxes due the United States would have had priority if liens therefor had been perfected under the laws of the State prior to the receivership and cited the decision of the Supreme Court of Washington in *Wilberg* v. *Yakima County* (132 Wash., 219), where it was held that if a tax is to be collected from personal property "it does not become a lien upon such property until it has been seized and distributed by the sheriff * * *." He emphasized the broad scope of the taxing power of the United States, referred to the decisions of the Supreme Court in *United States* v. *Fisher* (2 Cranch., 358); *Field* v. *United States* (9 Pet., 182); *Lane County* v. *Oregon* (7 Wall., 71); *United States* v. *Snyder* (149 U. S., 210), and other cases, and, after discussing the authorities, went on to say (at page 93):

"The foregoing citations certainly make it clear that the United States has power, in order to collect its taxes and its revenues and debts due it, to confer priority for them over those of the States."

Since the decision in *Spokane* v. *United States* there can be no doubt that the United States should be awarded priority here, unless the taxes due the State of New York can be regarded as supported by a sufficient lien to give them a preference over claims of the United States in spite of R. S. section 3466.

Counsel for the State of New York attempted to distinguish *Spokane County* v. *United States* on the ground that section 197 of the New York tax law provides that a franchise or gross earnings tax "shall be a lien upon and bind all the real and personal property of the corporation * * * until the same is paid in full," whereas the statute of the State of Washington before the court in the Spokane case was construed as imposing no effective lien prior to the taking of subsequent proceedings to enforce it. But section 197, as it read when the New York taxes in the case at bar became payable, did not specify when the tax lien would arise and section 201 provided that upon the

issue of a warrant by the tax commission commanding the sheriff to levy and sell the real and personal property of the taxpayer for delinquent taxes "such warrant shall be a lien upon and bind the real and personal property of the * * * corporation against which it is issued from the time an actual levy shall be made by virtue thereof." It might have seemed to result from these two sections (when read together) that the lien for State taxes only arises when a levy is made by the sheriff. But in *New York Terminal Co.* v. *Gaus* (205 N. Y., 514) a majority of the New York Court of Appeals held that section 197 imposed a lien for taxes which was superior to a mortgage. It is true that when *New York Terminal Co.* v. *Gaus* was decided section 197 provided that the taxes should "be a lien upon and bind all the real and personal property" of the corporation "*from the time when it is payable until the same is paid in full,*" and that by amendment subsequent to that decision section 197 was changed so that the words "from the time it is payable" were omitted. Thus when the franchise and gross earnings tax now before us accrued, section 197 had ceased to contain the words "from the time it is payable" and only provided that such a tax should be a lien "until the same is paid in full." Accordingly it might have been argued that, by the amendment, words in section 197 stating when the lien was to arise had purposely been omitted so as to leave section 201 to define the time. But the difficulty with this is that a similar contention was made in *Carey* v. *Keith, Inc.* (250 N. Y., 219), and the Court of Appeals there held that such an omission did not affect the time when the lien arose.

While it is clear that in the present case the taxes due the State of New York prior to the receivership were a general lien upon the real and personal property of the defendant at the time when the receivers were appointed, the question is not whether these taxes are statutory liens of some sort, but whether they are such liens as the courts of the United States have recognized as entitled to priority over claims due the Government.

The Supreme Court appears to have given priority to the Government under section 3466 or similar statutes in all cases except where the legal title of the taxpayer has been in some measure divested before the tax or other indebtedness became due. In *Thelusson* v. *Smith* (2 Wheat., 396), debts due the United States were given precedence over the lien of a judgment-creditor who had not levied an execution against the property of the debtor. Justice Washington said, at page 426:

"If * * * before the right of preference has accrued to the United States, the debtor has made a *bona fide* conveyance of his estate to a third person, or has mortgaged the same to secure a debt, or if his property has been seized under a fi. fa., the property is divested of the debtor, and can not be made liable to the United States. A judgment gives to the judgment-creditor a lien on the debtor's lands, and a preference over all subsequent judgment-creditors. But the Act of Congress defeats this preference, in favor of the United States, in cases specified in the sixty-fifth section of the Act of 1799."

At common law a real estate mortgage gave the mortgagee title subject only to an equity of redemption and a chattel mortgage divested the mortgagor's title in the same way. The Supreme Court accordingly treated the title as no longer in the estate of the mortgagor and gave Government taxes priority only over interests in the equity of redemption. (*Conard* v. *Atlantic Ins. Co.*, 1 Pet., 386; *Brent* v. *Bank of Washington*, 10 Pet., 596.) It was apparently this view of the divesting of the legal title that led the Supreme Court to subordinate Government taxes to mortgages in days when the legal title was generally regarded as in the mortgagee. It was reiterated by Justice Gray in *Savings Society* v. *Multnomah County* (169 U. S., 428), where he said:

"This court has always held that a mortgage of real estate, made in good faith by a debtor to secure a private debt, is a conveyance of such an interest in the land, as will defeat the priority given to the United States by Act of Congress in the distribution of the debtor's estates. * * *"

In view of the sweeping provisions of R. S. section 3466 it seems unlikely that it was intended to allow the mere statutory declaration by a State of a general lien to give the latter a preference over debts and taxes due the Government. Neither the decisions of the Supreme Court nor the specified priorities allowed third parties under R. S. section 3186 indicate that section 3466 is subject to any such limitation. We hold that the court below properly awarded priority to the United States.

The State contends that a portion of the franchise and gross earnings taxes (amounting to $238.26) which accrued *after* the appointment of the receivers

should be given priority as expenses of administration of the insolvent estate. In *McGregor* v. *Johnson* (39 Fed. (2d), 574) we allowed taxes on land accruing after the appointment of the receivers as a part of such administration expenses, but we did not pass on whether franchise taxes accruing during the receivership should be so treated. This question was not raised by the assignments of error, which only claim priority of the taxes as a whole by virtue of the State's sovereignty. We accordingly shall not review the decision of the trial court as to this matter. See *Spokane* v. *United States* (279 U. S., 85).

The order is affirmed.

SUPPLEMENT O.—OVERPAYMENTS.

SECTION 322.—REFUNDS AND CREDITS.

ARTICLE 1257: Limitations upon the crediting and refunding of taxes paid.

REVENUE ACT OF 1928.

Erroneous credit of an overpayment for one year against deficiencies barred from collection. (See Ct. D. 592, page 147.)

TITLE IV.—ADMINISTRATIVE PROVISIONS.

SECTION 606.—CLOSING AGREEMENTS.

ARTICLE 1301: Closing agreements relating to tax liability in respect of internal-revenue taxes. XI-27-5535 Ct. D. 509

FEDERAL TAXES—REVENUE ACT OF 1928—DECISION OF COURT.

CLOSING AGREEMENT—FRAUD.

Where, for the purpose of deceiving the creditors and stockholders of a corporation, the president and treasurer of the corporation make a return for the corporation which falsely shows net income instead of a loss and, without knowledge that the facts were other than as they appeared in the return and on the audit of the same, the tax thereon is received and a closing agreement executed in accordance with section 606 of the Revenue Act of 1928, there is no fraud within the meaning of subdivision (b) of that section that operates to make ineffectual the closing agreement as a bar to a suit to recover any part of the tax covered by the agreement.

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT.

D. W. Johnston, as Trustee in Bankruptcy of the Estate of DuPont Milling & Sales Corporation, Bankrupt, appellant, v. *John P. McLaughlin, Collector of Internal Revenue, appellee.*

Appeal from the District Court of the United States for the Northern District of California, Southern Division.

[February 8, 1932.]

OPINION.

WILBUR, C. J.: This is an action to recover taxes paid by the DuPont Milling & Sales Corporation upon its income for the year 1927, brought by its trustee in bankruptcy. The district court rendered judgment in favor of the defendant. Plaintiff appeals.

In the tax return for the company for the year 1927 its net income was stated to be $12,448.72. The tax thereon estimated by the taxpayer was $1,410.58. The tax was paid by the company and thereafter a closing agreement was executed by the company and the collector[1] and approved by the Secretary of the Treasury of the United States, all in accordance with the provisions of section 606 of the Revenue Act of 1928. It is provided that the agreement thus made—

"shall be final and conclusive, and, except upon a showing of fraud or malfeasance, or misrepresentation of a material fact—

* * * * * * *

"(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 is clear that under this statute the taxpayer can not recover the tax paid upon a tax liability thus agreed upon unless expressly authorized by said section 606 of the Revenue Act of 1928. This is conceded by the appellant and is so well settled by the decisions of the courts that a discussion of the matter is entirely unnecessary. (By the Court of Claims: *Lloyd-Smith* v. *United States*, 44 F. (2d), 990; *Parish & Bingham Corporation* v. *United States*, 44 F. (2d), 993; *Bankers Reserve Life Co.* v. *United States*, 42 F. (2d), 313 [Ct. D. 209, C. B. IX–2, 257]; *Aetna Life Ins. Co.* v. *Eaton* (C. C. A. 2), 43 F. (2d), 711 [Ct. D. 225, C. B. IX–2, 263].) These cases all arose under section 1106(b) of the Internal Revenue Act of 1926, but the principles therein established are applicable to the corresponding section (606) of the Revenue Act of 1928 (45 Stat., 874). Appellant, however, contends that there was fraud perpetrated within the meaning of subdivision (b) of section 606, and therefore the closing agreement does not bar a recovery of the tax paid. Appellant's contention is based upon a somewhat unusual situation. It is stipulated that although the report by the taxpayer showed a net income of $12,448.72 upon which a tax of $1,410.58 was justly due, that the return of the taxpayer was false in that during that year the corporation suffered a loss instead of a taxable gain.

It is claimed that this false return is made by the president, Paul A. DuPont, and the treasurer, W. P. Thompson, for the purpose of deceiving the creditors and stockholders of the corporation. The closing agreement was executed on behalf of the taxpayer by the vice president of the taxpayer corporation, Ralph D. Wilson. It is stipulated that the books of the corporation were intentionally prepared and kept under the direction of the president of the corporation, who owned and controlled the majority of its corporate stock, for the purpose of concealing the fact that the corporation suffered a net loss for the year 1927, that the income tax return was prepared for the purpose of deceiving the stockholders and creditors who were not acting in collusion with the president; that the Commissioner of Internal Revenue caused the books of the corporation to be examined and therefrom ascertained the income of the corporation to be in accordance with the return of the taxpayer, and thereupon prepared the closing agreement "without knowledge that the facts were other than as they appeared in the return and on the audit"; that the payment of the tax was received by the collector of internal revenue with no knowledge that the facts were other than as reported in the taxpayer's return. It is stipulated that they are now creditors of the corporation who were such at the time of the payment of the tax.

It is a fundamental principle of law that no person can take advantage of his own wrong. The appellant here bases his action upon the wrong committed by the DuPont Milling & Sales Corporation acting through its duly appointed officers. This can not be done. If an individual taxpayer had made the tax return showing an income never actually received for the purpose of deceiving his present or prospective creditors, he could not be heard to urge in a suit against the Government that he had made a false return in order to defraud his creditors. The rule is the same with reference to a corporation. The claim is here that the corporation for the purpose of deceiving its creditors made a false return to the Government. To claim that this fraudulent purpose was also directed toward deceiving the stockholders of the corporation does not

[1] The term "collector" apparently inadvertently used, as final agreement was signed by the Commissioner, as provided by law.

alter the fact that the trustee in bankruptcy is here asserting the rights of the corporation and not of the creditors or the stockholders. Indeed, so far as the stockholders are concerned in view of the insolvency of the corporation it is doubtful if they have any interest in the outcome of this litigation, but whether they have or not is entirely immaterial.

Judgment affirmed.

ARTICLE 1301: Closing agreements relating to tax liability in respect of internal revenue taxes. XI-32-5594 Ct. D. 528

FEDERAL TAXES—REVENUE ACT OF 1928—DECISION OF COURT.

CLOSING AGREEMENT—MISREPRESENTATION.

A misrepresentation made to a taxpayer by a person not an agent of the United States is not a misrepresentation within the meaning of subdivision (b) of section 606 of the Revenue Act of 1928 that operates to make ineffectual a closing agreement as a bar to a suit to recover any part of the tax covered by the agreement.

COURT OF CLAIMS OF THE UNITED STATES. No. L-326.

Virginia Trotter Hyde v. *The United States.*

[June 6, 1932.]

OPINION.

GREEN, Judge, delivered the opinion of the court.

The plaintiff brings this suit alleging that she has overpaid her taxes for the year 1927 in the sum of $1,788.86, which she asks be refunded.

It appears from the evidence that the plaintiff has executed what is commonly called a "closing agreement" with reference to her taxes for the year 1927, stipulating the liability thereon, which agreement was executed in accordance with the provisions of section 606 of the Revenue Act of 1928, and signed by the Commissioner of Internal Revenue and the Secretary of the Treasury in March, 1929. The law provides that such agreements shall be final and conclusive, "except upon a showing of fraud or malfeasance, or misrepresentation of a material fact." The argument made on behalf of plaintiff is to the effect that the amount of gain and profit received or due plaintiff from her father's estate was misrepresented to her by the trustees thereof, that by reason of this misrepresentation she overstated her income, and that consequently she is entitled to repudiate the agreement.

The statute does not expressly limit the misrepresentations upon which the agreement may be set aside to statements made by the agents of the Government, but a reading of the context shows plainly that the statute was not intended to apply to misrepresentations made by other parties.

This construction of the law makes it unnecessary to consider the other defenses set up by the defendant. The plaintiff's petition must be dismissed, and it is so ordered.

ARTICLE 1301: Closing agreements relating to tax liability in respect of internal revenue taxes. XI-41-5770 Ct. D. 581

(Also Section 23(c), Article 151.)

INCOME TAX—REVENUE ACT OF 1928—DECISION OF COURT.

1. CLOSING AGREEMENT—FINALITY—ADVICE OF REVENUE AGENT.

Proof that a person is prevented from taking a deduction by the advice of a revenue agent is not "a showing of fraud or malfeasance or misrepresentation of a material fact" which deprives of finality and conclusiveness a closing agreement under section 606 of the Revenue Act of 1928.

2. DEDUCTION—NEW YORK CORPORATE FRANCHISE TAX.

The corporate franchise tax paid to the State of New York for the year ended October 31, 1929, accrues in 1928 and not having been paid in 1929 is not deductible from gross income in 1929, under section 23(c) of the Revenue Act of 1928, as a tax paid or accrued in that year.

UNITED STATES DISTRICT COURT, SOUTHERN DISTRICT OF NEW YORK.

The Bell Syndicate, Inc., plaintiff, v. *Frank C. Bowers, as Executor of the Estate of Frank K. Bowers, Deceased, defendant.*

[June 2, 1932.]

OPINION.

GODDARD, District Judge: As the complaint now stands it must be dismissed. The allegations in the paragraph "Twelfth" of the complaint are not, in my opinion, broad enough to include proof of the facts necessary under section 606, subdivision (b), of the Revenue Act of 1928 which the plaintiff must rely upon. However, if the plaintiff is in a position to amend its pleading by setting up "fraud or malfeasance or misrepresentation of a material fact" so as to bring the case within said section 606, subdivision (b), it may do so; but an allegation to the effect that the taxpayer was prevented from taking the deduction of 1928 by the advice of the revenue agent would not be sufficient. (*Darling* v. *Commissioner of Internal Revenue*, 49 Fed. (2d), 111.) The plaintiff can not recover a refund for 1929 for section 23(c) allows as deductions only "taxes paid or accrued within the taxable year." The New York State franchise tax concededly was not paid during the year 1929 and under the rule laid down by the Supreme Court in *New York* v. *Jersawit* (263 U. S., 493), such a tax is regarded as accruing in 1928.

Accordingly the motion to dismiss the complaint is granted unless the plaintiff serves an amended complaint within 10 days. Settle order on notice.

SECTION 607.—EFFECT OF EXPIRATION OF PERIOD OF LIMITATION AGAINST UNITED STATES.

SECTION 607. XI-29-5552
Ct. D. 516

FEDERAL TAXES—REVENUE ACTS OF 1924 AND 1928—DECISION OF COURT.

1. CREDIT OR REFUND—OVERPAYMENT—WAIVER—MEANING OF "UNTIL" IN WAIVER.

Where the Commissioner and the taxpayer consent in writing to the assessment of a tax after the prescribed statutory period for its assessment and "until December 31, 1925," the word "until" is used as a word of inclusion and a payment made on that date is not an overpayment within the meaning of section 607 of the Revenue Act of 1928.

2. CREDIT OR REFUND—OVERPAYMENT—DATE OF PAYMENT BY CHECK.

The date of the receipt of an uncertified check in payment of a tax and not the date the check is cashed is the date the tax is paid within the meaning of section 607 of the Revenue Act of 1928.

3. WAIVER—ASSESSMENT—COLLECTION.

A consent in writing by the Commissioner and the taxpayer to the assessment of a tax after the prescribed statutory period contemplates also the collection of the tax and waives the bar of the statute as to the collection thereof.

DISTRICT COURT OF THE UNITED STATES FOR THE DISTRICT OF DELAWARE.

Remington Rand, Inc., plaintiff, v. *The United States, defendant.*

[April 4, 1932.]

OPINION.

NIELAS, J.: This is a suit by Remington Rand, Inc., a corporation of Delaware, against the United States under section 607 of the "Revenue Act of 1928" (26 U. S. C. A., section 2607; 45 Stat., 874) seeking to have refunded $30,079.39 additional income and profits taxes for the calendar year 1918, with interest, alleged to have been paid after the statute of limitations had barred collection of the taxes.

Section 607 of that Act provides:

"Any tax (or any interest, penalty, additional amount, or addition to such tax) assessed or paid (whether before or after the enactment of this Act) 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."

As this section is part of a tax law giving to taxpayers the right to secure refund of payments that are barred, "it is to be construed liberally in favor of the taxpayers to give the relief it was intended to provide." (*Bonwit Teller & Co.* v. *United States*, 283 U. S., 258, 263 [Ct. D. 334, C. B. X–1, 328].) However, the Supreme Court has also laid down the rule that, "The presumption is that taxes paid are rightly collected upon assessments correctly made by the Commissioner, and in a suit to recover them the burden rests upon the taxpayer to prove all the facts necessary to establish the illegality of the collection." (*Niles Bement Pond Co.* v. *United States*, 281 U. S., 357, 361 [Ct. D. 185, C. B. IX–1, 295]; *Phillips* v. *Dime Trust & S. D. Co.*, 284 U. S., 160, 167 [Ct. D. 426, C. B. X–2, 420].)

The period of limitation applicable to the assessment and collection of these taxes is prescribed in section 250(d) of the Revenue Act of 1921 which provides:

"The amount of income, excess-profits, or war-profits taxes due under any return made under this Act * * * for prior taxable years or under prior income, excess-profits, or war-profits tax Acts, * * * shall be determined and assessed within five years after the return was filed, unless both the Commissioner and the taxpayer consent in writing to a later determination, assessment, and collection of the tax."

The pertinent facts have been admitted by the stipulation of the parties. In 1927 Remington Rand, Inc., acquired by merger all of the assets of the Kalamazoo Loose-Leaf Binder Co. On June 16, 1919, the Kalamazoo company filed an income and profits tax return for the calendar year 1918 and paid the tax shown thereon in the year 1919. In January, 1924, the Kalamazoo company signed and filed an income and profits tax waiver for the year 1918, extending the statutory period of limitations for one year. In March, 1924, an additional assessment for the taxable year 1918, including the tax here in question, was made. In February, 1925, a second income and profits tax waiver was filed by the Kalamazoo company extending the statutory period of limitations on "assessment" of taxes until December 31, 1925. In December, 1925, the collector of internal revenue issued to the Kalamazoo company a notice and demand to pay the additional tax of $30,079.39 and interest of $3,158.34. On December 31, 1925, the Kalamazoo company delivered to the collector of internal revenue a check for $33,237.73 in payment of the additional assessment and interest demanded. Thereafter a claim for refund was duly filed asserting as a ground for the claim that the taxes were collected after the statute of limitations had barred collection. In March, 1930, the Commissioner of Internal Revenue rejected the claim.

In brief, the taxpayer filed his income and war-profits tax return for 1918 on June 16, 1919, and paid the tax shown on the return. The statute of limitations on the collection of these taxes was five years and expired June 16, 1924, in the absence of a waiver. In March, 1924, an assessment of additional taxes for 1918 was made against the taxpayer. In February, 1925, the taxpayer and the

Commissioner consented in writing to a later collection of the additional taxes by extending the statutory period of limitations on the "assessment" of taxes until December 31, 1925. On that day the taxpayer delivered to the collector an uncertified check for the amount demanded by him and the check was paid several days later by the bank on which drawn.

The plaintiff claims the right to have the amount paid to the collector refunded on three grounds. (1) That the check, if deemed payment, was delivered after the bar of the statute of limitations became effective and the day after the expiration of the period plaintiff had consented to waive the bar. (2) That plaintiff waived the bar of the statute of limitations to the "assessment" of taxes and not to their collection. (3) That the delivery of an uncertified check on December 31, 1925, was not payment within the period covered by the waiver, as payment occurred several days afterwards when the bank on which the check was drawn paid it.

Plaintiff contends that the waiver by its express terms expired at midnight on December 30, 1925, and that the tax was therefore collected after the running of the statutory bar of limitations. The merit of this contention turns on the construction to be given to the word "until" as used in the waiver. Is it used as a word of inclusion or exclusion? No specific meaning attaches to the word. Whether "until" imports inclusion or exclusion is to be determined by the intention of the parties as gathered from the facts and circumstances and the context of the writing. In internal revenue matters the taxable period usually covers the calendar year and includes December 31. Where the Commissioner and taxpayer use that day in a waiver it is reasonable to assume that they also use it inclusively as in tax returns. Light is thrown on the meaning of the word "until" as used in the waiver by the words "and shall then expire" immediately following. Webster defines "then" as meaning "at that time (referring to a time specified)." In the waiver the time specified is December 31, 1925. It is clear, therefore, that the waiver did not expire at midnight on the 30th day of December, 1925, but included the whole of December 31.

The second contention of the plaintiff is unsound. The parties to the waiver can not have intended to have the time for *assessing* the tax postponed and not the time for *paying* the tax also postponed. Postponing assessment includes postponing collection. (*Stange* v. *United States*, 282 U. S., 270, 277 [Ct. D. 274, C. B. X–1, 414]; *Washington Coal & Coke Co.* v. *Heiner*, 42 Fed. (2d), 681, 685, affirmed (C. C. A. 3) 55 Fed. (2d), 229 [Ct. D. 216, C. B. IX–2, 249]; *Solomon* v. *Heiner*, 43 Fed. (2d), 592.)

Plaintiff's remaining contention that payment can not be made by an uncertified check on the date of its delivery is conclusively answered by the Act of Congress (26 U. S. C. A., section 110) and the proof in this case that the check was honored. (*Second Nat. Bank* v. *United States*, 42 Fed. (2d), 344.)

The plaintiff is not entitled to have the tax and interest refunded.

SECTION 607. XI–41–5771
Ct. D. 582

FEDERAL TAXES—REVENUE ACT OF 1928—DECISION OF COURT.

COMPROMISE AGREEMENT—VALIDITY—COLLECTION BARRED.

Where after paying a deficiency the taxpayer's offer is accepted in compromise of a penalty and interest on the deficiency which recites that the deficiency was paid "without recourse," the deficiency is made a part of the agreement and the taxpayer is precluded from maintaining a suit for the recovery of any part of the deficiency or the amount paid in compromise. The compromise is not invalid because collection of the tax, penalty, and interest was barred by the statute of limitations at the time paid and compromised, the taxpayer and the Commissioner, through a misconstruction of the law, believing that the right to collect was not barred, and section 607 of the Revenue Act of 1928 requiring the refund of a tax, penalty, or interest paid after the expiration of the applicable period of limitation does not apply in a case where they were the subject of a compromise agreement.

COURT OF CLAIMS OF THE UNITED STATES. No. L–491.

Heber Hord v. *The United States.*

[June 6, 1932.]

OPINION.

LITTLETON, Judge, delivered the opinion of the court.

The question in this case is whether the plaintiff may maintain this action to recover an additional tax for 1918 of $3,962.38 paid April 6, 1927, and $729.73, offered and accepted April 12, 1927, in compromise of a 5 per cent penalty of $198.12 and interest of $1,439.45 on the deficiency, or either of such amounts.

It is urged by the plaintiff, first, that there was no valid compromise since collection of the deficiency, penalty, and interest was barred by the statute of limitation at the time payment was made; second, that the deficiency in tax was not a part of the compromise, and that the statement in the offer that the tax had been paid "without recourse" was without significance; third, that the amount paid in compromise of the penalty and interest is also refundable, inasmuch as liability for the tax was extinguished before the offer in compromise of the penalty and interest was made and the amount thereof paid in 1927; and, fourth, that since the tax and interest in question were paid after being barred they must be refunded under section 607 of the Revenue Act of 1928 regardless of the compromise agreement.

We are of the opinion that the offer of compromise and its acceptance by the Commissioner, with the approval of the Secretary of the Treasury, finally closed the case, and that plaintiff may not maintain this action to recover the additional tax or the amount paid in lieu of the penalty and interest. The additional tax of $3.962.38 was made a part of the compromise agreement, in which the plaintiff stated that he had paid this tax "without recourse." It is evident from the language of the offer in compromise that its acceptance by the Commissioner was conditioned upon payment of the tax without recourse; the plaintiff's agreement in that regard having become a part of the contract, it must be given effect. (*Hennessy* v. *Bacon*, 137 U. S., 78, 85; *Ely & Walker Dry Goods Co.* v. *United States*, 34 Fed. (2d), 429 [Ct. D. 102, C. B. VIII–2, 343]; *Parish & Bingham Corporation* v. *United States*, 44 Fed. (2d), 993; *Zemurray* v. *United States*, 64 C. Cls., 657; *Herbert DuPuy* v. *United States*, 67 C. Cls., 348 [Ct. D. 99, C. B. VIII–2, 337]; *Lyons* v. *Fitzpatrick*, 52 La. Ann., 697, 26 So., 110.) In *Hennessy* v. *Bacon*, supra, which involved a compromise, it was stated that "Such a settlement ought not to be overthrown, even if the court should now be of the opinion that the party complaining of it surrendered rights that the law, if appealed to, would have sustained."

We are unable to agree with the plaintiff that the compromise was invalid because collection of the tax, penalty, and interest was barred at the time paid and compromised. Both plaintiff and the defendant considered that under section 278 of the Revenue Act of 1924 the Government had six years from the date of the timely assessment in March, 1924, within which to make collection. Plaintiff now insists that the demand of the Government was wholly without legal right and was not disputable. We can not agree that the matters made the subject of the compromise were not disputable.

At the time of the compromise the highest courts passing upon the question of the Government's right to collect had held, in such cases, that when the limitation period for assessment expired after the date of the enactment of the Revenue Act of 1924 and assessment of the tax had been timely made, the Government had six years from the date of the assessment in which to enforce collection. In November, 1927, this conclusion was reached by the Circuit Court of Appeals, Fifth Circuit, in *Russell et al.* v. *United States* (22 Fed. (2d), 249 [T. D. 4107, C. B. VI–2, 133]). The question was not settled until January 2, 1929, by the decision in the case of *Russell et al.* v. *United States* (278 U. S., 181 [T. D. 4260, C. B. VIII–1, 206]).

In *Chicago Railway Equipment Co.* v. *Burnet* (282 U. S., 295 [Ct. D. 276, C. B. X–1, 323]) the court said:

"Whether or not the Commissioner would have been liable to the taxpayer for a collection made as the result of a jeopardy assessment in 1925, we need not determine. He clearly had the power to make such assessment and thereby compel the filing of a claim for abatement and the giving of a bond, or, if such claim and accompanying bond were not filed, to make collection and relegate respondent to an action at law. In the absence of a determination that this

deficiency was barred, it was the Commissioner's duty to proceed to insure the assessment and collection of the tax * * *."

The fact that the parties misconstrued the law did not render the compromise invalid.

Plaintiff insists that section 607 of the Revenue Act of 1928 specifically requires the refund of any tax, interest, or penalty paid after the period of limitation properly applicable thereto, if a timely claim is filed. We are of opinion, however, that this section does not apply in a case where the tax, penalty, and interest, paid after the expiration of the period of limitation, were the subject of a compromise agreement.

Plaintiff urges that if the compromise of April 12, 1927, included the settlement of the additional tax, the first compromise of the penalty for delinquency, July 28, 1921, also included the settlement of the tax liability for 1918 and that the Government was thereafter precluded from assessing and collecting any additional tax, penalty, and interest. The record, however, does not justify this conclusion. Plaintiff filed a claim for abatement specifically against the penalty for failure to file a return within the time required. He was advised that the claim would be rejected but that he had the privilege of submitting an offer of $5 in compromise of the penalty. Accordingly, an offer in that amount was submitted in lieu of the penalty of 25 per cent of the tax assessed upon the return, which offer was accepted and the penalty was abated. No investigation and audit of the return had been made, and nothing was said in the offer or in the acceptance thereof to indicate that either party intended finally to settle the tax liability.

The petition must be dismissed. It is so ordered.

SECTION 609.—ERRONEOUS CREDITS.

SECTION 609. XI–38–5699
Ct. D. 562

INCOME TAX—REVENUE ACT OF 1928—DECISION OF COURT.

1. CREDIT AGAINST BARRED DEFICIENCY—OVERPAYMENT.

A credit of an overpayment for one year against a deficiency for another year the collection of which is barred by the statute of limitations when the credit is made is void under section 609 of the Revenue Act of 1928 and there is no collection of the deficiency by such credit and no overpayment of the amount so credited within the meaning of section 607 of the Revenue Act of 1928.

2. SUITS—LIMITATION—ACCOUNT STATED.

A suit to recover an overpayment of tax grounded upon an account stated in a certificate of overassessment is barred by section 1069, Revised Statutes, if instituted more than six years after the accrual of the cause of action which arose upon delivery to the taxpayer of the certificate of overassessment.

COURT OF CLAIMS OF THE UNITED STATES. No. L–242.

Parks & Woolson Machine Co. v. *The United States.*

[May 31, 1932.]

OPINION.

LITTLETON, Judge, delivered the opinion of the court.

This suit is for the recovery of a tax for 1917 alleged to have been collected by credit at a time when collection was barred by the statute of limitation. Plaintiff claims that an overpayment of tax for 1918 applied on April 24, 1924, as a credit to an additional tax for 1917 assessed in March, 1923, was a collection of the 1917 deficiency out of time; that the Commissioner having disallowed its claim for refund of the 1917 deficiency, it should have judgment for the principal of the tax so collected by credit, with interest.

The defendant insists that there was no collection of the 1917 deficiency, either by cash or credit, for the reason that the credit, by which the Commis-

sioner attempted to collect the 1917 deficiency, was void under section 609 of the Revenue Act of 1928. When the Commissioner signed the schedule of overassessments March 5, 1924, for 1918, he believed that his action was a lawful collection by credit of the 1917 deficiency. This action was timely. The Commissioner, however, did not sign the schedule of refunds and credits until April 24, 1924. Since the credit in this case was taken April 24, 1924, the action was not timely. (*United States* v. *Swift & Co.*, 282 U. S., 468 [Ct. D. 290, C. B. X–1, 283]; *United States* v. *Boston Buick Co.*, 282 U. S., 476 [Ct. D. 293, C. B. X–1, 335].) The attempted collection of the 1917 tax by credit was void and of no effect under section 609 of the Revenue Act of 1928, which provides:

"(a) *Credit against barred deficiency.*—Any credit against a liability in respect of any taxable year shall be void if any payment in respect of such liability would be considered an overpayment under section 607.

* * * * * * *

"(c) *Application of section.*—The provisions of this section shall apply to any credit made before or after the enactment of this Act."

Section 607, referred to in section 609, provides that "Any tax * * * assessed or paid (whether before or after the enactment of this Act) 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." See, also, Report No. 2, pages 33 and 34, Ways and Means Committee, Seventieth Congress, first session, and Report No. 960, pages 41 and 42, Senate Committee on Finance, Seventieth Congress, first session. In view of the provisions of section 609, supra, the plaintiff may not recover.

Before suit can be maintained it must appear that there has been a payment of the amount of the 1917 tax for which suit is brought. Since the credit involved in this case is void by legislative direction, it is of no effect whatsoever. It is a nullity and is as if it had not been attempted. (*United States Refractories Corporation*, 23 B. T. A., 872.)

In view of the provisions of section 609, Revenue Act of 1928, the cases relied upon by plaintiff are not controlling. That section was not applicable to the facts in *Boston Pressed Metal Co.* v. *United States* (282 U. S., 409 [Ct. D. 287, C. B. X–1, 191]), relied upon by the plaintiff. In that case recovery was denied under the provisions of section 611 of the 1928 Act. The credit involved in that case was not void. Here the credit was against a barred deficiency and has been made void by special congressional enactment.

The certificate of overassessment for the fiscal period January 1 to June 30, 1918, was issued March 24, 1924. The issuance of this certificate created an account stated in favor of the plaintiff and against the United States. (*Bonwit Teller & Co.* v. *United States*, 283 U. S., 258 [Ct. D. 334, C. B. X–1, 328].) The period of limitation within which suit could have been instituted upon the certificate of overassessment to recover the overpayment for 1918 expired March 24, 1930. This suit was not instituted until June 17, 1930, more than six years after the accrual of a cause of action to recover the overpayment for 1918. Recovery of the overpayment was barred when the suit was instituted, even if it had been grounded upon an account stated.

The petition must be dismissed. It is so ordered.

SECTION 609(a).—ERRONEOUS CREDITS: CREDIT AGAINST BARRED DEFICIENCY.

(Also Section 322, Article 1257.)

XI–44–5820
Ct. D. 592

INCOME TAX—REVENUE ACT OF 1928—DECISION OF COURT.

1. CREDIT AGAINST BARRED DEFICIENCY—OVERPAYMENT.

A credit of an overpayment for one year against a deficiency for another year the collection of which is barred by the statute of limitations when the credit is made is void under section 609 of the Revenue Act of 1928 and there is no collection of the deficiency by such credit and no overpayment of the amount so credited within the meaning of section 607 of the Revenue Act of 1928.

2. SUIT—LIMITATION.

Where a claim for credit or refund of a tax is filed within the statutory period therefor and a certificate of overassessment is issued a part of the amount of which is credited to taxes for other years at a time when the collection of the tax for the other years is barred by the statute of limitations and where no suit was begun within the specified period for beginning suit after the payment of the tax provided by section 3226 of the Revised Statutes as amended, a second claim for a refund of the amounts so credited filed after the statutory period for the filing of the same does not revive the first claim and a suit to recover the amounts so credited, begun within the 2-year period provided in that section, after the disallowance of the second claim, can not be maintained.

3. SUIT—COLLECTOR—COUNT ON ACCOUNT STATED.

A cause of action stated in a count for money due on account stated can not be maintained against a collector.

4. SUIT—COLLECTOR—OVERPAYMENT CREDITED BY COLLECTOR.

Where an overassessment is paid to the predecessor in office of a collector, an action to recover the amount of the overassessment, which is credited against a tax for another year, can not be maintained against the collector, even though the collection of the tax against which the credit is taken is barred by the statute of limitations, when the collector, pursuant to instructions of the Commissioner, entered the overpayment as a credit.

5. SUIT—REFUND—OVERPAYMENT—BURDEN OF PROOF.

Where a certificate of overassessment is issued and the Commissioner later determines that there was in fact no overpayment of the tax, in a suit to recover an alleged overpayment the burden is upon the taxpayer to establish that the Government has money justly belonging to the taxpayer. The taxpayer is not entitled to a refund unless there has been an overpayment.

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIRST CIRCUIT.

Arthur C. Harvey Co., plaintiff, appellant, v. *John F. Malley and/or Malcolm E. Nichols, Former Collectors of Internal Revenue, defendants, appellees.*

Appeal from the District Court of the United States for the District of Massachusetts.

[June 27, 1932.]

OPINION.

WILSON, J.: This is an appeal from a judgment of the District Court of Massachusetts in an action at law to recover an alleged overpayment of income taxes for the year 1918. In the first count of its declaration, the plaintiff-appellant seeks to recover of the defendants, jointly and severally, the amount of the alleged overpayment under a count of indebitatus assumpsit; it also seeks to recover of John F. Malley, a former collector of internal revenue, in a second count for money had and received, the amount of the alleged overpayment; and in a third count for money had and received, to recover of Malcolm E. Nichols, the successor of Malley as collector of internal revenue, the amount of the alleged overpayment. Malley was a collector in 1919 when the alleged overpayment occurred, and Nichols, as Malley's successor, under the direction of the Commissioner of Internal Revenue, in 1923 credited the alleged overpayment to deficiencies of prior years.

A motion was filed by each defendant to compel the plaintiff to elect on which count it would proceed, on the ground there was misjoiner of actions and also a misjoiner of parties. The motion was denied and hearing ordered on the merits.

There was a waiver of a jury trial and the case was heard by the judge without a jury. A request for findings of fact and rulings of law was made by the plaintiff, but no special findings were made nor were the requested rulings of law either made or refused, nor were any exceptions to a refusal

to rule as requested taken "in the course of the trial." So far as any rulings of law were made "in the course of the trial," with one exception they were in favor of the plaintiff, and though an exception was allowed in this instance, it is not relied upon in the assignments of error.

The plaintiff assigns as error a refusal to direct that a judgment be entered for the plaintiff; but we do not find in the record any express motion to that effect. The sixth requested ruling that the credit of $74,648.39 (being the amount of an overpayment of the 1918 taxes as determined by the Commissioner in May, 1923), to alleged underpayments for the years 1915, 1916, and 1917 constituted an overpayment for those years under sections 607 and 609 of the Revenue Act of 1928, and should be refunded to the plaintiff, does not constitute a motion to direct a judgment; since whether a judgment should have been directed for the plaintiff depended upon other considerations than whether the application of an overpayment of the 1918 taxes to 1915, 1916, and 1917 deficiencies was void and constituted an overpayment for those years under sections 607 and 609 of the Revenue Act of 1928.

It is doubtful, therefore, whether under sections 649 and 700, R. S., any question of law is raised on the record for the consideration of this court by the appellant's assignments of error. The findings of fact are general, and no rulings of the court were excepted to "during the course of the trial," which are relied on. Exceptions, following an order of judgment, to alleged rulings in a written opinion of the judge assigning reasons for ordering a judgment for either party, are not rulings in the course of the trial. (*Fleischmann Cons. Co.* v. *United States*, 270 U. S., 349; *United States* v. *Smith*, 39 Fed. (2d), 851; *Wilson* v. *Merchants' Loan & Trust Co.*, 183 U. S., 121.)

As the court said in *Fleischmann Cons. Co.* v. *United States*: "It is settled by repeated decisions, that in the absence of special findings, the general finding of the court is conclusive upon all matters of fact, and prevents any inquiry into the conclusions of law embodied therein, except in so far as the rulings during the progress of the trial were excepted to and duly preserved by bill of exceptions as required by the statute. * * * To obtain a review by an appellate court of the conclusions of law a party must either obtain from the trial court special findings which raise the legal propositions, or present the propositions of law to the court and obtain a ruling on them. * * * That is, as was said in *Humphreys* v. *Third National Bank*, supra, 655, 'he should request special findings of fact by the court, framed like a special verdict of a jury, and then reserve his exceptions to those special findings, if he deems them not to be sustained by any evidence; and if he wishes to except to the conclusions of law drawn by the court from the facts found, he should have them separately stated and excepted to. In this way, and in this way only, is it possible for him to review completely the action of the court below upon the merits.'"

Each of the assignments of error in this case relates either to matters of fact or to conclusions of law embodied in the opinion. These are not open to review, as there were no special findings of fact and no exceptions to rulings on matters of law were taken during the course of the trial and duly preserved by a bill of exceptions, and no questions of law favorable to the plaintiff are raised on the pleadings.

But assuming that the requested ruling above referred to was in effect a motion to direct a judgment for the plaintiff, and could be considered as denied, and an exception duly taken; or that the ultimate facts upon which the rights of the parties depend were agreed to, and an exception would lie to the order of judgment for the defendant, we still think the judgment of the district court must be affirmed.

The facts are: That prior to 1918 the plaintiff company had closed its books for its fiscal year on June 30, but filed its returns, as then required by law, for the years 1915, 1916, and 1917 on the basis of the calendar year. To conform to the Revenue Act of 1918, the plaintiff in March, 1919, made a return for the first six months of 1918, on which return its tax for the six months was assessed as $302,438.83, in accordance with the provisions of section 226 of the 1918 Act (40 Stat., 1075). The Commissioner abated this tax to the amount of $75,461.39, and the appellant voluntarily paid to the defendant Malley as collector in 1919 the balance of $226,977.44.

Later, in September, 1919, the appellant filed an amended return, showing income for the full fiscal year from June 30, 1917, to June 30, 1918; and took, as the tax due for the six months from December 31 to July 1, 1918, the same

proportionate part of the tax for the entire fiscal year, computed at the 1918 rates, as the portion of the fiscal year falling in 1918 was of the entire fiscal year in accordance with the provisions of section 205 of the 1918 Act (40 Stat., 1061), which resulted, according to its return, in a tax of $234,088.50.

In October, 1920, it filed a second amended return showing the tax for the six months from December 31, 1917, to July 1, 1918, to be only $127,651.08, and claimed that the tax assessed on its original return in March, 1919, was excessive to the amount of $174,787.75. No details of the original assessment, which was evidently computed in accordance with the provisions of section 226 of the 1918 Act, are furnished.

On April 9, 1923, the plaintiff, as a result of an examination of its books by an internal revenue agent, filed a claim for refund based on the internal revenue agent's report of an alleged overpayment for 1918 of $156,390.41. In this claim, however, the taxpayer recognized that there were deficiencies for the years 1915, 1916, and 1917, and assented to the application of the overpayment to deficiencies for those years, amounting to $48,563.39, leaving a balance of $107,826.61, which it claimed should be refunded. On May 7, 1923, the Commissioner, adopting the view that in changing from a calendar year to a fiscal year the tax for any fractional part of a year should be computed in accordance with the provisions of section 205 of the 1918 Act, determined that the correct tax for 1918, less the abatement already allowed, and based on the examination of the appellant's books by the revenue agent, was $146,098, and that there had been an overpayment of the taxes due from the appellant for the six months in question of $80,879.44.

In November, 1923, the Commissioner issued his certificate of overassessment for the year 1918, showing the overpayment of $80,879.44. Certificates of overassessment issued by a Commissioner contain printed instructions to the collector to pay any balance to the taxpayer, after crediting such portion of the overpayment that may be required to make good any deficiencies for previous years shown on the books of the collector.

This direction of the Commissioner was carried out by the defendant Nichols, and $2,467.06 was refunded to the appellant in cash; $3,763.99, it is agreed, was properly credited to certain underassessments for the fiscal year ending June 30, 1920; and $74,648.39 was credited to alleged deficiencies for 1915, 1916, and 1917 in the following amounts: $348.74 for 1915, $4,751.03 for 1916, and $69,548.62 for 1917. But the collection on May 23, 1923, of any additional taxes for the years 1915, 1916, and 1917 was barred by the limitation in section 250(d) of the Revenue Act of 1921; and sections 607 and 609 of the Revenue Act of 1928 declared void any application of credits made after the limitation for collection of taxes.

The appellant's declaration sets forth as a basis of its right of recovery that the Commissioner in May, 1923, allowed a refund of $74,648.39 as an overpayment of the 1918 taxes; that it was erroneously credited by the defendant Nichols to the deficiencies in the 1915, 1916, and 1917 taxes; that on April 9, 1923, the plaintiff filed a claim for a refund of $107,826.61, and on July 27, 1929, it filed another claim for a refund of the sum of $74,648.39, which the Commissioner had determined in May, 1923, in accordance with the provisions of section 205 of the 1918 Act, was the amount of the overpayment of the 1918 taxes; that the claim filed in July, 1929, was denied, and, as the appellant contends, in accordance with the provisions of section 3226, R. S., this action was brought within two years after the denial of its claim for a refund.

To avoid the objection that its suit, begun in 1930, was not brought within five years of the alleged overpayment, which was in 1919, the appellant asserts that the claim filed in 1929 was only a reassertion of its claim filed in 1923; and having filed a claim for a refund within four years of the payment of the tax, and since the claim filed in July, 1929, being a reassertion of its claim filed in 1923, was disallowed, and this action was brought within two years of the disallowance, the provisions of section 3226, R. S., were complied with.

But the claim filed in April, 1923, was allowed by the Commissioner, though for a different amount. The only ground of action the appellant had after the allowance of its claim in May, 1923, must have been either on the certificate of overassessment issued on the latter date by the Commissioner, or against the defendant Nichols personally for an erroneous application of the alleged overpayment to taxes already barred; but on the record, as will later appear, there was no overpayment of the 1918 tax, and the appellant was therefore not

harmed by the act of the defendant Nichols. In respect to Malley's liability under the first count, it is also difficult to see how his act in accepting the payment of the taxes found due by the Commissioner based on the taxpayer's own return, could expose him to any action by the taxpayer, except for money had and received in case a refund was duly claimed and denied. But a claim for a refund barred by the statute can not be revived by filing a new claim and basing an action on its denial.

If the appellant had declared as on an account stated, or a promise to pay by reason of the certificate of overassessment issued by the collector in May, 1923, as in *Bonwit Teller & Co.* v. *United States* (283 U. S., 258, 265 [Ct. D. 334, C. B. X–1, 328]), we think its action would have to be brought against the United States, as neither of the defendants had anything to do with the issuing of the certificate of overassessment or were privy to any promise therein contained, either express or implied, to refund the overpayment.

The acts performed by Malley or Nichols as collectors were ministerial (*United States* v. *Swift & Co.*, 282 U. S., 468 [Ct. D. 290, C. B. X–1, 283]), and were done in the discharge of their several duties as a collector. (*Heffernan* v. *Alexander*, 48 Fed. (2d), 855; *Penn Smokeless Coal Co.* v. *Lewellyn*, 26 Fed. (2d), 743 [T. D. 4167, C. B. VII–1, 184]; *Semple* v. *Lewellyn*, 1 Fed. (2d), 745, 748–749.) The application of credits to deficiencies of other years by a collector, as shown by his books, is of no effect until approved by the Commissioner. (*United States* v. *Swift & Co.*, supra.)

Whether or not the claim filed by the appellant in April, 1923, for a refund based on an examination of its books by an internal revenue agent, together with the claim filed on July 29, 1929, was a sufficient compliance with section 3226, R. S., on which to base an action against a collector for money had and received, or whether the application by the defendant Nichols of the alleged overpayment of the 1918 taxes to an assessment already barred must be regarded as an erroneous collection (*Graham et al.* v. *Goodcell*, 282 U. S., 409, 424 [Ct. D. 287, C. B. X–1, 191]) is really not important in this case; since to recover in such form of action the taxpayer must prove that the Government has money in its possession justly belonging to the taxpayer.

"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." (*Lewis* v. *Reynolds*, 284 U. S., 281, 283 [Ct. D. 443, C. B. XI–1, 130].)

The record shows that when the second claim for refund was filed in July, 1929, the Commissioner, apparently under advice of counsel, made a redetermination of the 1918 tax for the six months from December 31, 1917, to July 1, 1918, which he had a right to do, though he could not collect any additional tax (*Lewis* v. *Reynolds*, supra), and found that the previous assessment in May, 1923, which showed an overpayment of $74,648.39 was erroneous, the former computation having been based on section 205 of the 1918 Act.

The appellant's tax in question was for a period entirely within the year 1918; and under section 226 of the 1918 Act (40 Stat., 1075), where a change is made from a calendar year to a fiscal year, and a portion of the first tax assessed under the 1918 Act was for a fractional part of the year 1918, the tax for the period shall be computed in the manner provided and at the rate for the calendar year in which the period falls. (*Appeal of Henry D. Weed*, 2 B. T. A., 84.)

Determined under section 226, the tax assessed in 1919 on the taxpayer's original return of March, 1919, to the amount of $302,524.65, less the abatement of $75,461.39, so far as anything appears in the record, was correct, and there was, therefore, no overpayment. At least, the record does not disclose any error. The burden in such cases, in an action against a collector for money had and received, is on the plaintiff to show that the Government has money justly belonging to the plaintiff. This burden the appellant has not sustained in this case.

The statement of the deputy commissioner in his letter to the appellant in December, 1929, denying its claim filed in July, 1929, that such portion of the overassessment which has not been refunded, having been credited against tax liabilities for prior years, will not be refunded, we interpret to be merely a categorical denial of the refund claim according to its terms, and that the reason assigned for the rejection of the claim was that the alleged overassess-

ment in May, 1923, was erroneously allowed in its entirety. In other words, there was no overassessment, and therefore the refunding of that part of the alleged overassessment which was on the books of the collector applied to prior tax liabilities was denied, because no such overassessment and overpayment occurred.

The judgment of the district court is affirmed.

SECTION 611.—COLLECTIONS STAYED BY CLAIM IN ABATEMENT.

SECTION 611. XI–33–5607
G. C. M. 10792

REVENUE ACT OF 1928.

General Counsel's Memorandum 6296 (C. B. VIII–2, 152), in which it was held that section 611 of the Revenue Act of 1928 is not applicable to the case where a claim for credit of an overpayment has operated to stay the collection of an outstanding assessment, is revoked, in view of the decision by the Court of Claims in *Ralston Purina Co.* v. *United States* (58 Fed. (2d), 1065), which held the taxpayer was estopped to assert that the Government had no right to retain that portion of the 1919 overpayment equal to the additional assessment for 1918.

In General Counsel's Memorandum 6296 it was held that section 611 of the Revenue Act of 1928, relative to taxes collected after the bar of the statute where collection was stayed by the filing of a claim in abatement, may not be relied upon as a basis for disallowing a refund of amounts collected by credit pursuant to a claim for credit filed by the taxpayer.

The Court of Claims, under date of June 6, 1932, rendered its decision in the case of the *Ralston Purina Co.* v. *United States.* In that case a timely assessment of a deficiency in tax in the amount of $23,846.88 was made against the taxpayer for the taxable year 1918 prior to June 2, 1924. No claim in abatement, or formal claim for credit, was filed, but the taxpayer, on March 14, 1924, addressed a telegram to the Commissioner requesting that collection of the deficiency be withheld until an overpayment made for 1919 "is adjusted." Upon the receipt of this telegram the Commissioner authorized the collector to withhold collection of the deficiency pending receipt of the schedule of overassessments covering the overpayment made for 1919. In January, 1925, after collection of the deficiency for 1918 had become barred, the Commissioner signed the schedule showing an overassessment in favor of the taxpayer for 1919 in the amount of $68,724.90. Of the overassessment (overpayment) thus allowed, $23,846.88 was credited against the deficiency in tax due for 1918 and the balance was refunded. In the suit brought in the Court of Claims the taxpayer sought to recover the amount of the overpayment applied as a credit upon the ground that collection of the deficiency was barred at the time the credit was made. The court held that under the circumstances involved in the case the taxpayer was estopped to assert that the Government had no right to retain that portion of the 1919 overpayment equal to the additional tax due for 1918.

In view of the foregoing decision, General Counsel's Memorandum 6296, supra, is hereby revoked.

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

SECTION 611.

REVENUE ACT OF 1928.

Abatement claim rejected before expiration of limitation period for collection. (See Ct. D. 572, page 70.)

SECTION 611. XI-42-5789
Ct. D. 586

INCOME TAX—REVENUE ACT OF 1928—DECISION OF COURT.

SUIT—COLLECTION—LIMITATION—CLAIM FOR ABATEMENT—TIME OF EXPIRATION OF UNLIMITED WAIVER.

A waiver unlimited as to the time within which an assessment for 1917 taxes may be made, which by Mimeograph 3085 (C. B. II-1, 174) is held to expire April 1, 1924, does not expire before midnight on that date, and a claim for abatement of such taxes filed before midnight on April 1, 1924, is filed within the statutory period for assessment and collection as extended by such waiver and complies with the condition relative to a claim for abatement contained in section 611 of the Revenue Act of 1928, which withdraws the statute of limitations upon collection as a ground for the recovery of a tax paid under the conditions therein stated.

DISTRICT COURT OF THE UNITED STATES FOR THE EASTERN DIVISION OF THE EASTERN JUDICIAL DISTRICT OF MISSOURI.

Century Electric Co., a Corporation, plaintiff, v. *United States of America, defendant.*

[June 18, 1932.]

OPINION.

FARIS, J.: Plaintiff, a corporation, sues the United States (the collector who collected the tax being no longer in office) for the sum of $71,776.90, together with interest from July, 1925, paid, as it is alleged, after the tax was barred by the statute of limitations.

The taxes in controversy were for the year 1917. The statute ran against the collection of said taxes, unless tolled by the facts and the law when applied to such facts, which facts are not at all in dispute.

These facts I find, so far as pertinent, are as follows: The taxpayer filed its return March 30, 1918, for the excess profits or war profits tax for the year 1917. According to the applicatory statutes, as both parties seem to concede, the statute would have barred, ordinarily, collection after March 30, 1923. But on January 27, 1923, an unlimited waiver, so-called, was signed by the taxpayer and the Commissioner of Internal Revenue, wherein such parties consented 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 Century Electric Co., for the year 1917 * * * irrespective of any period of limitations."

On the 11th day of April, 1923, a general rule or regulation was promulgated by the Commissioner, wherein he undertook *ex parte* to limit, by a regulation, the date of expiration of all of the so-called unlimited waivers then on file. So far as is pertinent, this regulation provided that, "Inasmuch as there are many waivers on file signed by taxpayers, containing no limitation as to the time in which assessments for 1917 may be made, all such unlimited waivers will be held to expire April 1, 1924."

On February 7, 1924, the Commissioner wrote the taxpayer that an immediate assessment of an additional or deficiency tax of $73,342.26 for the year 1917, would be made, inclosing a complete schedule and computation for the latter year, and other years not here in controversy.

On February 25, 1924, an assessment list containing, among taxes for other years also, the tax here in question, was sent to the plaintiff. To the letter of February 7, 1924, the plaintiff, on February 15, 1924, made protest, contending that the assessment was excessive, and requested that computation of the

taxes for 1917 be made under the special relief provisions of section 210 of the Revenue Act of 1917.

On March 21, 1924, the collector gave notice by mail to the plaintiff, that he held this tax for collection. Plaintiff thereafter, and on March 28, 1924, wired the Commissioner that it had not "received full benefits of section 250(d)," thus indicating, obviously, that plaintiff had received the notice sent March 21, 1924. (There is in the briefs some dispute as to whether such notice was actually received by plaintiff.)

To the above telegraphic complaint by plaintiff, as to the Commissioner's failure to fully comply with the provisions of section 250(d), the Commissioner wired plaintiff that he (the Commissioner) had advised the collector of the lack of compliance with section 250(d), and that the collector should accept the claim for abatement.

Upon this same point the Commissioner, on March 29, 1924, wrote the collector admitting lack of compliance with the provisions of section 250(d), and recommended to the collector "that a claim in abatement be accepted."

On April 1, 1924, plaintiff filed its claim for abatement of the taxes here in dispute, in the total sum of $71,776.90. Pending these matters, and on March 20, 1924, credit had been given in the sum of $1,565.39, on account of an overassessment against plaintiff for the year 1919. This accounts for the apparent discrepancy between the amount of $73,342.29, as shown on the schedule of February 7, 1924, and the amount here claimed by the plaintiff.

Pursuant to well-established local custom, efforts to collect were stayed, or, to be more exact, were not made by the collector pending the plaintiff's claim for abatement. This claim for abatement was denied by the Commissioner, on the 5th day of May, 1925, and plaintiff was so advised by letter, and on June 30, 1925, formal rejection of the claim for abatement was entered by the Commissioner. Notice and demand were thereupon made upon plaintiff, and on July 21, 1925, plaintiff paid to the collector the sum of $71,776.90, with interest, amounting in all to the sum of $77,519.05.

Thereafter, three years later, and in December, 1928, a claim for a refund of the sum of $73,342.29 for the taxes so paid, was made by plaintiff on the Commissioner. The sole ground of this claim was that the collection of the taxes here in controversy was barred by the statute of limitations when collection thereof was made. This claim for refund having been denied, this action was begun by plaintiff on the 25th day of April, 1929.

Numerous questions of law are mooted upon the record and in the briefs. I think I am restricted to one, and its incidents. That one is, whether the tax was barred by the statute of limitations when it was collected. This is the sole ground urged in the claim for a refund, and I am of opinion that plaintiff can not now mend its hold and urge others. I do not think plaintiff may now, in the light of its filing a plea for abatement, claim inherent invalidity in the assessment of this deficiency tax, on the mere ground that the 30 days' notice provided for by section 250(d) was not in fact given to it by the Commissioner. The record is wholly lacking in any proof whether this notice was or was not given. The only fact tending to indicate that it was not given is the telegram of the Commissioner to the plaintiff, and the letter of the Commissioner to the collector. Therein the Commissioner made the admission that section 250(d) had not been complied with, seemingly, by his office, and for this reason he recommended to the collector that he (the collector) permit to be filed, and entertain a plea in abatement, which accordingly was done by the plaintiff and by the Commissioner. But this discussion all goes to the fact of the validity of the assessment, and not as to the time thereof.

As said already in stating the facts, an unlimited waiver was executed by the plaintiff and the Commissioner, in consonance with the provisions of section 250(d) of the Revenue Act of 1921. This waiver was made and filed before the statute would have run in due course. It is my conclusion, therefore, that it is valid and binding on plaintiff. But as said already, the Commissioner, by a regulation, fixed the date of expiration of such waivers then on file, as of April 1, 1924, the precise language being that such unlimited waivers "will be held to expire April 1, 1924."

I conclude, therefore, and am of opinion, that the waiver here did not expire on March 31, 1924, but that it was in full force and effect during the whole of April 1, 1924. This view is in consonance with common acceptation, and with

the great majority of the ruled cases. Even the words "to," "till" and "until" a day named, have been held to include the whole of the day specified. (*St. Louis, etc., Railway Co.* v. *Gracey*, 126 Mo., 472, and cases cited; *State* v. *Mosley*, 116 Mo., 545.) Obviously, the words, "will be held to expire April 1, 1924," are, upon the phase of including the whole of the day named, infinitely stronger than the words "to," "till" or "until" a named day.

Therefore, I conclude and am of the opinion that the claim in abatement was filed prior to the time at which the statute bars collection. Upon this view it seems plain that section 611 of the Revenue Act of May 29, 1928, is applicable to this case. This section (now section 2611, Title 26, U. S. C.) provides, in effect, that the collection and payment of any tax assessed prior to June 2, 1924, wherein a claim in abatement has been filed (timely filed, of course) shall not be deemed a recoverable overpayment, within the purview of section 2607, Title 26, U. S. C., and that no money paid as and for taxes shall be recoverable because made after the running of the statute of limitations, as section 2607, supra, otherwise provides.

I have assumed, as both counsel for the parties did upon the trial, but without ruling the point specifically, that the general regulation of the Commissioner abrogating, on April 1, 1924, all unlimited waivers, is binding on the defendant, even absent the consent of the plaintiff to such abrogation. The point is interesting, but in view of the attitudes of the parties, it is not necessary to decide it.

The above facts and conclusions may be taken as findings of fact and conclusions of law, but if counsel for either plaintiff or defendant, or both, shall desire a more formal findings of facts and conclusions of law, they, or both or either of them, may submit such findings within 10 days.

The result is, as a matter of law, that judgment should be against plaintiff and in favor of defendant, that it go hence without day and recover its costs, which accordingly is ordered.

TITLE V.—GENERAL PROVISIONS.

SECTION 705.—INSTALLMENT SALES—RETROACTIVE.

SECTION 705. XI-31-5579
Ct. D. 524

INCOME TAX—REVENUE ACT OF 1928—DECISION OF COURT.

REFUND OR CREDIT—INSTALLMENT SALES OF PERSONAL PROPERTY—RETROACTIVE.

Where a taxpayer, who regularly sells personal property on the installment plan, by an original return made prior to February 26, 1926, the date of the enactment of the Revenue Act of 1926, changed the method of reporting his net income for the taxable year 1923 from the accrual basis to the installment basis and pays under duress before the enactment of the Revenue Act of 1928 an additional assessment for that year based first on the ground that the tax for that year should be computed by including, in computing income, amounts received during such year on account of sales of property made in prior years and second that the books of account did not contain adequate information and were kept so that income could not be accurately computed on the installment basis in accordance with the provisions of article 42 of Income Tax Regulations 69; and where after the enactment of the Revenue Act of 1928 the United States admits that the books were so kept that income could be accurately computed on the installment basis but retains on the first ground the amount collected as an additional assessment, section 705(a)1 of the Revenue Act of 1928 precludes a refund or credit of such additional tax.

UNITED STATES CIRCUIT COURT OF APPEALS, EIGHTH CIRCUIT.

Levi M. Willcuts, Collector of Internal Revenue for the District of Minnesota, appellant, v. *B. F. Gradwohl, appellee.*

Appeal from the District Court of the United States for the District of Minnesota.

[April 15, 1932.]

OPINION.

STONE, Circuit Judge, delivered the opinion of the court.

This is an action to recover refund of redetermined income taxes, paid under protest, for the years 1923, 1924, and 1925. It involves the application and construction of section 705 of the Revenue Act of 1928 (45 Stat., 881, U. S. C. A. Title 26, section 2705).

The pertinent facts are undisputed and are as follows: Prior to and during the years 1923, 1924, and 1925, appellee was a partner in the firm of Gittelson Jewelry Co., which was engaged in retail sales of jewelry on the installment plan. Prior to 1923, income tax returns and tax payments were made by the firm upon the accrual basis. In its original return for 1923, the firm changed to the installment basis and, during that and the two following years, returns and payments were upon that basis—no return being made for installment payments received during those years which arose from contracts made prior to 1923, and, therefore, included in the returns of those prior years upon the accrual basis.

In 1927, an audit of the books of the firm by a revenue agent for the years 1923, 1924, and 1925 resulted in notification of specified increases of income in each of those years and a proposed additional tax thereon was declared. Practically all of the increased tax (all here involved) was based upon inclusion as income, of installment payments received during those three years arising from contracts made prior to 1923 and returned, on the accrual basis, prior to that year. The grounds of assessment of the additional tax were (1) that such installment payments should have been included, in accordance with article 42 of Regulations 69 under the Revenue Act of 1926 applying retroactively; and (2) that the firm books did not contain sufficient information for the computation of the prior year amounts and, therefore, not adequate information for computation of income on the installment sale basis. Appellee consented to the deficiency items except the additions to income due to inclusion of the above installments. In February, 1928, under threat of enforcement and under protest, the additional taxes were paid. In April, 1928, and after a reaudit of the firm books, the Department admitted a partial overassessment but leaving more than $4,000 of the additional tax intact. Also, there was a finding that the necessary information for computation of firm income on the installment basis was available.

Both parties agree that the matter here, as below, is one purely of law and each of them relies upon section 705 of the Revenue Act of 1928. They differ as to what the law question here is.[1]

The statement of neither accords accurately with the facts. The facts (shown above) are that the firm used the accrual basis up to 1923; that it changed, by an original return, to the installment basis in 1923; that before

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[1] The "question presented" by this case is stated by appellant to be:

"Where a taxpayer, who was regularly engaged in the sale of merchandise upon the installment plan, kept his books, made his returns, and paid his taxes for a period of years upon the accrual basis of computing income, and where such taxpayer changed, effective January 1, 1923, by a seasonable original return to the installment method of computing and returning income—may he recover an overpayment of taxes for the years 1923, 1924, or 1925, without including in the taxable income for those years all income actually realized during the same under the installment method of computation?"

The statement of appellee is:

"Where a taxpayer was illegally assessed in 1927 by wrongful disallowance of the installment method, and paid such assessment under protest, can his recovery of the illegal exaction be barred by an attempted imposition of the double tax after the effective date of the relief Act (section 705, Revenue Act of 1928), which prohibited the determination of a deficiency upon that basis?

"Or, more fully stated:

the 1928 Act became effective, the tax in question was assessed and was thereafter collected under duress and protest; that there were two grounds for this additional assessment—one being the state of the firm accounts (not adequate for computation of income on installment basis), and the other being that the installments received on prior contracts (during accrual basis for returns) should be included; that after the Act of 1928 became effective, the Government abandoned the first ground and retained the collections on the second ground.

The question is, therefore, where a taxpayer changes from an accrual basis to an installment basis and unwillingly pays, before the Act of 1928, an additional tax, assessed and collected on the two grounds that the account books are incomplete and that installments received after the change from contracts returned before the change should have been included, and where the Government admits, after the above Act becomes effective, that the account books are complete but retains the collection on the other ground, does section 705 of that Act deny or allow enforcement of refund thereof?

Before this question can be answered by application of section 705 to the facts, that section must be construed. It is a peculiar piece of legislation. It is difficult to understand unless one has in mind the situation which occasioned it and also the result upon that situation which Congress intended this section should have. The logic to be employed is purely the "logic of the situation."

The situation intended to be affected was one which had gradually developed in the endeavors to ascertain the true income of taxpayers subject to taxation under the successive Acts passed under authority of the sixteenth amendment. A tracing of this development is necessary to an understanding of the situation upon which Congress acted through this section.

The sixteenth amendment empowered Congress to tax "incomes, from whatever source derived." There arose differences as to what constituted "income" within the meaning of the amendment. The Supreme Court determined this word in the amendment should be construed "in the ordinary sense" (*Eisner* v. *Macomber*, 252 U. S., 189, 204 [T. D. 3010, C. B. 3, 25]), "as used in common speech" (same, page 207, and see also *U. S.* v. *Kirby Lumber Co.*, 284 U. S., 1, 3 [Ct. D. 420, C. B. X–2, 356], and *Merchants' L. & T. Co.* v. *Smietanka*, 255 U. S., 509, 519 [T. D. 3173, C. B. 4, 34]). So construed, it was held to mean "'gain derived from capital, from labor, or from both combined,' provided it be understood to include profits gained through a sale or conversion of capital assets" (*Eisner* v. *Macomber*, 252 U. S., 189, 207). This definition has been repeatedly approved (*Taft* v. *Bowers*, 278 U. S., 470, 481 [Ct. D. 49, C. B. VIII–1, 226]; *Bowers* v. *Kerbaugh-Empire Co.*, 271 U. S., 170, 174 [T. D. 3881, C. B. V–1, 199]; *U. S.* v. *Phellis*, 257 U. S., 156, 169 [T. D. 3270, C. B. 5, 37]; *Goodrich* v. *Edwards*, 255 U. S., 527, 535 [T. D. 3174, C. B. 4, 401]).

Since the taxable period was a year, the practical problem was the ascertainment of this "gain" or "profits gained" by the taxpayer for each taxable year. Into this problem entered the important element of the record of transactions as shown by the books of account where such fairly mirrored the business of the taxpayer. Obviously, such books were not conclusive but they were, if complete and well kept, valuable as evidentiary guides to the real income or "gain." The use of such books led into and necessitated consideration of systems of accounting used therein. There were and are two accepted methods of such accounting resting on different bases. One was based on the theory of actual receipts and disbursements during the year. The other—called

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"Where a taxpayer was regularly engaged in the sale of merchandise upon the installment plan, kept his books, made his returns, and paid his taxes for a period of years upon the accrual basis of computing income; and

"Where such taxpayer changed, effective January 1, 1923, by a seasonable original return, to the installment method of computing and returning income, and paid his taxes for the years 1923, 1924, and 1925, computing the same, in accordance with the regulations then in force, to wit, on the basis of not including in income for such years amounts received on account of sales made prior to January 1, 1923, upon which the full tax had theretofore been paid; and

"Where such taxpayer was in 1928 compelled to pay an additional tax assessed by disallowing the installment method entirely; and

"Where such disallowance was in fact, and was later conceded to be, wrongful; and

"Where such taxpayer files claim for refund and upon reaudit was allowed the installment basis—

"May the Commissioner prevent the taxpayer recovering the illegal exaction, by assessing a new deficiency, after the effective date of the Revenue Act of 1928, upon the double-tax basis, prohibited by subsection 2 of section 705?"

accrual basis—was based upon liabilities to and against the taxpayer contracted for during the year. Since the former basis dealt with realizations it probably was a truer measure, yet the latter was not unacceptable. Therefore, both were recognized as proper methods to use in ascertaining true income.

However, the problem always existed of ascertaining the true income and the administrative officers were, by the statutes, given broad powers to that end. An early difficulty met by these officers was to ascertain the true annual income of taxpayers engaged in selling on deferred installments continuing beyond a taxable year. If such a taxpayer kept his books and was willing to return his tax and pay upon the accrual basis it was obviously no detriment, ordinarily, to the public revenue to allow this to be done. But when the taxpayer insisted upon dealing with realizations instead of contract potentialities, a troublesome question arose as to how the installments received within the tax year should be treated. Each installment was a part payment on a sales contract which involved a definite profit but how was this profit on the entire sale to be apportioned to the installments received during the tax year in course of performance of the contract? Obviously, Congress might determine, within constitutional limits, this matter but it did not expressly do so until the Revenue Act of 1926, section 212(d) (44 Stat., 23).

While our immediate concern is with the treatment of received installments during the "transition period" from accrual basis to installment basis—those years in the installment basis period when payments were received under contracts made during the accrual period—yet the definition and growth of the installment basis method are inseparably bound up with the treatment of the above transition period, therefore, it is more intelligible to trace the common history. Prior to the Act of 1926, this situation was handled through departmental regulations, promulgated under the broad grant in the several statutes, to the administrative officers to ascertain the true income. This installment situation was first dealt with in article 117 of Regulations 33 (revised), promulgated January 2, 1918. This was followed by Regulations 45, article 42, promulgated April 17, 1919, which defined a rule to measure income under installment sales as being "that proportion of each installment payment which the gross profit to be realized when the property is paid for bears to the gross contract price." The regulations, in providing how "such income may be ascertained," included in the total receipts for the taxable year "payments received on account of sales effected in earlier years." This regulation thus established and defined an "installment basis" for estimating income (in addition to the two other recognized bases) and provided for a change to this basis although it still permitted the accrual basis in installment situation. The effect of this regulation where changes were made from the accrual to this installment basis was, obviously, double taxation as to the installments paid after the change on contracts made before the change. This regulation was repeated by a promulgation of December 29, 1919. This situation resulted in Treasury Decision 3082 [C. B. 3, 463], promulgated October 20, 1920, which modified the regulation to the effect "that where the entire profit from installment sales has been included in gross income for the year in which the sale was made (accrual basis), no part of the installment payments received subsequently on account of such previous sales shall again be subject to tax for the year or years in which received." In compliance with this decision, article 42 of Regulations 45 was altered to exclude instead of include such installments received during the transition period (1920 edition, promulgated January 28, 1921).

This situation continued until early in 1925, when there came before the Board of Tax Appeals, for the first time, the question of the validity of ascertaining income in accordance with an installment basis. In the *Appeal of B. B. Todd* (1 B. T. A., 762), the Board held that the Revenue Acts had recognized no such basis and that it was not proper to use such. In that opinion, the Board severely criticized the injustice to other taxpayers in permitting the exclusion, during the transition period, of installments received therein from contracts made prior thereto during the accrual period. Because of this and other decisions,[2] sections 212(d) and 1208 appeared in the Revenue Act of 1926

[2] *H. B. Graves Co.* (1 B. T. A., 859), *Hoover-Bond Co.* (1 B. T. A., 929), *Charles A. Holman* (1 B. T. A., 628), *Six Hundred and Fifty West End Ave Co.* (2 B. T. A., 958), *A. R. Dennis* (2 B. T. A., 977), *Maurice E. Weed* (2 B. T. A., 539).

(44 Stat., 23 and 130). Section 212(d) provided that persons regularly dealing in, selling or disposing of personal property on the installment plan might return as income for a tax year "that proportion of the installment payments actually received in that year which the total profit realized or to be realized when the payment is completed, bears to the total contract price," and, as to certain casual sales provided they might "be returned on the basis and in the manner above prescribed." Section 1208 made section 212(d) retroactive beginning with taxes under the Act of 1916 and provided, subject to statutory periods of limitations, that any excess imposed theretofore should be credited or refunded as provided in section 284 of the Act. Thus, section 212(d) settled the propriety of using the installment basis in ascertaining income and placed that basis on "installment payments received" during the tax year and this was made retroactive as to all taxpayers not barred by the appropriate statute of limitation. This Act contained no expressed provision dealing with the transition period. However, the Department construed the statute (T. D. 3921 [C. B. V–2, 77], promulgated August 27, 1926) to mean that installments received during the transition period on contract made prior to the change should not be excluded and this was followed by Regulations 69, article 42 (promulgated August 28, 1926), to the same effect. This position was upheld by the decision of the Board of Tax Appeals, on July 26, 1927, in *Appeal of Blum's, Inc.* (7 B. T. A., 737), and, also, in *Warren Reilly* v. *Commissioner* (7 B. T. A., 1327), on September 7, 1927. That these constructions of the Act were in accordance with the intention of Congress is clearly shown by the committee of conference report (Sixty-ninth Congress, first session, H. Rept. 356, page 59), where, in speaking of the retroactive feature, it is said: "In the application of this provision it is intended that the installment provisions of Regulations 45, promulgated on December 29, 1919, will be substantially followed in settling all cases under prior Acts and under this bill."

The Department construed the retroactive provision of the Act to permit *amended* returns to be filed by taxpayers (not barred by limitation) in respect to taxes of prior years beginning with those under the Revenue Act of 1916, and numerous such amended returns were filed. This was the confused and uncertain situation concerning which Congress legislated in the Revenue Act of 1928.

That Act treated installment sales quite fully. As to the *future*, it repeated (in so far as here involved) the provisions of section 212(d) of the Act of 1926 (section 44 (a) and (b), 45 Stat., 805, U. S. C. Title 26, section 2044). In the same section (44(c)) it dealt expressly with the period of transition "from accrual to installment basis" and provided that "in computing his income for the year of change or any subsequent year, amounts actually received during any such year on account of sales or other dispositions of property made in any prior year shall not be excluded."

Recognizing the exasperating confusion and uncertainty (revealed in the above outline) which had theretofore and then existed as to the installment situation ,the Act, in section 705 (44 Stat., 881, U. S. C., Title 26, section 2705),* dealt therewith retroactively. The clearly revealed dominant purpose of the section is to compose and terminate this confusion and uncertainty in so far as it then existed except as to a narrowly defined class. Regarding the Act of 1926 as having approved the method of including payments of installments

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* SEC. 705. *Installment sales—Retroactive.*

(a) If any taxpayer by an original return made prior to February 26, 1926, changed the method of reporting his net income for the taxable year 1924 or any prior taxable year to the installment basis, then, if his income for such year is properly to be computed on the installment basis—

(1) No refund or credit of income, war-profits, or excess-profits taxes for the year in respect of which the change is made or any subsequent year shall be made or allowed unless the taxpayer has overpaid his taxes for such year, computed by including, in computing income, amounts received during such year on account of sales or other dispositions of property made in any prior year; and

(2) No deficiency shall be determined or found in respect of any such taxes unless the taxpayer has underpaid his taxes for such year, computed by excluding, in computing income, amounts received during such year on account of sales or other dispositions of property made in any year prior to the year in respect of which the change was made.

(b) Nothing in this section shall be construed as in any manner modifying sections 607, 608, 609, or 610 of this Act relating to the effect of the running of the statute of limitations.

received during the transition years under contracts prior thereto (Seventieth Congress, first session, H. Doc. 139, page 12), this section is limited to returns filed prior to the effective date (February 26, 1926) of that Act. It is dealing with those years when there were regulations contradictory upon this matter. In so dealing, it has in mind that during some years regulations permitted exclusion of such installments while during others they required inclusion and that taxpayers made returns in the light of the regulation in force at the time. Congress intends to protect this class of taxpayers and this alone, therefore, it confines the section to those who have filed "original" returns. It further limits this class to those who made the change to the installment basis prior to the tax year of 1925. A further limit was provisions (contained in sections 607–610, both inclusive) as to limitations within which refunds, credits and recoveries generally could be had. Another important limit was that no refund or credit could be had unless the taxpayer had "overpaid his taxes for such year, computed by including, in computing income, amounts received during such year on account of sales or other dispositions of property made in any prior year," and no deficiency assessment was allowable unless the taxpayer had "underpaid" through excluding such receipts. Considering these limitations, a concise statement of the class permitted to recover under this section is as follows. The only installment dealer who could have a refund or credit for overpayment was one who had changed from the accrual basis by an original return filed prior to February 26, 1926, for any tax year prior to 1925, and where such overpayment for which recovery was sought resulted from a computation of income including installments received from contracts made in prior years. This clearly meant that no refund or credit was to be allowed arising from inclusion of such installment payment receipts after the change to the installment basis. On the other hand, the Government was denied the right to assess additional taxes for exclusion of such receipts. In short, the purpose was to leave the taxpayer and the Government bound by the basis actually used and upon which payments had been actually made.[4]

Our next step is to apply this rule to the present facts. The change here was made by an original return, filed for the tax year 1923, before February 26, 1926, and the returns for 1924 and 1925 were also original returns. All of these returns excluded the received installment payments under contracts

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[4] In the report of the conference committee (H. Rept. 1882, Seventieth Congress, first session, pages 24–25) it was stated:

"The House bill contained no provision of retroactive application to taxpayers changing from the accrual to the installment basis for reporting income for tax purposes. The 1919 regulations of the Treasury prescribed in such cases the so-called double-tax rule. The 1920 regulations, however, abandoned this rule. In 1925 the Board of Tax Appeals held the 1920 regulations invalid upon the ground that they did not accurately reflect the income of the taxpayer during the transition period. Section 1208 of the Revenue Act of 1926 was a compromise provision writing into the law for the first time a statutory recognition of the installment basis, and adopting the double-tax rule of the 1919 regulations. In order to relieve taxpayers who have not yet paid the deficiencies resulting from the application of the double-tax rule (in accordance with section 1208) the Senate amendment provides that in such cases the amount of the deficiency will be computed in accordance with the single-tax rule; and inasmuch as the financial status of taxpayers who have already paid an amount sufficient to cover their tax liability when computed in accordance with the double-tax rule, will not be jeopardized, the Senate amendment provides that the double-tax rule shall be applied in computing the right to a refund or credit. The Senate amendment was made applicable to any taxpayer who filed an original return or an amended return prior to the effective date of the Revenue Act of 1926, and the taxable year 1924 or any prior taxable year.

"The House recedes with an amendment denying relief to a taxpayer who, for example, in 1922, filed an amended return for 1918, 1919, and 1920, shifting from the accrual to the installment basis. This taxpayer, however, will be granted relief for the year in which he filed an original return and for the years following."

In the discussion of this section in the Senate occurs the following (May 15, 1928, Sixty-ninth Congressional Record, part 8, pages 8697–8699):

"Mr. REED of Pennsylvania. In every case in which the taxpayer changed, it is probable he did it because he thought he was going to get a diminution in his taxes.

"Mr. CARAWAY. Did it have that effect?

"Mr. REED of Pennsylvania. In many cases it did. We have put a chart on the wall showing how it did have that effect.

"Mr. CARAWAY. What does the amendment now accomplish?

"Mr. REED of Pennsylvania. The amendment substantially allows the status quo to remain.

"Mr. CARAWAY. In other words, he got it and keeps it?

"Mr. REED of Pennsylvania. Those who got the advantage keep it, but new men can not come in and claim similar advantages, so that the system has to stop now.

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of prior years. This was in accordance with the regulations then in force. The taxes were paid in accordance with such returns. Had the matter stopped here this taxpayer would not be here complaining and the Government would, under section 705, be barred from declaring a deficiency because of this method of ascertaining income. But the matter went further. Thereafter, the Government assessed additional taxes based upon the failure to include such receipts in the income for those years. It is true that one of the reasons given was that the accounts of the taxpayer were not sufficient for ascertainment of income on this basis but that does not help the taxpayer since the other ground (that such receipts should have been included) was also stated and it does not help the Government since it concedes error therein in a matter of fact not disputed here nor in the trial court. To both grounds, the taxpayer disagreed and never conceded. The situation before us and the trial court is not affected by this abandoned reason for additional assessment. The payment was made under duress and protest.

The situation thus presented narrows down to the following: The taxpayer would have been protected, under section 705, had he not made payment of the additional tax; section 705 would have prevented recovery (refund or credit) of that payment had it been voluntarily made. Can there be such recovery where the payment was entirely involuntary—being under duress and protest?

We are constrained to determine that there can be no recovery. We can not say that this exacted tax was illegal. The change in return basis was entirely voluntary on the part of the taxpayer. The opinion in the *Appeal of B. B. Todd* (1 B. T. A., 762) reveals the possibilities of tax evasion if receipts during the transition period from contracts made prior thereto are excluded. Congress has expressly adopted the method of inclusion of such receipts (Revenue Act 1928), not to mention earlier action by the Department and the effect of the Revenue Act of 1926. In fact, the exaction of the additional tax, upon the basis of inclusion of such receipts, seems entirely proper. This collection being of a tax legally owing there can be no recovery thereof (*Western Union Tel. Co.* v. *Gottlieb*, 190 U. S., 412, 427) unless there is a right to recover for

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"Mr. REED of Pennsylvania. The proposed amendment offered by the Senator from Utah means that the situation is to remain as it is; that if the taxpayer tries to get a refund he has to get it on the construction of the law which is most adverse to him, while if the Treasury chooses to pursue him, then that law which is most adverse to it will obtain. It is utterly indefensible logically.

"Mr. CARAWAY. I think so myself.

"Mr. REED of Pennsylvania. And yet either of the other conclusions is indefensible.

"Mr. DILL. What will happen if we do not include this provision?

"Mr. REED of Pennsylvania. Then we have to go to one alternative or the other. We have to say that all the accounts have got to be opened up for a settlement on the accrual basis or else we have to make refunds to everybody who did not account on the installment plan. Both of those are wrong.

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"Mr. REED of Missouri. Mr. President, I want to ask the Senator from Pennsylvania a question to see if I correctly understood him. I understood the Senator to say that if a claim for a refund was made by a taxpayer, the rule of construction to be adopted would be the one most strongly against the applicant.

"Mr. REED of Pennsylvania. That is correct.

"Mr. REED of Missouri. If the Treasury Department should undertake to collect the taxes, then the rule of construction would be most strongly against the Treasury?

"Mr. REED of Pennsylvania. That is correct. Logically that is indefensible, but what it amounts to in substance is saying that the taxpayers who in the past have filed their returns and paid their taxes on either of these regulations shall be allowed to rest at that. They shall not get any advantage by changing retroactively their method of accounting, nor shall the Treasury be heard to say, 'What you did in the past was wrong.' While that can not be defended logically, it is a compromise, apparently satisfactory to the Treasury and to this group of taxpayers, between two alternatives, each of which seems indefensible. We can not allow them to come back and file new amended returns on the basis that pays the lowest possible tax. That is not fair to the great mass of taxpayers who have paid their taxes and let the thing lie. We can not, on the other hand, in fairness override the regulations retroactively which were in force part of the time and say that the man who filed a return in the spring of 1921, under perfectly good regulations then in effect, shall be assessed an additional tax because he did everything that the law then seemed to require. Hence this compromise.

"Mr. REED of Missouri. The effect of the compromise, then, if I understand the Senator, would seem to be that if a man makes an application for a return of tax, the rule which was hardest against him will be applied.

"Mr. REED of Pennsylvania. That is true.

"Mr. REED of Missouri. While, if the Treasury makes application for additional taxes, the rule which was hardest against it will be applied. *That would look like no one would get anything.*

"Mr. REED of Pennsylvania. *That is what we hope will result.*" [Italics supplied.]

irregularities (if this was an irregularity) given by statute. Appellee contends that section 705 affords a remedy. While there is much of persuasiveness in the able argument for appellee and in the situation itself yet section 705 was intended to compose and set at rest a situation. It set forth the condition and the only condition upon which such a tax, once paid, could be refunded or credited. It made no distinction between voluntary or involuntary payments. When we consider the situation dealt with by this section and the dominant purpose of the enactment, we should not disturb the certainty intended by Congress by a construction which will make exceptions where none are expressed nor intended.

The judgment should be reversed and the case remanded for a new trial.

SECTION 705.

REVENUE ACT OF 1928.

Original returns filed prior to February 26, 1926, changing method of reporting, for 1924 or any prior years, to the installment basis. (See Ct. D. 597, page 424.)

INCOME TAX RULINGS.—PART III.

REVENUE ACT OF 1926 AND PRIOR ACTS

TITLE I.—GENERAL DEFINITIONS.

SECTION 2.—GENERAL DEFINITIONS.

ARTICLE 1502: Association. XI-40-5745
Ct. D. 575

INCOME TAX—REVENUE ACTS OF 1924 AND 1926—DECISION OF COURT.

1. TRUST—ASSOCIATION—DEFINITION—ORGANIZATION OF DEVISEES.

An organization of devisees in quasi corporate form operating under a declaration of trust, whose purposes as declared in the trust instrument are "the acquisition, management, improvement and disposition of the trust property and all such other property as may be acquired from time to time," and which by the action of the trustees manages and operates the property in their charge as a business with the purpose to accumulate a profit by the use of it, is an association within the meaning of section 2(a) of the Revenue Acts of 1924 and 1926.

2. DECISION AFFIRMED.

The decision of the Board of Tax Appeals (22 B. T. A., 564) is affirmed.

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT.

Floyd M. Willis, Florence Holland Farnsworth, and Frank B. Verney, Trustees, petitioners, v. *Commissioner of Internal Revenue, respondent.*

Proceeding to review an order of the United States Board of Tax Appeals.

Before WILBUR and SAWTELLE, Circuit Judges, and JAMES, District Judge.

[May 2, 1932.]

OPINION.

JAMES, District Judge: The Board of Tax Appeals confirmed the assessment made by the Commissioner of Internal Revenue against petitioners of income tax amounts for the years 1924 and 1925 in the respective sums of $3,052.24 and $5,672.65. Petitioners contend that the trust being administered by them was not an "association" within the meaning of the revenue law, and that the income accruing thereto was not subject to be taxed.

Petitioners are trustees under an instrument executed by devisees named in the will of John F. Broadbent, deceased, who died at Boise, Idaho, in the year 1922. Of the property of Broadbent's estate 12 persons received equal undivided interests. This property consisted of 52 parcels of real estate, appraised at the time of distribution at a value of $1,529,500. There were also three mortgages, two for the amount of $35,000 each and one for the amount of $6,500. The real estate was largely improved by buildings; there was an office building containing 100 office rooms and 8 store rooms; also various other buildings, all rented for commercial purposes, such as restaurants, pool halls, a bank, etc. The devisees, believing that the property could not be equitably divided, notwithstanding that it was the desire of each to forthwith receive his or her allotted share, and failing to find immediate purchasers at what they considered fair values, concluded to pool their interests and form a trust. This they proceeded to do, and trustees were appointed to take over the property. It was at first provided that the trust should continue for a period

of two years, i. e., from December 18, 1923, to December 31, 1925. On November 10, 1925, an agreement extending the trust to December 31, 1950, was entered into by the beneficiaries.

The trust agreement was very broad in those provisions which conferred power on the trustees. The purposes declared in the trust instrument were, generally, "the *acquisition*, management, improvement and disposition of the trust property *and all such other property as may be acquired from time to time* for the benefit of the beneficiaries hereunder, and a division of the income, proceeds and avails of said trust property among the certificate holders as hereinafter provided." [Italic is added.]

Others of the very numerous provisions were appropriate, in the power given to the trustees, to enable the latter to fully carry out the purposes declared. For example, the trustees had discretion to distribute funds to the beneficiaries in such amounts as they chose during the trust term. They were authorized to borrow money; to use capital or income in the improvement of the property or in the *acquisition* of *other property*. Certificates were provided to be issued, representing the several beneficial interests, which certificates were made freely transferable at the will of the holder. The power to fill vacancies caused by the retirement of any trustee was given exclusively to the remaining trustees. The terms of the trust agreement could only be changed with the consent of the trustees, but the beneficiaries alone had power to extend the life of the trust.

The collection of the income tax from this trust is justified by the Commissioner under the claim that the trust organization, in form and in its practice, is an "association" as that term is to be understood where used in the Revenue Act of 1924, section 2 (43 Stat., 234). Simply stated the question is, did the trustees manage and operate the property in their charge as a business, with the purpose to accumulate a profit by the use of it, or was their sole purpose, intended and pursued, to dispose of it as rapidly as possible, market conditions considered, and divide the proceeds among the beneficiaries. As a liquidating trust purely the income would not be taxable; as a business venture the income would be taxable. The distinction is made clear in the cases *Hecht* v. *Malley* (265 U. S., 144 [T. D. 3595, C. B. III–1, 489]); *Blair* v. *Wilson Syndicate Trust* (39 Fed. (2d), 43, C. C. A. 5); *Commissioner* v. *Atherton* (50 Fed. (2d), 740, C. C. A. 9); and whether beneficiaries are left much or little control is immaterial (*Little Four Oil & Gas Co.* v. *Lewellyn*, 35 Fed. (2d), 149, C. C. A. 3 [Ct. D. 118, C. B. VIII–2, 264]; *White* v. *Hornblower*, 27 Fed. (2d), 777, C. C. A. 1).

The question is to be determined from the facts showing what the trustees did in their handling of the property. The terms of the trust instrument are not conclusive, but they indicate the purpose in the minds of the beneficiaries, and are of significance when it is observed that the trustees assumed much of the power conferred upon them. During the year 1924, the trustees collected from rents and other sources $123,302.70, and expended $81.500. Of the total receipts, $188,804.44 represented rents collected. Three parcels of real estate were sold during the same year for the aggregate price of $12,000. And on the two mortgages $70,000 was collected. Broadbent, the testator, had sold 50 feet of the lot covered by the office building, and the building under the two ownerships was operated thereafter by the use of common elevators and common heating facilities. The trustees, in 1924, arranged to acquire back the 50 feet by exchanging for it a corner lot across the street. They paid a cash difference of $15,000. As a part of the exchange transaction they agreed to tear down a row of "shacks" on property owned by the trust, and located immediately in the rear of the lot they relinquished; they agreed to erect a new building on this property, which they did at a cost of $55,000. No other real property was acquired so far as the evidence showed. No sales of property were made in the year 1925. The total sales to June, 1930 (the trust had then operated for more than six years), amounted to $79,000. The certificate holders were regularly paid income amounts, mainly in monthly installments. During the years 1924 and 1925, total disbursements to the beneficiaries amounted to $28 200 for each year. A regular office with a manager in charge was at all times maintained.

In their handling of the property, the trustees apparently used their best efforts to increase income and accrue profits. The exchange of property as noted, and the erection of a new building at a considerable cost, was considered without question as a profitable investment. Judged by their course of action as shown, it would be reasonable to assume that the trustees would continue

to deal with the property in like manner as long as the trust remained alive. Such acts, as enumerated, gave to the trust operations the character of an active business enterprise. (What constitutes the doing of business, *Flint* v. *Stone Tracy Co.*, 220 U. S., at page 171.) They went beyond transactions carried on for the single purpose of effecting a liquidation of assets. And for that reason the collection of an income tax was authorized under the terms of the Revenue Act.

The order of the Board of Tax Appeals is affirmed.

TITLE II.—INCOME TAX.

PART I.—GENERAL PROVISIONS.

SECTION 201.—DISTRIBUTIONS BY CORPORATIONS.

ARTICLE 1541: Dividends. XI–30–5562
G. C. M. 10699

REVENUE ACT OF 1926.

In the instant case the distributing corporation had at the time of the distribution sufficient earnings or profits accumulated after February 28, 1913, to pay the dividend distributed and the entire payment should be treated as an ordinary dividend in the hands of the recipient.

The M Company, a foreign corporation (hereinafter referred to as the Canadian corporation), in March, 1927, paid a dividend to the N Company (hereinafter referred to as the American corporation) in the amount of $20x$ dollars. The American corporation had, at the beginning of the year 1927, undivided earnings and profits accumulated after February 28, 1913, in the amount of $8x$ dollars. In April, 1927, the American corporation declared and paid a dividend to its stockholders in the amount of $18x$ dollars. A owned one-third of the stock in the American corporation and received one-third of this dividend, or $6x$ dollars.

The taxpayer, A, reported this distribution in his individual income tax return. He contends, however, that x dollars of the $6x$ dollars distributed to him by the American corporation were not available for distribution as an ordinary dividend by that corporation. His claim is based upon the theory that the entire year's earnings of the American corporation must be prorated to the dividend distribution date in order to determine the source of the distribution.

Pro rata apportionment of earnings to dividend distribution dates does not appear to have any specific statutory origin. The leading cases on the subject are *Edwards* v. *Douglas* (269 U. S., 204, T. D. 3797, C. B. V–1, 158) and *Mason* v. *Routzahn* (275 U. S., 175, T. D. 4131, C. B. VII–1, 194). These cases clearly stand for the proposition that *in the absence of a showing* of the amount available for dividend purposes the pro rata rule should be applied. The taxpayer admits the pro rata rule does not apply if there is a showing of the amount available for dividend distribution on a given date, but insists that there is no showing in the instant case.

Thus, the real question presented is what constitutes a showing of the amount available for dividend distribution on a given date. Under the taxpayer's theory it is necessary, in order to constitute a showing so as to determine the amount available for dividends as of the date of distribution, for the books of the company to be closed or balanced on that date. Section 201(a) of the Revenue Act of 1926 provides that the term "dividend" means any distribution made by a corporation to its shareholders, whether in money or in other property, out of its earnings or profits accumulated after February 28, 1913. Section 201(b) of the Revenue Act of 1926 provides that every distribution is made out of earnings or profits to the extent thereof, and from the most recently accumulated earnings or profits.

At the beginning of the year 1927 the American corporation had earnings accumulated after February 28, 1913, in the amount of $8x$ dollars. This amount, plus the $20x$ dollars dividend received in March, 1927, from the Canadian corporation, equals $28x$ dollars. Approximately one month after the dividend was received from the Canadian corporation a dividend was declared by the American corporation within the purview of section 201(b), supra.

The taxpayer does not claim that the distribution was out of earnings accumulated prior to March 1, 1913, nor show the distribution as being a liquidation of the assets of the corporation. He merely contends that the pro rata rule of determining the amount available for dividends should be applied, and that under that rule there were not sufficient earnings on hand to pay the entire amount of dividends. No evidence is submitted to show that the resolution which authorized the distribution treated such distribution as other than an ordinary dividend. The evidence shows conclusively that the earnings of the American corporation on hand at the beginning of the year 1927, plus the dividend received in March, 1927, from the Canadian corporation, were far greater than the amount of the dividend declared. Under *Edwards* v. *Douglas*, supra, and *Mason* v. *Routzahn*, supra, the pro rata rule should be applied in the absence of a showing relative to the amount of earnings available for payment of dividends. With respect to the taxpayer's contention that x dollars of the $6x$ dollars should be treated other than as an ordinary dividend, he has failed to show that on the dividend distribution date the American corporation actually did not have sufficient earnings or profits to pay the dividend.

The facts in this case actually show the American corporation to have had available for distribution as an ordinary dividend in April, 1927, $28x$ dollars, and in the absence of evidence as respects the corporate losses or how this money was spent, it follows that this constitutes a showing within the meaning of the rule laid down in *Edwards* v. *Douglas*, supra, and *Mason* v. *Routzahn*, supra.

In view of the foregoing, this office is of the opinion that the American corporation had on hand in April, 1927, sufficient earnings or profits accumulated after February 28, 1913, to pay the dividend of $18x$ dollars. It therefore follows that the entire $6x$ dollars received by A should be treated as an ordinary dividend.

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

ARTICLE 1541: Dividends. XI-32-5595
Ct. D. 530

INCOME TAX—REVENUE ACT OF 1921—DECISION OF COURT.

1. DIVIDENDS—LOANS—WITHDRAWALS BY SOLE STOCKHOLDER.

Where there is no evidence that a stockholder, owning all the shares of a corporation except qualifying shares, intended to repay his withdrawals from the corporation for which he gives to the corporation no notes or other evidences of indebtedness, pays no interest and is charged with none, the withdrawals to the extent that they are from earnings or profits of the corporation accumulated since February 28, 1913, are dividends to such extent within the meaning of section 201(a) of the Revenue Act of 1921, even though the withdrawals are charged against him on the books of the corporation.

2. SAME.

Where a corporation at the time distributions are made in 1921 to a stockholder owning all the shares of the corporation except qualifying shares has on hand earnings or profits accumulated since February 28, 1913, the distributions made by it are made out of such earnings or profits to the extent thereof and are dividends to such extent within the meaning of section 201(a) of the Revenue Act of 1921, although the distributions are made within the first 60 days of the corporation's taxable year and are in excess of the earnings or profits of the corporation on hand at the end of 1920 and although there is no formal declaration of a dividend and the owners of the qualifying shares do not participate in the distributions. Subdivision (f) of that section does not affect the taxability of such distributions after their receipt by a distributee.

3. DECISION AFFIRMED.

The decision of the Board of Tax Appeals (13 B. T. A., 729) is affirmed.

COURT OF APPEALS OF THE DISTRICT OF COLUMBIA.

L. J. Christopher, appellant, v. *David Burnet, Commissioner of Internal Revenue, appellee.*

Appeal from the Board of Tax Appeals.

Before MARTIN, Chief Justice, and ROBB, HITZ, and GRONER, Associate Justices.

[December 14, 1931.]

OPINION.

ROBB, Associate Justice: Appeal from a final decision of the Board of Tax Appeals (13 B. T. A., 729).

The material facts are as follows: Appellant, L. J. Christopher, entered the wholesale and retail ice cream, candy, and confectionery business in 1887 in Los Angeles, Calif., with a capital of approximately $50,000. The business was successful. Prior to 1914 appellant had acquired real estate and built thereon an extensive plant, and in that year he organized the L. J. Christopher Co. of California, under the laws of that State, with a capital stock of $400,300. To that company he transferred all the assets of the business, including the good will, in consideration of all its capital stock, except a few qualifying shares. Appellant was at all times president of the California company and owner of all its stock, except the qualifying shares and certain small blocks of stock held by employees, which were taken over by appellant prior to the sale hereinafter referred to.

From the date of its incorporation down to and including the year 1924, the California company made no formal declaration of dividends, but during that period appellant from time to time withdrew from the earnings of the California company money and other personalty. These amounts were charged against him on the books of the California company.

In February, 1921, the L. J. Christopher Co. of Delaware was organized under the laws of Delaware, and thereupon acquired all the personal property of the California company. The consideration paid by the Delaware company to the California company under the bill of sale was $125,000 cash and 1,250 shares of its 7 per cent preferred stock of the par value of $100 each. Appellant was president of both corporations. The cash was paid through a check of the Delaware company, payable to the California company. This check was indorsed by the California company to appellant, who deposited it in the bank in his personal account. During 1921 the Delaware company retired $25,000 par value of its preferred stock for the sum of $25,000. The check representing this payment was payable to and received by the California company, and by it indorsed to appellant, who deposited it in the bank to his personal account.

Prior to the sale to the Delaware company, the California company had placed orders for goods at a sale price of $12,093.46, and had paid this sum to the sellers. The goods were received subsequent to the sale and turned over to the Delaware company, who thereupon paid to the California company the cost of the goods. The California company did not dissolve after the sale of part of its assets to the Delaware company, and is now in existence, holding and controlling its remaining assets.

The Commissioner of Internal Revenue held that the amounts received by appellant in 1921 (aggregating $158,528.14) were dividends and taxable as such. The Board affirmed this finding.

Under section 201(a) of the Revenue Act of 1921 (ch. 136, 42 Stat., 227), the term *dividend* "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, * * *." The Board has found that appellant dominated and controlled these corporations and that, although his salary was $1,000 per month, he withdrew no part of it, but did withdraw money whenever it suited him to do so; that the California company from the date of its organization to and including the year 1921 (a period of 7 years) made no formal declaration of a single dividend. During all that time appellant was the owner of practically all the capital stock of the California company. It was a 1-man concern.

It is settled law that no formal dividend declaration is necessary where substantially all the stock is owned by a single individual. (*Atherton* v. *Beaman*, 264 F., 878; *Chattanooga Sav. Bank* v. *Brewer*, 17 F. (2d), 79, certiorari denied, 274 U S., 751 [T. D. 3986, C. B. VI–1, 161].) In the case last cited, two stockholders owning all the capital stock withdrew funds from the business without corporate action or authority, charging the withdrawals to themselves on the books of the corporation. It was held that such withdrawals constituted taxable dividends and not loans, as contended by the taxpayer. In the present case appellant executed no notes or evidences of indebtedness; paid no interest and none was charged against him; and we agree with the Board that "since there is no evidence in the record which indicates that L. J. Christopher intended to repay these withdrawals, the mere entries made on the books of charges against him can not convert into an asset what was in fact a distribution."

Appellant suggests that the distribution was not a dividend because the evidence fails to show that the holders of the qualifying shares participated therein. Assuming that the beneficial interest of the qualifying shares was not in appellant, the owners of such shares are not complaining; nor could they, having acquiesced in his management and control of the corporation for years. (*Ratcliff* v. *Clendenin*, 232 F., 61; *Allen* v. *Wilson*, 28 F., 677. See also *Hadley* v. *Commissioner of Internal Revenue*, 59 App. D. C., 139, 36 F. (2d), 543 [Ct. D. 153, C. B. IX–1, 266].) Certainly appellant is not in a position to complain.

It is contended that the Board erred in finding that the item of $12,093.46 was a dividend. On this point the Board said: "The petitioner further faintly contends that he should not be charged with the item of $12,093.46. The burden rests upon petitioner to overcome the findings of respondent (Commissioner) on this point. Although he testified at the hearing, he gave no testimony with respect to this item * * *." On this state of the record, the presumption in favor of the correctness of the conclusions below has not been overcome.

It further is contended that the Board erred in holding that appellant received a taxable dividend in the amount stated from the California company, "when under the provisions of section 201(f) of the Revenue Act of 1921 no

such amount was available to said company for the payment of dividends." Appellant argues that since he received the bulk of his withdrawals within the first 60 days of 1921, he can not in view of section 201(f) of the 1921 Act be charged with dividends in excess of the amount of the undistributed earnings of the corporation as of January 1, 1921. Such a construction of section 201(f), brings that section into conflict with section 201(b).

Section 201(b) reads: "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; * * *." [Italic ours.]

It has been held that this section means that so long as a corporation has on hand earnings or profits accumulated since February 28, 1913, and available for distribution, every distribution made to stockholders is made from the most recently accumulated earnings or profits, and in effect the statute creates a presumption that the distributions were so made. (*McCaughn* v. *McCahan*, 39 F. (2d), 3; *Leland* v. *Commissioner of Internal Revenue*, 50 F. (2d), 523 [Ct. D. 387, C. B. X–2, 300].)

Section 201(f) provides that "any distribution made during the first 60 days of any taxable year shall be deemed to have been made from earnings or profits accumulated during preceding taxable years; * * *. This subdivision shall not be in effect after December 31, 1921."

This subdivision first found its way into the taxing Acts as section 201(e) of the Revenue Act of 1918 (Act of February 24, 1919, ch. 18, 40 Stat., 1057), and was reenacted as section 201(f) in the 1921 Act. Just why it was enacted does not appear. It is, however, obvious that the apparent conflict between this subdivision and subdivision (b) of section 201 required elucidation by the administrative officers.

Regulations 45, article 1542, under the 1918 Act, was promulgated, in which section 201 was interpreted as follows:

"*Presumption as to source of distribution.*—In the case of a corporation other than a personal service corporation any distribution to stockholders is deemed to have been made so far as possible * * * (c) if during the first 60 days of a taxable year, from earnings or profits accumulated during preceding taxable years; and (d), if during the remainder of a taxable year after the first 60 days, from earnings or profits accumulated during the taxable year up to the date of distribution. The presumption contained in clauses (c) and (d) affects the determination of invested capital for the purpose of the war profits and excess profits tax, but has no effect upon the rates at which dividends paid in 1918 and subsequent years are taxed. * * *"

Regulations 62, article 1542(b), under the 1921 Act, was promulgated, in which section 201(f) was interpreted as follows:

"* * * The presumptions contained in this paragraph affect the determination of invested capital for the purpose of the excess profits tax, and are not in effect after December 31, 1921."

As thus interpreted, section 201(b) and section 201(f) of the 1921 Act do not conflict, for section 201(f) has no effect upon the rates at which dividends paid in 1921 are taxed in the hands of the distributee. Administrative regulations contemporaneously construing a statute and made for its enforcement, and which are not unreasonable or inconsistent with the statute, "will not be overruled except for weighty reasons." (*Fawcus Machine Co.* v. *United States*, 282 U. S., 375 [Ct. D. 278, C. B. X–1, 424].) The interpretation placed upon the statute by the administrative officers was not, in our view, either unreasonable or in conflict with the provisions of the statute. A similar section in the 1918 Act was (under Regulations 45) held to affect the determination of invested capital for the purpose of the excess profits tax. The 1921 Act (section 301) repealed the excess profits tax as to income received after the calendar year 1921, and it is significant that the same Act provided that section 201(f) (which the administrative officers had again held to affect only the determination of invested capital for the purpose of the excess profits tax) should likewise not be in effect after the calendar year 1921, to wit, December 31, 1921.

Finally, it is contended that the only issue raised in the pleadings was whether or not the distribution made by the California company was a liquidating dividend and that, therefore, the Board was without jurisdiction to determine that it was in fact an ordinary dividend. The record does not sustain this contention of appellant. Moreover, all the facts were before the Board and it found therefrom, as it was authorized to do, the correct amount of the

deficiency. (*Hughes* v. *Commissioner*, 38 F. (2d), 755; *Seufert Bros. Co.* v. *Lucas*, 44 F. (2d), 528; *Hurwitz* v. *Commissioner*, 45 F. (2d), 790. See, also, *Lewis-Hall Iron Works* v. *Blair*, 57 App. D. C., 364, 23 F. (2d), 972.)

The decision is affirmed.

Affirmed.

ARTICLE 1545: Distributions in liquidation. XI-40-5746
Ct. D. 574

INCOME TAX—REVENUE ACT OF 1926—DECISION OF COURT.

1. DIVIDEND—PARTIAL DIVIDEND IN LIQUIDATION.

A certain distribution paid to the stockholders of a corporation was not a regular dividend paid out of surplus and current earnings but is held to have been a liquidating dividend, one of a series of distributions in complete cancellation or redemption of all of its stock. An amount so distributed should be treated as in part or full payment in exchange for the stock in accordance with section 201(c) of the Revenue Act of 1926.

UNITED STATES CIRCUIT COURT OF APPEALS, EIGHTH CIRCUIT. MARCH TERM, 1932.

No. 9269. *Milton Tootle, jr., petitioner*, v. *Commissioner of Internal Revenue, respondent.*

No. 9270. *William D. Tootle, petitioner*, v. *Commissioner of Internal Revenue, respondent.*

No. 9271. *John W. Craver, petitioner*, v. *Commissioner of Internal Revenue, respondent.*

No. 9272. *Graham G. Lacy, petitioner*, v. *Commissioner of Internal Revenue, respondent.*

No. 9273. *Hal Y. Lemon, petitioner*, v. *Commissioner of Internal Revenue, respondent.*

No. 9274. *Milton Tootle, III, petitioner*, v. *Commissioner of Internal Revenue, respondent.*

On petitions to review the decisions of the United States Board of Tax Appeals.

Before STONE and KENYON, Circuit Judges, and CANT, District Judge.

[April 13, 1932.]

OPINION.

STONE, Circuit Judge, delivered the opinion of the court.

These are petitions to review redeterminations of the income taxes of petitioners for 1926. Each petitioner was a common stockholder in the Aunt Jemima Mills Co. (a Delaware corporation) and the controversy, in each case, is whether a dividend paid in 1925 is to be treated as an ordinary or as a dividend in course of liquidation. The taxpayers included it in their return as an ordinary dividend. The Commissioner and the Board of Tax Appeals determined it to be a partial dividend in a liquidation and, as such, taxable under section 201(c) of the Revenue Act of 1926 (U. S. C. A., Title 26, section 932, 44 Stat., 9, 10).

The facts are stipulated and are as follows: The Aunt Jemima Mills Co. was a Delaware corporation with a large amount of nonpar-value stock outstanding in the hands of various holders, including these petitioners. As of October 31, 1925, the balance sheet of the company showed surplus and earnings of $870,176 (including profits for 1925 of $363,296.97 and cash in banks and on hand of $146,330.19). On November 14, 1925, the company officers sent out notices for a stockholders' meeting, upon November 24, 1925, to consider the sale of the property and business to the Quaker Oats Co. This notice and a blank proxy were inclosed in a letter to the stockholders. Each of these stated that the Quaker Oats Co. had made an offer to purchase "all of its property and assets, including its business and good will, except its cash on hand and its claim or

claims against the United States for refund of Federal taxes" (not material here), and that the board of directors thought the offer should be accepted. In the letter, it was stated that the directors believed that the purchase price "with cash on hand" would be sufficient to pay "at least eighty dollars ($80) per share for the outstanding common stock of the company" and that "under this offer it is possible that the returns to holders of common stock might be slightly in excess of $80 per share."

The stockholders' meeting authorized the sale and a contract of sale was entered whereby the company sold and delivered, as of that date (November 24, 1925), all of the property, assets, business and good will "except only the cash on hand and in bank of the first party on October 31, 1925, as shown on said balance sheet, and the claims of the first party against the United States Government for a refund of Federal taxes." On the price of $4,202,077.28, a down payment of $2,000,000 was made. The balance was payable $1,202,077.28 upon delivery of assignments of all trade-marks and trade-mark registrations and $1,000,000 within 15 days after delivery of deeds to the real estate. The purchaser was to have the right to use the corporate name of the seller as far as the purchaser desired "to enable it to obtain the full benefit of the good will and of the business hereby sold." The company agreed "as soon as practicable after the transfer of the property * * * to liquidate and to distribute its assets among the stockholders, and will thereupon be dissolved as a corporation * * * which shall be completed not later than one year from the date of such transfer" or it would "distribute its assets among its stockholders, and will thereupon cause its capital stock to be reduced to a nominal amount, and transfer and assign such nominal amount of its capital stock" to the purchaser.

The initial payment of $2,000,000 was made on November 25, 1925. On December 12 or 15, 1925, the directors passed a resolution that "they deemed it advisable and most for the benefit of the corporation that it should be dissolved, and that its debts should be paid and that the remainder of its cash and the proceeds derived from the sale of its properties and assets should be distributed to its stockholders and the business of the corporation finally liquidated" and then called a meeting of the stockholders for January 15, 1926, "to consider the question of the final dissolution of the corporation and the distribution of its cash and the proceeds derived from its property and assets, after the payment of its debts, to its stockholders." Thereafter, and on the same day, was declared the dividend involved here, by the resolution following:

"Whereas, this corporation has sold to the Quaker Oats Co. all of its property and assets except cash on hand and its claim or claims against the United States Government for a refund of taxes, and this corporation has agreed to liquidate its affairs and to dissolve; and

"Whereas, it is estimated that the sum paid by the Quaker Oats Co. for the properties and assets of the corporation, together with cash on hand and other assets, will be sufficient to pay all holders of the nonpar-value common stock of the corporation, not less than eighty dollars ($80) per share; and

"Whereas, the board of directors of the corporation have called a meeting of its stockholders, to be held between the hours of 10 o'clock a. m. and 3 o'clock p. m., on Friday, the 15th day of January, 1926, to convene at 10 o'clock a. m., to consider the question of the final dissolution of the corporation and the distribution of its cash and the proceeds derived from its property and assets, after the payment of its debts, to its stockholders; and

"Whereas, the corporation now has on hand an earned surplus and undivided profits sufficient to distribute therefrom to each share of said nonpar-value common stock the sum of twenty-five dollars ($25); and

"Whereas, the board of directors in their judgment deem it advisable and most for the benefit of the corporation that such distribution should be made as a part payment of the total sum to be paid to the holders of such stock by reason of the sale of the properties and assets of the corporation to the Quaker Oats Co. and the dissolution of the corporation:

"Therefore, resolved, that the corporation distribute to the holders of its nonpar-value common stock from its earned surplus the sum of twenty-five dollars ($25) per share for each and every share thereof, upon condition, however, that such distribution shall constitute a part of the payment to be made to the holders of the nonpar-value common stock of the corporation by reason of the sale of its properties and assets to the Quaker Oats Co. and the dissolution of the corporation.

"Resolved, further, that the president and secretary of the corporation prepare and mail to each and every holder of the nonpar-value common stock of

the corporation, at his or her last known place of residence a written or printed notice, advising them of the distribution to be made to the holders of such stock, and requesting such stockholders to forward their stock to the corporation or to some bank or agent in the city of St. Joseph, Mo., in order that proper indorsement may be made thereon, when payment is made.

"Resolved, further, that all payments made to the stockholders by virtue hereof shall be a part of the total amount to be paid to such stockholders by reason of the sale of the properties and assets of the corporation, from which, together with cash on hand and the proceeds from other assets of the corporation, it is estimated that the holders of nonpar-value common stock will ultimately receive not less than eighty dollars ($80) per share for each and every share of such stock, and that no payment shall be made to any person or persons except stockholders of record at the time or times payments are actually made, and, unless and until the certificate or certificates evidencing such stock ownership shall be presented to the corporation, in order that proper indorsement of such payment or payments may be made thereon.

"Resolved, further, that the president and secretary of the corporation be, and they hereby are authorized and directed to pay, or cause to be paid, to the holders of the nonpar-value common stock of the corporation, from its earned surplus, the sum of twenty-five dollars ($25) per share, by reason of the distribution hereby ordered, when and not until the certificate or certificates evidencing such stock shall be presented to the corporation and indorsed as follows:

"'There has been paid upon this certificate the sum of twenty-five dollars ($25) for each and every share of nonpar-value common stock of Aunt Jemima Mills Co. evidenced by such certificate, pursuant to a distribution ordered by the board of directors of said corporation on the 15th day of December, 1925, said distribution being a part of the total sum to be paid to the holders of common stock by reason of the sale of the corporation's properties and assets to the Quaker Oats Co. and the final dissolution of the corporation.'

"AUNT JEMIMA MILLS CO.,
"By ———, *Secretary.*
———, *Treasurer.*"

Each of these petitioners was paid the dividend and the above indorsement was made upon his certificates of stock.

At the stockholders' meeting on January 15, 1926, a resolution was passed providing for and authorizing the directors and officers to proceed to dissolve the corporation and distribute the assets. On the same day, the directors declared a "liquidation dividend" of $50 per share paid "as soon as the certificate of the dissolution of the corporation shall be issued by the State of Delaware and the balance due to the corporation by the Quaker Oats Co. shall have been paid; provided, however, that no payment shall be made upon any certificate of stock until such stock shall be presented at the office of the corporation in St. Joseph, Mo., and until there shall be indorsed thereon the following certificate of payment, to wit:

"There has been paid on this date, upon each and every share of stock evidenced by this certificate the sum of fifty dollars ($50) as a liquidation dividend.

"Dated at St. Joseph, Mo., this —— day of ——, 1926.

----------,
"*Secretary.*

----------,
"*Treasurer.*"

Further liquidating dividends were authorized on June 1, 1926, of $3.50, on June 15, 1927, of $6.70, and on December 19, 1929, of $0.052 per share.

Petitioners present their argument under four headings with various subheadings. The first heading is that the stipulated facts compel the conclusion that this was an ordinary dividend because the directors had and exercised the discretion (without fraud) to declare this dividend from surplus and profits without impairment of capital and because the dividend was so declared under compulsion of the Revenue Act of 1926 (section 220 and Regulations 69, articles 353, 1545).

As to the first reason, two matters are destructive. The first is that the dividend was, as a matter of fact, not paid and could not have been paid from surplus and/or earnings. At the time this dividend was declared, the entire property of the corporation had been sold, under authorization of the stock-

holders, except the cash on hand and a claim for tax refunds. The contract of sale required the distribution of all assets to the stockholders and the dissolution or mere nominal existence of the corporation. This sale was on the basis of the balance sheet of October 31, 1925, which showed only $146,330.19 cash on hand while this dividend would require $831,825 to make payment on the outstanding common stock. While the balance sheet shows combined surplus and earnings of $870,176 (including the above cash on hand) it is clear that all thereof except the cash on hand was invested in property which passed to the purchaser. Without the initial purchase payment of $2,000,000, there would have been no funds to meet this dividend. Petitioners contend that:

"The mere fact that a sale of assets in which the surplus was in part temporarily invested produced the cash from which the dividend was paid does not indicate a liquidation of capital."

It is difficult to see how a part of a total price for all assets (which happen to include property bought with surplus and earnings) can be segregated and called "surplus" or "earnings." It is purchase price and nothing else.

The second difficulty with this position of petitioners is that the dividend was clearly intended by the directors to be a partial liquidation. It is true that the resolution speaks of having "on hand an earned surplus and undivided profits sufficient to distribute therefrom to each share * * * the sum of $25," and declares the distribution to be "from its earned surplus." However, the resolution itself sets out that the corporation has sold all of its property (except cash on hand and its tax refund claim) "and this corporation has agreed to liquidate its affairs and to dissolve"; that it is estimated that the purchase price, with cash on hand and other assets, will pay not less than $80 per share; that a call has been made for a stockholders' meeting to act upon dissolution and final distribution; that the directors deem it advisable that the distribution of this dividend be made "as a part payment of the total sum to be paid to the holders of such stock by reason of the sale of the properties and assets of the corporation to the Quaker Oats Co. and the dissolution of the corporation"; that "all payments made to the stockholders by virtue hereof shall be a part of the total amount to be paid to such stockholders by reason of the sale of the properties and assets of the corporation, from which, together with cash on hand and the proceeds from other assets of the corporation, it is estimated that the holders of nonpar-value common stock will ultimately receive not less than eighty dollars ($80) per share for each and every share of such stock"; and that no payment shall be made of this dividend until the stock certificate shall be indorsed with an indorsement stating that this distribution is "a part of the total sum to be paid to the holders of common stock by reason of the sale of the corporation's properties and assets to the Quaker Oats Co. and the final dissolution of the corporation."

In short, while the "distribution" was to be made from "earned surplus," it was very clearly stated that it was made as a partial distribution in view of dissolution and could not be received unless accepted upon that basis. There is no need to go beyond the terms of the resolution which made this distribution in order to determine conclusively the character of the distribution. If such were necessary, every attendant and surrounding circumstance would speak the same thought. Here was a corporation which had sold its entire assets and business and, as securing such result to the purchaser, had agreed to dissolve within a year. It had no further business except settlement of its tax refund claim, dissolution and distribution. All of this had been sanctioned by the stockholders. The sale had been consummated, the property delivered or in course of delivery, almost half of the purchase price paid and accepted and a meeting of stockholders called to comply with the contract requirement of dissolution. At the time this distribution was provided for, the corporation was an existing but not, in reality, a going business concern. The only business for which it existed had entirely ceased and it was obligated not to engage therein further.

As to the reason that the dividend was compelled by the provisions of the Act (section 220) and the departmental regulations. It may be that it was apprehension of the application of this section and these regulations which induced this distribution. That, however, does not determine the character of the distribution. Such character must be gathered from what was actually done.

The second heading of the argument is that this could not logically be treated as a distribution in liquidation "since no corporate action for dissolution had

been taken." It is contended that a corporation can not be "in dissolution" until after corporate action to that end by a stockholders' meeting properly convened. Without close examination and solely for the purpose of this controversy, it might be conceded that a corporation is not "in dissolution" until proper action therefor has been taken as required by the governing law. This does not help petitioners. Whatever complaint, if any, the State of Delaware or interested creditors might have made is not of concern here. The question here is not what the corporation could do but what it did. It may or may not be that the corporation could not legally distribute its assets until after it had complied with certain requirements of its parent State, but it did do that very thing and when it did so it created the situation to which the national taxing statute directly applied. These petitioners accepted and could have obtained this distribution dividend only upon condition that it was such. They can not now be heard to claim that the corporation had no right to make such character of distribution; that it is not, therefore, of such character and thus escape the applicable tax while they retain the dividend.

The third contention is that section 201, properly construed, can not apply to this situation because the section applies only to "actual distribution of capital" while this dividend was only of a part "of surplus earnings." The section carries its own definition. It reads: "Amounts distributed in partial liquidation of a corporation shall be treated as in part or full payment in exchange for the stock" (section 201(c)), and "amounts distributed in partial liquidation" is defined as meaning "a distribution by a corporation in complete cancellation or redemption of a part of its stock, or one of a series of distributions in complete cancellation or redemption of all or a portion of its stock" (section 201(b)). Was this dividend "one of a series of distributions in complete cancellation or redemption of all * * * of its stock"?

The directors had estimated to the stockholders that the contemplated sale (under a submitted offer) would result in "at least eighty dollars ($80) per share for the outstanding common stock." The stockholders had authorized the sale under a contract requiring dissolution within a year and distribution. The contract had been made. The property delivered or in course of delivery. Nearly half of the purchase price received and accepted. A stockholders' meeting to carry out the contract required dissolution and distribution had been called. The dividend (called "distribution" in the resolution declaring it) had been ordered "as a part payment of the total sum to be paid to the holders of such stock by reason of the sale of the properties and assets of the corporation to the Quaker Oats Co. and the dissolution of the corporation." It was an express condition that no payment of the dividend be made to any stockholder "until" his certificate of stock be indorsed that such payment was "a part of the total sum to be paid to the holders of common stock by reason of the sale of the corporation's properties and assets to the Quaker Oats Co. and the final dissolution of the corporation." By far the larger part of this dividend had to be and was paid from a payment on the purchase price. The stockholders' meeting was held and authorized complete dissolution and distribution. Subsequent "liquidation" dividends were declared which, with this dividend, totaled $85.252 per share. When the next to the last dividend was paid it was conditioned "upon the delivery of common stock certificates to be retained" by the directors and the last dividend was "payable at once to stockholders who have surrendered their certificates, and payable to those who have not surrendered their certificates, upon receipt of the certificates, which certificates will be retained by us."

From this outline, it must be clear that this dividend was never intended, nor understood to be, nor could be other than "one of a series of distributions in complete cancellation or redemption of all * * * of its stock." This is not an instance of doubtful application of the statute nor is the urged analogy of the application of dividends as between life tenant and remainderman useful.

The final contention is that the Board of Tax Appeals and the departmental regulations and rulings have uniformly construed similar dividends to be not in liquidation and that much weight should be accorded this "practical construction of a statute by officers or departments whose duty it is to enforce it." Without determining here whether the construction contended for has been that of the Board of Tax Appeals or of the administrative officers, it is enough to say that we entertain no doubt concerning the construction to be placed upon the provisions, here involved, of the statute.

The petitions for review must be dismissed.

ARTICLE 1545: Distributions in liquidation. XI-49-5898
Ct. D. 607

INCOME TAX—REVENUE ACT OF 1921—DECISION OF COURT.

1. DIVIDEND—REORGANIZATION—EARNINGS OF PREDECESSOR CORPORATION.

Where there is a reorganization of a corporation within the meaning of section 202(c)2 of the Revenue Act of 1921 involving the transfer of its assets and an exchange of its stock for stock of a new corporation on which no gain or loss is recognized under that paragraph, the two corporations are identical in a consideration of the nature for the purpose of taxation of a distribution in 1923 of the earnings of the old corporation accumulated since February 28, 1913, and a distribution in liquidation received in that year from the new corporation, which made no profits, is a dividend as defined by section 201(a) of the Revenue Act of 1921 to the extent that it is a distribution of the earnings or profits of the old corporation accumulated since February 28, 1913.

2. DECISION REVERSED.

The decision of the Board of Tax Appeals (22 B. T. A., 1171) is reversed.

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

Commissioner of Internal Revenue, petitioner, v. *Frederick A. Sansome, respondent.*

On petition of the Commissioner of Internal Revenue to review an order of the Board of Tax Appeals, vacating a deficiency assessed by him against a taxpayer upon his income tax for 1923.

Before L. HAND, AUGUSTUS N. HAND, and CHASE, Circuit Judges.

[July 26, 1932.]

OPINION.

L. HAND, Circuit Judge: Sansome, the taxpayer, on January 1, 1921, bought some shares of stock, having $100 par value, in a New Jersey company, which on April 1, 1921, sold out all its assets to another company of the same State. The new company assumed all existing liabilities, and issued its shares to the shareholders of the old, without change in the proportion of their holdings, though the number of new shares was increased five times, and they were without par value. The new charter differed only in that the company could manufacture other products besides silk, to which the charter of the old company had been confined. There was no other change in the "financial structure," as the phrase is.

The old company had carried upon its books a large surplus and undivided profits, which we may assume to have been altogether earned before January 1, 1921, and which the new company carried over at the same figure upon its books for the year, 1921, but somewhat reduced because of losses in 1922. The business made no profit, and the company was dissolved in 1923. During this year Sansome received payments upon his shares in liquidation which the Commissioner included in his returns as dividends for the year 1923, for the distribution of that year did not exhaust the surplus and undivided profits which still remained. Sansome protested; he wished to use these dividends to compute the "gain" upon his investment; that is, to take all liquidating dividends first to amortize his cost, or "base," and return any overplus as profit in the year, 1924, when the last payment was made. The question is whether section 201 of the Revenue Act of 1921 justified the Commissioner's position. The Board held that as the companies were separate juristic persons, the later one had distributed nothing "out of *its* earnings or profits."

Section 201 of 1921 differed from the same section in the Act of 1918, which expressly provided that all liquidation dividends should be taken as in exchange for shares, and that the gain should be computed by the formula which Sansome wished to use; and the Act of 1924 (section 201(c)) restored the law to its original form. The change of 1921 must have been deliberate and

we can not disregard it; it is also unequivocal, only distributions not allocated to profits by subdivision (b) may be used to reduce the subtrahend for computing the gain derived, or the loss sustained. This means that the shareholder is to be taxed upon the dividends as such so far as they represent profits, calculated under the preceding subdivision and that what is left shall be treated as amortizing his cost. The rule would work in some cases to the taxpayer's advantage and in others not; he escapes normal taxes pro tanto, provided he has enough income in later years to use as a deduction the loss calculated upon the reduced payments. (*McCaughn* v. *McCahan*, 39 Fed. (2d), 3 (C. C. A. 3); *Phelps* v. *Commissioner*, 54 Fed. (2d), 289 (C. C. A. 7) [Ct. D. 478, C. B. XI–1, 24]; *Appeal of Darrow*, 8 B. T. A., 276; *Appeal of Hamilton Woolen Co.*, 21 B. T. A., 324.)

Nor is there doubt as to the constitutionality of the section. When Sansome bought the old shares, the profits had indeed been already earned; yet he might be taxed upon ordinary dividends paid out of them (*United States* v. *Phellis*, 257 U. S., 156, 171, 172 [T. D. 3270 (Ct. D. 19), C. B. 5, 37]; *Taft* v. *Bowers*, 278 U. S., 470, 484 [Ct. D. 49, C. B. VIII–1, 226]). He could not successfully assert that such dividends must be computed as part of his gain on the transaction, but must be content with a corresponding allowance when he sold. If so, Congress might insist that a dividend in liquidation should be treated like any other, for while this may violate ordinary usage, once we conceive as income of the change from undivided profits to an immediately available dividend, the rest follows. The taxpayer gets his quid pro quo in the closing transaction. Though it is a chance whether the final resultant will be favorable or not, the dice are not loaded against him. Thus, there was income to tax as much as though the company continued its life; and it was not an unfair method.

All this the Board accepted, but held with Sansome, because it treated the company as new and independent, and the liquidating dividends as distributed out of capital, not "out of its earnings or profits," of which there were none. Under the Act of 1916, which had not yet developed the elaborate definition of the later statutes, greater corporate differences have been considered not to break the identity of the older company (*Weiss* v. *Stearns*, 265 U. S., 242 [T. D. 3609, C. B. III–2, 51]). In *Marr* v. *United States* (268 U. S., 536 [T. D. 3755, C. B. IV–2, 116]), still greater differences did indeed change the result, but for our purposes the decision is irrelevant, for the facts were wide of those at bar. *Western, etc., Co.* v. *Commissioner* (33 Fed. (2d), 695) (C. C. A. 4) was a stronger case for the petitioner here, and *Phillips* v. *Howe* (33 Fed. (2d), 891) (C. C. A. 3) was substantially on all fours, for we attach no importance to the language of the Pennsylvania statute. In *Pioneer, etc., Co.* v. *Commissioner* (55 Fed. (2d), 861) (C. C. A. 6) the new company had been organized in a different State, a conceivable distinction (vide *Marr* v. *United States*), but not enough. Even that is absent here.

However, we prefer to dispose of the case as a matter of statutory construction, quite independently of decisions made in analogous, though not parallel, situations. It seems to us that section 202(c)2 should be read as a gloss upon section 201. That section provides for cases of corporate "reorganization" which shall not result in any "gain or loss" to the shareholder participating in them, and it defines them with some particularity. He must wait until he has disposed of the new shares, and use his original cost as the "base" to subtract from what he gets upon the sale. Such a change in the form of the shares is "an exchange of property," not "a sale or other disposition" of them. Section 201 was passed, in some measure at least, to fix what should come into the computation of "gain or loss"; it allowed all payments except those cut out by subdivision (c). It appears to us extremely unlikely that what was not "recognized" as a sale or disposition for the purpose of fixing gain or loss, should be "recognized" as changing accumulated profits into capital in a section which so far overlapped the later. That in substance declared that some corporate transactions should not break the continuity of the corporate life, a troublesome question that the courts had beclouded by recourse to such vague alternatives as "form" and "substance," anodynes for the pains of reasoning. The effort was at least to narrow the limits of judicial inspiration, and we can not think that the same issue was left at large in the earlier section. Hence we hold that a corporate reorganization which results in no "gain or loss" under section 202(c)2 does not toll the company's life as a continued venture under section 201, and that what were "earnings or profits" of the original, or subsidiary, company re-

main, for purposes of distribution, "earnings or profits" of the successor, or parent, in liquidation. As the transaction—"reorganization"—between the companies at bar fell plainly within section 202(c)2, it seems to us that the Board was wrong.

Order reversed; cause remanded for further proceedings in accord with the foregoing.

SECTION 202.—DETERMINATION OF AMOUNT OF GAIN OR LOSS.

ARTICLE 1561: Determination of the amount of gain or loss. . XI–30–5563 G. C. M. 10754

REVENUE ACT OF 1924.

In *Ann Arbor Railroad Co.* v. *Commissioner* (Docket No. 34918), unreported, the Board of Tax Appeals held that section 202(b) of the Revenue Act of 1924 was not intended to prohibit the reduction of the basis for determining the loss by depreciation actually sustained prior to the inception of the Excise Tax Act of 1909.

General Counsel's Memorandum 8573 (C. B. IX–2, 168) modified.

Reference is made to General Counsel's Memorandum 8573, supra. In that memorandum the conclusion was reached that in computing the amount of gain or loss under section 202(a) of the Revenue Act of 1924 on the sale or other disposition of property, the adjustment to the basis required by section 202(b) of that Act to be made on account of "any item of loss, exhaustion, wear and tear, obsolescence, amortization, or depletion, *previously allowed* with respect to such property" [italics supplied], does not include a reduction of cost on account of depreciation sustained prior to 1909, for the reason that the Federal revenue laws in effect prior to that year contained no provision under which the Commissioner was required to consider depreciation deductions.

This conclusion was based primarily upon Solicitor's Memorandum 4249 (C. B. IV–2, 15), in which it was stated that depreciation "previously allowed" with respect to property, within the meaning of section 202(b) of the Revenue Act of 1924, contemplates an adjustment of "basis" "*only for deductions which have in prior years been actually granted by the Commissioner in computing the net income of the taxpayer.* The deduction for depreciation must, accordingly, not only have been allowable, but the Commissioner must have actually granted the deduction in determining net income *for prior years.* A deduction is not 'allowed' until it is passed upon and approved by the Commissioner. Depreciation, however, may be 'previously allowed,' although it has not been taken in a return, as its allowance, for example, in a claim for refund." [Italics in original.]

This office is now of the opinion that Solicitor's Memorandum 4249, supra, was intended to deal only with adjustment of basis for depreciation which occurred in 1909 and later years, that is, after the beginning of Federal revenue laws which take into consideration in some form or other depreciation as an annual deduction from gross income. The ruling was given too broad an application in General Counsel's Memorandum 8573, supra. This is indicated by the action of the Board of Tax Appeals in the case of *Ann Arbor Railroad Co.* v. *Commissioner* (Docket No. 34918), unreported to date, which in-

volved the question whether the cost of certain equipment which was retired during the taxable year 1924 should be reduced by depreciation sustained prior to July 1, 1907, for the purpose of determining the deductible loss for tax purposes. The Board held that section 202(b) of the Revenue Act of 1924 was not intended to prohibit the reduction of the basis for determining the loss by depreciation actually sustained prior to the inception of the Excise Tax Act of 1909.

In view of this decision by the Board of Tax Appeals, General Counsel's Memorandum 8573, supra, is hereby modified to accord with such decision.

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

ARTICLE 1561: Determination of the amount of gain or loss. XI-32-5596 Ct. D. 529

INCOME TAX—REVENUE ACT OF 1926—DECISION OF COURT.

1. INCOME—SALE—GAIN—TRANSFER OF STOCK.

The transfer by taxpayers to the S Amusement Co., pursuant to a written agreement, of one-half of the capital stock of the J Amusement Co., is held to constitute a sale which is not defeated by a collateral agreement that the taxpayers should make future contributions to or for the use of the J Amusement Co. for the construction of a theater or by the pledge of a part of the purchase price to secure this being done or by the actual use of part of it in making the contributions. The price of the stock being arrived at on condition that the taxpayers would pay the liabilities of the J Amusement Co. up to a specified date, an amount paid by the taxpayers in discharging such liabilities is a capital investment which added to the value of each one-half of the capital stock of that company, one-half of which amount should therefore be deducted from the consideration received from the sale of the stock in determining the amount of gain from the sale under section 202 of the Revenue Act of 1926.

2. DECISION AFFIRMED.

The decision of the Board of Tax Appeals (20 B. T. A., 334) is affirmed.

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT.

No. 6338. *J. C. Clemmons, petitioner*, v. *Commissioner of Internal Revenue, respondent.*

No. 6339. *Mrs. J. C. Clemmons, petitioner*, v. *Commissioner of Internal Revenue, respondent.*

No. 6340. *Sol. E. Gordon, petitioner*, v. *Commissioner of Internal Revenue, respondent.*

No. 6341. *Mrs. Sol E. Gordon, petitioner*, v. *Commissioner of Internal Revenue, respondent.*

Petitions for review of the decision of United States Board of Tax Appeals, district of Texas.

Before BRYAN, SIBLEY, and WALKER, Circuit Judges.

[December 18, 1931.]

OPINION.

SIBLEY, Circuit Judge: These are petitions by Sol E. Gordon and J. C. Clemmons and the wife of each to review a decision of the Board of Tax Appeals

whereby each petitioner was held to have realized a taxable gain during the year 1925 in a transaction involving the transfer to Saenger Amusement Co. of one half of the capital stock of the Jefferson Amusement Co., the other half being retained by the petitioners. The two wives are concerned because of the community property laws of Texas, but they do not figure otherwise in the transaction. Gordon and Clemmons owned the entire 500 shares of the capital stock of Jefferson Amusement Co., which had cost them $13,030.16. Threatened with competition in the local moving picture business by Saenger Amusement Co., they arranged as they describe it, "to go fifty-fifty" with that company in it and in the building of a better theater. On February 17, 1925, a written agreement was made between Gordon and Clemmons of the first part, and Saenger Amusement Co. of the second, which, after preliminary recitals, stated: "Now, therefore, said parties of the first part, for and in consideration of the sum of $87,500 agreed to be paid to them by said Saenger Amusement Co., have transferred, assigned, indorsed and delivered, and by these presents do transfer, assign, indorse and deliver unto the said Saenger Amusement Co. 250 shares, or an equal undivided one-half of the capital stock of the Jefferson Amusement Co." It was provided that the mode and manner of payment was to be later agreed on. The interest of Saenger Amusement Co. in the earnings was to date from March 1, 1925, and Gordon and Clemmons were immediately to negotiate with the owners of a named theater for a 10-year lease thereon. On February 28 a supplemental agreement was made, joined in by the Jefferson Amusement Co., which recited the former agreement and stated "that Sol E. Gordon and J. C. Clemmons do now sell, convey and deliver unto said Saenger Amusement Co. said 250 shares of the capital stock of Jefferson Amusement Co." in identified certificates. "The consideration above referred to was and is agreed to be paid by the Saenger Amusement Co. to Sol E. Gordon and J. C. Clemmons as follows, to wit, the sum of $10,000 cash in hand paid to said Sol. E. Gordon and J. C. Clemmons, the receipt of which is hereby acknowledged and confessed, and the balance evidenced by eight promissory notes executed by Saenger Amusement Co. and payable to Sol E. Gordon and J. C. Clemmons" as described, bearing 7 per cent interest from date and to be secured by the transferred stock certificates as collateral attached. There were mutual warranties against any local competition and other agreements including one by Gordon and Clemmons to pay off all liabilities of Jefferson Amusement Co. on March 1, 1925. The only obligation assumed by Jefferson Amusement Co. related to the erection of a new theater. The agreement as to that was that the maximum to be invested in land, construction and equipment should be $400,000, Saenger Amusement Co. obligating itself to furnish up to $100,000 as needed, Gordon and Clemmons $100,000, and Jefferson Amusement Co. by bonds or otherwise the balance. There was no express agreement as to whether the theater should be owned in proportion to the money advanced or whether the advances should be treated as proportionate contributions to the capital of Jefferson Amusement Co. The directors of the company were to be increased to six, of which Gordon and Clemmons were to name three and Saenger Amusement Co. three. On January 9, 1926, a further supplemental agreement was signed by all parties, increasing the cost limit of the theater to $500,000, and the contributions of Saenger Amusement Co. and Gordon and Clemmons to $120,000 each. In July, 1926, the capital stock was increased to $750,000 and a total of 3,750 shares was issued to Gordon and Clemmons, and a like amount to Saenger Amusement Co. It is found as a fact by the Board that on February 28, 1925, there was also an oral understanding between Gordon and Clemmons and Saenger Amusement Co. that as the notes given by the latter were paid the money would be accumulated in a special bank account by Gordon and Clemmons to be used by them in making their contribution toward the building of the theater. During 1925 there was no special account, but the payments went into the personal accounts at the bank of Gordon and Clemmons. Beginning February, 1926, there was a special account in another bank in their name. The accumulating balance was invested from time to time in interest-bearing stocks and loans in the name of Gordon and Clemmons, the income from which was returned to the account. The money was at all times subject to check by Gordon and Clemmons, and never by Jefferson Amusement Co. Payments to that company were by check drawn in its favor. The last payment to it was $12,500 on January 13, 1928, shortly after which the account was divided between Gordon and Clemmons and closed. The total

contribution by Gordon and Clemmons to the theater fund was $40,684.75, and by the Saenger Amusement Co. the same, Jefferson Amusement Co. having paid the balance. On these facts the United States contend that there was a sale by Gordon and Clemmons of 250 shares of stock in Jefferson Amusement Co. in February, 1925, on which a large profit was realized notwithstanding part of the proceeds was straightway pledged to secure performance of an obligation. Gordon and Clemmons contend that no gain was realized, at least not in 1925, the substance of the whole transaction being an enlargement and reorganization of the Jefferson Amusement Co. wherein Saenger Amusement Co. obtained one-half of its stock in return for money contributed through Gordon and Clemmons to that corporation.

The taxpayers' contention is not sustainable. It is true that in tax matters the courts must regard the substance rather than the mere form of the transaction; but effect must be given to what persons have done rather than what they say they intended. (*Weiss* v. *Stearn*, 265 U. S., 242 [T. D. 3609, C. B. III–2, 51]; *Pugh et al.* v. *Commissioner*, 49 Fed. (2d), 77.) Much less can courts regard that which might have been done but was never even attempted. It is true, as is argued, that Jefferson Amusement Co. might have doubled its stock at the outset and sold the increase to Saenger Amusement Co. for a sum of $175,000, the amount at which its assets were valued, as a result of which Gordon and Clemmons would have been left with one-half its stock and would have realized no gain. But this was not done. The increase of capital and division of the stock made in July, 1926, was not in pursuance of any agreement had in 1925. The Jefferson Amusement Co. had no part in the original main transaction. It sold no stock and was to get no cash. In both the first and second agreements in the plainest words it was said that Gordon and Clemmons were selling the stock. They received and receipted for the cash payment, and the notes representing the balance of the purchase money were payable to them. The proceeds were deposited by them in bank to their own credit. The written agreement to help build a theater in the future did not require that any particular money be used; and if it had it would not prevent the gain from the sale which produced the money being taxable, there being merely an investment provided for it in advance of its receipt. (*Lonsdale* v. *Commissioner*, 32 Fed. (2d), 537 [Ct. D. 93, C. B. VIII–2, 237]; *Detroit Egg Biscuit Co.* v. *Commissioner*, 9 B. T. A., 1365; *Hoult* v. *Commissioner*, 24 B. T. A., 79.) The oral understanding that the payments on the notes should be retained to insure that Gordon and Clemmons would have cash to carry out their agreement to help finance the construction of the theater was probably unenforceable in the face of the parol evidence rule. (*Pugh et al.* v. *Commissioner*, supra.) But if otherwise it was at most a pledge of the money to this end, and no more hindered the ownership of the notes and cash passing to Gordon and Clemmons than the pledge of the stock certificates hindered the ownership of them passing to Saenger Amusement Co. Jefferson Amusement Co. had no right or title to the notes or money unless and until Gordon and Clemmons should pay the money over to it. In point of fact only $40,684.75 of it ever went to Jefferson Amusement Co. and $25,000 of that amount was not paid until December, 1927, and January, 1928. Otherwise Gordon and Clemmons owned and used the money as their own, together with the interest earned on it. There was a completed sale of the stock by Gordon and Clemmons in 1925 resulting in gain; in nowise defeated by the collateral agreement to make future contribution to or for the use of the corporation, or by the pledge of the purchase price to secure this being done, or by the actual use of part of it in making the contribution.

A subsidiary question is whether the gain should be reduced by the whole or only by half of the $12,346.79 paid out by Gordon and Clemmons March 1, 1925, in discharging pursuant to agreement the liabilities of Jefferson Amusement Co. as of that date. This was agreed to be done in order to make the whole stock worth the $175,000 which had been agreed on as the value of the assets. The payment was an additional capital investment by Gordon and Clemmons which added $6,173.39 to the value of each half of the stock. In selling one half Gordon and Clemmons are entitled to deduct from the gain only $6,173.39 as part of the cost of that half. The remaining $6,173.39 must stand over until the other half of the stock shall be disposed of by them.

We agree with the conclusions of the Board of Tax Appeals and the petitions to review are denied.

ARTICLE 1561: Determination of the amount of gain or loss. XI–42–5790 Ct. D. 588

INCOME TAX—REVENUE ACT OF 1918—DECISION OF COURT.

GAIN OR LOSS — SALE — UNPRODUCTIVE TIMBERLAND — CARRYING CHARGES.

In the case of unproductive timber property acquired prior to March 1, 1913, taxes on the property paid after that date may not be added to its fair market value on that date for the purpose of ascertaining the gain derived from the sale of the property under section 202(a) of the Revenue Act of 1918.

UNITED STATES CIRCUIT COURT OF APPEALS, SIXTH CIRCUIT.

H. M. O. Lumber Co., appellant, v. *United States of America, appellee.*

Appeal from the United States District Court, Western District of Michigan.

[June 27, 1932.]

OPINION.

MOORMAN, Circuit Judge: The appellant lumber company acquired timberlands prior to March 1, 1913, which had a value as of that date of $310,182, and which it sold on an installment sale contract in 1920 at a profit. In the intervening years it received no income from the property or from other sources but expended a considerable sum thereon for taxes and to clear a right of way for a railroad and for a road. In its tax returns for the years 1921 and 1924 it added this expenditure to the March 1, 1913, value for the purpose of determining the profits resulting from the sale of the property. The Commissioner ruled that the expenditure could not be added to the March 1, 1913, value, and determined the profits accordingly. The company paid the tax assessed, filed claims for refunds, which were denied, and brought this suit. The district court upheld the Commissioner's decision, and the lumber company appeals.

The company did not set out in its claim before the Commissioner the amounts expended for a railroad right of way and a road as distinguished from the amounts expended for taxes and did not introduce proof on that subject on the hearing in court. As the case is not argued here as if any part of the expenditures were for such purpose, we treat them as if wholly for taxes.

The Revenue Act of 1918, section 202(a), provides:

"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—

"(1) In the case of property acquired before March 1, 1913, the fair market price or value of such property as of that date; * * *."

No Treasury regulation issued under this section provides for the adding of taxes paid subsequently to March 1, 1913, to the value as of that date for the purpose of ascertaining the gain derived from a sale. Appellant insists, however, that such procedure is required by section 234(a) of the Act of 1918 as construed by the Treasury regulations issued thereunder. This section, subsection 9, provides that in computing the net income of a corporation subject to the tax imposed by section 230, there shall be allowed as deductions:

"In the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion and for depreciation of improvements, according to the peculiar conditions in each case, based upon cost including cost of development not otherwise deducted: *Provided*, That in the case of such properties acquired prior to March 1, 1913, the fair market value of the property (or the taxpayer's interest therein) on that date shall be taken in lieu of cost up to that date: * * *."

The Treasury regulation relied upon, article 231 of Regulations 45, declares that:

"In the case of a timber property held for future operation by an owner having no substantial income from the property or from other sources, all expendi-

tures for administration, protection, and other carrying charges prior to production on a normal basis shall be charged to capital account; after such a property is on a normal production basis such expenditures shall be treated as current operating expenses."

Appellant contends that the taxes paid on the property here in question were carrying charges within the meaning of the above regulation. We find difficulty in assenting to that view. While business men often consider the taxes that have been paid on property in fixing a price at which the property may be sold at a profit, "yet taxes and interest, when properly defined, do not really represent anything paid into the capital investment." (*Westerfield* v. *Rafferty*, 4 Fed. (2d), 590, 593 [T. D. 3667, C. B. IV–1, 96].) The regulation in question was not issued as a formula for determining gains or losses from sales, but is the Treasury Department's interpretation of provisions in the Revenue Act specifying allowable deductions in "computing net income." Furthermore, its only effect as to the matters to which it seems to be directed is to permit the charging of expenditures on undeveloped timber property to capital, eventually to be depleted by "future operation," and, as said by the court below, there is a distinct difference between permitting such expenditures to be depleted by future operations and charging them to the capital value as of March 1, 1913, for the purpose of determining gains or losses from sales. We can not think the regulation was intended to authorize the latter procedure.

Whatever may have been the purpose or intended effect of the regulation, the statute itself is mandatory and obviously can not be changed or altered by administrative action. That is income which is derived from invested capital, whether in the form of dividends or profits on sales. The capital invested in property—nontaxable of course—is the cost or, in case the property was acquired before March 1, 1913, the ascertained value as of that date. Taxes subsequently paid on the property do not represent increase in value, but are paid as an incident to ownership. If they may be added to the March 1, 1913, value in determining the base for ascertaining gains from sale, there is no reason why interest on the investment should not also be added. The latter is impossible in view of *Hays* v. *Gauley Co.* (247 U. S., 189). Neither is a part of the invested capital. So much was held in *Westerfield* v. *Rafferty*, supra; *Fraser* v. *Commissioner* (25 Fed. (2d), 653); and *Central Real Estate Co.* v. *Commissioner* (47 Fed. (2d), 1036 [Ct. D. 362, C. B. X–2, 219]). Plainly, therefore, the taxes in question should not have been added to the March 1, 1913, value in determining gains from the sale. We find no reason to doubt and the appellant has cited no authority to show that taxing gains from sales on this basis is not within the purview of the sixteenth amendment.

Judgment affirmed.

SECTION 203.—RECOGNITION OF GAIN OR LOSS FROM SALES AND EXCHANGES.

ARTICLE 1571: Recognition of gain or loss. XI–34–5622
Ct. D. 543

INCOME TAX—REVENUE ACT OF 1921—DECISION OF COURT.

1. GAIN OR LOSS—RECOGNITION—SALE OF PROPERTY FOR STOCK.

Where the members of a partnership in 1921 organized a corporation for the purpose of acquiring and holding real estate owned by the partnership, and on a later day in the same month they paid cash or its equivalent in part payment for their subscriptions for 494 of the 500 shares of the corporation stock, and the corporation purchased the real estate at a specified price, paying therefor partly in cash and crediting the balance as a payment on the stock, the transaction is within the provisions of section 202(c)3 of the Revenue Act of 1921, and no gain or loss to the partners from the transaction is recognized under that paragraph.

2. DECISION AFFIRMED.

The decision of the Board of Tax Appeals (18 B. T. A., 332) is affirmed.

COURT OF APPEALS OF THE DISTRICT OF COLUMBIA.

Sylvester W. Labrot, Elizabeth H. Labrot, appellants, v. David Burnet, Commissioner of Internal Revenue.

Before MARTIN, Chief Justice, and ROBB, VAN ORSDEL, HITZ, and GRONER, Associate Justices.

[February 15, 1932.]

OPINION.

HITZ, Associate Justice: This case is here under chapter 27, sections 1001, 1002, and 1003 of the Revenue Act of 1926 (44 Stat., 9, 109–110), on petition for review of decisions of the United States Board of Tax Appeals.

Petitioners, husband and wife, were notified of a finding by the respondent of a deficiency in their income taxes for the year 1921, amounting in his case to some $12,500 and in hers to slightly less.

The questions involved are identical.

Something over 20 years ago they formed a partnership known as Labrot & Co. for the purpose of holding all of the property belonging to the partners.

Each of them owned a half interest in the partnership.

Thereafter the partnership acquired 550 acres of land in Anne Arundel County, Md., and extensively improved it under the name of Holly Beach Farm, all of which cost $195,443.38.

In 1920 the partnership purchased Tryall Farm, adjoining, containing about 450 acres, for $65,098.

July 8, 1921, the petitioners formed a corporation under the laws of Maryland, which they called Labrot & Co., Inc., for the purpose of taking over and holding the real estate then owned by the partnership.

Of its capital stock of 500 shares, par value $500 a share, petitioners subscribed for 494 shares, W. H. Labrot and S. W. Labrot, jr., 2 shares each, and one Mims and one Marshall 1 share each.

On July 26, 1921, the partnership paid $86,440.53 in cash or its equivalent, on account of these subscriptions.

The same day it made an offer to sell to the corporation Holly Beach Farm for $75,000 and Tryall Farm for $55,000, which offer was immediately accepted.

The corporation thereupon paid the partnership $75,000 by check for the Holly Beach Farm and similarly $5,000 on the purchase of Tryall.

The remaining $50,000 was credited on its books as a payment on the stock.

Thereafter petitioners in their income tax returns deducted as a loss the difference between the cost to the partnership of the two farms and the sale price to the corporation.

The deduction was disallowed by the Commissioner of Internal Revenue and his action was upheld by the Board of Tax Appeals.

Section 202(c)3 of the Revenue Act of 1921 provides:

"(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—

* * * * * * *

"(3) When (A) a person transfers any property, real, personal or mixed, to a corporation, and immediately after the transfer is in control of such corporation, or (B) two or more persons transfer any such property to a corporation, and immediately after the transfer are in control of such corporation, and the amounts of stock, securities, or both, received by such persons are in substantially the same proportion as their interest in the property before such transfer. For the purposes of this paragraph, a person is, or two or more persons are, 'in control' of a corporation when owning at least 80 per centum of the voting stock and at least 80 per centum of the total number of shares of all other classes of stock of the corporation."

The Board of Tax Appeals, in considering the application of that section to this case said:

"The substance of the transaction is that the partnership exchanged the farms for stock of the corporation, and that after the exchange the partnership was in control of the corporation, as the word control is used in the section of the statute just quoted. We are of opinion that the transaction is essentially

one of the kind in which Congress did not intend for the purposes of taxation to recognize either gain or loss, and that we should be governed by its substance and not its form."

With that reasoning of the Board of Tax Appeals we agree.

In transactions like the one before us, substance and not form determines the applicability of the taxing Act. (*Southern Pacific Co.* v. *Lowe*, 247 U. S., 330; *Gulf Oil Corporation* v. *Lewellyn*, 248 U. S., 71; *U. S.* v. *Phellis*, 257 U. S., 156 [T. D. 3270, C. B. 5, 37].)

Appellants neither gained nor lost by this transaction.

The fact that they incorporated themselves into a chartered company in no way enhanced their right to deduct losses from their taxable income. (*Tsivoglou* v. *U. S.*, 31 Fed. (2d), 706.)

Before their conveyance to the company they owned together a farm worth approximately $250,000.

After their conveyance their certificates of stock in the corporation were for all practical purposes their muniments of title to the same property.

If considered as a sale, it was, in effect, a sale to themselves for about half of the cost or value of the property, and we are of opinion that such a sale would not have been made to others for such a price.

While if deduction of the other half of the value invested was permissible as a loss, it follows that the appellants could as well have sold to themselves for a merely nominal consideration and deducted a greater loss.

We regard the case as falling within the provisions of section 202 of the statute hereinbefore quoted, and the decision of the Board of Tax Appeals is accordingly affirmed.

Affirmed.

ARTICLE 1572: Exchanges of property.

XI-36-5659
Ct. D. 555

INCOME TAX—REVENUE ACT OF 1918—DECISION OF COURT.

1. VALUATION—EVIDENCE.

The conclusion of the Board of Tax Appeals that certain shares of stock, at the time they were received in exchange for an oil and gas lease, had no fair market value involved a disregard of evidence having a substantial tendency to prove that at that time they had a fair market value.

2. VALUATION—FINDING OF COMMISSIONER—APPEAL TO BOARD.

In an appeal to the Board of Tax Appeals from the Commissioner's determination resulting from the finding of the Commissioner that certain shares of stock received for a lease had a fair market value of a certain amount at the time of their receipt, the finding of the Commissioner on the question of value is prima facie correct and the burden is upon the taxpayer to produce evidence to overcome this presumption and to show the correct value or that the shares had no fair market value at the time acquired by the taxpayer.

3. DECISION REVERSED.

The decision of the Board of Tax Appeals (14 B. T. A., 675) is reversed.

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT.

Commissioner of Internal Revenue, petitioner, v. *S. T. Swenson, Executor of the Estate of Mrs. Christina Swenson, Deceased, respondent.*

Petition for review of decision of the United States Board of Tax Appeals (District of Texas).

Before BRYAN, FOSTER, and WALKER, Circuit Judges.

[March 5, 1932.]

OPINION.

WALKER, Circuit Judge: The Commissioner of Internal Revenue assessed a deficiency of income tax for the year 1919 against the appellee as executor of

the estate of Christina Swenson, deceased. That assessment was a result of a finding by the Commissioner that 2,400 shares of the capital stock of the Swensondale Oil Co., a Texas corporation (herein referred to as the corporation), received in 1919, for an oil and gas lease on 414 acres of land, owned in community by the taxpayer and her husband, Peter Swenson, had at the time of that transaction a fair market value of $240,000. Upon appellee's petition for a redetermination of such assessment the Board of Tax Appeals held that the stock received in exchange for the oil and gas lease had no fair market value at the time of its receipt, and abated the assessment accordingly. That action of the Board of Tax Appeals is before us on the Commissioner's petition for review.

Uncontroverted evidence adduced in the hearing before the Board of Tax Appeals showed the following: During the years 1918 and 1919 the taxpayer and her husband owned under the community-property laws of Texas about 3,500 acres of land, located in one body, in Stephens County, all of which were acquired prior to the year 1913. At the time those lands were acquired it was not known or supposed that lands in that part of Texas contained oil or gas. In November, 1918, after the discovery of oil in the part of Texas in which those lands are located, Peter Swenson associated with himself eight other persons and organized the corporation, with an authorized capital of 3,000 shares of stock of the nominal par value of $100 each. The eight associates of Peter Swenson subscribed, at par, for 940 shares of the corporation's stock and paid therefor the sum of $94,000. Of the remaining 2,060 shares 1,800 were issued to Peter Swenson for an oil and gas lease covering 1,093 acres of the above-mentioned land. From the proceeds of the stock sold the Swensons received $10,000 in cash. Ten shares of that stock were issued to S. T. Swenson, a son of Peter Swenson, and 250 shares were issued to two persons jointly, as a promotion fee. The agreement under which the corporation was organized and the lease executed provided that should oil be discovered the Swensons should receive as a royalty one-eighth of the commercial oil produced from the land covered by the lease. At the time the corporation was organized no oil was known to exist nearer the Swensons' land covered by the lease than about 2½ miles. The corporation began drilling on the leased land on February 22, 1919, using for that purpose cash acquired from the sale of its stock. From the time of the beginning of the drilling operations the corporation intended to drill to a depth of 3,200 to 3,500 feet, unless oil in paying quantity should be found at a less depth. By April 14, 1919, that well had been drilled to the depth of about 2,200 feet without oil having been discovered. At that time the physical condition of the well was not satisfactory, gas pressure and salt water having been encountered at a depth of about 1,950 feet, and heavy expenses had been incurred in shutting off the gas and water, with a result that the corporation's cash resources were so reduced as to make it doubtful whether it would be financially able to undertake the drilling of another well in case of the first one being a failure. At that time seven or eight other wells were being drilled or had been drilled by other companies in territory surrounding the land covered by the above-mentioned lease, three northeasterly, one to the southeast, one south, and one to the west. Some of those wells were producing oil and others were not. Those to the north and northeast of the corporation's well were the more productive; those to the south and west less so, or failing altogether. Such were the circumstances when it was determined to increase the capital stock of the corporation from the original amount of 3,000 shares to 14,000 shares, and on April 14, 1919, Peter Swenson and his wife, the taxpayer, offered to the corporation an oil and gas lease on an additional tract of land containing 414 acres, as a basis for an increase in the capitalization of the corporation. On April 17, 1919, that lease was accepted by the corporation, the stockholders voting an increase of 11,000 shares in its capitalization, making the total number of shares 14,000, of the par value of $100 each. By the terms of the offer and acceptance, Peter Swenson and his wife, the taxpayer, subscribed for 2,400 shares, at par, of the increased capitalization, to be paid for with the oil and gas lease on the additional tract of 414 acres; 6,000 of the new shares to be issued to the holders of the original shares, making a 200 per cent stock dividend on the last-mentioned shares; and 2,350 of the new shares were to be sold at par. By May 15, 1919, all of the new shares which were to be offered for sale at par had been subscribed for, to be paid for in cash to the corporation, and $81,300 of the amount so agreed to be paid had actually been paid in cash. On the same day,

May 15, 1919, the directors of the corporation closed such stock subscriptions and applied for an amendment of its charter providing for the increased capitalization upon the above-mentioned basis. In that application that lease was arbitrarily stated to have a reasonable value of $865,000 or more. Up to May 15, 1919, no oil had been discovered anywhere on the land of the corporation or on land belonging to Peter Swenson and his wife, or anywhere nearer to such land than approximately two and a half miles. On April 17, 1919, and on May 19, 1919, and at all times between those dates, the corporation had no assets other than the two above-mentioned oil leases, some drilling machinery, largely second-hand, and such part of the cash actually paid to it on stock subscriptions as had not been expended in drilling its first test well. It had no income whatever. During the time that the corporation was capitalized at $300,000 par value, and after the increase in its capital to $1,400,000 par value, Peter Swenson and his wife, the taxpayer, owned a substantial majority (approximating 60 per cent) of its capital stock. They never sold any of this stock for money or property of any kind. On May 18, 1919, the above-mentioned well on land included in the first-mentioned lease came in, and proved to be a large oil producer.

At and prior to the time of the execution of the above-mentioned lease covering the tract containing 414 acres, there were numerous producing wells and many other wells in process of being drilled in the immediate vicinity of that land. In April and May, 1919, there was increased activity in the leasing of lands in the territory surrounding the Swenson lands. With the exception of the Swenson land all but a few small tracts in isolated places had been leased and unsuccessful efforts had been made to lease the Swenson land. In 1918, prior to the organization of the corporation, Peter Swenson received an offer of $1,000,000 cash for his land, supposed to include about 5,000 acres, with a one-eighth royalty interest, the prospective purchaser agreeing to drill 10 wells on the property. Peter Swenson was unwilling to part with his control of the right to oil and gas in the land owned by himself and his wife, and did not want any of the big oil companies to acquire stock in the corporation to which he made leases. Several witnesses, who qualified as experts in the business of oil and gas leasing, testified that at the time of the execution of the last-mentioned lease an oil lease on that land was worth from $700 to $1,200 per acre, and that if that land had been cut up into three or four parts all the leases on it would have been worth as high as $1,500 per acre. That part of the increased capital stock of the corporation which, under the plan adopted, was to be sold was offered for sale only to those who already were stockholders and to persons satisfactory to the Swensons and their original associates. It was agreed among them that the sale of that stock to outsiders should be confined to small buyers in order to keep out the big oil companies, which were trying to buy the stock and which had acquired interests all around the Swenson property. The new stock was allotted to the old stockholders, and most of it was bought by them, some of them taking more of the new stock than their allotment. The part of the new stock not taken by the old stockholders was bought by subscribers who were acceptable to Peter Swenson and his associates. The evidence showed that some of that stock was bought after the buyer had had an oil expert to make an investigation of the territory in which the land covered by leases to the corporation was located.

The Revenue Act of 1918 (40 Stat., 1057) provided:

"SEC. 202. (a) 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—

"(1) In the case of property acquired before March 1, 1913, the fair market price or value of such property as of that date; and

* * * * * * *

"(b) When property is exchanged for other property, the property received in exchange shall for the purpose of determining gain or loss be treated as the equivalent of cash to the amount of its fair market value, if any; * * *."

Treasury Regulations 45 [1920 edition], promulgated under that Act, provided:

"ART. 1566. *Exchange of property and stock.*—Where property is transferred to a corporation in exchange for its stock, the exchange constitutes a closed transaction and the former owner of the property realizes a gain or loss if the

stock has a market value, and such market value is greater or less than the cost or the fair market value as of March 1, 1913 (if acquired prior thereto), of the property given in exchange. * * *"

It appears from the opinion rendered by the Board of Tax Appeals that the fact that all of the increased capital stock which was offered for sale on April 17, 1919, was sold at par by May 15, 1919, was excluded from consideration as evidence of the market value of the 2,400 shares of that issue received in exchange for the lease covering the tract containing 414 acres, because the shares sold were not offered on the general market, but were sold at private sale to acquaintances of one or more of the old stockholders; and that in reaching the conclusion that no market value could be attributed to the stock received in exchange for the last-mentioned lease, the Board was influenced by the view that the speculative nature of the property for which that stock was exchanged kept that stock from having a market value. Expressions contained in that opinion indicate that the Board did not attribute *prima facie* correctness to the Commissioner's determination, and assumed or concluded that the burden was on the Commissioner to prove that at the time of the consummation of the last-mentioned lease the stock received in exchange therefor had a fair market value and what that market value was.

The evidence did not show the existence in fact of the ground relied on for excluding from consideration the circumstance that practically contemporaneously with the execution of the last-mentioned lease 2,350 shares of stock of the same issue as that received in exchange for that lease were sold at par. Most of those shares were bought by holders of the original stock of the corporation, only such of those shares as were not bought by original stockholders being offered for sale, and sold, to selected persons. The fact that corporate shares were readily sold at par is not kept from being evidence that other shares of the same issue had substantial market value at or about the time of such sale or sales by the circumstances that none of that stock was offered for sale to the general public, and that such of it as was sold was bought by holders of previously issued stock of the corporation and by other selected persons whose participation in the ownership of the stock of the corporation was desired by those in control of the corporation. The fact that such sales were so made had some tendency to prove that there was a market for the shares of stock received in exchange for the lease (which at par for the stock amounted to substantially more than $500 per acre), and that these shares could have been sold at a substantial price if they had been offered to the public for sale at that time. (*Penny & Long* v. *Commissioner of Internal Revenue*, 39 Fed. (2d), 849; *O'Meara* v. *Commissioner of Internal Revenue*, 34 Fed. (2d), 390, 395.) The conclusion that the 2,400 shares received in exchange for the lease had no market value at the time of the exchange well may be regarded as being inconsistent with the fact that within less than 30 days after the date of the exchange 2,350 shares of the same issue—all that was offered for sale to anyone—were sold at par for cash.

The value of property at a given time depends upon the relative intensity of the social desire for it at that time, expressed in the money it would bring in the market. That value depends largely on expectations as to what may be realized from the property in the future. (*Ithaca Trust Co.* v. *United States*, 279 U. S., 151 [Ct. D. 61, C. B. VIII–1, 313].) The fact that those expectations are highly speculative may not keep them from being influential in bringing about a willingness to expend money for the acquisition of the property or an interest in it. Though a venture is as speculative as a lottery, a chance or interest in it may be readily salable for a substantial sum of money. The law does not forbid the recognition of the proved exchangeable value of an asset because of the speculative nature of it. (*Collin* v. *Commissioner of Internal Revenue*, 32 Fed. (2d), 753.) Furthermore, it did not appear from the evidence that it was mere guesswork to attribute a substantial money value to the shares of stock in question at the time they were received in exchange for an oil and gas lease. At and prior to the date of that exchange there were extensive explorations and oil developments of near-by lands located on all sides of the tracts covered by the leases held by the corporation. Under the conditions shown by the evidence to have existed at the time those shares were acquired by the taxpayer, it was not to be assumed that those operations had not resulted in the acquisition of knowledge of facts furnishing a substantial basis for a reasonable belief that oil in paying quantity would be found in land

included in those leases. The shares of stock in question represented an interest in assets which included money, oil and gas leases covering more than 1,500 acres of land, an uncompleted well located on part of that land, and equipment used in drilling it. Evidence showed that the right to whatever oil and gas the land covered by those leases might contain was so desired by many persons at or about the time of the mentioned exchange that substantial sums of money were obtainable for oil and gas leases covering that land. Evidence tending to prove that at the time the shares in question were acquired the assets an interest in which those shares represented had, if offered to the public for sale, a presently realizable substantial money value properly was subject to be considered in determining whether those shares then had a fair market value, and what that market value was. (*Lamprecht* v. *Swiss Oil Corporation*, 32 Fed. (2d), 646, 652; *North American Telegraph Co.* v. *Northern Pacific Ry. Co.*, 254 Fed., 417; Holmes Federal Taxes (1923 Ed.), 511.) The Board's conclusion that those shares, at the time they were received in exchange for an oil and gas lease, had no fair market value involved a disregard of evidence having a substantial tendency to prove that at that time they had a fair market value.

The finding of the Commissioner on the question of value is *prima facie* correct. The burden was upon the respondent to produce evidence sufficient to overcome this presumption and to show the correct value upon which the tax was to be assessed, or that the subject of the tax had no fair market value at the time it was acquired by the taxpayer. (*Williams* v. *Commissioner of Internal Revenue*, 45 Fed. (2d), 61.)

It appears from the record that the Board of Tax Appeals, in reaching the conclusion that the shares of stock in question had no fair market value when they were acquired by the deceased taxpayer, was influenced by views or considerations inconsistent with rules of law applicable to questions presented for decision.

Because of the above indicated errors, the decision of the Board of Tax Appeals is reversed, and the cause is remanded for further proceedings not inconsistent with this opinion.

SECTION 204.—BASIS FOR DETERMINING GAIN OR LOSS, DEPLETION, AND DEPRECIATION.

ARTICLE 1591: Basis for determining gain or loss from sale. XI-43-5804 Ct. D. 589

INCOME TAX—REVENUE ACT OF 1926—DECISION OF COURT.

VALUATION—DETERMINATION OF VALUE ON MARCH 1, 1913.

The application of the formula provided by the third method contained in A. R. M. 34 (C. B. 2, 31) best reflects the fair market value on March 1, 1913, of stock sold by the taxpayer for the purpose of determining the amount of gain or loss from the sale. The fair market value as of that date may not be increased by the restoration of excessive depreciation disallowed by the Commissioner years after that date.

DISTRICT COURT OF THE UNITED STATES FOR THE NORTHERN DISTRICT OF OHIO, EASTERN DIVISION.

J. G. Robertson, plaintiff, v. *Carl F. Routzahn, Collector of Internal Revenue, defendant.*

[June 28, 1932.]

OPINION.

JONES, J.: By written stipulation, this case was tried and submitted for determination without the intervention of a jury. As the issues were finally

made up, a single question was presented upon which the plaintiff's right of recovery depends.

What was the fair market value as of March 1, 1913, of the 700 shares of the common stock of the Firestone Tire & Rubber Co. sold by the plaintiff in 1925?

On the basic date, this stock was unlisted but was traded in on the Cleveland Stock Exchange in small lots. If such sales alone furnish the sole basis for determining gain or loss permitted by the statute, I should find the fair market value to have been approximately $300 per share as of March 1, 1913. It is true that there was not a large number of the total shares outstanding available for trading. The stock was closely held by officers of the company and there was a considerable number of shares transferred on the books of the company which were not sold through the stock exchange. It is also true that the plaintiff himself placed the value of the shares at substantially the actual 1913 bid price in his 1923 and 1924 returns.

Two hundred thirty-five shares of the stock were sold through the Cleveland Stock Exchange over the period January 8, 1913, to April 28, 1913, in lots of from 5 to 50 shares, for a price ranging from 222½ to 350½ per share. The sale of the largest number of the shares during that period was in March at a price ranging from 283½ to 295½ per share. By far the largest number of the whole number of shares traded in appeared to have been on the plaintiff's account. I think that the limited number of sales of shares in the early months of 1913 do not conclusively fix a fair market value for determining gain because the statute provided that due regard should be given to the fair market value of the assets as of the basic date; but such sales should not be wholly disregarded in determining value of stock as of a certain date. The consideration of its value in subsequent years should not be given much weight beyond an immediate and restricted period. What the potential value of a stock on the basic date may have been is speculative without the consideration of subsequent events presently too uncertain to be reliable. The test is not the prospective or hoped for value, but it is what under then prevailing and pertinent circumstances was the fair market value, giving due regard to the fair market value of the assets as of the basic date.

What were the fair market values of stocks in the fall of 1929, gauged by the then promising but uncertain future? In the fall of 1929 a willing seller and an intelligent buyer would have traded on the basis of continued business expansion on a tremendous scale. There are too many "ifs" in measuring present values by future fruition. Fixing past values by subsequent events is not, in the nature of things, a reliable basis. Looking backward after the future is known is not a fair test. The value as of the basic date is not what the owner believes it to be worth, but what is it fairly worth in an intelligent and open trade? The statute fixes not the fair value, but the fair *market* value. This means what it is fairly worth as a marketable security or equity to be bought and sold in the course of business; something for which there is supply and demand and interested buyers and sellers.

The value as of March 1, 1913, can not be enhanced by the restoration of excessive depreciation disallowed by the Commissioner years afterwards. The value as of that date was based upon the asset value as the records stood. The fair market value as of a given date may not be increased by a subsequent increment not calculated or anticipated at the time, and which rested not upon any claim made by the company, but upon an adverse, arbitrary ruling by the Commissioner.

Upon due consideration, it is my opinion that the formula provided by Appeals and Review Memorandum 34 [C. B. 2, 31], and as applied by the Commissioner (Plaintiff's Exhibit No. 24), best reflects the fair market value of the stock in question. I think the fair market value as of March 1, 1913, was not in excess of $431.85 per share, as determined by the Commissioner, and probably, more accurately, lower, when due consideration is also given to actual sales and quoted market prices as of and shortly prior to the basic date.

Judgment may be entered for the defendant and special findings of fact and conclusions of law may be submitted.

ARTICLE 1594: Property acquired by gift or transfer in trust on or before December 31, 1920, or by bequest, devise, or inheritance. XI-29-5553 Ct. D. 517

INCOME TAX—REVENUE ACT OF 1926—DECISION OF COURT.

GAIN OR LOSS—BASIS—PROPERTY ACQUIRED BY BEQUEST.

Where a will provides that property shall be held in trust to pay the income therefrom to a life tenant and after the death of the life tenant to pay a part of the principal to C at a specified age, his interest to be divested if he dies without issue before reaching the age, the property distributed to C by the trustees is acquired within the meaning of section 204(a)5 of the Revenue Act of 1926 at the date of the death of the testatrix, and the basis provided by that paragraph in ascertaining gain on the sale of the property is its fair market value at that time, when the death occurs on or after March 1, 1913, and not its value at the date of distribution.

DISTRICT COURT OF THE UNITED STATES, DISTRICT OF NEW HAMPSHIRE.

John P. H. Chandler v. *John H. Field, Collector of Internal Revenue.*

[April 13, 1932.]

OPINION.

MORRIS, J.: This is an action brought by John P. H. Chandler of Portsmouth, N. H., against John H. Field, collector of internal revenue for the district of New Hampshire, for the recovery of a portion of the Federal income tax paid by him for the year 1925.

In the return filed by Chandler March 10, 1926, for the calendar year of 1925, the plaintiff showed a tax due in the amount of $2,382.99, which was paid in installments during the year 1926.

Subsequently, the Commissioner of Internal Revenue audited Chandler's return and as a result assessed against the plaintiff an additional tax for said year 1925 in the sum of $21,772.28, which was paid on April 30, 1928.

On March 10, 1930, the plaintiff filed with the defendant a claim for refund of a part of the tax paid and the claim was denied by the Commissioner in a letter June 13, 1930, and this suit was thereupon instituted.

The case comes before me upon an agreed statement of facts excepting that the parties were unable to determine and agree upon the age of the plaintiff.

Plaintiff's deposition was taken and from it *I find as a fact that John P. H. Chandler, the plaintiff, was born in Washington, D. C., March 22, 1885,* and was the son of United States Senator William D. Chandler, of New Hampshire.

The tax which is the subject of refund was assessed upon shares of stock in the St. Joseph Lead Co. which the plaintiff received under the will of his mother, Lucy L. H. Chandler, who died October 25, 1915.

The only material clause in the will reads as follows:

"Seventh: All the rest, residue and remainder of my property and estate of every kind and description, I give, bequeath and devise to my executors in trust for the following purposes:

"All the income of said property and, after the decease of my said husband, as aforesaid, to be paid by said trustees to my son John P. Hale Chandler at such times as they may deem proper; the sum of $150 a year to be paid quarterly, to my maid, Lydia E. Buzzell, during her life, provided she remains with me as such maid until my decease; one-third of the principal of said property and estate, after allowing for the payment of said sum to said Lydia E. Buzzell, to be paid to my said son when he shall arrive at the age of 30 years; one-third to be paid to him when he shall arrive at the age of 35 years; and one-third when he shall arrive at the age of 40 years. If, however, my son should not live to reach the ages herein specified and should die leaving children, then said trustees are to pay over to said children the entire amount of said property and estate or the entire amount of the balance thereof in case payment or payments to my said son have been made as aforesaid. And in

case my son should die leaving no children living at the time of his death, I give and bequeath to his wife Madeleine if then living, the sum of $10,000, and then said trustees are to pay over the sum of $500 to the Episcopal Church in Dover, N. H. (in memory of my grandmother, Abigail R. Lambert, and my aunt Elizabeth Little), then the one-half of said property and estate remaining to be paid to the Unitarian Church in said Dover (one-half of the income thereof to be used for the pastor's salary); the other one-half of said property and estate to be paid in equal amounts to the Children's Home, to the Wentworth Home for the Aged in said Dover (in memory of my parents and sister), to the Hayes Hospital in said Dover, and to the New Hampshire Society for the Prevention of Cruelty to Animals."

As above stated in the will, the plaintiff was to receive his share of the principal after the execution of the trust in three installments; the first when he became 30 years of age; the second when he became 35 years of age; and the third and last installment when he reached the age of 40.

During the year 1925, the plaintiff sold a number of shares of stock of the St. Joseph Lead Co. We are concerned in this action with only a part of those shares, to wit, 753 shares which were received by the plaintiff under the will of his mother. The plaintiff's claim for refund is based solely upon the basis used by the Commissioner of Internal Revenue in determining gain from the sales by the plaintiff of the 753 shares of stock.

The Commissioner in determining the gain from the sales used as a cost basis the value of said stock at the date of the death of the plaintiff's mother. In other words, the Commissioner has determined the gain by deducting from the selling price of the stock its value at the date of the death of Lucy L. H. Chandler.

It is contended by the plaintiff that there should be used as the basis for determining gain or loss the value of said stock at the date of its delivery to him. The 753 shares were actually delivered to the plaintiff by the trustees as follows: 660 shares on April 19, 1920; 75 shares on July 15, 1925; 18 shares on August 24, 1925.

The 93 shares which were distributed by the trustees in 1925 were sold during the same year for $3,817.53. The selling price of 660 shares which were distributed by the trustees in 1920 is not known inasmuch as this block of stock was sold by the plaintiff together with 4,140 additional shares from the same company and the sale which represents the 660 shares can not be identified; 4,800 shares of the stock of the St. Joseph Lead Co. (4,140+660) were sold for $210,337.76. The cost basis of the 4,140 shares of stock is $31,400.50. The gain from the sale of the entire 4,800 shares was determined by the Commissioner to be $170,357.26. If the Government's position as to the cost basis for determining the gain from the sale of the stock is sustained, no change is to be made in the amount of this gain. If the taxpayer's position is sustained then the gain from the sale of said 660 shares of stock shall be determined by deducting from the selling price of $210,337.76 the sum of $31,400.50 plus the cost basis as finally determined in this case.

The question to be determined is whether the basis date to be used in determining the gain or loss on the sale of the stock acquired by Chandler under the will of his mother is the value of said stock at the date of her death or its value at the date the stock was actually distributed to Chandler.

The applicable statutes and Department regulations thereunder are as follows:

The Revenue Act of 1926 provides in part as follows:

"SEC. 204. (a) The basis for determining the gain or loss from the sale or other disposition of property acquired after February 28, 1913, shall be the cost of such property; except that—

"(5) If the property was acquired by bequest, devise, or inheritance, the basis shall be the fair market 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 of the Revenue Act of 1921, or in subdivision (c) or (f) of section 302 of the Revenue Act of 1924, or in subdivision (c) or (f) of section 302 of this Act."

Regulations 69, Revenue Act of 1926, article 1594, provides in part as follows:

"In the case of property acquired by bequest, devise, or inheritance, its value as appraised for the purpose of the Federal estate tax or in the case of estates not subject to that tax, its value as appraised in the State court for the purpose of State inheritance taxes shall be deemed to be its fair market value when acquired."

The Treasury Department appears to have consistently held that the basis date for determining gain or loss on the sale of property acquired by bequest, devise or inheritance, is that of the decedent's death. This fact is evidenced by various regulations which have been promulgated from time to time. Paragraph 44 of Regulations 33 (1918); article 1562 of Regulations 45 (1919); article 1562 of Regulations 56 [45] (1920); article 1563 of Regulations 62 (1922); article 1594 of Regulations 65 (1924); article 1594 of Regulations 69 (1926).

The question narrows itself to the interpretation of the word "acquisition" as it appears in the context of the statute.

As I understand, the agreed statement of facts interpreted in conjunction with the declaration in the writ, if the plaintiff's contention is sustained, he is entitled to a refund of $762.62. If the defendant's contention is sustained, he is entitled to a verdict.

In the case of *Brewster* v. *Gage* (280 U. S., 327 [Ct. D. 148, C. B. IX–1, 274]), it was held that the basis of calculation in the case of stocks acquired by the taxpayer as a residuary legatee and sold by him, is not their value at the date of the decree of distribution, but their value at the date of the testator's death.

The plaintiff seeks to distinguish the Brewster case from the case at bar and calls attention to the fact that in the Brewster case the stock passed at once upon the settlement of the estate to the residuary legatee while in the case at bar there was an intervening trust under which the stock was held by trustees in trust to pay the income to a life tenant. Plaintiff further seeks to distinguish the two cases pointing out that in the Brewster case the residuary legatee took the entire title to the property subject to administration expenses and if he died before receipt of the same it passed to his heirs, whereas in the instant case the plaintiff took a vested remainder subject to be divested if he died without issue before reaching the specified age.

The court can see that the facts in the two cases are easily distinguishable but to my mind the distinguishable features are not of such a character as to make the holdings of the Supreme Court in the Brewster case inapplicable. It is true that the plaintiff in the case at bar might never have received his share of the property. What then would have been the situation presents another question. He did receive it and that is the fact with which we are dealing. Whatever rights he finally acquired date back to the death of his mother. That was the date of their inception. Those rights continued uninterruptedly from the date of her death until the stocks were physically delivered to the plaintiff.

In the Brewster case, Mr. Justice Butler says:

"Petitioner's right later to have his share of the residue vested immediately upon testator's death. At that time petitioner became enriched by its worth which was directly related to and would increase or decline correspondingly to the value of the property. And, notwithstanding the postponement of transfer of the legal title to him, Congress unquestionably had power and reasonably might fix value at the time title passed from the decedent as the basis for determining gain or loss upon the sale of the right or of the property before or after the decree of distribution. And we think that in substance it would not be inconsistent with the rules of law governing the descent and distribution of real and personal property of decedents to construe the words in question to mean the date of death."

In the same case the court further calls attention to various regulations of the Treasury Department in force between 1917 and 1928 establishing as a basis for gain or loss the fair market value of the property at the date of the death of the testator and further calls attention that since 1917 Congress in the passage of the several Revenue Acts has not changed the meaning and still uses the word "acquired." The interpretation given to it has continued for a series of years and for so long as to imply that the construction given to it by the administrative board having to do with the collection of revenue has received legislative sanction.

On this point Judge Butler says:

"These regulations were prepared by the Department charged with the duty of enforcing the Acts. The rule so established is reasonable and does no violence to the letter or spirit of the provisions construed. A reversal of that construction would be likely to produce inconvenience and result in inequality. It is a 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, 627; *Maryland Casualty Co.* v. *United States*, 251 U. S., 342, 349; *Swendig* v. *Washington Water Power Co.*, 265 U. S., 322, 331.)"

The interpretation given to the word "acquired" in the Revenue Act appears also to be in accord with the rulings of the highest courts in several States and various text writers. (See *Matter of Lansing*, 182 N. Y., 238; *Harvey* v. *Boaz*, 29 Ala., 168; *Vail* v. *Vail*, 49 Conn., 52; Schouler on Wills (6th Ed), section 3148.)

I do not think it is essential to enter into a discussion of the differences between a vested remainder, contingent remainder, executory devise and other forms of title known to the common law.

I hold that whatever title the plaintiff took dates back and was *acquired on October 25, 1915*, when his mother died.

A verdict will be entered for the defendant.

ARTICLE 1596: Property acquired upon an exchange.

XI–34–5623
G. C. M. 10433

REVENUE ACT OF 1926.

Where the taxpayer acquired stock in 1922 in an exchange which resulted in no recognizable gain or loss under section 202(c)1 of the Revenue Act of 1921, the basis to be used in determining the loss from the sale of the stock in 1926 is the cost or other basis of the stock exchanged therefor.

An opinion is requested relative to the basis to be used in determining the taxpayer's loss resulting from the sale in 1926 of stock in the P Company.

The taxpayer, A, was, during the years under consideration, engaged in the business of buying and selling securities for his own account. In October, 1922, the taxpayer exchanged $1.8y$ shares of stock of the M Company, $7.2y$ shares of stock of the N Company, and $5.4y$ shares of stock of the O Company, common B, for $45y$ shares of the P Company stock and $49.5y$ shares of the Q Company stock. The March 1, 1913, value of the M Company, the N Company, and the O Company stock exchanged was $1,333.4x$ dollars, and the fair market value of this stock at the date of the exchange was $3,168.3x$ dollars.

In November, 1922, the taxpayer exchanged $20.7y$ shares of the O Company class B common stock for $49.5y$ shares of the P Company stock. The March 1, 1913, value of the O Company stock exchanged was $315x$ dollars and the fair market value at the date of the exchange was $1,118x$ dollars. No taxable income was reported on these exchanges. (See section 202(c)1 of the Revenue Act of 1921.) In July, 1923, the taxpayer purchased $7.4y$ shares of the capital stock of the P Company for $.0003x$ dollars per share, or at a cost of $.002x$ dollars. During the year 1926 the taxpayer sold at public auction the entire $101.9y$ shares of the capital stock of the P Company acquired upon the purchase and exchanges noted above, and received therefor $2.7x$ dollars.

When the taxpayer filed his income tax return for the year 1926 he claimed that the basis of the P Company stock received in 1922 was to be determined from the fair market value of the N Company, the M Company, and the O Company stocks at the time of the exchanges. Accordingly, in his original return he determined that the cost of the $45y$ shares of the P Company stock which he acquired in October, 1922, was to be determined by apportioning the 1922 value of the M Company, the N Company, and the O Company stock ($3,168.3x$ dollars) between the $45y$ shares of the P Company stock

and the 49.5y shares of the Q Company stock. By this method he determined that the basis for computing loss from the sale of 45y shares of P Company stock acquired in October, 1922, was 1,508.7x dollars. With reference to the 49.5y shares of P Company stock acquired in November, 1922, for which 20.7y shares of O Company stock were given in exchange, the taxpayer computed the loss on the basis of the 1922 value of the 20.7y shares of the O Company stock, namely, 1,118x dollars. The cost of 7.4y shares of P Company stock purchased in July, 1923, namely, .002x dollars, was used as its basis. Thus the taxpayer used the basis of 2,626.702x dollars in computing his loss on the sale of the 101.9y shares of P Company stock in 1926.

The Bureau used the March 1, 1913, value of the stock given in exchange for the P Company stock in arriving at the basis to be used in computing the loss sustained by the taxpayer, and the actual cost of the P Company stock purchased in 1923. Under this method the basis was determined to be 949.952x dollars, and the loss was reduced by approximately 1,676.75x dollars. The taxable income for the year 1926 was increased by that amount and the taxpayer paid the tax and filed claim for refund.

Section 204(a)6 of the Revenue Act of 1926 provides:

> SEC. 204. (a) The basis for determining the gain or loss from the sale or other disposition of property acquired after February 28, 1913, shall be the cost of such property; except that—
>
> * * * * * * *
>
> (6) If the property was acquired upon an exchange described in subdivision (b), (d), (e), or (f) of section 203, the basis shall be the same as in the case of the property exchanged, decreased in the amount of any money received by the taxpayer and increased in the amount of gain or decreased in the amount of loss to the taxpayer that was recognized upon such exchange under the law applicable to the year in which the exchange was made. * * *

The basis of the property exchanged in 1922 was the March 1, 1913, value of the N Company, the M Company, and the O Company stocks. Therefore, if the P Company stock was acquired upon an exchange described in section 203 (b), (d), (e), or (f) of the Revenue Act of 1926 the basis used by the Bureau in computing the taxpayer's loss was correct. Admittedly subdivisions (d), (e), or (f) do not apply. Section 203(b)1 of the Revenue Act of 1926 reads:

> (b)(1) No gain or loss shall be recognized if property held for productive use in trade or business or for investment (not including stock in trade or other property held primarily for sale, nor stocks, bonds, notes, choses in action, certificates of trust or beneficial interest, or other securities or evidences of indebtedness or interest) is exchanged solely for property of a like kind to be held either for productive use in trade or business or for investment, or if common stock in a corporation is exchanged solely for common stock in the same corporation, or if preferred stock in a corporation is exchanged solely for preferred stock in the same corporation.

In a memorandum which accompanied the taxpayer's claim for refund it is contended that the exchange of the M Company, the N Company, and the O Company stocks for the P Company stock in 1922 is not such an exchange as is described in subdivision (b), (d), (e), or (f) of section 203 of the Revenue Act of 1926, because section 203(b)1 of that Act specifically provides that the exchanges therein referred to shall not include exchanges of stocks or other securities. In reality the taxpayer is contending that the word "describe" as used in section 204(a)6 of the Revenue Act of 1926 means "within the purview" of section 203(b)1 of that Act. This

contention is untenable. The word "describe" means to give an account of. Section 204(a)6 literally applies to every exchange of which an account is given in section 203(b)1, whether this account is by way of inclusion or exclusion.

Webster's New International Dictionary, 1927 edition, page 603, gives the following meaning to the word "describe":

To represent by words written or spoken; to give an account of; to make known to others by words or signs; as, the geographer *describes* countries and cities.

"Described" means only "represented by words written or spoken," "an account of which is given." Neither "described" nor any of its synonyms means "within the purview of," "under," or "within the scope of." Where one is referred to a place in which something is described, as a general proposition one would usually expect to find it described by way of inclusion rather than by exclusion, but whether it is included or excluded is quite immaterial if the thing is described. Hence, it appears to be a perversion of all normal modes of speech to say that a thing is not described in section 203(b)1 merely because it is therein described and then excluded.

The expression in section 204(a)6, "the amount of gain or * * * the amount of loss to the taxpayer that was recognized upon such exchange under the law applicable to the year in which the exchange was made," clearly recognizes that among the exchanges described in section 203(b)1 are exchanges, the gain or loss upon which is recognized. If the exchanges described in section 203(b) mean exchanges within the purview of section 203(b), as contended for by the taxpayer, this expression is wholly superfluous and absurd. This expression makes perfectly plain that what is contemplated is any exchange described in section 203(b). It is immaterial that the exchange occurred not under the Revenue Act in question but under some or any prior Revenue Act, and equally immaterial whether the gain or loss upon the exchange described is or was recognized or unrecognized. If, for example, section 204(a)6 means exchanges within the purview or within the scope of section 203(b), it is plain that the only exchanges within the purview of section 203(b) are the exchanges which occurred in taxable years covered by the particular Act.

The exchanges referred to herein did not result in recognizable gain or loss by reason of the fact that they took place in 1922 before section 202(c)1 of the Revenue Act of 1921 was amended. Section 202(d)1 of the Revenue Act of 1921 took care of the basis for gain or loss purposes of such exchanges. The latter section reads as follows:

(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, as amended by the Act of March 4, 1923 (42 Stat., 1560), reads as follows:

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 se-*

curities or evidences of indebtedness or interest), is exchanged for property of a like kind or use. [New matter in italics.]

The amendment was drafted to insure the recognition of gain or loss upon exchanges such as the exchanges which took place in the instant case. When Congress amended section 202(c)1 of the Revenue Act of 1921 it did not amend section 202(d)1 of that Act, because the latter provision specifically prevented a stepped-up basis in the case of exchanges, the gain or loss upon which could not be recognized.

That the basis provided in section 202(d)1 was to be used in computing gain or loss from sales that took place while the Revenue Act of 1924 was in effect is clearly shown by House of Representatives Report No. 179, Sixty-eighth Congress, first session, page 54. The House report reads in part as follows:

Section 204:

* * * * * * *

(2) Paragraph (6) corresponds to section 202(d)1 of the existing law. The general theory of this section is that *where no gain or loss is recognized as resulting from an exchange, the new property received shall, for purposes of determining gain or loss from a subsequent sale and for depreciation and depletion, be considered as taking the place of the old property* given up in connection with the exchange. The provisions of section 203 of the bill that no gain or loss is recognized from certain exchanges do not grant an exemption and are not so intended. * * * [Italics supplied.]

To the same effect see Senate Report No. 398, Sixty-eighth Congress, first session, page 17.

That portion of section 204(a)6 of the Revenue Act of 1926, supra, is identical with section 204(a)6 of the Revenue Act of 1924. The congressional committee reports of the Revenue Act of 1924 explicitly state that under section 204(a)6 of the Revenue Act of 1924 the basis is to be carried over wherever the gain or loss upon the exchange was not recognized. To contend that the stock acquired a stepped-up basis as the result of an exchange which resulted in no recognizable gain or loss under section 202(c)1 of the Revenue Act of 1921 is inconsistent with the express intent of Congress and the literal language of the statute.

In view of the foregoing, this office is of the opinion that the basis to be used in determining the loss resulting from the sale of the P Company stock acquired in 1922 is the cost or other basis of the stocks exchanged therefor.

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

ARTICLE 1603: Readjustment of partnership interests. (Also Section 214(a)8, Article 164.)

XI-35-5637
Ct. D. 550

INCOME TAX—REVENUE ACT OF 1921—DECISION OF COURT.

1. DEDUCTION—DEPRECIATION—REVALUATION OF ASSETS UPON INDUCTION OF NEW PARTNER.

The conveyance by a partner of part of his interest in the partnership and the induction thereby of a new member into the partnership do not under the laws of Pennsylvania dissolve the old partnership nor constitute a reason for deductions of allowances for depreciation of the partnership assets based upon their fair market value upon the date of the conveyance.

2. DEDUCTION—DEPRECIATION—VALUE OF ASSETS—FINDING OF BOARD.

There is substantial evidence to support the finding of the Board of Tax Appeals that the value of the assets of a partnership as of March 1, 1913, was their cost as reflected by the partnership books less depreciation to that date and such finding is therefore sustained.

3. DEDUCTION—DEPRECIATION—COST RECOVERED BY ALLOWANCE FOR DEPRECIATION.

Where the entire cost of assets is recovered through deductions for allowances for depreciation, no additional deduction is allowable in respect of such assets even though they are continued in useful service.

4. DECISION AFFIRMED.

The decision of the Board of Tax Appeals (20 B. T. A., 305) is affirmed.

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT.—OCTOBER TERM, 1931.

No. 4589. *Alpin J. Cameron, petitioner,* v. *Commissioner of Internal Revenue, respondent.*

No. 4590. *Alpin W. Cameron, petitioner,* v. *Commissioner of Internal Revenue, respondent.*

No. 4591. *William P. Denegre, petitioner,* v. *Commissioner of Internal Revenue, respondent.*

Petitions for review from the United States Board of Tax Appeals.

Before BUFFINGTON, WOOLLEY, and DAVIS, Circuit Judges.

[February 29, 1932.]

OPINION.

DAVIS, Circuit Judge: There are three cases here, involving income taxes for the year 1922, on petition for review from an order of redetermination of the United States Board of Tax Appeals. These cases were consolidated for hearing and decision (20 B. T. A., 305).

For a number of years prior to 1920, Alpin J. Cameron and William P. Denegre were partners trading in Pennsylvania, as wool-spinners, under the name of A. J. Cameron & Co. In 1920, Alpin W. Cameron, the son of Alpin J. Cameron, was made entitled to receive a quarter share of the partnership's earnings. At this time, the father gave the son a $250,000 interest in the assets of the firm. The gift was accomplished by transferring that amount on the books of A. J. Cameron & Co. from the father's capital account to a similar account of the son. No revaluation of assets was made by A. J. Cameron & Co.

The several taxpayers contend that a new partnership resulted from the gift to Alpin W. Cameron and that the allowance for depreciation of the partnership should be determined on the basis of the fair market value of the assets contributed to the partnership on that date.

The Board felt that even if a new partnership was actually formed on January 1, 1920, then there was no basis for a new rate of depreciation for there was no new cost to the old partners and no evidence of the identity of the particular part of the depreciable assets which the new partner had acquired.

Assuming the conclusion of the Board on this theory of the case to be right, yet the same conclusion may be reached on the ground that the transfer of part of the assets by the father to the son did not constitute a dissolution of the partnership.

The real question in this case is whether or not on any ground there should be a revaluation of the assets of the partnership trading under the name of A. J. Cameron & Co. because of the admission of the son as a partner on January 1, 1920.

Section 218(a) of the Revenue Act of 1921 (42 Stat., 227) provides that partners shall be liable for income tax only in their individual capacities and that the net income of each partner shall include his distributive share of the net income of the partnership.

The net income of a partnership is computed as if the partnership were an individual. Section 218(c), Revenue Act of 1921 (42 Stat., 227).

Section 214(a) of the Act of 1921 (42 Stat., 239) provides:

"That in computing net income there shall be allowed as deductions:

"(8) A reasonable allowance for the exhaustion, wear and tear of property used in the trade or business, including a reasonable allowance for obsolescence. In the 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."

This case arose in Pennsylvania and the laws of that Commonwealth as to what constitutes the dissolution of a partnership control. The statute provides that the "conveyance by a partner of his interest in the partnership does not of itself dissolve the partnership, nor, as against the other partners in the absence of agreement, entitle the assignee during the continuance of the partnership to interfere in the management or administration." (P. L. 18, Part V, section 27, March 26, 1915.) There is nothing in the evidence to indicate that the conveyance of a part of his interest in the partnership by the father to the son was intended by anyone to work a dissolution. This was the ordinary case of the admission of a son into the business without the thought on the part of anyone to dissolve the partnership. The Supreme Court of Pennsylvania has passed upon this exact question and held that such a conveyance as we have here from father to son does not dissolve the partnership. (*White* v. *Long*, 289 Pa., 525.)

There is no new partnership, no new assets, and hence no reason for the allowance of a new rate for the depreciation of the partnership assets. So far as we can ascertain, the situation was changed only in that the son received a part of the earnings of the partnership that had hitherto gone to the father.

The second question is whether or not the Board was justified in its finding of the value of the assets of the partnership as of March 1, 1913. It found that their value on that date was $300,782.34. It arrived at this figure by taking the cost of the assets then owned which was $429,689.06 less depreciation of $128,906.72. The controversy here is over the amount of depreciation to be allowed. The amount allowed by the Commissioner and Board was taken from the books of the partnership. This amount was fixed by the partnership in the ordinary course of business when there was nothing to influence its complete accuracy. Several witnesses of the petitioner say that the depreciation was not so much and so according to their appraisal made in 1926, the value of the partnership assets on March 1, 1913, was $396,000 or $397,000. The evidence gave the Board the alternative of accepting the retrospective appraisal of the taxpayer's witnesses, made in 1926, on the basis of cost of reproduction less an estimated amount for depreciation, or cost as reflected by the partnership books less a fair rate of depreciation to March 1, 1913. The Board chose the latter as the fair market value of the partnership assets on that date.

Administrative findings on issues of fact are accepted by courts as final if there was substantial evidence to support them, and no irregularity in the proceedings. (*Phillips* v. *Commissioner of Internal Revenue*, 283 U. S., 589, 600.) The taxpayers, themselves, laid emphasis on the accuracy of their plant accounts, and we think that their records, kept in ordinary course of business, are sufficient evidence to support the Board's findings.

Finally, the taxpayers contend that the Board was in error in affirming the action of the Commissioner (in determining the depreciation allowance for 1920 and 1921) in eliminating certain items of machinery and equipment in the amount of $464,607.67 from the depreciable assets account as of December 31, 1919.

The evidence establishes that these eliminated items were not only in use in 1921, but were also giving satisfactory service in 1926. But "the amount of the allowance for depreciation is the sum which should be set aside for the taxable year, in order that, at the end of the useful life of the plant in the business, the aggregate of the sums set aside will (with salvage value) suffice to provide an amount equal to the original cost." (*United States* v. *Ludey*, 274 U. S., 295, 300 [T. D. 4046, C. B. VI-2, 157].) Obviously, the taxpayers are

not entitled to a double deduction for the same capital assets, and if the fact is, as the Board found, that the assets have been fully depreciated, the taxpayers can no longer rightfully claim an allowance for depreciation even though such assets continue to give useful services.

In eliminating the items from the depreciable assets account, the Commissioner used a depreciation reserve which had in part accumulated prior to March 1, 1913, but that was accounted for in determining the March 1, 1913, value. This value and the cost of some property subsequently acquired were returned (save for a small amount remaining in 1920) by large depreciation allowances between March 1, 1913, and December 31, 1919. These assets had been fully depreciated on the partnership books and for those years, the Commissioner had allowed the rate claimed by the taxpayers except for some reduction in the rate for 1917, 1918, and 1919.

The Board has carefully considered the questions and its conclusions are evidently correct. Its order of redetermination is affirmed.

SECTION 205.—INVENTORIES.

ARTICLE 1612: Valuation of inventories. XI-37-5677
Ct. D. 559

INCOME TAX—REVENUE ACT OF 1918—DECISION OF COURT.

1. INVENTORIES—VALUATION—MANUFACTURER OF LUMBER.

Where a taxpayer, engaged in the manufacture and sale of lumber and taking inventories on the basis of cost or market, whichever is lower, treats as the cost of lumber of any grade the so-called average cost, which is arrived at by ascertaining the total cost of all lumber of all grades that had reached the same stage of manufacture and then dividing that total by the total number of feet of all grades manufactured, the amount so ascertained being treated as the cost of a foot of lumber of any grade, the action of the Commissioner and the Board of Tax Appeals in rejecting, as inadequate to reflect the true cost, the cost units employed by the taxpayer in its comparison with market prices for each grade is approved.

2. SAME—REDUCTION FOR ESTIMATED LOSSES.

A taxpayer, manufacturer of lumber, whose stock in trade is largely made up of goods in varying stages of production, and which includes in its inventories raw or unfinished product, may not reduce the value of its closing inventory taken at market by an amount of estimated losses on account of shrinkage, degrading, wastage, and discount.

3. DECISION AFFIRMED.

The decision of the Board of Tax Appeals (20 B. T. A., 394) is affirmed.

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT.

Industrial Lumber Co., Inc., petitioner, v. *Commissioner of Internal Revenue, respondent.*

Petition for review of decision of United States Board of Tax Appeals (District of Louisiana).

Before BRYAN, FOSTER, and WALKER, Circuit Judges.

[May 3, 1932.]

OPINION.

WALKER, Circuit Judge: The Commissioner of Internal Revenue assessed against the petitioner corporation, a manufacturer of lumber, a deficiency of income and profits taxes for the year 1920, that deficiency being a result of the rejection by the Commissioner of the petitioner's closing inventory for that year, and the disallowance by the Commissioner of deductions claimed by the peti-

tioner from the total shown by an alternative inventory submitted by the petitioner after the rejection of the inventory originally submitted. The closing inventory originally submitted by the petitioner, which kept its books on the accrual basis, purported to be "at cost or market, whichever is lower," as authorized by regulation. (Regulations 45, article 1582.) In taking that inventory petitioner ascertained the cost and the then prevailing market value of each item and listed that item at the lower of the two figures, with a result that where cost of the article was lower than market it was listed at cost, and where cost of the article was higher than market it was listed at market. What the petitioner treated as the cost of lumber of any grade was the so-called average cost, which was arrived at by ascertaining the total cost—including that of the raw material (the timber), sawing, handling and similar expenses—of all lumber of all grades that had reached the same stage of manufacture, and then dividing that total by the total number of feet of all grades manufactured, the amount so ascertained being treated as the cost of a foot of lumber of any grade, with a result that a given number of feet of lumber of the highest grade was assigned the same cost as the same number of feet of the lowest grade which had reached the same stage of manufacture. Petitioner's stock contained five grades of lumber, the grades being determined by the presence or absence of knots or other defects, the highest grade being designated "B—and—better," and the other grades being 1, 2, 3 and 4, the last stated being the lowest. The prices of different grades of lumber vary, according to condition and market demands, from $120 a thousand feet for the highest grade to $8 a thousand feet for the lowest grade. The findings of fact included the following as to petitioner's business:

"About 25 per cent of its product as it came fresh cut from the mill was in the form of railroad bridge timbers and beams, which were sold green, while the remaining 75 per cent required further processing before marketing. Under the methods followed by the petitioner about one-third of this residue, or 25 per cent of the whole, was cured in kilns, while the remainder, or 50 per cent of the whole, was air dried in the yards. Kiln drying required from three to five days and air drying from three to four months. After curing, the stock not held for sale in the rough was sent to the planing mills where it was dressed and trimmed in final preparation for market."

After the Commissioner had refused to accept the above-described inventory originally submitted, the petitioner submitted another inventory, in which the items were listed at market, the total at market being less than the total at cost. In that inventory, the petitioner claimed deductions from the total listed market value of the goods inventoried of stated amounts for, respectively, shrinkage and breakage, degrading, and discount. Those deductions were disallowed by the Commissioner. The rulings of the Commissioner were sustained by the Board of Tax Appeals.

It appears from the record that a ground relied on for rejecting the closing inventory originally submitted by the petitioner was that the evidence showed that petitioner in making that inventory applied to the several items listed the actual sale price for market, but not the actual cost price for cost. With reference to inventories the applicable statute provides:

"That whenever in the opinion of the Commissioner the use of inventories is necessary in order clearly to determine the income of any taxpayer, inventories shall be taken by such taxpayer 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." (Section 203, Revenue Act of 1918, 40 Stat., 1057.)

Regulations adopted in the exercise of authority conferred by the cited Act, section 1309, include those set out in the margin.[1]

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[1] *Need of inventories.*—In order to reflect the net income correctly, inventories at the beginning and ending of each year are necessary in every case in which the production, purchase or sale of merchandise is an income-producing factor. The inventory should include raw materials and supplies on hand that have been acquired for sale, consumption or use in productive processes, together with all finished or partly finished goods. * * * (Regulations 45 (1920 Ed.), article 1581.)

Inventories at cost.—Cost means:

(1) In the case of merchandise purchased, the invoice price less trade or other discounts, except strictly cash discounts, approximating a fair interest rate, which may be deducted or not at the option of the taxpayer, provided a consistent course is followed. To this net invoice price should be added transportation or other necessary charges incurred in acquiring possession of the goods.

The burden was on the petitioner to prove that the amount it assigned to an item listed in the inventory as the cost of that item was, at least approximately, the actual cost of it. In the absence of evidence tending to prove that the cost per foot of the raw material which went into lumber of one grade was the same as the cost per foot of the raw material which went into lumber of a different grade, the petitioner was not warranted in assuming that those costs were the same, though the other elements of the total costs were the same. It is a matter of common knowledge, of which judicial notice may be taken, that ordinarily the cost to a lumber manufacturer of the raw material—stumpage or logs—from which lumber is produced is based upon estimates as to the amounts and grades of lumber that may be expected to be produced from it, the price or cost of timber a large percentage of which may be expected to go into high grade lumber being higher than that of timber having the same footage, but from which a substantially smaller percentage of high grade and high priced lumber may be expected to be produced. It is not unusual for estimates made by timber cruisers to be availed of by prospective purchasers of timber. It reasonably may be inferred or supposed that ordinarily the estimates which influence an experienced and prudent lumber manufacturer in agreeing on the price to be paid for timber bought in effect amount to roughly determining the

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(2) In the case of merchandise produced by the taxpayer, (a) the cost of raw materials and supplies entering into or consumed in connection with the product, (b) expenditures for direct labor, (c) indirect expenses incident to and necessary for the production of the particular article, including in such indirect expenses a reasonable proportion of management expenses, but not including any cost of selling or return on capital whether by way of interest or profit. In any industry in which the usual rules for computation of cost of production are inapplicable, costs may be approximated upon such basis as may be reasonable and in conformity with established trade practice in the particular industry. (Ib., article 1583.)

Inventories at market.—Under ordinary circumstances, "market" means the current bid price prevailing at the date of the inventory for the particular merchandise in the volume in which ordinarily purchased by the taxpayer, and is applicable in the cases (a) of goods purchased and on hand, and (b) of basic elements of cost (materials, labor and burden) in goods in process of manufacture and in finished goods on hand; exclusive, however, of goods on hand or in process of manufacture for delivery upon firm sales contracts at fixed prices entered into before the date of the inventory, which goods must be inventoried at cost. Where no open market quotations are available, the taxpayer must use such evidence of a fair market price at the date or dates nearest the inventory as may be available, such as specific transactions in reasonable volume entered into in good faith, or compensation paid for cancellation of contracts for purchase commitments. Where, owing to abnormal conditions, the taxpayer has regularly sold such merchandise at prices lower than the current bid price as above defined, the inventory may be valued at such prices, and the correctness of such prices will be determined by reference to the actual sales of the taxpayer for a reasonable period before and after the date of the inventory. Prices which vary materially from the actual prices so ascertained will not be accepted as reflecting the market and the penalties prescribed for filing false and fraudulent returns may be asserted. Goods in process of manufacture may be valued for purposes of the inventory on the lowest of the following bases: (1) the replacement or reproduction cost prevailing at the date of the inventory; or (2) the proper proportionate part of the actual finished cost; or, under abnormal conditions, (3) the proper proportionate part of the sales price of the finished product, account being taken in all cases of the proportionate part of the total cost of basic elements (materials, labor and burden) represented in such goods in process of manufacture at the stages at which they are found on the date of the inventory. The inventories of taxpayers on whatever basis taken will be subject to investigation by the Commissioner, and the taxpayer must satisfy the Commissioner of the correctness of the prices adopted. He must be prepared to show both the cost and the market price of each article included in the inventory. * * * (Ib., article 1584.)

Inventories of lumber manufacturers.—1. Because of the impracticability of determining accurately the costs properly assignable to each species, grade, and dimension of lumber making up the product of the mill, lumber manufacturers may use as a basis for pricing inventories the average cost to the manufacturer of producing the inventoried products during the taxable year for which the return of net income is made.

2. If the quantity of lumber on hand at the time of inventory is greater than the total quantity of lumber produced during the current taxable year, it is evident that the excess stock has been carried over from the previous year's production, and such excess shall be valued at the average cost of production for the preceding taxable year.

3. A taxpayer who regularly allocates in his books of account such average cost to the different kinds and grades of lumber in proportion to the selling value of such kinds and grades may, subject in each case to the approval of the Commissioner upon audit of the return, make his returns of net income on that basis. * * * (Ib., article 1587.)

Valuation of inventories.—The Act provides two tests to which each inventory must conform: (1) It must conform as nearly as may be to the best accounting practice in the trade or business, and (2) it must clearly reflect the income. It follows, therefore, that inventory rules can not be uniform but must give effect to trade customs which come within the scope of the best accounting practice in the particular trade or business. In order to clearly reflect income, the inventory practice of a taxpayer should be consistent from year to year, and greater weight is to be given to consistency than to any particular method of inventorying or basis of valuation so long as the method or basis used is substantially in accord with these regulations. * * * (Ib., article 1582.)

values of the different parts of the timber which, respectively, will, in the process of manufacturing, go into different grades of lumber, with the results that the agreed-on price for the timber is the aggregate of the values assigned to the different parts of it which are expected to go into different grades of lumber, and that substantially different costs per foot will be attributed to the different parts of the timber which, respectively, will go into different grades of lumber. There was no evidence tending to prove that the actual cost per foot of the raw material which went into grade "B—and—better" lumber listed in the inventory was, even approximately, the same as the cost per foot of the raw material which went into No. 4 lumber, or any of the other numbered grades of lumber manufactured by the petitioner. There was no evidence tending to prove that the petitioner, in determining the cost of the raw material from which was produced the several items of lumber listed in its original inventory conformed to an accounting practice which had been adopted or followed in the lumber manufacturing trade or business, or to a practice which previously had been followed by the petitioner itself in its business.

It is not denied that it was impracticable for the petitioner to determine accurately the costs properly assignable to each grade of lumber listed in its inventory. That the officials charged with the administration of the statute recognized the impracticability of a lumber manufacturer doing so is indicated by an above set out regulation (article 1587), which permits the assignment to lumber of any grade of the average cost, not of lumber of all grades, but of lumber of that grade. If the petitioner, in determining the cost of each item of lumber listed in its original inventory, had arrived at the cost of the raw material used in producing that lumber by allocating to each foot of the raw material used in producing all the grades of lumber the average cost per foot of all the raw material so used in producing all grades of lumber in proportion to the selling value per foot of lumber of the different grades, it well might have been contended that such action was permissible by reason of it being analogous to a practice which was sanctioned by an above set out regulation. (Article 1587(3), supra.) But the evidence shows that the petitioner, instead of allocating to each foot of raw material used in producing the several grades of lumber the average cost per foot of the timber used in producing lumber of all those grades in proportion to the selling value per foot of such grades of lumber, attributed to each foot of timber used in producing any grade of lumber the same cost, without any regard to the widely differing selling values per foot of the several grades. In doing so the petitioner assumed the existence of a fact which no evidence adduced tended to prove. Furthermore, the fact so assumed lacks the appearance of probability, as it can not reasonably be supposed that the cost per foot to an experienced lumber manufacturer of the part of a saw log from which grade "B—and—better" lumber was expected to be produced would be the same as the cost per foot of the parts of that log which were expected to go into lower grades of lumber and into waste or refuse.

It is apparent that if the costs per foot of the timber used in producing two lots of lumber of different grades but having the same footage are substantially different the costs of the two lots are different, though other elements of the last-mentioned costs are the same. It well may be considered that, in the absence of supporting evidence, it is arbitrary and unreasonable to assign to timber used in producing grade "B—and—better" lumber the same cost per foot as is assigned to timber used in producing No. 4 lumber, and that a result of so doing is to misrepresent the costs per foot of lumber of both the grades mentioned. It is obvious that in determining which is lower, market or cost, a false result must be reached if for market the actual market price is used, but for cost something other than actual cost is used. We think it fairly appears from the record that the rejection of the closing inventory originally submitted by the petitioner was warranted because the evidence showed that in making that inventory the petitioner did not assign to the several listed items of lumber the actual costs of those items, and that what was treated as constituting such costs was substantially different from the actual costs. Certainly it does not appear from the record that the petitioner sustained the burden of proving that the Commissioner acted arbitrarily in concluding that the costs assigned to the several items listed in the original closing inventory were not the actual costs of those items, and that it was not shown that the valuations assigned to the

several listed items were arrived at by comparing actual cost with actual market, and taking the lower of the two figures. (*Lucas* v. *Kansas City Structural Steel Co.*, 281 U. S., 264, 271 [Ct. D. 223, C. B. IX–2, 299].)

What is complained of with reference to the closing inventory at market which was submitted by the petitioner after the rejection of the one above considered is the disallowance of claimed deductions from the stated total market value of the items listed in that inventory, the amounts sought to be deducted being for shrinkage and breakage, for degrade and for discount. Evidence showed that lumber was graded as it came from the saw, and was then stacked in piles and inventoried. The deductions claimed for shrinkage and breakage, and for degrade, were based on estimates of losses due to lumber shrinking and being broken between the time it was first graded and stacked and the time of its sale and shipment, and to changes of condition of some lumber during that time having the effect of requiring it to be assigned to a grade lower than the one to which previously it was assigned. The deduction of a stated amount as discount was based on the contention that such a deduction from the total market value shown was allowable in order to bring the inventory to a net realizable figure at the inventory date. Regulations applicable to inventories required to be furnished by a lumber manufacturer taxpayer do not indicate that it was contemplated by the officials who prepared those regulations that such deductions as the ones claimed would be allowable. It was not made to appear that the petitioner, in making such deductions, conformed to an established accounting practice in the lumber manufacturing business. The claimed deductions based on estimated losses due to shrinkage and breakage, and resulting from changes in conditions calling for degrading, covered alleged losses sustained after the expiration of the year 1920. The amounts of losses due to things which occurred entirely in a subsequent year were not factors proper to be considered in determining income in 1920. The market value of stocks on hand at the end of that year was not subject to be reduced by losses or deterioration which occurred in a subsequent year. The disallowance of the two claimed deductions now under consideration is sustainable on the ground that the evidence was such as justified findings that losses in the amounts and due to the causes stated were not proved to have been sustained prior to the end of the year 1920, and that the amounts of whatever losses due to the causes stated which may have been sustained prior to the end of the year 1920 were not established by evidence.

The inventory now in question being one at market, the prices therein assigned to the articles listed are to be taken to be the current prices prevailing at the date of the inventory for the goods listed, arrived at in a way prescribed by an applicable regulation (articles 1584 and 1587, supra) or in accordance with an approved accounting practice. The definition of market found in a just-mentioned regulation indicates the absence of any intention to make the conclusiveness of the total of such assigned prices shown by the inventory dependent upon the taxpayer being able to realize in cash the amount of that total at the inventory date, or to permit the making of such deductions as those claimed by the petitioner in order to bring the inventory to a net realizable figure at the inventory date. So far as we are advised, nothing in any regulation adopted or in any established practice indicates an intention to make the closing inventory required serve the purpose of showing what the taxpayer could realize in cash for his entire stock at the date of the inventory. It is not to be assumed that ordinarily the total amount shown by an inventory can, at the date of it, be realized in cash for the goods inventoried. It well may be supposed that not infrequently, even when conditions are normal, it may be found to be impossible to do so. Ability to do so is not to be accepted as a test of the sufficiency of an inventory in the absence of authentic evidence of an authoritative recognition of it as such. It seems reasonable to think that the adoption of the requirements that a lumber manufacturer taxpayer furnish a closing inventory was influenced by a purpose to enable tax officials—by examining that inventory in connection with the taxpayer's opening inventory for the same tax year, showings as to additions to stock during that year, sales, receipts and expenditures, and other factors proper to be considered—to determine what, if any, part of the taxpayer's income—his profits or gains—went into the goods listed in the closing inventory. It is a common practice to take inventories at cost. Inventory at market is a substitute for inventory at cost. The petitioner had, and

exercised, the election to make its closing inventory at market, because when the inventory was taken market was lower than cost. The regulation permitting this to be done evidences the conclusion that it is fair and reasonable to count at its market value at the time a closing inventory is taken the part, if any, of the taxpayer's income which had gone into goods on hand at the end of the year, though at the time that part of his income was acquired by the taxpayer its value was more than that indicated by the inventory. It was not made to appear that under any regulation adopted or any established accounting practice a taxpayer is entitled to deduct from the total shown by an inventory, whether taken at cost or at market, the amount of a discount required to bring that total to a sum which, at the date of the inventory, could be realized in cash for the goods inventoried. Nor was it made to appear that the allowance of the claimed deduction now under consideration was required to make the inventory a proper factor in the clear reflection of income. A result of allowing that deduction would be to make the inventory one, not at market, but at lower than market when market, as defined by regulations, the reasonableness or validity of which has not been challenged, was lower than cost. Certainly it can not properly be said that the action of tax officials now under consideration was violative of any adopted regulation, of any established practice in the lumber manufacturing business, or of any recognized rule of law. The practice adopted by the Commissioner and the Board of Tax Appeals with reference to claimed deductions from the total of an inventory taken at market is not to be interfered with unless clearly unlawful. (*Lucas* v. *American Code Co.*, 280 U. S., 445, 449 [Ct. D. 168, C. B. IX–1, 314].)

For the reasons indicated we conclude that none of the complained of actions of the Commissioner and the Board of Tax Appeals was erroneous.

The petition is denied.

SECTION 206.—NET LOSSES.

ARTICLE 1621: Net losses, definition and computation.

REVENUE ACT OF 1924.

Net losses of former corporation the assets of which had been acquired by new corporation. (See Ct. D. 513, page 252.)

ARTICLE 1621: Net losses, definition and computation.

XI–33–5608
Ct. D. 535

INCOME TAX—REVENUE ACTS OF 1924 AND 1926—DECISION OF COURT.

1. DEDUCTION—NET LOSS—WORTHLESS STOCK.

Where a taxpayer, devoting his time to inventing, uses a corporation, which he organized and of which and its affairs he was in active charge, to manufacture and market articles of his invention, purchases all its capital stock with the intention of disposing of it to the public, deals with the corporation as an entity and through it with the public, makes it his debtor, files separate returns of income for it and himself and claims deductions for debts owed him by the corporation, a loss of his investment in the stock of the corporation is not attributable to the operation of a trade or business regularly carried on by the taxpayer within the meaning of section 206(a)1 of the Revenue Act of 1924, and is therefore not an allowable deduction under subdivision (b) of that section.

2. SAME—WHEN STOCK BECOMES WORTHLESS.

A loss on account of worthless stock of a corporation occurs in 1924, when its assets are sold for less than an amount sufficient to pay its creditors, and not in 1925, when it is dissolved.

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

Hubert Dalton and Florence W. Dalton, plaintiffs-appellees, v. Frank C. Bowers, as Executor of the Last Will and Testament of Frank K. Bowers, as Collector of Internal Revenue of the United States for the Second District of New York, defendant-appellant.

[February 15, 1932.]

OPINION.

MANTON, Circuit Judge: The appellee, Hubert Dalton, is an inventor and engineer. In 1917, he organized the Dalton Manufacturing Co., a New York corporation, of which he became the president, treasurer and a director. He owned all the capital stock, which cost him $395,000, and made unsuccessful efforts to sell the stock to the public. He devoted his time to inventing, and used the Dalton Manufacturing Co. to manufacture and market articles of his invention. He was in active charge of the company and its affairs, and from its incorporation until September, 1924, spent the greater part of his time at its office, receiving no compensation for his labors, although he was credited with a salary from 1917 to 1922, inclusive. The company at no time was profitable and appellee loaned to it from 1920 to 1924 approximately half a million dollars for which it was indebted to him at the time of its dissolution. It manufactured articles of his invention only, but sold some small tools incidental to the articles manufactured. In 1924, it became badly involved financially, owing considerable money. In 1923, in his income tax return, appellee claimed a deduction for bad debts of $157,035.50, owed him by the corporation, claiming that it was unable to meet its obligations and pay its debts to him. In December, 1923, the liabilities exceeded the assets by $173,462, and in that year it ceased operations and took steps to wind up its business. Its assets were disposed of during 1924. The profits of the sale were insufficient to pay its creditors. However, the appellee advanced sufficient funds to the corporation for that purpose. It was not actually dissolved until 1925, when appellee surrendered his stock for cancellation.

In his return for 1925 he claimed a deduction for the loss sustained in his investment of $395,000 paid for the stock of the corporation, pursuant to section 206, subdivisions (a) and (b), of the Revenue Act of 1924 (43 Stat., 260). Under subdivision (a) the "net loss" means the excess of the deductions allowed by section 214 or section 234 over the gross income, with the following exceptions and limitations:

"(1) Deductions otherwise allowed by law not attributable to the operation of a trade or business regularly carried on by the taxpayer shall be allowed only to the extent of the amount of the gross income not derived from such trade or business."

Subdivision (b) provides:

"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."

Regulations 65, article 1621, provides that the net loss may include therein "losses from the sale or other disposition of real estate, machinery, and other capital assets used in the conduct of such trade or business. * * * In order to be entitled to claim an allowance for a 'net loss' the taxpayer must have suffered an actual net loss in a trade or business during the taxable year."

The questions presented here are (a) when was the loss sustained and (b) if in 1924, was it in a business or trade regularly carried on by the appellee.

There is no justification for saying that the business of the corporation was that of the appellee. During the period the appellee dealt with the corporation as an entity. When he paid the debts of the corporation, he drew on his

personal account in favor of the corporation's account and this made the corporation his debtor. Separate tax returns were filed by the corporation and by the appellee. He purchased the capital stock with the intention of disposing of it to the public. His individual time was spent in large part in matters of invention. In his return for 1923, he stated that the corporation ceased operations and took steps to wind up its business; that he advised the trade that no further orders would be accepted and the plant would remain closed. The loss now sought to be deducted was an investment which he made in the corporation and did not occur in the operation of the trade or business regularly carried on by the appellee. (*Mente* v. *Eisner*, 266 Fed., 161 (C. C. A. 2) [T. D. 3029, C. B. 2, 131]; *Bedell* v. *Commr.*, 30 Fed. (2d), 622 (C. C. A. 2); *Goldberg* v. *Commr.*, 36 Fed. (2d), 551 (Ct. App. D. C.); *Phipps* v. *Commr.* (C. C. A. 2), December 7, 1931; *Anderson* v. *U. S.*, 48 Fed. (2d), 201 (C. C. A. 5).)

By the statute, allowing the deductions and carrying over the loss for two years, Congress intended to give relief to persons engaged in an established business for losses incurred during a year of depression in order to equalize taxation in the two succeeding and more profitable years. It was not intended to apply to occasional or isolated losses. Congress had made this distinction. (*Anderson* v. *U. S.*, 48 Fed. (2d), 201 (C. C. A. 5); *Pabst* v. *Lucas*, 36 Fed. (2d), 614 (Ct. App. D. C.); *De Haven Mfg. Co.* v. *U. S.*, 31 Fed. (2d), 999 [Ct. D. 62, C. B. VIII–1, 235].) In *Nixon* v. *Lucas* (42 Fed. (2d), 833), this court considered a case where three petitioners owned all the stock of a corporation and made a practice of selling in the corporate name. Business was unsuccessful and the petitioners made loans to the corporation, agreeing to take in return the profits. The company sustained large losses and the petitioners divided these among themselves and claimed a deduction in their income tax returns. We said that the parties chose to deal with the corporation as a legal person, which they could do if they so desired; that the agreements created contracts with the same obligations as though the corporation had been an individual and the fact that the partners could at any time take over the assets and deal directly with their customers was not a reason for looking behind the pattern so devised and used; we said further that the losses of the corporation in the particular year were not the losses of the stockholders.

This taxpayer did not regard the business losses of the Dalton Manufacturing Co. as his loss. The loss sustained by the appellee which he seeks to charge off is a capital investment loss. The rule is well settled that the corporation will be looked upon as a legal entity. (*Donnell* v. *Herring-Hall Marvin Safe Co.*, 208 U. S., 267; *Klein* v. *Board of Tax Supervisors*, 282 U. S., 19.) It is only where the legal entity is used to defeat public convenience, protect fraud or defend crime, that the entity will be disregarded and the corporation be said to be an association of persons. (*U. S.* v. *Milwaukee Refrigerator Co.*, 142 Fed., 247; *Majestic Co.* v. *Orpheum Circuit*, 21 Fed. (2d), 720 (C. C. A. 8); *Boatright* v. *Steinite Radio Corp.*, 46 Fed. (2d), 385 (C. C. A. 10).)

Appellee relies principally upon the authority of *Washburn* v. *Commissioner* (51 Fed. (2d), 949 (C. C. A. 8)), where it appeared that a lawyer gave up his practice and devoted all his time to the management of various corporate enterprises which he had formed in his practice and in which he was financially interested. Four of these corporations were timber-holding companies which he alone managed. To open up more timberlands, he organized a railroad, advanced the money to build it and took back most of the stock. In 1922, he sold the stock, sustaining a heavy loss, and sought to deduct it in his 1923 return. He was allowed such deductions, as it was found that his occupation and avocation was the management of his own interests. The court said:

"A party may have interests in corporate stocks, have no particular occupation, and live on the return of his investments. That would not constitute business under the statute in question (section 204, Revenue Act 1921, now section 206, Revenue Act 1924). He may, however, take such an active part in the management of the enterprise in which he has investments as to amount to the carrying on of a business."

The building of the railroad was not an isolated transaction. It was constructed as an aid to the timber companies and was part of the general enterprise—"It was merely the *alter ego* of the petitioner." He maintained a completely organized office and gave his personal attention to the management of the various companies, receiving no salary except such as to cover the actual expenses involved. His income was the result not alone of his investments, but

also of the labor expended by him in the development of the companies. The combination of the two constituted his avocation. These facts, perhaps, distinguished the case from the instant case. At bar, it is clear no business is shown except that conducted by the Dalton Manufacturing Co. The taxpayer had an independent business, to wit, inventing. It must be borne in mind that the appellee here advanced $395,000, not to his own business, but to be applied to the purchase of stock in the corporation and he chose to deal with the public through the corporation. The loss he thus sustained was not a loss incurred in the regular occupation of a trade or business.

Moreover, it appears that the loss which the appellee now seeks to deduct was incurred when the stock proved worthless. This did not occur in 1925 when the corporation was dissolved. There was a net deficit at the end of 1924 of $714,344. All of the assets had been sold in that year. Appellee had ascertained the stock to be worthless prior to the end of 1924, and if any deduction was permissible, it should have been made in 1924. The Commissioner therefore was correct in holding that the stock was not ascertained to be worthless in 1925. (*Darling* v. *Commr.*, 49 Fed. (2d), 111 (C. C. A. 4); *Deeds* v. *Commr.*, 47 Fed. (2d), 695 (C. C. A. 6); *DeLoss* v. *Commr.*, 28 Fed. (2d), 803 (C. C. A. 2); *Royal Packing Co.* v. *Commr.*, 22 Fed. (2d), 536 (C. C. A. 9).)

Judgment reversed.

ARTICLE 1621: Net losses, definition and computation.

REVENUE ACTS OF 1921, 1924, AND 1926.

Amendment of articles 1601 and 1621, Regulations 62, 65, and 69. (See T. D. 4349, page 117.)

ARTICLE 1621: Net losses, definition and computation. XI-40-5747 Ct. D. 577

(Also Section 214(a)4, 5, and 6, Article 141.)

INCOME TAX—REVENUE ACT OF 1921—DECISION OF COURT.

1. DEDUCTION—NET LOSS—LOSS—PAYMENT UNDER A GUARANTY.

Where a person, whose sole business is that of president of a lumber corporation, without expectation of profit guarantees a contractor against a loss in the construction of a hospital which the latter agreed with the United States to build for a specified amount, an amount paid under such guarantee is not a net loss "resulting from the operation of any trade or business regularly carried on by the taxpayer" within the meaning of section 204(a) of the Revenue Act of 1921 and is not deductible from net income under subdivision (b) of that section; nor is it deductible as a loss under paragraph 4 or 5 of section 214(a) of that Act.

2. DECISION AFFIRMED.

The decision of the Board of Tax Appeals (18 B. T. A., 21) is affirmed.

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

Loretta A. Hines, Ralph J. Hines, and Charles M. Hines, as Executors of the Will of Edward Hines, Deceased, petitioners, v. *Commissioner of Internal Revenue, respondent.*

Petition for review of order of United States Board of Tax Appeals.

Before EVANS and SPARKS, Circuit Judges, and BALTZELL, District Judge.

[April 18, 1932.]

OPINION.

This appeal is taken from an order of redetermination of the United States Board of Tax Appeals, and involves the income taxes of Edward Hines, herein-

after referred to as Hines, for the year 1922. The statute authorizing the appeal is Revenue Act 1926 (ch. 27, 44 Stat., 9), sections 1001–1003.

Edward Hines, at the time of his death, was president of Edward Hines Lumber Co., hereinafter referred to as Lumber company, and had held that office continuously since about 1892. He died during the pendency of his appeal to this court, and petitioners are his executors.

Prior to or about 1917 the Lumber company contracted with Speedway Park Association, hereinafter referred to as Speedway, to furnish lumber for constructing an automobile speedway. During a part of 1917 Hines was absent from the city and during his absence delegated to the secretary of the Lumber company certain authority in the management thereof. While Hines was absent said secretary, acting for the Lumber company, in excess of his authority and without the knowledge of Hines, entered into what appeared to be a moral guarantee of certain indebtedness of the Speedway, which involved the Lumber company to the extent of several hundred thousand dollars.

Upon Hines' return the opening date of the Speedway, as advertised, was close at hand, and it was quite apparent that the plant would not be ready by that time unless said indebtedness guarantee was paid and money was furnished to pay the labor and other things necessary to complete the project. On Hines' recommendation this indebtedness was paid by the Lumber company, and as a result thereof it received $1,194,000 par value of mortgage securities of the Speedway, which was twelve-thirteenths of the Speedway's total outstanding mortgage securities. Later, in order to get complete control of the Speedway, the Lumber company purchased from certain stockholders their stock interest in the Speedway, and paid them therefor $64,177.94. Hines concluded that if the property of said Speedway could be held for several years it would increase materially in value. He also felt a personal responsibility, as president of the Lumber company, in having it make the aforesaid expenditures on behalf of the Speedway, and he personally offered the Lumber company $550,000 for its claim against the Speedway and for its mortgage securities which the Lumber company had taken over. That offer was accepted, and Hines thereupon took over the claim and securities.

In December, 1917, the war had stopped all activities of the Speedway, and in the spring of 1918 Hines began negotiations with the Government looking to its taking over the Speedway property for a hospital. The Government was partial to building a frame hospital on the Speedway site. Hines much preferred a fireproof building, and suggested that its cost would not greatly exceed the cost of a frame building. In support of his suggestion Hines procured Shank & Co., contractors, to submit a proposal to construct said fireproof building at a certain price, which proved to be satisfactory to the Government, and a contract embodying that proposal was entered into in March, 1920.

In order to induce the Government to construct a fireproof building, Hines agreed to and did contribute $1,000,000 toward the erection of it, and also indemnified Shank & Co. against any loss sustained by it in its erection.

The cost of the hospital, known as the Edward Hines Jr. Hospital, was $5,049,840.32, and the amount received from the Government under the contract was $3,282,498.79, making a loss to Hines, after deducting his contribution, of $767,341.53. Of this loss $282,632.15 was paid by Hines in 1920, $467,362.23 in 1921 and $17,347.15 in 1922.

At the time Hines purchased Speedway's mortgage securities from the Lumber company he did not have, nor did he at any time have, any trade, occupation or business except that of being president of the Lumber company and its affiliated subsidiary organizations; and when he was reimbursing Shank & Co. for its losses in the construction of the hospital there was no one to whom he could look for reimbursement, nor did he then expect to be reimbursed.

In an audit of Hines' return for 1920, he was allowed a deduction for loss of $282,632.15; for 1921 he was allowed as a loss said sum of $467,362.23, and his net loss for that year was $389,483.27. In determining Hines' tax liability for 1922, respondent allowed as a deduction for loss said sum of $17,347.15, but refused to apply the 1921 net loss against the net income of $35,515.33 determined for 1922.

Respondent asserted a deficiency in income tax for 1922 of $1,927.73, but in his amended answer claimed that the allowance of $17,347.15 as a deduction for that year was an error. The Board thereupon redetermined Hines' deficiency in the sum of $5,899.93.

SPARKS, Circuit Judge: The sole issue herein involved is the deductibility from income of Hines of the amount paid by him as a result of his guaranty to

protect Shank & Co. from loss incurred by them in the erection of the Edward Hines Jr. Hospital.

Petitioners contend, however, that Hines' loss was initiated when he bought the mortgage securities in December, 1917, and was not caused by his indemnifying contract with Shank & Co. in March, 1920. With this contention we can not agree. The purchase of the securities may have indirectly and eventually led to the execution of the guaranty contract, but it is certain that said purchase of securities in no way obligated Hines to execute the guaranty contract. There is no evidence of record that Hines sustained any loss in the entire transaction over and above the sum of $767,341.53, which he paid under his guaranty contract in the respective years of 1920, 1921, and 1922. This represented the difference between the cost of the hospital and the contract price received from the Government, plus Hines' contribution of $1,000,000. We think there is no causal connection between Hines' purchase of the bonds and his loss under his indemnifying contract.

It can not be denied that Hines sustained losses in 1921 and 1922 in the manner and amounts as hereinbefore set forth. Whether or not such losses are deductible from his income for those years depends upon the statutes set forth in the margin.[1]

The Board held that Hines' loss in 1921 was the result of an isolated transaction and was not a net loss resulting from the operation of any trade or business regularly carried on by Hines within the meaning of section 204(a), supra. It also held that the Commissioner erred in allowing a deduction of $17,347.15 in the same transaction for the year 1922, as representing a loss incurred in trade or business, or incurred in a transaction entered into for profit though not connected with the trade or business within the meaning of section 214(a), (4), and (5), supra.

We think both rulings of the Board are correct. It is quite obvious from the record that the activities which resulted in the losses to Hines were no part of the operation of any trade or business regularly carried on by him; but they constituted a distinct and isolated transaction, wholly separate from his trade or business, which was that of president of the Lumber company. The Lumber company had no interest in either the Speedway or the hospital after it sold the Speedway securities to him in December, 1917.

It is also apparent from Hines' testimony that in carrying out the projects of relieving the Lumber company and in guaranteeing the erection of the hospital he had no thought of making a financial profit. The gist of his testimony is that in the purchase of the securities he was trying to protect his good name with the Lumber company, which he very commendably thought was in issue by reason of an unwise deal of the secretary of that company, who was his brother-in-law, and on that account he said that he felt morally obligated to protect the Lumber company by purchasing the bonds. If at that time he really intended, as he testified, to profit by the purchase of the securities, that fact would have quite a tendency to relieve the pressure of the moral obligation which he says was then impelling him. Later he guaranteed the construction of the hospital in a certain manner and at a certain price, and his purpose was to do that thing regardless of what personal obligation it might cast upon him for he testified that he did not expect to be reimbursed therefor.

Similar questions have frequently been before the courts, and necessarily the determination of each case has depended upon the particular facts of the case

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[1] Revenue Act of 1921 (ch. 136, 42 Stat., 227):

SEC. 204. (a) That as used in this section the term "net loss" means only net losses resulting from the operation of any trade or business regularly carried on by the taxpayer (including losses sustained from the sale or other disposition of real estate, machinery, and other capital assets, used in the conduct of such trade or business); * * *.

(b) If for any taxable year beginning after December 31, 1920, it appears upon the production of evidence satisfactory to the Commissioner that any taxpayer has sustained a net loss, the amount thereof shall be deducted from the net income of the taxpayer for the succeeding taxable year; and if such net loss is in excess of the net income for such succeeding taxable year, the amount of such excess shall be allowed as a deduction in computing the net income for the next succeeding taxable year; the deduction in all cases to be made under regulations prescribed by the Commissioner with the approval of the Secretary.

SEC. 214. (a) That in computing net income there shall be allowed as deductions: * * *

(4) Losses sustained during the taxable year and not compensated for by insurance or otherwise, if incurred in trade or business;

(5) 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; * * *.

then before the court. Under the particular facts of this case we are convinced that Hines' losses were not deductible under the statutes cited. (*Rogers* v. *United States*, 41 F. (2d), 865 [Ct. D. 227, C. B. IX–2, 302]; *Pabst* v. *Lucas*, 36 F. (2d), 614; *Goldberg* v. *Commissioner*, 36 F. (2d), 651; *G. Angelo & Co.* v. *Commissioner*, 30 F. (2d), 193; *Bedell* v. *Commissioner*, 30 F. (2d), 622; *Avery* v. *Commissioner*, 22 F. (2d), 6 [T. D. 4116, C. B. VII–1, 155]; *Flint* v. *Stone Tracy Co.*, 220 U. S., 107; and *Washburn* v. *Commissioner*, 51 F. (2d), 949.)

Petitioners rely on *Washburn* v. *Commissioner*, supra, to support their contention, but the facts in that case relative to the trade or business regularly carried on by the taxpayer were very much different from those in the instant case, and the court, we think, properly held that Washburn's loss was occasioned by the operation of his regular trade or business, and hence it was deductible. The court in that opinion said:

"Obviously in every case a business to be regularly carried on must be characterized by a continuing activity in some field of business endeavor. The loss contemplated by the statute is an operating loss, and the party claiming it must be the operator of the trade or business in which the loss occurs."

The difference between that case and the one at bar is one of fact and not of law, and the same may be said as to the other cases cited by petitioners.

Petitioners also contend that there was error in the court's ruling because respondent introduced no evidence after amending his answer, and the burden was upon respondent to sustain the added facts. There is no merit in this contention. The evidence to sustain the amendment was already in the record, and the amendment merely caused the answer to conform to the facts proven.

The decree of the Board is affirmed.

ARTICLE 1621: Net losses, definition and computation.

REVENUE ACT OF 1918.

Net loss of new corporate entity created by consolidation under the law of New York. (See Ct. D. 615, page 415.)

SECTION 208.—CAPITAL GAINS AND LOSSES.

ARTICLE 1651: Definition and illustration of capital net gain. XI–50–5917 Ct. D. 611

INCOME TAX—REVENUE ACT OF 1924—DECISION OF SUPREME COURT.

1. CAPITAL GAIN—CAPITAL ASSETS—BONUS—ROYALTIES—MINERAL LEASE.

Where an owner in fee executes oil and gas leases on land for a specified term and as long thereafter as oil and gas should be produced by the lessee, in return for bonus payments in cash, and stipulated royalties, measured by the production of oil and gas, the bonus payments and royalties do not constitute "gain from the sale or exchange of capital assets" within the meaning of section 208 of the Revenue Act of 1924, but are taxable as ordinary income.

2. SAME—STATE LAW.

Where the State law regards an oil and gas lease as a present sale of the oil and gas in place it does not operate to constitute bonus payments made thereunder as "gain from the sale or exchange of capital assets" within the meaning of section 208 of the Revenue Act of 1924, which has its own criteria irrespective of any particular characterization of the payments in the local law. State law may control only when the operation of the Federal taxing Act by express language or necessary implication makes its own operation dependent upon State law.

3. DECISION REVERSED.

The decision of the Circuit Court of Appeals (56 F. (2d), 153) reversed.

SUPREME COURT OF THE UNITED STATES.

David Burnet, Commissioner of Internal Revenue, petitioner, v. *Henry Harmel.*

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

[November 7, 1932.]

OPINION.

Mr. Justice STONE delivered the opinion of the court.

Respondent, the owner in fee of Texas oil lands, executed oil and gas leases of the lands for three years and as long thereafter as oil or gas should be produced from them by the lessee, in return for bonus payments aggregating $57,000 in cash, and stipulated royalties, measured by the production of oil and gas by the lessee. In making his income tax returns under the Revenue Act of 1924 for the years 1924 and 1925, respondent reported the cash payments as gain from a sale of capital assets, taxable under the applicable section of the statute at a lower rate than other income. The Commissioner treated the payments as ordinary income taxed at the higher rate, and gave respondent notice of assessment for the deficiency. The order of the Board of Tax Appeals upholding the assessment (19 B. T. A., 376) was reversed by the Court of Appeals for the Fifth Circuit (56 F. (2d), 153), following its earlier decision in *Ferguson* v. *Commissioner* (45 F. (2d), 573). It was held that because Texas law, unlike that of other States, regards an oil and gas lease as a present sale of the oil and gas in place, the gain resulting from the cash payment received as consideration for the leases was taxable only as gain from the sale of capital assets. This court granted certiorari (286 U. S., 536), to resolve a conflict of the decision below with that of the Court of Claims, under corresponding provisions of the Revenue Act of 1921, in *Hirschi* v. *United States* (67 Ct. Cls., 637).

The Revenue Act of 1924 (ch. 234, 43 Stat., 262), like that of 1921 (ch. 136, 42 Stat., 232), taxed certain income derived from capital gains at a lower rate than other income. By section 208(a)1 "The term 'capital gain' means taxable gain from the sale or exchange of capital assets consummated after December 31, 1921." By section 208(a)8 "capital assets" means property held by the taxpayer for more than two years but does not include property "which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale in the course of his trade or business." Related provisions of the section define "capital loss" and "capital deductions" which, in some circumstances, are allowed as deductions from capital gain in order to arrive at the net gain taxed at the lower rate. The only question presented here is whether the bonus payments to the respondent, after allowed deductions, if any, are "gain from the sale or exchange of capital assets" within the meaning of the taxing Act.

Before the Act of 1921, gains realized from the sale of property were taxed at the same rates as other income, with the result that capital gains, often accruing over long periods of time, were taxed in the year of realization at the high rates resulting from their inclusion in the higher surtax brackets. The provisions of the 1921 Revenue Act for taxing capital gains at a lower rate, reenacted in 1924 without material change, were adopted to relieve the taxpayer from these excessive tax burdens on gains resulting from a conversion of capital investments, and to remove the deterrent effect of those burdens on such conversions. House Report No. 350, Ways and Means Committee, Sixty-seventh Congress, first session, on the revenue bill of 1921, page 10; see *Alexander* v. *King* (46 F. (2d), 235 [Ct. D. 294, C. B. X–1, 223]).

It is an incident of every oil and gas lease, where production operations are carried on by the lessee, that the ownership of the oil and gas passes from the lessor to the lessee at some time and the lessor is compensated by the payments made by the lessee for the rights and privileges which he acquires under the lease. But notwithstanding this incidental transfer of ownership, it is evident that the taxation of the receipts of the lessor as income does not ordinarily produce the kind of hardship aimed at by the capital gains provision of the taxing Act. Oil and gas may or may not be present in the leased premises, and may or may not be found by the lessee. If found, their abstraction from the soil

is a time-consuming operation and the payments made by the lessee to the lessor do not normally become payable as the result of a single transaction within the taxable year, as in the case of a sale of property. The payment of an initial bonus alters the character of the transaction no more than an unusually large rental for the first year alters the character of any other lease, and the taxation of the one as ordinary income does not act as a deterrent upon conversion of capital assets, any more than the taxation of the other.

Moreover, the statute speaks of a "sale" and these leases would not generally be described as a "sale" of the mineral content of the soil, using the term either in its technical sense or as it is commonly understood. Nor would the payments made by lessee to lessor generally be denominated the purchase price of the oil and gas. By virtue of the lease, the lessee acquires the privilege of exploiting the land for the production of oil and gas for a prescribed period; he may explore, drill and produce oil and gas, if found. Such operations with respect to a mine have been said to resemble a manufacturing business carried on by the use of the soil, to which the passing of title of the minerals is but an incident, rather than a sale of the land or of any interest in it or in its mineral content. (*Stratton's Independence* v. *Howbert*, 231 U. S., 399, 414, 415; see *Von Baumbach* v. *Sargent Land Co.*, 242 U. S., 503, 521.)

Long before the enactment of the capital gains provision in the 1921 Revenue Act, this court had to determine whether a mining lease was to be regarded as a sale. In interpreting the corporation tax law of 1909, it had occasion to consider the nature of the proceeds derived by the owner of mineral land from his own mining operations or from payments made to him by the lessee under a mining lease. That Act imposed an excise tax on corporations, measured by their income. Unlike the later Revenue Acts, it made no provision for a depletion allowance to be deducted from the proceeds of mining in order to arrive at the statutory income. It was argued that since the net result of the mining operation is a conversion of capital investment as upon a sale, the money received by the corporate owner or lessor, being its capital in a changed form, could not rightly be deemed to be income. But that argument was rejected, both with respect to the proceeds of mining operations carried on by the corporate owner on its land (*Stratton's Independence* v. *Howbert*, supra; *Goldfield Consolidated Mines* v. *Scott*, 247 U. S., 126; *Stanton* v. *Baltic Mining Co.*, 240 U. S., 103, 114), and with respect to payments made by the lessee to the corporate lessor under the provisions of a mining lease. (*Von Baumbach* v. *Sargent Land Co.*, 242 U. S., 503, 521, 522; *United States* v. *Biwabik Mining Co.*, 247 U. S., 116.)

Although these cases arose under the Act of 1909, before the enactment of the capital gains provision in the 1921 Act, they established, for purposes of defining "income" in a tax measured by it, that payments by lessees to lessors under mining leases were not a conversion of capital, as upon a sale of capital assets, but were income to the lessor, like payments of rent. And before the 1921 Act this court had indicated (see *Eisner* v. *Macomber*, 252 U. S., 189, 207 [T. D. 3010, C. B. 3, 25]), what it later held, that "income," as used in the Revenue Acts taxing income, adopted since the sixteenth amendment, has the same meaning that it had in the Act of 1909. (*Merchants Loan & Trust Co.* v. *Smietanka*, 255 U. S., 509, 519 [T. D. 3173, C. B. 4, 34]; see *Southern Pacific Co.* v. *Lowe*, 247 U. S., 330, 335.)

Congress legislated in the light of this history (cf. *United States* v. *Merriam*, 263 U. S., 179, 187 [T. D. 3535, C. B. II-2, 87]), and, in the absence of explicit language indicating a different purpose, it can not be taken to have intended that an oil and gas lease under the capital gains provision, any more than a mineral lease under the earlier Acts, should be treated like an ordinary sale of land or chattels, resulting in a conversion of capital assets. Such a construction would have disregarded legislative and judicial history of pursuasive force; it would have adopted a distorted, rather than the common meaning of the term "sale" (see *Old Colony R. R. Co.* v. *Commissioner*, 284 U. S., 552, 561 [Ct. D. 456, C. B. XI-1, 274]), and would have tended to defeat rather than further the purpose of the Act.

The respondent does not challenge the correctness of the construction of the statute which we adopt,[1] when applied to oil and gas leases under which the

[1] The capital gains provision of the 1921 Act (section 206) was held not to embrace receipts of the lessor from an oil and gas lease in *Burkett* v. *Commissioner* (31 F. (2d), 667); *Berg* v. *Commissioner* (33 F. (2d), 641 [Ct. D. 97, C. B. VIII-2, 280]); *Hirschi* v. *United States* (67 Ct. Cl., 637); *Ferguson* v. *Commissioner* (59 F. (2d), 891); and in *Alexander* v. *King* (46 F. (2d), 235 [Ct. D. 294, C. B. X-1, 223]), a similar construction was placed upon the like provisions of the 1924 Act.

title to the oil and gas passes to the lessee only on severance from the leasehold. But it is argued that the section can not be so applied to the bonus payments received by the lessor in the present case, because, under Texas law, an oil and gas lease operates immediately upon its execution to pass the title of the oil and gas, in place, to the lessee, and it is thus a sale of the oil and gas and a conversion of capital assets within the precise terms of section 208.

In *Group No. 1 Oil Corporation* v. *Bass* (283 U. S., 279 [Ct. D. 330, C. B. X–1, 153]), this court recognized that oil and gas leases have been characterized, in the decisions of the Texas courts, as present sales of the oil and gas in place, and we applied the rule of those decisions that ownership of the oil and gas passes from lessor to lessee on execution of the lease. There the question was not one of the interpretation of a Federal statute, but of the power of the Federal Government to levy a tax upon the income of a lessee of State lands derived from the sale of oil and gas abstracted by him from the land. It was objected that the tax was not within the power of the Federal Government because imposed on income derived from an instrumentality of the State. If the oil and gas had ceased to be property of the State before its removal by the lessee, it had, under the decisions of this court, ceased to be an instrumentality of the State, and the income derived from it was within the taxing power of the National Government. Whether the title had so passed was a question of State law, and the affirmative answer of the State courts necessarily led to the conclusion that the lessee's income was not immune from Federal income tax. (Compare *Burnet* v. *Coronado Oil Co.*, 285 U. S., 393, 399 [Ct. D. 485, C. B. XI–1, 265].)

Here we are concerned only with the meaning and application of a statute enacted by Congress, in the exercise of its plenary power under the Constitution, to tax income. The exertion of that power is not subject to State control. It is the will of Congress which controls and the expression of its will in legislation, in the absence of language evidencing a different purpose, is to be interpreted so as to give a uniform application to a nationwide scheme of taxation. (See *Weiss* v. *Wiener*, 279 U. S. 333, 337 [Ct. D. 60, C. B. VIII–1, 257]; *Burke-Waggoner Oil Association* v. *Hopkins*, 269 U. S., 110 [T. D. 3790, C. B. V–1, 147]; *United States* v. *Childs*, 266 U. S., 304, 309 [T. D. 3671, C. B. IV–1, 241].) State law may control only when the operation of the Federal taxing Act, by express language or necessary implication, makes its own operation dependent upon State law. (See *Crooks* v. *Harrelson*, 282 U. S., 55 [Ct. D. 271, C. B. X–1, 469]; *Poe* v. *Seaborn*, 282 U. S., 101 [Ct. D. 259, C. B. IX–2, 202]; *United States* v. *Loan & Building Co.*, 278 U. S., 55; *Tyler* v. *United States*, 281 U. S., 497 [Ct. D. 190, C. B. IX–1, 383]; see *Von Baumbach* v. *Sargent Land Co.*, supra, 519.)

But section 208 neither says nor implies that the determination of "gain from the sale or exchange of capital assets" is to be controlled by State law. For the purpose of applying this section to the particular payments now under consideration, the Act of Congress has its own criteria, irrespective of any particular characterization of the payments in the local law. (See *Weiss* v. *Wiener*, supra, 337.) The State law creates legal interests but the Federal statute determines when and how they shall be taxed. We examine the Texas law only for the purpose of ascertaining whether the leases conform to the standard which the taxing statute prescribes for giving the favored treatment to capital gains. Thus tested we find in the Texas leases no differences from those leases where the title to the oil and gas passes only on severance by the lessee, which are of sufficient consequence to call for any different application of section 208. The fact that title to the oil and gas is said to pass before severance, rather than after, is not such a difference. The economic consequences to the lessor of the two types of lease are the same. Under both, the payments made by the lessee are consideration for the right which he acquires to enter upon and use the land for the purpose of exploiting it, as well as for the ownership of the oil and gas; under both the bonus payments are paid and retained, regardless of whether oil or gas is found and despite the fact that all which is not abstracted will remain the property of the lessor upon termination of the lease.

Title to the oil and gas likewise passes from the landowner when he conducts mining operations on his own land. But, as was pointed out in *Stratton's Independence* v. *Howbert*, since that is only an incident to the use of his land for oil production, the operation, considered in its entirety, can not be viewed as a sale or a conversion of capital assets. Like considerations govern here.

The court below thought that the bonus payments, as distinguished from the royalties, should be treated as capital gain, apparently because it assumed that the statute authorizes a depletion allowance upon the royalties alone. (See *Ferguson* v. *Commissioner*, 45 F. (2d), 573, 577.) But bonus payments to the lessor have been deemed to be subject to depletion allowances under section 214(a)9, Revenue Act of 1924, by article 216, Treasury Regulations 65, as well as under earlier Acts. (Section 214(a)10, Revenue Act of 1921, article 215, Treasury Regulations 62.) Cf. *Murphy Oil Co.* v. *Burnet* (55 F. (2d), 17). The distinction, so far as we are advised, has not been taken in any other case. See *Alexander* v. *King*, supra; *Ferguson* v. *Commissioner* (59 F. (2d), 891); *Appeal of Nelson Land & Oil Co.* (3 B. T. A., 315); *Burkett* v. *Commissioner* (31 F. (2d), 667, and see the same case before the Board of Tax Appeals (7 B. T. A., 560)); *Berg* v. *Commissioner* (33 F. (2d), 641); *Hirschi* v. *United States*, supra. We see no basis for it. Bonus and royalties are both consideration for the lease and are income of the lessor. We can not say that such payments by the lessee to the lessor, to be retained by him regardless of the production of any oil or gas, are any more to be taxed as capital gains than royalties which are measured by the actual production. (See *Work* v. *Mosier*, 261 U. S., 352, 357–358.)

Reversed.

PART II.—INDIVIDUALS.

SECTION 212.—NET INCOME OF INDIVIDUALS DEFINED.

ARTICLE 23: Bases of computation. (Also Section 1208.) XI–42–5791 Ct. D. 587

INCOME TAX—REVENUE ACTS OF 1926 AND 1928—DECISION OF COURT.

1. NET INCOME—COMPUTATION—INSTALLMENT SALES—CONSTITUTIONALITY.

If a taxpayer entitled to the benefits of section 212(d) of the Revenue Act of 1926 elects for the taxable year 1917 to report its net income on the installment basis, that subdivision and section 1208 of the same Act require that in computing its income for that year amounts actually received in that year on account of sales of property made in any prior year shall not be excluded, notwithstanding the profits upon such sales were reported as income by the taxpayer in prior years in which it employed the accrual basis as the method of reporting its net income. Section 212(d) and section 1208 of the Revenue Act of 1926 as so construed are constitutional.

2. REFUND OR CREDIT—INSTALLMENT SALES.

Where a taxpayer, which regularly sells property on the installment plan, by an original return made prior to February 26, 1926, the date of the enactment of the Revenue Act of 1926, changed the method of reporting its net income for the taxable year 1917 from the accrual basis to the installment basis and paid before the enactment of the Revenue Act of 1928 (May 29, 1928) an additional assessment for that year resulting from the Commissioner's computation of the income for that year on the accrual basis under the view that the taxpayer's books of account did not contain adequate information to compute income accurately on the installment basis, if its income for that year can be computed accurately upon the installment basis section 705(a)1 of the Revenue Act of 1928 prohibits a refund of the additional tax unless the taxpayer has overpaid its tax for that year, computed by including, in computing income, amounts received during such year on account of sales of property made in any prior year.

UNITED STATES CIRCUIT COURT OF APPEALS, SIXTH CIRCUIT.

The Hoover-Bond Co., appellant, v. *U. G. Denman, Administrator with the Will Annexed of Charles H. Nauts, Deceased, appellee.*

Appeal from the District Court for the Northern District of Ohio, Western Division.

[June 27, 1932.]

OPINION.

HICKS, Circuit Judge: Appellant, herein called plaintiff, brought suit against the administrator of the estate of Nauts, a deceased revenue collector, to recover the sum of $13,108.87 with interest which it alleged was wrongfully exacted from it as income and profits taxes for the year 1917.

Plaintiff has been engaged since 1913 in the sale of furniture at retail. The principal portion of its sales was on the installment plan. The amount sued for represents an additional assessment for the year 1917 made on May 25, 1925, and paid by plaintiff upon the same date. No statute of limitations is involved. This additional tax arose out of the Commissioner's computation of plaintiff's income for 1917 upon the accrual basis. Plaintiff concedes that if this method is correct it is not entitled to recover but it insists that its income for that year should be computed (1) upon the installment basis and (2) by the single tax rule[1] and that when so computed it will appear that plaintiff has overpaid its taxes in the amount sued for.

For 1916 and prior years plaintiff had made its income tax returns upon the accrual basis. On April 1, 1918, it filed an original return for 1917. This return reflected a change in plaintiff's method of reporting. It excluded the amounts collected in that year upon sales made in previous years and upon which it claimed that it had been taxed in those years. This was done upon the theory that if it should again report such sales double taxation would result. It was thought that Treasury Regulations 33, article 120, promulgated January 2, 1918, justified such method of making returns. An examination of this regulation indicates to us that while it provides for installment returns it makes no specific provision for the application of either the single tax rule or the double tax rule. This regulation, however, was on April 17, 1919, supplanted by Regulations 45, article 42, which expressly authorized and required the double tax rule, but an amendment of this regulation (T. D. 3082 [C. B. 3, 107]) promulgated October 20, 1920, authorized the application of the single tax rule.

But all of these regulations were declared invalid by the Board of Tax Appeals in *Appeal of B. B. Todd, Inc.* (1 B. T. A., 762), for lack of any statutory basis. The decision in the Todd case naturally created uncertainty and confusion not only in the Bureau of Internal Revenue but among taxpayers who had changed their method of making returns from the accrual basis to the installment basis.

Under these circumstances section 212(d) was incorporated in the Revenue Act of 1926 (ch. 27, 44 Stat., 23, 130) and by section 1208 of the same Act section 212(d) was made to apply retroactively to the computation of income for the years 1916 to 1924, inclusive. Section 212(d) was the first legislative authority granted to installment dealers for reporting income upon the installment basis. The legislative history of this section and the interpretation of it by the Treasury Department as well as judicial construction of it, all indicate that its purpose was to require all installment payments made in the taxable year to be returned regardless of whether they were reflected in returns made in previous years upon the accrual basis. (*Willcuts* v. *Gradwohl*, C. C. A. 8, decided April 15, 1932 [Ct. D. 524, page 155, this Bulletin]; *Tull & Gibbs, Inc.*, v. *U. S.*, 48 Fed. (2d), 148, C. C. A. 9; *John M. Brant Co.* v. *U. S.*, 49 Fed. (2d), 126 (Court of Claims) [Ct. D. 222, C. B. IX–2, 192]; *Blum's, Inc.*, v. *Commissioner*, 7 B. T. A., 737; *J. B. Bradford Piano Co.* v. *Commissioner*, 15 B. T. A.,

[1] The single tax rule of computing net income on the installment basis is to exclude collections made in the taxable year on sales made in prior years and which had been already taxed in such prior years. The double tax rule is to include collections made in the taxable years on sales made in prior years and which had already been taxed in prior years.

1045, 1047; Treasury Decision 3921, promulgated August 27, 1926 [C. B. V-2, 24]; the report of the conference committee (House Report No. 356, first session Sixty-ninth Congress), pages 32 to 59.) Concretely, section 212(d) retroactively applied, required plaintiff, if it should elect to make its 1917 returns upon the installment basis, to observe the double tax rule rather than the single tax rule.

This legislative policy was recognized and continued in the Revenue Act of 1928 and we find no merit in the contention that it contravenes Article I, section 9, clause 4 of the Constitution. (*Tennessee* v. *Whitworth*, 117 U. S., 129, 137; *Hellmich* v. *Hellman*, 276 U. S., 233 [T. D. 4217, C. B. VII-2, 238]; *Tull & Gibbs* v. *U. S.*, supra.)

The effect, of course, of section 212(d) retroactively applied, was to upset returns made under the single tax rule for the years 1916 to 1924, inclusive. This situation was brought to the attention of Congress when the Revenue Act of 1928 was being considered and we think it manifest from the report of Senate proceedings (Sixty-ninth Congress, Record, part 8, pages 8697, 8699) that section 705 of the Revenue Act of 1928 (45 Stat., 881, 26 U. S. C., section 2705) was intended to grant a measure of protection to those taxpayers who fell within subsection (a), clause 2, of section 705, but we think that it is just as clear that the legislative intent was not to refund taxes already paid by a taxpayer who by an original return prior to February 26, 1926, had changed his method of reporting for 1924 or any prior years to the installment basis unless he had overpaid his taxes when computed by the double tax rule.

If plaintiff was entitled to file its 1917 return on the installment basis rather than the accrual basis (which both the district judge and the Board of Tax Appeals doubt—see *Hoover-Bond Co.* v. *Nauts* (42 Fed. (2d), 299 (D. C.)) and *Appeal of the Hoover-Bond Co.* (1 B. T. A., 929, 931)), then its case falls within section 705(a)1 of the Revenue Act of 1928 and under such circumstances plaintiff is no more entitled to recover than if it had filed its 1917 return upon the accrual basis. (See *Willcuts* v. *Gradwohl*, supra.)

Judgment affirmed.

SECTION 213(a).—GROSS INCOME DEFINED: INCLUSIONS.

ARTICLE 31: What included in gross income. XI-34-5624
Ct. D. 544

INCOME TAX—REVENUE ACT OF 1921—DECISION OF COURT.

1. INCOME—BONUS—RENTAL—DEDUCTION—LOSS—SALE OF BUILDINGS—BUILDINGS AS REALTY.

Where a taxpayer, the owner of an undivided three-fourths interest in improved real estate, accepts an offer "to pay the sum of $100,000 for the buildings" erected upon the property and to enter into a perpetual lease of the land upon which the buildings stand, and where the proposed lease does not purport to convey the buildings apart from the land or permit their severance and removal at the will of the lessee but requires them to be maintained in good condition by the lessee and to be replaced, in the event of removal under designated conditions, by other buildings of greater value, the executed lease, into which all antecedent agreements are merged, does not operate to create a legal or equitable estate in the buildings as realty and there is no constructive conversion of real property into personalty. The taxpayer therefore is not entitled to a deduction for a loss claimed to have resulted from the sale of the buildings and the $100,000 received by the taxpayer is a bonus paid for the leasehold estate in the nature of rental and is taxable income to him under the Revenue Act of 1921 in such proportion as it was in fact for his benefit.

2. DECISION AFFIRMED.

The decision of the Board of Tax Appeals (18 B. T. A., 588) is affirmed.

UNITED STATES CIRCUIT COURT OF APPEALS, SIXTH CIRCUIT.

George W. Crile, petitioner, v. *Commissioner of Internal Revenue, respondent.*

Petition to review decision of United States Board of Tax Appeals.

Before MOORMAN, HICKS, and HICKENLOOPER, Circuit Judges.

[February 5, 1932.]

OPINION.

HICKENLOOPER, Circuit Judge: On June 16, 1923, George W. Crile was the owner of an undivided three-fourths interest in certain improved real estate in the city of Cleveland. On the date mentioned he received an offer from the East Sixty-Third Euclid Co., in which that company offered "to pay the sum of $100,000 for the buildings" erected upon this property, and to enter into a perpetual lease of the lot or land upon which such buildings stood. The proposed lease did not purport to convey the buildings apart from the land or to permit their severance and removal at the will of the lessee, but required them to be maintained in good condition by such lessee and to be replaced, in the event of removal under designated conditions, by other buildings of concededly greater value. This offer was accepted, the lease was executed, and the sum of $100,000 was paid. Thereafter, in his income tax return for 1923, Doctor Crile claimed a loss of $59,960.89 said to have resulted from the sale of the buildings, which then had a depreciated value of $159,960.89. The Commissioner disallowed the deduction, and assessed the taxpayer upon additional income in the amount of $100,000, as a bonus paid for the leasehold estate. The Board of Tax Appeals affirmed.

Two different lines of argument are pursued by the petitioner. It is first claimed in the briefs that the sale of the buildings and the lease of the ground were independent transactions separately permissible under the established real estate law of Ohio, that the statute of frauds was satisfied by the written offer and acceptance, and that thereby a title to the buildings, as distinct from the land, was created in the so-called purchaser. It is also suggested in the alternative that the $100,000 payment is properly to be considered as a payment on account of the purchase price of the property as a unit, the privilege of purchase price fixed by the lease being reduced in that amount, but without the creation of any fixed obligation on the part of the lessee to pay the balance of the purchase price, referred to in the lease as "the privilege of purchase price." Thus, it is urged, the $100,000 is a return of capital, and should not be taxed as income for 1923, regardless of whether the deduction was properly disallowed, or whether, if the property subsequently reverted, this payment would then be regarded as income, in whole or in part, or merely as liquidated damages.

The latter argument above stated is much the more persuasive. Doubtless rentals may be paid in part in advance, and in part in installments during the continuance of the lease, and when this is the proper interpretation of the acts of and instruments executed by the parties the initial payment is truly income. Where, however, there is an intent to create in the "lessee" an interest in the property itself—as by way of purchase—even though that interest may be forfeitable by failure to perform conditions subsequent, and this intent is made manifest by the instruments duly executed to carry it into effect, the attending payment is a return of capital and should be so regarded, at least prior to forfeiture and reversion. There is, of course, no legal obstacle to one tenant in common leasing the interest of another tenant in common, and we assume that the undivided interest of such lessee tenant in common may consist of a definitely designated portion, or of the whole, of the building erected upon such lot, as well as of a proportionate interest in the entirety (*Cincinnati College* v. *Yeatman*, 30 Ohio St., 276); but in each such case two questions arise, (1) whether there has been in effect a constructive conversion of real property into personalty (cf. *Case Mfg. Co.* v. *Garven*, 45 Ohio St., 289), or, if this be not the effect of the acts of the parties, (2) whether there has been a legally sufficient and valid conveyance of, or the creation of a legal or equitable estate in, the buildings, not as personalty, but as realty, operating thus to create the requisite tenancy in common in such realty.

In the present case there was obviously no intent to effect a constructive conversion, for no present right of severance and removal was given, or future right, except upon an accompanying expenditure of the full value of the buildings for the direct or indirect benefit of the owner of the fee of the land. Was

there then a legally sufficient and valid conveyance of, or the creation of a legal or equitable estate in, the buildings as realty? We are constrained to find that there was not. The offer to "purchase" the buildings and its acceptance at best created but an executory contract of sale, which, although satisfying the statute of frauds as to such contracts (Ohio General Code, section 8620), was wholly ineffective as a conveyance. (Ohio General Code, section 8510; *Richardson* v. *Bates*, 8 Ohio St., 257, 261–262; *Langmede* v. *Weaver*, 65 Ohio St., 17, 30, 31.) The want of such conveyance was not cured by the lease into which all antecedent negotiations and agreements were merged. We are of the opinion that thereafter even the right of specific performance, upon which the creation of an equitable estate must depend, ceased to exist. The lease, and the lease alone, became the declaration and embodiment of the agreement of the parties, and under it the payment can be classified only as a bonus paid for the leasehold estate, as a consideration in the nature of rental. We are not here and now concerned with whether there might have been a reformation of the contract of lease. We must accept the situation as we find it. Under these circumstances there is no escape from the conclusion, not only that the deduction was properly disallowed, but that the payment of $100,000 was taxable income in such proportion as it was in fact for the benefit of petitioner.

Affirmed.

ARTICLE 31: What included in gross income. XI–37–5678
Ct. D. 560

INCOME TAX—REVENUE ACT OF 1918—DECISION OF COURT.

INCOME—TAXABILITY—SALE BY ALIEN PROPERTY CUSTODIAN.

Property of an alien enemy seized under the "Trading with the Enemy Act" of October 6, 1917, is, when returned under the "Settlement of War Claims Act" of March 10, 1928, subject to deduction for income tax on gain on capital assets resulting from a sale in 1919 made by the Alien Property Custodian.

DISTRICT COURT OF THE UNITED STATES FOR THE DISTRICT OF MARYLAND.

Chemische Fabrik von Heyden Aktiengelsellschaft, plaintiff, v. *Galen L. Tait, Collector of Internal Revenue for the District of Maryland, defendant.*

[May 19, 1932.]

OPINION.

CHESNUT, District Judge: This is a suit at law by the plaintiff to recover income tax collected for the year 1919 in the amount of $160,254.17. The defenses are: (a) That the tax (with the exception of the amount of $3,095.90, which has been refunded since the beginning of the suit) was properly due and payable; (b) that the plaintiff's claim for refund was not filed within four years after the payment of the tax, as is required by R. S. 3226 (Title 26, section 156), and (c) that if any amount of tax is recoverable, only 78 per cent is payable to the plaintiff and the remaining 22 per cent is payable to the Alien Property Custodian. At the hearing, for the first time, application was made by the plaintiff to make Howard Sutherland, Alien Property Custodian, a party plaintiff, by amendment to the declaration. The motion was taken under advisement. The case has been submitted on an agreed statement of facts and in addition thereto, the plaintiff has offered in evidence two exhibits. A jury trial has been waived in writing.

The substantial question raised is whether property of an alien enemy seized under the "Trading with the Enemy Act" is, when returned under the "Settlement of War Claims Act" subject to deduction for income taxes for gain on capital assets resulting from a sale made by the Alien Property Custodian; but under the pleadings the question is perhaps the narrower one, whether such taxes paid by the custodian to the collector, may be recovered by the former alien from the collector.

The agreed statement, much abridged, and not changed by the exhibits, shows the following facts:

The plaintiff is a corporation under the laws of Germany, engaged in the manufacturing and selling of chemical products. At the beginning of our war with Germany in 1917, this German corporation owned 747 out of a total issue of 750 shares of the par value of $200 each, in a New Jersey corporation which it had organized as a subsidiary in 1900. About July 17, 1918, the Alien Property Custodian, acting under the provisions of the Trading with Enemy Act, seized the 747 shares of stock and had a new certificate issued therefor in his name. On March 27, 1918, he sold this stock for $1,500,000. He set up on his books a record of the transaction designated as "Trust No. 23907" in the name of the plaintiff. The plaintiff was an alien enemy during the war, and of course, filed no income tax return and in fact was not doing business in any way in the United States.

On March 15, 1924, pursuant to the provisions of section 3176, R. S. (Title 26, section 97, U. S. C.), the deputy collector of internal revenue for the district of Maryland prepared an income and excess profits tax return for the year 1919 in the name of the plaintiff showing a tax payable in the sum of $503,206.46. The computation was based on the profit arising from the sale of the stock, taking its original value at its par of $200 per share. On March 28, 1924, the Commissioner of Internal Revenue made an assessment for the tax in the name of the plaintiff (and also designating the number of the trust, as above given on the books of the Alien Property Custodian); and on March 31, 1924, the Alien Property Custodian paid the tax out of the fund arising from the sale.

On January 21, 1926, plaintiff's attorney filed with the Commissioner of Internal Revenue his written appointment under power of attorney from the plaintiff, and on February 23, 1926, the same attorney (Adrian C. Humphreys) filed a similar power of atttorney from Howard Sutherland, Alien Property Custodian, dated February 9, 1926; and on February 16, 1926, Mr. Humphreys, as attorney in fact for the Alien Property Custodian (for Chemische Fabrik von Heyden Aktiengelsellschaft Trust No. 23907) filed a claim for refund with the Commissioner of Internal Revenue and stated as reasons therefor, among others, that the tax had been wrongfully computed and the profits realized from the sale were not subject to taxation in the hands of the Alien Property Custodian. And on April 12, 1928, the same attorney filed another claim for refund in the name of the plaintiff corporation setting out more specifically the reasons for the refund previously stated in the earlier claim. The fourth and fifth reasons for the refund as given in the latter claim are as follows:

"4. The seizure and sale of the taxpayer's property by the Alien Property Custodian as an act of war, was involuntary and without the owner's consent and is, therefore, a transaction which can result in no profit or loss and is not subject to tax under Revenue Act of 1918.

"5. The sale of the property mentioned herein is not subject to income or excess profits tax for the reason that upon seizure it became the property of the United States and as such is not subject to taxation."

On April 20, 1929, the Commissioner notified the Alien Property Custodian that the tax had been recomputed in the amount of $160,254.17, thus showing an overassessment in the original tax of $342,952.29, which amount was duly refunded to the Alien Property Custodian. The reduction in the tax on recomputation was based largely on substituting the March 1, 1913, value of the stock in lieu of the par value for determination of the realized profit from the sale. On March 12, 1931, the Commissioner again notified the Alien Property Custodian of a further reduction in the tax and refunded the amount of the overassessment, to wit, $3,095.90.

On July 13, 1928, plaintiff filed with the Alien Property Custodian its claim for return of property held in Trust No. 23907, and on or about April 25, 1929, the Alien Property Custodian paid to the plaintiff 78 per cent of the balance of the funds then in trust, and has also paid to the plaintiff 78 per cent of the amount of the refunded taxes. The claims for refund filed by the Alien Property Custodian, to the extent not allowed, were rejected by the Commissioner.

The principal contention of the plaintiff is that no income tax could be lawfully imposed on this fund because the plaintiff was an alien enemy during the year 1919, for which the tax was assessed, and then had no interest whatever in the property, which was *absolutely owned* by the United States and therefore, not subject to taxation. Reference is made to Federal appellate decisions defin-

ing the character of the holding of alien enemy property by the Alien Property Custodian as follows: *United States* v. *Chemical Foundation* (5 Fed. (2d), 207 (C. C. A. 3)), where the court said: "Upon seizure the title of the enemy owners was not held 'in suspension' but passed out of them and became vested legally or beneficially in the United States"—(affirmed on appeal, 272 U. S., 1); and *Commercial Trust Co. of New Jersey* v. *Miller* (262 U. S., 51, 56), where it was said: "Besides, under the Act, it is to be remembered the custodian succeeds to all the rights in the property to which the enemy is entitled as completely as if by conveyance, transfer or assignment." (*Henkels* v. *Sutherland*, 271 U. S., 298, 302; and *Munich Reinsurance Co.* v. *First Reinsurance Co.*, 300 Fed., 345 (D. C. Comm.).)

The contention is also stated in the form of the proposition that as the alien was divested of all property interest, no income accrued to it and, therefore, it had no income to tax because the Revenue Act can only reach realized income. (*Eisner* v. *Macomber*, 252 U. S., 189 [T. D. 3010, C. B. 3, 25].)

But in my opinion, the conclusion contended for is not sound in view of the Acts of Congress passed during and subsequent to the war and dealing with the subject of enemy property held by the Alien Property Custodian during the war and thereafter until authorized to be returned under the Act of Congress. The war, of course, brought about many new conditions and complications, and the history of the legislation in Congress shows that the subject was being dealt with progressively and in the light of developments as they occurred during and after the war. The legislation consists of two important Acts known as the "Trading with the Enemy Act," of October 6, 1917, with many amendments, and the more recent legislation, "Settlement of War Claims Act" of March 10, 1928. Convenient reference to this legislation can be found in 50 U. S. C., appendix, pages 189 and following. It will help to an understanding of the matter now under consideration to make reference to some of the statutes particularly dealing with the subject matter.

By section 6 of the "Trading with the Enemy Act," as originally passed, provision was made for the appointment of the Alien Property Custodian, who was to hold, administer and account for the property received under the general direction of the President.

Section 12 of the original Trading with the Enemy Act provides, in part:

"After the end of the war any claim of any enemy or of an ally of any enemy to any money or other property received and held by the Alien Property Custodian, or deposited in the United States Treasury, shall be settled as Congress shall direct."

And the section also now provides:

"The Alien Property Custodian shall be vested with all of the powers of a common-law trustee in respect to all property, other than money, which has been or shall be, or which has been or shall be required to be conveyed, transferred, assigned, delivered or paid over to him in pursuance of the provisions of this Act. * * * And shall have power to manage such property and do any act or thing in respect thereof or make any disposition thereof or of any part thereof, by sale or otherwise, and exercise any rights or powers which may be or become appurtenant thereto or to the ownership thereof in like manner as though he were the absolute owner thereof."

The Act of July 1, 1918 (chapter 113, section 1, 40 Stat., 646), provided that all taxes lawfully assessed by any body politic against property held by the Alien Property Custodian should be paid out of funds in his hands. As amended by what is known as the Winslow Act of March 4, 1923 (42 Stat., 1511—which has now become subsection A of section 24 of the Trading with the Enemy Act), the language is:

"The Alien Property Custodian is authorized to pay all taxes (including special assessments) heretofore or hereafter lawfully assessed by any body politic against any money or any other property held by him or by the Treasury of the United States under this Act."

And subsections (b) and (c) of section 24, added by Act of March 10, 1928, chapter 167, section 18—known as "Settlement of War Claims Act," provide as follows:

"(b) In the case of income, war-profits, excess-profits, or estate taxes imposed by any Act of Congress, the amount thereof shall, under regulations prescribed by the Commissioner of Internal Revenue with the approval of the Secretary of the Treasury, be computed in the same manner (except as here-

inafter in this section provided) as though the money or other property had not been seized by or paid to the Alien Property Custodian, and shall be paid, as far as practicable, in accordance with subsection (a) of this section. Pending final determination of the tax liability, the Alien Property Custodian is authorized to return, in accordance with the provisions of this Act, money or other property in any trust in such amounts as may be determined, under regulations prescribed by the Commissioner of Internal Revenue with the approval of the Secretary of the Treasury, to be consistent with the prompt payment of the full amount of the internal-revenue taxes.

"(c) So much of the net income of a taxpayer for the taxable year 1917, or any succeeding taxable year, as represents the gain derived from the sale or exchange by the Alien Property Custodian of any property conveyed, transferred, assigned, delivered or paid to him, or seized by him, may at the option of the taxpayer be segregated from the net income and separately taxed at the rate of 30 per centum. This subsection shall be applied and the amount of net income to be so prescribed by the Commissioner of Internal Revenue with the approval of the Secretary of the Treasury, as nearly as may be in the same manner as provided by section 208 of the Revenue Act of 1926 (relating to capital net gains), but without regard to the period for which the property was held by the Alien Property Custodian before its sale or exchange, and whether or not the taxpayer is an individual."

Section 9 of the Trading with the Enemy Act, with its many amendments, provides for the return of property held by the custodian, and it is under this section as amended by the Settlement of War Claims Act of 1928, that the plaintiff in this case on July 13, 1928, filed its claim for return of its former property which had been seized and which, as already stated, has been returned to the extent mentioned.

These statutes show very clearly that Congress intended that enemy property held by the Alien Property Custodian should be subject to current taxation substantially and as nearly as possible in the same way and to the same extent as the property of citizens or friendly aliens.

It is clear that the plaintiff's property was not absolutely confiscated while held by the Alien Propertly Custodian. It is true that it had no right or title therein which he could then enforce until authority was given by the further Act of Congress, but the substantial situation in expectation was that its rights would probably be restored in some form or to some extent when it was determined by Congress what disposition should finally be made of the property. (*Swiss National Insurance Co.* v. *Miller*, 267 U. S., 42; *United States* v. *Chemical Foundation*, 272 U. S., 1.) In this situation, it seems clear that Congress did not lack power to subject the property to deductions for current expenses of the Government. And there is certainly no injustice in subjecting alien enemy property to the same taxation as affected the property of our citizens. In this case it is not contended that the tax as ultimately computed involved any discrimination against the alien property. It is true, of course, that the sale of the plaintiff's property was involuntary so far as it was concerned, but this consideration is met by subsection (d) of section 24 of the Act, which makes applicable to sales of such property the provisions of the general income tax laws applicable to property compulsorily or involuntarily converted.

In the view I take of the matter the dominant and controlling consideration is that the "Settlement of War Claims Act" was an act of grace of the sovereign United States, and in returning the property this Government undoubtedly had the clear right to impose such terms and conditions as it pleased Congress to enact. The property could have been withheld entirely or confiscated beyond any legal right or remedy of the plaintiff. The sole question of law, which, therefore, controls the matter is, what was the intention of Congress as to the terms and conditions on which the property should be returned to the former alien enemy. And the answer to this, I think, must be found in the legislation which has been reviewed and which, in my opinion, particularly as evidenced by subsections (b), (c), (d), (e), and (f) of section 24 of the "Trading with the Enemy Act" (coming from the Settlement of War Claims Act of March 10, 1928) shows beyond any reasonable doubt that the intention of Congress was to return only the corpus of the property remaining after the payment of taxes and other expenses thereout; and the taxes referred to are expressly stated to include income and excess profits taxes computed on gain derived from the sale of property by the Alien Property Custodian for the taxable years 1917 and succeeding years. Obviously the intention was to make

the property subject retroactively to taxes for the designated years. If, therefore, the tax had not previously been paid by the Alien Property Custodian, it was the intention of this legislation to require the determination and payment of the tax before the return of the property to the former alien enemy.

This view of the law has recently been applied to a similar case by the United States Board of Tax Appeals in the case of *Paul Haberland* (21 B. T. A., 446), where, construing section 24 of the Trading with the Enemy Act, as being conclusive on the subject, the Board said:

"In section 24 of the Trading with the Enemy Act, Congress has specifically applied the taxing Acts to income arising out of property held by the custodian. The intent of Congress to apply the amendment of 1928 retroactively is manifest from the wording of subsection (b) referring as it does to 'income, war profits, excess profits or estate taxes imposed by any Act of Congress.' At the time the amendment of 1928 was enacted the taxing Acts imposing profits taxes had been repealed and unless the amendment is applied retroactively the reference therein to such taxes is meaningless."

Kahle v. *Commissioner* (43 Fed. (2d), 61 (C. C. A. 8), certiorari denied, 282 U. S., 292), and *Forstman* v. *Ferguson* (25 Fed. (2d), 47 (C. C. A. 3)), also upheld income taxation under similar though not identical situations. In the Kahle case, as in the instant case, the return on which the tax was based was made by the deputy collector. Against the contention that he lacked authority to do so, the court held the action of the deputy collector was authorized and proper.

A minor contention of the plaintiff in this case is that the tax was irregularly imposed because the assessment was made in the name of the plaintiff corporation which was not and could not be a taxpayer for the year 1919. It is to be noted, however, that the assessment also made reference to the particular trust in which the property was held by the Alien Property Custodian. The contention is that the property if taxable at all, should have been assessed in the name of the Alien Property Custodian. The point seems to me at most an irregularity of no material consequence in view of the whole situation.

With regard to the application to amend the declaration by including the present Alien Property Custodian as a party plaintiff, I had some doubts as to whether the amendment should be allowed. Reference is made by counsel for the plaintiff to the case of *Kombst* v. *United States* (Court of Claims, 52 Fed. (2d), 1030), where suit by a former alien enemy for a return of estate taxes improperly assessed during the war period was sustained. It is said, however, by counsel that after the decision was reported, it was called to the attention of the court that the suit could only properly have been prosecuted by the Alien Property Custodian. In the opinion, it is said:

"If there is a refund allowed, it must be paid to the custodian, who is now in control of the corpus."

And as the custodian was not a party to the suit, counsel state that he was made a party subsequent to the rendition of the opinion.

The first claim for refund in this case was filed in the name of the Alien Property Custodian by one of the present counsel for the plaintiff in this case. If there could be any recovery in this case, it seems clear to me that only 78 per cent thereof would be payable to the plaintiff directly, and the remaining 22 per cent would be payable to the Alien Property Custodian. If the conclusion which I have reached is correct, the point as to the amendment becomes unimportant, but in order to enable the plaintiff to have no defect in procedure in this case, I have allowed the amendment.

I have also had some question as to whether the plaintiff had any right to maintain this suit in its own name. The contention of its counsel is that the plaintiff had no interest or right whatever in the property at the time the tax is alleged to have become due, and none when it was paid by the custodian. On this theory it seems to me highly doubtful if the plaintiff in its own name has any standing whatever in court to recover a tax paid by the custodian to the collector of internal revenue. The suit is against the latter personally although, no doubt, any recovery would be paid by the Government. It seems quite inconsistent to me, on the plaintiff's theory of the case, to permit the plaintiff to recover against the defendant, a tax paid to the defendant by a third person out of property in which, at the time, the plaintiff had no interest whatever. As the rights of the plaintiff to a return of its property come only from section 9 of the Trading with the Enemy Act (as amended in 1928), it would seem to logically follow that its only right of recovery, if any, is against the Alien Prop-

erty Custodian. However, there is the possible view to be taken that the effect of the return of its property to the plaintiff by the custodian is in the nature of an assignment of all claims of the custodian with respect to the original corpus. The Kombst case above cited seems to imply that the right to recover the tax paid out of corpus follows the original control of the corpus. And possibly a right of suit by the plaintiff in this case may be implied from subsection (f) of section 24 of the Trading with the Enemy Act. But as I hold the tax is not recoverable at all, it is not necessary to rule upon this point of procedure.

And likewise, I find it unnecessary to rule upon the defense that the claim for refund as made by the plaintiff is not within the four years period. It would appear that it was filed within the period allowed to the plaintiff in subsection (f) of section 24. And the earlier claim for refund filed by the custodian was within the limited period if the plaintiff is entitled to the benefit of the act of the custodian.

The clerk is instructed to enter a verdict for the defendant, with exception noted for the plaintiff. On this disposition of the case it becomes unnecessary to file on the plaintiff's requested instructions.

ARTICLE 31: What included in gross income. XI–39–5721
G. C. M. 10941

REVENUE ACT OF 1926.

The taxpayer, a resident of Texas, had a vested interest in all community income received during the period January 1, 1927, to September 26, 1927, the date when the married relation was terminated by a final divorce decree. She is taxable with respect to her share of the community income notwithstanding the fact that she entered into an agreement with her husband in settlement of her community property rights.

An opinion is requested relative to the taxable status of A's interest in community property under the laws of Texas, where there has been a divorce and settlement of community property rights.

The taxpayer was formerly the wife of B. In February, 1927, she separated from her husband, and final divorce was granted September 26, 1927. The wife's share of the community income from January 1, 1927, to September 26, 1927, the date the final decree of divorce was entered, was $3.2x$ dollars. The taxpayer entered into an agreement with her husband whereby she received from him $.54x$ dollars in settlement of her community property rights. The question at issue is whether the taxpayer is liable for income tax on her vested interest in the community income from January 1, 1927, to September 26, 1927, consisting of $3.2x$ dollars, or whether she is liable for tax only with respect to $.54x$ dollars, the amount for which she surrendered her community property rights. The provision of law defining community property in Texas is contained in article 4619, Complete Texas Statutes, 1928, Vernon Law Book Co., reading in part as follows:

ART. 4619 [4622–3]. *Community property.*—Section 1. All property *acquired* by either the husband or wife *during marriage*, except that which is the separate property of either, shall be deemed the common property of the husband and wife; and all the effects which the husband and wife possess *at the time the marriage may be dissolved* shall be regarded as common effects or gains, unless the contrary be satisfactorily proved. * * * [Italics supplied.]

It is the settled law of Texas that when a marriage is once consummated the relation continues until dissolved by a decree of divorce or annulment, or until death of one of the parties; but whatever may be the cause for separation, it is not tantamount to

a dissolution of the marriage relation. (See section 586, Speer's "Law of Marital Rights in Texas," third edition.)

In *Kearse* v. *Kearse et al.* (262 S. W., 561) the Court of Civil Appeals of Texas, in discussing the community property rights of husband and wife after separation, stated as follows:

> The marriage relation can only be dissolved by death or judicial decree. At the beginning and during the entire existence of this relation, the law establishes a community of interests in all property acquired by either spouse, except that which is acquired by gift, devise, or descent. This partnership or community interest is not based in any sense on the idea of equality or contribution of labor or capital by the respective spouses, but exists on principles of a perfect union and equality of enjoyment of gains, regardless of inequalities induced by sickness, idleness, habits, or otherwise; it grows out of and depends upon the existence of the marital relation and not merely upon the existence of the family.
>
> * * * * * * * * * The statute is inexorable in its meaning wherein it provides that all property acquired by either husband or wife during the marriage, etc., shall be deemed common property. * * *

The court in that case cited *Routh* v. *Routh* (57 Tex., 589), wherein it was held that the rights of the parties resulting from the marriage relation are fixed by statute, and that separation does not work a forfeiture of the community property rights with respect to land acquired in Texas during the separation. Another case considered by the same court was *Merrell et al.* v. *Moore et al.* (104 S. W., 514). In that case the husband abandoned his wife and child. The wife, believing that the husband had obtained a divorce, remarried. It developed that the husband had not secured a divorce. The court held that the wife had not forfeited her share in the community property acquired by the first husband. In *First National Bank of Mount Calm* v. *Roller et al.* (299 S. W., 917) it was stated that a woman does not cease to be a married woman in the contemplation of the law although she may be permanently separated from her husband. (Cf. *Cromer* v. *Schafer*, 250 S. W., 444.)

Even abandonment for a period of 16 years, leaving the wife in possession of community real estate, does not prevent the husband from recovering his interest in the community property. (*Hardin et al.* v. *Hardin*, 217 S. W., 1108.) And, conversely, where the wife deserts her husband she does not lose her interest in the community estate. (*Hall et al.* v. *Hall et al.*, 241 S. W., 624.) In Texas the wife has a present vested interest in the community income and when filing a separate income tax return she should report therein one-half of the community income. (*Hopkins* v. *Bacon*, 282 U. S., 122.) This is true regardless of agreements between husband and wife changing the status of community income to separate income. (*Lucas* v. *Earl*, 281 U. S., 111; *Blair* v. *Roth*, 22 Fed. (2d), 932, certiorari denied 277 U. S., 588.) Income which at the time of its receipt is community income must be so treated for income tax purposes. (G. C. M. 9938, C. B. X–2, 115; G. C. M. 9953, C. B. XI–1, 13.)

Applying the foregoing principles to the instant case, the taxpayer had a vested interest in all community income received during the period January 1, 1927, to September 26, 1927, the date when

the married relation was terminated by a final divorce decree. As her share of the community income was $3.2x$ dollars, she is taxable on that amount in her separate return.

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

ARTICLE 31: What included in gross income. XI–47–5868
Ct. D. 602

INCOME TAX—REVENUE ACT OF 1918—DECISION OF COURT.

INCOME—EXEMPTION—LAND OF ALLOTTEE OF FIVE CIVILIZED TRIBES.

Neither section 2 nor section 6 of the Act of Congress of May 27, 1908 (35 Stat., 312), operates 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 CIRCUIT COURT OF APPEALS, TENTH CIRCUIT.

Dora Ellen Bagby, née Parks, appellant, v. The United States of America, appellee.

Appeal from the District Court of the United States for the Northern District of Oklahoma.

[July 14, 1932.]

OPINION.

LEWIS, Circuit Judge, delivered the opinion of the court.

The appellant, plaintiff below, brought this suit to recover income taxes assessed and paid for the year 1918. Her complaint was dismissed on demurrer, and she has appealed.

In support of her allegation that the taxes were erroneously and illegally assessed and collected she sets forth that she is and was at the time of her birth, August 12, 1902, a member of the Creek Tribe of Indians of one-sixteenth Indian blood, and was so enrolled; that there was allotted to her as her surplus allotment pursuant to the Act of March 1, 1901 (31 Stat., 861), supplemented by the Act of June 30, 1902 (32 Stat., 500), a described 120 acres, then in the Indian Territory and now in the State of Oklahoma; that the patent conveying the 120 acres to her was executed and delivered on July 5, 1907; that her guardian with the approval of the county court of Tulsa County, Okla., gave an oil and gas lease on the 120 acres, and it has produced oil continuously since 1908; that her estate has received and sold continuously one-tenth of the oil as her royalty, and also received in the year 1918 a sum of money as a bonus for extending the term of the lease; that her guardian included said bonus and royalties received during 1918 in her income tax return; that she was during all of that year and until August 12, 1920, a minor, and because of her minority, her guardianship, the supervising control over her estate retained in the Secretary of the Interior by the Act of March 27, 1908, and the further fact that she was in 1918 and ever since has been a ward of the United States, her income from said lease was nontaxable, and, therefore, said assessment and its collection was erroneous and illegal.

The issue thus tendered and joined by demurrer is one of law and must be determined by the correct interpretation of said Act of May 27, 1908 (35 Stat., 312). The sections for consideration are 1, 2, 4, and 6, and so far as material to this inquiry read thus:

"SECTION 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. * * *

"SEC. 2. * * * *And provided further*, * * * and 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 persons 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 who shall be citizens of that State or now domiciled therein as he may deem necessary 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 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 proper 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 such representative or representatives to make full and complete reports to the Secretary of the Interior. * * *"
(There are further paragraphs of this section not material here, because they deal with the duties of the Secretary and his representatives in the case of minors having restricted lands.)

The conditions set forth in section 9 of said Act are not applicable to the facts of this case.

Of course, the royalties and bonus received were not the land itself, but the tax here in question is in substance a tax on the land (*Pollock* v. *Farmers' Loan & Trust Co.*, 158 U. S., 601), which section 4 of the Act subjects "to taxation and all other civil burdens as though it were the property of other persons than allottees of the Five Civilized Tribes." The quoted phrase puts appellant in the same class as minors of non-Indian blood in a like situation, and as to them there can be no doubt of their liability to an income tax on rentals. So on reading the excerpts from sections 1 and 4 it would seem to be clear that the tax here in question is valid. But appellant relies on sections 2 and 6, contending that she and her allotment are still under restrictions, notwithstanding sections 1 and 4; that her estate is still under the supervising control of the Secretary of the Interior, and that until 1920 she was a minor ward of the United States, subject to its care and protection. That may be conceded, yet if it clearly appears from said Act and the Revenue Act that Congress intended to subject her income to the tax, the assessment was not erroneous and illegal. (*Goudy* v. *Meath*, 203 U. S., 146; *Choteau* v. *Burnet*, 283 U. S., 691 [Ct. D. 352, C. B. X–1, 355].) Section 2 prevents application of shorter periods of minority under State statutes and practice. (*M'Nee* v. *Whitehead*, 253 Fed., 546; *Barbre* v. *Hood*, 228 Fed., 658; *Truskett* v. *Closser*, 236 U. S., 223.) It is a temporary restriction on personal capacity, and supplants every State rule or law to the contrary, and coupled with section 6 demonstrates a continuing interest in and retention of a supervising care over the minor's estate to the extent therein limited; but that does not interfere with alienation of the allotment through proceedings in probate when it is to the interest of a minor that a sale be made, nor the minor's right to sell on reaching majority. There is nothing in section 6 or other parts of the Act expressing an intention to continue the restrictions on alienation which were removed by section 1 of the Act; and section 4 clearly subjected her land to taxation as though she were without Indian blood. It is our opinion that the rents and profits arising therefrom were subject to the tax which she now seeks to recover.

Affirmed.

ARTICLE 36: Long-term contracts. XI-34-5625
Ct. D. 545

INCOME TAX—REVENUE ACT OF 1918—DECISION OF COURT.

1. INCOME—COMPUTATION—LONG-TERM CONTRACTS.

The provision in article 36 of Income Tax Regulations 45 that persons engaged in contracting operations, who have uncompleted contracts, in some cases running for periods of several years, will be allowed to prepare their returns so that the gross income will be arrived at on the basis of completed work, is a valid regulation, and where such a person elects to employ such method of accounting on the long term contract basis and makes returns of income accordingly, he has no right to have income for a single year from uncompleted contracts computed on the annual accrual basis even if it is possible to determine from his books income upon the accrual basis of accounting.

2. DECISION AFFIRMED.

The decision of the Board of Tax Appeals (19 B. T. A., 181) is affirmed.

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT.

H. Stanley Bent, petitioner, v. *Commissioner of Internal Revenue, respondent.*

Upon petition to review an order of the United States Board of Tax Appeals.

Before WILBUR and SAWTELLE, Circuit Judges, and JAMES, District Judge.

[February 8, 1932.]

OPINION.

WILBUR, C. J.: Petitioner is a member of the copartnership of Bent Bros., engaged in the general contracting business, constructing reservoirs, dams and other similar work. The partnership made its returns to the Commissioner of Internal Revenue upon what is called the "long term completed contract" basis, by which the profit or loss incurred upon a contracting job covering more than one year was included in the return of income for the taxable year in which the job was completed. This was a consistent practice of the partnership from 1913 to 1923. A deficiency tax for the year 1920 was assessed by the Commissioner upon the individual income and surtaxes for the year 1920 to the petitioner in the amount of $12.73. Petitioner sought a review of this action by the Board of Tax Appeals. The Board sustained the method and manner of assessment by the Commissioner but fixed the amount of the tax at $60.50. The petitioner seeks to review this order of the Board of Tax Appeals.

The gist of the petitioner's contention is that the return and the assessment based thereon was erroneous for the reason that the partnership books were kept on the accrual basis in such fashion that the books correctly reflected the income for each taxable year and therefore that the assessment must be made for the taxable years 1920 and 1922 in accordance with the first clause of subdivision (b) of section 212 of the Revenue Act of 1918, chapter 18 (40 Stat., 1057). Consequently it is argued that the alternate method permitted by section 212 under the second clause of subdivision (b) is not applicable, and, for the same reason, that the rules of the Treasury Department permitting returns upon the long-term contract are not controlling. Subdivision (b) of section 212 is in part as follows:

"(b) The net income shall be computed upon the basis of the taxpayer's annual accounting period (fiscal year or calendar year, as the case may be) in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; but if no such method of accounting has been so employed, or if the method employed does not clearly reflect the income, the computation shall be made upon such basis and in such manner as in the opinion of the Commissioner does clearly reflect the income. * * *"

The taxes of the petitioner were assessed according to the terms of section 218 of the Revenue Act of 1918 with reference to individuals carrying on business in a partnership and the sole question involved on this petition to review the action of the Board of Tax Appeals is the correct method of computing the income of the partnership.

The method of accounting adopted by Bent Bros. is stated in the respondent's brief, and this statement has been accepted by the petitioner as the correct statement of the situation, and it is as follows:

"A separate account was kept in the partnership books for each project undertaken. At the end of the month this account was charged with the cost, whether paid or not, of all labor, materials, and direct expenses incurred during the month and chargeable to the project. At the close of the year the account was charged with its proportion of the indirect expenses, or overhead, of the business incurred during the year, whether paid or not. The overhead was distributed over the several projects upon which work had been performed during the year in the same proportions that the total costs of each project incurred during the year bore to the total costs of all projects incurred during the year. If the contract provided for payment upon completion of the project the customer's account was charged and the separate account of the project was credited when all work was completed and accepted. If payment was to be made as the work progressed, upon the basis of monthly estimates by the customer's engineer of work completed during the month and the amount of payment due therefor, the customer's account was charged, and the separate account of the project was credited, as such estimates were received, with the amount of payment shown to be due by the estimate. If the contract provided that a percentage of the amount due on each estimate was to be withheld pending completion and acceptance of the project, the separate account of the project was credited only with the payment due and the amount of the holdback was credited to 'retention account.' No accounting was made for any gain or loss on any project until the work was completed and accepted. Until that time the debit balance in a project account was considered an investment and carried on the books as an asset. When work was completed and the project accepted, the project account was closed by transferring the balance representing gain or loss to profit and loss account.

"The net income reported by the partnership in all returns filed for Federal income tax purposes was computed in accordance with the method of accounting employed in keeping the books.

"During 1920 the partnership was engaged on four projects which were not completed in the same taxable year in which work was begun. Devil's Gate Dam was commenced in 1919 and completed in 1920; work on Huntington Park Reservoir began in 1920 and was completed in 1921; work on Rodeo Drain started in 1920 and was completed in 1921; and work on San Dimas Dam began in 1920 and was completed in 1922.

"'Devil's Gate Dam was constructed within the Los Angeles County flood control district. This contract provided that compensation should be paid to the partnership upon the basis of monthly estimates of materials furnished and work completed. Compensation shown to be due by the monthly estimates of the chief engineer of the flood control district were usually paid by the 10th of the following month.

"In accordance with the method of accounting employed in keeping the books, the partnership included in the return for 1920 the entire compensation received for and all of the costs and expenses incident to the construction of Devil's Gate Dam which was completed in that year, but did not include the income or expenses relating to the three other projects commenced but not completed in that year. It was the partnership's custom to report income from each job when it was completed."

This method of accounting and reporting income was in strict accord with the regulations of the Treasury Department. Treasury Regulations No. 45 [1920 edition], article 36, provides as follows:

"ART. 36. *Long-term contracts.*—Persons engaged in contracting operations, who have uncompleted contracts, in some cases perhaps running for periods of several years, will be allowed to prepare their returns so that the gross income will be arrived at on the basis of completed work; that is, on jobs which have been finally completed any and all moneys received in payment will be returned as income for the year in which the work was completed. If the gross income is arrived at by this method, the deduction from such gross income should include and be limited to the expenditures made on account of such completed contracts. * * *"

Section 212 of the Revenue Act of 1918, thus interpreted by the regulations of the Treasury Department (Regulations 45, article 36) has been reenacted in

subsequent revenue laws without change. (Revenue Act of 1921, ch. 136, 42 Stat., 227; Revenue Act of 1924, ch. 234, 43 Stat., 253; Revenue Act of 1926, ch. 27, 44 Stat., 9; and Revenue Act of 1928, ch. 852, 45 Stat., 791.)

The reenactment of the statute in exactly the same terms where the statute has been interpreted by the regulations of the Treasury Department is "persuasive evidence of the legislative approval of the regulation." (*Brewster* v. *Gage*, 280 U. S., 327, 337 [Ct. D. 148, C. B. IX–1, 274], *Trust No. 5833, Security-First Nat'l Bank of Los Angeles*, v. *Welch, Collector, etc.*, No. 6583 [Ct. D. 490, C. B. XI–1, 138], decided by this court December 7, 1931.) Even in the absence of subsequent legislation the practical interpretation by the Department of the statute will not be disturbed if the statute is ambiguous or doubtful. "It is the settled rule that the practical interpretation of an ambiguous or doubtful statute that has been acted upon by officials charged with the administration will not be disturbed except for weighty reasons." (Id., page 336, *U. S.* v. *Jackson*, 280 U. S., 183.) Petitioner concedes that returns may properly be made and assessments levied upon the long term completed contract basis where the contract is a lump sum contract but contends that where the contract is upon the unit price basis it can be clearly determined from the books of the taxpayer just what income has accrued to the taxpayer during the taxable year and for that reason a resort to the alternate basis is not permissible under the statute and the regulations of the Treasury Department (Regulations 45, article 36).

It is well settled and it is conceded that the taxpayer may make his returns upon either a cash basis or accrual basis "in accordance with the method of accounting regularly employed in keeping the books of said taxpayer." (Revenue Act of 1918, section 212, subdivision (b), supra.) The respondent contends that the statute permits and the regulations expressly authorize a modification of the accrual method of bookkeeping and returns based thereon in cases of long-term contracts, while petitioner in effect contends that this method of making returns is not permissible if the books kept on accrual basis clearly reflect the income of the taxpayer for the taxable year. As applied to the situation in the case at bar, the petitioner contends that notwithstanding the fact that it kept separate job accounts showing disbursements and receipts on each job and apportioned to the job accounts at the end of each year its pro rata of the overhead expenses and did not carry over into its general accounting system the profit or loss of each job until the job was completed and the account closed, it was at all times readily ascertainable from the books of the partnership what the income of the partnership was for the taxable year upon the accrual basis, and therefore, notwithstanding the manner in which its books were kept, and notwithstanding the manner in which it made its returns to the collector of internal revenue, it was entitled to have all income received from jobs during the current year treated as income from which expenditures upon that job should be deducted. This contention relates back to the proper definition of "income," it being contended in effect that when the taxpayer adopts the cash basis of accounting the income for the current year is correctly reflected by the difference between the cash receipts and disbursements and likewise when the accounts are kept upon the accrual basis that the income is correctly reflected by the difference between the obligations incurred and income earned regardless of the actual receipts and disbursements. A moment's consideration indicates that the practical determination of income is one of great difficulty. Taxable income upon the accrual basis may be and usually is very different from the taxable income for the same year if it were determined upon the cash system of bookkeeping. In the long run the two systems would probably result in about the same amount of taxes were it not for the increase and decrease of the tax rate and the change in the rules as to exemptions and methods of taxation. In the choice of the accrual or cash basis method of accounting the matter is left to the discretion of the taxpayer regardless of the actual effect upon the amount of the tax, and there seems no good reason why in the special cases of long-term contracts the taxpayer should not have the right to suspend in the job account both expenses and receipts until it is ascertained whether on the whole job there has been a profit or loss. That was done by the taxpayer in this case. It is true that there is a more definite basis of ascertaining the amount of profit earned in the case of unit price contract or income upon a contract on the basis of cost plus a fixed fee than there is on a lump sum contract where payments reflect only a portion of the amount earned.

But in either event the contract is a unit and until the contract is completed and accepted it can not be definitely known what the profit may be or what loss may be suffered by the contractor. The books are full of instances where by reason of defective work or unsuspected obstacles or changes in prices of labor and materials contractors have suffered losses notwithstanding the unit price basis and in the case of the contract based upon cost plus a fixed fee the work may be prolonged over a long period of time by reason of difficulties in the work or the fee might be diminished or wholly lost because of inability to complete the contract. These observations, familiar to all, are made merely for the purpose of indicating that under such contracts the income, that is, the profit, derived from a contract is not necessarily reflected by the payments made thereunder for a particular period, whether such payments are upon a lump sum contract basis, or unit price basis, or cost plus a fixed fee basis. The point we have suggested may be illustrated by the recent decision of the Supreme Court in *Lucas, etc.*, v. *American Code Co.* (280 U. S., 445 [Ct. D. 168, C. B. IX–1, 314]). There the books of the taxpayer were kept upon the accrual basis. In 1919 the taxpayer discharged the sales manager in violation of his contract of employment. He sued for damages and in the year 1923 the taxpayer paid a judgment recovered by the employee for breach of the contract which occurred in 1919. The taxpayer sought to have this payment deducted from its income for the year 1919 upon the ground that its books were kept on the accrual basis and that the obligation to pay damages for breach of contract accrued at the time of the discharge and not at the time of payment of the judgment. The Supreme Court held that this contention could not be sustained, and in connection with the decision Justice Brandeis, speaking for the court, made some general observations upon the theory of the income tax law, which are applicable in principle to the case at bar. He said:

"Generally speaking, the income tax law is concerned only with realized losses, as with realized gains. (*Weiss* v. *Wiener*, 279 U. S., 333, 335 [Ct. D. 60, C. B. VIII–1, 257].) Exception is made, however, in the case of losses which are so reasonably certain in fact and ascertainable in amount as to justify their deduction, in certain circumstances before they are absolutely realized. As respects losses occasioned by the taxpayer's breach of contract, no definite legal test is provided by the statute for the determination of the year in which the loss is to be deducted. The general requirement that losses be deducted in the year in which they are sustained calls for a practical, not a legal test. And the direction that net income be computed according to the method of accounting regularly employed by the taxpayer is expressly limited to cases where the Commissioner believes that the accounts clearly reflect the net income. Much latitude for discretion is thus given to the administrative board charged with the duty of enforcing the Act. Its interpretation of the statute and the practice adopted by it should not be interfered with unless clearly unlawful."

In *Burnet, Commissioner*, v. *Sanford & Brooks Co.* (282 U. S., 359 [Ct. D. 277, C. B. X–1, 363]) the Supreme Court had occasion to deal with a long-term contract under which the work was carried on at a loss. The taxpayer each year returned its expenditures and receipts including those made and received upon the dredging contract. The contractor abandoned the work in 1915 and brought suit against the Government to recover damages from the Government in the amount that its expenditures under the contract exceeded its receipts and judgment was recovered for that amount ($176,271.88). The Commissioner contended that this amount, although it was equal to and no greater than the loss suffered by the contractor because of the contract, should nevertheless be returned as income in the year in which it was received and that in determining the tax of the taxpayer for that year that amount should be added to its other income for that year. The Court of Appeals held that this method was erroneous but the Supreme Court sustained the Commissioner's ruling. It should be observed that the contention by the taxpayer in that case was diametrically opposed to the contention made in the case at bar. There the taxpayer contended that the taxable gain or profit "can only be net profit ascertained on the basis of particular transactions of the taxpayer when they are brought to a conclusion." In view of the character of the contention there raised and the relevancy of the reasoning of the court upon that question to the principles involved in the case at bar and in view of the fact that the

regulations of the Treasury Department to long-term contracts were referred to by the court (Regulations 45, article 36), we quote from that decision at length:

"If respondent's contention that only gain or profit may be taxed under the sixteenth amendment be accepted without qualification (see *Eisner* v. *Macomber*, 252 U. S., 189 [T. D. 3010, C. B. 3, 25]; *Doyle* v. *Mitchell Bros. Co.*, 247 U. S., 179), the question remains whether the gain or profit which is the subject of the tax may be ascertained, as here, on the basis of fixed accounting periods, or whether, as is pressed upon us, it can only be net profit ascertained on the basis of particular transactions of the taxpayer when they are brought to a conclusion.

"All the Revenue Acts which have been enacted since the adoption of the sixteenth amendment have uniformly assessed the tax on the basis of annual returns showing the net result of all the taxpayer's transactions during a fixed accounting period, either the calendar year, or, at the option of the taxpayer, the particular fiscal year which he may adopt. Under sections 230, 232 and 234(a) of the Revenue Act of 1918 (40 Stat., 1057), respondent was subject to tax upon its annual net income, arrived at by deducting from gross income for each taxable year all the ordinary and necessary expenses paid during that year in carrying on any trade or business, interest and taxes paid, and losses sustained, during the year. By sections 235(a) and 213(a) gross income 'includes * * * income derived from * * * businesses * * * or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever.' The amount of all such items is required to be included in the gross income for the taxable year in which received by the taxpayer, unless they may be properly accounted for on the accrual basis under section 212(b). (See *United States* v. *Anderson*, 269 U. S., 422 [T. D. 3839, C. B. V-1, 179]; *Aluminum Castings Co.* v. *Routzahn*, ante, 92 [Ct. D. 270, C. B. X-1, 352].)

* * * * * * *

"But respondent insists that if the sum which it recovered is the income defined by the statute, still it is not income, taxation of which without apportionment is permitted by the sixteenth amendment, since the particular transaction from which it was derived did not result in any net gain or profit. But we do not think the amendment is to be so narrowly construed. A taxpayer may be in receipt of net income in one year and not in another. The net result of the two years, if combined in a single taxable period, might still be a loss; but it has never been supposed that that fact would relieve him from a tax on the first, or that it affords any reason for postponing the assessment of the tax until the end of a lifetime, or for some other indefinite period, to ascertain more precisely whether the final outcome of the period, or of a given transaction, will be a gain or loss.

* * * * * * *

"Under the statutes and regulations in force in 1920, two methods were provided by which, to a limited extent, the expenses of a transaction incurred in one year might be offset by the amounts actually received from it in another. One was by returns on the accrual basis under section 212(b), which provides that a taxpayer keeping accounts upon any basis other than that of actual receipts and disbursements, unless such basis does not clearly reflect its income, may, subject to regulations of the Commissioner, make its return upon the basis upon which its books are kept. (See *United States* v. *Anderson* and *Aluminum Castings Co.* v. *Routzahn*, supra.) The other was under Treasury regulations (article 121 of Regulations 33 of January 2, 1913, under the Revenue Acts of 1916 and 1917; article 36 of Regulations 45, April 19, 1919, under the Revenue Act of 1918) providing that in reporting the income derived from certain long-term contracts, the taxpayer might either report all of the receipts and all of the expenditures made on account of a particular contract in the year in which the work was completed, or report in each year the percentage of the estimated profit corresponding to the percentage of the total estimated expenditures which was made in that year."

We think it clear from the foregoing construction that Regulations 45, article 36, is a valid regulation that has been approved by Congress, that it is properly applicable to the situation presented by the record and that the taxpayer had an option which he exercised to keep his books and make his return upon the

long term completed contract basis and that the decision of the Board of Tax Appeals upon that point is correct.

With reference to taxes for the year 1922, it appears that in computing the tax the taxpayer made a mistake in addition amounting to $1,440. The total should have been $65,177.80, but the taxpayer incorrectly made the total $66,617.80. The Commissioner on examining the return increased the taxable income by $1,359.09 and computed the tax at $65,928.78. The petitioner filed a claim in abatement for the difference between the amount of taxes paid, $66,617.80, and the taxes as assessed by the Commissioner, $65,928.78. Upon consideration of the claim in abatement the Commissioner claimed an understatement of taxable income upon which the tax amounted to $671.02 and notified the taxpayer that the overassessment "will be made the subject of certificates of overassessment which will reach you in due course, * * *." The Board of Tax Appeals held that under these circumstances there was no determination of the deficiency within the meaning of sections 273 and 274 of the Revenue Act of 1926, and that therefore the Board had no jurisdiction in the matter. Petitioner claims that the original assessment by the Commissioner correcting the taxpayer's mistake in addition should be considered as the amount previously abated in determining whether or not the additional assessment was a determination of deficiency within the meaning of section 273 of the Revenue Act of 1926, supra.

The only reason that the petitioner objects to the decision of the Board of Tax Appeals with reference to the year 1922 is because of his desire to have the taxes for that year redetermined upon the basis which he contends should have been applied to both the years 1920 and 1922. In view of our conclusion he is not prejudiced by the ruling of the Board of Tax Appeals. As we understand the record petitioner makes no special point upon the tax of 1922 other than the general claim which we have discussed and decided.

Order affirmed.

ARTICLE 36: Long-term contracts.

XI–47–5869
Ct. D. 603

INCOME TAX—REVENUE ACT OF 1918—DECISION OF COURT.

1. LONG-TERM CONTRACTS—CONTRACTS FOR PURCHASE AND SALE OF OIL.

A person who enters into contracts of purchase and sale of oil is not thereby engaged in "contracting operations" within the meaning of article 36 of Income Tax Regulations 45, which allows persons engaged in contracting operations who have contracts running for more than a year to prepare returns on the basis of completed work.

2. DEDUCTIONS—LOSS—BREACH OF CONTRACT.

Where a person engaged in buying and selling oil has on hand at the end of 1919 a number of uncompleted contracts for the purchase and sale of oil and in 1920 one of such contracts for the purchase of oil is breached by the vendor and in order to complete some of such contracts of sale he is obliged to purchase oil in the open market at a higher price than specified in the breached contract, no part of a resulting loss is deductible in 1919.

DISTRICT COURT OF THE UNITED STATES, NORTHERN DISTRICT OF ILLINOIS, EASTERN DIVISION.

Lakeside Petroleum Co. v. *United States.*

[July 21, 1932.]

OPINION.

WOODWARD, District Judge: The plaintiff, during the year 1919, was a broker of fuel oils. It kept its books on a cash receipts and disbursements basis. It purchased fuel oil at a certain figure and then entered into contracts of sale for the same amount of oil. When the oil was shipped it gave in pay-

ment a bill of acceptance or a note. The oil was shipped directly to the purchaser who paid plaintiff for it upon its receipt. At the end of the year 1919 the plaintiff had a number of contracts for the purchase of oil from the Milliken company, the principal company from which it purchased its oils, under which deliveries were to be made from time to time and on which there remained further deliveries to be made by the seller during the year 1920. Also, at the end of the year 1919 plaintiff had a number of contracts for the sale of oils which were not entirely executed. On January 9, 1920, the Milliken company breached its contract and refused to furnish any more oil at the price and under the conditions agreed upon in the contract. Plaintiff, in order to fill some of its contracts of sale and deliver oils under its contracts, was forced to purchase oil in the open market at a higher price than as specified in its contract with the Milliken company.

On March 15, 1920, plaintiff filed its income and profits tax return for the year 1919 and the tax shown due thereunder was paid in 1920. In 1923 plaintiff filed an amended return for the year 1919 claiming that its contracts of sale which were not completed on December 31, 1919, should be called long-term contracts under the provisions of article 36 of Regulations 45 and part of the loss sustained in 1920 should be deducted from its profits in 1919. This return was rejected by the Commissioner. Plaintiff filed its claim for refund also was rejected. It now brings suit for the recovery of the amount of its claim for refund.

Article 36 of Regulations 45, so far as material, reads as follows:

"ART. 36. *Long-term contracts.*—Persons engaged in contracting operations, who have uncompleted contracts, in some cases perhaps running for periods of several years, will be allowed to prepare their returns so that the gross income will be arrived at on the basis of completed work; that is, on jobs which have been finally completed any and all moneys received in payment will be returned as income for the year in which the work was completed."

Palpably plaintiff does not put itself within this article. It was not engaged "in contracting operations." It entered into contracts of purchase and sale but there was no "contracting operations," which strictly mean operating as a contractor. There was no "completed work." There were no "jobs" which have been finally completed. There was no expense incurred except the purchase price of oil which was fixed by the contract. While article 36 of Regulation 62, promulgated under the Revenue Act of 1921, is not binding in this case, yet as it represents the construction which has always been put by the Government upon the phrase "long-term contracts," it is pursuasive. It provides that:

"As used herein the term 'long-term contracts' means building, installation, or construction contracts covering a period in excess of one year."

In other words, long-term contracts were contracting operations where work was done under the contract and expenditures and expenses were incurred thereunder often in different years from the time payments were received by the contractors.

That the conclusion of the Commissioner is correct is supported by the following cases, all of which are cited in the brief for the Government: *Burnet* v. *Sanford & Brooks Co.* (282 U. S., 359 [Ct. D. 277, C. B. X–1, 363]); *Shellsberger* v. *Commissioner* (38 Fed. (2d), 566); *Bacon Grain Co.* v. *Reinecke, Collector* (26 Fed. 2d), 705 [T. D. 4229, C. B. VII–2, 251]); *Ewing-Thomas Converting Co.* v. *McCaughn* (43 Fed. (2d), 503 [Ct. D. 43, C. B. VIII–1, 232]).

The finding will be in favor of the Government and against the plaintiff.

ARTICLE 47: Annuities and insurance policies.

REVENUE ACT OF 1926.

Treatment for income tax purposes of amounts received in settlement of an endowment insurance policy where the insured survives the maturity of the policy. (See I. T. 2635, page 63.)

ARTICLE 50: When included in gross income.

REVENUE ACT OF 1926 AND PRIOR REVENUE ACTS.

Taxable status of refunds of customs duties and taxes. (See Mim. 3958, page 33.)

ARTICLE 50: When included in gross income. XI-33-5609
Ct. D. 536

INCOME TAX—REVENUE ACTS OF 1918 AND 1921—DECISION OF COURT.

1. INCOME—YEAR ACCRUABLE—DISPUTED CLAIM.

Where a railroad corporation, whose properties are taken over by the United States and operated by the Director General of Railroads during the period of Federal control from January 1, 1918, to March 1, 1920, receives tolls during that period in which also certain interest accrues and where the right to the tolls and interest is not conceded by the director general but claimed for the United States and first became the subject of negotiations in 1923, when liability of the United States to the corporation for them was contested, the company neither asserting a claim thereto until the latter year nor accruing these items on its books nor returning them as accrued income in the Federal control years, the value of the tolls and interest which is realized by the corporation in 1923 upon a settlement of claims of the company and the director general against each other arising out of the use of the company's properties, is not income to the corporation, whose books are kept on the accrual basis, in the years of Federal control, but in the year 1923, when the Government's liability for either tolls or interest was definitely determined by the settlement.

2. DECISION AFFIRMED.

The decision of the Board of Tax Appeals (19 B. T. A., 969) is affirmed.

UNITED STATES CIRCUIT COURT OF APPEALS, SIXTH CIRCUIT.

Kentucky & Indiana Terminal Railroad Co., petitioner, v. *Commissioner of Internal Revenue, respondent.*

Petition to review an order of the United States Board of Tax Appeals.

Before HICKS and HICKENLOOPER, Circuit Judges, and SIMONS, District Judge.

[December 18, 1931.]

OPINION.

HICKS, Circuit Judge: Petition by Kentucky & Indiana Terminal Railway Co., a corporation, to review a decision of the Board of Tax Appeals affirming the action of the Commissioner of Internal Revenue in assessing against it on redetermination a deficiency in income taxes for the year 1923 in the sum of $30,697.87.

Prior to January 1, 1918, petitioner owned and operated railroad terminal facilities in Louisville. As a component part thereof it owned a bridge across the Ohio River over which it operated a double-track railroad. The bridge carried independent electric, telephone and street railway lines and the usual vehicular and pedestrian traffic for all of which petitioner charged rentals and tolls. The stock of petitioner was owned by three railway companies each owning one-third. Petitioner's properties including that portion of the bridge carrying the railway tracks were used for the business of the stock-holding companies.

All of petitioner's properties were taken over by the United States and operated by the Director General of Railroads under Federal control, from January 1, 1918, until March 1, 1920. There was no agreement for "just compensation" to petitioner for the use of its property upon the basis of the

"standard return" (Federal Control Act, ch. 25, section 1, 40 Stat., 451) but during Federal control the director general did pay petitioner from time to time on account of compensation an amount sufficient to pay the interest on petitioner's bonds. This was substantially all that was paid to petitioner during that period. Subsequent to the return of its property at the end of Federal control, petitioner and the director general entered into negotiations for a settlement of all matters between them. Upon presentation of their respective claims, specific in nature and amount, some of the items of each were mutually assented to while others were disputed. Upon such basis no settlement could be reached, whereupon specific items were disregarded and an agreement was arrived at by which petitioner paid the Government $50,000 in full settlement of all claims of either party.

Among these items was one for $382,391.60 which the director general had charged against petitioner for additions and betterments during the Federal control period. This item was undisputed. Petitioner was by law obligated to pay it. See Federal Control Act, March 21, 1918 (ch. 25, section 6, 40 Stat., 451, 453). Upon the other hand petitioner had debited the director general with bridge tolls collected by him in the sum of $231,178.99. It also claimed $1,711.93, interest upon quarterly balances, and $16,422.32, interest on completed additions and betterments.

The principal controversy was over the tolls. The amount was not questioned but the director general insisted that these tolls belonged to the Government. Prior to Federal control they were collected by petitioner and applied to operating expense and any deficit was defrayed by the three stock-owning companies. During Federal control there was never any understanding between the director general and petitioner as to the disposition or ownership of the tolls. The director general applied them to operating expenses just as had petitioner. He probably assumed that he was justified therein because he was paying as compensation a sufficient amount to discharge petitioner's bond interest. Petitioner claimed that these tolls constituted noncarrier revenue which belonged to it. The Board of Tax Appeals upon consideration of all disputed points between the petitioner and the director general concluded that at the settlement the director general had conceded to petitioner the merit of its claims for tolls and interest. We concur in this view.

We can not assume that the director general forgave the claim against petitioner for additions and betterments. We think the proper inference is that he allowed the bridge tolls and interest, which were less than the additions and betterments, to go in discharge thereof. If this is the correct view, it is obvious that through the settlement of the Government's claim for additions and betterments petitioner has received taxable income to the value of the tolls and interest. The contrary was urged before the Board of Tax Appeals but apparently has been abandoned here.

Petitioner, however, insists that the tolls having been collected in the Federal control years and the interest having accrued during the same period these items for tax purposes should be allocated to those years, instead of 1923, the petitioner having under the direction of the Interstate Commerce Commission kept its books upon the accrual basis. But the obstacle is that there was no acknowledgment or determination of liability on the part of the Government for either tolls or interest until the settlement in October, 1923. Petitioner made no demand for either tolls or interest during Federal control. It did not place these items upon its books or return them as accrued income in the Federal control years. This omission was not the result of oversight. It arose from the uncertainty petitioner entertained as to its duty to return the items for those years. This is significant inasmuch as the burden was upon petitioner to establish before the Board of Tax Appeals that the Commissioner should have allowed them for those years. (See *Burnet* v. *Sanford & Brooks Co.*, 282 U. S., 359, 366 [Ct. D. 277, C. B. X–1, 363].) The tolls were omitted from the original claim presented to the director general. Neither the tolls nor interest items became the subject of negotiations until June, 1923, when liability for each was vigorously disputed. We think that the event which definitely determined the Government's liability for either tolls or interest was the settlement in October following and that the taxable income in question arose then and not previously. (See *Lucas* v. *American Code Co.*, 280 U. S., 445, 449 [Ct. D. 168, C. B. IX–1, 314]; *Lucas* v. *Ox Fibre Brush Co.*, 281 U. S., 115, 120 [Ct. D. 265, C. B. IX–2, 384]; *Bauer Bros. Co.* v. *Commr.*, 46 Fed. (2d), 874, 876 (C. C. A. 6) [Ct. D. 361, C. B. X–2, 359].) These cases deal with expense rather

than income items but the applicable principle is the same. (See also *U. S. v. Anderson*, 269 U. S., 422, 441 [T. D. 3839, C. B. V–1, 179]; *Burnet v. Sanford & Brooks Co.*, supra.) Until the settlement it could not be known how petitioner would fare as a result of Government operation.

The decision of the Board of Tax Appeals is affirmed.

ARTICLE 50: When included in gross income. XI–35–5638 Ct. D. 549

INCOME TAX—REVENUE ACT OF 1924—DECISION OF COURT.

1. INCOME—YEAR ACCRUABLE—LITIGATED CLAIM.

Where a taxpayer, keeping its books on the accrual basis, has in 1921 a contingent claim to income, the right to which income is litigated and is sustained by virtue of a decision of the Supreme Court in 1924, in which an amount in settlement of the claim is received, the entire amount received in the latter year is income in 1924.

2. DECISION REVERSED.

The decision of the Board of Tax Appeals (19 B. T. A., 490) is reversed.

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT.

Commissioner of Internal Revenue, petitioner, v. *Southeastern Express Co., respondent.*

Petition for review of decision of the United States Board of Tax Appeals (District of Alabama).

Before BRYAN, FOSTER, and WALKER, Circuit Judges.

[March 4, 1932.]

OPINION.

BRYAN, Circuit Judge: During the World War all railway express companies in the United States were consolidated, and after the consolidation the American Railway Express Co. was the only one in the country until May 1, 1921, when the Southeastern Express Co. began to do business over what is called the Southern Railway System located principally in territory south of the Ohio and Potomac Rivers and east of the Mississippi, although it also operated over an electric railway line from Washington to Baltimore, and over the line of the Maryland & Pennsylvania Railway Co. from Baltimore to York, Pa. The territory selected by the Southeastern was promptly abandoned by the American. The Southeastern attempted to concur in the tariffs of the American. But the American thwarted this attempt by supplementary tariffs, by which it made through routes and joint rates applicable only between its own exclusive offices and the exclusive offices of the Southeastern, and thus continued its monopoly between common points, charging its local rates and taking the long haul on the theory that it was a carrier by railroad within the meaning of the Interstate Commerce Act as amended. After hearings, upon applications made by the Southeastern and certain shippers, the Interstate Commerce Commission in July, 1923, entered an order requiring the American to establish and maintain through routes and joint rates between its exclusive points north and east of Washington, and all points on the main line of the Southern Railway from Washington to Birmingham, with right of transfer at Washington. (*Southeastern Express Co.* v. *American Railway Express Co.*, 78 I. C. C., 126; 81 I. C. C., 247.) This order was contested in the courts, but was finally sustained in 1924 by the Supreme Court. (*United States* v. *American Railway Express Co.*, 265 U. S., 425.) In 1924 the American paid the Southeastern about $208,000 in settlement of the controversy between them. The Southeastern kept its books on the accrual basis, and accrued as income for the year 1921 $51,300 out of the total amount which it received in 1924 in

its settlement with the American. The Board of Tax Appeals decided that it was entitled to do this. (19 B. T. A., 490.) The Commissioner of Internal Revenue has filed a petition for review, and contends that the whole amount received in settlement by the Southeastern should be treated as income in 1924, the year in which it was actually received.

The returns of taxpayers, whether upon cash or accrual basis, must clearly reflect income. (Revenue Act of 1921, section 212(b); 42 Stat., 237.) The Southeastern did not earn the amount of $51,300 which it entered on its books in 1921, but would have earned that amount if it had been permitted to share with the American the existing rates over the through route, which it was contending should be, but which had not been, established. Whether the through rate would ever be established was uncertain, and was dependent upon the future determination by the Interstate Commerce Commission that such a route was necessary or desirable in the public interest. (49 U. S. C. A., section 15(3).) It follows that the Southeastern in 1921 had only a claim which ripened into a definite right in a later year. A mere contingent claim, especially a contested one, whether of loss or gain, may never be sustained or realized; it is too uncertain to be considered in making up an income tax return. (*Lucas* v. *American Code Co.*, 280 U. S., 445 [Ct. D. 168, C. B. IX–1, 314]; *Lucas* v. *North Texas Co.*, 281 U. S., 11 [Ct. D. 169, C. B. IX–1, 294]; *Lucas* v. *Ox Fibre Brush Co.*, 281 U. S., 115 [Ct. D. 265, C. B. IX–2, 384].)

The petition for review is granted, and the cause remanded for further proceedings not inconsistent with this opinion.

SECTION 213(b).—GROSS INCOME DEFINED: EXCLUSIONS.

ARTICLE 72: Proceeds of insurance—Compensation—Pensions.

REVENUE ACT OF 1926 AND PRIOR REVENUE ACTS.

Proceeds of so-called "Family income policy—20-year period." (See G. C. M. 10843, page 22.)

ARTICLE 73: Gifts and bequests. XI–31–5580
Ct. D. 526

INCOME TAX—REVENUE ACTS OF 1916 AND 1918—DECISION OF COURT.

1. EXEMPTION—GIFT—PAYMENTS UNDER AGREEMENT WITHOUT CONSIDERATION.

Held that the evidence of record does not support the finding that an agreement between a taxpayer and his employer is without consideration and intended only as a memorial of a gift. Amounts paid to the taxpayer in 1917 and 1919 pursuant to the agreement are therefore not exempt from tax under the Revenue Acts of 1916 and 1918.

2. SAME.

Where a taxpayer claims that an amount paid to him pursuant to an agreement between him and his employer is exempt from tax as a gift, the intention to make a gift must be established and where there is no evidence of such intention but persuasive evidence to the contrary, the amount is not exempt from tax. Although the payment is made without a legal duty to pay, it does not follow that the amount received by the taxpayer is exempt from tax, since additional compensation paid for past services may constitute taxable income.

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

Roy A. Weagant, plaintiff-appellee, v. *Frank Collis Bowers, as Executor of the Last Will and Testament of Frank K. Bowers, Deceased, former United States Collector of Internal Revenue for the Second District of New York, defendant-appellant.*

Appeal from the District Court of the United States for the Southern District of New York.

[April 13, 1932.]

OPINION.

SWAN, Circuit Judge: The plaintiff sued to recover sums paid by him as additional income taxes for the years 1917 and 1919 in the amounts of $6,042.77 and $3,072.09, respectively. The additional assessments resulted from the inclusion by the Commissioner of Internal Revenue in the taxpayer's gross income, of $33,333.33 received by him in the former year, and $16,666.66 in the latter year, from Marconi Wireless Co. of America, by whom he was employed. The taxpayer contends that these payments were gifts; the defendant that they were taxable income within the meaning of the Revenue Acts of 1917 and 1918. A jury having been waived by written stipulation, the case was tried to the court, who made findings of fact upon which he held that the plaintiff was entitled to recover. Judgment was entered accordingly.

This case was formerly before us in *Weagant* v. *Bowers* (24 F. (2d), 362), where we affirmed a judgment holding the complaint insufficient, but gave the plaintiff leave to file an amendment. This he did, and the appellant now challenges the amended complaint as being not materially different from the one held insufficient on the prior appeal. As to this it will suffice to say that we think the amended complaint alleges with adequate certainty facts which we said in our former opinion might, if properly proved, show a cause of action. The complaint now alleges that the instrument of October 3, 1917, though in form a contract, was a sham and never intended by the parties to be a contract; also facts to show the plaintiff gave no consideration for it.

The next contention of appellant is that the court's findings that the instrument of October 3, 1917, was a memorial of a gift, that the plaintiff gave no consideration for it, and that the payments in question were gifts instead of taxable income are wholly without support in the evidence. But before turning to the evidence we will consider the plaintiff's argument that in any event the 1917 tax was illegally collected because barred by the statute of limitations set up in section 250(d) of the Revenue Act of 1921 (42 Stat., 227, 265). The taxpayer's 1917 return was filed March 29, 1918; the additional tax for that year was assessed February 26, 1923, and was paid to the collector on April 26, 1923. Thus, although the assessment was made within 5 years after the date when the return was filed, the payment was made nearly 30 days after the expiration of the 5-year period. This was too late for the Government to begin a suit or "proceeding" for collection of the 1917 tax. (*Bowers* v. *N. Y. & Albany Lighterage Co.*, 273 U. S., 346 [T. D. 4009, C. B. VI–1, 268].) We may assume that the tax was paid to avoid distraint, as the complaint alleges, although the stipulation of facts admits only the fact of payment, and was illegally collected. See *Bonwit Teller & Co.* v. *United States* (283 U. S., 258, 259 [Ct. D. 334, C. B. X–1, 328]). But granting this, the question is of the plaintiff's right to recover it when his claim for refund neither asserted as a ground that the tax was collected more than five years after the return was filed nor alleged facts showing this to be the case. Revised Statutes section 3226 requires a claim for refund to be made in accordance with the regulations, and these required that all facts relied upon should be clearly set forth. (Article 1036, Regulations 62; article 1306, Regulations 65.) The plaintiff filed two claims for refund of the 1917 tax but each relied solely upon the ground that the disputed item of income was a gift. Neither claim disclosed the date when the taxpayer's return was filed and therefore did not set forth all the facts necessary to show that the tax was collected too late. Consequently the point is not now available to the plaintiff. *Connell* v. *Hopkins* (43 F. (2d), 773 (N. D. Tex.) [Ct. D. 248, C. B. IX–2, 407]) is squarely in point, and cases too numerous for complete citation have recognized the principle that a taxpayer who brings suit after a refund

has been denied can rely for recovery only on grounds presented to the Commissioner. (See *United States* v. *Felt & Tarrant Mfg. Co.*, 283 U. S., 269, 272 [Ct. D. 336, C. B. X–1, 431]; *J. P. Stevens Engraving Co.* v. *United States*, 53 F. (2d), 1 (C. C. A. 5); *Lewis A. Crossett Co.* v. *United States*, 50 F. (2d), 292 (Ct. Cls.) [Ct. D. 373, C. B. X–2, 392]; *Tucker* v. *Alexander*, 15 F. (2d), 356 (C. C. A. 8) [T. D. 3973, C. B. VI–1, 287], reversed on another ground in 275 U. S., 228.)

We now return to appellant's contention that the proof will not support the court's finding of a gift. Weagant was employed by the Marconi company as an assistant engineer, his duties including work of research and experiment. On February 5, 1914, in consideration of the continuance of his employment he signed a contract by which he agreed that on making any discovery or invention relating to his employer's business, he would disclose the same to his employer, "which said discovery or invention (even should the employee fail to disclose the same) shall become and be the property of the company at the time of such discovery or invention, for which patent or patents may be taken out by it or not and in the name of the employee or its own name at the option of the company." The contract also provided that he should execute all such papers, without remuneration other than his regular salary, as may be deemed necessary "to absolutely and fully vest the discovery or invention and the patent in the company." In 1917 Weagant made new and useful improvements in the art of wireless telegraphy and telephony, and applied for two United States patents covering the same. By two assignments referring respectively to his patent applications, he assigned to the Marconi company "the full and exclusive right to the said invention, as fully set forth and described in the specification accompanying the aforesaid application," and requested that the patent be issued to the company. Subsequently, the instrument of October 3, 1917, was executed by Weagant and the company. The execution of this instrument was authorized at a meeting of the executive committee, held on the same date, by a resolution reading as follows:

"Contract drawn and prepared by Messrs. Sheffield and Betts regarding patents of Mr. Weagant was submitted and read to the meeting. After due consideration thereof, on motion duly made and seconded it was

"*Resolved*, that the contract with Roy A. Weagant regarding patent on his most recent invention as presented to the meeting is hereby ratified, approved and confirmed and the officers of the company are hereby authorized and empowered to execute with the seal of the company said contract."

The instrument executed pursuant to this resolution is headed "Agreement made and entered into this 3d day of October, 1917." It recites Weagant's two 1917 applications for United States letters patent and his assignment of his interest in said applications. It also recites that "the company is desirous of acquiring from the said Weagant the whole right, title and interest in and to the said inventions for all countries foreign to the United States, and in and to all inventions which the said Weagant has made or may hereafter make as improvements upon the same in all countries foreign to the United States." Then follow the mutual promises: Weagant sells, assigns and transfers to the company the whole right, title and interest in said inventions and in and to all improvements which he has now made or which he may hereafter make on the same, and in and to all letters patent in all countries foreign to the United States for the said inventions or any improvements thereon; also he agrees that he will without further compensation do everything necessary to apply for patents in all foreign countries, the fees and incidental expenses being borne by the company. And the company agrees to pay to Weagant one-third of the net receipts or profits which it may thereafter obtain from the sale of any patents or applications for patents or patents granted in foreign countries for said inventions or any improvements thereon made by the said Weagant. Later in the year 1917 the company sold the patent rights in South American countries for $150,000, and paid to Weagant one-third thereof, $33,333.33 being paid in 1917 and $16,666.66 in 1919.

On its face the instrument of October 3, 1917, was a contract entered into by the company for the purpose of acquiring the patent rights in foreign countries on Weagant's said invention. It certainly taxes credulity to believe that this formal document drawn up by the corporation's attorneys was all a sham, intended merely to evidence a benevolent intent to make Weagant a gift in the

event that the foreign patent rights (assumed to have been already owned by the company under the contract of February 5, 1914) should subsequently be sold. This becomes all the more incredible when we look at the two subsequent contracts introduced as defendant's Exhibits 1 and 2. The former is an agreement of July 25, 1919, which recites that the parties have heretofore entered into an agreement dated October 3, 1917, relating to the disposition of certain inventions made by Weagant, and that the company desires to acquire an option to purchase from Weagant all his rights under said contract. Weagant agrees to release his rights if on or before January 1, 1920, he shall be paid $100,000 cash, another $100,000 of preferred stock in a prospective radio corporation, and a royalty agreement by the latter providing royalties running up to $300,000. This option was not exercised. It was superseded by defendant's Exhibit 2, dated January 2, 1920. This provided for the termination of Weagant's employment by the Marconi company and his employment by the Radio Corporation of America, and for the release of all Weagant's contracts with the Marconi company, specifying the contract of February 5, 1914, the contract of October 3, 1917, the contract of July 25, 1919, to all which we have already referred, and also another of April 3, 1913, which is not in the record. Weagant then, "with the consent of the Marconi company" assigned to the Radio Corporation all inventions which he had made or which he may make while in the Radio Corporation's employ, and under the terms of the agreement was to receive $50,000 cash, and conditionally $200,000 more. To say that the parties meant the contract of October 3, 1917, to create no rights and understood that it did not, when they were subsequently offering Weagant such sums as these to get rid of it, is really unbelievable.

The only evidence which tends to support the findings below is a deposition of Weagant. In response to questions of his counsel, he expressed the opinion that the contract of February 5, 1914, obligated him to turn over to his employer his inventions, thus giving the Marconi company foreign patent rights as well as patent rights in the United States. Hence he always considered the contract of October 3, 1917, as expressing only a "moral obligation" of the company to carry out its benevolent intention to make him a gift on account of the value of his antistatic inventions. He also says that the vice president of the company, when handing him the instrument, declared that it was intended to be an "expression of appreciation" for his work and to constitute a memorandum which would be "morally binding" on future directors of the company. Such evidence, if competent at all, certainly can not be allowed to outweigh the documentary proof. To us it seems clear that the parties thought the 1914 contract did not give the Marconi company patent rights in foreign countries. It did not expressly mention foreign countries and its language that Weagant's inventions shall become the company's is so tied up with references to obtaining patents that if the latter refer only to domestic patents, that limitation might reasonably be extended to cover the whole agreement. The parties have construed it that way. When there is ambiguity in the terms of a contract the practical construction which the parties have put upon it is entitled to great if not controlling influence. (*Topliff* v. *Topliff*, 122 U. S., 121, 131.) In the present case their interpretation should control and should preclude a court from reading the 1914 contract so as to make the 1917 contract a nudum pactum. The evidence will not justify the findings that the latter was without consideration and intended only as a memorial of a gift.

But even were it to be conceded that the company's promises contained in the writing of October 3, 1917, were without consideration because Weagant was already bound by the 1914 contract to turn over foreign as well as domestic patent rights, it need not follow that the payments made in 1917 and 1919 were proved to be nontaxable gifts. There is authority for the proposition that it is not enough to show that a payor was under no legal duty to pay and that "additional compensation" paid for past services may constitute taxable income. (*Noel* v. *Parrott*, 15 F. (2d), 669, 671 (C. C. A. 4) [T. D. 3908, C. B. V–2, 149].) This case was cited with approval in *Old Colony Trust Co.* v. *Commissioner* (279 U. S., 716, 730 [Ct. D. 80, C. B. VIII–2, 222]). (See also *Garey* v. *Commissioner*, 16 B. T. A., 274; *Binger* v. *Commissioner*, 22 B. T. A., 111; *Lumsford* v. *Commissioner*, 22 B. T. A., 881; compare *Blair* v. *Rossiter*, 33 F. (2d), 286 (C. C. A. 9).) These cases rest upon the view that an intention to make a gift must be established. In the case at bar there is no evidence that such was the intention of the Marconi company. In fact the form of the 1917 writing and the resolution of its executive committee are clear evidence to the contrary. And the subsequent agreements already referred to are equally

persuasive evidence to the same effect. Moreover the payments made to the plaintiff were treated by the company in its books as the cost of acquiring a capital asset.

Judgment reversed.

ARTICLE 74: Interest upon State obligations.

REVENUE ACT OF 1926.

Interest paid by a municipality upon principal awarded as compensation for property taken. (See Ct. D. 580, page 67.)

ARTICLE 74: Interest upon State obligations.

REVENUE ACT OF 1926.

Revocation of I. T. 2374 (C. B. VI-2, 36), relating to the exemption of interest on bonds issued by corporations formed under the act of the Legislature of Indiana, approved March 10, 1927. (See I. T. 2666, page 69.)

ARTICLE 88: Compensation of State officers and employees.

REVENUE ACT OF 1926 AND PRIOR REVENUE ACTS.

Officer of a county hospital for the indigent sick or dependent poor. (See G. C. M. 10814, page 113.)

SECTION 214(a)1.—DEDUCTIONS ALLOWED INDIVIDUALS: BUSINESS EXPENSES.

ARTICLE 101: Business expenses.

REVENUE ACTS OF 1921 AND 1924.

Payments made by new corporation in discharge of obligations of old corporation the assets of which had been acquired. (See Ct. D. 513, page 252.)

ARTICLE 101: Business expenses.

REVENUE ACT OF 1926 AND PRIOR REVENUE ACTS.

Legal expenses incurred in securing a refund of customs duties, or taxes, illegally or improperly collected. (See Mim. 3958, page 33.)

ARTICLE 101: Business expenses.

REVENUE ACT OF 1924.

Expense of prosecuting successful suit for slander. (See Ct. D. 542, page 268.)

ARTICLE 101: Business expenses. XI-40-5748
Ct. D. 578

INCOME TAX—REVENUE ACTS OF 1921, 1924, AND 1926—DECISION OF COURT.

1. DEDUCTION—BUSINESS EXPENSES—EXPENSES IN PROSECUTION OF CLAIM FOR COMPENSATION FOR PROPERTY CONDEMNED FOR PUBLIC USES.

Expenditures representing attorneys' fees, cost of appraisals and other like expenses made by a person in connection with the prosecution of his claim for compensation for property condemned for public uses are not "ordinary and necessary expenses paid or incurred in carrying on any trade or business" and are therefore not deductible under section 214(a)1 of the Revenue Acts of 1921, 1924, and 1926.

2. DECISION AFFIRMED.

The decision of the Board of Tax Appeals (21 B. T. A., 109) is affirmed.

COURT OF APPEALS OF THE DISTRICT OF COLUMBIA.

No. 5429. *Thomas Williams, appellant,* v. *David Burnet, Commissioner of Internal Revenue.*

No. 5430. *Henry K. S. Williams, appellant,* v. *David Burnet, Commissioner of Internal Revenue.*

Appeals from the Board of Tax Appeals.

Before MARTIN, Chief Justice, and ROBB, VAN ORSDEL, and GRONER, Associate Justices.

[May 23, 1932.]

OPINION.

MARTIN, Chief Justice: Appeals involving certain deductions taken by appellants in their income tax returns for 1921, 1922, 1924, 1925, and 1926.

It appears that in the year 1919, and for many years prior thereto, appellants owned a tract of land situate along the water front on Staten Island, N. Y. The property was suitable for business purposes, and appellants had used portions of it in carrying on various business enterprises. A part of the land was occupied, under lease from appellants expiring in 1923, by the firm of Ichabod T. Williams & Sons, a copartnership engaged in the wholesale lumber business. One of the appellants was a member of that firm. Another part of the property was under lease expiring in 1928, to the Edgewater Saw Mills Corporation, of which appellants, together with other parties, were stockholders. Other portions of the property had been transferred by appellants to the Stapleton Dock & Warehouse Corporation, a holding corporation, the capital stock of which was owned in equal shares by appellants.

On July 1, 1919, the commissioners of the sinking fund of New York City instituted proceedings to condemn the property for public uses in connection with the improvement of the water front and harbor facilities of New York City. Title to the property was regularly taken over by the city and notice was given for the owners to file with the court their claims for compensation. Thereafter such claims were filed by appellants, and on March 13, 1925, a judgment for $3,792,090.74 was recovered by them in the Supreme Court of Kings County. This judgment was affirmed by the appellate division (215 App. Div., 204, 438), and the latter judgment was affirmed by the court of appeals (246 N. Y., 1).

During the years 1921, 1922, 1924, 1925, and 1926 appellants made various expenditures in connection with the prosecution of their claim for compensation, including attorneys' fees, appraisals, and other like expenses. These expenditures were reasonable and necessary for their intended purpose, and their amount is not disputed.

In their income tax returns for the years in question appellants took deductions for these expenditures, upon the ground that they were ordinary and

necessary expenses paid in carrying on a trade or business, within the meaning of sections 214(a)1 of the Revenue Acts of 1921, 1924, and 1926.

The deductions were disallowed by the Commissioner of Internal Revenue, and his decision was sustained by the Board of Tax Appeals. (21 B. T. A., 109.) This appeal followed.

The section in question reads as follows:

"SEC. 214. (a) That in computing net income 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 * * *." (Revenue Act of 1921, 42 Stat., 227.)

The corresponding sections of the Revenue Acts of 1924 and 1926 are in identical language. (43 Stat., 253; 44 Stat., 9.)

In our opinion the fees and costs paid by appellants in the prosecution of their claim for compensation do not answer to the description of "ordinary and necessary expenses paid or incurred * * * in carrying on any trade or business." It is true that parts of the condemned lands had been leased by appellants to various business enterprises in which appellants were shareholders, but the expenditures in question were not incurred or paid by any of these. The land belonged to appellants as individuals, and compensation for it was due to them individually. The expense of the prosecution of their claim to compensation for the taking of their property was not incurred in carrying on a trade or business, or in producing or protecting taxable income. At most it was a capital expense in the protection of their rights arising from the ownership of the property, and in that aspect, as a loss, might be taken into account as a part of the cost of the property.

The present case bears a strong analogy to the defense by a taxpayer in a case involving the title to his lands. In Treasury Regulations 62 (1922 Ed.), article 293, it is provided that the costs of such a defense constitutes part of the cost of the property, and is not a deductible expense. The regulations of the Treasury Department under the Revenue Acts of 1921, 1924, 1926, and 1928 in effect limit deductible expenses under the provision for "ordinary and necessary expenses in carrying on a trade or business" to the current operating expenses incurred in producing the income. (Regulations 45, articles 101–111; Regulations 65 and 69, articles 101–112; Regulations 74, articles 121–132.) Such a long-continued administrative construction is not to be overruled unless plainly wrong. (*Universal Battery Co.* v. *United States*, 281 U. S., 374, 378 [Ct. D. 220, C. B. IX–2, 422].) The failure of Congress to enact legislation disapproving such administrative construction constitutes an implied approval thereof. (*Brewster* v. *Gage*, 280 U. S., 327, 337 [Ct. D. 148, C. B. IX–1, 274]; *Poe* v. *Seaborn*, 282 U. S., 101, 117 [Ct. D. 259, C. B. IX–2, 202]; *McCaughn* v. *Hershey Chocolate Co.*, 283 U. S., 488, 492 [Ct. D. 345, C. B. X–1, 444]. See *Simmons Co.* v. *Commissioner of Internal Revenue*, 33 F. (2d), 75 [Ct. D. 96, C. B. VIII–2, 317].) It has been held by this court in *Hutchings* v. *Burnet, Commissioner*, decided March 28, 1932, that the cost of defending taxpayer's title to ore lands which were not operated by taxpayer, was not an ordinary and necessary expense incurred in carrying on a trade or business.

We have examined the authorities cited by appellant, including *Kornhauser* v. *United States* (276 U. S., 145 [T. D. 4222, C. B. VII–2, 267]), but we think that the facts involved in the present case differ essentially from those in the cases cited by appellant.

The decisions of the Board of Tax Appeals are accordingly affirmed.

Affirmed.

ARTICLE 101: Business expenses. XI–46–5852
(Also Section 215, Article 292.) Ct. D. 598

INCOME TAX—REVENUE ACT OF 1926—DECISION OF COURT.

DEDUCTION—BUSINESS EXPENSE—CAPITAL EXPENDITURE—COMMISSION FOR NEGOTIATING A LONG-TERM LEASE.

A commission paid by a lessor to a broker for obtaining a lease for a term of years is a capital expenditure and is not deductible as a business expense under section 214(a)1 of the Revenue Act of 1926.

DISTRICT COURT OF THE UNITED STATES, NORTHERN DISTRICT OF ILLINOIS, EASTERN DIVISION.

Lily P. Stacey v. *United States.*

[July 19, 1932.]

OPINION.

WOODWARD, District Judge: The plaintiff grounds her right to recover on section 214(a)1 of the Revenue Act of 1926, which reads as follows:

"SEC. 214. (a) In computing net income 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, including a reasonable allowance for salaries or other compensation for personal services actually rendered; traveling expenses (including the entire amount expended for meals and lodging) while away from home in the pursuit of a trade or business; and rentals or other payments required to be made as a condition to the continued use or possession, for purposes of the trade or business, of property to which the taxpayer has not taken or is not taking title or in which he has no equity."

The plaintiff, a widow, is a housewife and during the year 1927 owned four tracts of real estate in Evanston, Ill. She testified that she handled her own property. She was not engaged in any trade or business. In 1927 she engaged brokers who negotiated a 99-year lease upon a building located upon one of the tracts owned by her. The brokerage fee amounted to one average year's rental of which $8,488.50 was paid during the year 1927. The broker's fee paid for the year 1927 exceeded the rental for that year.

In her income tax return for the year 1927 plaintiff included the sum of $8,488.50 in her deductions from gross income for the year 1927 in the computation of her net income upon which her Federal income tax was based. This deduction was disallowed by the Commissioner of Internal Revenue, the Commissioner holding that the brokerage fee should be spread over the term of the lease and accordingly allowed as a deduction during the year 1927 the sum of $85.74, which is one ninety-ninth (1/99) of the total commission paid. As a result of this adjustment, plaintiff was required to pay an additional tax and interest which she seeks to recover back in this action.

At the trial, evidence was offered and received subject to objection to the effect that the lease was surrendered by the lessee.

In order that an expenditure may constitute an allowable deduction under section 214(a)1 of the Revenue Act of 1926, three elements must concur:

(1) The expenditure must have been incurred "in carrying on any trade or business";

(2) It must have been an ordinary expenditure in such connection; and

(3) It must have been a necessary expense in such connection.

Plaintiff contends that all three elements are present, while the Government contends that the first and second elements as above designated are absent.

From the statement of facts above set forth it is difficult to bring the mind to a conclusion that during the year 1927 the plaintiff was engaged "in carrying on any trade or business" within the purview of the section relied upon.

The apparent object and purpose of this section is to provide for the deduction of trade and business expenditures such as are of a recurring, regular or frequent nature and not to incidental or isolated transactions. Such is the plain implication from a reading of all of section 214(a)1 and such has been the construction placed upon a similar clause of the Revenue Act of 1927 [1917] in the regulations of the Treasury Department interpreting the meaning of the words "trade" and "business" as used in the Revenue Act of 1917. I am of the opinion that under the facts stated the plaintiff in this case was not engaged "in carrying on any trade or business" for the year 1927.

But it is not necessary to rest the ruling in this case wholly upon the proposition that the plaintiff has not brought herself within the clause that she was not "carrying on a trade or business." The ruling may be placed upon the more substantial ground that the expenses for brokerage fees is not an "ordinary" expense within the meaning of the section under consideration. The question of whether or not brokerage fees paid in the negotiation of long-term leases constitute an ordinary expense "in carrying on a trade or business" has been the subject of frequent consideration by the Board of Tax Appeals with

considerable conflict of holding. However, in the case of *Bonwit, Teller & Co.* v. *Commissioner* (53 Fed. (2d), 381). the Court of Appeals of the Second Circuit has held that the fees paid a broker for negotiating a long-term lease on behalf of the taxpayer as lessor was an investment of capital and not a business expense. The words "ordinary expense" would seem to imply that the expense was an annual or at least a periodical or recurrent expense growing out of the conduct of a business as opposed to an expense which is extraordinary and infrequent. By incurring the extraordinary expense for the negotiation of the lease the plaintiff received in return something having a value which would extend over a period of years. I am inclined to follow and to base the ruling upon the holding of the court in the case of *Bonwit, Teller & Co.* v. *Commissioner*, supra.

The evidence which was received subject to the objection of the Government is excluded from consideration in arriving at the conclusion above stated and the objections of the Government to the reception will be sustained. It is not permissible to look to later events to ascertain whether the asset which the plaintiff received in exchange for the broker's commission was valuable. The proper treatment of the broker's commissions must be determined in the light of the fact and circumstances known in the taxable year of 1927.

The court finds the issues in favor of the defendant and judgment will be entered accordingly.

ARTICLE 102: Traveling expenses. XI–37–5679
G. C. M. 10915

REVENUE ACT OF 1918.

Railroad fare expended by a member of the faculty of a university in traveling from his place of regular employment, to his place of temporary employment at a summer school, is a deductible business expense. Recommended that I. T. 1238 (C. B. I–1, 122) be revoked.

In I. T. 1238 it was held that a member of the faculty of a university who instructs in the summer school of another university, some 500 miles from his place of regular employment, was not entitled to a deduction as a business expense of the railroad fare expended in traveling to and returning from the summer school. In I. T. 2481 (C. B. VIII–2, 291) it was held that the traveling expenses, including meals and lodging, incurred by a university professor, who spent 56 days tutoring in a city other than the city where he was regularly employed, were properly deductible in computing net income. In General Counsel's Memorandum 7133 (C. B. VIII–2, 85) it was concluded that traveling and other expenses incurred by a professional golf player incident to his participation in golf tournaments were properly deductible in determining his income tax liability. That memorandum was largely based on the decisions of the Board of Tax Appeals in *Hamilton Ward* (8 B. T. A., 704) and *Walter F. Brown* (13 B. T. A., 832).

It is the opinion of this office that the conclusion reached in I. T. 2481, rather than that contained in I. T. 1238, is in harmony with General Counsel's Memorandum 7133 and the Board of Tax Appeals decisions cited therein. It follows that railroad fare expended by a member of the faculty of a university in traveling from his place of regular employment, to his place of temporary employment at a summer school, is deductible as a business expense. It is accordingly recommended that I. T. 1238 be revoked.

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

ARTICLE 102: Traveling expenses. XI–37–5680
I. T. 2640

REVENUE ACT OF 1918.

I. T. 1238 (C. B. I–1, 122), holding that railroad fare expended by a member of the faculty at one university in traveling from his regular place of employment to his place of employment as an instructor in the summer school at another university is not deductible, is revoked, in view of General Counsel's Memorandum 10915 (page 245).

ARTICLE 104: Repairs.

REVENUE ACT OF 1918.

Treatment of assessments for local benefits in the case of an estate. (See G. C. M. 11330, page 247, and I. T. 2667, page 248.)

ARTICLE 112: When charges deductible. XI–43–5805
Ct. D. 591

INCOME TAX—REVENUE ACT OF 1918—DECISION OF COURT.

DEDUCTION—YEAR OF DEDUCTION—AMOUNT PAID IN SETTLEMENT OF JUDGMENT.

Where a taxpayer in 1920 wrongfully mines coal from land of another, which fact is not discovered until 1921, when an action for damages caused by the removal is instituted, an amount paid by the taxpayer in 1923 in settlement of a judgment is not deductible from gross income in 1920 as additional cost of coal removed and sold in the latter year.

UNITED STATES CIRCUIT COURT OF APPEALS, SIXTH CIRCUIT.

Robert H. Lucas, Collector of Internal Revenue for the District of Kentucky, appellant, v. *Providence Coal Mining Co., appellee.*

Appeal from United States District Court for the Western District of Kentucky.

[June 29, 1932.]

OPINION.

HICKENLOOPER, Circuit Judge: In the year 1920 the appellee, Providence Coal Mining Co., wrongfully mined certain coal underlying land belonging to one D. H. Cullen. This fact was not discovered until some time during 1921, and on December 22 of that year Cullen instituted an action against the appellee for damages caused by the removal. In due course this cause came to trial, and on April 28, 1922, a judgment for $9,000 was rendered covering not only the coal mined in 1920 (approximately 71 per cent of the total), but also that mined in the previous year. An appeal was taken from this judgment to the Court of Appeals of Kentucky. While the case was pending on appeal, the parties, on March 16, 1923, entered into a written agreement of settlement for the sum of $4,500. In its original return for 1920 appellee did not claim deduction for the liability incurred by the wrongful removal of this coal, but on March 31, 1923, filed an amended return for 1920, in which it claimed the $4,500 paid by it on March 16, 1923, as additional cost of coal removed and sold during 1920. The right to make deduction as in its return for the year 1920 was denied. Claim for credit or refund was likewise denied, and the appellee thereupon, having already paid the tax, brought suit against the collector of internal revenue to

recover, as illegally collected, such portion thereof as was attributable to the amount of the claimed deduction. The district court held that the appellee was entitled to a deduction from its gross income for 1920 of 71 per cent of the $4,500 paid in 1923, or $3,195, and rendered judgment for the tax resulting from the disallowance of this deduction, viz, $1,896.91, with interest.

Upon the principles this day announced in the decision of the case of *Commissioner of Internal Revenue* v. *R. J. Darnell, Inc.*, and especially in view of the close analogy between the facts of this case and those of *Lucas* v. *American Code Co., Inc.* (280 U. S., 445 [Ct. D. 168, C. B. IX–1, 314]), we are constrained to the opinion that the court below erred in denying defendant's motion for judgment. Just as in the case of *North American Oil Consolidated* v. *Burnet, Commissioner* (286 U. S., 417 (May 23, 1932) [Ct. D. 499, C. B. XI–1, 293]), it is held that a taxpayer need not report as income an amount which it might never receive, so in *Lucas* v. *American Code Co.*, supra, it was distinctly held that a taxpayer may not make deduction for a given year of losses of which the amount was wholly unpredictable, where the amount to be recovered, if there was legal liability, depended in large part on the course of future events, and where the company had not accrued on its books, within the tax year, a liability in the estimated amount of the loss. In our opinion this decision controls the instant case, which differs from the case of *The Landers Bros. Co.* v. *Commissioner*, decided at the present session, in that there the loss was definitely fixed and liquidated by agreement of the officers of the taxpayer within the taxable year. Compare, also, *Ewing Thomas Converting Co.* v. *McCaughn* (43 F. (2d), 503 (C. C. A. 3) [Ct. D. 43, C. B. VIII–1, 232]).

The judgment of the district court is reversed and the cause is remanded for a new trial.

SECTION 214(a)3.—DEDUCTIONS ALLOWED INDIVIDUALS: TAXES.

ARTICLE 133: Taxes for local benefits. XI–52–5949
(Also Section 214(a)1, Article 104; Section 214(a)8, Article 162; Section 219, Article 341.) G. C. M. 11330

REVENUE ACT OF 1918.

Recommended that Office Decision 613 (C. B. 3, 149), with respect to the treatment of assessments for local benefits, in the case of an estate, be revoked, in view of the decision of the Board of Tax Appeals in the case of *F. M. Hubbell Son & Co.* v. *Commissioner* (19 B. T. A., 612), and the decision of the Circuit Court of Appeals, Eighth Circuit, in the case of *F. M. Hubbell Son & Co., Inc.*, v. *Burnet* (51 Fed. (2d), 644, Ct. D. 411, C. B. X–2, 250, certiorari denied 284 U. S., 664).

An opinion is requested relative to Office Decision 613, which relates to special assessments or taxes for local benefits. The Income Tax Unit inquires whether that ruling should be revoked, in view of General Counsel's Memorandum 9461 (C. B. X–1, 120) and the decision of the Circuit Court of Appeals, Eighth Circuit, in the case of *F. M. Hubbell Son & Co., Inc.*, v. *Burnet*, decided July 20, 1931 (51 Fed. (2d), 644).

In Office Decision 613 it was held that amounts expended by an estate on account of special assessments for the maintenance or repair of streets or for sidewalk improvements levied upon property used in trade or business, if the same is necessary in the conduct of such trade or business, constitute allowable deductions. It was also stated in that office decision that amounts expended for replacements can, under no circumstances, be claimed as a business

expense, but "if such replacements, however, are used in connection with the business of the estate, a reasonable amount may be claimed for exhaustion, wear and tear of the property, including obsolescence. * * *"

The Board of Tax Appeals in *F. M. Hubbell Son & Co.* v. *Commissioner* took the position that the statutory provision (section 214(a)8 of the Revenue Acts of 1924 and 1926, relating to depreciation) upon which the petitioner relied contemplates the tax-free return only of the cost of assets in which the taxpayer has a capital investment and which in some way contribute to gross income, and that ownership of the improvement must be established. The Circuit Court of Appeals in *F. M. Hubbell Son & Co., Inc.*, v. *Burnet*, supra, affirmed the Board decision and stated in part as follows:

> While the statute does not in so many words declare that before a deduction from net income may be made on account of "the exhaustion, wear and tear of property used in the trade or business" it must appear that the property depreciated is property in which the taxpayer has *an absolute or qualified ownership* and that the "exhaustion, wear and tear" has resulted from the use of the property in the taxpayer's business, those are necessary implications. [Italics supplied.]

General Counsel's Memorandum 5589 (C. B. VIII–1, 83), which was in conflict with the Board decision in the Hubbell case, was revoked by General Counsel's Memorandum 9461, supra. Inasmuch as Office Decision 613 is also in conflict with the Board decision as well as the decision of the Circuit Court of Appeals in the same case, it is recommended that the office decision be revoked.

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

ARTICLE 133: Taxes for local benefits. XI–52–5950
(Also Section 214(a)1, Article 104; Section 214(a)8, Article 162; Section 219, Article 341.) I. T. 2667

REVENUE ACT OF 1918.

In view of General Counsel's Memorandum 11330 (page 247, this Bulletin), Office Decision 613 (C. B. 3, 149), with respect to the treatment of special assessments for local benefits in the case of an estate, is revoked.

SECTION 214(a)4, 5, AND 6.—DEDUCTIONS ALLOWED INDIVIDUALS: LOSSES.

ARTICLE 141: Losses.

REVENUE ACT OF 1921.

Progressive damage to a residence due to the ordinary action of the elements upon a badly constructed building. (See Ct. D. 510, page 392.)

ARTICLE 141: Losses. XI-33-5610
(Also Section 215, Article 291.) Ct. D. 534

INCOME TAX—REVENUE ACT OF 1926—DECISION OF COURT.

1. DEDUCTION—LOSS—PERSONAL EXPENSE—LEGAL EXPENSE—PROBATE OF WILL.

Expenses incurred for legal services in opposing unsuccessfully the probate of a will are a personal expense within the meaning of section 215(a)1 of the Revenue Act of 1926 and are not an allowable deduction, under section 214(a)5 of that Act, as a loss "in a transaction entered into for profit."

2. DECISION AFFIRMED.

The decision of the Board of Tax Appeals (21 B. T. A., 67) is affirmed.

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIRST CIRCUIT.

Helen A. P. Merriman, petitioner for review, v. *Commissioner of Internal Revenue.*

Appeal from Board of Tax Appeals.

Before BINGHAM, WILSON, and MORRIS, JJ.

[December 17, 1931.]

OPINION.

MORRIS, J.: This is a petition to review a decision of the Board of Tax Appeals affirming a decision of the Commissioner of Internal Revenue determining a deficiency of $492.33 in petitioner's income tax for the year 1926.

The facts are brief. During the taxable year 1926 the petitioner paid an attorney's bill and legal expenses incurred in 1923, in an unsuccessful effort to break the will of her aunt. The will was sustained by a decree of the surrogate court for New York County, N. Y., May 31, 1923. No proceedings were thereafter taken further to contest the will and the aunt's estate was settled in accordance therewith. The petitioner brought the suit with the hope that she would recover something out of the estate if she were successful in breaking the will.

The expenditure of $2,028.45, paid by the petitioner in 1926, was taken as a deduction by her in her income tax return for that year as a loss on a "transaction entered into for profit." The Commissioner disallowed the deduction on the ground that it was a personal expense and the Board of Tax Appeals affirmed the Commissioner's decision.

The only error argued is that "said Board erred in holding that said legal expenses were not deductible as a loss incurred in a transaction entered into for profit."

A decision of the case seems to turn upon the construction of the words "transaction entered into for profit," and more particularly upon the word "profit." Section 214(a)5 of the Revenue Act of 1926 provides as follows:

"In computing net income there shall be allowed as deductions: * * *.

"(5) 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."

Conceding the rule of interpretation of taxing statutes to be that in case of doubt they are to be construed most strictly against the Government and in favor of the taxpayer (*Gould* v. *Gould*, 245 U. S., 151, 153) still the language used must be given its usual and ordinary meaning keeping in mind the subject matter to which it relates. It can not under the rule of interpretation be strained beyond the breaking point in the interest of taxpayers. "Profit and loss" are well-known terms referable to business transactions. Profit is gain; loss more than wipes out all gain. It is unnecessary to try to give a comprehensive definition of either term. As ordinarily understood profit does not refer to what is already one's own but is an accretion to what one already possesses. Loss does not refer to what one has never had.

When the petitioner brought her suit to break her aunt's will it was to establish her right to what she must have claimed honestly belonged to her. To hold otherwise would be to impute to her dishonest motives. If the litigation had proved successful she would have received only such part of the testator's estate as justly belonged to her. That would not have been profit. The litigation was unsuccessful. Her anticipated share in the estate was denied her. It was not loss because she never possessed it. To hold that the expenses of litigation under the existing facts were a deductible loss because incurred in a transaction entered into for profit would be straining the meaning of "profit" beyond any ordinary or usual meaning of the word and beyond the sense in which it was used by Congress.

The decision of the Board of Tax Appeals is affirmed.

ARTICLE 141: Losses.

REVENUE ACT OF 1926.

Losses incurred in gambling in a jurisdiction where such transaction is legal. (See G. C. M. 10873, page 85.)

ARTICLE 141: Losses.

REVENUE ACT OF 1921.

Amount paid under guarantee against loss, made without expectation of profit. (See Ct. D. 577, page 207.)

ARTICLE 141: Losses. XI-50-5915
(Also Section 214(a)7, Article 152.) Ct. D. 609

INCOME TAX—REVENUE ACT OF 1924—DECISION OF COURT.

1. DEDUCTION—LOSS—BAD DEBT—CONTRIBUTION BY BANK STOCKHOLDER TO COVER ANOTHER'S MISAPPROPRIATION.

An amount voluntarily paid to a bank by a stockholder of the bank, of which he is a director and president, to cover an overdraft by a depositor and misappropriation of bank funds by the treasurer and thus to prevent the closing of the bank, is not deductible as a loss under section 214(a) of the Revenue Act of 1924; nor are any amounts in respect of options on coal lands and claims of the bank which were assigned to the president as security, all of which are worthless, deductible as bad debts, there being no change in their value after the president acquired them.

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

Estate of Angus Park, William C. Park, Executor, petitioner, v. *Commissioner of Internal Revenue, respondent.*

Petition to review a decision of the United States Board of Tax Appeals. Affirmed.

Before L. HAND, SWAN, and CHASE, Circuit Judges.

[May 23, 1932.]

OPINION.

Angus Park filed a petition for the redetermination of a deficiency in his income tax for 1924. While his petition was pending before the Board of Tax Appeals, he died and his executor was substituted in his stead but he will be referred to herein as the petitioner.

In 1921, the Bankers Trust Co. of Norwich, Conn., was organized as a State bank. Soon after that Mr. Park, who was a man of means and prominence in the community, was asked to become a director and to serve as president. He accepted, became the owner of 300 shares of capital stock and the bank began doing business.

It was discovered at a directors' meeting held on October 24. 1924. that the treasurer had permitted a depositor to overdraw about $40,000. The State bank commissioner was immediately requested to investigate. He began his examination of the bank's affairs late that afternoon and that evening reported to the directors that in addition to the overdraft there was a shortage of about $85.000 because of the treasurer's conversion of the bank's funds to his own use for speculation. He also told the directors that unless at least $100,000 in cash was put into the bank before noon the next day he would be obliged to close it. None of the directors but Park could find a way out. If the bank had closed the loss to all stockholders would have been total and that to depositors substantial. The stock was nonassessable but Mr. Park was unwilling to permit action which would result in loss to stockholders and depositors and offered to supply the $100,000 himself. He did so. He also agreed to stand any other defalcations of the treasurer which might be discovered later. He also did that. Aside from what was recovered on the treasurer's bond, a small recovery from his property and contributions from all but four of the directors Mr. Park was not repaid. None of the $100,000 was returned to him. The treasurer held some options on coal lands as security for the overdrafts and these together with claims the bank held against the depositor who had overdrawn and against its treasurer were assigned to Mr. Park but they turned out to be absolutely worthless, except to the extent of $1,581 recovered from the depositor and $7,574.35 from the treasurer.

There was no regular system in the bank for checking overdrafts that the treasurer failed to report or for discovering loans which had been made without the authorization of the board of directors.

The only deduction now to be considered is the $100,000 claimed in petitioner's income tax return for 1924 and disallowed by the Commissioner. This amount was charged off as a net loss on December 31, 1924.

CHASE, Circuit Judge: It is claimed that the $100,000 is deductible from 1924 income as a loss under the provisions of section 214 of the Revenue Act of that year. If so, the deduction must fall within some one of subdivisions (4), (5), (6), or (7) of section 214(a). They follow so far as material:

"(4) Losses sustained during the taxable year and not compensated for by insurance or otherwise, if incurred in trade or business;

"(5) 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; * * *;

"(6) Losses sustained during the taxable year of property not connected with the trade or business * * * if arising from fires, storms, shipwreck, or other casualty, or from theft, * * *;

"(7) Debts ascertained to be worthless and charged off within the taxable year * * *."

It is possible to eliminate subdivision (6) with only the observation that it could apply but in the respect that it relates to losses from theft and plainly means theft from the taxpayer. As nothing was stolen from this petitioner he can not maintain his claim under the theft provision even if it is assumed that a loss has been shown. Just as a corporation is, all idea of fraud aside, regarded as an entity separate and distinct from its stockholders (*Eisner* v. *Macomber*, 252 U. S., 189, 214 [T. D. 3010, C. B. 251]), so does a theft from the corporation differ from a theft from a stockholder.

To maintain it under either subdivision (4) or (5), the petitioner must prove that he sustained a loss during the taxable year. The bank did sustain a loss. Had the petitioner not made the contribution he did when he supplied the additional funds to the bank it may be taken for granted that he would have sustained a loss also though it is not possible to determine from this record how much that would have been or in what year it would have been ascertained. His stock would have been worthless but for his contribution. Yet we do not know what that stock was worth before or later. He may have been personally liable because of some failure in his duty to the bank in permitting its business to be conducted in such a way

that the treasurer could misappropriate its funds. But all this is mere speculation. No such claim was made so far as we know and certainly no liability on any such ground was admitted by the petitioner. He did not put in his $100,000 in additional money in settlement of any recognized legal liability so to do. He acted wholly as an honorable gentleman who was determined that no one should lose through the mismanagement of a bank of which he was the president and a director. What he recognized was a moral and not a legal duty. His conduct was in every way commendable. He did, indeed, use an additional $100,000 of his money to save the bank but the fact remains that he did save it and kept his stock from becoming worthless. Whether he ever suffered any loss or not does not appear. All we now know is that he increased his investment in the bank. If we assume, arguendo, that his connection with this bank was an engagement either in trade or business, or was a transaction entered into for profit though not connected with trade or business, voluntary additions to his investment though made to avoid a loss that would otherwise have to be taken, and made under circumstances which left no choice but to contribute or lose, increased his capital investment. Had the petitioner's stock been assessable and been assessed, whatever he had been obliged to pay because of the assessment would not have been a deductible loss but a contribution to capital. (*First National Bank of Wichita et al.* v. *Commissioner*, 46 Fed. (2d), 283 [Ct. D. 296, C. B. X–1, 384].) So where a stockholder sees fit to contribute additional funds to the capital account of the bank when his stock can not be assessed, he has merely added to the cost of his stock. His contribution may be turned into a loss by subsequent events but until such a result is shown no deductible loss under section 214 of the 1924 Act can be proved.

Such a contribution as the petitioner made can not be isolated from his other services to and dealings with the bank and possibly be considered by itself as a trade or business. Taken with them he has failed to prove a loss since the venture as a whole may have been profitable for all we know. If isolated and treated as a transaction not connected with a trade or business, it would be beyond reason to call it one entered into for profit, so that section 214(a)5 would apply, when obviously the $100,000 was put into the bank to discharge a moral obligation and prevent loss rather than with the expectation of profit as such. (Compare *Stephenson* v. *Commissioner*, 43 Fed. (2d), 348.)

Nor were the options on coal lands, which were assigned to the petitioner and were in fact worthless, and the claims assigned to him, debts ascertained to be worthless and charged off during the taxable year. There was no change in their value after the petitioner acquired them so far as the proof shows. If they should be treated as debts at all, they were debts taken as debts for whatever they may have been worth and there was nothing to charge off since they did not decrease in value after the petitioner got them. (See *Eckert* v. *Burnet*, 283 U. S., 140 [Ct. D. 325, C. B. X–1, 241].)

The decision of the Board of Tax Appeals is affirmed.

SECTION 214(a)7.—DEDUCTIONS ALLOWED INDIVIDUALS: BAD DEBTS.

ARTICLE 151: Bad debts. (Also Section 206, Article 1621; Section 214(a)1, Article 101.)

XI–28–5543
Ct. D. 513

INCOME TAX—REVENUE ACTS OF 1921 AND 1924—DECISION OF COURT.

1. DEDUCTION—BAD DEBTS—CHANGE FROM RESERVE METHOD.

Where a taxpayer adopts the reserve method of treating bad debts in accordance with article 151 of Regulations 62, relating to the income tax, and deducts from income in 1923 an addition to a reserve for bad debts, it may not, without the permission of the Commissioner, change the method of treating bad debts and deduct in 1924 under section 234(a)5 of the Revenue Act of 1924 the amount of its debts ascertained to be worthless and charged off in the latter year.

2. DEDUCTION—NET LOSS—NET LOSS OF PREDECESSOR CORPORATION.

Where a new corporation acquires the business and assets of an old corporation a net loss sustained by the old corporation may not be deducted under section 206 of the Revenue Act of 1924 in computing the net income of the new corporation.

3. DEDUCTION—BUSINESS EXPENSE—OBLIGATIONS OF PREDECESSOR CORPORATION DISCHARGED.

Where a new corporation acquires the business and assets of an old corporation and as a part of the consideration therefor assumes and agrees to pay all the debts and obligations of the old corporation, payments made by the new corporation in 1923 and 1924 in discharge of the obligations of the old corporation are capital expenditures and may not be deducted as a business expense under section 234(a)1 of the Revenue Acts of 1921 and 1924 in computing the net income of the new corporation.

4. DECISION AFFIRMED.

The decision of the Board of Tax Appeals (22 B. T. A., 105) affirmed.

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIRST CIRCUIT.

Athol Manufacturing Co., petitioner for review, v. *Commissioner of Internal Revenue.*

Before BINGHAM, WILSON, and MORRIS, JJ.

Appeal from Board of Tax Appeals.

[December 17, 1931.]

OPINION.

BINGHAM, J.: This is a petition to review a decision of the Board of Tax Appeals, rendered March 30, 1931, redetermining a deficiency in the petitioner's income tax for the year 1924 in the sum of $1,880.74.

The petitioner, the Athol Manufacturing Co., is a Massachusetts corporation, organized June 28, 1923. It was organized to take over and did take over the business and assets of another Massachusetts corporation of the same name. In its agreement for the purchase and taking over of the business and assets of the earlier corporation the petitioner, as a part of the consideration therefor, assumed and agreed to pay all the debts and obligations of every kind of the other corporation.

During the taxable year 1922, the old company sustained a net loss in excess of $100,000; and during the period of its operation from January 1 to June 30, 1923, it sustained a net loss of $425,979.24. In its tax return for 1924, the petitioner claimed a deduction of these sums as losses, which the Commissioner disallowed.

From July 1 to December 31, 1923, and during 1924 the petitioner paid certain sums on account of the obligations of the old company which it had assumed and agreed to pay as a part of the consideration for the business and assets of the old company. In its tax returns for 1923 and 1924 the petitioner claimed a deduction of these payments as ordinary and necessary expenses of its business. The Commissioner disallowed this claim, holding that these payments were a part of the price of the assets of the old company and were therefore capital items.

The old company, prior to its dissolution, had for several years made it a practice to set up on its books a reserve for bad debts in an amount equal to 1 per cent of its sales; but, in making its tax returns, it claimed its actual bad debts, ascertained to be worthless during the taxable year, as a deduction. The petitioner, after its organization, also set up on its books a bad debt reserve equal to 1 per cent of its sales; but in its first income tax return for the six months of its existence ending December 31, 1923, it claimed and received as a deduction the additions made to its reserve for that period. The additions to its reserve amounted to $3,338.75 while the petitioner's books showed but $52.30 of actual bad debts. Since 1923 the petitioner has continued to set up a bad debt reserve equal to 1 per cent of its sales, but it claimed a deduction in its tax return for 1924 of the actual bad debts ascertained to be worthless and charged off during the year. The additions to the bad debt reserve in 1924

amounted to $8,434.75, while its bad debts in 1924 and which it now claims should be deducted have been ascertained to be $20,895.21.

The Board of Tax Appeals held that the petitioner was a distinct entity from the old corporation; that the losses of the old corporation in 1922 and 1923 were not the losses of the petitioner under section 206(b), (e), and (f) of the Revenue Act of 1924, and such losses could not be deducted in the ascertainment of its net income.

As to the sums paid out by the petitioner during the six months of its existence in 1923 and in 1924 upon the obligations of the old company, which it has assumed and agreed to pay, the Board of Tax Appeals held that these payments were a part of the consideration for the purchase of the assets of the old company; that they were part of the cost to the petitioner of those assets and constituted a capital, not a business expense.

And, as to the remaining matter, it held that the petitioner, in its tax return for 1923, having deducted the sum of $3,338.75, the amount of the additions to its bad debt reserve for that period, and claimed that as a deduction in the ascertainment of its taxable income, instead of claiming a deduction on account of its bad debts amounting to $52.30, it was not entitled, in its tax return for 1924, to deduct its ascertained bad debts instead of the sum added to a reserve for bad debts, it not having first obtained permission to make such change, as required by Regulations 65, article 115. The Board, however, did increase the amount set up by the petitioner on its books as a reserve for bad debts for 1924 from $8,434.75 to $17,608.76.

We fail to see how we can add anything to what was stated by the Board of Tax Appeals in its opinion. We are in full accord with its ruling and finding that the petitioner was an independent entity from the old corporation whose assets and business it took over; that the losses sustained by the old company in conducting its business during 1922 and a part of 1923 were not the petitioner's losses and that it was not entitled to deduct the same in its tax return. We are also of the opinion and agree with the conclusion of the Board that the amounts paid out by the petitioner in 1923 and 1924 to satisfy the obligations of the old company, which it has assumed and agreed to pay, were not a business expense which it was entitled to deduct, but rather a capital expenditure. And we agree with the Board that the petitioner, having availed itself of the benefit of article 151 of Regulations 65 and, in its income tax return for 1923, deducted the amount set up as a reserve for bad debts, could not, in 1924, deduct the amount of its debts ascertained to be worthless, as it undertook to do, without having obtained permission therefor. We can hardly see why this appeal was taken.

The decision or order of the Board of Tax Appeals is affirmed.

ARTICLE 152: Examples of bad debts.

REVENUE ACT OF 1926.

Worthless claims as security for a debt. (See Ct. D. 609, page 250.)

ARTICLE 155: Reserve for bad debts. (Also Section 234, Article 561.)

XI-49-5899
Ct. D. 606

INCOME TAX—REVENUE ACT OF 1924—DECISION OF COURT.

1. DEDUCTION—BAD DEBTS—RESERVE FOR BAD DEBTS.

Where the evidence does not justify a holding that the taxpayer had elected the reserve method of treating bad debts in accordance with article 155 of Income Tax Regulations 62, a decision of the Board of Tax Appeals, which is prima facie correct, that the taxpayer is not entitled under section 234(a)5 of the Revenue Acts of 1921 and 1924 to a deduction for an addition to a reserve for bad debts is sustained.

2. DECISION AFFIRMED.

The decision of the Board of Tax Appeals (23 B. T. A., 1218) is affirmed.

UNITED STATES CIRCUIT COURT OF APPEALS, FOURTH CIRCUIT.

Atlantic Bank & Trust Co., petitioner, v. *Commissioner of Internal Revenue, respondent.*

On petition to review the decision of the United States Board of Tax Appeals.

Before PARKER and NORTHCOTT, Circuit Judges, and WAY, District Judge.

[June 13, 1932.]

OPINION.

NORTHCOTT, Circuit Judge: This is a petition to review a decision of the Board of Tax Appeals sustaining a determination of a deficiency in income taxes against the petitioner made by the Commissioner of Internal Revenue. The deficiency, as determined, was for the years 1922, 1923, and 1924, in the sums of $16,201.59, $2,327.71, and $3,344.55, making a total of $21,873.85.

The petitioner, during the years in question, was a bank organized under the laws of the State of North Carolina, with its principal place of business at Greensboro.

In its income tax return for the calendar year 1921, petitioner claimed a deduction of $5,000 as a bad debt evidenced by a certificate of deposit of the Bank of Coats, and also a deduction of $46,834.20 as a reserve for bad debts.

The Commissioner of Internal Revenue allowed the deduction of $5,000 as a bad debt for the calendar year 1921, but disallowed the deduction of $46,834.20 as a reserve, and his action was sustained by the Board of Tax Appeals. (10 B. T. A., 796.) From this decision the petitioner did not appeal.

In making its return for the year 1922, the petitioner claimed as a reserve for bad debts the sum of $125,000, and made no claim for specific bad debts. In the return for the year 1923, petitioner claimed as an addition to its reserve for bad debt the sum of $16,000, and also claimed as a deduction $34,134.27 for bad debts, and for the year 1924, claimed $20,000 as an addition to its reserve, and in addition claimed $5,988.28 for bad debts. The Commissioner held, as he had held with respect to the year 1921, that petitioner was not entitled to the amounts claimed for reserve for bad debts for any of the years 1922, 1923, and 1924.

On appeal the Board of Tax Appeals affirmed the action of the Commissioner.

The pertinent part of the Revenue Act of 1921 as applying to this appeal is as follows:

"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:

"(5) Debts ascertained to be worthless and charged off within the taxable year (or in the discretion of the Commissioner, a reasonable addition to a reserve for bad debts); and when satisfied that a debt is recoverable only in part, the Commissioner may allow such debt to be charged off in part."

A similar provision is found in section 234(a)5 of the Revenue Act of 1924.

Regulations No. 62 was prepared by the Commissioner of Internal Revenue under the Revenue Act of 1921. Article 151 of these regulations provides as follows:

"ART. 151. *Bad debts.*—Bad debts may be treated in either of two ways—(1) by a deduction from income in respect of debts ascertained to be worthless in whole or in part, or (2) by a deduction from income of an addition to a reserve for bad debts. For the year 1921 taxpayers may, regardless of their previous practice, elect either of these two methods and will be required to continue the use in later years of the method so elected unless permission to change to the other method is granted by the Commissioner.

"ART. 155. *Reserve for bad debts.*—Taxpayers for 1921 may elect the reserve method of treating bad debts, and for 1921 and subsequent years may deduct from gross income a reasonable addition to a reserve for bad debts in lieu of a deduction for specific bad-debt items.

"What constitutes a reasonable addition to a reserve for bad debts must be determined in the light of the facts, and will vary as between classes of business and with conditions of business prosperity. A taxpayer using the reserve method should make a statement in his return showing the volume of his charge sales (or other business transactions) for the year and the percentage of the

reserve to such amount, the total amount of notes and accounts receivable at the beginning and close of the taxable year, and the amount of the debts which have been ascertained to be wholly or partially worthless and charged against the reserve account during the taxable year." [T. D. 3997, C. B. VI–1, 222.]

It is evident that a taxpayer of this class must use one of two methods in claiming bad debts. Either the charge must be made for the specific debts claimed to be worthless or the reserve method must be used. The taxpayer may not use both methods, and if the reserve method be adopted article 155 of Regulations 62 must have been complied with. Here the petitioner, according to the determination of the Commissioner, had not properly gone on the reserve system. It had made returns for the year 1921 under both systems, and its claim for reserve had been disallowed not only by the Commissioner but by the Board of Tax Appeals. While petitioner only claimed a deduction for reserve in the year 1922 it does not show that for that year it had complied with article 155 of Treasury Regulations 62. Again in 1923 and 1924, petitioner claimed not only sums for reserve but claimed certain sums for specific bad debts, showing that it was not using the reserve method only.

It is most significant that the bank never opened a reserve account for bad debts on its books and never deducted from its assets the amounts claimed in its tax return for reserve, while on the other hand, it did deduct all amounts claimed as specific bad debts.

It is also significant that petitioner never made any request of the Commissioner to change its method.

The determination of the Commissioner is *prima facie* correct (*Wright et al.* v. *Commissioner of Internal Revenue*, 50 Fed. (2d), 727), and his determination can only be reversed by the Board of Tax Appeals upon evidence (*Burnet, Commissioner*, v. *Houston*, 283 U. S., 223 [Ct. D. 328, C. B. X–1, 343]). The burden was upon the petitioner not only to establish the fact that the determination of the Commissioner was erroneous, but to establish facts from which a correct determination could be made. (*Burnet* v. *Houston*, supra; *American Land & Investment Co.* v. *Commissioner*, 40 Fed. (2d), 336.) The Board is a fact-finding body (*Goldsmith* v. *Board of Tax Appeals*, 270 U. S., 117), and this court can not substitute its judgment for that of the Board. Having in mind these principles, we are led to the conclusion that the action of the Board, upon the evidence presented, in refusing to set aside the determination of the Commissioner, was right.

Petitioner has not only failed to show that the determination of the Commissioner was erroneous but has also failed to establish, by proper evidence, facts from which a correct determination could be made, in the event the Commissioner's determination had been held to be erroneous.

Attorneys for petitioner rely upon the cases of *Rhode Island Hospital Trust Co.* v. *Commissioner of Internal Revenue* (29 Fed. (2d), 339) and *First National Bank of Omaha* v. *Commissioner* (49 Fed. (2d), 70), but in both these cases the taxpayer had entered on its books an account showing a reserve for bad debts, and a different state of facts was presented from that existing here.

The decision of the Board is accordingly affirmed.

SECTION 214(a)8.—DEDUCTIONS ALLOWED INDIVIDUALS: DEPRECIATION.

ARTICLE 162: Depreciable property.

REVENUE ACT OF 1918.

Treatment of assessments for local benefits in the case of an estate. (See G. C. M. 11330, page 247, and I. T. 2667, page 248.)

ARTICLE 163: Depreciation of intangible property.

REVENUE ACT OF 1926 AND PRIOR REVENUE ACTS.

Contract of purchase of ore between mining company and smelting company. (See G. C. M. 10845, page 88.)

ARTICLE 164: Capital sum recoverable through depreciation allowances.

REVENUE ACT OF 1921.

Assets in useful service though entire cost has been recovered through deductions by allowances for depreciation. (See Ct. D. 550, page 196.)

SECTION 214(a)9.—DEDUCTIONS ALLOWED INDIVIDUALS: DEPLETION.

ARTICLE 223: Charges to capital and to expense in the case of oil and gas wells. XI-29-5554 G. C. M. 10686

REVENUE ACTS OF 1924 AND 1926.

The taxpayer as the assignee of a one-half interest in certain oil leases, the assignment being made in consideration of the drilling of an oil well on the property, may deduct one-half of the intangible cost of drilling the initial well or wells as an expense, or at its option same may be capitalized. The intangible cost of drilling a test well where the taxpayer did not obtain title to the lease until after the well was completed constitutes a capital investment and is not deductible as an expense.

An opinion is requested whether the M Company, for the years 1924, 1925, and 1926 as the assignee of a one-half interest in certain oil leases, the assignment being made in consideration of the drilling by the M Company of an oil well on the property, may charge off as development expense one-half of the intangible cost of the well under the provisions of article 223, Regulations 69, inasmuch as the taxpayer had theretofore exercised its option under the regulations of charging intangible drilling costs to expense.

In view of the fact that article 225 of Regulations 65 and article 223 of Regulations 69 have been restated in Treasury Decision 4333 (C. B. XI-1, 31), so as to incorporate therein certain details of administrative application and practice of long standing, the instant case has been considered in connection with that Treasury decision. Recourse has been had to copies of the original contracts, leases, and assignments of leases, by virtue of which the oil operations in question were undertaken by the taxpayer.

The question arises in connection with the intangible costs of drilling wells on three different groups of oil leases, in connection with each of which groups the taxpayer entered into a contract for the acquisition of a one-half interest in the underlying oil lease, and the drilling and operating of oil wells on the leased land. A summary of the pertinent facts, with relation to each of the groups, is as follows:

FIRST GROUP.

During the years 1924, 1925, and 1926 various individuals and corporations entered into contracts with the M Company where it was agreed in each instance that the individual or corporation was to assign to the M Company an undivided one-half interest in a specified oil lease. In each contract the M Company agreed to drill on the property a specified number of oil wells (in no case exceeding three)

at its own expense, and in some instances agreed to pay a specified sum in cash. In each contract it was agreed that, after the drilling of the well or wells specified in the contract, all future wells should be drilled at the joint expense of both parties and in each instance the M Company was to operate the lease. In each instance the assignment was executed, delivered, and recorded prior to the time the drilling operations began. In each instance the assignment was unconditional and on the usual printed form.

SECOND GROUP.

Under date of April —, 1925, one A, alleging himself to be the owner of a good, valid, and merchantable oil and gas mining lease on a tract of land in K County, State of L, entered into a contract with the M Company regarding the operation of this lease. The record indicates that A did not own this lease but had an option to purchase it. On this lease there was a well drilled to the 2,500-foot sand. In this contract A agreed to assign a one-half interest to the M Company. The M Company agreed to drill the well to a depth of 3,500 feet, free of cost to A. If the well produced, A was to pay one-half of the cost of new casing and the M Company was to pay A one-half of the cost of the old casing remaining in the well. All additional wells were to be drilled at the joint expense of the M Company and A. The M Company was to operate the lease, and A was to contribute his portion of the M Company's overhead in connection with the operation. As of July —, 1925, A obtained, by assignment, an eleven-sixteenths interest in the lease from a bank claiming to own such assigned interest. As of July —, 1925, the M Company acquired from the owners of the fee a lease to a large tract of land, including the land covered by the other lease. As of October —, 1925, the M Company apparently executed an assignment to A of a seven-sixteenths interest in the first lease, but the taxpayer asserts in its brief that it was a one-half interest. Drilling by the M Company began on August —, 1925. Three wells in all were drilled on this lease.

THIRD GROUP.

Under date of March —, 1926, the S Company entered into an agreement with B and C. By the terms of this agreement the S Company agreed to assign to B and C four oil and gas leases on land in T County, State of L. B and C agreed in consideration thereof to drill a test well on one of the leases to a depth of 4,000 feet. The agreement further provided that assignments of the four leases from the S Company to B and C should be placed in escrow in a bank in the city of U, to be delivered to B and C upon the completion of the test well.

As of the next day, March —, 1926, the M Company entered into a contract with B and C. By the terms of this agreement B and C agreed to assign to the M Company two of the S Company leases, and an undivided one-half interest in another of the S Company leases (the one on which the test well was to be drilled). B and C agreed to secure and assign to the M Company dry-hole contributions to the amount of $2x$ dollars. The M Company agreed to drill a well on the one lease to a total depth of 4,000 feet, unless oil and

gas in paying quantities were found at a lesser depth. B and C agreed to contribute $2x$ dollars toward the cost of this well, if it proved to be a producer, payment to be made as the oil was run. This well was otherwise to be at the sole expense of the M Company, except that if a producer came in B and C were to pay for one-half of the cost of the derrick and the casing of the well. All subsequent wells on the lease were to be drilled at the joint expense of both parties. Eight wells in all were drilled.

The contract between the M Company and B and C is, in substance, quite similar to the development contracts in connection with the other two groups of leases. The M Company was not to commence the well until the assignments to it were executed and delivered, although B and C's interest in the leases was still subject to the escrow above noted.

Drilling of the initial well was begun on April —, 1926, and completed on July —, 1926. As of July —, 1926, the S Company executed and delivered to the M Company a one-half interest in the lease, which assignment was recorded on July —, 1926, B and C received from the S Company the remaining undivided one-half interest in the lease.

From the foregoing statement of facts it is evident that the contracts and assignments underlying this case were varying forms of what are generally known as "free well" contracts. These are also known as undivided interest contracts, or "fifty-fifty" contracts. (Compare "The Law of Oil and Gas" by Mills and Wellingham, 1926 edition, page 321, section 226.)

Under arrangements of this nature a contract is entered into between the owner of an oil lease and an operating oil company, by the terms of which title to an undivided interest in the lease is agreed to be assigned to the oil company and the oil company agrees to pay a certain amount of cash and to operate the lease, either alone or with the assignor, and to bear the expense of drilling the first well (or the first two or three wells, as the case may be). The expense of drilling subsequent wells on the lease is shared jointly by the contracting parties in proportion to their several interests in the lease. It will be observed as a salient feature of these contracts that they are operating and development contracts, the consideration on the one part being the assignment of an undivided interest in a lease, and on the other part the drilling of one or more "free wells," plus, in some instances, an amount of cash paid by the assignee to the assignor, and then the subsequent operation at the joint expense of both parties.

This situation obtained in the instant case. The taxpayer entered into such contracts with several different individuals or groups, and with respect to several different leases or tracts. Since the facts in the three groups of leases differ, they will require separate consideration.

Taking up the first group of leases, it will be noted that in each instance the M Company entered into a contract with the owner of the lease, who, thereupon, by a separately executed instrument, assigned an undivided one-half interest in the lease to the M Company.

By the terms of these contracts the M Company agreed to pay a certain amount of cash (except in one or two instances) and to drill one, two, or three wells, free of cost to the other party, and thereafter to operate the lease at the joint expense of both parties. In each instance the assignment to the M Company was an absolute assignment, without condition, and the consideration, as set forth therein, was "one dollar (and other good and valuable considerations), the receipt of which is hereby acknowledged." In each instance the assignment was immediately recorded in the office of the proper county clerk. It appears to be the custom to do this in order to protect the operating company, in view of the fact that, under the terms of the contract, a very large outlay of money is required. In each instance the assignment was delivered before the well was begun.

In each of the contracts the M Company was to operate the lease, and all expenses after the first well (or two or three wells, as the case might be) were to be shared equally by both parties to the contract. Each party was to share in the oil runs.

From the foregoing it is apparent that the M Company, in getting an assignment of an undivided one-half interest in the lease before the drilling began, actually and immediately became the record owner of such assigned one-half interest.

This ownership was not postponed until the well was completed but dated from the time of the delivery of an unqualified assignment. In other words, when the M Company, after paying any cash required under the terms of the contract and after receiving delivery of an assignment, commenced drilling under the lease it was drilling on a bare undeveloped leasehold, owned jointly by it and the assignor.

In each of these cases the ownership of the one-half interest did not depend upon any contingency. When the M Company entered into a contract with the owner of the lease it required the owner to fulfill his part of the contract, namely, to assign outright an undivided one-half interest. The M Company, in turn, proceeded to fulfill its part of the contract, namely, pay whatever cash was required and to begin drilling. When it drilled it was drilling as much for its own interest as it was for that of the assignor. That is, when the consideration paid in fulfillment of the contract was cash and a well drilled free of cost to the other party, the other party did not own the whole well, nor did it own all of the equipment necessary for drilling the well. The assignor had only a one-half interest in the lease, and that one-half interest extended to everything on or connected with the lease, including the well and the equipment (except as reserved under the contract) and the oil produced from the well. In other words, when the M Company began drilling each of the stipulated wells it was drilling in each instance under a lease to which it had a right to a one-half interest previously perfected by assignment to it. For that reason, then, one-half of the intangible costs of drilling the initial well or wells was undoubtedly part of the expense of operating the M Company. Under the provisions of article 225, Regulations 65, or article 223, Regulations 69, such one-half of the intangible costs of drilling may, at the option of the M Company, be either deducted as an expense or capitalized. The restatement of the said articles in

Treasury Decision 4333, as above referred to, has not changed that right of the M Company.

In the second group of leases a lease was given to the M Company by the owner of the land, so that when drilling was begun the M Company apparently was the owner of the entire leasehold, or at least had an undivided leasehold interest in the land. It was drilling on land to which it had a right previously perfected by lease direct from the owner of the fee. When the well was completed the M Company assigned a part interest in the lease to A, with whom the M Company had the operating contract. In this case, likewise, the M Company's one-half of the intangible drilling costs may be capitalized or deducted as an expense, at the option of the M Company, under the provisions of the regulations referred to above.

A still different situation obtains in the case of the third group of leases.

In the third group of leases the leases were assigned by the S Company to B and C on condition that B and C would drill a test well to a given depth on one of the leases, but these assignments were placed in escrow to await the completion of the well. It was expressly stipulated that until this test well was completed B and C were to have no right or title in or to the lease. The next day B and C entered into an operating agreement with the M Company. This agreement was in many respects similar to the operating agreement in connection with the other groups of leases mentioned above. By this agreement the M Company was to drill a test well on the stipulated lease, free of cost to B and C. These individuals agreed to assign a one-half interest in the lease to be drilled, and also an entire interest in two other leases. All subsequent wells were to be drilled at the joint expense of both parties to the agreement. The M Company was to operate the lease. B and C were to contribute a certain amount of cash (payable out of the oil from the well if it was a producer) and to pay one-half of the cost of the derrick and of the casing (if the well was a producer). In this agreement B and C, alleging that they were owners of the lease, agreed to assign to the M Company a one-half interest in the lease on which the test well was to be drilled, and to make this assignment before the well was started. But this could not be done since they did not, as yet, have title to the lease, inasmuch as the assignment of the lease to them from the S Company was in escrow awaiting completion of the well.

It follows that the M Company when it drilled the well did not own an interest in the lease. Deriving its title to the one-half interest from B and C, the M Company did not have title greater than that of B and C. In other words, the M Company's title to the one-half interest was contingent on its completing the well, and the drilling of the well was part consideration for the assignment to the M Company of a one-half interest in a developed lease. Since this title rested on a contingency, and since the M Company could not get title until the well was completed, and since it was drilling under a lease which was not the M Company's but which it expected to own in common with B and C as a developed leasehold after the well was completed, the intangible costs of such drilling can not be regarded as expenses of operation of the M Company, but as consideration, in whole or

in part, for a one-half interest in a developed leasehold. This aspect of the case would seem to bring this well within General Counsel's Memorandum 932 (C. B. VI–1, 241), wherein it was stated in part as follows:

When the well was completed, on which contingency the assignee-taxpayer's right depended, it then had not a half interest in a bare leasehold plus a half interest in an oil well, but an undivided one-half interest in a developed leasehold. This it in effect acquired by the expenditure of $4x$ dollars in developing the lease, and therefore that entire sum should be capitalized as the cost to it of its new interest in a producing leasehold. Drilling costs may well be ordinarily properly deducted as operating expenses by a taxpayer where the development is one of a previously perfected right, but here these very drilling costs constitute the consideration for the acquisition of the producing rights and can be nothing else but capital investment, returnable by way of depletion against production. * * *

For the reasons set forth above, the intangible costs of drilling the test well in the third group of leases constituted a capital investment and not a deductible expense.

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

ARTICLE 223: Charges to capital and to expense in the case of oil and gas wells. XI–51–5934 Ct. D. 612

INCOME TAX—REVENUE ACT OF 1926—DECISION OF COURT.

1. DEDUCTION—DEPLETION—DEPRECIATION—COST OF DRILLING OIL WELLS.

Where a taxpayer exercises the option under article 223 of Income Tax Regulations 69 to charge to capital account returnable through depletion the cost of drilling oil wells and of hauling and placing equipment in the wells, amounts expended representing such cost are recoverable under the Revenue Act of 1926 through depletion rather than depreciation.

2. DECISION REVERSED.

The decision of the Board of Tax Appeals (23 B. T. A., 890) is reversed.

UNITED STATES CIRCUIT COURT OF APPEALS, FOURTH CIRCUIT.

David Burnet, Commissioner of Internal Revenue, petitioner, v. *Petroleum Exploration, respondent.*

On petition to review the decision of the United States Board of Tax Appeals.

Before NORTHCOTT and SOPER, Circuit Judges, and GLENN, District Judge.

[October 3, 1932.]

OPINION.

NORTHCOTT, Circuit Judge: This is a petition to review a decision of the United States Board of Tax Appeals reported in 23 B. T. A., 890.

The pertinent facts, about which there is no dispute, as found by the Board of Tax Appeals, are as follows:

"The petitioner (the taxpayer) is a corporation organized on September 25, 1916, under the laws of the State of Maine, and its principal office is at Sistersville, W. Va.

* * * * * * *

"The parties hereto have submitted the following stipulation of facts:

"'1. On December 31, 1924, the undepreciated investment of Petroleum Exploration in equipment in oil wells amounted to $475,975.02.

"'2. During the years 1925, 1926, and 1927 Petroleum Exploration capitalized on its books of account the total cost of new productive oil wells drilled, such charges representing amounts paid for equipment put into the wells, amounts paid to drilling contractors for drilling the wells, amounts paid for freight and haulage of the equipment, and amounts paid for labor in installing the equipment in the wells, as follows:

Year.	Cost of equipment.	Cost of drilling wells, hauling and placing equipment.	Total cost of completed producing wells.
1925	$121,303.03	$49,640.17	$170,943.20
1926	15,882.88	52,994.14	68,887.02
1927	56,626.31	2,659.26	59,285.57

"'3. The productive life of all producing wells, the total cost of which was capitalized as shown in paragraph No. 2 is more than one year.

"'4. Depreciation has been claimed by the petitioner and allowed by the Commissioner at a unit production rate, based on the length of life of the oil deposits.

"'5. The Commissioner, in making his computation of depreciation, has added to his depreciation schedules the cost of the equipment added each year, as shown in paragraph No. 2, but has not added the cost of drilling wells, hauling and placing the equipment.

"'6. Instead, the cost of drilling wells, hauling and placing the equipment, as shown in paragraph No. 2, has been added to the cost depletion schedules by the Commissioner; but depletion has been allowed on a statutory percentage basis (27½ per cent of gross income, not to exceed 50 per cent of net income) and is not based on cost.

"'7. The petitioner, in making its computation of depreciation as shown in its "Form O," has added the total cost of completed wells, including equipment, drilling, hauling and placing the equipment, to its depreciation schedules, no part of the cost of the wells being added to the cost depletion schedules.

"'8. If petitioner's method of computing depreciation be sustained by the Board, namely, by adding to the undepreciated investment shown in paragraph No. 1 the total cost of completed wells as shown in paragraph No. 2 (no part of such cost being added to the depletion schedules) an increase in the depreciation allowance will result as follows:

"'*Depreciation allowance.*

Year.	Computed by Commissioner's method.	Computed by petitioner's method.	Increase in depreciation allowance if petitioner's method be sustained.
1925	$82,826.35	$89,369.57	$6,543.22
1926	68,105.24	78,192.46	10,087.22
1927	66,015.91	75,161.03	9,145.12

"'9. If petitioner's method of computing depreciation be sustained, as shown in paragraph No. 8, a decrease in the depletion allowance will result as follows:

"'*Depletion allowance.*

Year.	Computed by Commissioner's method.	Computed by petitioner's method.	Decrease in depletion allowance if petitioner's method be sustained.
1925	$302,012.87	$300,860.43	$1,152.44
1926	277,900.70	275,191.94	2,708.76
1927	168,874.41	167,486.55	1,387.86

The statutes and Treasury regulations involved are:
Revenue Act of 1926 (ch. 27, 44 Stat., 9):

"SEC. 204. (c) The basis upon which depletion, exhaustion, wear and tear, and obsolescence are to be allowed in respect of any property shall be the same as is provided in subdivision (a) or (b) for the purpose of determining the gain or loss upon the sale or other disposition of such property, except that—

* * * * * * *

"(2) In the case of oil and gas wells the allowance for depletion shall be 27½ per centum of the gross income from the property during the taxable year. Such allowance shall not exceed 50 per centum of the net income of the taxpayer (computed without allowance for depletion) from the property, except that in no case shall the depletion allowance be less than it would be if computed without reference to this paragraph.

"SEC. 234. (a) 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 mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion and for depreciation of improvements, according to the peculiar conditions in each case; such reasonable allowance in all cases to be made under rules and regulations to be prescribed by the Commissioner with the approval of the Secretary. In the case of leases the deductions allowed by this paragraph shall be equitably apportioned between the lessor and lessee; * * *."

Treasury Regulations 69:

"ART. 221. *Depletion in the case of oil and gas wells.*—Under section 204(c)2, in the case of oil and gas wells, a taxpayer may deduct for depletion an amount equal to 27½ per cent of the gross income from the property during the taxable year, but such deduction shall not exceed 50 per cent of the net income of the taxpayer (computed without allowance for depletion) from the property. In no case shall the deduction computed under this paragraph be less than it would be if computed upon the basis of the cost of the property, or its value at the basic date, as the case may be. In general, "the property," as the term is used in section 204(c)2 and this article, refers to the separate tracts or leases of the taxpayer.

"ART. 223. *Charges to capital and to expense in case of oil and gas wells.*—Such incidental expenses as are paid for wages, fuel, repairs, hauling, etc., in connection with the exploration of the property, drilling of wells, building of pipe lines, and development of the property may at the option of the taxpayer be deducted as a development expense or charged to capital account returnable through depletion. If in exercising this option the taxpayer charges these incidental expenses to capital account, in so far as such expense is represented by physical property it may be taken into account in determining a reasonable allowance for depreciation. The cost of drilling nonproductive wells may at the option of the operator be deducted from gross income as a development expense or charged to capital account returnable through depletion and depreciation as in the case of productive wells. An election once made under the provisions of this article 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.

"ART. 225. *Depreciation of improvements in the case of oil and gas wells.*—Both owners and lessees operating oil and/or gas properties will, in addition to and apart from the deduction allowable for depletion as hereinbefore provided, be permitted to deduct a reasonable allowance for depreciation of physical property, such as machinery, tools, equipment, pipes, etc., so far as not in conflict with the option exercised by the taxpayer under article 223. The amount deductible on this account shall be such an amount based upon its cost or other basis equitably distributed over its useful life as will bring such property to its true salvage value when no longer useful for the purpose for which such property

was acquired. Accordingly, where it can be shown to the satisfaction of the Commissioner that the reasonable expectation of the economic life of the oil or gas deposit with which the property is connected is shorter than the normal useful life of the physical property, the amount annually deductible for depreciation on such property may be based upon the length of life of the deposit."

The sole question presented is whether the capitalized cost of drilling oil wells and of hauling and placing equipment in the wells is recoverable through allowances for depreciation or depletion. The Commissioner of Internal Revenue determined that this cost was properly recoverable through an allowance for depletion. Upon hearing before the Board of Tax Appeals this determination of the Commissioner was reversed.

The Treasury regulations cited above are authorized by Congress, and while the Secretary of the Treasury can not by a regulation alter or amend the law (*South Carolina Produce Ass'n* v. *Commissioner*, 50 Fed. (2d), 742), if within and in accordance with the Acts of Congress such regulations have all the force and effect of statutes. (*Burnet* v. *Moore Cotton Mills Co.*, 49 Fed. (2d), 59, and authorities there cited; *Brewster* v. *Gage*, 280 U. S., 327 [Ct. D. 148, C. B. IX–1, 274]; *Fawcus Machine Co.* v. *United States*, 282 U. S., 375 [Ct. D. 278, C. B. X–1, 424].)

It has been repeatedly held by this court, and there is no authority to the contrary, that the action of the Commissioner of Internal Revenue in determining a tax assessment is *prima facie* correct, and the burden is on the objecting taxpayer to show the action of the Commissioner to be erroneous. (*Lehman* v. *Tait*, 58 Fed. (2d), 20, and authorities there cited.)

Here the taxpayer was given the option under the provisions of article 223 of Regulations 69 to either charge the expenditures in question to development expense or charge them to capital account *returnable through depletion*. [Italics ours.] This option was exercised by the taxpayer by charging the expenditures to capital account, and by so acting the taxpayer must have done so with the full knowledge that such sums so charged must come back through depletion and not depreciation. This is the plain provision of the regulation.

It is true that article 225 of Regulations 69 permits an allowance for depreciation of physical property, but only so far as not to conflict with the option exercised by the taxpayer as to charging such expenditures to capital account, and such allowance is given only for such physical property as "machinery, tools, equipment, pipes, etc." The hole of an oil well itself certainly would not come within this classification, and could not be held to be physical property.

We are here concerned with the cost of putting down the hole through which oil is recovered from under the ground. In the oil well the hole in the ground performs a function, with respect to the oil brought out of the well, similar to that performed by the shaft or tunnel in a mine with respect to the ore brought out of the ground. Neither the shaft nor the hole can be, strictly speaking, termed improvements. They simply serve as conduits through which the mineral is recovered. The bare hole in an oil well does not deteriorate or depreciate as does a piece of machinery or as does the casing with which it is lined, and has no service life other than the period necessary to exhaust the body of the mineral which it reaches. Once the mineral is exhausted the hole is useless and of no value whatever, such as may be possessed by the casing which may be pulled or the machinery which may be removed to be used elsewhere. It seems to us that the proper and logical method of returning to the taxpayer the expense of drilling the hole is through depletion rather than depreciation, this, entirely aside from the implied agreement to accept depletion when the taxpayer exercised the option to charge the expense to capital account.

The allowance for depletion was intended by Congress to restore to the taxpayer his capital investment with respect to the oil and gas wells as that investment is used up or exhausted.

In *Lynch, Executrix*, v. *Alworth-Stephens Co.* (267 U. S., 364 [T. D. 3690, C. B. IV–1, 162]) the Supreme Court said:

"It is said that the depletion allowance applies to the physical exhaustion of the ore deposits, and since the title thereto is in the lessor, he alone is entitled to make the deduction. But the fallacy in the syllogism is plain. The deduction for depletion in the case of mines is a special application of the general rule of the statute allowing a deduction for exhaustion of property. While respondent does not own the ore deposits, its right to mine and remove the ore and reduce it to possession and ownership is property within the meaning of the general provision. Obviously, as the process goes on, this property

interest of the lessee in the mines is lessened from year to year, as the owner's property interest in the same mines is likewise lessened. There is an exhaustion of property in the one case as in the other. * * *"

If the cost of the hole is included in depreciation allowances as well as cost of machinery, tools, etc., which have a service life in no way connected with or dependent upon the length of time it takes to exhaust the mineral, then there is no expense whatever connected with an oil well left to be returned through depletion, and the regulation (article 223) is robbed of any meaning, except as to the exploration of the property.

In *Burnet* v. *Thompson Oil & Gas Co.* (283 U. S., 201 [Ct. D. 331, C. B. X–1, 390]), the court said:

"It is clear that Congress intended that the lessee of an oil well should be entitled to a reasonable allowance for depletion based upon cost or March 1, 1913, value. It did not, however, attempt to prescribe a formula for ascertaining it, but expressly delegated that function to the Commissioner of Internal Revenue, who was to make rules and regulations to that end. Pursuant to this authority, regulations were made, which required the deduction of depletion theretofore sustained in ascertaining the capital remaining in any year recoverable by depletion deductions. * * *

"The decision in the Ludey case (*United States* v. *Ludey*, 274 U. S., 295 [T. D. 4046, C. B. VI–2, 157]) has been adopted in the later statutes as affecting sales of capital assets, but the provision for annual depletion allowance has remained substantially unchanged. This in itself is persuasive evidence that Congress has approved the executive construction embodied in the regulations."

The long and consistent administrative construction, especially when it is, as here, clearly an admissible one and consistent with the purpose of the statute, should not be set aside unless plainly wrong. (*Universal Battery Co.* v. *United States*, 281 U. S., 580 [Ct. D. 220, C. B. IX–2, 422]; *Fawcus Machine Co.* v. *United States*, 282 U. S., 375 [supra]; *Williams* v. *Burnet, Commissioner*, 59 Fed. (2d), 357.)

A consideration of this question leads to the conclusion that the elements calling for both depletion and depreciation are present in an oil well. The outlay for geological study and survey is directly connected with the location or discovery of the oil deposit, and would seem to be not subject in any way to depreciation, but should be allowed under depletion when capitalized. So with the hole in the ground. It can not be withdrawn or inventoried as having any independent value or resold as may be done with casing, tools or machinery. As the wages for labor and other expenses in connection with the transportation and work of a geologist in prospecting an oil field are a part of the cost of discovery or development so the wages for labor in drilling a well are such a part of the cost of discovery or development as are not susceptible of depreciation.

Section 204 of the Act of 1926, above set out, provides for "depletion and for depreciation of improvements," and goes on to leave the rules and regulations to be prescribed "by the Commissioner with the approval of the Secretary." Such rules and regulations have been prescribed and are apparently reasonable and just. Under these regulations, the cost of the drill hole of an oil well, and as it seems to us to be natural, is not subject to depreciation, but, should be allowed for, especially when capitalized, under the head of depletion.

The Board of Tax Appeals rests its decision in the instant case on its decision in the case of *A. T. Jergens Trust Co.* (22 B. T. A., 551), where a similar question was presented; and the Court of Claims in the recent case of *Dakota-Montana Oil Co.* v. *United States* (decided July 5, 1932), has by a majority opinion reached the same conclusion as the Board. We are, however, of the opinion that the regulations are reasonable and having been in force for a long time they should be sustained, particularly where the taxpayer, as in this case, availed itself of the identical regulations to capitalize expenditures for intangibles, thus accepting the provision that such expenditures should be returned through allowances for depletion. The taxpayer can not accept the benefits of the regulation and reject the accompanying obligation.

In conclusion we wish to say that if any of the expense of wages, hauling, etc., in connection with the casing, operating tools, machinery, etc., are included in the Commissioner's allowance for depletion it is our opinion that such expense should be depreciated. It is impossible for us to tell from the record the fact as to this question, but, as to allowances for all expense of putting

down the drill hole the Commissioner was right in making such allowances under the head of depletion. It follows that the decision of the Board of Tax Appeals must be reversed.

ARTICLE 223: Charges to capital and to expense in the case of oil and gas wells.

REVENUE ACT OF 1924.

Intangible cost of drilling group of oil wells for acquisition of one-half interest in underlying oil lease. (See G. C. M. 10686, page 257.)

SECTION 214(a)10.—DEDUCTIONS ALLOWED INDIVIDUALS: CONTRIBUTIONS OR GIFTS.

ARTICLE 251: Contributions or gifts.

REVENUE ACT OF 1926.

Contributions to nonpartisan scientific agency of citizens' inquiries for promotion of better government. (See I. T. 2654, page 39.)

ARTICLE 251: Contributions or gifts. XI–52–5948
G. C. M. 11324

REVENUE ACTS OF 1918, 1921, AND 1924.

In determining net income for the purpose of computing the amount of charitable contributions allowable as deductions under section 214(a)11 of the Revenue Acts of 1918 and 1921, capital losses can not be excluded.

In *Hallie D. Elkins* v. *Commissioner* (24 B. T. A., 572, page 8, this bulletin) the Board of Tax Appeals concluded that a taxpayer was entitled to disregard a capital net loss in arriving at the net income upon which the 15 per cent deduction authorized under section 214(a)10 of the Revenue Act of 1924 was computed.

Recommended that I. T. 2104 (C. B. III–2, 152) be modified.

In I. T. 2104 it was held that inasmuch as losses resulting from the sale or exchange of capital assets are deductible under section 214 of the Revenue Acts of 1918, 1921, and 1924, and enter into the computation of the net loss that is deductible under section 206 of the Revenue Act of 1924, such losses can not be excluded in computing the net income for the purpose of determining the amount of charitable contributions that are deductible under section 214(a)11 of the Revenue Acts of 1918 and 1921 and section 214(a)10 of the Revenue Act of 1924.

In *Hallie D. Elkins* v. *Commissioner* the Board of Tax Appeals concluded that a taxpayer was entitled to disregard a capital net loss in arriving at the net income upon which the 15 per cent deduction authorized under section 214(a)10 of the Revenue Act of 1924 was computed.

It is apparent, therefore, that the conclusion reached in the Elkins case is inconsistent with that reached in I. T. 2104 in so far as cases arising under the Revenue Act of 1924 are concerned. The acquiescence of the Commissioner in the Elkins decision presents for determination the question whether that decision or I. T. 2104 should be followed in cases arising under the Revenue Acts of 1918 and 1921.

In the Elkins case the Board stated in part as follows:

The Revenue Acts of 1918 and 1921 contain no provision similar to section 208(c) of the 1924 Act, and capital losses, if deductible, are deductible under section 214 of those two prior Acts, and we may say, without deciding, that the ruling seems to be a correct interpretation of the 1918 and 1921 Acts. * * *

In view of the foregoing it is the opinion of this office that the statutory structure of the Revenue Acts of 1918 and 1921 requires that the principle of I. T. 2104 be followed in determining the net income upon which the deduction authorized by section 214(a)11 of the Revenue Acts of 1918 and 1921 is computed.

It is therefore recommended that I. T. 2104 be modified accordingly. (See Mim. 3986, on page 29.)

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

ARTICLE 251: Contributions or gifts. XI–52–5951
I. T. 2668

REVENUE ACT OF 1924.

In view of the conclusion of the Board of Tax Appeals in *Hallie D. Elkins* v. *Commissioner* (24 B. T. A., 572, page 3, this bulletin) and General Counsel's Memorandum 11324 (see on page 267), I. T. 2104 (C. B. III–2, 152) is modified, in so far as it holds that capital losses can not be excluded in computing net income for the purpose of determining the amount deductible for charitable contributions under the Revenue Act of 1924.

SECTION 215.—ITEMS NOT DEDUCTIBLE.

ARTICLE 291: Personal and family expenses.

REVENUE ACT OF 1926.

Legal services in opposing unsuccessfully probate of will. (See Ct. D. 534, page 249.)

ARTICLE 291: Personal and family expenses. XI–34–5626
(Also Section 214(a)1, Article 101.) Ct. D. 542

INCOME TAX—REVENUE ACT OF 1924—DECISION OF COURT.

1. DEDUCTION — BUSINESS EXPENSE — PERSONAL EXPENSE — LEGAL EXPENSE—SLANDER OF CONTROLLING STOCKHOLDER OF CORPORATION.

Legal expenses incurred by the president, general manager, and controlling stockholder of a corporation in the successful prosecution of a suit for slander, the judgment in which is uncollectible, instituted by him in order to protect his reputation and the corporation's business from possible injury, are a personal expense within the meaning of section 215(a)1 of the Revenue Act of 1924 and are not allowable as a deduction as a business expense under section 214(a)1 of that Act.

2. DECISION AFFIRMED.

The decision of the Board of Tax Appeals (22 B. T. A., 674) is affirmed.

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

Ernest E. Lloyd, petitioner, v. *Commissioner of Internal Revenue, respondent.*

Petition for review of decision of United States Board of Tax Appeals.

Before EVANS and SPARKS, Circuit Judges, and BALTZELL, District Judge.

[February 8, 1932.]

OPINION.

BALTZELL, District Judge: The petitioner was, during the year 1924, and for many years prior thereto had been, a resident of the city of Chicago, Ill. He was president and general manager of the E. E. Lloyd Paper Co. during all of the time in question, owning a majority of the stock of that company. In the month of February, 1924, petitioner attended the annual conventions of the American Pulp and Paper Association and the Jobbers and Merchants Association in New York City. While attending these conventions, he learned that one W. T. P. Wardrop, of Boston, Mass., was circulating false statements and derogatory remarks concerning his reputation and character for integrity, reliability and sobriety, and that these statements and remarks were being brought to the attention of his customers and competitors.

In order to protect his reputation and incidentally to protect the business of the E. E. Lloyd Paper Co., petitioner filed a suit for damages for slander against Wardrop in the Circuit Court of Suffolk County, Mass., knowing at the time the suit was filed that any judgment that might be rendered in his favor would be uncollectible. As a result of this suit, he recovered judgment against Wardrop, but never realized anything thereon. In connection with this suit he expended the sum of $2,810.65 during the year 1924 for attorneys' fees and expenses, which sum was deducted by him in determining his taxable income for that year. Respondent disallowed this deduction and determined a deficiency income tax for the year 1924 in the sum of $604.56. This determination was approved by the Board of Tax Appeals, from which decision this appeal was prosecuted.

The question presented is whether or not the attorneys' fees paid and the expenses incurred by petitioner in the prosecution of this slander suit are deductible as ordinary and necessary expenses of his trade or business in computing his net income for the year 1924.

Section 214(a) of the Revenue Act of 1924 provides that in computing net income 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, * * *."

Section 215(a) of the above Act provides that in computing net income no deduction shall in any case be allowed in respect of—

"(1) Personal, living, or family expenses."

It is the contention of petitioner that he is entitled, under section 214(a), in computing his net income for the year 1924, to deduct the amount paid by him for attorneys' fees and expenses in the aforementioned slander suit as an "ordinary and necessary expense paid or incurred" in carrying on his business. The respondent contends that such expenditures were purely personal and come within the provisions of section 215(a), and are, therefore, not deductible.

It is apparent that the Revenue Act does not permit a taxpayer to deduct from his gross income all losses sustained by him during any given year in determining his net or taxable income. Such losses or expenditures as are permitted to be deducted are purely statutory. A taxpayer, in making his tax return, has no right to any deductions from his gross income unless such deductions are provided for by the revenue statute. (*Lynch* v. *Alworth-Stephens Co.*, 267 U. S., 364; 69 L. Ed., 660; 45 S. Ct., 274 [T. D. 3690, C. B. IV–1, 162]; *Goldfield Consol. Mines Co.* v. *Scott*, 247 U. S., 126; 62 L. Ed., 1022; 38 S. Ct., 465; *Von Baumbach* v. *Sargent Land Co. et al.*, 242 U. S., 503; 61 L. Ed., 460; 37 S. Ct., 201.)

If, therefore, the attorneys' fees and expenses paid by petitioner are ordinary and necessary expenses incurred by him in carrying on his business, then, under section 214(a), he is entitled to have such payments deducted. In order that such payments may meet the requirements of the statute, they must be both an *ordinary* expense and a *necessary* expense. (*Hubinger* v. *Commr. of Int. Rev.* (C. C. A. 2), 36 F. (2d), 724.)

There can be no doubt that the slanderous reports circulated by Wardrop were such as would tend to blacken the character or reputation of petitioner. This was a personal injury, however, and one for which, under the law, he was entitled to recover damages. The suit was not instituted by the corporation of which he was president, but by petitioner himself. In practically every case where slanderous reports are circulated about an individual and damage his character or reputation, such reports affect indirectly, and, to a certain extent, the business in which he is engaged. Any expense, however, incurred by him in defending his good name under such circumstances, can not be said to be *ordinary and necessary expenses incurred in carrying on his business.*

Slander has been defined to be "words falsely spoken, which are injurious to the reputation of another." (Bouvier Law Dictionary.) This definition indicates that when the slanderous words spoken are about the reputation of an individual such individual himself is the one who suffers the injury. Any damages recovered for such injury is recovered by the individual. Applying this rule to the instant case, the injuries were suffered by the petitioner, and had he collected the amount of the judgment, such sum would have been his own private property and would have had no connection whatsoever with his business. The E. E. Lloyd Paper Co. neither profited nor lost by the suit. The fact that petitioner was unable to collect the judgment which he recovered does not alter or change the situation.

The expenses incurred in the prosecution of the slander suit were not *ordinary and necessary expenses incurred in carrying on his business,* and he was, therefore, not entitled to deduct the amount thereof in determining his net income for the year 1924, under section 214(a). Such expenses were personal and fall within the provision of section 215(a).

The decision of the Board of Tax Appeals is affirmed.

ARTICLE 292: Capital expenditures.

REVENUE ACT OF 1926.

Commission for negotiating a long-term lease. (See Ct. D. 598, page 243.)

SECTION 217.—NET INCOME OF NONRESIDENT ALIEN INDIVIDUALS.

ARTICLE 320: Compensation for labor or personal services. XI-27-5536 Ct. D. 512

INCOME TAX—REVENUE ACT OF 1918—DECISION OF COURT.

INCOME—SOURCES WITHIN THE UNITED STATES—NONRESIDENT ALIEN.

Where a nonresident alien professional singer makes two contracts in the United States with a domestic corporation doing business there under which he sings in the United States for the purpose of enabling the corporation to make phonograph records of selections rendered by him and is paid compensation in the United States by the corporation at a fixed sum for each record sold or a percentage of the list price of the records sold, the first contract providing that he agrees "to make these records" and the second that he "grants all rights in and to" the matrices and records to the corporation, the contracts are only for personal services. The gross income received by the singer from the sale of records in foreign countries by foreign corporations, pursuant to contracts under which the domestic corporation furnished matrices of its selections and the foreign corporations were obliged to pay the domestic corporation all royalties which it was required to pay the singer, is gross income from sources within the United States within the meaning of section 213(c) of the Revenue Act of 1918.

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

Dorothy Caruso Ingram, Formerly Dorothy P. B. Caruso, Ancillary Administratrix of the goods, chattels and credits of Enrico Caruso, Deceased, appellant, v. *Frank C. Bowers, as Executor of the Estate of Frank K. Bowers, Deceased, appellee.*

Appeal from a judgment of the District Court for the Southern District of New York.

[March 21, 1932.]

OPINION.

L. HAND, Circuit Judge: The plaintiff is the widow and ancillary administratrix of the singer, Caruso, who during his life paid the sums at issue in discharge of deficiency assessments of income taxes for the years 1918, 1919, and 1920. She sued to recover these; the case was tried before a jury of one, and the judge directed a verdict for the defendant at the end of the evidence and wrote an opinion stating the facts in detail. (*Ingram* v. *Bowers*, 47 Fed. (2d), 975 [Ct. D. 306, C. B. X–1, 372].) We adopt his statement, and refer to it as the premise of our discussion.

The case turns upon the meaning of the phrase, "gross income from sources within the United States," as used in section 213(8) of the Revenue Act of 1918; for we assume arguendo that, as the judge found, Caruso was a non-resident alien. If his agreements with the Victor company were no more than contracts for personal services, it makes no difference whether we hold, as was held below, that the source of the resulting income was the services rendered, or the promise to pay the royalties. The first has the authority of a departmental ruling (C. B., Dec., 1920, page 128), and whatever inferences may be drawn from the amendments in the statutes from 1921 forward (section 217(a)3 of the Acts of 1921, 1924, and 1926; section 119(a)3 of 1928). On the other hand we find it difficult to distinguish *Edwards* v. *Keith* (231 Fed. Rep., 110 (C. C. A. 2), and *Woods* v. *Llewellyn* (263 Fed. Rep., 106 (C. C. A. 3). A priori, the source of an income would seem to be determined by the same factor, whether time or place be in question; that if that source is the consideration for the promise, and not the promise itself, the return for services rendered before any tax was imposed would not be a gain from any taxable source. However, we are not driven to a decision on this point, because if the source is the promise, the promisor was also within the United States, and the same result follows as though the service was the source.

The more vital question is whether the contracts were for more than personal services; whether they gave to Caruso some interest in the matrices and records, or, if there was any copyright, in the copyright, and whether the payment can in this wise be looked at as emanating from property. If so, the plaintiff argues, the sums in suit came from the foreign matrices; if not, then at least from the foreign companies. As to both matrices and records the second contract is too clear for question; it provides that Caruso "grants all rights in and to" them. The first contract contained no such words, but we think that the result was the same. In it he only agreed "to make these records," meaning of course, to sing into the recording apparatus, and the Victor company, to pay him a royalty as records made from the resulting matrices were sold. The company was to manufacture both; prima facie they became its chattels like anything else of its make. If it was intended to give Caruso an interest in them, some such reservation was to be expected, and there was none. The fact that his return was called a royalty is immaterial; it was so described in the second contract which was not equivocal. No remedy was created by which he could assert any such rights. It appears to us that the purpose was the same as was expressed later, and if so, he had no proprietary interest in the profits arising out of the records. If there be a copyright under section 1(e) of the Copyright Act—which we do not say—it became embodied in the matrices, as a literary composition is embodied in its text. Any putative monopoly would do no more than prevent the copying of these, and it passed with the property in them. It was not impliedly reserved separate from them, for that would have interfered with their full enjoyment which the manufacturer was certainly to have.

Nor can we see how the source of the payments could be the royalties paid by the foreign companies to the Victor company. They did not promise to

pay Caruso, or to assume the obligations of the company. Whether in the event of its insolvency, he could have had recourse to their promise is beside the mark. Assuming as much, it would be only as security for the Victor company's performance, and that would not change the source of the income while it continued to perform. For argument we may even assume the contrary after default; it never did default; all the payments here in question came from it. This would be equally true, though by a long stretch we were to assimilate the situation to that in *In Re Waterson Berlin & Snyder Co.* (48 Fed. (2d), 704 (C. C. A. 2)), and hold that Caruso had a lien upon the matrices sent to the foreign companies. That would again be only as security, for, under the doctrine of that decision, the second assignee does not, by accepting the transfer, become personally liable on the promise of the first. As long as the first assignee performs, the assignor's rights against the second remain in abeyance; if he defaults, they are against the property alone. Thus, on no theory can it be said that the source of this income was outside the United States.

Judgment affirmed.

SECTION 218.—PARTNERSHIPS.

ARTICLE 336: Distributive shares of partners. XI–44–5821
Ct. D. 593

INCOME TAX—REVENUE ACT OF 1921—DECISION OF COURT.

INCOME—ASSIGNMENT OF FUTURE INCOME.

An instrument, by which a member of a partnership in liquidation transfers to B a part of his interest in and to the profits and all other moneys and benefits to be derived and realized from the partnership business which shall be received on and after the date of the instrument, merely assigns future income without any actual transfer of the property from which the income is derived and the distributive share of the partner in the partnership income which is received by B by virtue of the instrument is income of the partner.

UNITED STATES DISTRICT COURT, SOUTHERN DISTRICT OF NEW YORK.

Emerson E. Rossmoore, plaintiff, v. *Charles W. Anderson, Collector of Internal Revenue, defendant.*

[July 6, 1932.]

OPINION.

COXE, D. J.: This is an action to recover $34,876.70, paid under protest September 22, 1927, on account of additional income taxes of $27,882.77, assessed against the plaintiff for 1921, together with interest of $6,993.93 to the date of payment. The facts have all been stipulated; and the issue is purely one of law.

The plaintiff was one of three members of the firm of Rossmoore & Abbott, engaged in the accounting business in New York City. On November 1, 1920, the three partners signed a dissolution agreement providing that no new business should be undertaken, and for the completion and liquidation of the pending commitments. This agreement constituted the plaintiff liquidator of the business at a compensation of $12,000 for his entire services; it specified that the cash on hand, amounting to $70,732.92, including capital contributions, should forthwith be distributed, except for a $5,000 reserve for disbursements; and it further provided that upon completion of the liquidation the firm name should cease to be used.

By January 3, 1921, the sole assets of the firm, exclusive of office furniture and supplies, and of the disbursement reserve, consisted of (1) moneys receivable for services rendered by the firm prior thereto; and (2) moneys to become due for services by reason of the completion of service contracts on hand on that date.

On January 3, 1921, the plaintiff executed and delivered to his wife, Sarah Rossmoore, a written instrument by which he transferred to her individually, one-third, and to her, as trustee for their two minor children, the remaining two-thirds of "all his right, title and interest, in and to the profits, and any and all other moneys, advantages, interests and benefits to be derived and realized from and out of the said partnership business now in liquidation, which shall be received on and after the date hereof," exclusive of the $5,000 reserve and the $12,000 to be paid the plaintiff for his services as liquidator. The trusteeship with respect to the fund for the children was subsequently taken over by the plaintiff. The instrument of transfer contains, however, no provisions for revocation, and is by its terms absolute.

During the liquidation, Sarah Rossmoore individually and as trustee for the two children received in 1921 $54,259.86, representing the distributive share of the plaintiff in the firm income for that year, and she returned as income the amounts so received, and paid taxes thereon. The plaintiff in his individual return for 1921 reported the amount of his compensation as liquidator received in that year, but did not return anything representing his distributive share in the firm, it being his contention that the assignment to his wife effectively transferred to her, individually and as trustee, his entire interest in the firm in liquidation, and that the amount distributed in 1921 was in no sense income to him. The Commissioner, on the other hand, disregarded for tax purposes the transfer of January 3, 1921, and assessed to the plaintiff, as his individual income, the entire amount distributed in 1921 on account of the plaintiff's interest in the firm. It is to recover the additional tax due to the inclusion of these amounts in the plaintiff's return, together with the interest thereon, that this action has been brought.

Section 52 of the New York partnership law provides that "a partner's interest in the partnership is his share of the profits and surplus and the same is personal property." This was also true under the common law. (*Blodgett* v. *Silberman*, 277 U. S., 1.) It is further provided in section 53 of the New York act that "a conveyance by a partner of his interest in the partnership does not of itself dissolve the partnership * * *; but it merely entitles the assignee to receive in accordance with his contract the profits to which the assigning partner would otherwise be entitled." This modified the common law rule with respect to partnerships in general (*Meinhard* v. *Salmon*, 249 N. Y., 458, 471); but the "conveyance" mentioned in the statute gives no interest in the firm assets as such, and, during the continuation of the partnership, is ineffective to remove from the transferring partner his income tax burden on subsequent profits. (*Mitchell* v. *Bowers*, 15 Fed. (2d), 287 [T. D. 3982, C. B. VI–1, 244]; *Harris* v. *Commissioner*, 39 Fed. (2d), 546.)

Is the situation different by reason of the execution of the liquidating agreement of November 1, 1920? This agreement is referred to in the stipulation as "a dissolution agreement," and although counsel for the Government appeared to contest that designation on the trial, I have no reason to doubt that the agreement actually worked a dissolution of the partnership. But even on dissolution, a partnership is deemed to continue for the purposes of winding up; and under the terms of the present agreement, the unfinished business of the partnership consisted largely of contracts upon which additional accounting services were to be performed before the amounts payable to the firm could be realized. This was necessarily so because of the extremely personal nature of the business; and the fact that it took until 1927 to complete the liquidation, indicates that the "profits" in which the plaintiff had an interest were principally those to be made in the future through the personal efforts of the plaintiff and those connected with the firm rather than such as might be realized from finished business. The agreement was in the nature of an arrangement for a continuation of the business under the plaintiff's management with a limitation on his authority to undertake new work; and I do not think it had any material effect on the tax liability of the individual partners in so far as future income from partnership business was concerned.

I am satisfied also that the transfer of January 3, 1929, merely assigned future income without any actual transfer of the property from which this income was to be derived. It is, as aptly stated by Mr. Justice Holmes in *Lucas* v. *Earl* (281 U. S., 111), a case where "the fruits are attributed to a different tree from that on which they grew." (See also *Burnet* v. *Leininger*, 285 U. S., 136.) The transfer by the plaintiff was of his interest "in and to the profits and any and all other moneys, advantages, interests and benefits *to be* derived and realized" * * * "which *shall be* received on and after the date hereof,"

indicating clearly that the intention was only to transfer whatever the plaintiff might be entitled to at some subsequent date from the earnings which had not then been made, and profits which could only be realized from future operations of the business.

The cases cited by the plaintiff in support of his contention are not analogous, as they concern transfers of property, together with the income resulting therefrom; whereas in the present case the plaintiff's interest in the partnership, even in liquidation, was only his share in the profits and surplus after the accounting (New York partnership law, section 53, subdivision 2); and the amounts distributed by the partnership in 1921 had to come through the partnership, and did not spring directly from any property transferred under the instrument of January 3, 1921.

There may be a decree for the defendant dismissing the complaint with costs.

SECTION 219.—ESTATES AND TRUSTS.

ARTICLE 341: Estates and trusts.

REVENUE ACT OF 1918.

Treatment of assessments for local benefits in the case of an estate. (See G. C. M. 11330, page 247, and I. T. 2667, page 248.)

SECTION 222.—CREDIT FOR TAXES IN CASE OF INDIVIDUAL.

ARTICLE 382: Meaning of terms.

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

Amendment of Regulations 45, 45 (1920 edition), 62, 65, and 69. (See T. D. 4348, page 119.)

SECTION 223.—INDIVIDUAL RETURNS.

ARTICLE 404: Return of income of nonresident alien.

REVENUE ACT OF 1926.

Return made by citizen of United States under power of attorney. (See G. C. M. 11000, page 298.)

PART III.—CORPORATIONS.

SECTION 231.—CONDITIONAL AND OTHER EXEMPTIONS OF CORPORATIONS.

ARTICLE 517: Religious, charitable, scientific, literary, and educational organizations and community chests.

REVENUE ACT OF 1926 AND PRIOR REVENUE ACTS.

Incorporated store operated by an association of students at a university. (See I. T. 2636, page 102.)

ARTICLE 517: Religious, charitable, scientific. literary, and educational organizations and community chests.

REVENUE ACT OF 1926.

Nonpartisan scientific agency of citizens' inquiries for promotion of better government. (See I. T. 2654, page 39.)

SECTION 233.—GROSS INCOME OF CORPORATIONS DEFINED.

ARTICLE 541: Gross income. XI–32–5597
Ct. D. 531

INCOME TAX—REVENUE ACTS OF 1918, 1921, 1924, AND 1926—DECISION OF COURT.

1. INCOME—ROYALTIES UNDER LEASES OF COAL LANDS.

Royalties received by a lessor under leases of coal lands constitute gross income under the Revenue Acts of 1918, 1921, 1924, and 1926, although under State law the leases constitute sales of the mineral in place and the royalties are part payment of the purchase price.

2. RES JUDICATA—DIFFERENT PARTIES.

A determination by a court of competent jurisdiction of a fact distinctly put in issue as a ground for recovery in a suit against a collector is not res judicata in a subsequent proceeding against the Commissioner before the Board of Tax Appeals.

3. GAIN OR LOSS—COMPROMISE OF SUIT—DAMAGE FOR COAL REMOVED AND INJURY TO PROPERTY.

Where the taxpayer sues for damages for compensation for coal wrongfully removed from its mine by an adjacent owner and also for injury to its mine property and the Board finds that the amount of coal removed can not be ascertained, it can not be determined that any part of the amount received in 1924 in compromise of the suit is taxable gain in that year in which there is no final disposition of the taxpayer's property.

4. EVIDENCE—USE OF STIPULATION OF FACTS.

Where a stipulation is filed by a lessor of coal lands before the time had arrived for the filing of computations under rule 50 of the Board of Tax Appeals, under which the hearing is confined strictly to the consideration of the correct computation of the deficiency resulting from the determination already made, the Board may properly take into consideration, in determining the depletion rate, the estimated tonnage in place on March 1, 1913, as shown by the stipulation, although the stipulation is made merely to aid in the computation of the deficiency under rule 50.

5. EVIDENCE—HEARING UNDER RULE 50 OF BOARD.

Where the taxpayer, lessor, at the hearing before the Board to determine the issues puts in evidence only one of several contracts of lease as typical of all the rest under which the right of the lessee to mine additional coal to offset the excess of royalties paid for in any year is limited to the next succeeding year after the amount necessary to produce the minimum royalty for that year had been mined, and, at a hearing under its rule 50 which under the rule is confined strictly to the consideration of the correct computation of the deficiency resulting from the determination already made, the taxpayer offers to show that, under two leases, the coal paid for in several years substantially exceeded the coal mined and that the payments were made as minimum royalties required under the leases, with leave, to the lessee, at any subsequent time to take out the coal paid for, the Board in the exercise of its discretion may refuse the offer. The evidence offered being in the taxpayer's possession from the beginning of the proceedings before the Board, the refusal to accept such evidence is not an abuse of its discretion.

6. DECISION AFFIRMED IN PART, REVERSED IN PART, AND ONE CASE REMANDED.

The decision of the Board of Tax Appeals (18 B. T. A., 901) affirmed in part, reversed in part, and one case remanded for further proceedings.

UNITED STATES CIRCUIT COURT OF APPEALS, FOURTH CIRCUIT.

No. 3214. *D. J. F. Strother, petitioner,* v. *Commissioner of Internal Revenue, respondent.*

No. 3215. *Bankers Pocahontas Coal Co., petitioner,* v. *Commissioner of Internal Revenue, respondent.*

On petitions to review the decisions of the United States Board of Tax Appeals.

Before PARKER and SOPER, Circuit Judges, and BAKER, District Judge.

[January 25, 1932.]

OPINION.

SOPER, Circuit Judge.

Bankers Pocahontas Coal Co. v. *Commissioner.* No. 3215.

The subject matter of this suit involves income and profit taxes of the Bankers Pocahontas Coal Co. for the calendar years 1920–1926, as determined by the Board of Tax Appeals. Deficiencies in substantial amounts were charged against the taxpayer in each of these years; and a petition to review was filed. The Board made the following findings of fact with reference to the property concerned:

"In July, 1912, the Bankers Pocahontas Coal Co., a West Virginia corporation, acquired the fee simple title to approximately 6,200 acres of coal lands, including both the surface and the mineral rights in the State of West Virginia. The land had no appreciable value except for the coal content.

"Upon incorporation in 1912, the corporation acquired by formal assignment and has continued to retain the beneficial interest of the original owners in certain contracts affecting the coal content which were executed in 1901 and 1902 with various operating companies and to which contracts the 6,200 acres and coal content were subject.

"These contracts were originally prepared by D. J. F. Strother, who at that time was attorney, director and stockholder in the predecessor corporations. The form of the contracts is that prevailing in the West Virginia coal fields, which followed the Pennsylvania form of contract as introduced by Pennsylvanians who were largely instrumental in the early coal development in the West Virginia field."

Each of these contracts purported to be a contract of lease between the prior owners of the land, as lessor, and a coal mining company, as lessee, covering a tract of land in McDowell County, W. Va., for a period of 30 years from January 1, 1901. It was provided that the lessee should have the sole and ex-

clusive privilege of mining and coking coal on the premises, and of conducting a general mercantile business thereon. In consideration thereof, the lessee agreed to pay to the lessor, as rental for the premises, a royalty (ranging from 1 cent to 10 cents) for each ton of coal mined and sold or used for any other purpose than the manufacture of coke, and a larger amount for each ton of coke manufactured and sold upon the premises. In some cases, a minimum annual rental or royalty (ranging from $4,000 to $10,000) was agreed upon. In addition, the lessee agreed to pay all taxes assessed against the property, or the coal mined, coked or manufactured. The lessee was given the option to renew the lease at its expiration; and provision was made for the final valuation and disposition of the improvements placed upon the land by the lessee.

The contention of the taxpayer is that these contracts, executed in the years 1901 and 1902, and acquired by it in the year 1912, were sales of coal in place that were fully complete before the sixteenth amendment went into effect; and that the royalties received during the period 1920 to 1926 were merely payments of obligations that existed unconditionally on March 1, 1913, and were not income taxable under the Federal Revenue Acts. It is said that this construction of mining leases as sales of coal in place is the law of the State of West Virginia, laid down by its highest court, and is therefore a rule of property which the Federal courts must respect and enforce. The Board of Tax Appeals, however, overruled this contention and directed that the royalties should be included in the gross income of the taxpayer, subject to taxation.

The application of the income tax statutes passed in conformity with the sixteenth amendment to the proceeds of mining was first considered by the Supreme Court in *Stanton* v. *Baltic Mining Co.* (240 U. S., 103). The court held that a tax on the product of a mine is not, in its essence, a direct tax on property merely because some exhaustion of the ore body must result from the working of the mine; and that even though an adequate allowance is not made for the depletion of the mineral, the tax does not become a direct tax on property because of its ownership. On the contrary, it was held in accordance with its former ruling in *Stratton's Independence* v. *Howbert* (231 U. S., 399), that such a tax is a true excise levied on the business of carrying on mining operations. The Supreme Court reiterated and applied this rule in *Von Baumbach* v. *Sargent Land Co.* (242 U. S., 503), where it was held that royalties from mining leases on lands in Minnesota constituted income subject to the Corporation Tax Law of 1909. It was pointed out that under the law of Minnesota, such leases are not merely conveyances of the ore in place, and do not constitute a sale of any part of the land, but the ore derived from the operation of the mines constitutes rents and profits from the land. Commenting on this rule, the court said:

"Ordinarily, and as between private parties, there is no question of the duty of the Federal court to follow these decisions of the Minnesota Supreme Court, as a rule of real property long established by State decisions. (*Kuhn* v. *Fairmont Coal Co.*, 215 U. S., 349, 360.) Whether in considering this Federal statute we should be constrained to follow the established law of the State, as contended by the Government, we do not need to determine. The decisive question in this case is whether the payments made as so-called royalties amount to income so as to bring such payments within the scope of the Corporation Tax Act of 1909. The prior decisions of this court in *Stratton's Independence* v. *Howbert* (231 U. S., 399) and *Stanton* v. *Baltic Mining Co.* (240 U. S., 103), in which the Stratton case was followed and approved, are decisive of this question."

The court also held that there was no difference as to taxability of the gains from the mining operations, whether the ore was extracted by the mine owner, as in the Stratton case, or by a lessee of the owner, as in the case of the Sargent Land Co.

All of this ground was considered by the Circuit Court of Appeals of the Third Circuit in *Rosenberger* v. *McCaughn* (25 F. (2d), 699 [T. D. 4171, C. B. VII–2, 253]), a case which related to income taxes based on royalties or rents from coal lands in Pennsylvania. In that State, the courts apply a different rule from that in vogue in Minnesota and hold that mining leases constitute sales of the mineral in place; and it was therefore argued that the case must be distinguished from the decisions of the Supreme Court we have cited. But it was held, and we think properly, that the rules of decision laid down by the State courts with regard to property, while generally controlling upon the

Federal courts, do not necessarily govern those courts in the interpretation of the laws of Congress in regard to taxation, and, it was pointed out that in *Von Baumbach* v. *Sargent Land Co.*, supra, the Supreme Court had reached the conclusion that royalties from mines constituted taxable income wholly aside from the construction placed by the Minnesota courts upon mining leases. The Supreme Court declined to review this interpretation of its decision when it denied certiorari (278 U. S., 604); (see also *Hirschi* v. *United States*, 67 Ct. Cls., 637, certiorari denied, 280 U. S., 576; *Berg* v. *Commissioner*, 33 F. (2d), 641, certiorari denied, 280 U. S., 598 [Ct. D. 97, C. B. VIII–2, 280]; *Burkett* v. *Commissioner*, 31 F. (2d), 667, certiorari denied, 280 U. S., 565; *Alexander* v. *King*, 46 F. (2d), 235 [Ct. D. 294, C. B. X–1, 223]).

We shall assume, for the purposes of this decision, that the law of West Virginia, like that of Pennsylvania, is that a mining lease constitutes a sale of the mineral in place. It was said in *Coal Co.* v. *Overholt* (81 W. Va., 427, 434) that the English and many American decisions hold that when, in a mining lease, the parties contract with reference to a mineral known to exist, the quantity of which is unknown and incapable of exact ascertainment, and the lessee covenants to bring forth a minimum quantity annually, and to pay a minimum royalty, the contract amounts to a sale of the mineral in the land and the lessee is bound to pay the minimum price. (See also *Feather* v. *Baird*, 85 W. Va., 267; *Urpman* v. *Lowther Oil Co.*, 53 W. Va., 501; *Toothman* v. *Courtney*, 62 W. Va., 167; *Smith* v. *Root*, 66 W. Va., 633.)

Nevertheless, we think that the royalties in question, subject to the deduction allowed by the Acts of Congress, constitute taxable income. There can be no doubt that it was the intention of Congress to tax them. It is provided in section 234(a) of each of the pertinent statutes, to wit, the Revenue Act of 1918 (40 Stat., 1057), the Revenue Act of 1921 (42 Stat., 227), the Revenue Act of 1924 (43 Stat., 253), and the Revenue Act of 1926 (44 Stat., 9), that in computing the net income of a corporation subject to the income tax, in the case of mines and other natural deposits, there shall be allowed as a deduction, a reasonable allowance for depletion, according to the peculiar conditions in each case. It does not follow, as the taxpayer assumes, that the royalties cease to be income under the Acts of Congress because the leases are sales and the royalties are part payment of the purchase price under the law of West Virginia. It is obvious, as the Supreme Court has pointed out, that something more is involved under a mining lease than a sale and delivery of valuable property. Before the business is complete, there must take place the whole process of locating, extracting and preparing the ore for market. This is a manufacturing process, and in this aspect the royalties are seen to be income of the business and as such subject to taxation. The Federal courts must respect the local laws of property laid down by the courts of the State, but the power of Congress to tax must be judged by the realties of the situation and not by the logic of State rules of property, pushed inexorably to their extreme.

In *Weiss* v. *Wiener* (279 U. S., 333 [Ct. D. 60, C. B. VIII–1, 257]), the taxpayer, who was in the business of taking long leases on real property and subletting, claimed the right to make an annual deduction from his income for estimated depreciation of the buildings, but the Supreme Court decided that the claim was unfounded since he was not the owner of the property. The court said (page 337):

"It does not matter that in Ohio, where the properties lie, these long leases are treated as in many respects like conveyances of the fee. The Act of Congress has its own criteria, irrespective of local law, that look to certain rather severe tests of liability and exemption and that do not allow the deductions demanded whatever the lessees may be called. We understand this to be the view taken by the Department for a long time, and we are of opinion that it should not be disturbed."

It may be noted, in passing, that the Supreme Court of Appeals of West Virginia itself did not apply the rule with regard to mining leases literally when it came to the subject of taxation; for in *Harvey Coal & Coke Co.* v. *Dillon* (59 W. Va., 605) it held that a mining lease, similar in all substantial respects to those involved in the pending case, constituted a chattel real, taxable to the lessee under a West Virginia statute which provided for the taxation of personal property, including, in that term, chattels real. This decision was made notwithstanding the contention that the deed created not a chattel real but a sale of the coal itself in situ, taxable only as realty.

The taxpayer does not seem to deny the force and effect of the decisions of the Supreme Court we have cited, but claims that the court has since discarded the theory laid down in these cases and has returned to the well-established rule that the State law of property must be accepted and applied by the Federal courts. Reference is made to *Tyler, Adm.*, v. *United States* (281 U. S., 497 [Ct. D. 190, C. B. IX–1, 383]), *Crooks, Col.*, v. *Harrelson* (282 U. S., 55 [Ct. D. 271, C. B. X–1, 469]), and *Poe, Collector*, v. *Seaborn* (282 U. S., 101 [Ct. D. 259, C. B. IX–2, 202]); but it is obvious that each of these decisions turned upon the fundamental question whether the property sought to be taxed came within the purview of the taxing statutes. When it was clear that such was the case, the Federal statute was given effect; as in *Tyler* v. *U. S.* (281 U. S., 497), where the court held that the value of a tenancy by the entireties should be included in the gross estate of a decedent, for the purpose of computing the tax upon the transfer of the net estate, although, under the State law applicable to such an interest, it could not be said in a strict sense of the term that a transfer of the property had taken place. In the other cited cases, on the other hand, property was held to be excluded from the tax proposed because it did not come within the terms of the statute, and this conclusion was maintained although it was occasioned by observance of a State rule of property, and it was clear that the ruling would bring about a lack of uniformity in the incidence and operation of the tax in different States by reason of diversity of local property rules. The Supreme Court has never abandoned the rule as to the effect of State decisions on questions of property; but it has held in some instances that State decisions do not cover the whole ground to which the Federal taxing statutes relate, and in other instances, that the statutes or decisions of the State lay down rules which define and limit the property which Congress has undertaken to tax.

It is next objected that even if the royalties of the mine are taxable, an insufficient allowance for depletion has been made. The Commissioner estimated the allowance at 3.6 cents per ton, as the value of the coal in place on the basic date of March 1, 1913; and the deficiencies were determined on this basis. The taxpayer contends that an allowance of 5 cents per ton should have been made because this sum has been fixed as res adjudicata between the parties by reason of a judgment of the District Court of the United States for the Southern District of West Virginia rendered on January 21, 1928. The Commissioner had previously determined a deficiency against the taxpayer for the years 1914 to 1919, using the unit value of 3 cents per ton, and had imposed additional taxes in the sum of $6,267.08, which the corporation had paid under protest. Thereafter it brought an action against the collector of internal revenue at Parkersburg, W. Va., wherein the court determined that the rate should be 5 cents per ton, and rendered a judgment in favor of the taxpayer for $5,373.01, which the United States paid. Hence the taxpayer claims that the question is no longer open between it and the Government, since it is a general principle that when a fact is distinctly put in issue, and directly determined by a court of competent jurisdiction between the parties in a lawsuit as a ground for recovery, it can not be disputed in a subsequent suit between the same parties or their privies, even if the second suit is for a different cause of action. (*Southern Pacific R. R.* v. *U. S.*, 168 U. S., 1, 48; *New Orleans* v. *Citizens Bank*, 167 U. S., 371.)

The rule is applicable, however, only when the subsequent suit is between the same parties or their privies. The taxpayer maintains that we have that situation in the present litigation because the United States in reality is its opponent in both cases, being represented by the collector of internal revenue in the prior suit, and by the Commissioner of Internal Revenue now. But the argument is refuted by the decision in *Sage* v. *United States* (250 U. S., 33), where it was expressly ruled, against the protest of the Government, that the court was not bound by a judgment in a former suit concerning the same subject matter between the taxpayer and a collector of internal revenue, because a suit against a collector of internal revenue is personal and its incidents, such as the nature of the defenses open and the allowance of interest, are different. This ruling has recently been cited with approval by the Supreme Court in *Graham & Foster* v. *Goodcell* (282 U. S., 409, 430 [Ct. D. 287, C. B. X–1, 191]). The decision of the District Court for the Southern District of West Virginia was therefore not binding upon the Commissioner, and he had the authority to determine anew, as a question of fact, what allowance should be made for the depletion of the mine.

In reviewing the Commissioner's determination, the Board took into consideration not only the evidence introduced before the district court in the prior case, but also additional evidence. The president of the corporation testified that the cost of the property, when acquired in 1912, did not exceed $507,000, a fact casting strong light on the value of the property on March 1 of the following year; in 1915, an engineer estimated that there were then 20,000,000 tons of minable coal, having a total value of $1,000,000; on December 31, 1917, an entry was made upon the general ledger of the taxpayer that the estimated value as of March 1, 1913, on the basis of 20,000,000 tons of coal at 5 cents a ton was $1,000,000; and the income tax return filed for these years claimed a March 1, 1913, value of the property of $1,000,000. A stipulation, filed by the parties before the findings of fact and opinion of the Board were made, to be received as a statement of fact upon any question necessary to any computation under rule 50 of the Board, contained a schedule showing that the estimated recoverable tonnage on March 1, 1913, was 37,608,642 tons. The stipulation also included a résumé of the leases, with the approximate acreage and royalties per ton in each, and also the tonnage mined and royalties received for the years 1913 to 1919, inclusive, as well as the tonnage mined, the tonnage paid for and the royalties received for the years 1920 to 1926. From this résumé of facts, it is obvious that there was substantial evidence to support the finding of the Board. As it pointed out, an allowance of 3.6 cents per ton would return to the taxpayer a total of $1,353,911.11 upon the tonnage estimated in the stipulation. It is true, as the taxpayer contends, that a different result might have been based upon the evidence in the record; but it is not the province of this court to find the facts anew. We merely ascertained whether there is substantial evidence to support the findings of the Board.

The taxpayer objects to the use by the Board, in determining the depletion rate, of the estimated tonnage in place on March 1, 1913, as shown by the stipulation. It is said that the stipulation was made merely to aid in the computation of the deficiency under rule 50. The rule is applicable when the Board determines the issues in any proceeding, and withholds decisions of deficiencies for later computation. If the parties are in agreement as to the amount, copies of their computation are filed for entry of the decision; but if not in agreement, the parties may file their respective computations, and an opportunity to be heard is afforded. But any hearing is strictly confined to the consideration of the correct computation, and no argument may be made upon issues or matters disposed of by the report of the Board, or upon any new issues. The stipulation was filed in this case before the time had arrived for the filing of computations under the rule. The Board had not yet determined the principles to be applied in the computation of the deficiencies, and one of the important issues was the rate of depletion to be used in case the royalties should be held to be income. The stipulations of fact were obviously filed by the parties to enable the Board to reach correct conclusions upon the disputed points. We think the Board properly took the stipulated facts into consideration in determining the depletion allowance. They could not justly have been considered for one purpose, and not for others.

After the Board had filed its findings and opinion, the parties filed conflicting computations of deficiency, which then came on for hearing under rule 50. The taxpayer then for the first time made the point that the schedules filed showed that under two leases, the coal paid for in several years substantially exceeded the coal mined, and offered to introduce the leases to show that the payments were made as minimum royalties required under the contracts, with leave, to the lessees, at any subsequent time, to take out the coal paid for. The Commissioner objected to the offer as new matter not receivable at that stage of the proceedings, under the provisions of the rule. The Board decided that the offer constituted in effect a request for rehearing and reargument; and finally filed its order of decision without granting a rehearing or considering the evidence offered. This ruling the taxpayer assigns as error.

It is provided in Regulations 45, 62, 65, and 69, article 216, that in case a lessee under a mining lease is required to pay annually a specified sum to be applied in payment of royalty for mineral, whenever the same shall be extracted and removed, the value in the ground to the lessor, for purposes of depletion, of the number of units so paid for in advance, will constitute an allowable deduction from the gross income of the year in which the payment shall be made. It would have been proper to have introduced the leases in evidence at the original hearing of the case before the Board had determined the issues involved. But the taxpayer put in evidence only one of the con-

tracts of lease as typical of all the rest. Under this form of lease, the right of the lessee to mine additional coal to offset the excess of royalty paid in any year was limited to the next succeeding year after the amount necessary to produce the minimum royalty for that year had been mined. To such a situation under the facts proved, article 216 had no relevance. The Board was accordingly correct in its ruling that to receive in evidence the new matter offered by the taxpayer was equivalent to the granting of a rehearing of the case. It was within the sound discretion of the Board to grant or deny the taxpayer's motion; and since the evidence must have been in the possession of the taxpayer from the beginning, we can not say that the discretion of the Board was abused. (*Boggs and Buhl* v. *Com.*, 34 F. (2d), 859, 861.)

Another question for decision relates to the sum of $3,770.40 paid to the corporation in 1924 as damages for an unlawful trespass. The Board made the finding of fact that in 1920, the Flanigan Coal Co., which owned land adjacent to that of the taxpayer, trespassed on the latter's land and removed coal to which it had no right. It then destroyed the entries and as a result the extent of its operations could not be determined. The situation was discovered in 1923, whereupon the taxpayer brought suit for damages and claimed compensation not only for the coal removed, but also for damages to the property. In 1924 the suit was compromised by the payment mentioned, but this settlement had no relation to the coal extracted as the amount of the same could not be determined. The Board quoted the testimony of the president of the corporation to the effect that the destruction of the entries had absolutely destroyed the method of going into the mine at that point; that he and his engineers had estimated that the damages to the property and to the seam of coal were at least $10,000; and that $3,770.40 was accepted because the trespasser at the time was in a precarious financial condition.

The Commissioner held that the damages received constituted gross income in the year 1924; that the trespasser had mined or damaged 15,000 tons of coal; and that the taxpayer was entitled to deduct from the amount received the sum of 3.6 cents per ton, or $540, for depletion. The Board sustained this action. It said that a loss caused by a tortious act, if not compensated for by insurance or otherwise, is deductible from gross income; but that the evidence did not afford facts from which the amount of the loss might be determined; and that the cost of the coal removed by the trespasser or its value on March 1, 1913, was not known. Hence it held that no deduction could be allowed for loss in 1920. As to the year 1924, it made the following statement:

"The same situation obtains with respect to the year 1924. The company received from the trespasser $3,770.40. The petitioner has found that all but $540 of this amount (which he has allowed as a deduction from gross income as depletion) constituted taxable income of the company for 1924. The company has submitted no evidence that the cost or March 1, 1913, value of the coal removed by the trespasser was in excess of $540, or that such basis plus damages to the property was in excess of $540. The determination of the Commissioner is therefore sustained for lack of evidence showing error on the part of the respondent."

The taxpayer objects to this addition to its income for the year 1924, on the ground that the money paid by the trespasser was merely compensation for injury to the mine, and was in effect a return of capital. Any loss or gain in the transaction could be determined under the circumstances only upon a final disposition of the property. We think this position is sound. If the taxpayer were asking for a deduction from income in 1920 for the loss caused by the trespass in that year, it would be within the province of the Board to determine whether the evidence submitted by the taxpayer was sufficiently definite to justify the allowance claimed. The finding of the Board, that the amount of coal removed could not be ascertained, showed that the amount of the loss was uncertain. But this finding likewise shows that the Commissioner's action in adding the sum of $3,770.40 to the gross income of the taxpayer in 1924, was without foundation. If there had been substantial evidence to support the finding that 15,000 tons of coal had been unlawfully extracted, and that $3,770.40 had been paid solely in settlement of that wrong, it would have been proper to have added this amount to the gross income, less the expenses for collection and an allowance for depletion. The balance remaining would have been as clearly profit in the taxpayer's hands as if it had been paid by a lessee operating on a royalty basis. But the situation is confused by the fact that the amount of coal extracted is not known. So

far as can be told from the record, the amount paid by the trespasser may not have exceeded payment at the rate of 3.5 cents per ton. In addition, there is the uncontradicted evidence of substantial damage to the approach to the mine.

These circumstances show that the Commissioner was not warranted in adding the sum of $3,770.40, less an estimated depletion allowance of $540 to the corporation's taxable income for the year 1924. We are not dealing with a situation like that considered by the Supreme Court in *Burnet* v. *Sanford & Brooks Co.* (282 U. S., 359 [Ct. D. 277, C. B. X–1, 363]), but with a loss of capital investment. In *Doyle* v. *Mitchell* (247 U. S., 179, 185), the court, speaking of such a question, said: "In order to determine whether there has been a gain or loss, and the amount of gain, if any, we must withdraw from the gross proceeds an amount sufficient to restore the capital value that existed at the commencement of the period under consideration." A taxpayer is not allowed to deduct a loss from gross income until the amount is definitely fixed and ascertained; and for the same reason, he should not be charged with gain on pure conjecture unsupported by any foundation of ascertainable fact. (See *Burnet* v. *Logan*, 283 U. S., 404 [Ct. D. 351, C. B. X–1, 345].)

It follows that as to the determination of the deficiencies of the corporation for all of the years in question except the year 1924, the action of the Board is affirmed, and as to that year, the case is remanded for further proceedings in accordance with this opinion.

Strother, petitioner, v. *Commissioner of Internal Revenue.* No. 3214.

This case relates to the income of a stockholder of the Bankers Pocahontas Coal Co. derived from dividends by which the greater part of the royalties which the corporation received, were distributed. During the several years involved in the foregoing case, 1920 to 1926, Strother, as one of the corporation's stockholders, received dividend payments from the company and reported them in his income tax returns, but did not return them as taxable income. The Board found, in its original findings of fact, that the corporation made distribution of the entire amounts received by it as royalties, including any depletion reserve. The Commissioner determined as deficiencies against Strother the total amounts received by him from the company, and made no allowance for that part of the moneys which constituted depletion of the capital. Upon these facts, the Board held in its opinion that to the extent that the distribution made by the corporation constituted a distribution of depletion reserve, the amount received by Strother was nontaxable.

The opinion established, as we have seen, that the royalties constituted income to the corporation, and not the proceeds of sale of mineral in place, and that the proper allowance for a depletion reserve was at the rate of 3.6 cents per ton. By stipulation of the parties, the decision on these matters was adopted in the Strother case. After the decision was rendered, a hearing was held upon the recomputation of the Strother deficiencies. Strother objected to the new computation proposed by the Commissioner because it did not provide for the deduction from the dividends received of a proportionate part of the entire allowance for depletion. It seems that the total depletion allowance of the corporation for the years in question was $125,000, but the computation was made as if the total allowance was only $90,000. Apparently, the Commissioner held that a sum retained by the corporation in each year to meet the tax deficiency was in fact part of the allowance for depletion, and to that extent, the allowance for depletion had not been included in the dividends. Another question seemingly involved was whether or not in determining how much of the dividends were capital, the total net income and the total depletion for the year should be pro rated to the date of each dividend payment.

These questions appear to be those which are raised by the petitioner; but the record in the case is so vague that we can not obtain a clear conception either of the facts to be considered or the questions of law to be decided. This situation doubtless arose because the important questions in which the parties were interested were those concerning the character of the royalty payments as return of capital or income, and if income, the proper allowance to be made on account of depletion. A decision could not be reached in the Strother case until these questions had been determined. At the hearing on the question of recomputation of the Strother deficiencies, it was pointed out

by counsel for the Commissioner that the record did not supply a complete basis for recomputing the Strother tax; that strictly speaking, the taxpayer had failed to maintain the complete burden of proof, but that this was not reasonably to be expected under the circumstances. It was conceded that the recomputation proposed by counsel for Strother was literally in compliance with the decision of the Board, but that this decision was in need of revision. Thereupon, the Board announced that it would make an amendment of its findings of fact, and this was filed after the hearing. Instead of the statement that the corporation distributed the entire amount received from its operating contracts, the finding was substituted that the corporation used such portion of the royalties as was necessary for the payment of administration expenses, set aside a certain reserve to meet the Federal taxes, and distributed the rest to the stockholders. No change was made in the opinion as to the holding that to the extent the amounts received by Strother included depletion reserve, they were not taxable; and without further recomputation, the decision complained of was promptly entered.

The Government's brief in the case before us suggests that the record does not contain sufficient facts to permit a determination of the questions raised, and that therefore the Board's decision should not be disturbed. We think, however, that under the circumstances, it would be just for the Board to give further consideration to the Strother case, and to afford the taxpayer an opportunity to introduce additional testimony to bring out the facts necessary to a decision of the issues involved. The case will therefore be remanded for further proceedings in accordance with the opinion in the case of *Bankers Pocahontas Coal Co.* v. *Commissioner*, in so far as it determines the questions involved herein, and without prejudice to the right of petitioner to rely upon the legal positions as to other matters urged upon this appeal.

Case No. 3214, remanded for further proceedings.

Case No. 3215, modified.

ARTICLE 545: Sale and retirement of corporate bonds.

REVENUE ACT OF 1926 AND PRIOR REVENUE ACTS.

What constitutes retirement of bonds. (See G. C. M. 10739, page 65.)

SECTION 234.—DEDUCTIONS ALLOWED CORPORATIONS.

ARTICLE 561: Allowable deductions. XI–33–5611
Ct. D. 537

INCOME TAX—REVENUE ACT OF 1918—DECISION OF COURT.

DEDUCTION—BUSINESS EXPENSE—ADDITIONAL COMPENSATION—OBLIGATION ARISING AFTER YEARS WHEN SERVICES WERE PERFORMED.

A reasonable amount of additional compensation paid by a corporation subsequent to 1920 for services performed in 1919 and 1920, the legal obligation to pay for which was not incurred in those years but arose by virtue of a resolution of the directors in 1921, is not deductible in 1920 under section 234(a)1 of the Revenue Act of 1918 as a business expense paid or incurred in that year.

DISTRICT COURT OF THE UNITED STATES FOR THE DISTRICT OF DELAWARE.

Desco Corporation, plaintiff, v. *United States of America, defendant.*

[January 15, 1932.]

OPINION.

NIELDS, J.: This is a suit against the United States for the recovery of $19,798.94 alleged to have been erroneously or illegally collected from plaintiff

as an additional income and excess-profits tax for the year 1920. The additional tax arose from the disallowance by the Commissioner of Internal Revenue of an item of $48,070 deducted by the plaintiff from its 1920 tax return. The suit was tried by the court without a jury.

FINDINGS OF FACT.

1. Plaintiff is a jobber and dealer in electrical, mill, plumbing, and ship supplies and a contractor for covering pipe at Wilmington, Del. It was incorporated in 1889 under the name of Delaware Electric & Supply Co. Its name was changed to Desco Corporation in 1930.

2. In 1920 Frederick E. Stone was president and treasurer; Herbert R. Smith was vice president and general manager; and Earle C. Comegys was secretary and sales manager. These three gentlemen held a majority of the outstanding capital stock and constituted its board of directors.

3. In 1919 the directors voted that each of the three officers should receive a salary of $60 per week, which was paid throughout the year 1920.

4. The plaintiff made a practice of paying its officers small salaries.

5. Plaintiff's books of accounts were kept on an accrual basis. At the close of each year an inventory was taken and was usually completed in about two and one-half months.

6. Additional compensation to officers and important employees was frequently voted by the directors when the profits justified it. The prospect of such additional compensation was definitely held out to certain employees by the officers. In 1919 and 1920 the directors informally discussed additional compensation and the payment thereof from profits.

7. March 14, 1921, the directors voted additional compensation to the officers and certain employees of the company duly recorded in the following minute:

"The treasurer presented his report for the year ending December 31, 1920, which after being read was approved and ordered filed. Owing to the unusual care and responsibility the board on motion decided that the officers be granted a bonus of $15,000 each as additional compensation for their work performed for the last two years. At the same time Mr. Smith for the employees presented to the board a request for further consideration on account of a number of the employees for the same reasons. On motion bonuses were thereupon granted to G. E. Vandergrift for $2,000; J. P. Armor, W. J. Robinson, and J. H. Dallett for $250 each; Geo. F. Leach for $150; A. I. Mousley, $50; W. E. James, S. Springer, E. P. Comegys and J. E. Holley for $25 each; C. Brown for $20, all payable at the discretion of the treasurer."

8. Plaintiff's books for 1920 had not been closed and upon the passing of the above resolution an entry was made as of December 31, 1920, on the ledger of the company under the heading "Salaries," in the words, "Bonus a/c 48,070." This amount was subsequently paid in accordance with the terms of the resolution.

9. The compensation voted the officers and employees March 14, 1921, was reasonable in amount and justified under all the circumstances.

10. March 15, 1921, plaintiff filed its income and profits tax return for 1920 and deducted the amount of $48,070 in its return as an ordinary and necessary expense.

11. The Commissioner of Internal Revenue disallowed the deduction of $48,070 from the income of plaintiff for the year 1920 and determined the amount of deficiency tax in controversy.

The statute involved is the Revenue Act of 1918 (40 Stat., 1057, ch. 18). Section 234(a) of that Act provides:

"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:

"(1) All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered, * * *."

The sole question in the case is whether plaintiff may lawfully deduct from its gross income for the year 1920 the sum of $48,070 as additional salaries and compensation for services rendered during 1919 and 1920. The answer to this question depends upon the subordinate question whether such compensation represented an expense "incurred" in the year 1920. Since the suit is one to recover taxes erroneously exacted the burden is on the plaintiff to prove the

facts establishing the invalidity of the tax. (*United States* v. *Anderson*, 269 U. S., 422. 443 [T. D. 3839, C. B. V–1, 179]: *Burnet* v. *Houston*, 283 U. S., 223, 227 [Ct. D. 328. C. B. X–1, 343].) The books of the taxpayer were kept upon an accrual basis. Under that system an expense accrues when all the events have occurred from which liability is determined and the liability has become fixed even though payment is not yet due. (*United States* v. *Anderson*, 269 U. S., 422.) Whether the term "incurred" as used in the Revenue Act of 1918 is used in a technical legal sense, or in an economic or bookkeeping sense, expenses are not incurred unless there has arisen a legal obligation to pay them and they do not accrue within a given taxable year unless all of the events which fix the amount and determine the liability of the taxpayer to pay occur within that year. (*Bauer Bros. Co.* v. *Commissioner of Internal Revenue*, 46 Fed. (2d), 874 [Ct. D. 361, C. B. X–2, 359]. Certiorari denied, 283 U. S., 850.) If the plaintiff did not incur any liability for the payment of the additional compensation during 1920 the action of the Commissioner of Internal Revenue in disallowing the expense was proper. There is no evidence of the existence of any contract, oral or written, assuring officers or employees additional compensation for services when the profits of the company justified it. Until the passage of the resolution of the board of directors on March 14, 1921, there was no obligation upon the plaintiff to pay its officers or employees any additional compensation. There is some evidence that during the year 1920 and prior thereto the board of directors informally discussed the question of salaries of officers and important employees and the practice of the company in paying bonuses when earnings warranted it. There is some evidence as to statements to new employees that bonuses would be paid. This evidence, however, falls far short of warranting the court in finding a legal liability or obligation on the part of the plaintiff to pay this additional compensation. The additional compensation was wholly dependent upon the action of the directors of the company. Their action in 1921 was not retroactive so as to incur an obligation in 1920 when no such obligation existed during that year.

The facts of this case are substantially identical with those in *Bauer Bros. Co.* v. *Commissioner of Internal Revenue* (46 Fed. (2d), 874). The reasoning in that case is equally convincing when applied to the facts in this case. (See also *Lucas* v. *Ox Fibre Brush Co.*, 281 U. S., 115 [Ct. D. 265, C. B. IX–2, 384]; *United States* v. *Anderson*, 269 U. S., 422; *S. Naitove & Co.* v. *Commissioner of Internal Revenue*, 32 Fed. (2d), 949 [Ct. D. 77, C. B. VIII–2, 295]; *Block & Kohner Mercantile Co.* v. *United States*, 37 Fed. (2d), 877, 879 [Ct. D. 152, C. B. IX–1, 298]; *Indiana Rubber & Insulator Wire Co.* v. *Commissioner of Internal Revenue*, 20 B. T. A., 1201.)

CONCLUSIONS OF LAW.

1. The disallowance by the Commissioner of Internal Revenue of $48,070 from plaintiff's income for the year 1920 was correct.
2. Judgment should be entered for defendant.

Exceptions may be filed within four days.

ARTICLE 561: Allowable deductions.

XI–36–5660
Ct. D. 552

INCOME TAX—REVENUE ACT OF 1926—DECISION OF COURT.

DEDUCTION—BUSINESS EXPENSE—GRATUITY—REFUND OF INTEREST PAID.

Where a corporation, owner of the capital stock of the B Corporation, sells to a number of its stockholders a number of shares of stock of the B Corporation, taking in payment interest-bearing notes the interest on which is reported in tax returns as gross income in the years it was received and the notes are canceled and noninterest-bearing notes received in lieu thereof, the refund to the makers of the notes of the interest paid pursuant to a resolution of the directors, passed more than two years after the cancellation of the notes and indicating in no way that the interest was improperly collected, is a gratuity and not an ordinary and necessary business expense deductible under section 234(a)1 of the Revenue Act of 1926.

COURT OF CLAIMS OF THE UNITED STATES. No. K-338.

Louden Machinery Co. v. *The United States.*

[May 2, 1932.]

OPINION.

WHALEY, Judge, delivered the opinion of the court.

The plaintiff is suing to recover the sum of $1,814.57, being the amount of interest returned by it to certain of its stockholders in the year 1925, having been paid by the said stockholders on certain demand promissory notes bearing interest at the rate collected.

It is contended by the plaintiff that the amount returned to its stockholders was an ordinary and necessary business expense and deductible from its gross income for that year. The plaintiff was the owner of the capital stock of the Porter Company. It sold to a certain number of its stockholders a certain number of shares of the Porter Company common stock at par and took in payment therefor the demand promissory notes of each stockholder, and these notes were secured by the assignment of the shares of stock of the Porter Company as collateral for the payment of the notes. The notes were in the ordinary form of collateral notes and bore interest at the rate of 6 per cent per annum, payable annually. The plaintiff kept its books on an accrual basis and made its tax return on the calendar year basis. At the end of the calendar year 1921 there had accrued on the company's books interest to that date in the sum of $13,875, and this amount was included in its taxable income for the year 1921. On January 1, 1922, these interest-bearing notes were canceled and noninterest-bearing notes were given in lieu thereof. Certain of the stockholders had protested, and continued to protest, that it was never intended the notes should carry interest, but the treasurer of the plaintiff, who was one of the originators of the plan to purchase this stock, not only paid the interest on his note, but insisted and required the other note makers to pay interest as called for in the notes. As the interest payments were made to the plaintiff company, they were reported as income in its Federal tax return for the years in which the payments were collected, and taxes were duly paid thereon. In January, 1925, more than two years after these interest-bearing notes had been canceled and the interest collected in cash, or by notes, the board of directors of plaintiff company passed a resolution directing that the interest be refunded to those stockholders who had paid it. This was done, either by payments in cash, or by cancellation of the notes given in payment of the interest. The plaintiff deducted from its gross income for the year 1925 the amount of the interest refunded. The Commissioner of Internal Revenue disallowed this deduction and by reason of its disallowance, assessed against and collected from the plaintiff an additional tax of $1,814.57. A claim for refund was filed and rejected.

The sole question in this case is whether the refunding of this interest is an ordinary and necessary expense or a "gratuity." The makers of the notes were legally bound to pay the interest, and as it was collected it was entered on the books of the company as income and returned as part of the gross income of the company, and taxes were paid thereon. No question was made at that time that the collection of the interest was erroneous, or an illegal collection. If there had been any doubt as to the illegality of its payment, then the plaintiff overstated its income for the years in which the interest charges were collected by the amount of such interest, and could have filed a claim for overpayment for those years. This was not done, but, on the contrary, the company treated it as part of its income and returned it for taxation. In 1925 the board of directors refunded these interest charges to the makers of the notes. The resolution is silent as to any illegal collection, or any notation that the notes should not have carried interest, and indicates in no way that the interest had been improperly collected. After the passage of this resolution the treasurer of the company who had prepared the notes originally, and was one of those who paid the interest and was entirely familiar with the transaction from the making of the notes to the passage of the resolution, entered on the books of the company the refunding of this amount under the head of "gratuities."

The company was under no legal obligation to repay the interest collected as it had been legally collected under legal contracts entered into by the respective stockholders. It was under no moral obligation to refund this amount. It was a voluntary and gratuitous act. The taking of this amount out of the assets of the company and paying it over to certain stockholders by order of the board of

directors could not in any way or any manner be construed as an ordinary and necessary expense paid or incurred in carrying on the trade or business. The record does not show that the company received any benefit as a consideration for this refundment. On the other hand those who purchased the stock and gave their notes did receive a benefit in that for years they did not have to pay any carrying charges on their notes given in payment for the stock. (See *Northwestern Cabinet Co.* v. *Commissioner*, 13 B. T. A., 533, and *Dieckerhoff, Raffloer & Co.* v. *Commissioner*, 17 B. T. A., 1251.)

In our opinion, the Commissioner was correct in holding that the return of the interest was not an ordinary and necessary business expense and deductible as such. The petition should be dismissed.

It is so ordered.

ARTICLE 561: Allowable deductions. XI-38-5700 Ct. D. 566

INCOME TAX—REVENUE ACT OF 1918—DECISION OF COURT.

DEDUCTION—AMORTIZATION—PIPE-LINE CORPORATIONS.

Pipe-line facilities owned by pipe-line corporations, common carriers, the business of which is exclusively the transportation of oil from the oil wells of other corporations to the refineries of other corporations, are not facilities constructed or acquired for the production of articles contributing to the prosecution of the war within the meaning of section 234(a)8 of the Revenue Act of 1918 and the corporations are not entitled to deductions for amortization provided by that paragraph. This conclusion is not affected because they are affiliated with a parent corporation, owning all their stock, which is engaged in the production of articles contributing to the prosecution of the war produced from the oil transported by the pipe-line companies and such facilities are operated as plant facilities of the consolidated group, 98 per cent of the oil transported by the pipe-line corporations being for use by the parent company.

COURT OF CLAIMS OF THE UNITED STATES. NOS. K-368, K-369, K-370, K-371.

The Texas Pipe Line Co. v. *The United States.*

The Texas Pipe Line Co. of Oklahoma v. *The United States.*

The Texas Co. v. *The United States.*

The Texas Co. et al. v. *The United States.*

[May 31, 1932.]

OPINION.

LITTLETON, Judge, delivered the opinion of the court.

The amortization deductions claimed in these cases are by the Texas Pipe Line Co., a Texas corporation, and the Texas Pipe Line Co. of Oklahoma, an Oklahoma corporation, on pipe-line facilities acquired by these corporations upon organization on July 1, 1917, and certain pipe-line facilities thereafter constructed and installed by them. The pipe-line properties acquired by these two corporations upon organization were paid in to them by the Texas Company in exchange for which the pipe-line companies issued to the Texas Company their entire capital stock with the exception of qualifying shares and throughout the period from July 1, 1917, to December 31, 1918, the Texas Company owned all of the capital stock of the two pipe-line corporations.

The controlling issue in the cases is whether the pipe-line properties of the two pipe-line corporations, the business of which was exclusively the transportation of oil from the oil wells of other corporations to the refineries of other corporations, were facilities constructed or acquired for the production of articles contributing to the prosecution of the war within the meaning of section 234(a)8 of the Revenue Act of 1918 (40 Stat., 1057, 1058).

The Commissioner held, and the defendant here insists, that these pipe-line companies, being common carriers, were not producing articles for the prosecution of the war within the meaning of the statute and the regulations; that the right to this deduction must be determined on the basis of the nature

of the business engaged in by the pipe-line companies and the purpose for which the facilities were acquired, constructed, and used by the taxpayer claiming the deduction.

The plaintiff's pipe-line companies contend that the amortization deduction provided in the statute is properly allowable on facilities of a pipe-line company, a member of a consolidated group, engaged in the production of petroleum products where all the stock of the pipe-line companies is owned by the parent company and such facilities are operated as a plant facility of the consolidated group; that the properties of the Texas Pipe Line Co. and the Texas Pipe Line Co. of Oklahoma on which amortization deductions are claimed in this suit were acquired or installed by the members of a consolidated group during the war period and were used for the production of war articles.

During the war period the Texas Company was engaged in the production of petroleum and its products, which were articles contributing to the prosecution of the war. This corporation owned, operated, and maintained oil wells and refineries, and, until July 1, 1917, owned and operated as a part of its business certain pipe-line facilities for conveying crude petroleum from the wells to its refineries.

In February, 1917, the Legislature of the State of Texas by enactment of chapter 30 of the General Laws of Texas, 1917, declared oil pipe-line companies to be common carriers and placed them under the jurisdiction of the railroad commission of the State.

By the provisions of chapter 31 of the General Laws of Texas, 1917, the legislature required all Texas corporations owning or operating oil pipe lines separately to incorporate such pipe lines and, in the case of ownership of oil pipe lines beyond the border of Texas, authorized additional pipe-line corporations to be organized outside of the State and the transfer of such pipe-line properties to them. In every such case the statute permitted the oil-producing companies to acquire and own all of the capital stock of the separate pipe-line corporations.

July 1, 1917, the Texas Company conveyed to the Texas Pipe Line Co. and the Texas Pipe Line Co. of Oklahoma, all of its pipe-line properties then owned in the States of Texas and Louisiana and, on the same date, conveyed to the Texas Pipe Line Co. of Oklahoma all of its pipe-line properties then owned in the State of Oklahoma. These transfers were due to the Texas statute above mentioned declaring all pipe-line companies to be common carriers and requiring that such companies be separately incorporated.

The pipe-line properties with respect to which amortization is claimed were constructed by the Texas Pipe Line Co. and the Texas Pipe Line Co. of Oklahoma after July 1, 1917. As common carriers these corporations were required to and did offer their services to the public for the transportation of oil at prescribed shipping rates. Ninety-eight per cent (98 per cent) of the oils transported by these pipe-line companies was for the Texas Company. The Texas Company owned all of the capital stock of the two pipe-line companies and these corporations were therefore affiliated within the meaning of section 240 of the Revenue Act of 1918. In 1919 the Texas Company prepared and filed a consolidated income and profits-tax return for 1918 for itself and the Texas Pipe Line Co. and the Texas Pipe Line Co. of Oklahoma, affiliated companies. A deduction for amortization of war facilities was shown. The Commissioner allowed an amortization deduction to the Texas Company for pipe-line properties constructed and owned by it up to July 1, 1917, but denied the deduction for amortization of any of the properties owned by the two pipe-line corporations after that date on the ground that the cost of acquisition and the cost of construction of the pipe lines were borne by the Texas Pipe Line Co. and the Texas Pipe Line Co. of Oklahoma, transportation corporations, not entitled under the statute to such a deduction.

Section 234(a)8, supra, provides that "In the case of buildings, machinery, equipment, or other facilities, constructed, erected, installed, 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 contributing to the prosecution of the present war, 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, * * *." A similar provision is found in section 234(a)8 of the Revenue Act of 1921 (42 Stat., 227, 255). Article 183 of Regulations 62 (1922 edition), promulgated February 15, 1922, under the provisions of the Revenue Act of 1921, provides as follows:

"ART. 183. *Property cost of which may be amortized.*—The taxpayer may deduct from gross income a reasonable allowance for amortization of the cost of buildings, machinery, equipment, or other facilities, constructed, erected, installed, or acquired on or after April 6, 1917, for the production of articles contributing to the prosecution of the war against the German Government, and of vessels constructed or acquired on or after such date for the transportation of articles or men contributing to the prosecution of such war.

"The allowance may be deducted only by taxpayers who after April 6, 1917, have constructed or otherwise acquired plant or other facilities for the actual production of articles contributing to the prosecution of the war. It is not sufficient, to entitle the taxpayer to the allowance, that the nature of his business is such as to contribute to the production of articles. For example, a taxpayer, such as a railroad, whose business activities are confined to transportation (other than water transportation) is not entitled to the allowance. A taxpayer, the nature of whose business is the actual production of articles, however, may claim the allowance with respect to the cost of all buildings, machinery, equipment or other facilities which were constructed for use or which were used in connection with the production of such articles, both in the acquisition and transportation of raw material, the actual process of manufacture or other conversion, and the transportation and marketing of the finished product. * * *"

The Treasury Department has consistently held, and we think correctly, that a taxpayer whose business activities are confined to transportation, other than transportation by water, of articles or men contributing to the prosecution of the war, is not entitled to the amortization allowance provided in the statute. The Department has also consistently held, as provided in the regulations, that a particular taxpayer, *the nature of whose business is the actual production of articles* contributing to the prosecution of the war may claim an allowance with respect to the cost of all buildings, machinery, equipment, or other facilities which were constructed for use or *which were used in connection with the production of such articles, both in the acquisition and transportation of raw material*, the actual process of manufacture or other conversion, *and the transportation and marketing of the finished product.*

The question before the court in these cases does not fall within the last-mentioned rule provided in the regulations and followed by the Treasury Department, inasmuch as we are here dealing with separate and distinct corporations. The Texas Company was engaged in the production of articles contributing to the prosecution of the war, but the transportation of crude oil from which those articles were manufactured through the facilities, upon which amortization is here claimed, was not made by the Texas Company and was not a part of its business; such transportation was carried on by the pipe-line companies, separate and distinct taxpayer corporations. Under the Texas statutes the pipe-line companies were common carriers engaged in the business of transporting for profit such articles as should be entrusted to them by the public. Their income was derived from charges on transportation of oil; they did not sell or produce any article; they carried raw material and delivered the same to the consignee in the same natural state in which received from the shipper. For the purpose of the deduction provided in the statute, their activities were in no wise different from those of a railroad company. In *Hampton & L. F. Ry. Co.* v. *Noel* (300 Fed., 438 [T. D. 3619, C. B. III-2, 134]), a railroad company enlarged its facilities to provide service during the war for the Langley Field aviation station and engaged in the transportation of articles for the prosecution of the war. It sought a deduction for amortization of war facilities in its return for the year 1918. The claim was disallowed by the Commissioner and this action was upheld by the court. The court pointed out that the statute clearly did not intend to permit land transportation companies to take such a deduction. The reasoning of the court and the decision denying deduction are applicable to the question involved in these cases. See, also, Law Opinion 1074 (C. B. 5, 159). But the plaintiffs in this case contend that the amortization deduction provided in the statute is allowable to the pipe-line companies because they were members of a consolidated group of corporations, one of which consolidated group, i. e., the Texas Company, was engaged in the production of petroleum products which were articles contributing to the prosecution of the war. The fact that a particular taxpayer whose business is in no wise the production of articles is affiliated with another corporate taxpayer which is engaged in the production of articles contributing to the prosecution of the war does not alone bring the first corporation within

the provisions of section 234(a)8. Affiliation does not destroy the corporate entity nor change the separate identity of each member of the affiliated group. The consolidated group of corporations is not the taxpayer. The fact that one member of the consolidated group may be entitled to a certain deduction under the statute does not give the other members of the affiliated group the right to claim such deduction if, as separate and distinct taxpayers under the statute, they are not entitled to it.

Items of gross income and deductions are not consolidated for the purpose of determining the net income and the tax. It is only the net income of the separate corporate taxpayers, members of the affiliated group, that is consolidated and treated as the consolidated net income for the purpose of computing the tax to be allocated and assessed to the several corporations in accordance with the net income properly assignable to each. (*Swift* v. *United States*, 67 C. Cls., 322.) The consolidated group therefore may only receive the benefit of the deduction for amortization of the facilities in question if the pipe-line companies individually and as separate corporate taxpayers are entitled under the statute to the deductions. As such separate taxpayers, and independently of the business carried on by the Texas Company, the pipe-line companies did not come within the provisions of section 234(a)8 and were not entitled to a deduction for amortization of their properties. The ownership of their stock by the Texas Company, which, as a separate and distinct taxpayer corporation, was entitled to the amortization deduction on its facilities, does not change the situation. (*First National Bank of Chicago* v. *United States*, 69 C. Cls., 312; 283 U. S., 142 [Ct. D. 335, C. B. X–1, 406].) The properties and facilities upon which the deduction for amortization is claimed were purchased or installed by the pipe-line companies. The costs of acquisition and construction of pipe-line facilities were the costs of the pipe-line companies. The statute allows the deduction for amortization only to the corporations bearing the cost of acquisition or construction, which, in this case, were the pipe-line companies. (*Military Equipment Co.*, 2 B. T. A., 36.)

We have considered the cases of *G. M. Standifer Construction Corporation* (4 B. T. A., 525) and *United States Refractories Corporation* (9 B. T. A., 671), relied upon by plaintiffs, but the facts and circumstances in the cases before this court distinguish them from the cases mentioned before the United States Board of Tax Appeals.

The plaintiffs are not entitled to recover and the petitions are therefore dismissed. It is so ordered.

ARTICLE 561: Allowable deductions.

REVENUE ACTS OF 1921 AND 1924.

Taxpayer not electing reserve method of treating bad debts. (See Ct. D. 606, page 254.)

ARTICLE 564: Interest.

XI–35–5639
Ct. D. 546

INCOME TAX—REVENUE ACT OF 1926—DECISION OF COURT.

1. DEDUCTION—INTEREST—DIVIDENDS—PAYMENTS TO HOLDERS OF PREFERRED STOCK.

Where a corporation issues a form of preferred stock, in accordance with its certificate of incorporation, which does not entitle the holders to demand a fixed rate of return upon their investment but only such dividends not exceeding 8 per cent per annum as are payable from the net earnings of the corporation, which provides that in case of liquidation of the corporation they are not to be paid from its assets on an equality with its creditors but are to be preferred over the common shareholders only, and which provides for redeeming the stock upon certain conditions, the holders of the preferred stock do not become creditors of the corporation by virtue of their ownership of the stock and payments in the name and form of dividends to the holders of the preferred stock are not deductible as interest under section 234(a)2 of the Revenue Act of 1926.

2. DECISION AFFIRMED.

The decision of the Board of Tax Appeals (19 B. T. A., 643) is affirmed.

COURT OF APPEALS OF THE DISTRICT OF COLUMBIA.

The Finance & Investment Corporation, appellant, v. David Burnet, Commissioner of Internal Revenue.

Appeal from the Board of Tax Appeals.

Before MARTIN, Chief Justice, and ROBB, VAN ORSDEL, and GRONER, Associate Justices.

[March 7, 1932.]

OPINION.

MARTIN, Chief Justice: This appeal relates to corporation income taxes for the year 1925. Appellant, a Delaware corporation, claimed certain deductions in its returns for that year for payments made during the year to its preferred stockholders, claiming that the holders of the preferred stock had thereby become creditors of the corporation, and that the payments although called dividends were in fact interest. The Commissioner, however, held that the payments were dividends and not interest, and therefore disallowed the deductions. A corresponding deficiency was then asserted in the corporation's taxes, and this was sustained upon appeal by the Board of Tax Appeals. (19 B. T. A., 643.) The record is now before us.

Section 234 of the Revenue Act of 1926 provides:

"(a) In computing the net income of a corporation subject to the tax imposed by section 230 there shall be allowed as deductions:

* * * * * * *

"(2) All interest paid or accrued within the taxable year on its indebtedness, * * *."

The amounts in question were paid by the corporation under the name and form of dividends payable to the holders of its preferred stock, and the sole issue in the case is whether the payments are deductible as interest under the provisions of the Act. The answer depends in large part upon the terms of the company's certificate of incorporation and the stock certificates held by the payees.

It is provided in substance by the certificate of incorporation that 4,000 shares of preferred stock, of the par value of $25 per share, may be issued by the directors, which shall entitle the holders thereof to receive, and the corporation shall be bound to pay out of the net earnings, a cumulative dividend at the rate of 8 per cent per annum, before any dividend shall be set apart or paid on the common stock; the holders of preferred stock shall have no voting power; in case of liquidation or dissolution the holders of preferred stock shall be paid the par amount of their shares and unpaid accumulated dividends thereon before any amount shall be paid to the holders of common stock, but shall not participate in any further distribution of the assets of the company; any part of the preferred stock shall be subject to redemption at the election of the company or of the holders thereof, at par plus accrued unpaid dividends on December 25, 1925, or at any dividend day thereafter, provided that the corporation shall not be required to redeem more than 10 per cent of the outstanding preferred stock at any one dividend date, and such redemption shall be in the order of application therefor; if redemption is at the election of the corporation 5 per cent of the par value is to be added to the payment, but a discount of 5 per cent is to be deducted upon redemption made at the option of the stockholders; the corporation may also prescribe a specified notice to be given either by the company or by the holders, or by both, as a condition to the exercise of the right of redemption.

The preferred stock certificates upon which the sums now in question were paid conform to the foregoing provisions.

In our opinion the holders of such preferred stock did not thereby become creditors of the corporation, and the payments in question were received by them as dividends and not as interest.

This conclusion follows from the fact that they were not entitled to demand a fixed rate of return upon their investment, but only such dividends not exceeding 8 per cent per annum as were payable from the net earnings of the company; also that in case of liquidation of the corporation they were not to be paid from its assets on an equality with its creditors, but were only to be preferred over the common stockholders. (*Scott* v. *B. & O. R. Co.*, 93 Md., 475; *Lockhart* v. *Van Olstine*, 31 Mich., 76. See also *Warren* v. *King*, 108 U. S., 389.)

Appellant lays especial stress upon the provision contained in the preferred-stock certificates, to the effect that the "stock is redeemable in whole or in part at the election of the corporation or of the stockholders upon 60 days' written notice prior to any dividend-payment date on or after December 31, 1925." Appellant contends that this provision shows that the so-called preferred stock is actually a certificate of indebtedness. We think not. These terms provide for redeeming the stock upon certain conditions, and do not treat it as a debt.

The payments in question are nowhere called "interest" but always "dividends" in the certificate of incorporation and in the stock certificates. But even if they were called interest, when in fact dividends, they would not be accredited as interest. In article 564 of Treasury Regulations 65, promulgated under the Revenue Act of 1924, it is provided that "so-called interest on preferred stock, which is in reality a dividend thereon, can not be deducted in computing net income." This regulation has been in effect under all the Revenue Acts, beginning with that of 1918 and including that of 1928.

"On the other hand, if the instrument executed by a corporation has every essential feature of a certificate of preferred stock and is issued in usual form of such stock, it is a certificate of preferred stock and not a contract for the payment of money, although it may provide for redemption by the corporation by a certain time or on certain conditions, and in such a case the holders are stockholders and not creditors until a change is actually made." (14 C. J., 417.)

In *Armstrong* v. *Union Trust & Savings Bank* (248 Fed., 268), the court held, where a corporation, authorized to issue preferred stock, issued certificates reciting that the holder was the owner of shares of preferred stock and entitled to interest on the par value thereof, and providing for a premium in case of retirement within 10 years from issuance, the holders of such certificates are preferred stockholders, and not creditors, the purchasers of the certificates no doubt expecting to participate in dividends declared after payment of stipulated interest, for it can not be assumed that the purchasers expected to be creditors and at the same time share in dividends.

In *Elko Lamoille Power Co.* v. *Commissioner of Internal Revenue* (50 F. (2d), 595), a corporation issued preferred stock without voting power, bearing 7 per cent cumulative dividends payable semiannually, preferred as to income and assets, callable after 3 years at 110, the stock was sold on representations that it would be redeemable at any time on demand with accumulated dividends. In an effort to make the dividends deductible, the board of directors had by resolution ratified these representations, the stock was carried on the books as "preferred stockholders interest account," and there was evidence that some stockholders regard the purchase as a loan.

The court held that the holders of the preferred stock were not creditors, and the dividends paid upon it were not deductible as interest. The court distinguished the case from *Arthur R. Jones Syndicate* v. *Commissioner of Internal Revenue* (23 F. (2d), 833), cited by appellant, upon the ground that the preferred stock in the latter case was a direct obligation of the corporation with a definite date for payment, and not merely redeemable at the option of the corporation.

This ruling is applicable to the instant case wherein the right to redeem is reserved upon prescribed terms at the election of the stockholder or the corporation, but no express time is fixed for payment without the exercise of such option.

The decision of the Board of Tax Appeals is accordingly affirmed.

ARTICLE 564: Interest. XI–40–5749
Ct. D. 576

INCOME TAX—REVENUE ACT OF 1921—DECISION OF COURT.

1. DEDUCTION—DIVIDEND—INTEREST—STOCK—BORROWED MONEY.

Where stock of a corporation is issued in an amount equivalent at par to cover loans to it, and the corporation enters into an agreement which recites that the stock had been sold and transferred, for the repurchase of the stock at a specified price together with an amount equal to a stated per cent per annum from the date of issuance of the stock and that the stock issued should be considered as "preferred stock and guaranteed dividends in an amount equal to 7 per cent," and where the amount of such loans is included in the invested capital of the corporation for years prior to the taxable year, and on all the stock of the corporation there is distributed in the taxable year out of profits accumulated since February 28, 1913, sums equivalent to 7 per cent of the par value of the stock, the recipients of such stock are vested with the rights of stockholders and such payments made to the stockholders are not interest on money borrowed deductible from gross income but are dividends within the meaning of section 201 of the Revenue Act of 1921, notwithstanding that the stock is issued in violation of State law.

2. DECISION AFFIRMED.

The decision of the Board of Tax Appeals (20 B. T. A., 667) is affirmed.

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT.

Angelus Building & Investment Co., a Corporation, petitioner, v. Commissioner of Internal Revenue, defendant.

Upon petition to review an order of the United States Board of Tax Appeals.

Before WILBUR and SAWTELLE, Circuit Judges, and JAMES, District Judge.

[March 21, 1932.]

OPINION.

JAMES, District Judge: In this proceeding, brought by the petitioner corporation, to review a decision of the Board of Tax Appeals, there is presented the question whether certain payments made by the petitioner in 1922 to persons listed as holders of its stock, are to be considered as dividends, or as interest on money borrowed. If the former, they were not deductible from gross revenue in computing income tax; if the latter they were deductible. The Commissioner held that the payments were dividends distributed to shareholders and hence were not deductible. The Board of Tax Appeals approved that ruling.

By the Revenue Act of 1921 (42 Stat., 227), section 201, dividends, not deductible from gross income, are defined as:

"Any distribution made by a corporation to its shareholders or members, whether in cash or in other property, out of earnings or profits. * * *"

Treasury Regulations 62, article 564, provided that:

"So-called interest on preferred stock, which is in reality a dividend thereon, can not be deducted in arriving at a net income."

Petitioner was organized as a "family corporation" in the year 1910, having for its general purposes the subdivision and sale of real estate. Up to December 31, 1919, A. H. Braly and Herman Janss, brothers-in-law, owned all of the issued corporate stock. Prior to the date last mentioned, J. H. Braly, father of A. H. Braly and of Mrs. Janss, had loaned to the petitioner large sums of money. A. H. Braly had advanced money for use in the business of the company. The brothers-in-law had also owned what was known as Braly-Janss Investment Co., in equal shares, the assets of which had been

transferred to petitioner, at the stated value of $70,000—A. H. Braly and Herman Janss taking credit on petitioner's books by open account in the amount of $35,000 each.

On December 31, 1919, all stock issued was canceled and reissued in several amounts. As J. H. Braly, the father, was then a man 88 years of age, his sons, A. H. Braly and H. H. Braly, and daughter, Mrs. Janss, were designated to act as his trustees. Stock was issued to them at par in amount sufficient to cover the sum of his cash loans or advances to petitioner, which at the time were in excess of $200,000. Stock was also issued to cover amounts carried on open account to the credit of A. H. Braly and Herman Janss. Additional stock was issued separately to A. H. Braly which was apparently for cash. Other changes in and additions to the stock issue were subsequently made, which are not necessary to be detailed. On all of the stock there was distributed during the year in question sums equivalent to 7 per cent on par. These payments were entered on the books of the corporation as "interest," and no dividend account was carried. The petitioner claimed that the transactions whereby stock was issued to J. H. Braly's trustees to cover amounts advanced by J. H. Braly, and to A. H. Braly in amount equivalent to his open account credit, were mere forms and did not convert the "loans" into stock purchases. In income returns for prior years (1920 and 1921) the petitioner had included these alleged loan amounts as "invested capital."

On January 18, 1920, J. H. Braly's trustees signed with the petitioner an agreement which first recited that as the corporation had sold and transferred to the trustees "certain certificates of corporate stock" for cash, the trustees agreed to resell the stock to the corporation upon payment by it of the full price of $1 per share, "together with an amount equal to 6 per cent interest per annum, compounded quarterly from the date of issuance of said first-mentioned certificate." A. H. Braly at the same time in writing agreed to pay the interest specified "until said stock is taken up by first party." A further agreement of date April, 1922 (the tax year concerned herein), changed the interest agreed to be paid to 7 per cent on the repurchase of the stock; with the added conditions that none of the parties concerned would dispose of the shares without the consent of the others, and that the assets of the corporation would not be disposed of except as necessary in the proper conduct of the business. It was also stated that the stock issued to Braly trustees and to A. H. Braly should be considered as "preferred stock and guaranteed dividends in an amount equal to 7 per cent." Repurchase agreements are by no means unusual in sales transactions involving corporate stock.

As stated the claim of the petitioner is that it never treated the stock issued to cover advances made by the several parties, as converting the loan accounts into any different form of obligation; and never intended so to do. Mr. A. H. Braly testified as follows:

"We wanted to get it in more convenient form, and we also wanted something behind that account. Therefore we decided as a convenience and more as a matter of bookkeeping to issue stock to him and myself for the indebtedness with a rate of interest specified to us so that we could retire the stock as money came in. We thought this would be more convenient than trying to give securities in the shape of mortgages. It would be more difficult to release those than to reissue stock."

Plainly it was the intention that the recipients of the stock should be, in their relation to the corporation, vested with the rights of stockholders. How else could the share representation put "something behind" the accounts as A. H. Braly said was desired. By plain interpretation, stock representation was what was intended to be given, and it was given.

A taxpayer can not, by a form of book entry, merely, change the amount of an income total. Can it be doubted that had the status of the Braly trustees, and A. H. Braly, as stockholders been challenged by a stranger with an interest, that the trustees and Braly would have stoutly maintained their right to the shares for what they purported to be? Otherwise, how could the possession of the certificates have protected them in the way Mr. A. H. Braly testified it was designed they should be protected? The charging of the amounts of money received from these sources to invested capital in former years (1920–1921); the payment of the same rate of "interest" to all stockholders out of profits; the recitals in the agreement first mentioned that the stock had been "sold and transferred" to the Braly trustees; are all facts indicating that the holders of the certificates were to be invested with the character of stockholders of

the corporation. The Commissioner was therefore authorized to conclude that the payments made by the company to all stockholders constituted a division of profits in proportion to shares, and that they were, within the meaning of the revenue law, "dividends." Whether the attempt to change the form of the stock from "common" to "preferred" was effectual or not, would make no difference in the result in the income tax computation (*Elso Lamoille Power Co.* v. *Commissioner*, 50 Fed. (2d), 593—this circuit); neither would the written agreements shown to have been made, in our view, in anywise change the relation of the parties, or convert that relation into something different from the ordinary one existing between a corporation and its shareholders.

But petitioner has a further contention to urge against the tax assessment: That has to do with the provisions of the corporate securities act of California. That act, designed to give State supervision over the stock issues of corporations for the protection mainly of the investing public, requires that permits must be secured from the State corporation commissioner before shares are issued and sold or transferred. It declares that any stock disposed of without such a permit having been first secured shall be void. The contention in essence is that when shares are issued in violation of the State law, dividends actually paid to the persons, the holders of such stock, out of the profits of the corporation, can not be taken account of in estimating income taxes due the Government. If this contention is valid, then a convenient method is made available by which income taxes required to be paid by corporations may be materially reduced in amount. The Government in the collection of its revenues takes no notice of any situation of accountability to a State that the taxpayer may have caused to exist through his own wrongdoing. His transactions are as he has made them, and if real income credits have been created which are subject to be taxed, they are to be assessed accordingly. Thus income derived from an unlawful business may be made to pay its toll in taxes in the same percentages as that which is reaped from legitimate enterprises.

The following decisions, as cited by respondent, are in their general effect applicable: *California Iron Yards Co.* v. *Commissioner* (47 Fed. (2d), 514); *Fidelity-Philadelphia Trust Co.* v. *Commissioner* (47 Fed. (2d), 36 (C. C. A. 3) [T. D. 4239, C. B. VII–2, 373]). In the case last noted, the court said:

"It is well settled that a State law can not be given an effect for tax purposes which conflicts with the provisions of a Federal revenue law and defeats the collection of the tax."

Petitioner, subsequent to the submission of this case on oral argument, filed an additional list of authorities. The most pertinent of these is *Garrison Company* v. *Commissioner*, decided by the Circuit Court of Appeals for the Eighth Circuit on January 25, 1932 [Ct. D. 551, page 386, this bulletin]. The court there decided that promissory notes given to an Arkansas corporation for its stock, where the constitution of that State forbade the taking of notes in payment of corporate shares, could not be properly included as a part of the invested capital of the company concerned. It had been held by the Supreme Court of Arkansas that such notes could not be recovered upon in a suit against the maker by reason of the constitutional provision. The decision does not furnish a rule which, under the facts here, will determine the judgment to be made. The circuit court in the Garrison company case particularly referred to the argument made on the part of the Commissioner, which was in brief:

"* * * That results from transactions that are in violation of State law, and not enforceable contracts in the State, are still recognized for Federal tax purposes if they are of a kind that would otherwise come within the Revenue Acts."

And the court said:

"It is unnecessary to discuss the proposition thus generally stated for the reason that the transaction in the case at bar does not come within its terms."

Treasury regulations are then quoted, wherein it is provided that:

"Enforceable notes or other evidences of indebtedness * * * may be considered as tangible property in computing * * * invested capital to the extent of the actual cash value of such notes * * *."

And the court went on to say:

"It is plain from the language of the regulation that the promissory notes in the case at bar could not be considered tangible property in computing the corporation's 'invested capital' * * *."

That is, as the notes were not enforceable (the reasons which made them so are immaterial), they did not come within the descriptions of the regulations, but were by the general terms of such regulations excluded from "invested capital."

The case of *Strother* v. *Commissioner*, decided by the Circuit Court of Appeals of the Fourth Circuit on January 25, 1932 [Ct. D. 531, page 275, this bulletin], also cited by petitioner, is not considered applicable here. Quite pertinent to the subject discussed are the observations of this court as made in *Osburn California Corporation* v. *Welch* (39 Fed. (2d), 41 [Ct. D. 173, C. B. IX–1, 250]). There the court, by Judge Rudkin, said:

"It is contended that the Dominguez stock became capital in the hands of the Osburn Corporation, because section 11 of article 12 of the California Constitution provides that no corporation shall issue stock or bonds except for money paid, labor done, or property actually received, and that Congress can only tax income as distinguished from capital. But Congress has power to impose a tax upon incomes and, as an incident, to define what shall constitute income; and the power of Congress in that regard is not limited or circumscribed by the laws of the several States."

We are of the opinion that the decision of the Board of Tax Appeals should be affirmed.

It is so ordered.

SECTION 235.—ITEMS NOT DEDUCTIBLE BY CORPORATIONS.

ARTICLE 582: Capital expenditures. XI–32–5598
Ct. D. 532

INCOME TAX—REVENUE ACT OF 1921—DECISION OF COURT.

1. DEDUCTION—LOSS—CAPITAL EXPENDITURE—ELIMINATION OF COMPETITION.

Where corporations become the stockholders of a new corporation which pursuant to their sole purpose acts as their agent for the execution of their plan to purchase the tangible assets and good will of certain competitors in order thereby to discontinue the business of the competitors and eliminate them from competition, amounts paid by the stockholders in liquidation of their liability under their guaranty of the bonds of the new corporation issued as a part of the plan are a part of the cost of eliminating competition, are therefore capital expenditures and are not deductible as losses under section 234(a)4 of the Revenue Act of 1921.

2. DECISION AFFIRMED.

The decision of the Board of Tax Appeals (17 B. T. A., 452) is affirmed.

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT.

Newspaper Printing Co., petitioner, v. *Commissioner of Internal Revenue, respondent.*

Petition for review from the United States Board of Tax Appeals.

Before DAVIS, Circuit Judge, and THOMSON and WATSON, District Judges.

[February 5, 1932.]

OPINION.

THOMSON, District Judge: The facts of this case are entirely clear, and the conclusion which should be reached is largely one of law.

Prior to January, 1923, there were five competing publishing companies in Pittsburgh: The Newspaper Printing Co., the Press Publishing Co., the Post

Publishing Co., the Dispatch Publishing Co., and the Leader Publishing Co. The three first might be designated as taxpayers, the latter as competitors. It being the opinion of the taxpayers, that there were more newspapers in the city than the revenues justified, they decided to purchase the business and assets of the Dispatch and Leader, which we name as competitors. To accomplish this end, the three first named companies organized the Union Publishing Co., a corporation of the State of Delaware, with a capital stock of $20,000, of which each of the three named companies subscribed to one-third. The Union Publishing Co. then issued bonds in the sum of $1,590,000, each of the three subscribers to its stock guaranteeing the payment of $530,000 of these bonds.

On February 13, 1923, the Union Publishing Co. bought out the competitors, except cash and accounts receivable, and immediately discontinued the publication of the papers so acquired. The company then proceeded to liquidate the tangible assets, the money procured thereby being applied to its borrowed indebtedness. On December 31, 1923, the company transferred the remaining assets to its creditors, the value being applied on its borrowed indebtedness, which left a balance of $1,315,390.48 unpaid, for which each of the three above-named companies was liable as a guarantor to the extent of one-third. The petitioner the Newspaper Printing Co., deducted this one-third, or $438,460.14 from gross income in its tax return for 1923, as a fixed accrued liability as of December, 1923. This claim was disallowed by the Commissioner, and his action was affirmed by the Board of Tax Appeals. From this action, the present appeal was taken.

In determining the question before the court, there are certain admitted facts, which seem to us not only material, but vital. The purpose and object of the plan is conceded. E. R. Stowl, manager of the Union Publishing Co., testified (R., 53):

"The object of the Union Publishing Co. was simply to dispense with these two newspapers on the theory that there were more newspapers in the town than could live from the income which was derived from possible newspaper earnings."

In the stipulated facts (R., 50) it is stated:

"The purpose of said Newspaper Printing Co., Press Publishing Co., and Post Publishing Co. in causing said Union Publishing Co. to be created was to provide an agency by means of which the papers known as the Leader and the Dispatch could be purchased and the publications of those papers discontinued."

Thus there can be no question that the Union Publishing Co. was the mere agent for the carrying out of the plan of purchase and eliminating from competition the Dispatch and Leader. The plan was duly considered by the interested parties as beneficial to the petitioner. This is shown by the resolution of the directors of that body at a meeting held on February 13, 1923, authorizing the company to guarantee the bonds. The material part of the resolution is as follows:

"Whereas the purchase of the property and assets of the Dispatch Publishing Co. and the Leader Publishing Co. by the Union Publishing Co. will inure greatly to the benefit of the business of this company and also will benefit it as a stockholder of the Union Publishing Co."

The new company was formed in February, 1923. It had no assets or business of its own. On February 13, the petitioner authorized the guaranteeing of the bonds, and on the same day, the two newspapers were purchased and publication discontinued. These facts conclusively indicate that the purchase price, the discontinuing of publication, the issuance of bonds, etc., were agreed upon in advance, and simultaneously executed and carried out.

In applying taxing statutes, courts must look to the substance, rather than the form of a transaction. *United States* v. *Phellis* (257 U. S., 156 [T. D. 3270, C. B. 5, 37]), *McCaskill Co.* v. *United States* (216 U. S., 504), and many other cases which might be cited.

The companies who formed the Union Publishing Co., looking over the field, decided that it was wise and worth the cost, to buy out and discontinue the business of the competitors. To accomplish this end, the Union Publishing Co. was created as their agent. This agency accomplished the desired object at a cost of $1,315,390.48, plus the amount of capital stock of $20,000. Acting merely as the agent to carry out the transaction, the acts of the agent clearly became the acts of the principals. Thus the cost to the agent of eliminating the undesirable competition, was in fact, the cost to the principal. While the

system may be considered somewhat involved, it is easily understood. Ultimately, the cost fell where it properly belonged—upon the principals. The simple question then arises, whether the cost of eliminating competition can constitute a loss within the meaning of section 234(a)4 of the Revenue Act of 1921; or whether the value of the thing procured, that is, the elimination of competition is a capital asset to be carried to capital account. That the cost of eliminating competition is a capital asset, has been established by a long line of decisions of the Board of Tax Appeals.

In this case it appears to be clear, that the taxpayer was willing to pay the amount of its claimed loss, for the benefits to be derived from the elimination of the two competitors. The value of this intangible asset, which must be presumed to be measured by its cost, should have been credited to the capital account and carried as a capital asset. The fact that business men, perhaps of wide experience, were willing to pay out the money in return for the gain, clearly negatives any idea that they contemplated that the gain would be less than the expenditure.

In this case, there were purchased, both the tangible assets and the good will, while the tangible assets only, were sold. What the taxpayer here considered a loss, is represented by the good will, which he did not sell and now has.

To us, it is therefore clear, that the taxpayer did not sustain a loss within the meaning of section 234 of the Revenue Act of 1921; that the expenditure was neither an ordinary nor a necessary expense in carrying on the taxpayers' business.

We therefore affirm the decision of the Board of Tax Appeals.

SECTION 239.—CORPORATION RETURNS.

ARTICLE 624: Returns of foreign corporations. XI–40–5750
(Also Section 223, Article 404.) G. C. M. 11000

REVENUE ACT OF 1926.

Where a foreign corporation has specifically appointed a citizen of the United States, who is a resident in this country, to prepare and file an income tax return for it, such return is valid for all legal purposes. The liability to file a return for a foreign corporation is not limited to an agent who has the receipt and control of the income of the taxpayer, or who has knowledge of its business activities in the United States. The foregoing principles are also applicable to cases where returns are filed on behalf of nonresident alien individuals.

The opinion of this office is requested whether the return, Form 1120, filed in behalf of the taxpayer, a foreign corporation, is a complete return under article 624 of Regulations 69, and whether the ruling made in this case is applicable to returns similarly prepared and signed in behalf of a nonresident alien individual.

The real question involved is whether the return filed under a power of attorney issued in favor of A, a citizen of the United States, in behalf of the M Company, a foreign corporation, is a valid return under section 239(a) of the Revenue Act of 1926 and article 624 of Regulations 69. The return is not signed by the officers of the corporation, but is signed by A, who certified that the return was made under power of attorney from the taxpayer stipulating for such services, and upon information furnished by the taxpayer.

Article 624 of Regulations 69 reads as follows:

Every foreign corporation and corporation satisfying the condition set forth under section 262, having income from sources within the United States, must make a return of income on Form 1120. If such a corporation has no office

or place of business here, but has a resident agent, he shall make the return. Although the foreign corporation is not engaged in business in this country and has no office, branch, or agency in the United States, it is required to make a return if it has received income from sources within the United States.

Section 239(a) of the Revenue Act of 1926 provides as follows:

Every corporation subject to taxation under this title shall make a return, stating specifically the items of its gross income and the deductions and credits allowed by this title. The return shall be sworn to by the president, vice president, or other principal officer and by the treasurer or assistant treasurer. If any foreign corporation has no office or place of business in the United States but has an agent in the United States, the return shall be made by the agent. * * *

It should be noted that section 239(a) specifically provides that "If any foreign corporation has no office or place of business in the United States but has an agent in the United States, the return shall be made by the agent." To the same effect is article 624, supra. In the instant case the foreign corporation had no office or place of business in the United States, but did have income from sources in the United States derived from an investment in American securities.

A power of attorney issued in favor of A is contained in the file. This power of attorney was executed May —, 1927, and was signed by B and C, who are officers of the corporation. The power of attorney states that the taxpayer, a corporation duly organized under the laws of the foreign country and having its place of business in the city of R, has made, constituted, and appointed A, "its true and lawful attorney for and in the name, place, and stead of the undersigned, *to make any and all income tax returns*, certificates, or other instruments, which he may consider necessary or proper in order that the undersigned may comply with the income tax laws of the United States of America and the regulations of the Commissioner of Internal Revenue issued in respect thereto." [Italics supplied.] Under the power of attorney the taxpayer also undertakes to advise its attorney "of any and all income" which it receives in the taxable period "from or through sources within the United States," all of which income is to be included in the return made to the United States by its attorney.

Mechem, in discussing a contract of agency and "power of attorney," states that the contract, when one exists, by which the relation of principal and agent is created, is called a "contract of agency"; the right of the agent to represent the principal is called his "authority" or "power"; when the authority is conferred by formal instrument in writing it is said to be conferred by "letter of attorney" or more commonly by "power of attorney." (Section 35, Mechem's Law of Agency.) The same authority states that the term "attorney" is often used in the law of agency as synonymous with the word "agent," particularly when the authority is conferred by a written instrument. (Section 71, Mechem's Law of Agency.) A power of attorney, however, is not restricted to one whose profession is to give advice and assistance in legal matters, but may be issued in favor of a broker, bank official, auctioneer, shipmaster, etc. When a power of attorney is executed in favor of a lawyer it is frequently intended that he act merely as agent for his principal, rather than as a barrister. The courts recognize that an agent for any purpose may be, and often is, appointed by a writing called his power or letter of

attorney, which is defined as an instrument authorizing a person to act as the agent or attorney of the person granting it. (*Stockwell* v. *Whitehead*, 47 Ind. App., 423, 94 N. E., 736; *Ankeny* v. *Young Bros.*, 52 Wash., 235, 100 Pac., 736; *Frink* v. *Roe*, 70 Cal., 296, 11 Pac., 820.)

This office has previously held in Office Decision 586 (C. B. 3, 284) that where an insurance broker in the United States had the control of certain income of the foreign corporation it was required to file a return. But the liability to file a return for a foreign corporation is not limited to an agent who has the receipt and control of the income of the taxpayer, or who has knowledge of his business activities in the United States. The statute provides that if the foreign corporation has no office or place of business in the United States but has an agent, in the United States, *the return shall be made by the agent.* Such is the situation in the instant case. It follows that where the foreign corporation has specifically appointed a citizen of the United States, who is a resident in this country, to prepare and file an income tax return for it, such return is valid for all legal purposes.

In the instant case the power of attorney was executed May —, 1927. The return, "Corporation income tax return," Form 1120, was executed May —, 1928, and filed in the office of the collector. It is therefore held that the return is a valid return and meets the requirement of the statute and article 624 of Regulations 69.

The foregoing principles are also applicable to cases where returns are filed in behalf of nonresident alien individuals. It is stated in section 223(c) of the Revenue Act of 1926, relating to individual returns, that if the taxpayer "is unable to make his own return" the return shall be made by "a duly authorized agent." Likewise article 402 of Regulations 69 provides that the return may be made by an agent, when by reason of "absence" or "nonresidence" the person liable for the return is unable to make it. It follows that where a power of attorney is granted to A specifically authorizing him to prepare a return for a nonresident alien individual, a return prepared under such agency appointment is valid.

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

SECTION 240.—CONSOLIDATED RETURNS OF CORPORATIONS.

ARTICLE 632: Consolidated returns. XI-32-5599
Ct. D. 533

INCOME TAX—REVENUE ACT OF 1921—DECISION OF COURT.

1. CONSOLIDATED RETURNS—ELECTION—COMMISSIONER'S RULING.

The ruling of the Commissioner that a corporate taxpayer is not affiliated with another corporation so as to entitle them to file a consolidated return for the year 1921 does not prevent or impair the free exercise of the right to file a consolidated return for that year if they are affiliated within the meaning of section 240(c) of the Revenue Act of 1921, and where the taxpayer is affiliated with another corporation in 1922 and files a separate return for the latter year it makes its election under subdivision (a) of that section and its tax must be computed and determined upon the basis of its separate return.

2. DECISION AFFIRMED.

The decision of the Board of Tax Appeals (16 B. T. A., 610) is affirmed.

COURT OF APPEALS OF THE DISTRICT OF COLUMBIA.

Radiant Glass Co., appellant, v. *David Burnet, Commissioner of Internal Revenue.*

Appeal from a decision of the Board of Tax Appeals.

Before MARTIN, Chief Justice, and HITZ and GRONER, Associate Justices.

[December 7, 1931.]

OPINION.

MARTIN, Chief Justice: An appeal involving income taxes for the calendar year 1922.

Appellant is an Arkansas corporation, and for the calendar year 1922 it made out and filed its corporate income tax return, showing no net revenue subject to assessment. However an examination of appellant's books of account and records, made for the Commissioner of Internal Revenue in 1926, disclosed a number of errors in the return, among which was an excessive claim of deduction for depreciation in the sum of $13,338.54. As a result of this examination the Commissioner determined a tax deficiency of $405.62, and reported this to appellant in due course.

Thereupon in June, 1926, appellant filed a petition with the Commissioner, not denying the inaccuracy of the return filed by it nor the correctness of the Commissioner's deficiency determination based upon the return, but contending by way of avoidance that in the year 1922 it was affiliated with the Times-Record Co., another Arkansas corporation, and the two companies were entitled to file a consolidated return for that year, but instead of doing so they filed separate returns, whereas a consolidated return if filed would have shown no net revenue subject to assessment. The prayer of the petition was that the taxable income and income tax of the two companies for 1922 be treated and computed as a consolidation under the Revenue Act of 1921.

Under article 632, Treasury Regulations 62, Revenue Act of 1921, affiliated corporations were obliged to file consolidated returns for the year 1921, but for the year 1922 such corporations were permitted to file either consolidated or separate returns at their election.

In the year 1921, being the year preceding that of this return, appellant and the Times-Record Co. were owned by the same interests and understood that they should file a consolidated return for that year as affiliated corporations. They filed a questionnaire with the Commissioner of Internal Revenue to secure a ruling concerning their right to make such a return. The Commissioner, acting upon a report of the affiliated section of the Bureau of Internal Revenue, ruled that the corporations were not affiliated in law, and accordingly should not file a consolidated return. The two companies thereupon filed separate returns for the year 1921.

In the following year when appellant came to make out and file its tax return for 1922, the relations of the companies remaining the same, it again filed a separate return, being that now in question.

In the year 1926, the Commissioner of Internal Revenue, overruling the answer theretofore given by him to the 1921 questionnaire, permitted an amendment of the returns for 1921, to wit, the year when a consolidated return of affiliated corporations was obligatory, but refused to permit an amendment of the returns for 1922, when such corporations were entitled to file either separate or consolidated returns at their election.

The Commissioner accordingly denied appellant's petition relating to the 1922 return, and the Board of Tax Appeals sustained his decision.

We agree with the decision of the Board.

When appellant came to make out and file its return for the year 1922, it was entitled, if affiliated with the Times-Record Co., to file either a separate or consolidated return. The ruling of the Commissioner upon the questionnaire in the prior year did not prevent or impair the free exercise of that right. Such a ruling does not have the force of law, nor are the courts bound by it. (*United States* v. *Hurst*, 2 F. (2d), 73.) The status of appellant and the Times-Record Co. was to be finally determined by the courts, and not by the Commissioner. (*Fidelity Nat. Bank* v. *Commissioner*, 39 F. (2d), 58, 61.)

Accordingly it was the right of appellant if affiliated to file a consolidated return if it so elected, and to appeal to the Board of Tax Appeals and to the courts for a judicial determination of its rights. Instead of taking this course appellant filed an inaccurate separate return for 1922, and rested upon it until it was corrected by the Commissioner in 1926. Until corrected that return reported no taxable income, and a consolidated return could have been of no greater advantage to appellant. The Commissioner was justified under these circumstances in denying appellant's petition.

The courts have uniformly held that the right of choice or election to file one or another sort of return is exercised by filing the return. (*Lucas* v. *Nat. Baseball Club*, 42 F. (2d), 984; *Alameda Inv. Co.* v. *McLaughlin*, 33 F. (2d), 120 [Ct. D. 101, C. B. VIII–2, 326]; *Levi Strauss Realty Co.* v. *United States*, 41 F. (2d), 55.)

In *Rose* v. *Grant* (39 F. (2d), 340), it is held that where husband and wife had made a single joint return of income, the Commissioner could decline to accept separate returns after the time for filing had expired. The court said: "The statute gives the right to the husband and wife to file either a separate or a joint return, but not to change from one to the other at any time it appears to their advantage to do so. The impossibility under such a system of determining the amount of the tax due as required by section 250(b) of the Revenue Act of 1921 (42 Stat., 264), as well as the administrative inconvenience thereof, condemns it."

Moreover, it is held in *Alameda Inv. Co.* v. *McLaughlin*, supra, a case bearing some analogies with this, that a refusal of the Commissioner of Internal Revenue to permit corporations to file a consolidated return of income under Revenue Act of 1921 (section 240(a), 42 Stat., 260), for an income year in which separate returns had theretofore been filed, is not a breach of a legal obligation and not subject to review, irrespective of the right of such corporations to have filed a consolidated return in the first instance. This conclusion, based upon the terms of section 240(a), supra, is manifestly correct, and is conclusive in this case.

The decision of the Board is accordingly affirmed.

Affirmed.

ARTICLE 633: When corporations are affiliated. XI–27–5537 Ct. D. 511

INCOME TAX—REVENUE ACT OF 1921—DECISION OF COURT.

1. CONSOLIDATED RETURN—AFFILIATION—CONTROL.

Where the S Corporation, owning 70 per cent of the capital stock of the K Corporation, holds an option to purchase 25 per cent of the shares of the latter corporation owned by W, which provides that if the S Corporation should elect to exercise its option then W should have the right for 30 days thereafter to purchase from the S Corporation all its shares of the K Corporation, the S Corporation does not own or control, within the meaning of section 240(c) of the Revenue Act of 1921, W's 25 per cent of the stock of the K Corporation so as to authorize affiliation of the two corporations under that clause.

2. DECISION REVERSED.

The decision of the Board of Tax Appeals (17 B. T. A., 1236) reversed.

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

Commissioner of Internal Revenue, petitioner, v. *Walden Knife Co., respondent.*

Before L. HAND, SWAN, and CHASE, Circuit Judges.

Appeal from the United States Board of Tax Appeals.

[December 7, 1931.]

OPINION.

This proceeding involves deficiencies in taxes of Walden Knife Co., a New York corporation, for the years 1921, 1922, and 1923. The sole issue presented to the Board of Tax Appeals was whether said taxpayer was affiliated with

certain other corporations during the years in question. The Board decided that affiliation existed, and redetermined the alleged deficiencies accordingly. The Commissioner has petitioned for review. Order reversed.

For the findings of fact and opinion below, see 17 B. T. A., 1236.

Per curiam: The corporations with which the taxpayer claims to have been successively affiliated (for convenience referred to as Simmons) owned 70 per cent of the taxpayer's capital stock and held options to purchase the remaining 30 per cent comprising 100 shares owned by Andrews and 500 shares owned by Whitehead. Andrews' option gave Simmons the right to purchase his shares at a stipulated price at any time upon demand. Were the Whitehead option of the same character, the case would present the question which the parties seem to think is before us, namely, whether such an option gives the holder of it "control" of the stock within the meaning of section 240 of the Revenue Act of 1921, defining affiliation (42 Stat., 260). We may assume without decision that it does.

But the option given by Whitehead is very different. It provided that if Simmons should elect to exercise its option, then Whitehead should have the right for 30 days thereafter to purchase from Simmons at their book value all the share of Walden Knife Co. This cross-option in favor of Whitehead gave him as much control over all the shares as the option in favor of Simmons could give over the 500; indeed, it left with Whitehead the final say as to ownership of the shares. (Cf. *Wadhams & Co.* v. *United States*, 67 Ct. Cls., 235 [Ct. D. 121, C. B. VIII–2, 332].) However unlikely it may be that Whitehead would have the financial means to purchase all the stock is quite as immaterial as is the fact that the business of the Walden Knife Co. was, economically speaking, entirely within the control of Simmons. It has now been authoritatively determined that section 240 contemplates "a legally enforceable control." (*Handy & Harman* v. *Burnet*, 47 F. (2d), 184 (C. C. A. 2) [Ct. D. 339, C. B. X–1, 409]; affirmed by the Supreme Court November 23, 1931.) Simmons did not have that kind of control of Whitehead's 25 per cent of the taxpayer's capital stock. Accordingly it was in error to hold that the taxpayer was affiliated with Simmons, and the order of the Board of Tax Appeals must be reversed.

SECTION 245.—TAXES ON INSURANCE COMPANIES.

ARTICLE 681: Reserve funds.

REVENUE ACT OF 1926 AND PRIOR REVENUE ACTS.

Deductions of net additions to reserve funds of insurance companies. (See I. T. 2665, page 134.)

ARTICLE 685: Other deductions.

XI–38–5701
Ct. D. 563

INCOME TAX—REVENUE ACT OF 1926—DECISION OF COURT.

DEDUCTION—INTEREST CREDITED—LIFE INSURANCE COMPANY—CASH RECEIPTS AND DISBURSEMENTS METHOD.

Interest accrued and credited in 1926, but not paid in that year, to policyholders under policy contracts providing that it was "subject to withdrawal on demand" does not constitute a constructive payment of the interest in 1926 and is not an allowable deduction in that year, under section 245(a)8 of the Revenue Act of 1926, from the gross income of a life insurance company employing, as required by the Revenue Act of 1926 and the income tax regulations thereunder, the cash receipts and disbursements method of accounting.

COURT OF CLAIMS OF THE UNITED STATES. No. K–323.

The Massachusetts Mutual Life Insurance Co. v. *The United States.*

[May 31, 1932.]

OPINION.

LITTLETON, Judge, delivered the opinion of the court.

The plaintiff, a life insurance company, was required by the revenue statute and the regulations of the Treasury Department in force during 1926 to determine its income and deductions, and compute its tax on the basis of receipts and disbursements as distinguished from an accrual basis.

The question in this case is whether the plaintiff is entitled to deduct from gross income for 1926, as interest paid, the amount of such interest credited to its policyholders during the year 1926. The policyholders were notified during the year of the amount of interest so credited and that it would be paid upon demand or handled in accordance with the terms of the policy contract, upon receipt of notice of the desire of the policyholder. The policy contract, under which the plaintiff became liable for the interest so credited, provided that it was "subject to withdrawal on demand." If a policyholder did not withdraw the interest or surrender it for application by the company in reduction of premiums or to purchase participating paid-up additions, it was allowed to accumulate and interest on such accumulations was thereafter credited to the policyholders. In these circumstances the plaintiff contends that interest in the amount of $544,964.40 credited to the policyholder was constructively paid by it and was a proper and legal deduction from gross income for the year in which credited.

The defendant insists that the interest item of $544,964.40 is purely an accrued item which, under the law and the regulations, is not an allowable deduction on the cash receipts and disbursements basis of accounting, which method of accounting the plaintiff was required to and did employ; that article 51 of Treasury Regulations 69, and prior regulations under prior Revenue Acts provide that "Income which is credited to the account of or set apart for a taxpayer and which may be drawn upon by him at any time is subject to tax for the year during which so credited or set apart, although not then actually reduced to possession. To constitute receipt in such a case the income must be credited to the taxpayer without any substantial limitation or restriction as to the time or manner of payment or condition upon which payment is to be made. * * * If the income is not credited, but is set apart, such income must be unqualifiedly subject to the demand of the taxpayer, * * *" applies solely to the recipients of a credit when, according to the method of accounting employed by the taxpayer making the credit, there is a payment for income tax purposes; that the regulation therefore can have no application to a credit by a taxpayer employing the cash receipts and disbursements method of accounting.

The plaintiff relies upon *Corliss* v. *Bowers* (281 U. S., 376 [Ct. D. 188, C. B. IX–1, 254]); *Commissioner* v. *Bingham* (35 Fed. (2d), 503 [Ct. D. 207, C. B. IX–2, 289]); *Hadley* v. *Commissioner* (36 Fed. (2d), 543 [Ct. D. 153, C. B. IX–1, 266]); *Chicago, R. I. & P. Ry. Co.* v. *Commissioner* (47 Fed. (2d), 990); *Charleston & W. C. Ry. Co.* v. *Burnet* (50 Fed. (2d), 342): *John A. Brander* (3 B. T. A., 231); *Chipley* v. *Commissioner* (25 B. T. A., 1103). These cases are not applicable to the question here involved. The Corliss case involved income from a revocable trust and the Bingham and Hadley cases involved the question whether dividends declared and made unqualifiedly subject to the demand of the stockholders were income in the year in which declared and set apart. When a dividend is declared and set apart to the stockholders the amount thereof is separated from the invested capital of the corporation and the provisions of the above-quoted regulation have been consistently applied. Section 201(e) of the Revenue Act of 1921 specifically provided that such dividends constitute income to the stockholders. The two railroad cases involved the question whether the amounts accrued and deducted by the corporations from gross income in the years credited but not paid constituted income to the corporations in subsequent years when the credits were charged to profit and loss. The Brander and Chipley cases involved the question whether a salary credited to an officer of a corporation employing the accrual method of accounting and available for withdrawal by him, constituted income, and the rule announced in the regulation quoted was applied. It will be seen, therefore,

that in the ordinary case the question of constructive receipt of income arises where the taxpayer making the credit employs the accrual method of accounting. In such cases the credit constitutes a payment for tax purposes, and it has been consistently held that the person to whom the amount is credited and made unqualifiedly subject to his demand may not escape taxation thereon by failing to withdraw it.

Other than in the administration of estates or trusts, as to which the statute specifically provides for a deduction of credits under certain circumstances, we know of no instance, and none has been called to our attention, in which it has been held that an amount credited but not paid by a taxpayer employing the cash receipts and disbursements method of accounting constitutes income to the person to whom credited. It is not claimed that the interest credited by the plaintiff to its stockholders during 1926 was taxed as income to them in that year by the Commissioner. To hold that an amount credited by a taxpayer employing a cash receipts and disbursements method of accounting constitutes a payment, and is, therefore, deductible from gross income in the year in which credited, would destroy the distinction between the accrual and the receipts and disbursements methods of accounting which is recognized and made controlling by the revenue statutes. (*United States* v. *Anderson*, 269 U. S., 422 [T. D. 3839, C. B. V–1, 179]; *United States* v. *Mitchell*, 271 U. S., 9, 12 [T. D. 3865, C. B. V–1, 233].) It follows therefore that plaintiff is not entitled to a deduction of the interest credited to its policyholders during 1926 on the ground that there was a constructive payment thereof in that year.

It is also urged by the plaintiff that section 245(a)8 of the Revenue Act of 1926 authorizes a deduction by insurance companies of interest *paid* or *accrued*, within the taxable year on its indebtedness. The language of this subsection is the same as section 234(a)2 relating to deductions by ordinary corporations, and section 214(a)2 relating to deductions by individuals, and, in our opinion, the term "paid or accrued" must be construed according to the method of accounting employed as provided in section 200(d) of the Revenue Act of 1926. We think that in the enactment of subdivision (8) of section 245(a), of the Revenue Act of 1926, Congress did not intend to make an exception in favor of insurance companies to the recognized rule that deductions from gross income should be determined in accordance with the method of accounting employed.

The petition is dismissed. It is so ordered.

SECTIONS 246 AND 247.—TAX ON INSURANCE COMPANIES.

ARTICLE 692: Gross income of insurance companies.

REVENUE ACTS OF 1921, 1924, AND 1926.

Deductions of net additions to reserve funds of insurance companies. (See I. T. 2665, page 134.)

PART IV.—ADMINISTRATIVE PROVISIONS.

SECTION 257.—RETURNS TO BE PUBLIC RECORDS.

ARTICLE 1090: Inspection of returns. XI–51–5945
T. D. 4359

INSPECTION OF RETURNS.

Regulations governing the inspection of returns of individuals, partnerships, estates, trusts, corporations, associations, joint-stock companies, and insurance companies, made pursuant to the requirements of section 2, Tariff Act of 1913; Title I, Revenue Act of 1916; Title II, Revenue Act of 1917; Titles II and III and section

1000, Title X, Revenue Act of 1918; Titles II and III and section 1000, Title X, Revenue Act of 1921; Title II and section 700, Title VII, Revenue Act of 1924; Title II, Revenue Act of 1926; Title I, Revenue Act of 1928; and Title I, Revenue Act of 1932, or any such Act as amended. Former regulations bearing on the same subject superseded.

TREASURY DEPARTMENT,
Washington, D. C.

To Collectors of Internal Revenue and Others Concerned:

Section 257(a) of the Revenue Act of 1926 provides:

Returns upon which the tax has been determined by the Commissioner shall constitute public records; but, except as hereinafter provided in this section and section 1203, they shall be open to inspection only upon order of the President and under rules and regulations prescribed by the Secretary and approved by the President. * * *

Section 257(c) provides:

The proper officers of any State may, upon the request of the governor thereof, have access to the returns of any corporation, or to an abstract thereof showing the name and income of the corporation, at such times and in such manner as the Secretary may prescribe.

Section 257(d) provides:

All bona fide shareholders of record owning 1 per centum or more of the outstanding stock of any corporation shall, upon making request of the Commissioner, be allowed to examine the annual income returns of such corporation and of its subsidiaries. * * *

Section 55 of the Revenue Act of 1928 provides:

Returns made under this title shall be open to inspection in the same manner, to the same extent, and subject to the same provisions of law, including penalties, as returns made under Title II of the Revenue Act of 1926.

Section 55 of the Revenue Act of 1932 provides:

Returns made under this title shall be open to inspection in the same manner, to the same extent, and subject to the same provisions of law, including penalties, as returns made under Title II of the Revenue Act of 1926.

Pursuant to these provisions of law the President orders that returns of individuals, partnerships, estates, trusts, corporations, associations, joint-stock companies, and insurance companies filed under the provisions of section 2 of the Tariff Act of October 3, 1913; Title I of the Revenue Act of 1916; Title II of the Revenue Act of 1917; Titles II and III and section 1000, Title X, of the Revenue Act of 1918; Titles II and III and section 1000, Title X, of the Revenue Act of 1921; Title II and section 700, Title VII, of the Revenue Act of 1924; Title II of the Revenue Act of 1926; Title I of the Revenue Act of 1928; and Title I of the Revenue Act of 1932, or any such Act as amended, shall be open to inspection in accordance and upon compliance with the following rules and regulations:

1. These regulations deal only with inspection of returns in so far as it is necessary for the President to approve regulations on this subject. Other uses to which returns may be lawfully put, without action by the President, are not covered by these regulations.

2. The word "return," when so used shall, unless otherwise indicated, include income and profits tax returns, and also special excise tax returns of corporations filed pursuant to section 1000, Title X, of each of the Revenue Acts of 1918 and 1921, and pursuant to section 700 of Title VII of the Revenue Act of 1924. Any other word or term used in these regulations which is defined by the Revenue Acts shall be given the definition contained in the Act under which the particular return is made.

3. Information returns and other written statements filed with the Commissioner of Internal Revenue designed to be supplemental to or to become a part of tax returns shall be subject to the same rules and regulations as to inspection as are the tax returns themselves.

4. Except as hereinafter specifically provided, the Commissioner of Internal Revenue may, in his discretion, upon written application setting forth fully the reasons for the request, grant permission for the inspection of returns in accordance with these regulations. The officers and employees of the Treasury Department whose official duties require inspection of returns may inspect any such returns without making such written application.

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 show-

ing 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.

10. The return of a corporation shall be open to inspection by the president, vice president, secretary, or treasurer of such corporation, or, if none, by any of its principal officers, upon satisfactory evidence of identity and official position, or by the duly constituted attorney in fact of such officer. The return of a corporation which has since been dissolved, shall, in the discretion of the Commissioner of Internal Revenue, be open to inspection to any person who under these regulations might have inspected the return at the date of dissolution.

11. The "access" to returns of corporations provided for in subdivision (c) of section 257 shall be considered as inspection of returns within the meaning of subdivision (a) of said section.

12. The "examination" of returns of corporations provided for in subdivision (d) of section 257 shall be considered as inspection of returns within the meaning of subdivision (a) of said section.

13. When the head of an executive department (other than the Treasury Department) or any other United States Government establishment desires to inspect or to have some other officer or employee of his branch of the service inspect a return in connection with some matter officially before him, the inspection may, in the discretion of the Secretary of the Treasury, be permitted upon written application to him by the head of such executive department or other Government establishment. The application must be signed by such head and must show in detail why the inspection is desired, the name and address of the taxpayer who made the return, and the name and official designation of the one it is desired shall inspect the return. When the head of a bureau or office in the Treasury Department, not a part of the Internal Revenue Bureau, desires to inspect a return in connection with some matter officially before him, other than an income, profits tax, or corporation excise-

tax matter, the inspection may, in the discretion of the Secretary, be permitted upon written application to him by the head of such bureau or office, showing in detail why the inspection is desired. The Secretary of the Treasury, upon such conditions and limitations as he may impose, is authorized to permit the inspection of returns, upon the written request of the Secretary of Commerce, by such officers and employees as the Secretary of Commerce may designate, for statistical purposes.

14. In the case of returns or copies thereof furnished by the Department for use in legal proceedings, only such inspection as necessarily results from such use is permitted.

15. Except as provided in paragraph 14 returns may be inspected only in the office of the Commissioner of Internal Revenue, Washington, D. C., unless such returns are in the custody of a collector of internal revenue or internal revenue agent in charge, in which event the return may be inspected in the office of such collector or agent, but only in the presence of an internal revenue officer designated by the collector or agent for that purpose. When the returns are in the custody of a collector of internal revenue or internal revenue agent in charge, such collector of internal revenue or internal revenue agent in charge is authorized to grant permission for the inspection of such returns in accordance with these regulations.

16. The Commissioner of Internal Revenue shall cause to be prepared a written decision in every case in which an overassessment (whether resulting in a refund, credit, or abatement) of an income, war-profits, excess-profits, estate, or gift tax is allowed, in excess of $20,000, and such decision shall be considered a public record and shall be open to inspection, during regular hours of business, in the office of the Commissioner of Internal Revenue or such office as he may designate. Such decision shall give the amount of the overassessment and shall be accompanied by a brief summary of the relevant facts and a citation of the authorities applicable thereto, or, in a case in which a decision of a court or of the Board of Tax Appeals has become final, by a citation of the court or Board decision. Under no circumstances shall the provisions of this paragraph be construed as making any return, or any part thereof, open to inspection, or as authorizing the source of any income, gains, or profits, or the specific transactions resulting in losses or expenditures, to be made public; nor shall any of the information contained in any return or relating thereto be made public except in accordance with, and to the extent necessary in carrying out, these regulations.

17. A person who, under these regulations, is permitted to inspect a return may make and take a copy thereof or a memorandum of data contained therein.

18. By section 3167, Revised Statutes, as amended by the Revenue Act of 1918, and reenacted without change in section 1311 of the Revenue Act of 1921 and in section 1018 of the Revenue Act of 1924 and in section 1115 of the Revenue Act of 1926, it is made a misdemeanor for any person to print or publish in any manner whatever not provided by law any income return, or any part thereof or source of income, profits, losses, or expenditures, appearing in any income return, which misdemeanor is punishable by a fine not exceeding $1,000 or by imprisonment not exceeding one year or both, at the discretion of the court, and if the offender be an officer or employee of the United States, by dismissal from office or discharge from employment.

19. All former regulations issued with the approval of the President in respect of inspection of returns are hereby withdrawn.

20. These regulations shall remain in force until expressly withdrawn or overruled.

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

Approved December 13, 1932.

HERBERT HOOVER,
The White House.

EXECUTIVE ORDER—INSPECTION OF INCOME TAX RETURNS.

Pursuant to authority conferred upon the President by section 257(a) of the Revenue Act of 1926, section 55 of the Revenue Act of

1928, and section 55 of the Revenue Act of 1932, it is hereby ordered that returns filed under section 2 of the Tariff Act of October 3, 1913; Title I of the Revenue Act of 1916; Title II of the Revenue Act of 1917; Titles II and III and section 1000, Title X, of the Revenue Act of 1918; Titles II and III and section 1000, Title X, of the Revenue Act of 1921; Title II and section 700, Title VII, of the Revenue Act of 1924; Title II of the Revenue Act of 1926; Title I of the Revenue Act of 1928; and Title I of the Revenue Act of 1932, or any such Act as amended, shall be open to inspection in accordance and upon compliance with rules and regulations prescribed by the Secretary of the Treasury and approved by me, bearing even date herewith.

HERBERT HOOVER.

THE WHITE HOUSE,
December 13, 1932.

PART V.—PAYMENT, COLLECTION, AND REFUND OF TAX AND PENALTIES.

SECTION 270.—DATE ON WHICH TAX SHALL BE PAID.

ARTICLE 1203: Collection of tax by suit. XI-37-5681
Ct. D. 558

FEDERAL TAXES—ESCROW AGREEMENT—DECISION OF COURT.

SUIT—ESCROW AGREEMENT OR CASH BOND—FINDING OF NO DEFICIENCY BY BOARD OF TAX APPEALS.

Where an escrow agreement in the nature of a cash bond is given in connection with a claim for abatement as security for payment of so much of an additional tax assessed as should ultimately be determined by the Commissioner to be due, the certification of the collector to the escrow agent of the final determination to be final with respect to fixing the liability of the taxpayer for the tax in question, and, after the rejection of the claim and the certification by the collector of the final determination by the Commissioner, the taxpayer appeals to the Board of Tax Appeals from the determination of the Commissioner, the order of the Board that there is no deficiency pursuant to its decision that the collection of the tax was barred by the statute of limitations has no effect upon the right of the Government to have recourse against the cash deposited with the escrow agent under the agreement.

UNITED STATES CIRCUIT COURT OF APPEALS, EIGHTH CIRCUIT.—MAY TERM, 1932.

No. 9342. *United States of America, appellant,* v. *Martin Hotel Co., a Corporation, et al., appellees.*

No. 9347. *Martin Hotel Co., a Corporation, et al., appellants,* v. *United States of America, appellee.*

Appeals from the District Court of the United States for the District of Nebraska.

[May 18, 1932.]

OPINION.

SANBORN, Circuit Judge, delivered the opinion of the court.

In March, 1924, the collector of internal revenue for the district of Iowa assessed additional corporate income and profits taxes against the Martin

Hotel Co. for the year 1918 of $2,306.96, and for the year 1919 of $25,593.21; and against the M. & M. Hotel Co. for the year 1918 of $2,338.31, and for the year 1919 of $13,525.12. He notified both companies of these additional taxes on March 18, 1924, and demanded their payment. Thereupon the taxpayers filed claims for the abatement of these taxes, and asked that collection be stayed. The assessments were transferred to the internal revenue collection district of Nebraska in June, 1924, at the request of the taxpayers. The Commissioner of Internal Revenue refused to consider the claims in abatement and to refrain from collecting the taxes unless their payments was secured. On July 10, 1924, in consideration of the postponement of proceedings to collect the taxes until the claims for abatement were determined, the taxpayers and E. C. Eppley, an officer of each of them, deposited with the Omaha National Bank, of Omaha, Nebr., $48,000, in accordance with the terms of a declaration of trust or escrow agreement, which was delivered to the collector of internal revenue for the district of Nebraska as security for the payment of the additional taxes assessed or so much thereof as should ultimately be determined to be due. This agreement, which was, in effect, a cash bond, after reciting the assessment of the additional taxes, that they were due and collectible, and that the taxpayers had filed claims for their abatement, provided:

"Now, for the protection of the interests of the United States during the pendency of said claims of said hotel companies for abatement of said taxes, said Martin Hotel Co. and said M. & M. Hotel Co. by arrangements with said E. C. Eppley, have caused to be deposited with Omaha National Bank at Omaha, Nebr., as escrow agent, the principal sum of $48,000 to be used in the payment of all such taxes hereinbefore referred to, as may eventually be determined by said Commissioner of Internal Revenue to be due from said Martin Hotel Co. and said M. & M. Hotel Co. upon final consideration of said claims for abatement filed by said Martin Hotel Co. and said M. & M. Hotel Co.

"Now, therefore, this declaration of trust is made by said Omaha National Bank, escrow agent, for the purpose of stating the terms and conditions of said trust:

"1. Said principal sum of $48,000 so deposited with said Omaha National Bank as escrow agent hereunder, shall be held by said escrow agent until the final determination of said additional corporation income taxes due from said Martin Hotel Co. and said M. & M. Hotel Co. for the years 1918 and 1919 is made by said Commissioner of Internal Revenue in accordance with the procedure prescribed by the law and regulations for such cases. Said final adjustment and determination shall be certified to said Omaha National Bank by said collector of internal revenue for the district of Nebraska and such certification shall be final with respect to fixing the liability of said taxpayers for the years in question."

The agreement then provides that if, within 10 days after the final determination of the taxpayers' liability is made, they shall pay any and all additional corporation income taxes found due from them, or either of them, upon the final hearing of their claims in abatement, and shall exhibit to the escrow agent satisfactory proof of payment, the escrow agent shall deliver to them the principal sum; that if, at the end of 10 days after the final determination of their tax liability, they shall not have paid the taxes found due upon final consideration of their claims, then, upon notice to that effect from the collector of internal revenue for the district of Nebraska, the escrow agent shall pay over to the said collector all of the principal sum of $48,000 that may be necessary to pay the additional taxes finally determined to be due from the taxpayers, together with any penalties or interest thereon, and shall pay over any balance remaining to the taxpayers.

In reliance upon this agreement, the Government postponed proceedings to collect the additional taxes pending the consideration of the claims for abatement, and on August 24, 1925, the Commissioner of Internal Revenue considered those claims, and on that day advised the taxpayers that there remained unabated of the additional taxes of the Martin Hotel Co. for the year 1918, $746.70, and for the year 1919, $14,518.48; and of the additional taxes of the M. & M. Hotel Co. for 1918, $1,084.64, and for 1919, $11,544.22; and advised them of their right to file a protest within 30 days. They filed such a protest, and he again considered their claims, but did not change his determination, and so informed them by letter of March 23, 1926. In that letter

he advised them that, under section 274 of the Revenue Act of 1926, they were allowed 60 days in which to file an appeal with the Board of Tax Appeals "contesting in whole or in part the correctness of this determination."

On October 5, 1927, the collector of internal revenue for the district of Nebraska certified in writing to the Omaha National Bank that a final adjustment and determination had been made by the Commissioner of Internal Revenue with reference to the additional taxes in question, and that none of the taxes had been paid as finally determined, and he demanded so much of the $48,000 deposited as was necessary to pay the taxes with interest. This demand was not complied with.

The taxpayers did not appeal to the Board of Tax Appeals from the determination by the Commissioner of the deficiencies in their 1918 taxes, but did appeal from his determination of the deficiencies in the 1919 taxes. On January 15, 1930, the Board of Tax Appeals filed an opinion (see *Martin Hotel Co. and Affiliated Corporations, petitioners,* v. *Commissioner of Internal Revenue, respondent* (18 B. T. A., 826)) reciting that the taxpayers had set up the statute of limitations as a bar to the collection of the deficiencies in their taxes for the year 1919 as determined by the Commissioner, and that the Commissioner claimed that the escrow agreement was a waiver of the right of appeal to the Board or a waiver of the statute of limitations. The Board said:

"With respect to the Martin Hotel Co. and the M. & M. Hotel Co., the questions presented are two: First, whether the so-called escrow agreement executed by them constitutes a waiver of their right to ask of this Board a review of the deficiencies finally determined against them, and, second, does that agreement, if not a waiver of jurisdiction, constitute a waiver of the statutory limitation against collection?"

And, further:

"We hold that the agreement in question does not constitute a waiver of the right of these two taxpayers to appeal to the Board and that we have jurisdiction to entertain the appeal.

"In respect to the question raised that the escrow agreement constitutes a waiver of the statute of limitations, we see nothing in its terms to cause it to be considered as anything more than a personal bond with a cash deposit as security and having no more effect than bonds given in several other cases upon which we have passed in which a similar question has been raised. * * *

"We hold that the so-called escrow agreement of July 10, 1924, did not constitute a waiver of the 5-year statute of limitations and, as the admitted facts show that the returns in question were filed more than five years prior to the date of the determination of the deficiencies in question and that the assessments were made prior to the enactment of the Revenue Act of 1924, that collection of these deficiencies is, upon authority of *Russell* v. *United States,* supra (278 U. S., 181 [T. D. 4260, C. B. VIII–1, 206]), now barred. This conclusion is not in conflict with the decision in the case of *United States* v. *John Barth Co.* (279 U. S., 370 [Ct. D. 65, C. B. VIII–1, 189]). As we read that case it involves solely the question of the defendant's liability under suit brought upon the obligation created by the execution of a bond under a specific provision of the taxing Act, not here involved, calling for such bond and granting the taxpayers a stay of collection in cases where it was furnished. In the proceeding before us we consider the so-called escrow agreement only for the purpose of determining whether it constitutes a waiver of jurisdiction, or a waiver of the statutory limitation in respect to collection of the tax as such, and we do not pass upon the question as to whether these taxpayers have liabilities under the escrow agreement and created thereby."

The Board then ordered that a decision be entered "that collection of the deficiencies determined in respect to these * * * petitioners is now barred by the statute of limitations." The decision and order of the Board, so far as is here material, is as follows:

"In accordance with the findings of fact and opinion of the Board of this proceeding of January 15, 1930, it is hereby * * * ordered and decided that for the calendar year 1919 there is no deficiency in income or profits taxes in respect to any of the following petitioners herein: Martin Hotel Co., Sioux City, Iowa; M. & M. Hotel Co., Cedar Rapids, Iowa. * * *"

No appeal was taken from this decision.

The Government brought suit against the bank, as escrow agent, joining Mr. Eppley and the taxpayers, to recover so much of the deposit as equaled

the amount of the additional taxes as finally determined by the Commissioner, with interest. The defense against the claim so far as it was based on the 1918 taxes was that they were outlawed when the escrow agreement was made, and, so far as it was founded upon the 1919 taxes, that the Board of Tax Appeals had determined that there was no deficiency in such taxes. The case was tried without a jury. The court held the bank liable as to the amount of the 1918 taxes and interest, but was of the opinion that the decision of the Board of Tax Appeals that there was no deficiency in the 1919 taxes precluded the Government from recovering the amount of those taxes and interest under the terms of the escrow, and that therefore the taxpayers were entitled to all of the $48,000 deposited except so much as was required to cover the 1918 taxes. Both sides appealed, but the correctness of the court's decision as to the 1918 taxes is now conceded, and the dismissal of Appeal No. 9347 is consented to. We are therefore only concerned with that portion of the judgment of the court below which denies to the Government the right to recover under the escrow the amount of the 1919 taxes and interest.

The escrow agreement of July 10, 1924, was for the protection of the interests of the United States during the pendency of the claims for abatement. The deposit was "to be used in the payment of all such taxes hereinbefore referred to as may eventually be determined by said Commissioner of Internal Revenue to be due * * * upon final consideration of said claims for abatement." The escrow agent was to hold the deposit "until the final determination of said additional corporation income taxes due from said Martin Hotel Co. and said M. & M. Hotel Co. for the years 1918 and 1919 is made by said Commissioner of Internal Revenue in accordance with the procedure prescribed by the law and regulations for such cases." The final adjustment and determination was to "be certified to said Omaha National Bank by said collector of internal revenue for the district of Nebraska," and such certification was to "be final with respect to fixing the liability of said taxpayers for the years in question." If the taxpayers failed to pay the taxes 10 days after final determination, the bank was to pay over so much of the deposit as should be necessary to cover the taxes with interest and penalties.

The Commissioner made a determination of the amount of the additional taxes upon a final consideration of the claims for abatement. This final determination was certified to the bank by the collector. The taxpayers did not pay the taxes within the 10 days specified, and the bank did not pay them out of the deposit.

It is now conceded that the certification by the collector was final as to the 1918 taxes, since no appeal was taken from the determination of the Commissioner with respect to them, but it is contended that it was not final as to the 1919 taxes, with reference to which the Board of Tax Appeals found no deficiency.

Assuming that the taxpayers might impeach the certificate of the collector in spite of their agreement as to its finality, and assuming that the agreement contemplated that the determination by the Commissioner should be subject to review by the Board of Tax Appeals, and that its determination should be deemed to be his determination, we think it still does not appear that the Government was not entitled to recover. The escrow agreement referred to a tax liability of the taxpayers for the years 1918 and 1919 as it existed July 10, 1924, and was intended to secure the payment of the taxes which were then due and subject to collection, but the amount of which was then in dispute. There was at that time no controversy between the Government and the taxpayer with reference to the collectibility of the taxes, but only as to their amount. The agreement and the deposit made thereunder protected the Government in foregoing its remedies for the collection of the taxes and left it with a secured claim for an amount equal to what it should finally be determined was the correct amount owed by the taxpayers as corporate income taxes for the years 1918 and 1919 and interest.

The Board of Tax Appeals never passed upon the question of the amount of additional income taxes owed by the taxpayers for the year 1919. It failed to do this for the reason that the taxpayers asserted that the collection of the deficiencies as ultimately determined was barred by the statute of limitations, and the Board specifically passed upon no other issue, and concluded that there was no deficiency in those years because the collection of the taxes as such was then barred. The decision which was entered by the Board was no broader than its opinion and findings, and was in conformity with section 601 of the

Revenue Act of 1928, amending section 906(e) of the Revenue Act of 1926 (ch. 852, 45 Stat., 871, 872), which provided: "If the assessment or collection of any tax is barred by any statute of limitations, the decision of the Board to that effect shall be considered as its decision that there is no deficiency in respect of such tax."

Had the Board of Tax Appeals determined that, upon the merits, there were no deficiencies in corporate income taxes for the year 1919, there might be some substantial basis for holding that its decision must, under the terms of the escrow agreement, be regarded as the final determination of the Commissioner, and that, therefore, the certification by the collector did not fix the taxpayers' liability or the obligation of the bank under the escrow agreement, regardless of the fact that the agreement provided that such certification was to be final. Considering, however, the substance of what was decided by the Board, and disregarding mere form, the action of the Board constitutes nothing more than a finding that the liability of the taxpayers for additional taxes for 1919, as determined by the Commissioner, was no longer enforceable as such. It did not disturb the determination of the Commissioner as to the amount of additional taxes which were due and unpaid for the year 1919, and the payment of which was secured by the deposit. It is our opinion that the Commissioner's determination, certified to the bank by the collector of internal revenue, must stand as fixing the liability of the taxpayer under the provisions of the escrow agreement, and that the decision of the Board of Tax Appeals had no effect upon the right of the Government to have recourse against the deposit in the hands of the bank.

In the case of *Gulf States Steel Co. et al.* v. *United States* (56 Fed. (2d), 43 [Ct. D. 464, C. B. XI–1, 305]), the Circuit Court of Appeals of the Fifth Circuit had before it substantially the same question that is presented here. The court said (page 44):

"The appeal presents the single question whether the finding by the Board of Tax Appeals on a petition for redetermintion 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). 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.)"

We think that the case before us is also ruled by the case of *United States* v. *John Barth Co.*, above referred to.

Appeal No. 9347 is dismissed, and in appeal No. 9342, so much of the judgment as is appealed from is reversed and the case remanded for further proceedings not inconsistent with this opinion.

ARTICLE 1203: Collection of tax by suit. XI–49–5900
Ct. D. 608

FEDERAL TAXES—LIABILITY ON BOND—DECISION OF SUPREME COURT.

SUIT—BOND—ABATEMENT OF TAX—FINDING OF BOARD OF TAX APPEALS.

Where a bond is executed, to stay the collection of an additional assessment, pending disposition of a claim for its abatement, 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.

SUPREME COURT OF THE UNITED STATES.

Gulf States Steel Co. and National Surety Co., petitioners, v. The United States of America.

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

[November 7, 1932.]

OPINION.

Mr. Justice MCREYNOLDS delivered the opinion of the court.

In the District Court for Alabama—August 25, 1930—the United States sued the Gulf States Steel Co., principal, and National Surety Co., surety—petitioners here—upon a bond dated September 9, 1925, whereby they agreed to pay Snead, collector of internal revenue, so much of the additional income and profits taxes for 1917 assessed by him against the principal in 1921 "as is not abated." Judgment on a verdict went for plaintiffs; the Circuit Court of Appeals affirmed; the matter is here by certiorari.

Petitioners say the sole question presented is whether the additional taxes were abated by the determination of the Board of Tax Appeals (July 10, 1928) in a proceeding brought by the Steel company to review the Commissioner's final rejection of its demand for abatement. The Board held "that the respondent is now barred by statute from collecting any part of the additional assessment made in April, 1921, and that there is no deficiency for the year 1917." It directed entry of an order to that effect.

The petition for certiorari asserts: "The sole question in this case is whether the final decision of the Board that there was no deficiency 'abated' the tax." The following is the only specification of error relied on here—"That the court erred in holding that the claim for the deficiency of taxes was not abated by the final decision of the United States Board of Tax Appeals that there was no deficiency." And in their brief counsel for petitioners say—"The sole question in this case is whether the final decision of the Board that there was no deficiency 'abated' the tax."

March 28, 1918, the Steel company filed its income and excess profits tax return for 1917 and shortly thereafter paid the amount apparently due. In April, 1921, the Commissioner made a deficiency assessment of $153,815.30; May 6, 1921, the company filed claim and demand for abatement of this entire sum upon the ground that the additional assessment was unwarranted and illegal in so far as it results—(1) From the failure to compute the invested capital by including the actual cash value of claimant's property on January 1, 1914; (2) from the action of the examiners in deducting only 7 per cent of invested capital, instead of 8 per cent; and (3) from disallowance of certain interest payments as part of invested capital.

March 13, 1923, 15 days before the 5-year statute would have barred collection of the deficiency assessment—the additional tax being wholly unpaid and the abatement claim undetermined—in order to secure delay and further consideration of objections, the taxpayer as principal, with the American Surety Co. as surety, gave the collector a bond for $175,350 which recites—

"The condition of the above obligation is such that, if the said Gulf States Steel Co. will indemnify the said W. E. Snead as collector as aforesaid, or his successor in office, against all loss, cost, damage, and expense to which he may be put by reason of having allowed the said Gulf States Steel Co. to withhold the payment to him, as such collector, of the sum of one hundred and fifty-three thousand eight hundred fifteen and 30/100 dollars ($153,815.30), claimed of it under the War Revenue Act of 1917, pending the filing, by the said Gulf States Steel Co. of additional facts and information in support of a claim for the abatement of said amount heretofore filed by it, then this obligation to be null and void, otherwise, to be and remain in full force and effect."

April 3, 1925, in order to obtain release of the American Surety Co. from the above-described bond, also to make certain the payment of whatever the collector might thereafter finally declare to be payable under the deficiency assessment of 1921, the Steel company executed a second obligation and pledged as security $200,000 United States Liberty loan bonds. This obligation recites—

"Whereas the Gulf States Steel Co. did execute a bond in the penal sum of one hundred seventy-five thousand, three hundred and fifty dollars ($175,350), and in favor of W. E. Snead, collector of internal revenue, for the district of Alabama, which said bond was signed by the American Surety Co. of New York, as surety, under date of the 13th day of March, 1923, and was given in support of a claim for the abatement of assessments, penalties and interests, under the Revenue Act of 1917. Being desirous of relieving the above bound surety company and further securing the payment of any amount found to be due the United States Government under the above Revenue Act, now, therefore, if the undersigned Gulf States Steel Co. shall pay to W. E. Snead, collector, or his successors in office, such amount of the claim as is not abated, together with all costs, damages, penalties, interest, or other expense connected therewith, then this obligation shall be void, otherwise it shall remain in full force and effect."

September 9, 1925, the Steel company as principal, and National Surety Co. as surety, executed the bond in suit, conditioned as follows—

"Whereas, an additional income tax has been assessed for the year 1917 in the sum of one hundred fifty-three thousand eight hundred and fifteen dollars and thirty cents ($153,815.30), with penalty and interest against the Gulf States Steel Co. of Birmingham, Ala. A claim for the abatement of the additional tax was filed with the collector of internal revenue for the district of Alabama at Birmingham. On the 3d day of April, 1925, the Gulf States Steel Co. did execute its bond securing the payment of so much of the additional assessment, penalties and interest as is not abated. In lieu of surety on the above bond the said company did deposit with the Federal Reserve Bank of New York, under section 1029 of the Revenue Act of 1924, the following described United States, Fourth Liberty Loan 4¼% Gold Bonds of 1933–8 series, being of the par value of $200,000 (coupons), numbers * * *. The above bonds were deposited on account and subject to the orders of W. E. Snead, collector of internal revenue for the district of Alabama. Now, therefore, if W. E. Snead, collector of internal revenue, shall release and surrender the said bonds to the said company, and the principal, or sureties, either or both, shall pay to the said collector so much of the amount of the claim as is not abated, together with penalties and interest thereon as provided by law, then this obligation shall be of no effect. Otherwise, it shall remain in full force."

May 12, 1926, the Commissioner finally rejected *in toto* the Steel company's long pending claim for abatement of the additional assessment of 1921 and gave proper notice. This notice among other things stated—"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."

By an original petition to the Board of Tax Appeals, July 9, 1926, the Steel company asked a "redetermination of the deficiency set forth by the respondent (Commissioner) in his notice of deficiency * * * dated May 12, 1926." The prayer follows—

"The petitioner prays for relief from the deficiency asserted by the respondent and from payment of the taxes assessed in the following and each of the following particulars:

"(a) That the petitioner be allowed as a deduction from its gross income for the year 1917, the sum of $47,021.82 as amortization of the cost to it of the lease (or stock) of Clinton Mining Co. or as depletion or exhaustion of the leased properties based upon a cost of $145,000; or

"(b) That the Clinton Mining Co. be granted a reasonable allowance for the exhaustion or depletion of the leased properties based upon a March 1, 1913, value of the leasehold, and that amount so allowed be deducted in computing the consolidated net income of the petitioners and Clinton Mining Co. for the year 1917;

"(c) That the petitioner be allowed $11,000,000 in computing its invested capital for 1917, on account of the property paid in for stock on December 1, 1913.

"Wherefore petitioner prays that this Board may hear and determine the deficiency herein alleged."

By an amended petition, March 2, 1927 (after *Bowers* v. *New York & Albany Lighterage Co.*, February, 1927, 273 U. S., 346 [T. D. 4009, C. B. VI–1, 268]) the Steel company renewed its request for "a redetermination of the deficiency set forth by the respondent in his notice of deficiency" dated May 12, 1926.

The petitions are identical except the amended one contains two new paragraphs which allege extinguishment through the statute of limitations of all liability of the Steel company for the additional taxes; also the following new prayer—

"(d) That the Board determine that the liability of the petitioner for the payment of the alleged deficiency has been extinguished by the running of the statute of limitations upon its collection and/or that the collection of said alleged deficiency was barred at the expiration of five years after said returns were filed."

The Board of Tax Appeals in July, 1928, held—"None of the bonds in the instant case can be said to constitute a consent in writing by both the Commissioner and the taxpayer to a later determination, assessment and collection of the tax in question, and no other exception to the running of the statute of limitations provided in any of the Acts being present, and no suit or proceeding for the collection of tax having been begun prior to the expiration of five years from the date of filing the return, and the 5-year period having expired prior to the passage of the Revenue Act of 1924, we hold that the respondent is now barred by statute from collecting any part of the additional assessment made in April, 1921, and that there is no deficiency for the year 1917. (*Bowers* v. *New York & Albany Lighterage Co.*, 273 U. S., 346; *C. B. Shaffer* v. *Commissioner*, 12 B. T. A., 298; *United States* v. *The John Barth Co.*, 279 U. S., 370 [Ct. D. 65, C. B. VIII–1, 189]; *Art Metal Works* v. *Commissioner*, 9 B. T. A., 491.) Our decision in this respect in no wise disposes of any questions arising as to liability on the bond." The consequent formal entry recites—"It is ordered and adjudged that the collection of the deficiency, if any, in income and excess profits taxes for the year 1917 is barred by the statute of limitations * * *."

Bowers v. *New York & Albany Lighterage Co.* (February 21, 1927, 273 U. S., 346) construed the provision, Revenue Act 1921, prohibition suit or proceeding for the collection of income or excess profits taxes, after five years subsequent to the return and held it applied both to suits in court and to distraint proceedings. Prior to this tax officers went upon the view that the statute of limitations did not apply to distraint.

United States v. *The John Barth Co.* (279 U. S., 370, May 13, 1929) ruled that the limitation in Revenue Acts 1918, 1919, 1921, and 1924 upon the time within which income and excess profits taxes may be assessed and suits begun to collect is inapplicable where the suit is upon a bond given to secure payment of taxes theretofore returned and assessed, in order to obtain postponement of payment pending decision upon claim for abatement; also, that a bond made in such circumstances affords a cause of action separate and distinct from one to collect the tax.

Prior to 1924, in order to contest the Commissioner's assessment, the taxpayer had to pay the sum demanded and bring suit to recover. (*Graham* v. *Dupont*, 262 U. S., 234, 258 [T. D. 3486 (Ct. D. 33), C. B. II–1, 226].)

Title IX—Board of Tax Appeals—Act June 2, 1924 (ch. 234, 43 Stat., 253, 336), established the Board of Tax Appeals and authorized it to hear appeals from the Commissioner's action in respect of deficiencies before payments, etc. Under this Act if the Board disallowed an alleged deficiency, thereafter the Commissioner could enforce collection only by suit in court.

The Revenue Act, February 26, 1926—Title X; Board of Tax Appeals—(ch. 27, 44 Stat., 9, 105, 107), amended Title IX—Board of Tax Appeals, Organization and procedure—Act of 1924, supra, by adding thereto, among other things (under subtitle "Organization and procedure") the following wholly new paragraph:

"SEC. 906. (e) If the assessment or collection of any tax is barred by any statute of limitations, the decision of the Board to that effect shall, for the purposes of this title and of the Revenue Act of 1926, be considered as its decision that there is no deficiency in respect of such tax."

Section 274 (a) and (b) of this Act are in the margin.[1]

The Revenue Act, May 29, 1928, "Title IV—Administrative provisions" (45 Stat., 791, 871, 872, ch. 854), amended the above-quoted section 906(e) to read—"If the assessment or collection of any tax is barred by any statute of limitations, the decision of the Board to that effect shall be considered as its decision that there is no deficiency in respect of such tax."

The original complaint in the present cause alleges that the Steel company's claim for abatement of the additional assessment for the year 1917 was rejected by the Commissioner May 12, 1926, "for the full amount thereof, whereby there remained unpaid and unabated of the said assessment one hundred fifty-three thousand, eight hundred fifteen dollars and thirty cents ($153,815.30), which said finding and determination of the Commissioner of Internal Revenue rejecting said claim for abatement has remained and now is in full force, vigor and effect, unvacated, unreversed and unmodified and is subject to no credits, set-offs or counterclaims other than hereinafter set forth." Petitioners denied this allegation. They maintained that the Commissioner's action had been reversed and the additional taxes abated by the opinion and ruling of the Board of Tax Appeals and this seems to have been the only point relied upon in the Circuit Court of Appeals which rejected petitioners' theory and approved the challenged judgment on the bond.

Concerning the Board's action that court said—"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 limitations 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."

The bond in suit must be construed in the light of surrounding circumstances. (*Hill* v. *American Surety Co.*, 200 U. S., 197, 203, 204, 205.) They are narrated above.

As in *United States* v. *Barth*, supra, the plain purpose of the first bond—March 13, 1923—was to prevent immediate collection of the assessed additional taxes and to provide against any loss which might follow delay whether through extinguishment of rights under the statute of limitations or otherwise. We think it sufficiently clear that the two succeeding bonds were intended to continue the protection afforded by the first. The taxpayer, having attained its purpose through these bonds, now claims that the United States can not enforce the obligation which induced the delay contemplated by all parties. It seeks escape through literal construction of a statute evidently designed to protect taxpayers in different circumstances.

Considering the state of the record, it is only necessary now to pass on one point—Were "the additional assessments, penalties and interest" "abated" by the Board of Tax Appeals final determination, within the meaning of the bond in suit. Unless this is answered in the affirmative, the judgment below must stand. There is no suggestion that it should be upset upon any other ground.

Petitioners maintain that the Board had jurisdiction of the appeal from the Commissioner; that it definitely ruled "the collection of the deficiency, if any, of income and excess profits taxes for the year 1917 is barred by the statute of limitations" and that the necessary result of this ruling was abatement of the

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[1] SEC. 274. (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.

(b) If the taxpayer files a petition with the Board, the entire amount redetermined as the deficiency by the decision of the Board which has become final shall be assessed and shall be paid upon notice and demand from the collector. No part of the amount determined as a deficiency by the Commissioner but disallowed as such by the decision of the Board which has become final shall be assessed or be collected by distraint or by proceeding in court with or without assessment.

additional assessments, mentioned in the 1925 bond. This conclusion, they say, is inescapable under the clear mandate of section 906(e), Revenue Act of 1924, as amended by the Acts of 1926 and 1928—"If the assessment or collection of any tax is barred by any statute of limitations the decision of the Board to that effect shall be considered as its decision that there is no deficiency in respect of such tax."

As the provisions of section 906(e) first came into the law after execution of the bond, they could not then have been within contemplation of the parties. The bond of 1925, like the two preceding ones, was given to protect the United States against loss; it referred to the tax liability existing March 13, 1923—$153,815.30—and was intended to guarantee payment of that sum unless reduced or annulled by some future payment of the Commissioner. Payment might have been enforced; but the taxpayer claimed the amount assessed was too high and procured further delay for investigation by executing the bond. The possible abatement—partial reduction or annulment—there referred to depended upon the future decision of the Commissioner.

On appeal to the Board the taxpayer challenged the assessment as erroneous; also, because under the statute of limitations there remained no right to enforce the tax. As to the first ground, the Board found nothing. It declared only that the statute had run against the right to collect the tax—this upon the taxpayer's prayer. In no proper sense was there a redetermination of the deficiency assessed in 1923. The anticipated bar of the tax by the statute could not affect the controversy—was not the point in issue, was not disputed. The bond required payment of a stated sum under the assessment already made, unless this should be abated by the Commissioner. What abatement should be allowed was the matter before him and a reexamination of his determination was necessarily limited to those matters which might have been presented to him. By the prayer based on the statute of limitations the taxpayer defeated a determination of the real controversy.

In the circumstances, possibly, a decision upon the merits might have been regarded as the Commissioner's action within the implication of the bond. The effective scope of the decision rendered is no broader than the issue, opinion and findings. It left undisturbed the Commissioner's assessment of 1923. This the bond undertook to pay wholly without regard to the right to enforce the tax as such.

The existence of the bar under the statute, as against the lien or right to enforce the tax as such, was never the subject of controversy—was not denied. And as the present suit is not to enforce the tax as such, but an obligation given in contemplation of the loss of right to enforce, a decision proclaiming this loss is but announcement of something expected by all parties—an unfruitful pronouncement upon an immaterial point. (*United States* v. *Barth*, supra. See *United States* v. *Martin Hotel Co.*, 59 F. (2d), 549 [Ct. D. 558, page 310, this bulletin].) As the Board failed to pass upon the Commissioner's refusal to reduce the amount of the assessment, that sum, with interest, etc., now represents what is due upon the bond. The Board expressly disclaimed purpose to rule concerning this obligation—the question was not present. It might, with propriety, have examined the objections to the amount of the 1923 assessment; but the taxpayer asked another course.

Section 906(e) may find proper application on an ordinary appeal, as for example, where the Commissioner's right to assess is challenged because the statute of limitations had run, or where, as in *Bowers* v. *New York & Albany Lighterage Co.*, supra, the collector asserts the right to enforce payment by distraint after the statutory bar. It can have no application to what may have been said or done by the Board when undertaking to redetermine a deficiency having no possible relation to the statute of limitations.

The literal construction of section 906(e) proposed by the petitioners would lead to consequences manifestly unjust, if not absurd. When the bond in suit was executed the statute had extinguished the right of the United States to enforce the tax as such. That Congress thereafter actually intended to release the parties whenever the Board should declare this fact is beyond belief. The thing announced by the Board had no real relation to the obligation of the bond. When possible, every statute should be rationally interpreted with the view of carrying out the legislative intent. We can not attribute to Congress the purpose necessary to support petitioners' urgence.

Affirmed.

SECTIONS 273 AND 274.—DEFICIENCY IN TAX.

ARTICLE 1232: Assessment of a deficiency. XI-34-5627
Ct. D. 540

INCOME TAX—REVENUE ACT OF 1926—DECISION OF COURT.

1. BOARD OF TAX APPEALS—JURISDICTION—DEFICIENCY NOTICE ERRONEOUSLY ADDRESSED—EFFECT OF APPEAL.

Where a trustee files a return of income for a trust and a notice of a deficiency, pursuant to section 274(a) of the Revenue Act of 1926, which is received by the trustee, is erroneously addressed to the beneficiary of the trust and erroneously refers to the deficiency as that of the beneficiary, the general appearance by the trustee in an appeal it filed to the Board of Tax Appeals from the Commissioner's determination waives the defect in the notice and confers jurisdiction of the appeal upon the Board.

2. DECISION REVERSED.

The decision of the Board of Tax Appeals (20 B. T. A., 162) is reversed.

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

Commissioner of Internal Revenue, petitioner, v. *The New York Trust Co., Trustee under Trust Indenture, dated December 24, 1921, by and between Conrad Henry Matthiessen and said the New York Trust Co., respondent.*

Before MANTON, AUGUSTUS N. HAND, and CHASE, Circuit Judges.

[December 7, 1931.]

OPINION.

Petition to review an order of the Board of Tax Appeals. The order entered dismissed the appeal for lack of jurisdiction, upon suggestion of the petitioner, for the insufficiency of the deficiency notice served. (20 B. T. A., 162.) Order reversed.

MANTON, Circuit Judge: The New York Trust Co. became trustee for Conrad Henry Matthiessen who, by irrevocable indenture dated December 24, 1921, conveyed to it 6,000 shares of common stock of the Corn Products Refining Co., which cost him, on April 27, 1906, $141,375. At the date of transfer, the stock was valued at $557,500. During the year 1922, the trustee sold the 6,000 shares for $603,385. On March 15, 1923, the trustee filed an income tax return for the year 1922 for the trust, reporting a profit of $87,385. The beneficiary filed no tax return for 1922. He was then a minor and under the terms of the trust, was not entitled to receive any income from the trust and therefore was not subject to a tax. The collector, upon examination of the return, imposed an additional tax liability of $238,275.95.

In the tax return filed by the trustee, in the space provided for the name and address of the taxpayer, were the words "The New York Trust Co. as Trustee for Erard Matthiessen (a minor) of indenture dated December 24, 1921." On May 22, 1926, the internal revenue agent rendered his report to the supervising internal revenue agent in New York of his examination of the books and records of the "New York Trust Co. as trustee for Erard Matthiessen (a minor) of indenture dated December 24, 1921, 100 Broadway, New York City, N. Y." On August 28, 1926, a form letter transmitting the report to the Commissioner had only one line for the taxpayer's name and it was filled in "Ernard Matthiessen (a minor)" with "N. Y. Trust Co., trustee," entered below on the line for the address. On June 28, 1926, a copy of the report was mailed to the New York Trust Co. with a letter of transmittal addressed, "New York Trust Co., as trustee for Erard Matthiessen (a minor)," etc. A protest against the report was filed under a similar caption by the New York Trust Co. On February 8, 1927, the Commissioner in proposing an assessment of deficiency

as determined by the revenue agent, erroneously directed the letter to "Mr. Erard Matthiessen, c/o New York Trust Co., Trustee, 100 Broadway, New York, N. Y." This letter was received and answered by respondent. A conference was held by a representative of the trust company with the Bureau of Internal Revenue in regard to the deficiency proposed against the New York Trust Co. as trustee. A letter denying a postponement of the conference due to the fact that the statutory period for assessment would shortly expire was mailed February 25, 1927, and on March 12, 1927, a 60-day deficiency letter was mailed and had attached thereto a statement captioned: "Mr. Erard Matthiessen, c/o New York Trust Co., Trustee, 100 Broadway, New York, N. Y." The statement was as follows:

"Under date of February 8, 1927, you were advised that the report of the internal revenue agent in charge at New York, N. Y., a copy of which was furnished you under date of May 22, 1926, had been reviewed in this office and approved as submitted.

"The deficiency in tax of $238,275.95 resulted from the adjustment of income from sale of 6,000 shares of Corn Products Refining Co. stock assigned by Conrad H. Matthiessen in 1921 to the New York Trust Co., as trustee, for your benefit.

"In determining taxable profit from this transaction the examining officer used the difference between the selling price and the original cost of this stock to the donor, Conrad H. Matthiessen.

"In a conference held in this office it was contended that taxable profit represented the difference between the selling price and the value of the stock at the time it was transferred to the trustee in 1921.

"After careful consideration of the evidence submitted it is held that the profit as computed under article 1562, Regulations 62, is correct, and the findings by the examining officer are therefore sustained.

"Payment of the tax should not be made until a bill is received from the collector of internal revenue for your district, and remittance should then be made to him."

On April 29, 1927, another letter was addressed to the New York Trust Co., as trustee, referring to the deficiency letter of March 12, 1927, upholding the Bureau's decision as to the taxation of the profit of the sale of the stock.

On May 9, 1927, the respondent filed with the Board of Tax Appeals, a petition for redetermination of the tax set forth by the Commissioner in his notice of deficiency dated March 12, 1927. It was filed in the name of the New York Trust Co. as trustee, reciting, among other things, that the notice of deficiency was mailed to the petitioner and that the tax in controversy was income tax for the year 1922. It was verified by an officer of the trust company, and attached thereto, as Exhibit A, was a copy of the letter of March 12, 1927. No question was raised by the pleading as to the adequacy of the notice nor was any question of jurisdiction. The content was based solely upon the question of profit derived from the sale of the stock. An answer was filed to the petition by the Commissioner of Internal Revenue on July 8, 1927, and an amended answer was filed December 7, 1929, alleging that a hearing had been had on March 2, 1927, between the attorney for the trustee and representatives of the Commissioner. On December 9, 1929, a hearing was had before the Board of Tax Appeals at which counsel for the trustee moved to amend the petition previously filed so as to read: "The notice of deficiency (a copy of which is attached and marked 'Exhibit A') was mailed to Erard Matthiessen on March 12, 1927." and, "The respondent had erroneously determined Erard Matthiessen's gross income for the year 1922" and "(b) In so far as section 202(a)2 of the Revenue Act of 1921 purports to authorize respondent to tax petitioner or Erard Matthiessen, an alleged profit upon the sale, * * * that the said Erard Matthiessen is not liable, as a matter of law, for any income tax on any profit derived from the sale of said Corn Products Refining Co. stock," and petitioner's prayer asked that the proceeding be disallowed for the alleged deficiency as set forth. The Board on June 30, 1930, dismissed the petition for lack of jurisdiction.

The question presented on this appeal is whether the error committed in addressing the deficiency notice, mailed March 12, 1927, precluded the Board of Tax Appeals from examining the merits of the deficiency tax. A trustee named in the trust is included among those named in the Revenue Act of 1921 as a taxpayer (42 Stat., 227), and the fiduciary must make a return for the

estate or trust for which he acts, under section 219(b) of that Act. Section 274(a) of the Revenue Act of 1926 (ch. 27, 44 Stat., 9) provides:

"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."

Section 274(a), it will be observed, provides that "The Commissioner is authorized to send notice of such deficiency to the taxpayer by registered mail." The "taxpayer" as referred to in the taxing statutes has not a narrow or restricted meaning. (*U. S.* v. *Updike*, 281 U. S., 489 [Ct. D. 192, C. B. IX–1, 228]; *Routzahn* v. *Tyroler*, 36 Fed. (2d), 208 (C. C. A. 6).) There was no special form of deficiency notice required, but the purpose of the Act is that the taxpayer shall be notified of the deficiency by mail. The Act intends to give him an opportunity to appeal to the Board of Tax Appeals and a proceeding before the Board is invoked by the taxpayer. He does not merely submit to the jurisdiction of the Board. (*California Yards Co.* v. *Commr.*, 47 Fed. (2d), 514 (C. C. A. 9).) Under section 274(d) the taxpayer may waive the requirement under section 274(a) and permit the immediate assessment of any part or all of the deficiency. Section 274(e) gives jurisdiction to the Board to redetermine the correct amount of the deficiency even if the amount so determined is greater than the amount of the deficiency, and notice thereof must be mailed to the taxpayer if a claim for such greater deficiency is asserted by the Commissioner at or before the hearing or rehearing. Where a 60-day letter was mailed to the wrong number of a street but actually received by the taxpayer, it was held to be sufficient. (*Dilks* v. *Blair*, 23 Fed. (2d), 831 (C. C. A. 7).) Where a notice of deficiency was mailed to a successor in business, whereas the respective taxes were due from its predecessor, it was held that failure to designate it as a transferee was not fatal nor did it deprive the Board of its jurisdiction. (*Burnet* v. *San Joaquin Fruit & Investment Co.*, decided June 22, 1931 (C. C. A. 9) [Ct. D. 406, C. B. X–2, 260].)

At bar the notice was not only received by the taxpayer, but it apparently was fully understood as referring to the liability of the trust company as trustee for this beneficiary. There is no finding by the Board that the method of addressing the trustee misled. Because the deficiency notice was addressed as it was, it was a harmless error. The trust company filed a return as trustee for Erard Matthiessen and paid a tax as such trustee. Subsequently its books and records relating to the trust were examined by the revenue agent and the trust company had been furnished with a copy of the agent's report disclosing a deficiency. It listed items on the return of the trust company as trustee and the correction made in the profit on the sale of the securities. Moreover, the letter referred to conferences had with the trust company's representatives regarding the sale of the stock belonging to the trust and stated that the officers acting for the trustee intended to protest. The letter transmitting the report was addressed to the trust company as trustee, referred to the recent examination which had been made, mentioned the additional tax and offered an opportunity to protest within 30 days after the time when the report would be sent to Washington for final action. All this clearly gave notice of the subject matter contained in the deficiency notice of March 18, 1927, and in effect, advised them that if they did not successfully protest a demand for payment would be forthcoming. It could waive the requirement that another notice be sent, in the same way that the taxpayer may waive a demand for taxes necessary to create a lien. (*In re Baltimore Pearl Hominy Co.*, 5 Fed. (2d), 553 (C. C. A. 4).) A taxpayer may waive a requirement for filing a refund claim prior to suit. (*Tucker* v. *Alexander*, 275 U. S., 228 [T. D. 3973, C. B. VI–1, 287].) In *Burnet* v. *San Joaquin Fruit & Investment Co.* (June 22, 1931, C. C. A. 9), a deficiency notice for 1920 taxes was sent to the San Joaquin Fruit & Investment Co., Tustin, Calif. This company was the successor and transferee of the San Joaquin Fruit Co., the latter having been dissolved in 1922 and the investment company having taken over its assets in that year. A deficiency letter had been sent in 1921 for taxes, addressed to the "San Joaquin Fruit Co., c/o San Joaquin Fruit & Investment Co., Tustin, Calif." The investment company appealed to the Board of Tax Appeals in each case describing itself as the "taxpayer," "formerly the San Joaquin Fruit Co." and "successor to the San Joaquin Fruit Co., through change of name only." Continuances were had on

the hearings and the Investment company later, by leave, amended its pleadings so as to raise the question of the identity of the taxpayer. The circuit court of appeals reversed a holding that there was no deficiency against the company for 1920 and dismissing the appeal based on the deficiency letter for 1921 taxes for lack of jurisdiction, and held that the Investment company in law and in fact was the taxpayer and had so admitted in its pleadings. It participated in the hearings before the Board of Tax Appeals and raised no question as to the 60-day letters until after the time had expired within which determination could be had against the Fruit company, and the case had been tried in part upon the theory that it was liable for the taxes. It was therefore estopped from changing its position and denying liability. The Investment company had actual notice of the deficiency notices, and the mere failure to designate the company as a transferee was held not to be fatal and did not deprive the Board of Tax Appeals of jurisdiction.

The failure on the part of the Commissioner was said to be procedural only. The court said:

"The San Joaquin Fruit & Investment Co. was in law and in fact the 'taxpayer' in the instant case, and so held itself out in its own pleadings, further setting forth the theory upon which it regarded itself as the 'taxpayer'; namely, that it was 'formerly the San Joaquin Fruit Co.' and 'successor to the San Joaquin Fruit Co. through change of name only.'"

Taxpayers can not repudiate waivers of the statute of limitations upon which the Government relied. (*Aiken* v. *Burnet*, 282 U. S., 277 [Ct. D. 275, C. B. X–1, 417]; *Loewer Realty Co.* v. *Anderson*, 31 Fed. (2d), 268 (C. C. A. 2) [Ct. D. 125, C. B. VIII–2, 218].) This taxpayer will not be permitted to change its position after proceeding as it did, in an effort to prevent the collection of the tax and thus deny jurisdiction to the Board which it invoked. As was said in *United States* v. *New York & Ontario S. S.* (216 Fed., 61 (C. C. A. 2)):

"But a general or voluntary appearance is regarded as equivalent to the service of process. * * * A general appearance, therefore, under ordinary conditions is held to confer jurisdiction of the person on the court; the defendant being estopped to object for want of such jurisdiction."

The appearance here before the Board of Tax Appeals was general, not special, and the respondent waived any defect in the notice by invoking the jurisdiction of the Board of Tax Appeals.

Order reversed.

ARTICLE 1235: Interest on a deficiency.

REVENUE ACT OF 1926.

Demand for tax made on taxpayer and bondsman in 1927 and 1928, respectively. (See Ct. D. 565, page 337.)

SECTIONS 277 AND 278.—PERIOD OF LIMITATION UPON ASSESSMENT AND COLLECTION OF TAX.

ARTICLE 1271: Period of limitation upon assessment of tax. XI–34–5628 Ct. D. 541

INCOME TAX—REVENUE ACT OF 1926—DECISION OF COURT.

1. ASSESSMENT—LIMITATION—APPEAL TO BOARD—SUSPENSION OF RUNNING OF STATUTE OF LIMITATION—EFFECT OF AMENDED PETITION.

Where a taxpayer files an original petition with the Board of Tax Appeals which relates to deficiencies for the years 1923 and 1925 and thereafter files an amended and supplemental petition in which is asked a redetermination of the deficiency for the year 1925 only, the amended petition does not supersede or destroy the original petition or constitute an abandonment of the complaint as to the deficiency for 1923; and a motion by the Commissioner

at the close of the trial as to the deficiency for the year 1925 to dismiss the appeal as to the deficiency for the year 1923 and to sustain the deficiency found for the latter year is then properly before the Board for its decision thereon. The time between the filing of the amended petition and the motion to dismiss is therefore embraced in the period during which the running of the statute of limitations on the making of an assessment of a deficiency for 1923 is suspended as provided in section 277(b) of the Revenue Act of 1926.

2. DECISION AFFIRMED.

The decision of the Board of Tax Appeals (18 B. T. A., 1123) is affirmed.

UNITED STATES CIRCUIT COURT OF APPEALS, SIXTH CIRCUIT.

Atlas Plaster & Fuel Co., petitioner, v. *Commissioner of Internal Revenue, respondent.*

Petition to review an order of the United States Board of Tax Appeals.

Before MOORMAN, HICKS, and HICKENLOOPER, Circuit Judges.

[February 5, 1932.]

OPINION.

HICKS, Circuit Judge: The respondent, Commissioner of Internal Revenue, found a deficiency in income taxes against petitioner, Atlas Plaster & Fuel Co., in the sums of $448.34 and $2,959.39 for the years 1923 and 1925, respectively. Petitioner sought a redetermination by the Board of Tax Appeals.

Respondent moved a dismissal of its petition because it did not conform to rule 5 of the Board. The Board denied this motion but on November 5, 1927, petitioner by permission filed an amended petition styled "Amended and supplemental petition" in which it sought a redetermination of the deficiency for 1925 only. Respondent answered this amended and supplemental petition.

As to the year 1923: At the close of the hearing before the Board respondent moved a dismissal of the appeal in so far as it related to the year 1923 and a confirmation of the finding that there was a deficiency for said year in the sum of $448.34. Petitioner could not effectively object to the amount of said deficiency because it had not attempted to show that the Commissioner was wrong but it primarily took the position that the matter of taxes for 1923 was not then before the Board at all; that the amended and supplemental petition filed November 5, 1927, dealing with taxes for 1925 only, had superseded the original petition and that the complaint touching the taxes for 1923 had been abandoned since that date. It further insisted that excluding the time during which the original petition was before the Board, to wit, from July 20, 1927, until November 5, 1927 (see Revenue Act of 1926, ch. 27, section 274(a) and section 277(b)), the limitation period of four years within which any assessment could be made had expired.

We do not find it necessary to consider whether as a matter of technical pleading, either at equity or in law, an amended and supplemental petition supersedes the original entirely or whether it becomes incorporated with and is a continuation thereof. We are not confronted with such question. We are concerned only with the practice and procedure of the Board of Tax Appeals established by its rules pursuant to section 907(a) of the Revenue Act of 1924 as amended by section 1000 of the Revenue Act of 1926. Rule 7 thereof provides for the filing of an original petition while rule 18 under the caption "Amended and supplemental pleadings" regulates the amendment of petitions. We do not think that it was ever contemplated by these rules that amended and supplemental petitions should supersede or destroy the initial one. Obviously the purpose of amended and supplemental pleadings is to provide a method by which imperfections in the frame or structure of the original petition might be remedied.

We conclude that the issue made by the original petition as amended and the answer as amended was pending before the Board at the time of its final

decision confirming the tax deficiency found by the Commissioner for 1923 (see *Capital Bldg. and Loan Ass'n* v. *Commr.*, 12 B. T. A., 349) and no error appearing the order of the Board is affirmed.

As to the year 1925: Under the provisions of the Revenue Act of 1921 (ch. 136, section 34(a)1, petitioner in computing its net income for 1925, deducted $24,600 and $15,880 as salary for and compensation to William Selke, its president, and Lydia Selke, its secretary-treasurer, respectively. The Commissioner disallowed $12,000 and $8,400 respectively of these deductions upon the ground that they were excessive. The Board upheld the Commissioner and its finding must prevail unless the evidence clearly and convincingly requires a contrary conclusion. (*Tracy* v. *Commr.*, 53 Fed. (2d), 575, 579 (C. C. A. 6) [Ct. D. 468, C. B. XI–1, 205]; *Guarantee Bond & Mtg. Co.* v. *Commr.*, 44 Fed. (2d), 297, 298 (C. C. A. 6).)

Petitioner, a corporation, was organized in 1907 with a capital stock of $10,000. Subsequently Wm. Selke bought 51 shares, a controlling interest, for $5,100. Thereafter he purchased the balance of the stock. The business consisted of mixing and selling plaster. It was not successful until 1922 but thereafter it paid 6 per cent dividends. During the years 1923, 1924, and 1925 its stock was owned in the following proportions: Wm. Selke, 48 shares; Lydia Selke, 49 shares; and a Mr. Hopper, vice president, 3 shares. Gross sales, salaries and net income after deducting salaries for those years are set out in the margin.[1] The Department increased the net income for 1925 from $12,191.22 to $12,555.87. This net income with the salaries claimed would amount to $53,235.87 of which the salaries alone would constitute 76.4 per cent. The salaries alone would constitute 324 per cent of the net income. The table[1] indicates that although the net income in 1925 was nearly $2,000 below that of 1923, the salary of the president was increased $12,000 and that of the secretary-treasurer $14,400. It is shown that both Wm. Selke and Lydia Selke, his wife, devoted themselves exclusively and faithfully to the service of petitioner and that Wm. Selke aided it with his personal credit but this does not show that the amounts paid them for their services in 1925 constituted "ordinary and necessary expenses." (See *Botany Worsted Mills* v. *U. S.*, 278 U. S., 282, 293 [Ct. D. 39, C. B. VIII–1, 279].)

In determining whether salaries are excessive the Board of Tax Appeals must necessarily exercise its own judgment and discretion—reasonable allowances can not be ascertained with mathematical precision. Every case must stand upon its own peculiar facts and circumstances. We are not justified in declaring that the Board of Tax Appeals was wrong and its order confirming the finding of the Commissioner as to the deficiency for the year 1925 is affirmed.

ARTICLE 1271: Period of limitation upon assessment of tax.

XI–37–5682
Ct. D. 557

INCOME TAX—REVENUE ACT OF 1924—DECISION OF COURT.

1. WAIVER—VALIDITY—EXECUTION BY SECRETARY.

Where, pursuant to section 278(c) of the Revenue Act of 1924, a consent in writing to the assessment of a tax after the prescribed statutory period is executed, which bears the seal of the taxpayer and is signed in the name of the taxpayer by its secretary within the scope of his general duties and at the instance of its president and comptroller in charge of its tax matters, the consent, which is signed by the Commissioner, is valid and effective to toll the statute.

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[1] See following table.

	1923.	1924.	1925.
Gross sales	$168,392.99	$205,281.71	$301,644.20
Net income	14,142.00	18,671.42	12,191.22
Salaries:			
President	12,600.00	12,600.00	24,600.00
Secretary-treasurer	1,480.00	7,480.00	15,880.00
Vice president	200.00	200.00	200.00

2. SAME—REPUDIATION.

Where the taxpayer knew that the Government had relied upon a consent in writing to the assessment of a tax after the expiration of the prescribed statutory period and had received a substantial reduction in its tax in consequence of the same and where the taxpayer had acquiesced in the waiver by payment of the tax assessed by virtue thereof without protest and had allowed substantially four years to elapse without questioning the validity of the waiver, the taxpayer can not be permitted to repudiate its consent.

UNITED STATES CIRCUIT COURT OF APPEALS, SIXTH CIRCUIT.

The Philip Carey Manufacturing Co., appellant, v. *Charles M. Dean, Former Collector of Internal Revenue, appellee.*

Appeal from the District Court for the Southern District of Ohio, Western Division.

[May 13, 1932.]

OPINION.

HICKS, Circuit Judge: This suit was brought by appellant to recover income and profits taxes for the year 1918 assessed against and paid by it. Appellant claimed that the assessment and collection were barred by the statute of limitations. The case was heard by the judge without a jury. At the close of the evidence each party moved for judgment. Appellant's motion was denied, and that of appellee was granted. Appellant excepted and filed its bill of exceptions. There were no requests for special findings of fact or conclusions of law and the findings were general. Nothing was preserved for review except the question of law, whether the evidence indisputably required a judgment for appellant.

There was on file in the Bureau of Internal Revenue a waiver extending the period for the assessment and collection of 1918 taxes until December 29, 1924. On October 17, 1924, the Commissioner wrote appellant that an examination had disclosed an additional tax against it for 1918 in the sum of $158,270.02. Appellant protested and requested a conference, which was held at Washington on December 8, 1924, between representatives of the Bureau and Mr. Crabbs, president and director of appellant; Mr. Ignatius, its comptroller; Mr. Cassatt, its general counsel, and Mr. Allen, also of counsel. The president and comptroller of appellant had charge of its tax matters. At the conference there was an agreement, subject to confirmation by the Commissioner, who was not present, that the taxes should be reduced to $151,475.25. It was expected that when the matter was finally passed upon the Commissioner would, if given a reasonable time for its consideration, confirm the conference agreement, but all parties knew that if the Commissioner should be compelled to act before December 29, the expiration date of the existing waiver, the assessment would very probably be at the larger figure and that collection would be made immediately. With the matter thus pending some one (evidently by oral request for the files of neither party disclosed any correspondence upon the subject) procured or received an official form of waiver from the Bureau and either delivered or transmitted it to Mr. Buse, secretary of appellant, who on December 20, 1924, six days before the expiration of the existing waiver, executed it by signing it as follows: "The Philip Carey Manufacturing Co., Taxpayer, by E. L. Buse, Secretary," and by affixing the seal of appellant thereto. It was then transmitted to the Bureau, signed by the Commissioner and filed on December 23, 1924.

On January 24, 1925, the Bureau completed its final audit and transmitted a statement thereof to appellant. This statement fixed the tax liability at the sum of $151,475.25, the exact amount agreed upon at the conference, and called appellant's attention to the fact that a waiver expiring December 20, 1925, was on file. The tax was assessed in April, 1925, and was paid without protest on May 19, 1925.

Matters stood thus until April, 1929, when appellant filed a "claim for refund" upon the ground that the waiver executed December 20, 1924, was invalid and void for lack of authority in the secretary to execute it. The claim was that the powers of the secretary were limited to those set forth

in Article IV, section 3, of the "regulations" of appellant.[1] The refund was denied, suit was instituted and the burden was upon appellant. (*Stern Bros. & Co.* v. *Burnet*, 51 Fed. (2d), 1042, 1046 (C. C. A. 8) [Ct. D. 476, C. B. XI–1, 311].)

We think the district judge was right.

Appellant can not be heard to say that its *president* and *comptroller* were unauthorized to execute the waiver. They were in charge of the whole tax matter. (*Independent Ice & Cold Storage Co.* v. *Commissioner*, 50 Fed. (2d), 31, 33 (C. C. A. 5) [Ct. D. 471, C. B. XI–1, 308].) The waiver involved no more than giving the consent of the taxpayer in writing to the extension of the limitation period. These officers were represented by counsel who were with them at the conference and no doubt advised them (if we can assume that they needed such advice) of the pressing necessity of such consent. The urgent necessity of the matter creates an inference that it was not overlooked. (See *Greer* v. *U. S.*, 245 U. S., 559, 561.) Having authority to act they had the authority to direct the secretary to act for them (see *Trustees for O. & B. S. Coal Co.* v. *Commr.*, 43 Fed. (2d), 782, 784 (C. C. A. 4); *Christopher Co.* v. *Commr.*, 55 Fed. (2d), 530, 531), and there is room for the inference that they did. The statute did not require them to sign the waiver personally. It required the taxpayer to sign it (section 250(d) of the Revenue Act of 1921, 42 Stat., 227; 278(a) of the Revenue Act of 1924, 43 Stat., 253) and it is not unreasonable to conclude that the secretary signed for the taxpayer at their instance or that of some authorized agent. We think this was clearly within the scope of the general duties of a secretary (Bouvier's Law Dictionary, volume 2, 12th ed., page 507) as recognized in the "regulations" of appellant, the relevant portions of which we have italicized.

We do not think that this inference in appellee's favor is destroyed by any countervailing evidence. The testimony of appellant's president and comptroller that they did not know of the execution of the waiver until about four years afterwards is not conclusive. The Bureau letter of January 24, 1925, giving express notice of the waiver on file had been in appellant's files since that date and the taxes were paid upon the approval of counsel without any protest that their assessment and collection were barred for lack of a proper waiver. The testimony of Buse, aside from the fact that he identifies his signature upon the waiver of December 20, 1924, is of little value. He has wholly forgotten the transaction. The record indicates that the president and comptroller have likewise forgotten many of its details. The testimony of appellant's remaining witnesses was almost wholly negative in character. The testimony of appellant's tax counsel who participated in the Washington conference and who afterwards approved the payment of the tax was not introduced nor its absence accounted for. The seal upon the waiver of December 20, 1924, is prima facie evidence that it was placed there by the secretary with the authority of appellant. (*Maryland Finance Corporation* v. *Duvall*, 284 Fed., 765, 770 (C. C. A. 5); *Bliss* v. *Harris*, 38 Colo., 72.)

We think there is ample basis for the judgment. We can not assume that the secretary, after 23 years of experience in that capacity, either voluntarily or thoughtlessly executed an unauthorized instrument.

Finally, we think that appellant should not be permitted to repudiate this waiver. It knew that the Government had relied upon it and it had received a substantial reduction in its tax by the reaudit and had itself acquiesced by payment of the tax without protest and had allowed substantially four years to elapse without complaint. (See *Commissioner* v. *New York Trust Co.*, 54 Fed. (2d), 463, 465 (C. C. A. 2) [Ct. D. 540, page 320, this bulletin]; *U. S.* v. *Kemp*, 12 Fed. (2d), 7, 8 (C. C. A. 5) [T. D. 3858, C. B. V–1, 326]; *Stern Bros. & Co.* v. *Burnet*, supra; *Liberty Baking Co.* v. *Hoiner*, 34 Fed (2d), 513, 517 (D. C.), aff'd. 37 Fed. (2d), 703 [Ct. D. 194, C. B. IX–1, 231].)

We do not deem it necessary to pass specifically upon whether a resolution of the board of directors of appellant on March 23, 1925,[2] was a ratification of the waiver.

Affirmed.

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[1] SEC. 3. *Secretary.*—It shall be the duty of the secretary to keep an accurate record of the proceedings of the stockholders and directors, give all notices required, keep proper books of accounts and books for transfer of stock issue, attest all certificates of stock and in general, *to perform all the duties which usually pertain to said office*, or required of him by the board of directors.

[2] Resolved that the acts of the officers in the general conduct of the business in the past be, and the same are, hereby approved and ratified and adopted by unanimous vote.

ARTICLE 1271: Period of limitation upon assessment of tax.

XI-39-5722
Ct. D. 570

INCOME TAX—REVENUE ACT OF 1926—DECISION OF COURT.

1. WAIVER—VALIDITY—EXECUTED AFTER EXPIRATION OF STATUTORY PERIOD—STATUTORY PERIOD EXPIRED PRIOR TO ENACTMENT OF THE REVENUE ACT OF 1924.

A consent in writing by a taxpayer to waive the statute of limitations operating against the assessment and collection of a tax executed after the date of the enactment of the Revenue Act of 1924 and before the enactment of the Revenue Act of 1926 is valid and binding upon the taxpayer even though the waiver is executed after the expiration of the statutory period and the statutory period expired prior to the date of the enactment of the Revenue Act of 1924.

2. WAIVER—DURESS.

A waiver of the statute of limitations with respect to his individual tax liability for 1917 executed and filed by a member of a partnership is not exacted by duress because executed and filed pursuant to the advice of the Commissioner that if such waiver should be filed he would consider making a special assessment of the profits tax of the partnership for the year 1917 under section 210 of the Revenue Act of 1917.

3. NOTICE OF DEFICIENCY—SUFFICIENCY.

A written notice sent by the Commissioner to a taxpayer of his final determination of a deficiency for 1917 in an amount stated complies with the notice required by section 274(a) of the Revenue Act of 1926.

COURT OF CLAIMS OF THE UNITED STATES. No. K-488.

Peter L. McDonnell v. *The United States.*

[May 31, 1932.]

OPINION.

LITTLETON, Judge, delivered the opinion of the court.

The first contention of the plaintiff is that the written consent executed by him waiving the statute of limitation for assessment and collection of a deficiency against him for 1917 was executed after the expiration of the statute of limitation; that it was obtained by duress and was, therefore, invalid. He further insists that since the period of limitation for making an additional assessment for 1917 expired prior to June 2, 1924, and the waiver in question was given after that date and before the enactment of the Revenue Act of 1926, the waiver in question is invalid under the decision of the Circuit Court of Appeals for the Second Circuit in *Uncasville Mfg. Co.* v. *Commissioner,* decided February 1, 1932. We find no merit in the contention of the plaintiff that the waiver was invalid because executed after the expiration of the statute of limitations (*Stange* v. *United States,* 282 U. S., 270 [Ct. D. 274, C. B. X-1, 414]), nor in the claim that it was obtained under duress.

The matter of the computation of the partnership's profits tax under the special relief provisions of section 210 of the Revenue Act of 1917 was entirely within the discretion of the Commissioner. (*Williamsport Wire Rope Co.* v. *United States,* 277 U. S., 551 [T. D. 4172, C. B. VII-2, 323].) Had the Commissioner proceeded to collect from the partnership the excess-profits tax due by it under the normal tax provisions of the Revenue Act of 1917 on its income for that year, as he had a right to do, such tax would have amounted to $100,005.14, and there would have been no overassessment against the partnership and no additional tax due by the partners. It can not be said that a waiver executed by the plaintiff in order to obtain a reduction in the amount of the profits tax due by the partnership through a computation under the relief provisions of the statute was exacted by duress. He executed the waiver

because it was to his advantage to do so. The Commissioner was not required to compute the tax of the partnership under the special relief provision, and had he declined to do so neither the partnership nor the plaintiff would have had any legal right to complain. (*Maas* v. *United States*, 282 U. S., 822.) Any adjustment in the profits-tax liability of the partnership necessitated a corresponding adjustment in the distributive interests of the partners and a reduction of partnership income increased the taxable income of the individual partners. The Commissioner therefore advised the plaintiff and the other partner of McDonnell & Truda that if waivers of the statute of limitation with respect to their individual tax liability for 1917 should be filed by them he would give consideration to the determination of the profits tax of the partnership under the special relief provisions of section 210. Accordingly the plaintiff duly executed such waiver. He was not forced to do so, and the results obtained as a result of the execution of the waiver were favorable to him.

The case of Uncasville Mfg. Co., supra, holds that where the statutory period expired prior to June 2, 1924, waivers executed after that date and before the approval of the Revenue Act of 1926 were invalid.

We have carefully considered the decision of the learned Circuit Court of Appeals for the Second Circuit, but we are unable to concur in the conclusion that a waiver executed under such circumstances is invalid and that a tax collected on the basis thereof must be refunded. (*Burnet* v. *Chicago Railway Equipment Co.*, 282 U. S., 295 [Ct. D. 276, C. B. X–1, 323]; *Brown & Sons Lumber Co.* v. *Burnet*, 282 U. S., 283 [Ct. D. 279, C. B. X–1, 274]; *Aiken* v. *Burnet*, 282 U. S., 277 [Ct. D. 275, C. B. X–1, 417]; *Stange* v. *United States*, supra.)

In the Uncasville case, the court said:

"Confessedly, had the time for assessment expired after June 2, 1924, the waivers would have been good, though executed after the expiry of the time to assess or collect. (*Burnet* v. *Railway Equipment Co.*, 282 U. S., 295.) However, section 278(e) of the Act of 1924 declared that the section as a whole should not allow the assessment or collection of a tax, barred by existing limitations on June 2, 1924. Subdivision (c) of section 278 is necessary to the assessments because they depend upon the waivers, and there was no other law, regulating waivers in effect after June 2, 1924. Thus, if subdivision (e) confines subdivision (c) to cases where the assessment was not barred on June 2, 1924, the company is right. In spite of some intimation in *Burnet* v. *Chicago Railway Co.* which, however, expressly reserved the point, we think that an analysis of section 278 as a whole does not admit of any other construction. * * *"

In none of the cases cited was collection barred on the date of the enactment of the Revenue Act of 1924; however, in *Aiken* v. *Burnet*, supra, a waiver had been given before the enactment of the Revenue Act of 1921, which fixed a limitation period of five years. The court held that the taxpayer had sufficient authority, in the absence of any statute, to execute a valid waiver, and that the Commissioner, under the same circumstances, had authority to accept such waiver and bind the Government. The court further held that a waiver signed is valid to extend the subsequently enacted limitation upon collection. Other waivers were secured in the Aiken case under the Revenue Act of 1921, and were held valid to authorize assessment on March 12, 1925. Again in *Brown & Sons Lumber Co.* v. *Burnet*, supra, the court infers that the last of the three waivers involved in that case would have been sufficient standing alone. A footnote in the opinion states: "Inasmuch as the second and third waivers were in themselves sufficient to extend the period for collection, the first waiver may be disregarded in this connection, as was done by the lower court. See 38 F. (2d), 428." In Brown & Sons Lumber Co. case, supra, the first waiver was filed December 13, 1920, and the second on December 10, 1923; the third waiver was filed October 25, 1924. In the Uncasville Mfg. Co. case the court construed section 278(e) of the Revenue Act of 1924 as a *prohibition* upon the giving of a waiver by a taxpayer and the acceptance thereof by the Commissioner. We are unable to find any provision in the 1924 Revenue Act which precludes a taxpayer from voluntarily waiving the benefits of the statute of limitation, nor do we find anything in such Act prohibiting the Commissioner's acceptance of such waiver. This view seems not to have been presented in the Uncasville Mfg. Co. case, supra; it was not commented upon by the court in its opinion. The court merely stated that subdivision (e) of section 278 of the Revenue Act of 1924 limits the pre-

ceding subdivision (c) of section 278 so that subdivision (c) does not *authorize* the extension of time for assessment by a waiver executed after the enactment of the Revenue Act of 1924 where the time for assessment expired prior to the enactment of that Act. In *Burnet* v. *Chicago Railway Equipment Co.*, supra, in footnote 5, page 300, to the statement in the opinion that "We need not determine whether respondent is correct in assuming that section 278(e) qualifies section 278(c) in respect to waivers on assessment of taxes barred prior to June 2, 1924," it is stated that "Subdivision (e) can not be said to qualify every other subdivision in section 278. Nothing indicates an intention to have it limit the effect of section 278(a) which permits assessment to be made or suit to be brought at any time in the case of a false or fraudulent return or a failure to file any return. * * * *Nor is there any indication that it should qualify subsection (c) which provides for the giving of waivers.*" [Italics ours.] We conclude, therefore, that the Revenue Act of 1924 does not preclude a taxpayer from waiving the benefit of the statute of limitation, and that a waiver given after the enactment of the Revenue Act of 1924, in a case where the statutory limitation had expired prior thereto, and before February 26, 1926, is valid.

The plaintiff next contends that the Commissioner failed to comply with the statutory requirement of assessment and collection of the tax for the reason that he did not send to the plaintiff a notice of the deficiency, as required by section 274(a) of the Revenue Act of 1926. We think this contention of the plaintiff is unimportant as affecting his right to institute a proceeding before the United States Board of Tax Appeals under the Revenue Act of 1926 upon receipt of notice of assessment, which would have constituted the Commissioner's final determination had the Commissioner failed to mail him a formal notice prior to assessment. However, the facts show that the Commissioner fully complied with the requirements of section 274. May 22, 1926, the Commissioner notified the plaintiff of a proposed assessment of a deficiency for 1917, allowing him 30 days within which to protest the same or to execute a waiver of his right to file a petition with the Board of Tax Appeals consenting to immediate assessment. The waiver was not executed, but plaintiff filed a protest setting forth that the correct tax was $4,386.15 instead of $4,549.03, as proposed by the Commissioner in the 30-day letter. The protest was considered and allowed and thereafter, on July 12, 1926, the Commissioner sent the plaintiff a written notice of his final determination of a deficiency for 1917 in the amount of $4,386.15. This notice complied with section 274(a) of the Revenue Act of 1926. The Commissioner was not required specifically to advise plaintiff in this notice of his right to institute a proceeding before the Board. The plaintiff did not institute a proceeding before the Board of Tax Appeals with respect to this deficiency and thereafter, on October 9, 1926, more than 60 days after the mailing by the Commissioner of the notice of his final determination, the Commissioner assessed the deficiency and collected the same October 23, 1926. Section 274(a) of the Revenue Act of 1926 does not require any special form of notice, but provides only that if the Commissioner determines that there is a deficiency he is authorized to send notice of such deficiency to the taxpayer by registered mail. The notice of July 12, 1926, which was received by the plaintiff, complied with this requirement.

The petition is dismissed. It is so ordered.

ARTICLE 1271: Period of limitation upon assessment of tax. XI-39-5723 Ct. D. 571

INCOME AND EXCESS PROFITS TAXES—REVENUE ACT OF 1926—DECISION OF COURT.

ASSESSMENT—LIMITATION—SPECIAL ASSESSMENT—COMMISSIONER'S AUTHORITY.

Where income and excess profits taxes are assessed and collected within the prescribed statutory period, a later determination and computation of the excess profits tax under section 328 of the Revenue Act of 1918, indicating an overassessment, and the mailing of letters by the Commissioner showing the results thereof do not constitute the allowance of an overassessment nor an assessment

of the tax for the purpose of computing the statutory period of limitation within which the Commissioner may assess and collect a tax; and the Commissioner's determination and computation of the tax liability as disclosed in a later letter written after the statutory period for assessment had expired in accordance with which he issued and approved a schedule of overassessment allowing the taxpayer's claim for credit in an amount less than that indicated in the earlier computation did not constitute an assessment of a tax after the expiration of the statutory period of limitations within which the Commissioner could assess and collect the tax.

COURT OF CLAIMS OF THE UNITED STATES. No. K–546.

The Western Shade Cloth Co. v. *The United States.*

[May 31, 1932.]

OPINION.

LITTLETON, Judge, delivered the opinion of the court.

We are unable to agree with the contention of the plaintiff that a determination and computation of a tax liability by the Commissioner's office and the mailing of a letter showing the results thereof constitute an assessment of the tax as that term is used in the revenue statutes for the purpose of computing the statutory period of limitation within which the Commissioner may assess and collect a tax, or adjust the tax liability of a taxpayer for the purpose of allowing or rejecting claims for abatement, credit, or refund. The limitation for making assessments is suspended under certain circumstances where a proceeding is instituted before the Board of Tax Appeals, but those provisions of the statute are inapplicable to the question presented in this case. The tax sought to be recovered in this case was duly assessed and paid on or about July 16, 1919.

Long prior to the determination of the Commissioner with respect to the plaintiff's profits tax, as disclosed by his letter of July 15, 1927, and the schedule of overassessment signed January 5, 1928, the Commissioner had timely assessed and collected an income and profits tax of $249,715.68 for 1918. No further assessment or collection of a tax for 1918 was ever found necessary or was made by the Commissioner. All that the Commissioner did after the tax for 1918 had been assessed and paid was to determine whether, in his discretion, the profits tax imposed by the statute upon the consolidated net income, which tax had been assessed and paid, should be reduced through a computation of the profits tax in the manner specified in section 328 of the Revenue Act of 1918.

The plaintiff had filed an application with the Commissioner requesting that the profits tax for 1918 be so computed. Within the time allowed by law plaintiff filed two claims for credit with respect to the tax paid for 1918. The Commissioner considered the plaintiff's application for relief under section 328, and concluded that the application should be allowed. He thereupon, on June 13, 1921, made a computation of the profits tax under section 328 which showed a profits tax of $38,641.41 and an income tax of $60,553.07 upon the net income shown in the return, or a total income and profits tax liability of $99,194.48. On that date he mailed plaintiff a notice showing this determination. On the basis of the tax so computed the overassessment was $150,521.10. This determination and computation did not constitute an assessment within the meaning of the statute. The Commissioner was free to make a further determination and computation with respect to the profits tax liability under section 328 before he had made any allowance of an overassessment in the manner provided by law.

No schedule of overassessment or certificate of overassessment was ever signed or issued by the Commissioner upon the basis of the computation shown in the letters of June 13 and November 8, 1921. The plaintiff had filed claims for credit and the period of limitation within which the Commissioner could allow an overassessment, overpayment, or a credit was suspended. The mailing of the letter of June 13, 1921, did not constitute the allowance of an overassessment or overpayment. (*Martin M. Philipsborn* v. *United States*, 72 C. Cls.,

545, 53 Fed. (2d), 133.) Before the Commissioner had finally acted upon the claims for credit in the manner provided by the statute, the matter of the correct tax liability of the plaintiff was open for consideration and determination by him. (*Lewis* v. *Reynolds*, 284 U. S., 281 [Ct. D. 443, C. B. XI–1, 130].) Until he had taken final action with respect to the claims for credit in the manner provided in the statutes, either by rejecting or allowing the same, he was free to make as many determinations and computations of the plaintiff's correct tax liability as he deemed necessary, either under section 328 of the Revenue Act of 1918 or with respect to any other feature affecting the correct tax liability, for the purpose of determining whether there had been an overassessment or overpayment and whether any portion thereof should be credited or refunded. (*Oak Worsted Mills* v. *United States*, 68 C. Cls., 539 [Ct. D. 151, C. B. IX–1, 326].)

The Commissioner's determination and computation of the tax liability for 1918, as disclosed in the letter of July 15, 1927, in accordance with which he issued and approved a schedule of overassessment allowing plaintiff's claims for credit in the amount of $134,907.90 instead of $150,521.10 as indicated in an earlier computation, did not constitute an assessment of a tax of $15,613.20 for 1918 after the expiration of the statutory period of limitation within which the Commissioner could assess and collect the tax for 1918.

The petition must be dismissed. It is so ordered.

ARTICLE 1272: Period of limitation upon collection of tax.

XI–29–5555
Ct. D. 518

INCOME TAX—REVENUE ACTS OF 1921 AND 1924—DECISION OF COURT.

1. ASSESSMENT—COLLECTION—LIMITATION—RETURN REQUIRED FOR FISCAL YEAR FILED ON CALENDAR-YEAR BASIS.

Where a taxpayer files returns on a calendar-year basis for the years 1918 and 1919 on June 16, 1919, and May 15, 1920, respectively, but is required by section 212(b) of the Revenue Act of 1918 to file its returns on the basis of a fiscal year ending January 31, the return filed for the calendar year 1918 is not the return required by section 239 of that Act for the fiscal year ending January 31, 1919, and the period of limitation on the assessment and collection of the tax for that fiscal year, provided by section 250(d) of the Revenue Act of 1921 and section 277(a)2 of the Revenue Act of 1924, commences to run from May 15, 1920.

2. SUIT—DEFENSE—BOND.

A bond given within the statutory period for the collection of a tax conditioned to pay any tax found to be due is a defense to a suit by the taxpayer based upon the ground that the tax was collected after the expiration of the statutory period therefor.

COURT OF CLAIMS OF THE UNITED STATES. No. L–368.

National Shirt Shops, Inc., v. *The United States.*

[May 2, 1932.]

OPINION.

WILLIAMS, Judge, delivered the opinion of the court.

This is a suit to recover income and excess-profits taxes paid by the plaintiff for the taxable period ending January 31, 1919, in the amount of $55,986.84, with interest thereon from the date of payment.

The plaintiff during the period involved kept its books on the basis of a fiscal year ending January 31. Under the regulations (article 25, Regulations 45) it was required to make its tax returns on that basis, and the Commissioner of Internal Revenue was required by section 212(b) of the Revenue Acts of 1918 and 1921 to compute the net income in accordance with that system of accounting. The plaintiff did not make its tax returns on the basis of its fiscal year, but on June 16, 1919, filed its income and excess-profits tax returns for the calendar year 1918, and on May 15, 1920, filed its returns for the calendar year 1919.

The calendar year returns for 1918 and 1919 could not be reconciled with the plaintiff's books, and in February, 1923, the Commissioner of Internal Revenue adjusted the calendar-year returns for 1918 and 1919 to the basis of fiscal years ending January 31, 1919, and January 31, 1920, respectively, and assessed for the fiscal year ending January 31, 1919, an additional tax of $100,031.47.

On April 7, 1925, a warrant of distraint was issued against the plaintiff and notice of levy was served on banks wherein plaintiff carried accounts. Immediate payment was demanded by the collector, and on April 10, 1925, plaintiff, protesting that collection of the tax was barred by the statute of limitations, made a cash deposit of $10,000 and posted a surety bond in the sum of $100,000 guaranteeing payment of the balance. The collector thereupon issued a certificate of discharge of the tax liens. Subsequently the additional assessment was satisfied in full by the abatements, credits, and cash payments set out in findings 12 and 13 of our findings of fact. Of the total amount of the additional assessment, only $55,986.84 is involved in this suit, the cash payments of $36,974.79 on December 28, 1925, $5,000 on February 19, 1926, $5,000 on May 3, 1926, and the credit of $9,012.05 of September 30, 1925. (Finding 12.)

The plaintiff contends the tax was collected subsequent to the running of the statute of limitations, as fixed in section 250(d) of the Revenue Acts of 1918 and 1921 (40 Stat., 1083; 42 Stat., 265), and is refundable as an overpayment under section 607 of the Revenue Act of 1928.[1]

Plaintiff's contention is based on the assumption the statute of limitations commenced to run against collection of the tax on June 16, 1919, the date on which the return for the calendar year 1918 was made. If the plaintiff is right in this contention the 5-year period in which collection could be made expired June 16, 1924, and the surety bond was posted after the bar of the statute had fallen on the collection of the tax.

The position of the Government is that the statute of limitations against the collection began to run on May 15, 1920, the date on which the return for the calendar year 1919 was filed, and expired May 15, 1925. It is also contended the bond was valid and precludes recovery, even if the statutory period for collection had expired when it was filed.

Section 250(d) of the Revenue Acts of 1918 and 1919 bars the collection of any tax after the expiration of five years from the date when the return was due or made. Since the Commissioner is required to compute the net income upon the basis of the taxpayer's annual accounting period, fiscal year or calendar year, as the case may be, a return, sufficient to start the running of the statute of limitations, must be one that covers the entire taxable period. Where there are two returns, each covering only a part of the taxable year, both of which are necessary to a correct computation of the net income and the tax liability for such taxable year, the statute begins to run from the date of the last return. (*Paso Robles Mercantile Co.* v. *Commissioner*, 33 Fed. (2d), 653; *P. L. Mann* v. *United States*, 71 C. Cls., 31; *American Hide & Leather Co.* v. *United States*, 71 C. Cls., 114 [Ct. D. 444. C. B. XI–1, 201].)

In *Paso Robles Mercantile Co.* v. *Commissioner*, supra, the court said:

"That under the circumstances the petitioner did not have the legal right to make returns for calendar years is virtually conceded. Article 25 of Regulations 45, among other things, provides: 'A taxpayer having an existing accounting period which is a fiscal year within the meaning of the statute not only needs no permission to make his return on the basis of such a taxable year, but is required to do so, regardless of the former basis of rendering returns.' If that be true, and petitioner was bound to make return for the year ending January 31, it could not expect an assessment until a return was in for the whole of that year. True, a return purporting to cover the tax year, if merely erroneous or defective, may start the running of the statute; but where there are two or more returns each of which covers only a part of the year, and all of which the Commissioner must have before he can intelligently determine the net income for such year and made the requisite assessment, it would be unreasonable to hold that the statute begins to run before the last one is in, and be is thus for the first time enabled to perform his duty."

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[1] SEC. 607. Any tax (or any interest, penalty, additional amount, or addition to such tax) assessed or paid (whether before or after the enactment of this Act) 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.

The plaintiff contends that the opinion of the Circuit Court of Appeals in *Paso Robles Mercantile Co.* v. *Commissioner*, supra, and the opinion of this court in *Mann* v. *United States*, supra, are inapplicable to the question presented in this case whether the calendar year 1918 return filed June 16, 1919, apparently after an extension of time, was a return for the fiscal year ending January 31, 1919, and, therefore, sufficient to start the running of the statute of limitation for the assessment and collection of any tax due for the fiscal year ending January 31, 1919. The plaintiff undertakes to distinguish the *Paso Robles Mercantile Co.* case on the ground that with respect to that taxpayer the Commissioner of Internal Revenue assessed the tax for the fiscal year on the basis of the two calendar-year returns by taking eleven-twelfths of the tax from the first return and one-twelfth from the second return, whereas in the present case the Commissioner did not compute the tax for the fiscal year by that method but on the basis of actual income shown for the fiscal year beginning February 1, 1918, and ending January 31, 1919, as disclosed by the company's books when examined by the revenue agent; and that the decision of this court in *Mann* v. *United States*, supra, in which the court held that the calendar year 1919 return was the return for the fiscal year ending January 31, 1919, was based on the decision of the Court of Appeals in *Paso Robles Mercantile Co.*, supra.

Plaintiff further insists that in the Mann case the Commissioner of Internal Revenue treated the calendar year 1919 return as the return for the fiscal year ending January 31, 1919, whereas in the present case he acted upon the 1918 calendar-year return as the return for the fiscal year ending January 31, 1919. In *Mann* v. *United States*, supra, and in *American Hide & Leather Co.* v. *United States*, supra, this court squarely held that the calendar year 1918 return was the return for the fiscal taxable period ending January 31, 1918, and that the calendar year 1919 return was the return for the fiscal year beginning in 1918 and ending the calendar year 1919, and this is true independently of the method employed by the Commissioner in determining the tax due for the fiscal taxable period of less than 12 months and for the subsequent taxable year. The limitation period within which the Commissioner may assess a tax for the fiscal taxable period in 1918, or a subsequent fiscal year, begins to run from the date on which the return, which is to be regarded as *the* return under the statute, for such taxable period is filed. The Supreme Court, in the American Hide & Leather Co. case, did not disturb the holding of this court that the calendar-year returns were returns for the fiscal period, or year, ending within the calendar year for which such returns were filed, but held that for the purpose of computing the statute of limitation within which a claim for refund could be filed, the date on which the returns for the fiscal period, or year, were due should be used instead of the earlier date on which the calendar-year returns were filed. In the Mann case and in the American Hide & Leather Co. case the taxpayers' books were kept on the fiscal-year basis, as were those of the plaintiff, and in those cases the Commissioner of Internal Revenue determined the tax for the fiscal year beginning in 1918 and ending in 1919 on the basis of the net income shown by the books. The calendar-year returns in those cases and in the present case did not purport to be returns for the fiscal year ending in a calendar year subsequent to the calendar year for which they were filed. The contention of the plaintiff overlooks the fact that by treating the calendar year 1918 return as the return under the statute for the fiscal year beginning in 1918 and ending in 1919, the taxpayer would be left in a position of having filed no return for the fiscal taxable period of less than 12 months under section 226 of the Revenue Act of 1918 beginning January 1, 1918, when as a matter of fact, the taxpayer had filed a return for that period when he made his calendar year 1918 return.

The Revenue Act of 1917 did not require that returns be made in accordance with the method of accounting employed by the taxpayer, i. e., fiscal year or calendar year, but under that Act a taxpayer was permitted to file calendar-year returns even though its books were kept on a fiscal-year basis. The Revenue Act of 1918, section 200, required that the return be made on the basis of the fiscal year or calendar year, according to the method of accounting employed by the taxpayer. Therefore, taxpayers who kept their books on a fiscal-year basis and filed calendar-year returns for 1917, 1918, and subsequent years were

required to make a return for the fiscal taxable period January 1, 1918, to the end of the fiscal year beginning in 1917 and ending in 1918 and for each fiscal year of 12 months thereafter, unless the method of accounting should be changed with the approval of the Commissioner. (*Appeal of Weed*, 2 B. T. A., 84.) For the purpose of the statute of limitation therefore the calendar year 1918 was the return for the fiscal taxable period falling within that calendar year. The contention of the plaintiff therefore that the calendar year 1918 return was *the* return under the statute, for the fiscal year beginning February 1, 1918, and ending January 31, 1919, is without merit.

The statutory period of limitation on collection of the tax due for the fiscal year ending January 31, 1919, therefore expired on May 15, 1925, which date was five years after the date on which the calendar year 1919 return was filed. The surety bond was filed April 10, 1925, within the period collection could be legally enforced. By giving the bond plaintiff avoided the immediate collection of the tax through the distraint proceedings then pending and secured further time in which to contest the validity of the tax. The bond operated not only to postpone the collection of the tax but also to suspend the running of the 5-year statutory limitation on the collection of the tax. (*United States* v. *John Barth Co.*, 279 U. S., 370 [Ct. D. 65, C. B. VIII–1, 189].)

The bond constituted a separate and distinct agreement, voluntarily entered into between the plaintiff and the Government at a time when collection of the tax was legally enforceable, which took the place of their rights and privileges under the limitations of section 250(d) of the Revenue Acts of 1918 and 1921. Through the promise and agreement represented by the bond, the rights of the parties under the revenue laws were postponed and incorporated in the bond which insured the payment of the tax. (*United States* v. *Onken Bros. Co.*, 23 Fed. (2d), 367 [T. D. 4108, C. B. VI–2, 270]; *George A. Mendes & Co.* v. *Bowers, Collector*, 21 Fed. (2d), 1008 [T. D. 4093, C. B. VI–2, 145].) It is immaterial whether the subsequent payments were made in satisfaction of the tax or of the bond. (*Mascot Oil Co., Inc.*, v. *United States*, 70 C. Cls., 246, affirmed 282 U. S., 434 [Ct. D. 286, C. B. X–1, 190].)

In view of our decision that the surety bond was filed before the statute of limitations had expired on the collection of the tax, it is not necessary to discuss either the plaintiff's contention that the bond was secured by duress, or the defendant's contention that the bond was valid even though filed after the expiration of the statute.

The petition will be dismissed. It is so ordered.

ARTICLE 1272: Period of limitation upon collection of tax.

REVENUE ACT OF 1924.

Application of a waiver of restrictions against assessment to the collection of the tax. (See Ct. D. 516, page 142.)

ARTICLE 1272: Period of limitation upon collection of tax. XI–38–5702 Ct. D. 564

EXCESS PROFITS TAX—REVENUE ACTS OF 1917 AND 1926—DECISION OF COURT.

COLLECTION—COMMENCEMENT OF STATUTORY PERIOD—PARTNERSHIP—REQUIREMENT OF EXCESS PROFITS TAX RETURN.

A partnership, not exempt from the excess profits tax, which has a net income in excess of $6,000 and more than a nominal invested capital for its calendar year 1917 is required to make an excess profits tax return for that year. A balance sheet attached to its information return of income does not comply with the requirement of an excess profits tax return under that Act and the filing of the information return does not commence the running of the period of limitation on collection provided in section 277(a)3 of the Revenue Act of 1926.

COURT OF CLAIMS OF THE UNITED STATES. No. L–14.

Peter L. McDonnell and Dominic A. Truda, Former Partners of the Partnership McDonnell & Truda, v. *The United States.*

[May 31, 1932.]

OPINION.

LITTLETON, Judge, delivered the opinion of the court.

This suit was instituted by the former partners of the dissolved partnership of McDonnell & Truda to recover $29,748.40, being excess-profits tax of $24,863.28 for the calendar year, and interest of $4,885.12 thereon paid September 29, 1926. Refund claims were timely filed and were rejected within two years immediately preceding institution of this suit. It is alleged that the tax and interest were collected after the expiration of the statute of limitation of five years, and this contention is predicated upon the claim that the partnership return of income, Form 1065, filed April 1, 1918, was a sufficient compliance with the statute and that the filing of the excess-profits tax return, Form 1102, was not necessary.

Plaintiffs further insist that the invested capital of the partnership was nominal and that it was taxable at 8 per cent under section 209 of the Revenue Act of 1917.

The Commissioner of Internal Revenue held, and we think correctly, that the partnership was required to file a profits-tax return, Form 1102, and that the balance sheet, which the partnership attached to its income tax return, Form 1065, was not a sufficient compliance with the statute and the regulations. The books and records of the partnership were examined and investigated by the Commissioner through a revenue agent, with the result that it was determined that the partnership actually had a large invested capital within the meaning of section 207 of the Revenue Act of 1917, and the facts establish that the partnership had more than a nominal invested capital. March 18, 1923, the Commissioner made a jeopardy assessment of excess-profits tax against the partnership in the amount of $100,005.14. The partnership protested this additional assessment and requested that the profits tax be computed and determined under the special relief provisions of section 210 of the Revenue Act of 1917. Upon the recommendation of the Committee on Appeals and Review, to which it was sent by the Commissioner after the claim of the partnership that the tax should be determined under section 209 of the Revenue Act of 1917 had been denied, the Commissioner tentatively computed the profits tax of the partnership under the special relief provisions, which computation showed an overassessment of $75,141.86. Each change or proposed change in the partnership's tax liability naturally affected the income tax liability of the individual partners and was reflected in the determination of their taxes. When the jeopardy assessment of $100,005.14 was made against the partnership, overassessments were allowed the individual partners in the amounts of $9,500 each. When the jeopardy assessment was reduced to $24,863.28 an additional assessment of about $6,800 was proposed against each partner. Ultimately the tax liability of the partnership and the two partners was reconciled and closed out together.

Upon the facts in this case we are of opinion that the partnership of McDonnell & Truda was required to file an excess-profits tax return, Form 1102, and that in the circumstances the filing of the return of income, Form 1065, was not a sufficient compliance with the statutes and the regulations. (*Updike* v. *United States,* 271 U. S., 661 [T. D. 3815, C. B. V–1, 312]; *Beam* v. *Hamilton,* 289 Fed., 9 [T. D. 3519, C. B. II–2, 217]; *Rockland & Rockport Lime Corporation* v. *Ham,* 38 Fed. (2d), 239; *Morris County Crushed Stone Co.,* 6 B. T. A., 800.) Assessment and collection of the tax in question were not therefore barred at the time made. (*Commissioner* v. *The Pilliod Lumber Co.,* 281 U. S., 245 [Ct. D. 266, C. B. IX–2, 396]; *Updike* v. *United States,* supra.)

The petition is dismissed. It is so ordered.

WHALEY, Judge; WILLIAMS, Judge; GREEN, Judge; and BOOTH, Chief Justice, concur.

ARTICLE 1272: Period of limitation upon collection of tax. (Also Sections 273 and 274, Article 1235.)

XI-38-5703
Ct. D. 565

FEDERAL TAXES—BOND—DECISION OF COURT.

1. BOND—VALIDITY—LIMITATION ON SUIT.

Where a bond is given in connection with a claim for the abatement of a deficiency assessed, by reason of which the collection of the deficiency is postponed, the bond reciting that the principal has perfected an appeal from the determination of the Commissioner and desires that the payment of the deficiency be extended until the determination of the appeal, the bond is an enforceable contract the validity of which is affected neither by the fact that it was executed under the erroneous assumption that an appeal to the Board of Tax Appeals had been perfected nor the fact that the bond and the claim for abatement were not filed in time.

2. SUIT—BOND—LIMITATION.

Section 1047, R. S., providing a period of limitation on a suit for any penalty or forfeiture has no application to a suit on a bond to recover the penalty therein fixed for a breach thereof.

3. ACCORD AND SATISFACTION—COLLECTION OF A CHECK BY COLLECTOR.

The assent of the Secretary of the Treasury is essential to a compromise of any civil case "arising under the internal revenue laws" and the collection of a check by a collector tendered in full settlement of a claim of the United States for an internal revenue tax does not itself constitute an accord and satisfaction.

4. INTEREST.

Where a bond is given in 1925 in connection with a claim for abatement of a tax assessed in that year and the notice of the rejection of the claim for abatement is given to the taxpayer and the demand for the tax is made on the taxpayer in December, 1927, and on the surety July 14, 1928, the United States is entitled to interest on the tax at the rate of 12 per cent at least after July 14, 1928.

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT.

William L. Hughson, appellant, v. *United States of America, appellee.*

Appeal from the District Court of the United States for the Northern District of California, Southern Division.

[May 23, 1932.]

OPINION.

WILBUR, Circuit Judge: This action was brought by the United States to recover upon four bonds executed by appellant Hughson as surety and defendant Hader as principal, for the purpose of staying the collection of deficiency taxes assessed against defendant Hader for the years 1920, 1921, 1922, and 1923. Defendant Hader not being before the court, judgment was rendered against appellant only, for the amount of the bonds together with interest thereon at the rate of 6 per cent per annum from the date of the bond to July 15, 1928, and thereafter at 12 per cent per annum. Appellant set up lack of consideration for the bonds. One of the recitals of the bonds was as follows:

"Whereas, the principal herein has perfected an appeal from the determination of the Commissioner assessing the deficiency tax for the year * * *, and desires that the payment of the deficiency tax be extended until the determination of said appeal, as a matter of fairness and justice."

In view of this recital it is contended by appellant that there was no consideration for the bonds because they were executed under the erroneous assumption that appeals had been perfected, whereas the appeals were in fact taken prematurely. There is no merit in this contention.

The trial court found that the consideration for the bonds was that the collector should refrain from enforcing immediate payment of the tax which he did until after the petition for abatement filed by the taxpayer had been con-

sidered and determined by the Commissioner. A somewhat similar question was disposed of by the Court of Claims in *Roberts Sash & Door Co.* v. *United States* (38 F. (2d), 716 [Ct. D. 177, C. B. IX–1, 227]), which was affirmed by the Supreme Court in 282 U. S., 812, on the authority of *United States* v. *John Barth Co.* (279 U. S., 370 [Ct. D. 65, C. B. VIII–1, 189]). The only distinction between these cases and the case at bar is that in the case of *Roberts Sash & Door Co.* v. *United States*, supra, the recital in the bond was that the taxpayer was about to file a claim in abatement, whereas he filed no such claim. The Court of Claims said:

"The consideration for the bond was in the fact that a tax had been assessed, and by reason of the filing of the bond its collection was postponed. The validity of the bond was not affected by the failure to file the plea in abatement."

Appellant claims that the action is barred by the provisions of section 791, Title 28, U. S. C. A., which provides that:

"No suit or prosecution for any penalty or forfeiture, pecuniary or otherwise, accruing under the law of the United States, shall be maintained, except in cases where it is otherwise specially provided, unless the same is commenced within five years from the time when the penalty or forfeiture accrued;" etc.

Section 791, supra, has no application to a suit on a bond to recover the penalty therein fixed for a breach thereof. The section applies to a penalty or forfeiture "imposed in a punitive way for an infraction of a public law." (*Meeker & Co.* v. *Lehigh Valley R. R.*, 236 U. S., 412, 423.) There is nothing in *Farni* v. *Tesson* (66 U. S., 309), cited by appellant, in conflict with this view. (See, also, *United States* v. *John Barth Co.*, 279 U. S., 370, supra.)

Appellant claims that the bonds were not accepted or approved. The trial court found as a fact that the collector acted upon the bonds in delaying collection of the tax in accordance with his purpose. This was sufficient to constitute the bond an enforceable contract.

Appellant claims that neither the bonds nor abatement claims were filed in time. As already pointed out, it is immaterial whether the claims in abatement were ever filed. (*Roberts Sash & Door Co.* v. *United States*, 38 F. (2d), 716, supra.)

Appellant claims that there was an accord and satisfaction arising from the fact that appellant tendered a check for $100 in full settlement of the claims of the Government against him. It is claimed that by indorsing and collecting this check an accord and satisfaction was established. Appellant cites numerous cases on this subject, none of which deal with transactions with the Government. The collector who received the check had no authority to compromise the claim against the appellant by express agreement, much less by implication. (Section 3229, R. S.; *Botany Worsted Mills* v. *United States*, 278 U. S., 282 [Ct. D. 39, C. B. VIII–1, 279].) The assent of the Secretary of the Treasury is essential to a compromise of any civil case "arising under the internal revenue laws." (See *Botany Worsted Mills* v. *United States*, supra.)

Appellant claims that the allowance of interest at 12 per cent per annum after July 15, 1928, is erroneous. But the bonds in suit imposed a liability for the deficiency in tax plus all penalties and interest. The bonds were given on August 18, 1925, under the Revenue Act of 1924, which provides that where an extension of time is given interest runs on the deficiency at 6 per cent for the period of the extension and thereafter at 1 per cent per month. (Revenue Act 1924, section 274(g), 43 Stat., 298.) The same rule applies to jeopardy assessments such as these made under section 276(a)2 and section 274(d) of the Revenue Act of 1924; and section 279(a) provides for interest at the rate of 1 per cent per month, if the amount included in the notice and demand is not paid within 10 days after such notice and demand. The demand referred to is that made by the collector upon the taxpayer after the claim in abatement has been rejected in whole or in part. A similar provision occurred in the Revenue Act of 1926 and the Revenue Act of 1928. (Sections 274(k), 276(a)2, (b), and 279(j), Act of 1926; 273(f) and 294 (a), (b), Act of 1928.) The notice of the rejection of the claim for abatement and demand for the tax was made on the taxpayer in December 9, 1927, and on the bondsman July 14, 1928. The Government was entitled to interest at 12 per cent at least as soon as July 15, 1928. (*U. S.* v. *Maryland Casualty Co.*, 49 F. (2d), 556 [Ct. D. 371, C. B. X–2, 381].)

There is no other point raised which merits discussion.

Judgment affirmed.

ARTICLE 1272: Period of limitation upon collection of tax. XI-39-5724 Ct. D. 569

INCOME TAX—REVENUE ACT OF 1924—DECISION OF COURT.

ASSESSMENT—COLLECTION—LIMITATION—WHEN ASSESSMENT MADE.

The filing of a return does not constitute the assessment of the tax shown thereon within the meaning of section 278 of the Revenue Act of 1924 but requires an act of the Commissioner; and when the Commissioner signed the assessment certificate accompanying a supplemental assessment list listing the taxpayer with an assessment in the amount shown on the return the assessment was made. The assessment on January 20, 1925, being within five years from the date the return was filed, as provided in section 277(a)2 of the Revenue Act of 1924, the United States had under section 278(d) of that Act six years from that date within which to collect the tax.

COURT OF CLAIMS OF THE UNITED STATES. No L-293.

David Davidovitz v. *The United States.*

[May 31, 1932.]

OPINION.

LITTLETON, Judge, delivered the opinion of the court.

Plaintiff contends that for the purpose of the statute of limitation the assessment of the tax in question, being a portion of the total tax shown by him to be due upon the return filed, was made on March 15, 1920, when he filed his return, without further action by the Commissioner of Internal Revenue, and that, therefore, the period within which collection by distraint or otherwise could be made expired March 15, 1925. He insists that the signing by the Commissioner of an assessment list and certificate does not constitute the assessment of tax within the meaning of the various Revenue Acts and that for the purpose of the operation of the statute of limitations, as provided in the various taxing statutes, particularly section 278 of the Revenue Act of 1924, the computation of tax upon the return filed by the taxpayer is the assessment thereof. It is contended, therefore, that the total amount collected constitutes an overpayment within the meaning of section 607 of the Revenue Act of 1928.

Section 250(d) of the Revenue Act of 1918 provides that "the amount of tax due under any return shall be determined and assessed by the Commissioner within five years after the return was due or was made." Every Revenue Act, beginning with the Act of 1916, to and including the Revenue Act of 1928, specifically requires the Commissioner of Internal Revenue "to determine and assess" the amount of the taxes due under any return and specifies the time within which the Commissioner should make the assessment.[1]

The assessment of the tax involved in this suit was made when the Commissioner, on January 20, 1925, signed the assessment certificate which accompanied the supplemental assessment list of that date. The collection by distraint having been made within six years thereafter, as provided in section 278(d) of the Revenue Act of 1924, was made within time, and plaintiff is therefore not entitled to recover. Until the Commissioner acted no assessment was made. When he signed the assessment certificate on January 20, 1925, which was within five years from the date the return was filed, as provided in section 277(a)2 of the Revenue Act of 1924, the defendant had, under section 278(d) of the Revenue Act of 1924, six years from that date within which to collect the tax. The tax was assessed after the enactment of the Revenue Act of 1924 and the case of *Russell et al.* v. *United States* (278 U. S., 181 [T. D. 4260, C. B. VIII-1, 206]) sustains the action of the defendant rather than the contention of the plaintiff. The cases cited by the plaintiff in support of its contention are not in point upon the question involved in this case. The petition must be dismissed. It is so ordered.

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[1] Section 9(a) of the Act of 1916; section 250(d) of the Act of 1921; sections 271 and 277 of the Acts of 1924 and 1926; and section 57 of the Act of 1928.

ARTICLE 1272: Period of limitation upon collection of tax. XI-41-5772 Ct. D. 584

INCOME AND PROFITS TAXES—REVENUE ACTS OF 1921 AND 1924—DECISION OF COURT.

1. COLLECTION—LIMITATION—ESTOPPEL.

Where the collector makes demand for payment of a deficiency duly assessed for 1918 and the taxpayer by telegram asks that collection be withheld until an overpayment for 1919 is adjusted, to which request the Commissioner accedes and advises the collector not to collect the deficiency until receipt of the schedule of overassessment for 1919, the telegram is as construed by the Commissioner an agreement on the part of the taxpayer that if the United States would relieve it of the burden of paying the deficiency prior to the allowance of a refund for 1919 the United States might retain a sufficient amount of the 1919 overpayment to satisfy the deficiency and the taxpayer is estopped to assert that the United States had no right to credit a part of an overpayment for 1919 against the deficiency on the ground that the credit was made after the expiration of the statutory period for collection of the deficiency.

2. ASSESSMENT—LIMITATION—RETURN FOR FISCAL YEAR 1918.

The period of limitation on the assessment of income and profits taxes of a corporation for its fiscal year 1918 prescribed by section 250(d) of the Revenue Act of 1921 runs from the filing of its completed return pursuant to section 239 of the Revenue Act of 1918.

COURT OF CLAIMS OF THE UNITED STATES. No. L-506.

Ralston Purina Co. v. *The United States.*

[June 6, 1932.]

OPINION.

LITTLETON, Judge, delivered the opinion of the court.

Plaintiff first contends that the deficiency for the fiscal year 1918 was not timely assessed. The return for that fiscal year, to be used in computing the statute of limitation within which the Commissioner could make an assessment for such fiscal year, was the completed consolidated return filed by plaintiff June 16, 1919, under and pursuant to the provisions of the Revenue Act of 1918, approved February 24, 1919, which was retroactive to January 1, 1918. (*Davis Feed Co.*, 2 B. T. A., 616; *Covert Gear Co.*, 4 B. T. A., 1025; *Fred T. Ley*, 9 B. T. A., 759; *A. Cellers et al.*, 16 B. T. A., 411; *National Paper Products Co.*, 26 B. T. A., 92, decided May 17, 1932; *United States* v. *Updike*, 1 Fed. (2d), 550 [T. D. 3654, C. B. III-2, 196], affirmed 8 Fed. (2d), 913 [T. D. 3815, C. B. V-1, 312]; *United States* v. *Updike*, 25 Fed. (2d), 746, affirmed 32 Fed. (2d), 1, 281 U. S., 489 [Ct. D. 192, C. B. IX-1, 228]; *Whitney Bodden Shipping Co.* v. *United States*, 72 C. Cls., 653 [Ct. D. 437, C. B. XI-1, 318]; 52 Fed. (2d), 1003; I. T. 1875, C. B. II-2, 238.) The additional assessment of $23,846.88, March 6, 1924, for the fiscal year 1918 was therefore timely.

The deficiency of $23,846.88 for 1918 was timely assessed. At the time the collector mailed plaintiff a notice of the deficiency and made demand for payment thereof, he had three months within which to make collection. Plaintiff was advised by the Commissioner at the time the assessment was made that inasmuch as the deficiency had been assessed without giving plaintiff an opportunity to appeal, as provided in section 250(d) of the Revenue Act of 1921, it had the privilege of filing a claim in abatement with respect to the deficiency. No protest of the deficiency was made and no claim in abatement was filed. The plaintiff appears to have agreed to the correctness of the deficiency for 1918. In order to be relieved of the burden of having to pay the additional tax of $23,846.88 due for 1918, plaintiff communicated with the Commissioner by telegram in which it asked that collection of the additional tax due for 1918 be withheld *until* the overpayment for 1919 was adjusted. In our opinion this

telegram to the Commissioner was an agreement on the part of the plaintiff that if the Government would relieve it of the burden of paying the additional tax for 1918 prior to the allowance of the refund for 1919 the Government might retain a sufficient amount of the 1919 overpayment to satisfy the deficiency for 1918. In consideration thereof the Commissioner advised the collector to take no steps to collect the deficiency until receipt of the schedule of overassessment for 1919. But for the plaintiff's telegram to the Commissioner the additional tax for the fiscal year 1918 would have been collected or a distraint proceeding for the collection thereof would have been begun prior to the expiration of the limitation period of five years after the return for 1918 was filed on June 16, 1919. When the overpayment of $68,724.90 for the fiscal year 1918 was determined on November 3, 1924, and formally allowed on March 7, 1925, the Government retained $23,846.88 thereof, as the plaintiff had requested and agreed should be done, and the balance of $44,878.02 was duly refunded to plaintiff, together with interest of $17,051.26. Plaintiff was duly notified of the action taken. It made no objection thereto and for more than five years thereafter acquiesced in the action which had been taken. In these circumstances it is our opinion that plaintiff is estopped to assert that the Government had no right to retain that portion of the 1919 overpayment equal to the additional tax due for 1918. In *Dickerson* v. *Colgrove* (100 U. S., 578), the court said:

"The estoppel here relied upon is known as an equitable estoppel, or estoppel *in pais*. The law upon the subject is well settled. The vital principle is that he who by his language and 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."

The relief of equitable estoppel is administered in favor of one who has been induced to alter his line of conduct with respect to the subject matter in controversy so as to have foregone some right or remedy which he otherwise would have taken. Under the doctrine of equitable estoppel, a person is held to a representation made or a position assumed, where otherwise inequitable consequences would result to another, who, having the right to do so under all the circumstances of the case, has, in good faith, relied thereon. (Cf. *J. C. Hunt*, 45 Fed. (2d), 781; *Louis Werner Sawmill Co.*, 26 B. T. A., 141, decided May 24, 1932.) Although this case is not a suit in equity but is one at law in *assumpsit*, however, an *assumpsit* of this kind is of an equitable nature (*New York Life Insurance Co.* v. *Anderson*, 263 Fed., 527), and the defendant may rely upon any defense which shows that the plaintiff in equity and good conscience is not entitled to recover in whole or in part. (*Myers* v. *Hurley Motor Co.*, 273 U. S., 18; section 274(b) of the Judicial Code; section 398, U. S. C. A., Title 28.)

The facts and circumstances in this case distinguish it from the ordinary case where the taxpayer files the usual claim for credit. A claim for credit is directed primarily to the year in which there is an overpayment and operates to protect the rights of the person making it with respect to the statute of limitation for the year of the overpayment. That the plaintiff's telegram in this case was construed by the Commissioner as its agreement to the collection of the 1918 tax out of the 1919 overpayment, as and when allowed, is evidenced by the fact that the Commissioner on November 3, 1924, prior to the allowance of the overpayment for 1919, advised the plaintiff to file a claim for refund for 1919 to protect its interest against the statute of limitation for that year. The telegram in this case was not a claim for credit, but it was directed primarily to the collection of the additional tax for 1918. By its terms the plaintiff represented to the Commissioner that if he would instruct the collector not to collect the 1918 tax, it would consent to a satisfaction thereof out of the 1919 overpayment when allowed. The telegram was therefore more than a mere request for delay. It was a promise that the 1918 deficiency would be paid out of the 1919 overpayment.

It is urged by counsel for plaintiff that the Commissioner's reason for not collecting the tax for 1918 earlier than he did was due to the fact that he misunderstood the law and considered that there was no limitation on his

right to collect by distraint. Assuming that the Commissioner so construed the statute, this does not help the plaintiff, inasmuch as the facts in this case show that had it not been for the representation made by plaintiff to the Commissioner the tax for 1918, in the amount sought to be recovered, would have been timely collected.

The petition is dismissed. It is so ordered.

ARTICLE 1272: Period of limitation upon collection of tax.

XI-44-5822
Ct. D. 594

FEDERAL TAXES—LIABILITY ON BOND—DECISION OF COURT.

SUIT—BOND—ESTOPPEL.

Where a bond, conditioned to pay such amount of a tax assessed as may be found to be due and reciting that the principal "has filed his claim for abatement" of the tax, is accepted by the United States and the claim, which was filed three years after the delivery of the bond, is considered and collection of the tax is postponed in reliance on the bond, in a suit upon the bond the surety is estopped to deny that a claim for abatement had been filed when the bond was executed, where the United States has not misinformed the surety that a claim had been filed nor misled the surety in any other manner.

UNITED STATES DISTRICT COURT, SOUTHERN DISTRICT OF NEW YORK.

L. 47-191. *United States of America, plaintiff*, v. *Massachusetts Bonding & Insurance Co., defendant.*

L. 46-182. *United States of America, plaintiff*, v *Samuel Hurtig, Principal, and Massachusetts Bonding & Insurance Co., a Corporation, Surety, defendants.*

[July 14, 1932.]

OPINION.

PATTERSON, D. J.: Two actions on bonds were by stipulation tried together. The stipulation provided for trial by a jury of one and for a directed verdict. Most of the facts are also covered by stipulation. The first suit involved a bond in connection with an income tax liability of one Jules Hurtig. The second involves a similar bond in connection with an income tax liability of one Samuel Hurtig.

In the first suit, it was shown that on March 12, 1921, Jules Hurtig filed an income tax return for the year 1920, disclosing a tax liability in the amount of $17,379.85, and at the same time made payment of one-fourth of the tax shown to be due, $4,344.96. On May 16, 1921, Hurtig filed an amended return, showing a total tax liability for 1920 in the reduced amount of $13,047.41, and an unpaid balance in the amount of $8,702.45. The United States thereafter demanded payment and a warrant of distraint was issued. To stay proceedings, Hurtig as principal and the defendant surety company as surety gave a bond dated January 31, 1923, in the sum of $10,000 to the United States. The recital in the bond is:

"Whereas the said Jules Hurtig has been assessed a tax by the Commissioner of Internal Revenue in the principal sum of eight thousand seven hundred two and 45/100 dollars ($8,702.45) and whereas, the said Jules Hurtig has filed his claim in abatement against said tax;"

The recital is followed by this condition:

"Now, therefore, if the said claim in abatement shall be denied in whole or in part by the Bureau of Internal Revenue, and upon notice and demand of the said Frank K. Bowers, collector of internal revenue, or his successor in office, the said Jules Hurtig, pays to the said Frank K. Bowers, as collector of internal revenue, or his successor in office, the said tax or such amount thereof as may be found due, together with such penalties and interest as may accrue thereon, then this obligation to be null and void; otherwise to be and remain in full force and effect."

No claim in abatement was actually filed by Hurtig until March, 1926. The claim was allowed in part, but there remained due from Hurtig for 1920 income tax the sum of $4,398.02 which was demanded from him without success. He died prior to the bringing of suit on the bond. In disputing its liability on the bond, the surety company shows that it believed a claim in abatement to have been filed prior to the delivery of the bond, and that it would not have executed the bond had it known that no such claim had been filed.

The case involving Samuel Hurtig is similar. Samuel Hurtig on March 26, 1921, filed his 1920 income tax return showing a liability of $1,028.84 and paid on account the sum of $257.21, leaving a balance of $771.83. No further payments were made although demanded, and a warrant of distraint was finally issued. To stay collection, Samuel Hurtig and the surety company gave a bond dated April 6, 1923, in the sum of $1,000. This bond recited that Hurtig had been assessed a tax of $833, and had filed a claim in abatement against the tax. The condition of this bond was substantially the same as in the case of Jules Hurtig. No claim in abatement was filed by Samuel Hurtig until March, 1926. The claim was rejected, and demands for payment of the unpaid tax of $771.63 were unavailing. The case is defended only by the surety company.

The two cases differ only in minor details, and the discussion of the first one will control the disposition of the second one as well. The situation is one where the tax collector was about to enforce collection of an alleged tax liability and where in order to obtain a stay of collection the taxpayer as principal and a surety company as surety gave a bond in favor of the Government, reciting that a claim in abatement had been filed and providing that if the claim was denied and the taxpayer paid the required tax the bond to be void; otherwise to be in full force. Apparently the claim in abatement was not filed until three years later. The claim was denied, and after demand and nonpayment by the taxpayer recourse is sought on the bond.

The defense is that the bond was void at its inception, because the filing of a claim in abatement prior to the execution of the bond was one of the stipulated conditions of the bond, and no claim had then been filed. This defense, however, is disposed of by the rule that the obligor on a bond accepted and acted upon by the obligee is estopped to deny a material fact recited in the bond. (*Bruce* v. *United States*, 17 How., 457; *Daniels* v. *Tearney*, 102 U. S., 415; *Hime* v. *Morse*, 218 U. S., 493; *McIver Construction Co.* v. *Hurtitz*, 144 Md., 451.)

Here the taxpayer and the surety jointly represented to the Government that the claim had been filed and induced it to forego collection of the tax. The Government did not seek out the surety and ask it to furnish a bond, nor did it ever tell the surety that a claim in abatement had been filed. It remained passive, accepted the bond and postponed collection of the tax in reliance on the bond. It later took the claim in abatement when filed, considered it and denied the claim. The bond served the purpose for which it was given. I regard it of no moment that the Government upon careful scrutiny of its records could have discovered that no claim in abatement had been filed when the bond was delivered to it. It had no ready or convenient means of learning this and was reasonable in relying upon the representation by the taxpayer and surety that a claim had been filed. I can not see that the case differs from the situation in an appeal bond, where the obligors are estopped to deny that an appeal has been taken if that is recited as a fact in the bond and if the appellant has derived an advantage from the giving of the bond.

The matter would be different if the Government had informed the surety that a claim in abatement had been filed when the fact was otherwise. In such a case the mistake would be a mutual one and the bond would be void. (*Bleney* v. *Rogers*, 174 Mass., 277.)

The case bears no resemblance to the cases where an obligee knowingly misleads a surety by concealing material information concerning the risk, the circumstances creating a duty to speak and the concealment being equivalent to fraud. (See *Griswold* v. *Hazard*, 141 U. S., 260, 284; *Phillips* v. *United States Fidelity & Guaranty Co.*, 200 App. Div., 208; *Damon* v. *Empire State Surety Co.*, 161 App. Div., 873.)

A verdict in favor of the plaintiff will be directed in each of the two actions.

ARTICLE 1272: Period of limitation upon collection of tax.

REVENUE ACT OF 1926.

Limitation period for assessment expiring before enactment of the Revenue Act of 1924. (See Ct. D. 596, page 373.)

ARTICLE 1272: Period of limitation upon collection of tax. XI-52-5952 Ct. D. 614

INCOME TAX—REVENUE ACTS OF 1924 AND 1926—DECISION OF COURT.

1. WAIVER—COLLECTION—LIMITATIONS.

Where timely assessment of 1917 taxes was made in 1923, under an unlimited waiver, which by departmental ruling expired on April 1, 1924, collection in 1927 and 1928 under a series of waivers, the last of which expired on December 31, 1927, is timely, under the provisions of sections 278 (c), (d), and (e) of the 1926 Act. Subsection (e) of section 278 of the 1924 Act did not limit the right to execute a valid waiver under subsection (c) of said Act.

2. CASE DISTINGUISHED.

Uncasville Manufacturing Co. v. *Commissioner* (56 Fed. (2d), 893) distinguished.

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT.

Pacific Coast Steel Co., a Corporation, appellant, v. *John P. McLaughlin, United States Collector of Internal Revenue for the First Collection District of California, appellee.*

Upon appeal from the District Court of the United States for the Northern District of California, Southern Division.

[August 22, 1932.]

OPINION.

MCCORMICK, District Judge: A corporate taxpayer, Pacific Coast Steel Co., brought this action at law in the District Court for the Northern District of California for the recovery of income and excess profit taxes for the calendar year of 1917, claiming that said taxes were illegally assessed and collected as deficiency taxes. Pursuant to stipulation, the case was tried by the court, sitting without a jury, and upon special findings, a judgment was entered for the defendant. The taxpayer has prosecuted this appeal from the judgment, and the sole issue is whether or not collections of taxes on June 30, 1927, and August 27, 1928, respectively, were made after the applicable periods of limitation had barred the right of the collector to make them.

The pertinent facts found by the court below are as follows:

On March 30, 1918, plaintiff filed its income and profits tax return for the calendar year 1917.

On June 24, 1920, the Commissioner of Internal Revenue forwarded to plaintiff a tentative determination of tax deficiency wherein plaintiff was notified that the Commissioner asserted a claim of $209,876.47, for deficiency taxes because of an understatement by plaintiff in the return of March 30, 1918.

On December 9, 1922, the Commissioner determined that the correct amount of deficiency tax that was due from the plaintiff for said calendar year 1917 was $257,443.30.

On December 16, 1922, plaintiff and the Acting Commissioner of Internal Revenue entered into a written agreement whereby the plaintiff consented to a determination, assessment and collection of income, excess profits or war profit taxes due under any return made by or on behalf of it for the years 1911 to 1917, inclusive, under the Revenue Act of 1921 or under prior tax Acts irrespective of any period of limitations.

On February 9, 1923, the deficiency tax of $257,443.30, was assessed against plaintiff for the calendar year 1917, and, on April 1, 1923, notice and demand for the payment of such deficiency tax was made upon plaintiff but no proceeding to collect a deficiency tax for 1917 was instituted prior to December 7, 1925, when by a written instrument executed by plaintiff and the Commissioner the plaintiff waived until December 31, 1926, the time prescribed by law for making any assessment of the amount of income, excess profits or war profits taxes due under any return made by or on behalf of it for the years 1917 to 1920, inclusive, under existing or prior Revenue Acts, and again on November 29, 1926, by a similar writing, the plaintiff extended the period of waiver of time for making any assessment of said taxes under any return made by or on behalf of it for the year 1917 under existing or prior Revenue Acts until December 31, 1927.

A second notice and demand was made upon plaintiff on or about July 16, 1927, wherein defendant collector claimed a deficiency tax due from plaintiff in the sum of $129,920.06, upon its tax liability for 1917. In this notice and demand, plaintiff was informed that overpayments by it of taxes in 1918 and 1919, including the amount of $111,953.71, had been on June 30, 1927, credited upon the deficiency tax of 1917.

On August 27, 1928, plaintiff under written protest and to avoid seizure and sale of its property paid to the defendant collector $103,111.16, as deficiency taxes due and interest in the further sum of $26,808.90, the entire amount of $129,920.06, to apply against the determined deficiency taxes due from the plaintiff for the calendar year 1917. On October 23, 1928, plaintiff filed with the defendant collector, for transmittal to the Commissioner of Internal Revenue, a demand and claim of refund for taxes so paid as income and excess profits taxes and interest thereon in the aggregate sum of $284,252.20 upon the ground that the assessment and the collection of such taxes was illegal and barred by the statutes of limitations. The Commissioner on December 14, 1928, rejected entirely said claim for refund, refused to return any part of said sum of money, and plaintiff thereupon brought this action.

When plaintiff filed its income tax return on March 30, 1918, the time within which the amounts of any tax due thereunder could be assessed or collected was controlled by section 250(d) of the Revenue Act of 1918 (ch. 18, 40 Stat. L., 1057, 1083), which as far as applicable to this appeal reads:

"SEC. 250. (d) Except in the case of false or fraudulent returns with intent to evade the tax, the amount of tax due under any return shall be determined and assessed by the Commissioner within five years after the return was due or made, and no suit or proceeding for the collection of any tax shall be begun after the expiration of five years after the date when the return was due or was made. * * *"

When the assessment of February 9, 1923, involved in this appeal, was made and applicable to it, there was in effect the Revenue Act of 1921 (42 Stat. L., 227, 265). Section 250(d) thereof, as far as it is applicable here, reads:

"The amount of income, excess-profits, or war-profits taxes due under any return made under this Act for the taxable year 1921 or succeeding taxable years shall be determined and assessed by the Commissioner within four years after the return was filed, and the amount of any such taxes due under any return made under this Act for prior taxable years or under prior income, excess-profits, or war-profits tax Acts, * * * shall be determined and assessed within five years after the return was filed, unless both the Commissioner and the taxpayer consent in writing to a later determination, assessment, and collection of the tax; and no suit or proceeding for the collection of any such taxes due under this Act or under prior income, excess-profits, or war-profits tax Acts, * * * shall be begun, after the expiration of five years after the date when such return was filed, but this shall not affect suits or proceedings begun at the time of the passage of this Act: * * *."

It is conceded by appellant that the assessment of the additional tax of $257,443.30, having been made February 9, 1923, was timely, and no question is raised by the taxpayer on the claims for refund or in the pleadings in the court below, and none is urged here, against the regularity or validity of this assessment.

Moreover, notwithstanding the waiver was according to its terms unlimited in time, it is indisputable that under the decisions of the Supreme Court in *Aiken* v. *Burnet* (282 U. S., 279 [Ct. D. 275, C. B. X–1, 417]) and *Stange* v. *U. S.* (282 U. S., 270 [Ct. D. 274, C. B. X–1, 414]), and pursuant to regulations of

the Commissioner of Internal Revenue promulgated April 11, 1923 (Mim. 3085, C. B. II–1, 174), the voluntary waiver dated December 16, 1922, extended the time for both assessment and collection of the 1917 taxes only to April 1, 1924. This was because a departmental ruling terminated all such waivers April 1, 1924.

The appellant contends, however, that the court below erred in holding that the second waiver—the one executed on December 7, 1925—operated retroactively to extend the time in which the collection of taxes assessed on February 9, 1923, could be made. In other words, the argument is that because the waiver of December 16, 1922, expired April 1, 1924, all right to subsequently collect the taxes that were validly assessed on February 9, 1923, ceased when the Revenue Act of 1924 became law by reason of the terms of that Act and specifically because of subdivision (c), (d), and (e) of section 278 thereof.

The 1924 Act (43 Stat. L., 253) became effective on June 2, 1924. Section 277(a) thereof, as far as material to this appeal, states:

"Except as provided in section 278 and in subdivision (b) of section 274 and in subdivision (b) of section 279 (274 and 279 are not involved in this appeal)— * * *

"(2) The amount of income, excess-profits, and war-profits taxes imposed by * * * the Revenue Act of 1917, 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 for the collection of such taxes shall be begun after the expiration of such period."

Section 278, (c), (d), and (e), respectively, of the Act provides:

"(c) Where both the Commissioner and the taxpayer have consented in writing to the assessment of the tax after the time prescribed in section 277 for its assessment the tax may be assessed at any time prior to the expiration of the period agreed upon.

"(d) Where the assessment of the tax is made within the period prescribed in section 277 or in this section, such tax may be collected by distraint or by a proceeding in court, begun within six years after the assessment of the tax. Nothing in this Act shall be construed as preventing the beginning, without assessment, of a proceeding in court for the collection of the tax at any time before the expiration of the period within which an assessment may be made.

"(e) This section shall not (1) authorize the assessment of a tax or the collection thereof by distraint or by a proceeding in court if at the time of the enactment of this Act such assessment, distraint, or proceeding was barred by the period of limitation then in existence, or (2) affect any assessment made, or distraint or proceeding in court begun, before the enactment of this Act."

The appellant's position concretely stated is that subdivision (e) of section 278 limits and qualifies subdivision (c) of the same section so as to prevent taxpayers from effectively waiving the benefit of the statute of limitation in all cases where the right of the Government to collect taxes was barred on the date of the enactment of the Revenue Act of 1924, to wit, June 2, 1924.

We find no language in subdivision (e) of section 278 or in any other part of the Act of 1924 that expressly forbids taxpayers from, pursuant to the comprehensive wording of subdivision (c), voluntarily waiving the bar against the collection of validly assessed and unpaid taxes, the collection of which was barred on June 2, 1924. Subdivision (e) merely declares that section 278 of the 1924 Act shall not authorize the assessment or the collection of such taxes. There being no clear prohibition against taxpayer's voluntary waiver or limitation for collecting taxes that have been timely assessed, it would be straining and amplifying the terms of (e) and unnecessarily restricting the broad and inclusive language of (c) to construe section 278 as appellant contends. We should not adopt a construction that would require giving to the statute a meaning not expressed by the language used.

Statutes of limitation barring the collection of taxes that are justly due and unpaid must receive a strict construction in favor of the Government, and limitation in such cases will not be presumed in the absence of clear congressional action. (*Loewer Realty Co.* v. *Anderson*, C. C. A. 2, 31 Fed. (2d), 268 [Ct. D. 125, C. B. VIII–2, 218].)

Moreover, the Supreme Court has held that the right of waiver of statutes of limitation by taxpayers does not necessarily depend upon statutory authorization. (See *Stange* v. *United States*, 282 U. S., 270 [supra]; *Aiken* v. *Burnet*,

282 U. S., 280 [supra]: *Florsheim Bros., etc.*, v. *United States*, 280 U. S., 453 [Ct. D. 167, C. B. IX-1, 260].) There is inherent in the taxpayer what may be termed a common law right to waive the benefit of the bar of limitation.

As illustrative of the broad effect that should be given to voluntary waivers of limitation against collections of taxes the Supreme Court has pointedly said in *Aiken* v. *Burnet*, supra:

"It is contended that the waiver of February 5, 1921, is invalid because it was executed prior to the enactment of section 250(d) of the Revenue Act of 1921, which was the first of the Revenue Acts to provide in terms for the giving of waivers. The argument is that prior to the enactment of that section the Commissioner lacked authority to accept waivers of the limitation on the period within which assessment might be made under the Acts of 1916 and 1917. This contention is not sound. The limitation periods on assessment could be waived by the taxpayer in the same fashion as other statutes of limitations are waived. No reason appears why the Commissioner could not accept such a waiver prior to the Act of 1921. Although the Government might at that time still have brought suit even though the period for assessment had expired, it was thought desirable to follow the normal and simpler course of assessment and collection by distraint proceedings because of the advantages afforded. The Commissioner requested the taxpayer to execute a waiver in cases where prolonged reexamination of the return seemed necessary. If authority was needed for the acceptance of such waivers, it may be found in the general broad administrative provisions of the respective Acts. Even after the Act of 1921, a so-called waiver was not a contract. The requirement in section 250(d) of that Act that the Commissioner sign the consent was inserted to meet exigencies of administration, and not as a grant of authority to contract waivers."

The obligation of the appellant to pay the 1917 taxes had been actually fixed and determined by a valid assessment made prior to June 2, 1924, the day the Revenue Act of 1924 went into effect, and therefore the waivers under consideration in this appeal are distinguishable from those involved in *Uncasville Mfg. Co.* v. *Commissioner* (C. C. A. 2, 56 Fed. (2d), 893). In the latter case all of the deficiency taxes were assessed for the years in question subsequent to June 2, 1924. Upon that date the time had already expired for assessment for deficiencies for the years involved. Waivers were then given authorizing the Commissioner to assess deficiencies and acting on such waivers, he assessed them. The Circuit Court of Appeals for the Second Circuit in that case construed 278(e) of the 1924 Revenue Act as confining 278(c) of the same Act to instances where assessment was not barred on June 2, 1924. In the Uncasville action it thus appears that the obligation to pay, as well as the right of the Government to enforce payment of the deficiency taxes, did not exist on June 2, 1924, while here the tax debt and obligation were fully established and existent at all times since February 9, 1923. All that was accomplished by the waiver of December 7, 1925, was to revive the remedy of collection for a fixed and just debt that was due and undischarged on that date. There was no attempt by the waiver under consideration here to thereby create an indebtedness that did not exist and had not been established at the time of the waiver.

There are many strong intimations in the opinion of Mr. Justice Brandeis in *Burnet* v. *Railway Equipment Co.* (282 U. S., 295), that sustain our conclusion that the waiver of December 7, 1925, is valid and effective under section 278 of the Revenue Act of 1924. In footnote 5 on page 300 of the official report of the Supreme Court decision in the Burnet case relative to a statement in the opinion—

"We need not determine whether respondent is correct in assuming that section 278(e) qualified section 278(c) in respect to waivers on assessment of taxes barred prior to June 2, 1924"—

The following explanation appears:

"'Subdivision (e) can not be said to qualify every other subdivision in section 278. Nothing indicates an intention to have it limit the effect of section 278(a) which permits assessment to be made or suit to be brought at any time in the case of a false or fraudulent return or a failure to file any return. * * * Nor is there any indication that it should qualify subsection (c) which provides for the giving of waivers. * * * The decision in *Russell* v. *U. S.* (278 U. S., 181), involved the interpretation of subdivision (d) which

extended the period of collection without any act on the part of the taxpayer. Subdivision (c) is effective only if the taxpayer voluntarily executed a waiver."

The validity and effect of waivers given by taxpayers subsequent to June 2, 1924, and after the expiration of the period of assessment of deficiency taxes were considered by this court in *California Iron Yards Co.* v. *Commissioner of Internal Revenue* (47 Fed. (2d), 514), and Judge Wilbur in the course of the opinion in that case said:

"The petitioner seeks to review the action of the Board of Tax Appeals in affirming an order of the Commissioner of Internal Revenue fixing a deficiency tax of the petitioner for the years 1918, 1919, and 1920. The principal question in the case involves the validity and effect of a waiver of January 16, 1925. This waiver was signed more than five years after the return made by the petitioner for the year 1919, and it is contended by the petitioner that, inasmuch as this waiver was executed more than five years after return, and therefore after the limitation for assessment of the tax for the year 1919, it did not authorize the assessment which was made by the Commissioner on December 16, 1925. As the courts were divided upon that question (see note 1, page 146, opinion of Supreme Court in *Stange* v. *United States*, 51 S. Ct., 145, 75 L. Ed., 335, affirming 68 Ct. Cl., 395, decided November 4, 1929), and, as the matter was then pending before the Supreme Court in that case on certiorari from the Court of Claims, it was suggested that a decision herein be postponed until the decision by the Supreme Court in that case. This decision was rendered January 5, 1931. It is there held in accordance with the contention of the Commissioner in this case that the waiver was effective, notwithstanding that it was executed after the running of the statute of limitations. It follows that a properly executed waiver was effective, notwithstanding the expiration of the period of making the assessment before the execution of the waiver."

A fortiori—should a properly executed waiver of the bar against collection of a tax that had been timely assessed be held effective and binding.

In *Hart Glass* v. *U. S.* (48 Fed. (2d), 435), the Court of Claims in considering the scope of waivers under 278(c) of Revenue Acts of 1924 and 1926, said:

"By virtue of section 278(c) of the Revenue Acts of 1924 and 1926 * * * the waiver herein, although filed after the limitations had run against the assessment of taxes against the plaintiff for the year 1918, revived in the Commissioner authority to make an assessment within the period covered by the waiver."

See also the recent decision of the Court of Claims in *McDonnell* v. *U. S.*, reported in Prentice-Hall Federal Tax Service on June 16, 1932, 1656 [Ct. D. 564, page 335, this bulletin], under paragraph 1308, sustaining the validity of voluntary waivers of taxpayers of the benefit of the statute of limitations where such waivers were given after the enactment of the Revenue Act of 1924 in cases where the statutory limitation had expired prior to the effective date of said Act and to the same effect see decisions of the Court of Appeals of the District of Columbia in *Pottash Bro.* v. *Burnet* (50 Fed. (2d), 317) and *Consumers Ice Co.* v. *Burnet* (50 Fed. (2d), 342).

We are of the opinion that the waiver voluntarily executed by the appellant taxpayer on December 7, 1925, was effective and that it operated to revive the right of the Government to collect the taxes that had been lawfully assessed on February 9, 1923, although at the time this waiver was given and prior to the date the Revenue Act of 1924 became effective, the statute of limitations had run against the remedy of collection. We think this conclusion is in consonance with the decision of the Supreme Court. (See *Burnet* v. *Railway Equipment Co.*, 282 U. S., 298; *Stange* v. *U. S.*, 282 U. S., 274; *Brown & Sons* v. *Burnet*, 282 U. S., 283 [Ct. D. 279, C. B. X–1, 274]; *Aiken* v. *Burnet*, 282 U. S., 277.)

The appellant concedes that if the waiver of December 7, 1925, is effective the collection made by the appellee on June 30, 1927, is valid and does not constitute an overpayment which appellant can recover because the waiver of December 7, by its terms, ran to December 31, 1926, and the third waiver, that of November 29, 1926, extended the time for collection beyond June 30, 1927, to wit, to December 31, 1927. Our conclusion that the waiver of December 7, 1925, is valid and appellants' concession relative thereto disposes of any necessity of considering section 1106(a) of the Revenue Act of 1926 that provided that the bar of the statute of limitations against the United States in respect

of any internal revenue tax shall not only operate to bar remedy, but shall extinguish the liability as well. It should be noted, however, that this section was by the Revenue Act of 1928 repealed as of February 26, 1926. (Section 612, ch. 852, 45 Stat. L.)

It is finally contended, however, assuming that the waiver of December 7, 1925, is valid for all purposes, that the collection made on August 28, 1928, was unauthorized and illegal. The argument in support of this contention is that because the third and last waiver had by its own terms expired before this collection was made, all right to collect was terminated on the expiration date of the waiver, notwithstanding the Revenue Act of 1926, which extended the period for collection to six years after the date of assessment, became effective before the expiration date specified in the waiver. We think this position untenable.

Prior to December 31, 1927 (the expiry date of the last waiver), the Revenue Act of 1926 (ch. 27, 44 Stat. L.) became law. This law became an inextricable part of the waiver. Its terms and provisions must be read into and with the waiver. Section 277(3) thereof, as far as applicable to this appeal, reads:

"(3) The amount of income, excess-profits, and war-profits taxes imposed by * * * the Revenue Act of 1917, 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."

Section 278, (c), (d), and (e), respectively, of said Act provides:

"(c) Where both the Commissioner and the taxpayer have consented in writing to the assessment of the tax after the time prescribed in section 277 for its assessment the tax may be assessed at any time prior to the expiration of the period agreed upon.

"(d) Where the assessment of any income, excess-profits, or war-profits tax imposed by this title or by prior Act of Congress 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 or by a proceeding in court (begun before or after the enactment of this Act), but only if begun (1) within six years after the assessment of the tax, or (2) prior to the expiration of any period for collection agreed upon in writing by the Commissioner and the taxpayer.

"(e) This section shall not bar a distraint or proceeding in court begun before the enactment of the Revenue Act of 1924; nor shall it authorize the assessment of a tax or the collection thereof by distraint or by proceeding in court (1) if at the time of the enactment of this Act such assessment, distraint or proceeding was barred by the statutory period of limitation properly applicable thereto, unless prior to the enactment of this Act the Commissioner and the taxpayer agreed in writing thereto, or (2) contrary to the provisions of subdivision (a) of section 274 of this Act."

Section 274(a) is the section which provides that the Commissioner must give notice to the taxpayer of a deficiency in the tax and within 60 days from such notice the taxpayer may petition the Board of Tax Appeals for a redetermination of the deficiency. This section has no application to this appeal.

When sections 277(3) and 278 (c), (d), and (e) of this Act are considered together and in relation to one another and then applied to the facts as found by the court below, it is clear that the collection of August 28, 1928, was valid and legally authorized.

The assessment of February 9, 1923, was validly made within five years after the return was filed on March 30, 1918, as required by section 277(3) and as the three voluntary waivers effectively operated to extend the time for collection of the taxes so assessed to December 31, 1927, it is obvious from the plain and explicit terms of section 278 (c), (d), and (e) that were in effect during the period that was specified in the last waiver that the appellee was given the right to enforce this tax liability by collection at any time within six years after the date of the assessment or until February 9, 1929. Subdivision (d) expressly refers to an assessment timely imposed by this title or "by prior Act of Congress * * * (whether before or after the enactment of this Act)." And it clearly authorizes collection of taxes made under such an assessment at any time within six years from the assessment.

The terms and provisions of the 1926 Revenue Act respecting the period of limitation upon assessment and collection of taxes are different from those of the Revenue Act of 1924. While section 278(d) of both Acts provide a 6-year period after the date of assessment for collection of the tax, the 1924 Act in section 278(e) thereof provides that section 278 shall not affect any assessment made before the enacting of the 1924 statute. No such condition is found in the Revenue Act of 1926. To the contrary, this latter statute in 278(d) thereof expressly made the 6-year period for collection applicable to assessments "before or after the enactment" of the Act. It is clear, therefore, that *Russell* v. *United States* (278 U. S., 181 [T. D. 4260, C. B. VIII–1, 206]), which held that the 6-year period for collection provided for in the 1924 Act did not apply where the assessment was made prior to June 2, 1924 (the effective date of the Revenue Act of 1924), because to make the 6-year period applicable to such assessments would "affect" them contrary to the express terms of (e) of section 278 of the 1924 Act, is not in point.

This court had before it in *Toy* v. *United States* (45 Fed. (2d), 1 [Ct. D. 289, C. B. X–1, 454]), an analogous situation to the one now under discussion, except that the part of the Revenue Act of 1926 that was considered in the Toy case was section 311, relating to estate taxes, instead of section 278, dealing with income and profits taxes, but the limitation and waiver features of both sections are identical. In the Toy case, the estate tax return was filed August 16, 1922, and a suit for collection of this tax was brought November 14, 1927. It was held that the 6-year period for collection provided by the Revenue Act of 1926 applied. Appellant seeks to distinguish this case from the one at bar because in the Toy case the five years for the assessment and collection of the tax did not expire until after the enactment of the 1926 Revenue Act and therefore that Act could extend the limitation period by imposing the 6-year period for collection, but we think that the operation of the waivers, under section 278, whereby the right of collection was extended to a date after the enactment of the 1926 Act, as well as the terms of the 1926 Revenue Act itself, make the principle of the Toy case applicable here.

We have in an earlier part of this opinion mentioned that it has been settled by the Supreme Court in *Florsheim Bros. Co.* v. *U. S.* (280 U. S., 466) and in *Aiken* v. *Burnet*, supra, that the taxpayers' waivers of the statute of limitation in assessment and collection of taxes are not contracts that limit the power of the Government from enforcing by legislation the payment of taxes beyond the time specified in waivers, and although the appellant couched the terms of the last waiver in a manner specifically providing that "this waiver of the time for making any assessment '(collection)' as aforesaid shall remain in effect until December 31, 1927, and shall then expire," it can not thereby disable the Government from prolonging the period for collection by statute enacted while the waiver was in force. The 1926 Revenue Act gave a 6-year period for the collection of all assessments, timely assessed and existing at the time the Act went into effect, without excepting those where waivers had been given.

In the Florsheim case, supra, the Supreme Court said:

"The Government contends that the 'income and profits tax waivers' executed by the corporations were waivers by them of the statutory period for another year; that while these waivers were still in force and while the corporations' liability was thus still alive, the Revenue Acts of 1924 and 1926 were passed, increasing the period for collection to six years after assessment; that these Acts are applicable to the cases at bar; and that, since the collections were made within six years after the assessments, they were timely made. The corporations insist that the 'waivers were not merely waivers extending the statutory period, but were binding contracts which limited the time in which the Commissioner could assess and collect the taxes; and that no change in the law made after the date of the contracts and enlarging the time for collection can affect their rights.' They urge that the 1924 and 1926 Acts did not purport to extend the periods thus limited by contract; and that, if construed as extending such periods, the provisions of these Acts are unconstitutional. They conceded that, in the absence of contract, a legislature may constitutionally lengthen or shorten the period in which a right may be enforced by legal proceedings.

"We are of opinion that the contention of the Government must prevail."

The district court was correct in holding that none of the collections in this case were barred by the statutes of limitation. The judgment is affirmed.

SECTION 280.—CLAIMS AGAINST TRANSFERRED ASSETS.

ARTICLE 1291: Claims in cases of transferred assets. XI-29-5556 Ct. D. 519

FEDERAL TAXES—BANKRUPTCY—DECISION OF COURT.

1. COLLECTION—ATTEMPTED DISSOLUTION OF CORPORATION.

The provisions of the statutes of Illinois that before a dissolution of a corporation organized under the laws of that State shall be accomplished all debts or liabilities shall be discharged and the property of the corporation delivered to such persons as are entitled to the same and that a full and complete verified report of the date and manner of payment of the debts be made to the secretary of state are conditions precedent to the cessation of the existence of the corporation, their purpose is defeated by a false statement under oath to the secretary of state that there were no corporate debts or liabilities and a failure to comply with them renders the attempted dissolution inoperative and void as to the United States, and an assessment against the corporation is valid which is made pursuant to corporate action taken after the attempted dissolution and made after compliance with the statutory procedure necessary for the same commenced after the attempted dissolution.

2. SAME—CLAIM AGAINST SUCCESSOR TRUST.

Where the only consideration for the transfer of corporate assets to trustees is a promise by the latter to pay the debts and discharge the liabilities of the corporation, the United States, having established the legal liability of the corporation for a debt due the United States, is entitled to have the claim for the debt allowed against the trust estate in a court of bankruptcy whose duty it is to treat the property of the bankrupt as a trust fund for the benefit of the creditors of the corporation according to their respective priorities.

3. SAME—IDENTITY OF CORPORATION AND SUCCESSOR TRUST.

Where the assets of a corporation are transferred to a trust for the benefit of the stockholders of the corporation in proportion to their respective interests therein, the officers of the trust are the same as the officers of the corporation and the trust enters on its books as its own debt the tax liability of the corporation, a bankruptcy court will regard the corporation and the trust as the same entity with the result that the tax due from the corporation is a direct liability of the bankrupt trust estate.

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

In the matter of Wolf Manufacturing Industries, Bankrupt; Robert L. Tudor, Trustee, appellant, v. *United States of America, appellee.*

[February 24, 1932.]

OPINION.

LINDLEY, J.: This appeal involves the question of whether the district court rightfully overruled the objections of the trustee in bankruptcy to the claim of the Government for income taxes.

Wolf Manufacturing Co., an Illinois corporation, on December 31, 1920, transferred all its assets to Fred Wolf, Paul A. Wolf, Leo F. Wolf and Fred A. Wolf, as trustees under a so-called common law trust, upon the sole consideration that the trustees discharge the liabilities of the corporation. In the trust agreement it was provided that the trustees should use and employ the trust property "first in paying the corporate debts of the Wolf company and discharging the liabilities of said corporation," and further they should conduct the business and manage the property as previously. On March 21, 1921, the

stockholders voted to dissolve the corporation, and on December 28, 1921, report of such dissolution was filed with the secretary of state, who, on the same date, issued certificate of dissolution. At that time there were in existence at least two Federal tax liabilities, one for the year 1919, which is here in controversy, and another for the year 1920, which appeared in the balance sheet of assets and liabilities taken over by the trust.

The Government, investigating the corporation's tax report for 1919, requested and received from it, on February 16, 1925, a waiver of the statute of limitations extending the statutory period for assessment to December 31, 1925. On September 1, 1925, the Commissioner sent by registered mail to the corporation notice of assessment of additional income tax for 1919 in the amount of $31,443.70. On October 31, 1925, the corporation filed with the United States Board of Tax Appeals its appeal from said assessment. Both the waiver and petition for appeal were executed in the name of the corporation by Fred A. Wolf, as secretary and treasurer of the same. On March 5, 1928, the Board made its decision finding that there was a deficiency in the income tax paid by the corporation for the year 1919 in the amount of $28,673.72. No review of this decision was ever sought.

The trust became bankrupt June 12, 1929. The original claim for the aforesaid additional tax, plus interest, was filed on September 17, 1929, and the amended claim, here relied upon, on March 17, 1930. The trustee objected to allowance of the claim upon the grounds that collection was barred by the statute of limitation and that the bankrupt was not liable for the taxes as a transferee of the corporation. The referee sustained the objections. Upon review the district court reversed and set aside the order of the referee and directed the allowance of the claim.

The appellant contends that the waiver by the corporation, its appeal and its appearance before the Board of Tax Appeals were the acts of a dissolved corporation and therefore void, and that there has been no compliance with the statutory requirements necessary in order to hold the trust liable for the assessment.

The statute of Illinois upon voluntary dissolution of a corporation provides that before a dissolution shall be accomplished a corporation shall "pay and discharge all its corporate debts and liabilities" and "distribute its corporate assets amongst the persons entitled thereto." Having complied with these mandatory directions, the corporation shall then report to the secretary of state "a complete itemized list of all corporate debts and liabilities" and "the date and manner of payment of each debt and liability existing." Another section of the statute provides in effect that the remedies of third persons against the corporation shall not be affected by the dissolution if asserted within two years from the date thereof. This latter provision is not material upon the issue herein presented.

The statute here under consideration is a comparatively recent one, and the Supreme Court of Illinois has not passed upon the effect of a failure to comply with the provisions thereof. It becomes our duty, therefore, to determine the intent of the act. Obviously, proceedings to bring to an end a corporation, a creature of the State, empowered to acquire property, transact business, and incur debts, is one that must be guarded with the strictest of supervision by the State. Having brought the corporation into the world and having authorized incurrence of liabilities to others, the State's evident obligation before ending the existence of its creation is to place all possible reasonable guards against injustice and injury to third persons. In recognition of that duty, and in order to protect creditors, its mandate in the statute allowing dissolution is that all debts and liabilities shall be discharged and the property delivered to such persons as are entitled to the same, and full and complete verified report of the manner of payment of the debts be made of record. These are conditions precedent to the cessation of existence of the legal entity. Consequently, if the corporation does not comply with the statute, so far as the rights of third persons are concerned, the dissolution is inoperative and void.

In *American Bank & Trust Co.* v. *Hahn* (48 Fed. (2d), 588), this court approved the decision of the lower court to the effect that failure to give the requisite statutory notice prevented an effective dissolution as to such creditors as were not notified. In *Frank* v. *Wedderin* (68 Fed., 818 (C. C. A. 5)) it was remarked, "when such dissolution is brought forward to defeat creditors, the court should see that all the formalities prescribed by the laws of the State and

the charter of the corporation to bring about a legal dissolution of the corporations are strictly complied with." These pronouncements are consonant with the public policy of the State of Illinois as announced by the supreme court in repeated decisions. Thus, in *Commercial Trust Co.* v. *Mallers* (242 Ill., 50), the court said: "It is a part of the settled public policy of this State that upon the dissolution of a corporation, no matter how the dissolution may be effected, the corporation shall nevertheless be regarded as still existing for the purpose of settling up its affairs." (See also *Singer & Talcott Stone Co.* v. *Hutchinson*, 176 Ill., 48, and *Ewen* v. *American Fidelity Co.*, 261 U. S., 322.)

In view of the theory in Illinois that the property of a corporation constitutes a trust fund for the payment of the debts of the corporation (see *Wheeler* v. *Pullman Iron Co.*, 143 Ill., 197), and the further policy of the State that dissolution shall not be completed until and unless such fund is protected and the statute strictly complied with, it follows that the dissolution of the corporation in the present instance can have no legal effect as to creditors if it is not in compliance with the essential provision of the statute above noted.

The record discloses that when the attempted dissolution was reported, the corporation under oath assured the secretary of state that there were no corporate debts or liabilities. This was a positive misrepresentation of fact directly contrary to the purpose of the provision of the enactment, and defeating the same, for if the State was erroneously advised that all debts had been paid and discharged it could only assume that the corporate assets had been distributed to the persons entitled to the same, and that it was unnecessary to file a completely itemized list of corporate debts as required by the statute. Whatever might be the effect as to other persons, there can be no question that this failure to comply with the statutory provisions prevented the dissolution from becoming an effective bar to the Government's action in attempting to collect the tax. And there having been no compliance with the statute by the corporation and the dissolution being void as to the Government, the 2-year limitation provided for actions against a dissolved corporation where dissolution is perfected does not apply.

It follows therefore that the Government properly made assessment of taxes, that the Board of Tax Appeals had jurisdiction of the parties when it entered judgment, and that the amount found due was adjudicated in the final order, of which no review has been had.

We have observed that the only consideration for the transfer of the corporate assets to the trustees was the agreement by the latter to pay the debts and discharge the liabilities of the corporation, and that the property received in trust was to be devoted first of all to the discharge of such debts and liabilities. Upon such written contract, under the statutes of Illinois and Indiana, actions are barred in 10 years. Within that time the Government filed its claim in the court of bankruptcy, showing that there had been legally established a tax liability against the corporation in the sum claimed.

Both Illinois and Indiana recognize the rule that third persons for whose benefit a contract is made may bring action thereon. (See *Commercial* v. *Kirkwood*, 172 Ill., 563; *Dean* v. *Walker*, 107 Ill., 540; *Chicago Title & Trust Co.* v. *Central Trust*, 312 Ill., 396; *Hess* v. *Lackey*, 191 Ind., 107; *Tinkler* v. *Swaynie*, 71 Ind., 562; *Ransdel* v. *Moore*, 153 Ind., 393.) And despite what may be the rule in various other Commonwealths, the same rule has long abided in the Federal courts. (See *Hendrick* v. *Lindsay*, 93 U. S., 143; *Princes Amusement Co.* v. *Wells*, 271 Fed., 226 (C. C. A. 6, certiorari denied, 254 U. S., 701); *Gibson* v. *Victor Talking Machine Co.*, 232 Fed., 225; *Barker* v. *Pullman*, 124 Fed., 555 at 567; *Blackmore* v. *Parkes et al.*, 81 Fed., 899 (C. C. A. 6); *In Re Dresser*, 135 Fed., 495 (C. C. A. 2); *Millett* v. *Omaha Bank*, 30 Fed. (2d), 665 (C. C. A. 8).) It follows that the Government, having established the legal liability of the corporation, was entitled to file and have allowed its claim in the bankrupt estate of the parties who assumed and agreed to pay such liabilities. Furthermore, it was the court's duty, sitting as a court in equity, to treat the property of the bankrupt as a trust fund for the benefit of the creditors of the corporation according to their respective priorities.

We are of the opinion also that the court was justified in treating the tax as a direct liability of the bankrupt on the ground that there was identity of entity in the two organizations. The members of the Wolf family who were beneficiaries of the trust were the stockholders of the corporation. As such they authorized the transfer of the assets to themselves for the old stockholders in the same proportions. Officers of the corporation became identical

officers of the trust. The only change was one from corporate existence to trust existence. The waiver, executed in the name of the corporation, was signed by the secretary and treasurer of the trust. The appeal, perfected in the name of the corporation, was executed by the same officer of the trust. The trust voluntarily entered on its books, as its own debt, the tax liabilities of the corporation for 1920. It was as if the Wolf family removed themselves and their property from one house to another; as if they changed their address but none of their traits, obligations or property rights.

The bankruptcy court, being a court of equity, looks beyond the mere outward shell to the parties in interest—beyond the fictions of law and corporate forms to the purposes and officers who are identified with that purpose. (See *McCaskill Co.* v. *U. S.*, 216 U. S., 504.) The Federal Government recognizes rules of property but is not compelled to recognize transfers which result in no substantial change in beneficial ownership. (See *Osburn California Corporation* v. *Welch*, 39 Fed. (2d), 41 [Ct. D. 173, C. B. IX–1, 250].)

The bankrupt estate is liable for the tax as an entity of the same identity as the original taxpayer. It is also liable, under the terms of the trust agreement, to pay the tax liability of the corporation. The decree of the district court is affirmed.

ARTICLE 1291: Claims in cases of transferred assets.

XI–35–5640
Ct. D. 547

INCOME TAX—REVENUE ACT OF 1926—DECISION OF COURT.

TRANSFEREE—TRANSFER WITHOUT CONSIDERATION.

In the circumstances disclosed it is held that the transfer of certain assets of the S Company to the E Company was without consideration to the S Company. The E Company is therefore subject to the liability of a transferee of the property of the S Company in respect of a tax imposed upon the S Company as provided by section 280(a)1 of the Revenue Act of 1926.

DISTRICT COURT OF THE UNITED STATES FOR THE WESTERN DISTRICT OF LOUISIANA, SHREVEPORT DIVISION.

Exchange National Bank of Shreveport, La., plaintiff, v. *United States of America, defendant.*

[March 14, 1932.]

OPINION.

DAWKINS, J.: Plaintiff seeks to recover from the United States the sum of $2,063.71 alleged to have been paid under protest as income taxes for the year 1924, assessed against the National Security Co. of Shreveport, on the claim of the Government that the plaintiff bank had taken over or absorbed the property and assets of the said Securities company, and was, therefore, liable for said taxes under section 280 of the Revenue Act of 1926.

Defendant denies the material allegations of the petition and of course alleges in substance that the taxes were lawfully collected.

Some time prior to the first of 1925, the national bank examiner, having found certain questionable paper in the portfolio of the Exchange National Bank of Shreveport, which affected its capital stock and surplus, called upon the stockholders to make the same good. Rather than assess themselves upon their stock, a separate corporation was formed by some of the stockholders of the bank, under the name of the Exchange National Securities Co. (but was later changed to National Securities Co.) and referred to herein as the Securities company, which took over this paper and paid the bank therefor the sum of $70,000. The funds with which to make the purchase were raised by subscriptions to the stock of the Securities company.

Thereafter, on February 7, 1925, Messrs. Minor Meriwether and E. A. Conway, desiring to enter the banking business, made an agreement with E. C. Payne, then president of the bank, to purchase a controlling interest in its capital stock, amounting to some 1,500 shares. There was still additional

questionable paper in the bank, and Payne agreed unconditionally, not only to guarantee all bills receivable and accounts due the bank, but also to indemnify it against any indebtedness which might be due by it to the extent that either might affect the capital, surplus and undivided profits up to $213,000. As further security, it was stipulated that he should deposit with the bank the sum of $43,750, in cash, to draw interest at the rate of 4 per cent per annum, so long as it was not necessary to apply the same to the discharge of the guaranty. It was further stipulated that of the price of $185,000 paid to Payne for the 1,500 shares of stock, being at the rate of $125 per share, $35,000 was to be the consideration for the unconditional guaranty above mentioned. Payne was then president of the Securities company, which was engaged in the business of discounting purchase price notes, given for automobiles, and it was provided in said agreement that the bank, of which Meriwether and Conway were to assume control, as a part of the consideration, would continue to discount this paper for the Securities company up to $200,000 on certain specified terms. It was further agreed that the name of the Securities company should be changed so as not to resemble that of the bank, which was later done by changing it to the National Securities Co.

On February 11, 1925, the said agreement was carried out by the payment of the purchase price and transfer of the bank stock, the deposit of the $43,750, and the execution by Payne in favor of the bank, Meriwether and Conway of the guaranty agreement. In said indemnity or guaranty it was provided that either Meriwether, Conway, the Exchange National Bank or its assigns, might enforce the same by appropriate action.

Later, the stockholders of the Securities company, who had also owned some of the stock in the bank, transferred by Payne to Meriwether and Conway, concluded that there might be some equity or surplus remaining after the discharge of the obligations for which the $43,750 was deposited on March 2, 1925. This money had been realized from the sale of the bank stock to Meriwether and Conway, and a resolution was passed by the board of directors of the Securities company, authorizing the underwriting of the guaranty given by Payne to the bank. In this way the Securities company, or the stockholders thereof other than Payne, were permitted to share in the benefits, if any, to accrue from a refund of this deposit of $43,750.

Thereafter, on April 13, 1926, in discharge of this obligation to Payne, the Securities company passed another resolution, authorizing Payne and H. A. Blocker, or either of them, to sign "any and all notes and other instruments in favor of the Exchange National Bank * * * to effectually carry out the assumption of that certain act of guaranty executed by E. C. Payne in favor of the said bank, the obligation of the said E. C. Payne having been assumed by this corporation."

Thereafter, on April 15, 1926, Blocker signed for the Securities company a blank agreement or pledge, authorizing the bank to apply any and all securities or collaterals which might be held for account of the Securities company to any obligation due by it, and on the same day, Payne, as president of the Securities company, signed a note in favor of the bank for the sum of $21,307.94, which represented the balance due the bank after realizing as far as possible up to that time on the questionable paper held by it and guaranteed by Payne. The Securities company having sold its business of discounting or financing automobile paper to the United States Securities Co., that is all notes and contracts held by it arising therefrom (which in effect put an end to its existence), turned back to the bank as collateral for the said pledge agreement and note of date April 15, 1926, all of the old paper or obligations which remained of that taken over at its organization by the Securities company under the original purchase and for which it had been paid $70,000 to the bank. An amount was ultimately collected sufficient, with the deposit of $43,750, to reduce the balance due upon the note to something over $17,000, which remains unpaid to the bank.

It is the contention of the plaintiff that the transfer by the Securities company of these assets, to wit, the remainder of the questionable obligations taken over in 1924, was in fulfillment of its assumption of the guaranty of Payne, and that the consideration flowing to it was the hope or expectation that there would be an equity or surplus remaining from the deposit of $43,750, to be returned to the Securities company for the benefit of its stockholders. On the other hand, defendant claims that the assumption of the guaranty, if it ever existed, was to Payne and not to the bank, and that when the resolution of

April 13, 1926, was passed and the blank agreement of pledge and note for $21,307.94 were executed on April 15, 1926, the same were done without any consideration from the bank, and that the latter having received or absorbed all of the remaining assets of the Securities company, became liable for the income taxes of the Securities company, due for the year 1924, under the provisions of section 280 of the Revenue Act of 1926.

I think it reasonably clear that, in the first instance, the attempt to put the Securities company in the place of Payne with respect to the guaranty to the bank, was a transaction wholly between him and the said Securities company, to which the bank was in no wise a party, and that when the resolution of April 13, 1926, was passed and the note and pledge of April 15, 1926, was signed, it had been definitely ascertained that there would be no equity remaining from the $43,750 deposit. So that the transfer of the remaining assets of the Securities company to the bank was without consideration to that company and was in effect an attempt by it and its stockholders to have whatever might be realized from these assets applied upon the bank's debt.

In these circumstances, I am constrained to hold that the bank became liable under said section of the Revenue Act for the income taxes which had accrued and were due by the Securities company. It follows that the plaintiff's demand must be rejected. Proper decree should be presented.

ARTICLE 1291: Claims in cases of transferred assets.

XI-35-5641
Ct. D. 548

INCOME TAX—REVENUE ACT OF 1926—DECISION OF COURT.

1. ASSESSMENT—LIMITATION—TRANSFEREE.

The mailing of a notice of deficiency to a transferee within one year after the expiration of the period of limitation for assessment against the taxpayer is within the period of limitation for assessment of the liability of the transferee provided in section 280(b)1 of the Revenue Act of 1926 and an assessment of the deficiency against the transferee, notice of which was mailed to the transferee within that period, is not barred because the notice to the taxpayer of the deficiency was mailed to the taxpayer after the expiration of the statutory period for assessment of the tax against the taxpayer.

2. DECISION AFFIRMED.

The decision of the Board of Tax Appeals (19 B. T. A., 1080) is affirmed.

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT.

City National Bank, petitioner, v. *Commissioner of Internal Revenue, respondent.*

Petition for review of decision of the United States Board of Tax Appeals (District of Texas).

Before BRYAN, FOSTER, and WALKER, Circuit Judges.

[February 22, 1932.]

OPINION.

BRYAN, Circuit Judge: This is a petition to review a decision of the Board of Tax Appeals, which held the City National Bank of Wichita Falls, Tex., liable, as transferee of the assets of the National Bank of Commerce, for a deficiency in the income tax of the latter for that part of the year 1920 ending April 30, when the two banks were consolidated under the provisions of the Act of Congress of November 7, 1918. (40 Stat., 1043.) The opinion of the Board is reported in 19 B. T. A., 1080.

After the consolidation business was continued in the name of the City National Bank and as survivor it of course became the owner of the assets of the Bank of Commerce. On May 23, 1921, income tax return was filed in the name of the Bank of Commerce for the period beginning January 1, 1920, and ending April 30, 1920, the date of the consolidation. A deficiency notice was

mailed to it in July, 1926, and to the National City Bank, as transferee in November, 1926. It is therefore to be conceded that the assessment and collection of the tax as against the transferor bank was barred by the 5-year statute of limitations. (Revenue Act of 1918, section 250(d), 40 Stat., 1083.) The question for decision is whether the assessment was likewise barred as against the City National Bank, transferee and petitioner here. The Revenue Act of 1926 provides that the period of limitation for assessment of a tax liability of a transferee shall be one year after the expiration of the period of limitation for assessment against the taxpayer. (Section 280(b)1; 26 U. S. C. A., section 1069.) According to the plain terms of this statutory provision, the assessment against petitioner was made well within the statutory period applicable to a transferee, and it could be collected by suit instituted within six years thereafter under section 278(b) of the same Act (26 U. S. C. A., section 1061). But it is argued that in the absence of a valid and timely assessment against the transferor taxpayer there can be no assessment or enforcement of the tax against the transferee, because of the general provision contained in section 278(b), which makes the assessment of income tax within the period of limitation a condition precedent to collection by suit. The case of *United States* v. *Updike* (281 U. S., 489 [Ct. D. 192, C. B. IX–1, 228]) is cited in support of this argument, but clearly it is not in point. There the question was as to the period applicable to the collection of an assessment. Suit was brought seven years after the assessment was made, or more than a year after it was barred. The question here relates to the period allowed for assessment, which under section 280(b)1 was made within the statutory period. There is and could be no contention here that the suit to collect the tax was barred. It is also contended that the transferee can not be held, because under section 1106(a) the statute of limitations not only operates to bar the remedy but extinguishes the liability. A complete answer to that contention is that limitation had not run against the transferee, because the assessment of its liability was made within the year allowed by section 280(b)1 after the expiration of the period of limitation for assessment against the taxpayer.

The petition for review is denied.

SECTION 282.—BANKRUPTCY AND RECEIVERSHIPS.

ARTICLE 1293: Bankruptcy and receiverships. XI–30–5564
Ct. D. 522

FEDERAL TAXES—BANKRUPTCY—DECISION OF COURT.

ORDER BARRING FILING OF CLAIM FOR TAXES DUE THE UNITED STATES.

An order of a referee in bankruptcy barring the United States from participating in the estate of a bankrupt unless a claim against the estate for taxes due be filed on or before a specified date does not bar, while undistributed funds remain in the hands of the trustee in bankruptcy, the filing after that date of a claim by the United States against the estate for taxes assessed after that date.

UNITED STATES CIRCUIT COURT OF APPEALS, SIXTH CIRCUIT.

United States of America, appellant, v. *W. K. Elliott, Trustee in Bankruptcy of Pricy A. Varney, appellee.*

Appeal from the District Court for the Eastern District of Kentucky.

[April 15, 1932.]

OPINION.

HICKS, Circuit Judge: Alexander Varney died prior to 1924. Pricy A. Varney is his widow. On August 3, 1925, she was adjudged a bankrupt. Appellee Elliott was appointed trustee of her estate. On May 12, 1927, the Commissioner

of Internal Revenue filed with Elliott as receiver of the estate of Alexander Varney a claim for income and profits taxes for the years 1919 to 1924, inclusive. From the ensuing correspondence it developed that Elliott was not receiver of the estate of Alexander Varney but a question arose as to whether the taxes claimed were chargeable to the estate of Pricy A. Varney. Whereupon on June 28, 1927, the trustee filed a petition in the bankruptcy court for an order barring the United States from participation in the estate upon *any claim* for taxes for the years in question; or, in the alternative, directing it to file its claim on or before a day certain.

Upon consideration of this petition the referee ordered that the United States file any claim seeking taxes out of the estate of Pricy A. Varney on or before September 1, 1927, and further ordered that if such claim should not be filed by that date the United States would be barred from participating in the estate. The collector was served with a copy of this order.

At the instance of the Commissioner an investigation made in March, 1929, disclosed that Pricy A. Varney, herself, had failed to file returns of income for the years 1918 to 1925, inclusive, whereupon the Commissioner filed returns for her and made special assessments against her (Title 26, section 97, U. S. C.) for those years in the aggregate sum of $5,752.18, and on March 21, 1929, the collector filed a claim therefor in the bankruptcy court against her estate and sought priority of payment under section 64–a, b(7) of the Bankruptcy Act. The trustee moved to strike this claim upon the ground that it was barred by the order of June 28, 1927. The referee sustained the motion and his action was confirmed.

Neither the amount nor legality of the claim was questioned and at the time it was stricken there remained in the court, undistributed, funds sufficient for its payment. We think the court erred in disallowing the filing of the claim. We do not think that the right of the Government to file its claim and have it considered on its merits by the court was unconditionally destroyed by the bar order. Such orders were sustained *In re Anderson* (279 Fed., 525, 527, C. C. A. 2) and in *In re Stavin* (12 Fed. (2d), 471, 473, D. C.). They lie in the inherent power of the court. They are analogous to the usual orders in creditors' suits and insolvent proceedings in chancery whereby claimants are required to come in within a limited period or be excluded from participation in assets. (Daniels Chancery Practice, 4th American ed., Volume II, page 1204.)

But such orders in bankruptcy are within the control of the court until the termination of the case and may be revoked if no one suffers injury thereby. (*In re Ives*, 113 Fed., 911, 913, C. C. A. 6; see also *People* v. *Hopkins*, 18 Fed. (2d), 731, 733, C. C. A. 2.) We think the circumstances here call for an application of this principle. The fund being in court, the taxes may yet be paid and the trustee have credit therefor as provided by section 64–a, Bankruptcy Act. Creditors acquired no vested interest in the fund in virtue of the bar. The order was intended only to hasten the winding up of the estate and to protect the trustee in its distribution. (*In re Anderson*, supra, 529; *People* v. *Hopkins*, supra.) It has been the practice of equity courts to abrogate the time limit for filing claims where reasonable explanation is offered for failing to comply and to let in claimants upon such terms as might be imposed as long as the fund is in court. (Daniels Chy. Pl. and Prac., supra, page 1205; *In the Matters of Howard*, 76 U. S., 175, 184; *Johnson* v. *Waters*, 111 U. S., 640, 674; *Olcott* v. *Headrick*, 141 U. S., 543, 548; *Grinnell* v. *Merchants Ins. Co.*, 16 N. J. Eq. Rep., 283, 284; *Brooks* v. *Gibbons*, 4 Paige (N. Y. Chy. Rep.), 374; *Burchard* v. *Phillips*, 11 Paige (N. Y. Chy. Rep.), 66; see also *Wechsler* v. *U. S.*, 27 Fed. (2d), 850, 851, C. C. A. 2; *U. S.* v. *Birmingham Trust & Savings Co.*, 258 Fed., 562, 564, C. C. A. 5.) We do not think that the Government in seeking to collect taxes should be treated with less favor than general creditors. In this case it could not have presented its claim before the expiration of the limited period because the taxes were not assessed until afterwards. In this respect the case differs from *In re Anderson*, supra, relied upon by appellee, but is similar to *In re Bates Machine & Tractor Co.* (8 Fed. (2d), 424, 425, D. C. [T. D. 3762, C. B. IV–2, 98]), cited by appellant.

We recognize that the assessment was not made nor the claim presented until about a year and a half after the prescribed period but it must be remembered that the assessment was upon a return made by the Commissioner after an independent investigation of the affairs of the bankrupt and because of her default. If laches should be attributed to the revenue agents of the Government under such circumstances it should not be imputed to the

Government itself in a case involving its pecuniary interests. (*San Pedro & Canon Del Agua Co.* v. *U. S.*, 146 U. S., 120, 135; *U. S.* v. *Beebe*, 180 U. S., 343, 354; *U. S.* v. *Michigan*, 190 U. S., 379, 405.)

The order of the district court is reversed and the case remanded with directions to reverse the order of the referee and allow the presentation of the claim.

SECTION 284.—CREDITS AND REFUNDS.

ARTICLE 1304: Claims for refund by taxpayers. XI–39–5725
(Also Section 1116, Article 1371.) Ct. D. 568

INCOME AND EXCESS PROFITS TAXES—REVENUE ACT OF 1926—DECISION OF COURT.

1. SUIT—PROPER PARTY—BAR—CONSOLIDATION OF COMPANIES—ASSIGNMENT OF CLAIM FOR TAXES.

Where the C Corporation results from the consolidation of the B Corporation and the M Corporation, the C Corporation acquiring the assets and assuming the liabilities of the consolidated companies and becoming the owner of any claim for the refund of taxes assessed against the B Corporation, the C Corporation is the proper party to prosecute a suit for the refund of such taxes and section 3477 of the Revised Statutes forbidding all transfers and assignments of any claim upon the United States before its allowance does not prohibit such suit.

2. COLLECTION—LIMITATION—CREDIT—WHEN ALLOWED.

A credit of any income or profits tax is allowed under section 1116 of the Revenue Act of 1926 on the first date on which the Commissioner signs the schedule of overassessments in respect thereof and the signing of that schedule within the statutory period of limitation on the collection of the tax against which the credit is taken accomplishes a lawful collection thereof.

COURT OF CLAIMS OF THE UNITED STATES. No. L–477.

Consolidated Paper Co. v. *The United States.*

[May 31, 1932.]

OPINION.

LITTLETON, Judge, delivered the opinion of the court.

Upon the facts in this case with reference to the organization of the plaintiff and the acquisition by it of the assets, through the consolidation of the Boehme & Rauch Co. and the Monroe Binder Board Co., we are of opinion that the plaintiff is the proper party to prosecute this suit, and that the maintenance of the suit by the plaintiff is not prohibited by section 3477 of the Revised Statutes. The facts show that the plaintiff acquired the assets and assumed the liabilities of the Rauch company and the Binder Board company, as the result of a consolidation. Although certain assets of the consolidated companies, including claims of the nature here involved, had been eliminated from the inventory values used as the basis for issuing preferred stock, the common stock of the plaintiff bore an indorsement to the effect that such assets, if and when realized, should be distributed solely among the holders of its common stock issued in exchange for stock of the company which had owned such assets. The common stock certificates of the plaintiff each bore an additional indorsement showing whether the same was issued in exchange for stock of the Rauch company or the Binder company. The plaintiff is therefore the owner of the claim and if there should be recovery it will be credited to the so-called "Boehme & Rauch account," and if there should eventually be a net credit in that account, the amount thereof will be disbursed as a special dividend to the then holders of the plaintiff's stock issued in exchange for the Boehme & Rauch stock. The right to participate in any recovery in this case depends therefore upon the ownership of the stock of

the plaintiff and has no connection with the original owner of Boehme & Rauch stock, as such. We think this question is controlled by the decisions in *Seaboard Air Line Railway* v. *United States* (256 U. S., 655) and *Kingan & Co., Inc.*, v. *United States* (44 Fed. (2d), 447).

The plaintiff contends with reference to the last question that the credit of overpayments for 1914 to 1919, inclusive, against the tax of $103,347.78 for 1920 was allowed by the Commissioner October 31, 1927, on which date the collection of the 1920 tax was barred; that the Commissioner's first allowance on October 12, 1926, was canceled and was therefore void and of no effect as a collection of the 1920 tax.

The defendant insists that since the credit in this case was allowed after the enactment of the Revenue Act of 1926, the signing of the schedule of overassessments on September 20, 1926, constituted the allowance of the credit within the meaning of section 116 of the Revenue Act of 1926 rather than the signing of the schedule of refunds and credits, Form 7805–A, and that since none of the entries made on the schedule of overassessment on this form was erased or deleted, there is no merit in the claim of the plaintiff that there was no allowance of credit until the Commissioner signed a supplemental schedule of refunds and credits on October 31, 1927. The claim of the defendant is predicated upon the language of subdivision (b)(2) of section 1116, which provides that the term "date of the allowance of the refund" means, in any case, the first date on which the Commissioner signs the schedule of overassessments in respect thereof.

We are of opinion that the position taken by the defendant on this point is correct. Prior to the enactment of the Revenue Act of 1926 it was held in *Girard Trust Co.* v. *United States* (270 U. S., 163 [T. D. 3919, C. B. V–2, 209]), that a refund or credit was allowed when the Commissioner approved the schedule of refunds and credits prepared and forwarded to him by the collector of internal revenue after the collector had made appropriate entries in the schedules of overassessments theretofore signed by the Commissioner and transmitted to the collector. That case arose under section 1324(a) of the Revenue Act of 1921, which provided that upon the allowance of a claim for refund or credit, interest should be paid under certain circumstances. Section 1019 of the Revenue Act of 1924 provided that upon the allowance of a refund or credit, interest should be paid thereon to the date of the allowance. Section 1116 of the Revenue Act of 1926, however, provided that upon the allowance of a credit or refund, interest should be paid in the case of a refund to the date of the allowance, and in the case of a credit to the due date of the amount against which the credit is taken, but if the amount against which the credit is taken is an additional assessment then to the date of the additional assessment. The reason for making the change with reference to the payment of interest upon an overpayment credited against a tax due for another year and the allowance of interest on an overpayment to be refunded was that the taxpayer should receive interest on an overpayment only during the time that he was not indebted to the Government for a like amount. (*Riverside & Dan River Cotton Mills* v. *United States*, 69 C. Cls., 70, 37 Fed. (2d), 965 [Ct. D. 215, C. B. IX–2, 269].) The language of section 1116 is that "Upon the allowance of a credit or refund * * * interest shall be * * * paid on the amount of such credit or refund * * * from the date such tax * * * was paid to the *date of the allowance* of the refund, or in the case of a credit, to the due date of the amount against which the credit is taken, but if the amount against which the credit is taken is an additional assessment * * * then to the date of the assessment of that amount."

Subdivision (b)(2) of this section provides that "As used in this section the term 'date of the allowance of the refund' means, in the case of any income, war-profits, or excess-profits tax, the first date on which the Commissioner signs the schedule of overassessments in respect thereof." Subdivision (c) of this section also provides that "This section shall be applicable to any refund paid, and to any credit taken, on or after the date of the enactment of this Act, even though such refund or credit was allowed prior to such date."

The plaintiff contends that the definition of "the date of the allowance of the refund" is specifically limited to that term as used in section 1116 for the purpose of determining the last interest date in the case of a refund and that a different date is prescribed in the case of a credit; that the section plainly lays down a rule for the computation of interest and does not, in any sense, change the situation as to when a refund is allowed or a credit taken, as a matter of substantive law.

We think, however, that Congress intended by subdivision (b)(2) of section 1116 to fix the date of the allowance of an overpayment in the case of any income, war-profits, or excess-profits tax, whether the amount allowed was to be refunded or credited, and, in so doing, it definitely fixed the date of such allowance as the first date on which the Commissioner signs the schedule of overassessments in respect thereof. In defining the term "date of allowance of the refund," Congress was construing the word *refund* in the broad sense of an overpayment rather than in the technical sense of a repayment to the taxpayer by check of an overpayment, where the taxpayer was not indebted for a tax for any other year, or the repayment by check of the excess of overpayment credited. This construction is supported by Report No. 52 of the Senate Committee on Finance, Sixty-ninth Congress, first session, and Conference Report No. 356, page 56, Sixty-ninth Congress, first session, and which it was stated that "In the case of *refunds*, interest is allowed 'to the date of the allowance of the refund.' In practice, the Commissioner first signs a schedule of overassessments, which is sent to the collector *in order to determine whether the overpayment should be credited or refunded.* The committee amendment proposes to fix as the date on which a *refund* is allowed the date on which the Commissioner signs the schedule of overassessments." [Italics supplied.]

The language of subdivision (a) of section 1116, considered as a whole, seems clearly to indicate that there should be no distinction between the date of allowance of a credit and the date of allowance of a refund. The committee reports, explaining the intention and purpose of subdivision (b)(2) of section 1116, support this interpretation. In reality, the allowance of a credit is the allowance of a refund. In either case that which is allowed is an overpayment. When a credit is allowed there is technically and legally the allowance of a refund, but, instead of paying the same by check, the amount thereof is applied in satisfaction of a tax due the Government by the particular taxpayer for another year or period. In actual practice, refunds and credits are allowed by the Commissioner on the same schedule and in the same manner, and the procedure in both cases is the same.

In this case the Commissioner signed the schedule of overassessment September 20, 1926, and the amount of $103,347.78 thereof, which had been paid, was applied by the collector on October 1, 1926, to the satisfaction of the outstanding tax indebtedness of $114,753.38 of the plaintiff on the original return for 1920. The credit was therefore allowed September 20, 1926. As stated in *United States* v. *Swift & Co.* (282 U. S., 468 [Ct. D. 290, C. B. X–1, 283]), "This construction of the Act brings about uniformity in administration, as it makes the allowance of credits and refunds simultaneous." The proviso contained in the first deficiency Act, approved February 28, 1927, hereinbefore quoted, required the report to the Congressional Joint Committee on Internal Revenue Taxation only with respect to "any claim allowed" by the Commissioner, and, in order to make such report it was not necessary for the Commissioner to cancel his allowance of the overpayment to be credited or repaid by check.

Plaintiff urges that this court held in *Atlas Powder Co.* v. *United States* (69 Ct. Cls., 558, 40 Fed. (2d), 136) that a credit is allowed within the meaning of section 1116 of the Revenue Act of 1926 when the Commissioner signs the schedule of refunds and credits. The question in that case was whether the credit was taken on the date the Commissioner signed the schedule of overassessments or the date on which he signed the schedule of refunds and credits, or the date on which he mailed to the taxpayer the certificate of overassessment. Both the schedule of overassessments and the schedule of refunds and credits involved in that case were signed and approved by the Commissioner prior to the enactment of the Revenue Act of 1926. That case is not, therefore, authority for the contention made by the plaintiff in this case.

In view of our conclusion that the credit was allowed under section 1116 of the Revenue Act of 1926 when the Commissioner signed the schedule of overassessments on September 20, 1926, it is not necessary to discuss the claim of the plaintiff that a credit is allowed under the 1926 Act when the Commissioner signs the schedule of refunds and credits, and that the relisting of the overpayments and credits, which first appeared on the schedule of refunds and credits duly signed by the Commissioner within the period of limitation within which the tax for 1920 could be legally collected, on a supplemental schedule which the Commissioner signed October 31, 1927, had the effect of making that date the date of the allowance of the credit.

The petition is dismissed. It is so ordered.

ARTICLE 1305: Limitations upon the crediting and refunding of taxes paid. XI-31-5581 Ct. D. 525

INCOME TAX—REVENUE ACT OF 1926—DECISION OF COURT.

SUIT—JURISDICTION—APPEAL TO BOARD.

Where after the enactment of the Revenue Act of 1926 the Commissioner has notified a taxpayer of a deficiency under section 274(a) of that Act in respect of a tax imposed by a prior Act and the taxpayer files a petition with the Board of Tax Appeals for the redetermination of the deficiency, a suit, instituted during the pendency of the appeal to the Board to recover the amount of a jeopardy assessment, which was made before the enactment of the Revenue Act of 1924 for the year for which the deficiency was determined and paid during the pendency of the appeal, is prohibited by section 284(d) of the Revenue Act of 1926.

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIRST CIRCUIT.

Brampton Woolen Co., plaintiff appellant, v. *John H. Field, Collector of Internal Revenue, defendant appellee.*

Appeal from the District Court of the United States for the District of New Hampshire.

[February 25, 1932.]

OPINION.

WILSON, J.: This is an appeal from a judgment of the District Court of New Hampshire in an action at law brought by the appellant against the appellee, who is the collector of internal revenue for the district of New Hampshire, to recover a sum alleged to have been unlawfully collected of the appellant, under threat of distraint, as a deficiency tax for the year 1918. The appellant is a corporation conducting a textile mill in the State of New Hampshire.

The Revenue Act of 1918 was not approved until February 24, 1919, and owing to the shortness of the time for computing the tax for 1918 before March 15 under the new Act, the Commissioner suggested to taxpayers the filing of a "tentative return," so called, on or before the latter date, and that an extension of time would then be granted for filing a complete return.

On March 14, 1919, the appellant filed a "tentative return" on Form 1031-T, showing a tax due for the year 1918 of $120,000, and, as required by the Revenue Act of 1918, paid one-fourth of that sum, $30,000, upon the filing of the return. The appellant filed a complete return on June 14, 1919, showing a tax for the year in question of only $73,657.46, which was in due time paid.

The Revenue Act of 1921 provided that a tax under the Revenue Act of 1918 might be assessed at any time within five years of the date of filing a return, which date the Supreme Court held in *Florsheim Bros. Co.* v. *United States* (280 U. S., 453 [Ct. D. 167, C. B. IX-1, 260]) was the date of the filing of the complete return, which in this case was June 14, 1919.

On February 7, 1924, the Commissioner notified the appellant of a deficiency tax for the year 1918 of $62,001.27, and suggested that in the event that the taxpayer desired to appeal and to avoid an immediate assessment, a waiver of the statute limiting the period of assessment and collection be filed. A waiver was filed with the Commissioner in Washington on February 27, 1924, but apparently was not in time under the procedure in the Department to prevent a jeopardy assessment, which was made by the Commissioner on March 13, 1924. On March 30, the appellant filed a claim for an abatement of the entire amount of $62,001.27, the grounds of which are stated as follows:

"Assessment previously made was erroneous, due to the fact that the revenue agent did not take into consideration the proper adjustment of salaries to officers, reasonable depreciation allowance, as well as amortization of war facilities installed during the year and due to handling of war orders. The information and brief are being prepared now to clearly reflect the above and will be presented to the Treasury Department for consideration at an early date."

On June 7, 1924, the appellant also filed a claim for a refund for the years 1918, 1919, and 1920. From March 30, 1924, up to October 23, 1926, frequent hearings or conferences with the Income Tax Unit were had relating to its claim for refunds, and particularly to its claim for an abatement of the deficiency tax assessed in March, 1924, based on the grounds set forth in its claim for abatement.

While a small allowance for an overassessment for 1919 was made and another small claim for refund on its 1918 tax was later filed by the appellant and denied, they do not appear to have any effect on the result of this action, as no further action was taken in relation thereto after the decision of the Commissioner on October 23, 1926.

On October 23, 1926, the Commissioner notified the appellant that its claim for abatement of the deficiency tax assessed on March 13, 1924, was rejected, and a complete restatement of the appellant's income for the year 1918 and a recomputation of its tax for that year was sent the appellant, showing both the deficiency assessed in February, 1924, and that a further deficiency of $2,224.95 resulted from the recomputation. The appellant was notified that, unless it protested within 30 days, the additional deficiency shown by the recomputation, a formal 60 days' notice of the additional deficiency would be given, and to give sufficient time for consideration it was suggested that another waiver be filed, which was done November 15, 1926, extending the period for assessment to December 31, 1927.

On January 8, 1927, the Commissioner formally notified the appellant of the assessment of the deficiency of $2,224.95; and on March 1, 1927, the appellant filed with the Board of Tax Appeals an appeal from the Commissioner's assessment of the second deficiency tax, based on the following errors:

"(a) The failure of the Commissioner to allow as a deduction from gross income in the year 1918, depreciation upon the machinery of the Newport plant of the taxpayer at the rate of 15 per cent per annum.

"(b) The failure of the Commissioner to allow as a deduction from gross income in the year 1918, an additional salary amounting to thirty thousand dollars ($30,000) voted by the board of directors of the taxpayer as special compensation for services rendered by the four officers in the year 1918."

No further steps were taken in determining the amount of tax due except in hearings before the Board of Tax Appeals, or toward collecting any part of the deficiency assessed in March, 1924, until 1928, when in June the collector sent the appellant a letter suggesting that the appellant file a bond if it desired the collection of the deficiency tax further delayed.

The appellant failing after several more requests to file such a bond, the collector, on September 3, 1929, gave notice that if not paid at once, he would proceed by distraint to collect, to avoid which the appellant on September 9, 1929, paid the amount with interest totaling $82,561.70. On October 16, 1929, the appellant filed a claim for a refund of the sum so paid, which was denied by the Commissioner on the 6th day of December, 1929, whereupon the appellant on March 11, 1930, filed its writ and declaration in this action in the District Court of New Hampshire to recover the amount. The declaration contains three counts: One for the recovery of the entire sum based solely on the ground that it was collected after the limitation for collection fixed by the Revenue Acts of 1918, 1921, 1924, 1926, and 1928; a second based on the claim for allowance on account of the increase in salaries; and a third based on the alleged depreciation due to war conditions.

To this action the Government filed a plea to the jurisdiction of the court on the ground that, there being an appeal pending before the Board of Tax Appeals, instituted after the passage of the 1926 Revenue Act, and after notice of a deficiency by the Commissioner in accordance with section 274(a), under which appeal the entire computation of the appellant's tax for 1918 was involved, section 284(d) and section 1003 of the Revenue Act of 1926 (44 Stat., 67, 110) prohibited any action at law by a taxpayer in a district court to recover an alleged overpayment.

The district court overruled the plea to the jurisdiction as to the first count, and sustained the plea as to the second and third counts seeking a refund by reason of the increase in salaries and for depreciation of machinery due to extraordinary conditions during the war period, presumably on the ground that those items were expressly in issue before the Board of Tax Appeals under the appellant's petition to the Board, March 1, 1927; but holding that the status of the prior assessment of March 13, 1924, had already been finally

determined, and could not be made the subject of adversary proceedings in the determination of an additional deficiency, unless affected by the waivers.

The waiver filed in February, 1924, was for an unlimited period, but on February 10, 1925, a second waiver was filed to remain in effect until December 31, 1925; on September 16, 1925, a third waiver was filed, extending the period of limitation for another year from the expiration of the last waiver, or until December 31, 1926; and on November 15, 1926, a fourth waiver was executed and filed, and, as above stated, extended the period of limitation for another year from the expiration of the last prior waiver, or until December 31, 1927.

It can not be said that under the 1926 Revenue Act, in view of these waivers, a tax assessed for the year 1918 had become a fixed and unchangeable sum on an appeal before the Board of Tax Appeals, and that, therefore, in this case only the deficiency assessment of $2,224.95 was involved in the appeal of March 1, 1927. When the question of a deficiency is under consideration, the entire tax is involved and must be recomputed. (*Bankers Reserve Life Co.* v. *United States*, 44 Fed. (2d), 1000 [Ct. D. 303, C. B. X–1, 286]; *James* v. *United States*, 38 Fed. (2d), 140 [Ct. D. 175, C. B. IX–1, 241]; *Ohio Steel Foundry Co.* v. *United States*, 38 Fed. (2d), 144; *Lewis et al.* v. *Reynolds*, 48 Fed. (2d), 515 [Ct. D. 347, C. B. X–1, 180], affirmed in opinion of Supreme Court handed down January 4, 1932.)

By express provision in section 273 of the Revenue Acts of 1924 and 1926, a deficiency is determined by first finding the true tax for the year in question, and subtracting therefrom the tax assessed on the taxpayer's return, plus any deficiency previously assessed, and all sums collected without assessment, if any, in addition to the tax computed on the taxpayer's return, less certain deductions defined in the Acts.

The Board of Tax Appeals in February, 1930 (18 B. T. A., 1975), sustained the Commissioner in his recomputation of the 1918 tax, which resulted in an additional deficiency, and denied the appellant's claim for a deduction by reason of the alleged increase in salaries accruing in 1918, and also for the deduction claimed for extraordinary depreciation of machinery. From this decision an appeal was taken to this court, which on November 26, 1930, handed down a decision (45 Fed. (2d), 327), holding in effect that the deficiency tax assessed in March, 1924, was the subject of adversary proceedings in the appeal to the Board of Tax Appeals in 1927, at least to the extent of the claim for the increase in salaries, and that the appellant's claim for a deduction of salaries should have been allowed. It reversed the decision of the Board on this point, and presumably sustained it on the other issue involved, if any assignment of error was made with reference thereto; and, if not, the decision of the Board of Tax Appeals was final as to all other issues that might have been considered on the appeal. The amount of the tax of the appellant for the year 1918 was then, and not until then, finally determined, subject, of course, to review by the Supreme Court on certiorari.

A deduction from the prior deficiency tax was accordingly made by the Board by reason of the increase in salaries, and a refund voluntarily made of the sum of $22,660. A disclaimer for the above sum, which with interest amounted to $27,211.56, was filed in this action in the district court before judgment, leaving a balance sought to be recovered of $55,350.14, with interest from September 11, 1929.

After a plea to, and a hearing on the merits, the district court ordered judgment for the defendant on the ground that the collection on September 11, 1929, of the amount of the first deficiency assessment with interest was, by reason of the waivers, within the time allowed for collection under section 278(d), viz, six years after assessment, it having been assessed on March 13, 1924.

The plaintiff appealed from the judgment of the district court and assigned as errors (1) that the court erred in holding that the collection of the amount of the first deficiency tax was not barred by the applicable periods of limitations set forth in the Revenue Acts of 1924, 1926, and 1928; (2) that the district court erred in holding that unless the waiver expressly provided for the collection of a tax previously assessed, it did not extend the time for collection; and (3) that the court erred in holding that the waiver of November 15, 1926, which referred only to assessments, extended the period for collection of the tax assessed in March, 1924.

The question of jurisdiction of the subject matter being always open, the Government strongly urges that the district court was without jurisdiction, on

the ground that the taxpayer having appealed to the Board of Tax Appeals from the determination by the Commissioner of an additional deficiency tax in January, 1927, the Board of Tax Appeals, and this court on appeal therefrom, under sections 284(d) and 1003 of the Revenue Act of 1926, had exclusive jurisdiction to determine the amount of the appellant's tax for the year 1918, and thereafter no action would lie at common law against the collector for a refund.

The waivers of February 27, 1924, February 10, 1925, and September 16, 1925, extended the period for collection of the 1918 tax beyond the enactment of the 1926 Act. Whatever was the effect of the waiver filed in November, 1926, on the collection of the tax, the district court properly found that the waivers above enumerated extended the period for assessing any tax found due from the taxpayer to December 31, 1927. When the Commissioner on October 23, 1926, denied the taxpayer's claim for an abatement of the deficiency assessment of March, 1924, and recomputed the entire tax of the appellant for 1918, showing an additional deficiency of which he gave formal notice in January, 1927, he must have taken into consideration, as it appears he did from the exhibits on file, not only the correct tax for the year in question, but also the original assessment on the taxpayer's complete return, as well as the deficiency assessment of March, 1924, as he was required to do under section 273 of the Revenue Act of 1924 and 1926. The Board of Tax Appeals, and this court on review, had before it the same questions as were raised on the petition for the abatement of the deficiency assessment of March, 1924, viz, the alleged increase in salaries and the abnormal depreciation of its machinery owing to war conditions during 1918.

In determining the additional deficiency upon appeal, the Board was also obliged to review the Commissioner's recomputation of the entire tax, and to take into consideration the disputed questions previously raised in connection with the abatement of the first deficiency assessment. If the taxpayer's claim for deductions were allowed, there not only would be no additional deficiency, but the tax assessed as a deficiency on March 13, 1924, would be materially reduced, as, indeed, it was on the appeal to this court, and by the disclaimer in this action. Whether the additional deficiency tax was adjusted in the amount refunded is not clear on the record, but the inference is from the language of the "decision" of the Board following the decision of this court filed January 28, 1931, that it entered into the adjustment. The "decision" of the Board in part reads as follows:

"Pursuant to the mandate of the United States Circuit Court of Appeals for the First Circuit filed January 28, 1931, * * *. The parties having on May 2, 1931, filed a written stipulation respecting the tax liability of the petitioner here it is, therefore,

"Ordered and decided that there is an overpayment for the year 1918 in the amount of $22,660.

"LOGAN MORRIS, *Member.*

"Dated Washington, D. C., May 2, 1931."

We are of the opinion from a consideration of the scope and purpose of the 1926 Act that, in consequence of the waiver of November 15, 1926, and by the appeal to the Board in March, 1927, even though the waiver purported to be a waiver only as to assessments (see *Stange* v. *United States*, 282 U. S., 270 [Ct. D. 274, C. B. X–1, 414]), the limitations in the Revenue Acts on the collection of taxes for the year 1918 in respect to the deficiency taxes assessed against the appellant were tolled, pending the final determination of the tax for the year in question on appeal and review; and that the collection of the amount of the first deficiency assessment in September, 1929, while it may have been unnecessary at that time in order to preserve the rights of the Government, was not illegal, not being barred by the limitations of sections 277 and 278 of the 1924 Act. And having been collected, sections 284(d) and 1003 of the Revenue Act of 1926 exclude original jurisdiction by the courts in any action to recover a refund until the amount of the tax due for the year in question is finally determined.

One of the purposes of the 1926 Act was to remedy a condition existing under the Act of 1924, whereby a taxpayer could apply to the Board of Tax Appeals, and whatever the result, then bring an action *de novo* in the district court. See report of Senate Committee on Finance on Revenue Act of 1926, Sixty-ninth Congress, first session. "The hearing before the Board was at that time little more than a preliminary skirmish." (*Blair* v. *Curran*, 24 Fed. (2d), 390.)

Under the Act of 1926, except in few instances, and mainly where proceedings were already begun before the Board under the 1924 Act, the jurisdiction of the Board, and of this court on appeal, was made exclusive. (*Ohio Steel Foundry Co.* v. *United States*, 38 Fed. (2d), 144.)

As the court said in the last case cited, page 148:

"We think section 284(d) of the Revenue Act of 1926 (26 U. S. C. A. section 1065(d)) contemplated that no suit should be instituted by a taxpayer for the recovery of a tax after the Commissioner has determined and notified such taxpayer of a deficiency in respect of the tax for such taxable year, in the event of institution by the taxpayer of a proceeding before the Board of Tax Appeals for the redetermination of such a deficiency. * * *

"Had the Commissioner determined a deficiency in respect of the tax of this plaintiff for the year 1918 and mailed to it a notice of such determination, and the plaintiff herein had instituted a proceeding before the Board of Tax Appeals prior to the bringing of this suit, we think this suit would, under such circumstances, be premature and this court would be without jurisdiction to entertain it. Under such circumstances it would be incumbent upon the taxpayer to raise all questions relating to his tax liability for the taxable year, in respect of which the Commissioner had determined the deficiency, before the Board of Tax Appeals and to pursue his remedy with respect both to the deficiency and to any claimed overpayment to a conclusion under the provisions of the Revenue Act of 1926, either by accepting the decision of the Board, which has become final by the expiration of the time for filing of a petition for review of such decision, or by prosecuting such review to a conclusion as provided by law."

But even if the district court had jurisdiction, we think that its judgment should be affirmed, whether or not section 278 (d) and (e) of the Act of 1926 controls. No claim is made in the appellant's declaration, or in the hearing on the merits, that the balance of the amount sued for, after deducting the amount of the disclaimer, was not a valid tax. The only claim made is that the collection was barred by the limitations fixed in sections 277 and 278 of the Act of 1924, as interpreted in *Russell* v. *United States* (278 U. S., 181 [T. D. 4260, C. B. VIII–1, 206]), and that the period of collection was not extended by the waiver filed in November, 1926.

The Supreme Court, however, in the case of *Lewis et al.* v. *Reynolds*, supra, held that, in a suit to recover a tax alleged to have been illegally collected after the period of limitation had run, the taxpayer must show that no part of the tax was due; that such an action for a refund is in the nature of an action for money had and received, and the taxpayer must show that the collector has money that belongs to him. The court said:

"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."

We hold, however, that the case should have been dismissed below for want of jurisdiction.

The judgment of the district court is vacated, and the case is remanded to that court with direction to enter an order dismissing the case for want of jurisdiction.

ARTICLE 1305: Limitations upon the crediting and refunding of taxes paid.

XI–39–5726
Ct. D. 573

EXCESS PROFITS TAX—REVENUE ACT OF 1926—DECISION OF COURT.

REFUND OR CREDIT—LIMITATION—INADEQUATE DEDUCTIONS—DECREASE OF INVESTED CAPITAL.

Where a taxpayer has paid a special assessment of excess profits tax under section 210 of the Revenue Act of 1917 and the Commissioner determines statutory invested capital for the year 1918 including a paid-in surplus allowed for a sulphur deposit and where he decreases the invested capital for 1918 on account of accrued depletion and depreciation, including deductions for depreciation and depletion for 1917 in excess of those previously

allowed for that year, an overpayment for 1917 attributable to the increased deductions for 1917, the increase of which results in a decrease of invested capital for 1918, is alone within the purview of section 284(c) of the Revenue Act of 1926 which does not contemplate the retroactive allowance of the paid-in surplus as an item of statutory invested capital for 1917 which may have some necessary relation to the increased deductions for 1917.

COURT OF CLAIMS OF THE UNITED STATES. No. K–452.

Freeport Texas Co., Freeport Sulphur Co., Freeport Terminal Co., Freeport Town Site Co., Freeport Light, Water & Ice Co., Freeport Sulphur Transportation Co. v. *The United States.*

[May 2, 1932.]

OPINION.

GREEN, Judge, delivered the opinion of the court.

The facts in the case are stipulated and set forth at length in the findings, but we shall refer only to such facts as we consider necessary to understand the issues in the case.

The plaintiffs are affiliated corporations engaged in the business of producing and marketing sulphur. The Freeport Texas Co. was the parent company and the owner of all of the capital stock of the other plaintiffs joined.

About April 1, 1918, the plaintiffs each filed a return for their income and excess profits tax for the fiscal year ending November 30, 1917, except that the Freeport Town Site Co. filed no separate excess profits tax return. The Freeport Texas Co. filed also a consolidated excess profits tax return for the affiliated group. The Commissioner of Internal Revenue examined and audited these returns in 1919, and reduced the depletion deduction, which resulted in an increase of the taxable income and in an increase of the total tax liability to $1,733,914. The difference between this amount and the amount of $108,471.23 shown by the original return was paid by plaintiffs.

In June, 1919, the plaintiffs filed a consolidated income and profits tax return for the fiscal year ending November 30, 1918, and reported a consolidated invested capital of $37,285,083.98, which included an addition of $31,050,415.86 to the amount of consolidated invested capital and surplus as shown by the plaintiffs' books. This increase over the book value was based upon the original value of the sulphur deposits which the company owned. In adjusting the plaintiffs' tax liability for the fiscal year 1918, the Commissioner found the value of the sulphur deposits to be $13,375,857 at the date of acquisition, and this value was used for the purpose of determining the invested capital and depletion deductions after making certain adjustments for accrued depletion during the years 1913 to 1917, of which the amount $2,106,753.20 represents depletion for the fiscal year of 1917. The Commissioner found that plaintiffs' consolidated invested capital for the fiscal year 1918 was reduced by their failure to take adequate deductions for depletion and depreciation for the fiscal year 1917 in the amount of $691,806.80 for depletion and $29,860.10 for depreciation, making a total of $721,666.90. Subsequently the Commissioner made a reexamination of the plaintiffs' tax liability for the fiscal year ending November 30, 1917, and in the light of all the evidence determined it to be $1,003,720.84; the consolidated invested capital for 1917 was determined to be $16,605,060.92, and the consolidated net income was determined to be $4,384,445.36; computed the amount of overpayment of taxes to be $730,193.16, and held that the refund to which the plaintiffs were entitled for the fiscal year 1917, due to their failure to take adequate deduction for depletion and depreciation, was $321,713.11, which was paid to plaintiffs. Thereafter the plaintiffs filed a claim for refund of $408,480.05, being the difference between the amount of refund allowed and paid and the total amount of overpayment. This application was denied by the Commissioner on the ground that the amount refunded was all that had been overpaid on account of the taxpayers' failure to take adequate deduction for depletion and depreciation. The issue in the case is whether this ruling of the Commissioner was correct.

Plaintiffs contend that the facts in the case bring it within the provisions of section 284(c) of the Revenue Act of 1926 (44 Stat., 66), which provides as follows:

"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) or (g) has expired."

On behalf of the defendant it is said that plaintiffs took as a deduction in their 1917 returns depletion in a much larger sum than was subsequently allowed. The argument is that it is not the deduction that the taxpayer failed to get but only that which he fails to take that is covered by the provisions set out above, and this construction finds some support from the fact that where the taxpayer took a deduction in his return, which the Commissioner failed to allow, he had an adequate remedy for this disallowance at the time thereof. Upon this theory and under the facts in the case, the Commissioner might have refused to allow any refund whatever. The Commissioner, however, did allow a large refund. Defendant, however, does not urge the application of this theory and we do not find it necessary to pass upon it.

It will be observed at the outset that the plaintiffs seek to recover a refund of $408,480.05 by reason of having failed to take deduction for depletion and depreciation for the fiscal year 1917, in the amount of $691,806.80, and that the Commissioner has already allowed $321,713.11 upon the original claim, so that plaintiffs are asking for a reduction in taxes of $730,193.16 by reason of the failure to take deduction for depletion in the sum of $691,806.80. Or, in other words, plaintiffs claim a refund in a sum which exceeds the amount of the deductions which fix the amount of the refund. Counsel for the defendant say in argument that this is manifestly absurd. Without going so far as to say that it is impossible that such a result would follow, it is apparent that it is highly improbable, and we think it will appear clearly upon further consideration that all and probably the most of the overpayment did not result from the failure to take proper deductions for depletion.

The Commissioner made a calculation, according to the Bureau regulations, of the amount of the overpayment resulting from the failure to take adequate deductions. Plaintiffs contend that the method used by the Commissioner in so determining the amount of the overpayment is purely theoretical, and insist that plaintiffs' taxes could not, in the first instance, have been properly computed in such manner. It may be conceded that if the Commissioner had been able to compute the taxes for 1917, in the first instance, upon the facts as now known to exist, the computation would not be made in the manner shown in Finding 14, for if the correct amount invested was ascertainable plaintiffs were not entitled to the benefit of the special assessment provisions which were used in computing the 1917 tax. But this is not material nor do we need to determine whether the method used to compute the overpayment gave exactly correct results. If we exclude the computation made by the Commissioner, we have no evidence before us as to the correct sum which constituted overpayment resulting from the failure to take proper deductions in 1917. The contention of the plaintiffs is that the Commissioner should have used the amount which he found to be invested capital for 1917 after the proper deductions were made and the value of the ore deposits redetermined. This contention seems to be based on the theory that no figure or sum was used as the amount of the invested capital in the original computation of the taxes for 1917, and, as the correct amount of the invested capital for 1917 has now been determined, this sum should be used not only in computing the correct taxes of plaintiffs for 1917, but also the amount of overpayment thereon. This is manifestly incorrect. The plaintiffs asked to have the provisions of section 210 of the Act of 1917 applied in determining the amount of their taxes for that year. The Commissioner complied with the request, so computed the taxes, and his conclusion to apply this section, and his determination of the taxes thereunder was an exercise of his discretionary powers and is not now subject to review. (*Williamsport Wire Rope Co.* v. *United States*, 277 U. S., 551 [T. D. 4172, C. B. VII–2, 323].) The provisions of section 284(c) of the Revenue Act of 1926, under which plaintiffs claim a refund, do not change the general manner of computing the tax under section 210 of the Revenue Act of 1917. They merely

provide that under certain circumstances allowance shall be made for deductions that had not been taken. In computing the taxes under the provisions of this section the Commissioner did not use the correct amount of invested capital, as subsequently ascertained, for the provisions of this section only apply where "The Secretary of the Treasury is unable in any case satisfactorily to determine the invested capital," but it was impossible to compute the excess profits taxes without the use of a certain sum as the amount of invested capital, for one of the main provisions of the excess-profits tax depends on the percentage of the profits on the amount of invested capital. The Commissioner, in computing the 1917 tax, accordingly fixed and used a certain sum as the amount of invested capital. This sum, for want of a better term, we will call "Constructive invested capital," and we assume that it was the best estimate that the Commissioner could make of the amount of invested capital at the time he applied the "special assessment" provision. If, in computing the amount of change in plaintiffs' taxes for 1917 resulting from the failure to take proper deductions, a change was made in the amount of invested capital to make it accord with the increase in value of the ore deposits, or for any other reason, the overpayment would then be determined, not by the results of the failure to take the proper deductions, but by what resulted from changes made in the invested capital which resulted from other causes.

In order to determine accurately the amount of the difference in plaintiffs' taxes caused by reason of the failure of the plaintiffs to take certain deductions, the computation must be made in accordance with section 210 of the 1917 Act, allowing plaintiffs the amount of the deductions which they should take and using the same figures for the constructive invested capital as the Commissioner used. In other words, the computation must be made in the same manner in which the Commissioner would have made it, had he known of these deductions at the time he originally computed the tax. But this we can not do, as the agreed facts do not show the amount of this constructive invested capital. It would seem that evidence on this point could have been obtained, but we assume that it was not furnished by plaintiffs because under the theory of their counsel the sum used by the Commissioner as the amount of invested capital in making his original calculations is immaterial.

The contentions made on the part of the plaintiffs show, as we think, a misunderstanding of the statute. Three matters are required to be established by the provision under consideration. These matters appear quite plainly from the statute, but the misapprehension arises from the fact that they are often applied to the wrong year. They are—

First, a decrease in the invested capital of the taxpayer. This, however, applies to the subsequent year, not to the year for which the taxpayer may recover an overpayment.

Second, that such decrease is due to the fact that the taxpayer failed to take adequate deductions in previous years. Here again the "decrease" is the decrease in subsequent years which must be due to the failure to take "adequate deductions in previous years."

Third, the above matters having been shown, it must further appear that the result is that there has been an overpayment of income or profits taxes in the *previous* years.

It seems to be thought that if the taxpayer failed to take adequate deductions in previous years, this is sufficient to entitle it to recover for *any* overpayment resulting therefrom. This is an error, for such a state of facts will not entitle the taxpayer to recover unless by reason thereof the invested capital of the taxpayer is *reduced in a subsequent year*, and if the invested capital is reduced, even then only to the extent that an overpayment is caused by the failure to take such reductions. Or, in other words, as stated in the statute, unless "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," and even then it must further appear that this has resulted in an overpayment of income or profits taxes in the previous year and the extent thereof must be shown.

After having applied the two provisions of the statute first mentioned above, we find that the outstanding defect in plaintiffs' case arises in connection with the third requirement, as we shall see upon a further consideration of the facts of the case.

The Commissioner, in 1919, increased the unit value of the ore deposits. This undoubtedly entitled the plaintiffs to additional deductions for depletion

in 1917, and these reductions would be reflected in a decrease of invested capital for 1919, but only to the extent of the amount thereof; and for and on account of the failure to take these deductions, the Commissioner reduced the taxes of plaintiffs for 1917. As this amount which was allowed by the Commissioner did not cover the whole of the overpayment, it is assumed on the part of the plaintiffs that the overpayment resulted entirely from the failure to obtain the proper deductions. This is manifestly an error for the following reasons:

The failure to take proper deductions in 1917 on account of the increase made by the Commissioner in the unit value of the ore deposits did, as we have stated above, decrease to a certain extent the invested capital for the following years and caused the plaintiffs to make an overpayment for 1917. But the overpayment for 1917 was not caused entirely, nor as we think even principally, by this failure to get the proper deductions. While an overpayment was caused thereby, the same matter that gave rise to it also gave rise to an overpayment in another manner. If plaintiffs had been allowed the value which the Commissioner subsequently fixed upon their ore deposits the result would have been to greatly *increase* the amount of their invested capital; and if their invested capital had been increased in accordance with this value the result would have been to have lowered their excess profits tax, as that tax was based on the relative percentage of their profits to invested capital. This explains how it is that plaintiffs are claiming the right to have a total refund (including what has been refunded before) of taxes in the sum of $730,193.16 by reason of the failure to take deduction for depletion in the sum of only $691,806.80. Plaintiffs make this claim because they are now seeking to recover not only the overpayment of taxes resulting from the failure to take proper depletion but also the overpayment of taxes resulting from a failure to obtain proper adjustment of their invested capital in accordance with the value of their ore reserves. It may be said that conceding this to be a fact, it nevertheless remains that plaintiffs have overpaid the taxes of 1917 in a greater sum than they have yet received. This may be conceded, but the plaintiffs sue under a special provision of the statute which allows them to recover notwithstanding the statute of limitations, if certain facts have been shown. If these facts have not been shown there can be no recovery, and in no event can plaintiffs recover beyond the amount of overpayment resulting from the failure to allow adequate deductions for depletion. (See *Southwestern Oil & Gas Co.* v. *United States*, 29 Fed. (2d), 404 [Ct. D. 36, C. B. VIII–1, 211].) We think, as was said in the same case on further consideration by the Circuit Court of Appeals (34 Fed. (2d), 446), that to sustain the contention of the plaintiffs we would have to read into the statute upon which plaintiffs base their case, a provision which would enable the plaintiffs not merely to recover overpayments resulting from any of the matters required to be shown by section 284(c), but *any overpayment* for the previous year or years. This is not the law. The statute of limitations applies to any overpayment caused by matters not specified in said section 284(c).

It should be observed also in this connection that there is no evidence by which we can determine how much of the overpayment was caused by the increased value given to the ore deposits, and, as stated above, there can be no recovery under the law for an overpayment so caused.

If we concede for the sake of the argument that the method used by the Commissioner in calculating the overpayment is wrong, there is then no way of determining whether it gave the plaintiffs too much or too little. There is no testimony upon which we can make a segregation of the amount of overpayment resulting from a failure to receive proper deductions for depletion in 1917, and the amount thereof which resulted from the failure to make the proper adjustment of invested capital for that year. The Commissioner made the plaintiffs an allowance which he considered was all to which the plaintiffs were entitled under the statute and there is nothing to show that the plaintiffs are entitled to anything more.

There is also another reason, as we think, why plaintiffs can not recover. It will be observed that what plaintiffs seek now is to have their taxes recomputed without any regard to section 210 of the Act of 1917, although they had heretofore requested that their taxes be computed thereunder. We do not think that the plaintiffs, after having originally requested that the section last named above be applied and having their taxes computed in accordance therewith, can now say that they prefer to have their taxes computed in some other

way which would reduce them. It will be noted that even if plaintiffs had filed a claim for refund they could not have the decision given by the Commissioner when he was acting under the provisions of section 210 reviewed by this court, although the Commissioner could of his own volition correct any mistakes or errors that occurred in computing the taxes under this section. He did make a recomputation and a refund, and, while we have no way of estimating it exactly, it would seem that plaintiffs were granted as much as they were entitled under the provision by virtue of which the suit is brought.

The petition of the plaintiffs must be dismissed and it is so ordered.

WHALEY, Judge, and WILLIAMS, Judge, concur.

LITTLETON, Judge, concurring: The defendant's computation gives the plaintiffs the refund of all the overpayment to which they are entitled under section 284(c). The Commissioner's method of computing the amount of overpayment refundable may not be mathematically perfect, but when, as in this case, various factors of computation and various profits-tax rates are applicable, it is clear that the result of his computation is more nearly correct than any that we can work out or that has been suggested by the plaintiffs. The plaintiffs, while admitting that the only overpayment which they may recover is limited to the overpayment for 1917 resulting from their failure to receive the benefit of adequate deductions from income for depletion and depreciation, contend that the entire overpayment for 1917 of $730,196.16 was due to their failure to take or receive the benefit of adequate deductions for 1917, which deductions, when properly computed, operate to decrease invested capital in the subsequent year.

The argument in support of this claim is that plaintiffs' correct invested capital was determined *for the first time* when the Commissioner was called upon to refund the overpayment for 1917; that the previous determination and computation of the profits tax for 1917 under section 210 of the Revenue Act of 1917 must be ignored, because the provisions of that section limit its application to cases where the invested capital can not be satisfactorily determined, and the plaintiffs' consolidated invested capital could be determined; that section 284(c) of the Revenue Act of 1926 makes no mention of invested capital for "previous years"; and that there is only one "invested capital," and that is the *correct* invested capital; that, therefore, in determining the amount of refund payable under section 284(c), the *correct* invested capital for 1917 must be used, and the refund computed upon the correct percentage of excess-profits tax to net income, instead of at a rate considerably lower than the rate at which the additional profits tax was paid.

It is further pointed out by plaintiffs that the Commissioner of Internal Revenue in 1919 when he determined and computed the profits tax in accordance with section 210 of the 1917 Act and determined the additional tax of $1,625,442.77, which was paid, made only one change in the net income reported in the return, such change being a reduction in the depletion unit from $9.39141 to $2.80 per ton; that if the depletion unit had not been reduced the plaintiffs would have had the benefit of an invested capital of $36,217,521.26 shown on the return. This, the plaintiffs say, makes the entire overpayment determined by the defendants on April 29, 1927, by the use of the correct invested capital of $16,605,060.92 and correct net income of $4,384,445.36, refundable under section 284(c).

The plaintiffs are in error in contending that the defendant's determination under section 210 of the Revenue Act of 1917 of the amount of profits tax computed upon such determination is immaterial to a determination of the amount of the overpayment refundable under section 284(c). The provisions of section 210 are mandatory if the Commissioner is unable satisfactorily to determine invested capital, and if he concludes that he can not determine invested capital it is his duty to so compute the profits tax. This section is recognized in the revenue law as much as is section 207 of the 1917 Act, and a tax computed thereunder is as legal and valid as a tax computed on invested capital determined under section 207. Section 284(c), which was first enacted as a part of section 252 of the Revenue Act of 1921, does not mention invested capital for the previous year or years, nor does it mention any factor that might affect the correct tax liability for such previous year or years except those deductions from gross income which, when increased in order to determine the correct invested capital for a subsequent year, had the effect of reducing invested capital and thereby increasing the profits tax

for the year under consideration over what such taxes would be if the deductions claimed and allowed in such previous year were permitted to stand. It is clear that the words "such overpayment" for the previous year refer to an overpayment measured by the inadequate deductions and nothing else, and that the words "with the result that there has been an overpayment" do not contemplate a determination of statutory invested capital where it has not theretofore been determined or a redetermination of invested capital through the retroactive allowance of a paid-in surplus, or for any other reason, except as it may be affected by deductions from gross income. It is evident in this case that the determination of the correct invested capital for 1917 was the cause of a large portion of the overpayment which had been made as the result of the assessment of an additional tax based upon a computation of the excess-profits tax under section 210. Any portion of the overpayment resulting from this is not now refundable.

The excess profits tax computed by the Commissioner in 1919 under section 210 and paid by plaintiff for 1917 was $1,506,169.87, and the correct profits tax computed in 1927 on the correct invested capital and correct net income was $795,816.87, a difference of $710,353. The income tax determined by the Commissioner in 1919 on the net income computed without allowing adequate deductions for depletion and depreciation was $227,744.13, and the income tax determined in 1927 upon the correct net income, after allowing adequate deductions for depletion and depreciation and after adjusting the income on account of certain inventory items and a claimed deduction for royalties disallowed, resulting in a net decrease in income of $140,748.98, was $207,903.97, a difference of $19,840.16. The income and profits tax determined and computed by the Commissioner of Internal Revenue under the provisions of section 210 of the Revenue Act of 1917 upon a consolidated net income of $4,525,194.34 determined, without allowing plaintiffs adequate deductions for depletion and depreciation, amounted to $1,733,914. This resulted in the payment of an additional tax of $1,625,442.77 in excess of that shown and paid on the returns. The total income and profits tax computed upon the same net income of $4,525,194.34 arrived at without the allowance of adequate deductions for depletion and depreciation and increased to $5,106,112.26 by proper adjustments in respect of the opening and closing inventories for 1917 and the restoration to income of the amount claimed as a deduction on the returns as royalties, and upon the correct consolidated invested capital of $16,605,060.92, was $1,325,433.25. The correct income and profits tax for 1917 computed upon a correct consolidated net income of $4,384,445.36 arrived at by making all proper adjustments and allowing adequate deductions for depletion and depreciation and upon the correct invested capital for 1917 of $16,605,060.92, is $1,003,720.84. It is clear therefore that the difference of $231,929.48 between the tax computed without the allowance of adequate deductions, but with all other proper and legal adjustments, and the tax computed upon the correct consolidated net income after the allowance of adequate deductions and upon the correct invested capital is that portion of the overpayment for 1917 resulting from the failure of the plaintiffs to take or receive the benefit of adequate deductions for 1917.

The fact that had the Commissioner of Internal Revenue in 1919 not reduced the value of the depletion unit below what it should have been, the plaintiffs would have received an adequate deduction for depletion in 1917 and would have had the benefit of a corresponding invested capital and, therefore, would not have overpaid its tax, does not help the plaintiffs' case. Section 284(c) does not contemplate or include within its terms any items affecting the tax which may have some necessary relation to the inadequate deductions. It is the deductions, the increase of which in a subsequent year results in a *decrease of invested capital* for the subsequent year, that mark the limit of the amount which may be refunded after the expiration of the statute of limitations, and no other items are included however closely they may be connected or related to such deductions.

ARTICLE 1305: Limitations upon the crediting and refunding of taxes paid. (Also Sections 277 and 278, Article 1272.)

XI-45-5838
Ct. D. 596

INCOME TAX—REVENUE ACT OF 1924—DECISION OF COURT.

1. REFUND—LIMITATION—CREDIT BY DIRECTION OF TAXPAYER.

Where a credit for a tax on the personal income of a partner is applied by his direction against a tax assessed against and owed by the partnership of which he is a member, he can not recover the amount of the credit, regardless of the time when his claim for the refund of the amount of the credit was filed and even though the credit was applied after the statutory period for the collection of the partnership tax.

2. ACCOUNT STATED.

Where a claim for refund of or credit for a tax for a particular year is not filed but the Commissioner, within the statutory period for the allowance of a refund without the filing of a claim therefor, approves a schedule of refunds and credits showing an amount of tax for that year refundable, there is no account stated between the taxpayer and the United States by virtue of the Commissioner's approval of the schedule.

3. SAME.

The evidence does not show that an account stated between the taxpayer and the United States was rendered to the taxpayer.

4. COLLECTION—LIMITATION.

Where the statutory period for assessment has expired before the enactment of the Revenue Act of 1924, section 278(d) of that Act does not authorize the collection of an assessment at any time within six years of the date of the same.

COURT OF CLAIMS OF THE UNITED STATES.

David Daube v. *The United States.*

[July 5, 1932.]

OPINION.

GREEN, Judge, delivered the opinion of the court.

The Commissioner of Internal Revenue having found that plaintiff had overpaid his individual income tax for the years 1916, 1917, 1918, 1919, and 1920, credited the amount of such overpayments upon a deficiency in taxes of Westheimer & Daube, a firm of which the plaintiff was a member. There is no dispute as to the overpayment, the deficiency in the tax of the partnership, or the credits made by the Commissioner thereon, but plaintiff, claiming that the action of the Commissioner in making these credits was illegal, brings suit to recover the amount of the overpayments and credits. Since the filing of the petition, the plaintiff has abandoned his claim for the credits made from overpayments on the taxes of 1916, 1917, and 1920. The issue now is with reference to the credits made out of overpayments for 1918 and 1919.

With reference to the credits made of overpayments of the taxes for these two years, the contention for plaintiff is that the credits were made after the expiration of the period of the statute of limitations for the collection of taxes for the years on which these two overpayments were made. It is contended on behalf of the defendant that the credits were made before the expiration of the statutory limitations and that in any event the plaintiff is not entitled to recover for the reason that no application for a refund was filed within the time prescribed by law.

On the question of the statute of limitations the cases of *Florsheim Bros. Co.* v. *United States* (280 U. S., 453 [Ct. D. 167, C. B. IX-1, 260]), and *Northwestern Barb Wire Co.* v. *United States* (70 C. Cls., 329), are cited on behalf of defendant to show that section 278(d) of the 1926 Act permitted the

collection of the partnership tax at any time within six years from the time of the additional assessment against the partnership, which was on March 29, 1924. But in those cases it appeared that the statute of limitations had not expired when the Act of 1926 went into effect.

In the case at bar the parties agree that the period of limitation for the collection of the partnership taxes for 1917 was extended by the so-called "unlimited" waiver which the partnership had filed to April 1, 1924, when it expired. Thus the period of limitation ended prior to the enactment of the 1924 Act, which in subdivision (d) of section 278 authorized the collection to be made within six years from the assessment of the tax. But in subdivision (e) of the same section, there was a provision that the section should not authorize the collection of a tax if at the time of the enactment of the Act such assessment was barred by the statutory period of limitations properly applicable thereto. We are of the opinion that neither the Revenue Act of 1924 nor that of 1926 is of any help to defendant's case. (See *Russell* v. *United States*, 278 U. S., 181 [T. D. 4260, C. B. VIII–1, 206].)

The defendant contends that both of the claims of the plaintiff now at issue are barred by reason of the fact that no claim for refund as to either of them was filed until more than four years after the payment of the sum which is sought to be recovered. Plaintiff does not concede this to be the fact as to the claim for refund of the taxes of 1918, but argues that if it be a fact it is immaterial for the reason, as plaintiff claims, that one basis of the suit is the rendition of an account stated on which a suit may be commenced within the time of the rendition of the account notwithstanding the provisions with reference to the filing of claims for refund. In support of this position the plaintiff cites the case of *Bonwit Teller & Co.* v. *United States* (283 U. S., 258 [Ct. D. 834, C. B. X–1, 328]).

The facts in the case present a very unusual situation and are quite different from those in the Bonwit Teller case, supra, where only one taxpayer was involved. It appears that on November 10, 1923, the Commissioner mailed to the plaintiff a "statement" which showed that he had found that additional taxes were due from the plaintiff for the years 1916, 1917, and 1920, and that for the years 1918 and 1919 there had been an overassessment, in each case specifying the amount, and that there was altogether a net overassessment of $13,502.90.

On January 26, 1924, the Commissioner signed an assessment list for the district of Oklahoma upon which appeared the additional assessments hereinabove referred to, and on January 31, 1924, the Commissioner signed a "schedule of overassessments," which schedule showed an overassessment of taxes in favor of plaintiff for the year 1918 of $22,151.88 and for the year 1919 of $2,628.26. This schedule was sent to the collector with instructions to examine the accounts of the taxpayer and apply the overpayment as a credit against any taxes due, entering the same on the schedule, which the collector did, and after signing the schedule returned it to the Commissioner of Internal Revenue. It then showed that $11,277.24 of the overpayment of 1918 taxes was credited against additional assessments of 1916, 1917, and 1920 taxes. At the same time, the collector made out a schedule of refunds and credits dated February 27, 1924, which he forwarded to the Commissioner along with the schedule of overassessments. This schedule listed as refundable $10,874.64 out of the taxes paid for 1918 and $2,628.26 out of the taxes paid for 1919. The Commissioner signed an approval of this schedule and an authorization of the payment thereof on March 29, 1924, notwithstanding the fact that he had on file an agreement and directions of plaintiff to apply certain of his overpayments to the additional assessment against the partnership which he had previously informed plaintiff and the partnership would be made. On the same day (March 29, 1924) the Commissioner made an additional assessment of taxes in the sum of $53,012.47 for 1917 against the partnership.

The authorization of the payment of the overassessment signed by the Commissioner was clearly made by oversight, but a check for $13,502.90, the amount of the overassessment, was issued pursuant thereto on April 23, 1924, and forwarded to the collector for delivery to the plaintiff. The collector, however, returned the check without delivering it. It is not material to this branch of the case, but it is evident this was done because the collector knew that about February 23, 1924, plaintiff and the other members of the partnership of Westheimer & Daube had individually signed and mailed to the Commissioner an instrument which constituted an agreement between themselves with reference to the disposition of overassessments to which they

might be individually entitled and further authorized and requested the Commissioner—

"* * * to apply and credit the amount refundable to each and all of the individual members of said partnership for 1918 against the additional tax assessed against said partnership for the year 1917 and this agreement to be taken and accepted as full and complete authority therefor."

In a prior paragraph of this agreement it recited that—

"* * * the said partnership of Westheimer & Daube has been assessed an additional excess-profits tax of $53,012.47 as shown by Commissioner's letter dated February 11, 1924."

After the return of the check, the Commissioner wrote again to the collector giving him instructions as to the distribution of the amounts of the overassessment, and accordingly, on August 7, 1924, the collector applied the sum of $10,874.64, the balance of the overassessment for 1918, and also the sum of $2,628.26, overassessed for 1919, upon the taxes outstanding against the partnership for the year 1917.

All this seems to have been perfectly satisfactory to the plaintiff until long afterwards. A few days before the 6-year limitation on suits had expired for bringing suits against the Government this action was commenced, apparently on an afterthought that there was a chance to recover back the amount so paid on the ground that the application had been made after the expiration of the period of limitations.

We think the plaintiff has misapprehended the principles of law applicable to the overpayment of 1918 as we consider those principles to be. It is still contended on the part of the plaintiff that defendant had no right to apply the amount of any overassessment against plaintiff upon the partnership taxes after the period of limitation had expired, and there is much discussion as to the effect of the provisions of the Revenue Act with reference to the application of "credits" upon a tax when the period of limitation for its collection has expired. As we view these provisions they were only intended to control when the "credit" was made upon other taxes of the same party whose taxes for a particular year were overpaid and have no application when an overpayment by one taxpayer is "credited" upon the taxes of another. The law applicable to this part of the case is no different than it would be if the plaintiff had directed the amount of any refund coming to him to be applied on the taxes of John Jones or some other taxpayer. True, the plaintiff was a member of the partnership against which an additional assessment had been made and these taxes could be enforced against him by proper proceedings, but they had not been assessed against him. They were assessed against another taxpayer and money used to pay them pursuant to the joint agreement went to the benefit of his partners as well as himself. When one taxpayer authorizes the payment of money due him upon the taxes of another a situation results which is not covered by the revenue statutes but simply by the general law. In this particular case the application of the overpayment was made after the statute of limitations had run, but the statute then in force did not extinguish the debt due from the taxpayer. It merely abrogated the remedy. It is not necessary to decide whether the plaintiff could have recalled his direction to so apply the money at any time before the application was made. He did not do so, and when once the application had been made in accordance with plaintiff's directions the Government could retain the money provided there was any consideration for the transaction. The fact that the partnership still owed the money and the debt still existed was, as we think, sufficient consideration, and therefore the overpayment for 1918, which was covered by the instrument to which we have referred, can not be recovered by the plaintiff regardless of the time when the claim for refund was filed or account stated was rendered. In fact the schedule never having been presented to plaintiff there was no occasion that he should indicate dissent or approval. When the 1918 refund was finally allowed a complete agreement existed between the Commissioner and the plaintiff as to what should be done with the overassessment, the Commissioner having previously stated what he intended to do and the plaintiff not only accepted the proposition of the Commissioner but directed the application in accordance therewith.

There remains the sum of $2,628.26, overpayment for the year 1919, to which no reference is made in the agreement and directions given by plaintiff, which we have considered above. The defendant contends that no claim for refund

of the 1919 taxes having been filed, the deficiency assessment was properly made against the partnership within the time covered by the waiver filed by the partnership, that it had the right to apply the overpayment of plaintiff's taxes for 1919 on the partnership assessment, and that in any event the application for payment of refund is now barred by the statute of limitations. The petition recites that a Treasury check in the amount of $13,502.90, drawn to the order of plaintiff, was on August 7, 1924, applied by the collector against the additional assessment against the copartnership for the year 1917, and a letter from the Treasury Department reciting that this check had been returned by the collector and had been "deposited as a repayment to the appropriation from which drawn" is attached to the petition. Neither the collector nor the Commissioner applied the check which had been issued in favor of the plaintiff in the manner recited by the petition. It was simply turned back into the Treasury, and the transaction has been so fully explained in connection with the 1918 taxes that we need not recite the particulars any further. The petition does allege that on a schedule dated March 29, 1924, approved by the Commissioner, a credit was made of $4,449.50 against an alleged additional tax for the year 1917 out of the overpayments for 1918, and avers that such credit was without "warrant in law." But this has no reference to any overpayment of 1919. In argument counsel for plaintiff contend that under the holding in the case of Bonwit Teller & Co., supra, he is entitled to recover that portion of his taxes for 1919 which was applied on the partnership taxes. Plaintiff's claim is not definitely stated in the petition, but it is evident that he can not recover even for the 1919 overpayment under the special provisions of the Revenue Act, for the reason that no claim for refund was filed. If he recovers at all it must be upon the theory that there was an account stated between the parties by virtue of the schedule signed by the Commissioner March 29, 1924, which, it is urged, under the Bonwit Teller case, gave the plaintiff six years in which to commence suit under the general statute applicable to claims against the Government. In considering whether there was an account stated between the parties upon which plaintiff may rest his case, it becomes necessary to consider the fundamental rules upon which such a case may be based.

The main principles with reference to an account stated are well settled and so far as we are able to ascertain no court has ever varied from them. In a general way it is said, "An account stated is an agreement between parties who have had previous transactions of a monetary character that all the items of the account representing such transactions, and the balance struck, are correct, together with a promise, express or implied, for the payment of such balance." (1 C. J., 678, section 249, citing numerous authorities.) It is of course necessary that some kind of a statement of the account must be rendered (Idem, 679, section 250); and there must be "an admission by one party of the correctness of the balance struck by the other, or some other evidence to show that the party sought to be charged has by his language or conduct admitted the correctness of the account." (Idem, section 251.) Of special importance is the rule that, "To constitute an account stated each party must understand the transaction as a final adjustment of the *respective demands* between them taken into consideration in the accounting." (Italics ours.) (Idem, 683, section 259.) Also, that "To constitute an account stated, the correctness of the balance must receive the assent, express or implied, of both parties. A certain fixed sum must be admitted by the one party to be due to the other, and where there are mutual or cross demands, the parties must come to an agreement as to the allowance or disallowance of the items composing the account; there must be an adjustment, a balance struck, and an assent to the correctness of the balance." (Idem, 685, section 263.) The right of action arises from the implied promise to pay which is based on this agreement.

It is not absolutely necessary that the account should be stated or the assent thereto given in writing. It is sufficient if it is so communicated that the minds of the parties can come to an agreement as to the balance due one or the other, and do come to such an agreement; but if the minds of the parties do not meet, there is no account stated.

It has also been held that "where an account rendered by one party to another is relied on by the latter to charge the former as regards items in favor of the latter, the account is to be taken as an entirety, and the account is evidence in favor of the former as to items therein in his favor." (Idem, 681, section 252.)

"The parties can not state an account by agreeing to part of the items, and leaving the others open for future adjustment or litigation." (Idem, 684, section 260, citing *New York Fire Underwriters* v. *Bougham*, 97 N. Y. S., 402, holding that the test of an account stated is that the minds of the parties met as to the amount due.)

Nor does it make any difference that a claim made in the account may be groundless, although if any part of the claim is disputed so that the balance stated is not admitted it does not become an account stated. (*Columbia River Packing Co.* v. *Tallant*, 132 Fed., 271.) It is contended in argument on behalf of the defendant that the partners were individually liable for the partnership taxes and that this gave defendant the right to credit the plaintiff's overassessment for 1919 on the partnership taxes, but it is not necessary to pass on the question thus raised, as our decision does not depend upon its determination.

It thus appears that an account stated necessarily includes all the claims that are made by the respective parties at the time of its presentation or rendition; that it applies not only to what may be admitted by one party but to cross demands made by the other which have no direct or even no indirect connection with the claim admitted by the other party, and the foundation of a suit thereon is that the balance is struck and agreed upon between the parties on their respective claims. The admission of one item in the account of the transactions between the parties offset by another item will not support an action on an account stated as to the item admitted, although it may constitute evidence of the correctness thereof in an action otherwise commenced. On the other hand, the presentation of an account admitting an item in favor of the party presenting it, but offsetting it by a claim upon an item against the party to whom the account was presented and striking a balance may, if no objection is made within a reasonable time, become an account stated for the balance so struck.

The authorities supporting these principles are so numerous that it is impractical to cite them within the reasonable limits of an opinion, and the decisions are so uniform and so universally accepted in their holdings that we see no necessity for making further reference to any of them.

It is not necessary in this case to decide whether all the principles laid down above apply to the facts in the case. The first question to be determined is whether a statement of any kind was presented by defendant to plaintiff which showed the condition of the account between the parties, for the rule is absolute that unless some kind of an account or statement is presented or communicated by one party to the other which shows the balance due on the accounts between the parties, there is no foundation for a claim upon an account stated. Indeed this is so obvious that it would not need to be stated if it were not necessary in considering the evidence in this case, which fails to show the presentation of any account or instrument showing any amount due to plaintiff, or any agreement as to the balance due.

The only communication that the plaintiff received from the defendant which in any way pertains to the amount due is the so-called 30-day letter written by the deputy commissioner to the plaintiff and dated November 10, 1923. There are several statements in this communication that we think show plainly that it can not be considered as an account stated.

In the first place, the letter refers to a statement which is made part thereof, which clearly shows that nothing that was in the letter was intended as a final statement of the amount due on the account between the parties or even any items thereof. This statement made it plain that taken as a whole the communication was merely a recital of what was proposed to be done in the future and that it did not admit that any amount whatever was due plaintiff or would be due on the account between the parties when the proposed action should be taken. In fact the action which made the overassessment valid, and the assessment of the deficiency tax against the partnership were both done or made some time after the letter was written, and the whole proposition and the statement were all predicated upon the concluding words of the statement, which are as follows:

"The overassessment shown herein will be made the subject of a certificate of overassessment which will reach you in due course through the office of the collector of internal revenue for your district. If the tax in question has not been paid, the amount will be abated by the collector. If the tax has been paid, the amount of overpayment will first be credited against unpaid income tax for another year or years and the balance, if any, will be refunded to you by check of the Treasury Department. *It will thus be seen that the overassessment*

does not indicate the amount which will be credited or refunded since a portion may be an assessment which has been entered but not paid." (Italics ours.)

It will be observed that by this statement the taxpayer is not told that he will be paid the amount of any overpayment but that such overpayment will be credited on unpaid tax for other years, and it should be noted in this connection that it makes no difference as to whether the defendant had the right to credit this overpayment on the unpaid taxes of the partnership, as the defendant at the time was setting out its claims, and even if they were wrongfully made they constituted no admission that anything was due the plaintiff. Besides this, the plaintiff was specially warned by the portion of the statement italicized above that the overassessment should not be taken as any indication of the amount which would be credited to him or refunded. This language was evidently intended to make it clear to him that the letter and the statement constituted no acknowledgment of any indebtedness, and the subsequent proceedings on the part of the plaintiff show that he understood the statement just as it read.

It is true that by some oversight the Commissioner subsequently prepared a letter stating the amount of the overassessment, which, with a check for the amount thereof, was sent to the collector. But the collector, perceiving the error, did not forward the check or the letter to the plaintiff but returned it to the Commissioner. Nothing was received by the plaintiff which pertained to the condition of the account between plaintiff and defendant except the letter of November 10, 1923, to which reference has been made above.

Although the letter last above referred to was the only communication from defendant to plaintiff with reference to the balance due on the accounts between the parties, there seems now to be some claim that the schedule of refunds and overassessments signed by the Commissioner on March 29, 1924, constituted an account stated. No such claim is set up by counsel for plaintiff in argument unless it be by a mere citation of the Bonwit Teller case, supra. In any event this schedule of refunds and credits was not presented to plaintiff. When it was forwarded to the collector he must have seen at once that an oversight had occurred. It not only was at variance with what the Commissioner had originally written plaintiff would be done, but if taken in the sense now claimed for it on behalf of the plaintiff it was absolutely contrary to the express directions which plaintiff himself had given to the Commissioner and of which the collector was advised. The collector therefore sent this schedule with the check for $13,502.90 back to the Commissioner and the Commissioner then directed the collector to credit the amount thereof against the 1917 assessment against the partnership of Westheimer & Daube. For so much of this credit as came out of the overassessment for 1918 ($10,874.64), the Commissioner had, as we have heretofore shown, express directions from the plaintiff to apply it on the partnership tax; for the remainder ($2,628.26), he did not have any directions from the plaintiff as to how it should be applied, but it will be observed in this connection that the plaintiff had made no claim for its refund.

This muddle, which arose from the oversight of the Commissioner, resulted in what the evidence shows to have been an entirely erroneous statement of refunds and credits. By express direction of the plaintiff the greater part of this refund was, as we have already shown, to be applied on the partnership taxes. We think the evidence shows clearly that the schedule was issued by mistake, but in any event it utterly fails to comply with the requisites of an account stated. The plaintiff had never revoked his directions as to what should be done with the overassessment for 1918 and the minds of the parties had come to no agreement in relation thereto, or as to what should be done with the overassessment for 1919 with reference to which plaintiff had made no claim.

It should also be observed that the petition does not set forth a cause of action based upon an account stated. There is nothing in it referring to any statement of account received from the defendant. On the contrary, the action is based upon the allegation that the overpayments mentioned therein were illegally credited on the tax of Westheimer & Daube for the reason that the statute of limitations had run against the assessment and collection thereof at the time the credit was made and that claims have been filed for the refund thereof.

So far as the claim made by plaintiff that he is entitled to recover upon an account stated is concerned, the case is altogether different from that of Bonwit Teller & Co., supra. In that case a second count was set up in the petition which asked recovery on a certificate issued and delivered to the plaintiff stating the amount due, while in the case at bar, as we have already seen,

there is no allegation in the petition with reference to anything of the kind. No question was raised either in this court or in the Supreme Court on the submission of the Bonwit Teller case as to whether the certificate upon which the second count of the petition was based constituted an account stated and the argument was confined to other points involved. Consequently neither court passed upon the question as to whether this certificate was sufficient to constitute an account stated in favor of the plaintiff and it will be noted in this connection that the authorities cited as supporting a right to bring suit thereon, all refer to cases where a certificate had been issued by the proper authorities allowing plaintiff's claim, authorizing its payment, and plaintiff brought suit for the amount directly stated by the certificate to be due him. In our judgment the opinion of the Supreme Court is no authority for holding that the certificate issued in the Bonwit Teller case was an account stated. Be this as it may, we have, as we think, a firm ground for our decision on other matters. The letter in the Bonwit Teller case contained no warning to the plaintiff that nothing was decided thereby. It advised the plaintiff that a definite sum would be refunded or credited. In the case at bar, the 30-day letter in its final concluding statement notified the plaintiff that the whole matter was still undecided. In this connection it should be said that we do not think the fact that more than one year was taken into consideration in considering the accounts of the respective parties has anything to do with the principles relating to an account stated. Certainly no authority can be given for any such position. The underlying principle of an account stated is that it states the balance existing between the two parties and shows to which of the two parties this balance is due.

The cases that have been cited by counsel for plaintiff and others that have been called to our attention do not support the theory that an account stated was rendered in the case at bar. In each and all of them a claim was filed by the plaintiff for refund of the amount illegally collected. The claim as filed was approved in the full amount thereof and the approval certified by the proper officer. When a plaintiff presents a claim and it is allowed in full by the proper officer, manifestly the minds of the parties have met upon an account stated, and a promise to pay the amount agreed upon is implied. In the case at bar no claim whatever was filed for a refund of the overpayment on the taxes of 1919. In the case of Bonwit Teller & Co., supra, a claim was also filed by the plaintiff and there was a certification. But cases where the plaintiff presents a claim to the Government which is allowed and certified are no authority for upholding the action in such a case as the one at bar where no claim has been filed, no statement made by one party to the other, and there has been no meeting of the minds of the parties or agreement thereon, or any facts shown in evidence from which an agreement might be implied. An unbroken line of authorities, we think, should not be overruled in order to enable the plaintiff to recover a payment which in justice and equity was owing to the Government.

The plaintiff's petition must be dismissed and it is so ordered.

WHALEY, Judge; WILLIAMS, Judge; and BOOTH, Chief Justice, concur.

ARTICLE 1305: Limitations upon the crediting and refunding of taxes paid. XI-47-5870 Ct. D. 601

INCOME TAX—REVENUE ACT OF 1926—DECISION OF COURT.

SUIT—JURISDICTION—APPEAL TO BOARD OF TAX APPEALS—DISMISSAL BY BOARD.

Where after the enactment of the Revenue Act of 1926 a person files a petition with the Board of Tax Appeals and the Board on his motion dismisses the proceeding for reasons other than lack of jurisdiction by an order stating that the Board is unable from the pleadings to determine the amount of the deficiency as determined by the Commissioner, section 284(d) of that Act prohibits a suit to recover any part of the tax paid for the taxable year in respect of which the Commissioner determined the deficiency, even though the Commissioner acquiesced in the motion to dismiss.

DISTRICT COURT OF THE UNITED STATES FOR THE DISTRICT OF MARYLAND.

Warren Manufacturing Co., a Corporation, plaintiff, v. Galen L. Tait, Collector of Internal Revenue for the United States Collection District of Maryland, defendant.

[July 28, 1932.]

OPINION.

COLEMAN, District Judge: The sole question here presented is whether this court has jurisdiction to entertain the present suit which is brought by the plaintiff to recover income taxes alleged to have been illegally collected by the Government, and is to be determined by the construction to be placed upon section 284(d) of the Revenue Act of 1926 (26 U. S. C. A., 1065(d)). The pertinent language of this section is as follows: "If the Commissioner has mailed to the taxpayer a notice of deficiency under section 1046 of this title and if the taxpayer after February 26, 1926, files a petition with the Board of Tax Appeals within the time prescribed in such section, no credit or refund in respect of the tax for the taxable year in respect of which the Commissioner has determined the deficiency shall be allowed or made and no suit by the taxpayer for the recovery of any part of such tax shall be instituted in any court except"—and then follows exceptions which admittedly are not applicable to the present case.

The material facts as they appear from the pleadings, and as to which there is no dispute, are that the plaintiff company claimed that the Government was in error in the value that it placed upon the company's capital assets as of March 1, 1913, and in finding a gain from the sale of those assets for $287,950 in 1922. That is, the plaintiff company claimed that the true value of certain water power and other water rights on March 1, 1913, was $287,950, and that thus no profit had been derived from their sale in 1922. However, the Commissioner determined a deficiency for that year, and gave the company notice thereof on February 22, 1926, advising it that it might appeal the deficiency determination to the Board of Tax Appeals. This was done on July 13, 1926. However, on May 21, 1927, this appeal was dismissed, upon motion of the company in which the Government acquiesced, by the following order of the Board of Tax Appeals:

"This proceeding having been called from the day calendar of May 18, 1927, and counsel for the petitioner having filed a motion to dismiss the proceeding, without objection by counsel for the respondent, it is hereby

"ORDERED that the motion to dismiss be and the same is hereby granted. The Board is unable from the pleadings to determine the amount of the deficiency as determined by the Commissioner.

(Signed) "C. M. TRAMMELL,
"*Member, United States Board of Tax Appeals.*

"Dated, Washington, D. C., May 21, 1927."

Some six weeks later, namely, on July 5, 1927, the company paid the amount of the claimed deficiency, namely, $57,382 and thereafter nothing appears to have been done until January 2, 1931, when the company filed with the collector of internal revenue its claim for refund and upon it being rejected, the company instituted, on June 30, 1931, the present suit to recover the deficiency, with interest.

Upon the pleadings, the precise question arises upon the Government's demurrer to plaintiff's replication, the substance of this demurrer being that section 284(d) of the Revenue Act of 1926 must be literally construed. On the other hand, the gist of plaintiff's contention is that where, as in the present case, the taxpayer has taken a mere preliminary step by filing an appeal with the Board of Tax Appeals, but before the case is reached by the Board, or anything done by it, he, of his own motion in which the Government acquiesces, disposes of the case so far as the Board is concerned, he has done nothing which the statute endeavors to prevent; and that since he no longer has redress to the Board, he is left without his day in court and is deprived of his just rights, unless he can prosecute the present suit.

The precise question appears to be an original one. At least none of the reported decisions have passed upon it, nor has the court been referred to any unreported decision involving the exact point. There are, however, a large number of decisions interpreting section 284(d) of the Revenue Act of 1926,

which may, for brevity, be divided into three classes. First, those cases where application is made to the courts (either the district courts or the Court of Claims), before an appeal is taken to the Board of Tax Appeals (see *Camp* v. *U. S.* (C. C. A. 4), 44 F. (2d), 126; *Ohio Steel Foundry Co.* v. *U. S.* (Ct. of Cl.), 38 F. (2d), 144); second, those cases where the taxpayer endeavors to sue in court after an appeal taken to the Board of Tax Appeals, and the latter's decision is still pending (see *James* v. *U. S.* (Ct. of Cl.), 38 F. (2d), 140 [Ct. D. 175, C. B. IX–1, 241]; *James* v. *U. S.* (Ct. of Cl.), 38 F. (2d), 143; *Brampton Woolen Co.* v. *Field*, 56 F. (2d), 23 (C. C. A. 1) [Ct. D. 525, page 362, this bulletin]). Lastly, those cases where the taxpayer endeavors to sue in court, subsequent to a final adjudication of the matter by the Board of Tax Appeals. (See *Bindley* v. *Heiner* (D. C. Pa.), 38 F. (2d), 489 [Ct. D. 156, C. B. IX–1, 356] (interpreting 26 U. S. C. A., 1120 (a), Revenue Law of 1926, section 319, a statute governing estate taxes and in all respects similar to 26 U. S. C. A. (1065(d)); *Bankers' Reserve Life Co.* v. *U. S.*, 44 F. (2d), 1000 [Ct. D. 303, C. B. X–1, 286]; certiorari denied 51 Sup. Ct., 485; *Green* v. *MacLaughlin*, 55 F. (2d), 423.)

Briefly summarized, the result of the three classes of decision is that where a suit is instituted in a Federal court before the Board of Tax Appeals is petitioned, the court is not ousted of its jurisdiction by such petition, but if, after notice of a deficiency, the taxpayer elects to proceed before the Board of Tax Appeals, then no matter whether the question is still pending before the Board, or has actually been decided by it, he is precluded from recourse to the courts. See especially *Bankers Reserve Life Co.* v. *U. S.*, supra.

The history of, and the primary objects sought to be obtained by the creation of the Board of Tax Appeals must be understood. The Board was created in 1924. One of its principal objects was to relieve the taxpayer of the hardship of paying a deficiency assessment before contesting the same, which was necessary prior to that time. But also it was intended to relieve the Federal courts of the great burden of tax litigation to which they exclusively fell heir, by transferring it to a new agency, which, by its specialized work, would be an expert body better fitted than a court of general jurisdiction, to hear and decide tax questions. By the 1924 statute, the taxpayer was permitted immediately to appeal from the deficiency assessment to the Board of Tax Appeals, or at his option, to pay the claimed amount, and thereafter sue for its refund in the district court. In 1926, the Board's powers were further extended. It was permitted not only to decide whether the actual deficiency was due or not, but to determine that even a greater deficiency than had been claimed was due. (26 U. S. C. A., 1048(c); Revenue Act of 1926, 274(e).) On the other hand, it might find no deficiency to be due, but rather that the taxpayer had made an overpayment, and might order a refund to him. (26 U. S. C. A., 1065(e); Revenue Act 1926, 284(e).) Also, a review of the Board's decision was limited by appeal to the Court of Appeals of the District of Columbia, or to the appropriate Circuit Court of Appeals, subject to the right to petition the Supreme Court on certiorari. (26 U. S. C. A., 1226; Revenue Act 1926, 1003.)

A literal interpretation of section 284(d) of the Act of 1926 leaves no ground for doubting the correctness of the Government's contention, because that section, as we have seen, provides that if the taxpayer has filed a petition with the Board, no suit shall be instituted by him for the recovery of any part of the tax. In support of this literal construction, the Government refers to the report of the Committee on Finance of the Senate respecting this section at the time it was before the Senate for adoption, in which we find the following statement:

"But if he (the taxpayer) does elect to file a petition with the Board, his entire tax liability for the year in question (except in case of fraud) is finally and completely settled by the decision of the Board when it has become final. Whether the decision is by findings of fact and opinion, or by dismissal, as in case of lack of prosecution, insufficiency of evidence to sustain the petition, or on the taxpayer's own motion." (Report of the Committee on Finance of the Senate, Sixty-ninth Congress, first session, at page 25.)

In addition, the Government relies upon the following section of the Act of 1926 (26 U. S. C. A., 1217(d)):

"A decision of the Board (except a decision dismissing a proceeding for lack of jurisdiction) shall be held to be rendered upon the date that an order specifying the amount of the deficiency is entered in the records of the Board. If the Board dismisses a proceeding for reasons other than lack of jurisdiction

and is unable from the record to determine the amount of the deficiency determined by the Commissioner, or if the Board dismisses a proceeding for lack of jurisdiction, an order to that effect shall be entered in the records of the Board, and the decision of the Board shall be held to be rendered upon the date of such entry."

Thus this section determines the date upon which certain decisions of the Board shall be considered to have been rendered, and it is to be noted that among such decisions are to be included dismissal of a proceeding when the Board is unable, from the record, to determine the amount of the deficiency fixed by the Commissioner. When we refer to the action taken in the present case by the Board when dismissing the proceeding, we find the assigned reason to be that the Board was unable from the pleadings to determine the amount of the deficiency so fixed. Therefore, the Board may be said to have rendered a decision within the meaning of this section, which would prevent any subsequent action in the courts. See *Camp* v. *U. S.*, supra, and *Bindley* v. *Heiner*, supra.

As was said by the Board in *Capital Building & Loan Association* (12 B. T. A., 349), in holding that the clerk was without authority to dismiss the appeal, "When a proceeding is instituted before this Board there come into being other rights than that of the petitioner to secure a redetermination of his tax liability. The filing of the petition imposes certain restrictions upon respondent in the assessment and collection of the tax. It may affect the period of limitations on assessment or collection, and the right of the Commissioner to thereafter increase the tax. It also creates in the respondent the right to set up a demand that the deficiency should be increased. * * *" This case would seem to indicate that regardless of any effect that it might have upon the subsequent jurisdiction of Federal courts, an appeal to the Board should only be capable of withdrawal by a decision of the Board as such. Accordingly, even aside from section 1217(d), what was done in the present case would then amount to a decision.

But even assuming that this was a dismissal, rather than a decision, it is difficult to see just how the Commissioner's assent to a taxpayer's motion to dismiss the proceeding before the Board improves, as the company here contends, his standing before this court. Certainly, it is not arguable that if the Government consented to the dismissal of a suit upon which the statute of limitations had run, such consent would allow the taxpayer to successfully overcome the running of the statute in a new action. The most that is arguable is that the taxpayer should not be able to dismiss his appeal to the Board without the acquiescence of the Government, but no inference may be drawn from this that such assent now confers upon this court any jurisdiction.

In conclusion, while the result here reached is undoubtedly a harsh one from the point of view of the taxpayer, especially since he would appear no longer to have any redress before the Board, suffice it to say that the remedy lies with the legislative body, Congress, and not with the courts. Accordingly, the Government's demurrer must be sustained, with the result that the proceeding must be dismissed for lack of jurisdiction.

SECTION 325 (REVENUE ACT OF 1918).—TERMS RELATING TO INVESTED CAPITAL.

ARTICLE 811 (REGULATIONS 45): Intangible and tangible property. XI–50–5916 Ct. D. 610

EXCESS PROFITS TAX—REVENUE ACT OF 1918—DECISION OF COURT.

INVESTED CAPITAL—INTANGIBLE PROPERTY—CONTRACT—RIGHT TO BUY AND SELL A BEVERAGE.

A contract conferring the right to purchase from the manufacturer at a certain price and to distribute by sale over certain territory a beverage having an established reputation, the process of the manufacturer and composition of which is secret and the formula of its composition protected from general knowledge, is "intangible property" as defined by section 325(a) of the Revenue Act of 1918.

UNITED STATES CIRCUIT COURT OF APPEALS, FOURTH CIRCUIT.

John F. Jones, Collector of Internal Revenue for the District of South Carolina, appellant, v. H. D. and J. K. Crosswell, Inc., appellee.

Appeal from the District Court of the United States for the Eastern District of South Carolina, at Columbia.

[August 1, 1932.]

OPINION.

NORTHCOTT, Circuit Judge: This is an appeal from a judgment of the District Court of the United States for the Eastern District of South Carolina in favor of the appellee (plaintiff below) for the sum of $11,660.81 and interest, in a suit at law, to recover excess profits taxes assessed and collected by the United States for the years 1918, 1919, and 1920 under the provisions of the Revenue Act of 1918.

A jury was waived and the suit tried by the court on stipulations of fact.

In February, 1903, H. D. and J. K. Crosswell, a partnership, acquired a contract to bottle and sell coca-cola within certain territorial limits of the State of South Carolina and to purchase coca-cola sirup from the Coca-Cola Bottling Co. at a stated price per gallon. Thereafter, subcontracts were entered into by the partnership with 12 bottling companies to purchase sirup and bottle coca-cola within certain prescribed limits of the State of South Carolina. The partnership, which was formed in 1903, continued until it was incorporated on March 10, 1915, under the laws of the State of South Carolina with a capital stock of $5,000 par value. The stock of the corporation was issued to the partners for the business of the partnership.

The agreed actual cash value of the contracts at the time they were paid in for stock was $162,500.

The appellee timely filed income tax returns on a personal service basis for the years 1918, 1919, and 1920, showing no tax due. The Commissioner of Internal Revenue determined that the appellee was not entitled to be classed as a personal service corporation and determined its tax liability under the provisions of section 302 of the Revenue Act of 1918 for each of the years, which determination resulted in a deficiency being asserted against the plaintiff for each of the years.

From the deficiencies so asserted the appellee filed a petition with the United States Board of Tax Appeals seeking a review of the Commissioner's determination, on the grounds (1) that the appellee was entitled to personal service classification, or, (2), if such classification was denied, to special assessment under the provisions of sections 327 and 328 of the Revenue Act of 1918. After a hearing before the Board of Tax Appeals the determination by the Commissioner of Internal Revenue was affirmed (6 B. T. A., 1315). The deficiencies determined by the Commissioner of Internal Revenue and affirmed by the Board of Tax Appeals were thereafter assessed, together with interest, the same being paid by the appellee in December, 1927. The appellee duly filed claims for refund of the taxes and interest so paid and upon rejection thereof by the Commissioner of Internal Revenue brought this suit.

Pertinent provisions of the Revenue Act of 1918 (40 Stat., 1057, 1088, 1089, 1091–1093) are sections 325, 326, 301, and 302. It is admitted that the sole question involved is whether the contracts in question, valued at $162,500, and transferred to appellee for its capital stock, are "tangible" or "intangible" property for the purpose of computing "invested capital" and excess profits taxes for the years in question.

Section 325(a) of the Revenue Act of 1918 provides:

"The term 'intangible property' means patents, copyrights, secret processes and formulae, good will, trade-marks, trade-brands, franchises, and other like property;

"The term 'tangible property' means stocks, bonds, notes, and other evidences of indebtedness, bills and accounts receivable, leaseholds, and other property other than intangible property; * * *."

At common law and in the ordinary acceptance of the term, the contracts would undoubtedly be classified as "intangibles," but, Congress, as it has the right to do, has defined "tangibles" and "intangibles" for taxation purposes.

It, therefore, remains to be seen whether the classification set up by Congress specifically places these contracts under the head of "tangibles"; otherwise they must remain classified as they ordinarily would be, as "intangibles."

When Congress carved out from the great mass of personal property which is and always has been held to be intangible property certain exceptions, the same being "stocks, bonds, notes, and other evidences of indebtedness, bills and accounts receivable, and leaseholds" and made such property tangible, it did not say "and other like property." Being exceptions carved out of the general rule, intangible property not specifically mentioned as being tangible property must be excluded. The maxim "expressio unius est exclusio alterius" applies. It is a well-settled principle of statutory construction that the expression of one thing excludes others not expressed. (*The Paulina's Cargo*, 7 Cranch, 52; *Wood* v. *United States*, 16 Pet., 342; *United States* v. *Arredondo*, 6 Pet., 691; *Philadelphia, Wilmington & Baltimore R. R. Co.* v. *Howard*, 13 How., 307; *Arthur* v. *Cumming et al.*, 91 U. S., 362; 25 C. J., 220.)

Further, when a statute limits a thing to be done in a particular mode, it includes a negative of any other mode. (*Raleigh, etc., R. Co.* v. *Reid*, 13 Wall., 269.)

This foregoing principle is most aptly stated in the case of *In re Heath* (144 U. S., 92), in which it was held that the affirmative description of the cases in which the jurisdiction may be exercised under the Circuit Court of Appeals Act of March 3, 1891, implies a negative on the exercise of such power in other cases.

Certainly the contracts are not "stocks, bonds, notes, and other evidences of indebtedness, bills and accounts receivable and leaseholds," and they are not of that class of property ordinarily designated as "tangibles." On the other hand, the inherent qualities of the contracts are similar to those which characterized the items listed as "intangibles" in section 325(a). They are contracts having a special value because they carried the exclusive right to handle a beverage in certain territory. This beverage had a large sale because of its established reputation, something closely akin to good will, if it could not properly be termed just that. The process of its manufacture or composition was secret, and the formula for its composition was protected from general knowledge. Again, privileges partaking in their nature of an exclusive right to use a certain thing or service have commonly come to be termed "franchises," a meaning differing from the legal definition of a franchise as being a special privilege conferred by the Government on the individual. Thus we frequently hear of an Associated Press franchise. These contracts were certainly "like property" to "secret formulae," because the subject matter with which they dealt was protected by a secret process, and they were again "like property" to "good will," because they were valuable because the subject matter with which they dealt was largely valuable because of the reputation that had been built up for coca-cola as a drink through wise handling and extensive advertising covering a number of years. The "trade brand" Coca-Cola itself was of great value.

The property here involved is a contractual privilege. It is the right to buy a product at a certain price and to distribute that product by sale over certain territory, and in many respects partakes of the nature of a private franchise.

The phrase "other like property" should not be given a narrow or restricted meaning. The word "like" means "substantially similar." It is thus defined in Webster's International Dictionary:

"1. Having the same, or nearly the same, appearance, qualities, or characteristics; resembling; similar to; similar, alike."

In the Century Dictionary and Cyclopedia the word "like" is thus defined:

"1. Of similar form, appearance, or quality; of corresponding kind, amount, extent, degree, etc.; corresponding; equal or equivalent; analogous; agreeing in some noticeable respect."

Funk & Wagnalls New Standard Dictionary of the English Language gives this definition of the word "like":

"1. Having resemblance; nearly identical in appearance or characteristics; approximate; similar; often formerly with to or unto before the object compared; as, like methods; as like as two peas. 2. Almost or quite the same in the quality considered; equal or nearly equal; virtually equivalent."

(See, also, *United States* v. *Wallace*, 116 U. S., 398; *Bliss* v. *Bliss*, 221 Mass., 201.)

It is contended on behalf of appellee that the contracts under consideration here are similar to the tangible property enumerated in the statute, but even were this true such similarity would not be sufficient to bring them under the classification of "tangible" made by Congress, because the statute enumerates the tangibles specifically and does not follow the enumeration with the phrase "other like property." When the enumeration does not include specifically the property, it can not be brought in under any general terms, because there are no general terms. One of the general rules of statutory construction is that a proviso or exception in a statute is to be strictly construed, and one who sets up an exception must establish it as being within the words as well as the reason thereof. (*Spokane & I. E. R. Co.* v. *United States*, 241 U. S., 344.)

No statute is to be construed as altering the common law further than its words import. (*Ross* v. *Jones*, 22 Wall., 576; *Ransom* v. *Williams*, 2 Wall., 313.)

Carried to its logical conclusion, the contention made on behalf of appellee leads to a wholly impossible result. Thus a patent is necessarily held to be an intangible because so enumerated in the statute, while a contract entered into between a patentee and a licensee, under appellee's contention, would be a "tangible." Here the secret process or formula for producing coca-cola is clearly an intangible, and it is reasonable to conclude that a contract dealing with coca-cola should also be classed as an "intangible" unless it is otherwise specifically provided by statute.

The rule relied upon by the learned judge below for reaching his conclusion that these contracts were "tangibles," that all the "intangibles" possessed the common characteristic of being given protection by special statutes certainly does not apply to "good will," and, therefore, could not have been in the contemplation of Congress when it made the classification.

While we have been able to find no decision bearing directly on this point, somewhat similar contracts have been held to be intangible property for the purposes of taxation. (*Bacon Coal Co.* v. *United States*, 34 Fed. (2d), 706; *Daily Pantagraph, Inc.*, v. *United States*, 37 Fed. (2d), 783.)

In *Strong Publishing Co.* v. *Commissioner of Internal Revenue* (56 Fed. (2d), 550 [Ct. D. 514, page 389, this bulletin]), Judge Evans said:

"Final determination of this close question must turn upon the effect of the words 'and other like property' as used in the first clause of section 325(a). This expression must be given some range of equivalents. Such equivalency extends to species of property somewhat like the different kinds enumerated—'patents, copyrights, secret processes and formulae, good will, trade-marks, trade-brands, franchises, * * *.'

"All of these species of property are in law and in commerce recognized as possessing attributes somewhat different from 'stocks, bonds, notes and other evidences of indebtedness, bills and accounts receivable, leaseholds, * * *.' And that which earmarks their differences, specifically and as a group, is the presence or absence of speculativeness in determining their value.

"Considering all the circumstances—the language of the statute, the purpose of the classification of property into tangible and intangible, the differences in the certainty with which their value may be ascertained—we conclude that the circulation of a newspaper falls within the comprehension of the clause 'other like property' used in the first paragraph of section 325(a)."

There is here no such doubt as to the intention of Congress as would justify our deciding the question in favor of the taxpayer. The contracts in question are "intangibles." The judgment of the court below is accordingly reversed.

SECTION 325 (REVENUE ACTS OF 1918 AND 1921).—TERMS RELATING TO INVESTED CAPITAL.

ARTICLE 811 (REGULATIONS 62): Intangible and tangible property.

REVENUE ACTS OF 1918 AND 1921.

Circulation of newspaper as intangible property. (See Ct. D. 514, page 389.)

SECTION 326 (REVENUE ACT OF 1918).—INVESTED CAPITAL.

ARTICLE 833: Tangible property paid in: evidences of indebtedness. XI-35-5642 Ct. D. 551

EXCESS PROFITS TAX—REVENUE ACT OF 1918—DECISION OF COURT.

1. INVESTED CAPITAL—TANGIBLE PROPERTY—PROMISSORY NOTES IN PAYMENT OF STOCK—ARKANSAS.

Promissory notes of a subscriber can not under the laws of Arkansas be legally received in payment for stock of a corporation organized under the laws of that State and are void as between the maker and the corporation; no amount on account of such notes may therefore be included in the invested capital of the corporation under section 326 of the Revenue Act of 1918.

2. DECISION AFFIRMED.

The decision of the Board of Tax Appeals (17 B. T. A., 460) is affirmed.

UNITED STATES CIRCUIT COURT OF APPEALS, EIGHTH CIRCUIT.

The Garrison Co., petitioner, v. *Commissioner of Internal Revenue, respondent.*

On petition to review decision of the United States Board of Tax Appeals.

Before VAN VALKENBURGH, BOOTH, and GARDNER, Circuit Judges.

[January 25, 1932.]

OPINION.

BOOTH, Circuit Judge, delivered the opinion of the court.

This is a petition for review of a decision of the Board of Tax Appeals, and involves redetermination of income and profits taxes of the petitioner for the year 1920.

The question of the value of petitioner's depreciable assets, which was also before the Board of Tax Appeals and was covered by its decision, is not involved on this appeal.

The short facts are as follows: The petitioner was incorporated under the laws of the State of Arkansas in 1919, having 2,000 shares of capital stock of $100 par value. Five individuals subscribed for 999 shares of the stock and paid for the same, $55,000 in cash for 550 shares, and their promissory notes amounting to $44,900 for 449 shares. The makers of the notes were solvent. The stock issued for the notes was thereafter held by the corporation as security for the payment of the notes.

The Commissioner, in his audit of the petitioner's return for 1920, excluded from the computation of invested capital the face amount of the notes, namely, $44,900. This action of the Commissioner was affirmed by the Board of Tax Appeals.

The question on this review is whether promissory notes in the face amount of $44,900, or any portion thereof, may be included in taxpayer's invested capital for 1920 as cash or tangible property *bona fide* paid in for stock under section 326 of the Revenue Act of 1918.

The term "invested capital" is defined in the Revenue Act of 1918 as follows:

"SEC. 326. (a) That as used in this title the term 'invested capital' for any year means (except as provided in subdivisions (b) and (c) of this section):

* * * * * * *

"(2) Actual cash value of tangible property, other than cash, bona fide paid in for stock or shares, at the time of such payment, but in no case to exceed the par value of the original stock or shares specifically issued therefor, unless the actual cash value of such tangible property at the time paid in is shown to the satisfaction of the Commissioner to have been clearly and substantially in

excess of such par value, in which case such excess shall be treated as paid-in surplus."

The term "tangible property" is defined in section 325(a) as follows:

"SEC. 325. (a) That as used in this title—

* * * * * * *

"The term 'tangible property' means stocks, bonds, notes, and other evidences of indebtedness, bills and accounts receivable, leaseholds, and other property other than intangible property."

The basis of the action of the Commissioner and the Board of Tax Appeals was the provision in Article XII of the Constitution of Arkansas, reading as follows:

"ARTICLE XII.

"ISSUE AND INCREASE OF STOCK, ETC., OF PRIVATE CORPORATIONS.

"SEC. 8. No private corporation shall issue stocks or bonds, except for money or property actually received or labor done, and all fictitious increase of stock or indebtedness shall be void; nor shall the stock or bonded indebtedness of any private corporation be increased, except in pursuance of general laws, nor until the consent of the persons holding the larger amount in value of stock shall be obtained at a meeting held after notice given for a period not less than 60 days, in pursuance of law."

This provision of the Arkansas constitution has been construed by the courts of that State in several cases:

In *Bank of Commerce* v. *Goolsby* (129 Ark., 416), the supreme court of that State held that the taking of a note by a corporation in exchange for its capital stock was a violation of the constitutional prohibition.

In *Bank of Manila* v. *Wallace* (177 Ark., 190), it appeared that Wallace had bought from one Thompson stock in the Jonesboro Cotton Mills, a corporation, and had given Thompson a promissory note in payment. Thompson discounted the note at the appellant bank, and it brought suit thereon against Wallace. The issues in the case were, *first*, whether Wallace bought the stock of the corporation through Thompson as its agent, or bought stock owned by Thompson; *second*, if the stock bought was the stock of the corporation, whether the bank was an innocent purchaser of the note. The court in its opinion said (page 192):

"The evidence was sufficient to justify the court in submitting to the jury, first, whether the note was given for stock of the corporation and whether Thompson was simply acting for the corporation, and, second, whether the appellant was an innocent purchaser.

"If the note was given for stock in the corporation and Thompson was merely acting for the corporation, selling its stock, then, under the law as settled by the decisions of this court, the note was void. And if the bank was not an innocent purchaser, it could not recover."

See also *Krumpen* v. *Taylor* (40 S. W. (2d), 775 (Ark.)); *Lepanto Gin Co.* v. *Barnes* (31 S. W. (2d), 746 (Ark.)); *Bank of Dermott* v. *Measel* (172 Ark., 193).

Petitioner cites and relies largely upon two cases: *Ellis* v. *Jonesboro Trust Co.* (17 S. W. (2d), 324 (Ark.)) and *Memphis, etc., R. R.* v. *Dow* (120 U. S., 287).

In the Ellis case, suit was brought by the Trust company, which was a banking corporation, against Ellis upon a promissory note which had been given by him to the Trust company to cover a voluntary assessment which had been authorized by the board of directors of the Trust company because of impairment of capital as found by the State bank commissioner. Among the defenses set up by Ellis to the note was an allegation that the note was void under section 8 of Article XII of the Arkansas constitution and the decisions of the Supreme Court of Arkansas. In reference to this defense, the supreme court in its opinion said:

"We are also of the opinion that the note is not void under section 8, of Article XII, of the constitution * * *.

"In construing this section of the constitution it has been several times held by this court that a note given to a private corporation for the purchase price

of corporate stock is neither money nor property actually received within the meaning of the constitution, and that such a note is void, except in the hands of an innocent purchaser, as having been executed in violation of the constitution. * * *

* * * * * * *

"But the cases cited have no application here. * * *

"There was here no issue or increase of stock or of indebtedness of the corporation in connection with the execution of the note. Ellis received no stock. His stock had been previously issued to him and had been paid for by him, and, instead of 'watering the stock,' his note was intended to give it a value which it would not otherwise have had. Since the constitutional prohibition is directed against the issuance of 'watered stock,' it can not be construed to prohibit a stock assessment note executed to give value to stock already issued, paid for, and outstanding."

The Dow case, while it involved the construction of section 8, Article XII, of the constitution of Arkansas, did not involve that part of the section construed in the cases cited above. In the Dow case the question involved was whether certain bonds issued by a railroad corporation were fictitious as having been issued without any consideration received in money, property or labor. It was held, under the facts disclosed, that the bonds had not been so issued as to be fictitious.

In the case at bar, the question is whether promissory notes taken by an Arkansas corporation in payment for its stock are valid. The Dow case does not pass upon that question.

It is further contended by petitioner that results from transactions that are in violation of State law, and not enforcible contracts in the State, are still recognized for Federal tax purposes if they are of a kind that would otherwise come within the Revenue Acts.

It is unnecessary to discuss the proposition thus generally stated for the reason that the transaction in the case at bar does not come within its terms.

Treasury Department Regulations 45 (1920 Edition), article 833, reads as follows:

"ART. 833. *Tangible property paid in: evidences of indebtedness.*—Enforcible notes or other evidences of indebtedness, either interest bearing or noninterest bearing, of the subscriber received by a corporation upon a subscription for stock may be considered as tangible property in computing its invested capital to the extent of the actual cash value of such notes or other evidences of indebtedness at the time when paid in, but only (*a*) if such notes or evidences of indebtedness could under the laws of the jurisdiction in which the corporation was organized legally be received in payment for stock, and (*b*) if they were actually received by the corporation as absolute, and not as conditional, payment in whole or in part of the stock subscription."

It is plain from the language of the regulation that the promissory notes in the case at bar could not be considered tangible property in computing the corporation's "invested capital" for the reason that such notes could not, under the laws of Arkansas, be legally received in payment for stock. The notes in question in the hands of the corporation were void and valueless.

The final suggestion of petitioner is that, though the promissory notes taken by the corporation for 449 shares of stock are void, yet the 550 stock certificates paid for in cash and representing $55,000 can be considered to represent also $44,900 as surplus.

We think the suggestion finds no support in section 326(a)2 or in the cases cited by petitioner, and is without merit. No surplus of assets was created by the corporation or received by it by taking void notes in payment for its stock and holding the stock as collateral.

In view of the provision above quoted contained in the constitution of the State of Arkansas, and the decisions of its courts construing the same, we think the decision of the Board of Tax Appeals was right, and it is affirmed.

SECTION 326 (REVENUE ACTS OF 1918 AND 1921).—INVESTED CAPITAL.

ARTICLE 851 (REGULATIONS 62): Intangible property paid in. (Also Section 325, Article 811.)

XI-28-5544
Ct. D. 514

EXCESS PROFITS TAX—REVENUE ACTS OF 1918 AND 1921—DECISION OF COURT.

1. INTANGIBLE PROPERTY—CIRCULATION STRUCTURE OF A NEWSPAPER.

The circulation structure of a newspaper is intangible property within the meaning of section 325(a) of the Revenue Acts of 1918 and 1921.

2. INVESTED CAPITAL—PAID-IN SURPLUS—INTANGIBLE ASSET.

The value of an intangible asset may not be included in the computation of invested capital as paid-in surplus under section 326(a)3 of the Revenue Acts of 1918 and 1921.

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

Strong Publishing Co., petitioner, v. Commissioner of Internal Revenue, respondent.

Before EVANS, SPARKS, Circuit Judges, and BALTZELL, District Judge.

Petition for review of order of United States Board of Tax Appeals.

[March 9, 1932.]

OPINION.

EVANS, Circuit Judge: We are in the instant case, called upon to review the action of the Board of Tax Appeals which assessed deficiency taxes against petitioner in the following amounts: 1919, $133,447.48; 1920, $41,664.97; 1921, $35,204.68. Differences exist between the parties over the amount of petitioner's "invested capital" for these three years. Respondent refused to include three items (the value of the Associated Press membership, the circulation of petitioner's newspaper, and its good will) as part of the taxpayer's "invested capital." Failure to persuade the Board of Tax Appeals of the correctness of its contention in this respect accounts for the assessment of the deficiency taxes and petitioner's appeal to this court for redress.

The facts: The Chicago Daily News Co. was incorporated in 1893 to succeed another company by the same name. It was engaged in the publishing of a daily newspaper in Chicago. Victor Lawson was its sole stockholder. In 1926, it secured an amendment to its charter with a resultant change in its name to Strong Publishing Co.

When incorporated in 1893, the capital stock was fixed at 1,500 shares with $100 par value. In 1917, the stock was increased to 18,000 shares, the additional stock going to Lawson in exchange for real estate and a note. The assets acquired in 1893 by the Chicago Daily News Co. consisted of buildings and leaseholds, machinery and equipment, cash, accounts receivable, inventories, and deferred charges aggregating $1,081,304.88. Its outstanding liabilities were $666,792.88. It had a net book value of $414,512 or a surplus over par value of its capital stock of $264,512. The Commissioner included this latter amount in petitioner's "invested capital." Its listed assets did not mention good will, Associated Press membership, or circulation. Upon petitioner's incorporation, however, these items were all transferred to it.

Petitioner's complaint is grounded upon the refusal of the respondent to include as "invested capital" the three items above mentioned, which concededly have a substantial value.

Authority for including or excluding an asset as a part of the "invested capital" must be found in the statutes. Likewise, we must look to the same source to ascertain the meaning of intangible assets. The applicable statutes are quoted below.[1]

The controverted questions may be stated thus: (1) Is circulation of a newspaper intangible property within the definition of the statute? (2) Is intangible property to be included in "invested capital" by virtue of section 326(a)3?

Petitioner contends that circulation is tangible property, but admits that good will and Associated Press membership are intangible property. It contends, however, that even though intangible property, all three items should be included as a part of its "invested capital" because they come within the provision of section 326(a)3. Respondent denies that circulation is tangible property and denies that any intangible property should be included in "invested capital" under said subsection (3).

Circulation—Whether tangible or intangible.—The circulation of the paper was 192,495 in 1893, and petitioner claims that it was reasonably worth at least $1,759,000. It contends that circulation is an item distinct from good will (defined by the statute to be an intangible) and one which is salable *per se* (citing the instance of a sale of a single edition of a newspaper). In enumerating the characteristics of circulation, the petitioner states that it is a more permanent and substantial asset than physical property.

From these facts petitioner argues that inasmuch as circulation is not like any of the items specifically denominated by the statute to be intangible and since it also is not covered by the catch-all phrase "other like property," it must *ex necessitate* be included in the statutory definition of tangible property, which provides that tangible property shall include (after enumerating specific items) "other property other than intangible property."

Is circulation so akin to "patents, copyrights, secret processes and formulæ, good will, trade-marks, trade-brands, franchises," as to fall within the residuary phrase "other like property"?

It may be conceded for the purpose of the argument that circulation is an item distinct from good will, yet it does not follow that they are not inherently alike in their essential aspects. Circulation grows as the good will of the paper increases. It is, generally speaking, a manifestation of the existence of good will. Without good will there would hardly be a well-sustained circulation. The value and extent of both circulation and good will are dependent upon the same factors—service and the policy of the paper. If the service or policy of

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[1] Section 325(a) of the Revenue Act of 1918 provides:

"That as used in this title—

"The term 'intangible property' means patents, copyrights, secret processes and formulæ, good will, trade-marks, trade-brands, franchises, and other like property;

"The term 'tangible property' means stocks, bonds, notes, and other evidences of indebtedness, bills and accounts receivable, leaseholds, and other property other than intangible property; * * *."

Section 326(a) provides:

"That as used in this title the term 'invested capital' for any year means (except as provided in subdivisions (b) and (c) of this section):

"(1) Actual cash bona fide paid in for stock or shares;

"(2) Actual cash value of tangible property, other than cash, bona fide paid in for stock or shares, at the time of such payment, but in no case to exceed the par value of the original stock or shares specifically issued therefor, unless the actual cash value of such tangible property at the time paid in is shown to the satisfaction of the Commissioner to have been clearly and substantially in excess of such par value, in which case such excess shall be treated as paid-in surplus: *Provided*, That the Commissioner shall keep a record of all cases in which tangible property is included in invested capital at a value in excess of the stock or shares issued therefor, * * *;

"(3) Paid-in or earned surplus and undivided profits; not including surplus and undivided profits earned during the year;

"(4) Intangible property bona fide paid in for stock or shares prior to March 3, 1917, in an amount not exceeding (a) the actual cash value of such property at the time paid in, (b) the par value of the stock or shares issued therefor, or (c) in the aggregate of 25 per centum of the par value of the total stock or shares of the corporation outstanding on March 3, 1917, whichever is lowest;

"(5) Intangible property bona fide paid in for stock or shares on or after March 3, 1917, in an amount not exceeding (a) the actual cash value of such property at the time paid in, (b) the par value of the stock or shares issued therefor, or (c) in the aggregate 25 per centum of the par value of the total stock or shares of the corporation outstanding at the beginning of the taxable year, whichever is lowest: *Provided*, That in no case shall the total amount included under paragraphs (4) and (5) exceed in the aggregate 25 per centum of the par value of the total stock or shares of the corporation outstanding at the beginning of the taxable year; * * *."

the paper varies, the circulation and good will vary accordingly. All the property characteristics ascribed to circulation are certainly as indiscriminately identifiable with intangible as with tangible property. They may be said to be in inseparable alliance with both.

In the only reported decision, *Daily Pantagraph* v. *United States* (37 F. (2d), 783), outside of the Board of Tax Appeals holdings, circulation was held to be intangible property.

True, there may be circulation without good will. In fact, instances may be cited where circulation is large whereas the attitude of the public toward the publication is ill. But good will, as used in the statute and as a legal term, is more comprehensive than when used colloquially. It has been defined in *Brown* v. *Bensinger* (84 Atl. (Md.), 79) as:

"'Good will' is 'the advantage or benefit which is acquired by an establishment beyond the mere value of the capital stock, funds, or property employed therein, in consequence of the general public patronage and encouragement which it receives from constant or habitual customers on account of its local position, or from celebrity or reputation for skill, or affluence or punctuality, or from other accidental circumstances or necessities, or even from ancient partialities or prejudices.'"

It was of this sort of good will of which Congress spoke when it defined it to be intangible property.

Nor have we overlooked the fact that circulation as such, alone and separated from the rest of the business of publishing a newspaper, may be sold, and possesses, in some instances, substantial value. But this fact alone is not significant. For, although salability and assignability as such may evidence property existence, they bear only inconsequently on the distinctions between tangible and intangible property.

The true test by which the two kinds of property may be distinguished is traceable to, and must be found in, their evaluation differences. Congress was not interested in the characteristics of these two classes of property save as such characteristics related to their property values. For Congress was dealing with invested capital (because rate of return on invested capital affected rate on taxable income), and it made its classification of property into tangible and intangible property and defined both, and limited the amount of intangible property which could be included in invested capital, because of its interest in the base upon which the taxpayer's income taxes were computed.

Examining the species of property enumerated under the two heads, the chief difference between them, which bears on value, is to be found in the certainty and definiteness with which their value may be ascertained. While no doubt the value of each species of property specifically included within the definition of intangible property may be estimated and appraised, there is nevertheless uncertainty about its value, an indefiniteness, a speculative quality which is absent from the value of the property specified and defined as tangible.

Final determination of this close question must run upon the effect of the words "and other like property" as used in the first clause of section 325(a). This expression must be given some range of equivalents. Such equivalency extends to species of property somewhat like the different kinds enumerated—"patents, copyrights, secret processes and formulæ, good will, trade-marks, trade-brands, franchises, * * *." All of these species of property are in law and in commerce recognized as possessing attributes somewhat different from "stocks, bonds, notes and other evidences of indebtedness, bills and accounts receivable, leaseholds, * * *." And that which earmarks their difference, specifically and as a group, is the presence or absence of speculativeness in determining their value.

Considering all the circumstances—the language of the statute, the purpose of the classification of property into tangible and intangible, the differences in the certainty with which their value may be ascertained—we conclude that the circulation of a newspaper falls within the comprehension of the clause "other like property" used in the first paragraph of section 325(a).

Paid-in surplus: Does subdivision (3) of section 326(a) include intangible as well as tangible property? The regulations exclude intangible property from this subdivision. But the regulations can not govern if contrary to the provisions of the statute. The courts passing on the question have held that intangible property could not be included as paid-in surplus under this subdivision (3). (*Landesman-Hirscheimer Co.* v. *Commissioner*, 44 F. (2d), 521 (C. C.

A. 6); *Lafayette-South Side Bank* v. *Commissioner*, 33 F. (2d), 646 (Ct. App. D. C.); *Baker & Taylor Co.* v. *United States*, 21 F. (2d), 789 [T. D. 4109, C. B. VI–2, 285]; *Lewis A. Crossett Co.* v. *United States*, 50 F. (2d), 292 (Ct. Cls.) [Ct. D. 373, C. B. X–2, 392]; *Colorado Continental Lumber Co.* v. *United States*, 42 F. (2d), 327 (Ct. Cls.); *Daily Pantagraph* v. *United States*, 37 F. (2d), 783 (Ct. Cls.); *Tulsa Tribune Co.*, 21 B. T. A., 1405; *Herald-Despatch Co.*, 4 B. T. A., 1096.)

In view of these decisions, it would be futile to discuss at great length the underlying question here involved, which is primarily one of statutory construction. Our conclusion is that the first three subsections of section 326(a) deal with tangible property only, and subsections (4) and (5) deal specifically with intangible property and offer an explanation of congressional action in classifying the taxpayer's invested capital into tangible and intangible property. The maxim, *generalia specialibus non derogant*, applies.

We are unable, however, to agree with the Board of Tax Appeals in its conclusion that petitioner was not entitled to include any part of its intangible property as invested capital. Subsection (4) authorizes the inclusion of intangible property up to one-fourth of the par value of the total stock of the corporation outstanding on March 3, 1917 (if such amount be lower than the value of the intangibles paid in and of the stock issued therefor). As the capital stock, in the instant case, outstanding at such date was of the par value of $150,000, petitioner was entitled, upon it showing sufficient value in the way of intangible assets, to have $37,500 included in its invested capital for this item.

Other questions presented by petitioner's brief, we have duly considered and deem discussion of them unnecessary.

The order of the Board of Tax Appeals is reversed with directions to increase petitioner's invested capital by the sum of $37,500 for each of the years in question and to recompute its tax accordingly.

TITLE X.—BOARD OF TAX APPEALS.

SECTION 1002.—VENUE.

SECTION 1002. XI–27–5538
(Also Section 214(a)4, 5, and 6, Article 141.) Ct. D. 510

INCOME TAX—REVENUE ACTS OF 1921 AND 1926—DECISION OF COURT.

1. VENUE—REVIEW OF BOARD'S DECISION—DEATH PENDING APPEAL TO BOARD.

Where a taxpayer dies pending his appeal to the Board of Tax Appeals and his executors are substituted as parties by order of the Board, one an inhabitant of the second circuit and the other an inhabitant of the fifth circuit, section 1002(a) of the Revenue Act of 1926 does not require a review of the Board's decision to be by the Court of Appeals of the District of Columbia as in the case of an individual not an inhabitant of any circuit, and the Circuit Court of Appeals for the Second Circuit has jurisdiction of a petition to review the decision by virtue of that subdivision.

2. DEDUCTION—LOSS—CASUALTY—FAULTY CONSTRUCTION.

Where there is damage to a residence due to rapid disintegration of its foundations built over salt water and lowlands and there is evidence of no unusual action by the elements to cause the same, there is a substantial basis for the finding of the Board of Tax Appeals, which is binding on a Circuit Court of Appeals, that the loss is due only to the ordinary action of the elements upon a badly constructed building. Such loss does not arise from a casualty within the meaning of section 214(a)6 of the Revenue Act of 1921 and is not an allowable deduction under that paragraph.

3. DECISION AFFIRMED.

The decision of the Board of Tax Appeals (18 B. T. A., 674) is affirmed.

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

Hugh M. Matheson and Willis D. Wood, Executors of the Estate of William J. Matheson, Deceased, petitioners, v. Commissioner of Internal Revenue, respondent.

Before MANTON, AUGUSTUS N. HAND, and CHASE, Circuit Judges.

Appeal from United States Board of Tax Appeals.

[December 7, 1931.]

OPINION.

From an order of the Board of Tax Appeals approving a deficiency found by the Commissioner of Internal Revenue in the income taxes of William J. Matheson, deceased, for the years 1922 and 1923, petitioners, as executors of his will, appeal. Affirmed.

AUGUSTUS N. HAND, Circuit Judge: The first question raised by this appeal is whether this court has jurisdiction to review the proceedings of the Board of Tax Appeals.

William J. Matheson maintained a residence and a business office within the State of New York and also a residence within the State of Florida. He filed his income tax returns in the office of a collector of internal revenue within the second circuit. The Commissioner assessed a deficiency against him and he sought a review before the Board of Tax Appeals. While that proceeding was pending he died, and the executors of his will were substituted as parties by order of the Board. One of them, Willis D. Wood, was an inhabitant of the State of New York, and the other, Hugh M. Matheson, an inhabitant of the State of Florida.

Venue for appeals from the Board of Tax Appeals to the courts of appeal is governed by section 1002 of the Revenue Act of 1926, which provides for review—

"(a) In the case of an individual, by the Circuit Court of Appeals for the circuit whereof he is an inhabitant, or if not an inhabitant of any circuit, then by the Court of Appeals of the District of Columbia."

Because of the fact that William J. Matheson died before this appeal was taken and his executors were inhabitants of different districts, it is claimed that the present review is by a person who is "not an inhabitant of any district" and, therefore, must be had in the Court of Appeals of the District of Columbia. But, after the death of William J. Matheson, his executors became the real parties in interest. (*McNutt* v. *Bland*, 2 How., 9.) Each executor could, therefore, seek a review in the court of appeals of the circuit whereof he was an inhabitant and the appeal in the present case might lie either to the Court of Appeals of the Second Circuit, of which Willis D. Wood was an inhabitant, or to the Court of Appeals of the Fifth Circuit, of which Hugh M. Matheson was an inhabitant. In *Rusk* v. *Commissioner* (as yet unreported) the Court of Appeals of the Seventh Circuit held that the death of a taxpayer pending a review before the Board of Tax Appeals did not abate the proceeding. The taxpayer's executors, who were residents of the seventh circuit, were substituted and the decision by the Tax Board went against them. It was held that an appeal from the Board of Tax Appeals properly lay to the Circuit Court of Appeals of the Seventh Circuit because the word "individual" used in section 1002(a) of the Revenue Act of 1926 embraced executors as well as the original taxpayer.

The words of section 1002(a) providing that appeals by individuals who are not inhabitants of any circuit should be taken to the Court of Appeals of the District of Columbia apparently relate to persons living outside of any circuit and can not reasonably be thought to cover resident taxpayers who die leaving executors living within one of the circuits. The burden of requiring representatives of such estates to proceed to Washington to have their appeals heard should not be imposed without the plainest language. We think the appeal was properly taken.

The important question remaining for consideration is whether the Board of Tax Appeals erred in refusing to allow $42,692.26 paid out by William J.

Matheson in 1922 and $28,655.05 paid out in 1923 for losses arising from an alleged "casualty" deductible under section 214(a)6 of the Revenue Act of 1921. Section 214(a) provides—

"That in computing net income there shall be allowed as deductions:

* * * * * * *

"(6) Losses sustained during the taxable year of property not connected with the trade or business * * * if arising from fires, storms, shipwreck, or other casualty, or from theft, and if not compensated for by insurance or otherwise. Losses allowed under paragraphs (4), (5), and (6) of this subdivision shall be deducted as of the taxable year in which sustained unless, in order to clearly reflect the income, the loss should, in the opinion of the Commissioner, be accounted for as of a different period * * *."

The loss which the taxpayer sought to deduct from his income was due to a rapid deterioration of his residence built on Key Biscayne, an island in Biscayne Bay, about 12 to 15 miles south of Miami, Fla. His residence consisted of two stories in Moorish design, with a landing stage or basement extending over the waters of Biscayne Bay and in part over the lowlands of Key Biscayne. The Board of Tax Appeals determined that:

"The foundation on which the superstructure was laid consisted of piles driven into the mud to bedrock and incased in concrete. Of these piles 310 were entirely under water and the remainder, 100 in number, protruded a few feet above mean water level. The longest span from center to center of any of the piles was 3 feet, but a great number of piles were so placed that there was only a 2-foot span from center to center. As originally built no fill or rubble was placed around the piling, a dock being constructed to permit yachts to dock alongside the residence.

"Concrete sills were placed on the piling and 4-inch floor beams were then constructed from sill to sill. The floor beams were made of concrete reinforced with ⅞-inch steel bars and had a span of 28 feet. It was not possible to obtain locally ⅞-inch steel bars 28 feet in length and in lieu thereof there was employed in the construction of each floor beam 16-foot lengths of ⅞-inch steel which were lapped in the middle of each beam for a distance of 2 feet. This lapping caused four ⅞-inch bars to be placed together in a 4-inch concrete beam, leaving only a thin shell of concrete covering the four bars at the center of the span. Such method of construction permitted salt moisture to penetrate the porous cement and come in contact with the reinforcing steel bars. This caused the bars to rust and corrode and converted the point where the most strength was needed in the whole structure into a point of weakness.

"This rusting and corrosion spread progressively to all of the reinforcing steel used throughout the structure, as well as other metal used in the construction of the building, such as electric light conduits, etc. During the year 1922 the roof and every concrete floor of the structure was in imminent danger of falling. The lower part of the concrete joints and terra cotta filler tiles had become detached from the body of the construction, leaving the reinforcing steel hanging free and without bond in the concrete. The concrete protecting the piling supporting the foundation of the building had been washed away, leaving the wooden piles exposed. The petitioner caused the damage to his residence to be repaired, expending in such repairs approximately $2,500 during the year 1921, $42,692.26 during the year 1922, and $28,655.05 during the year 1923. * * *"

The Board of Tax Appeals concluded that the damage which had to be repaired was due to a progressive deterioration caused by faulty construction, and not to any "casualty," within the meaning of section 214(a)6, and accordingly refused to allow the cost of repairs as a deduction from gross income.

The taxpayer introduced evidence showing an unusual rainfall during 1922 and 1923, and a storm, the effects of which he thought disastrous, which occurred on February 21, 1922. But there was evidence that the rainfall could not perceptibly raise the water level of the ocean and that the wind never reached a velocity of more than 30 miles per hour. The question, therefore, arises whether a rapid disintegration of the foundations of an edifice built over waters and lowlands, which, if well constructed, would stand for years, can be regarded as a "casualty."

In our opinion, the word "casualty" as used in section 214(a)6 is an event due to some sudden, unexpected or unusual cause. Anything less than

this renders it hardly distinguishable from depreciation from ordinary wear and tear which can not be deducted by a taxpayer in the case of property that is not used in trade or business. (Section 214(a)8.) While it is contended that the concrete casing of the piles was washed away by storms and tides so that the piles became exposed, eaten by worms and weakened, the evidence that there were no unusual winds and that there was nothing to cause extraordinary tides afforded a substantial basis for the conclusion of the Board of Tax Appeals that the loss was due only to the ordinary action of the elements upon a poorly constructed building. In such circumstances we are bound by its findings and hold that the damage did not arise from a casualty resembling "fires, storms or shipwreck." The disintegration was due to encasement of the steel framework in walls of concrete so thin as to let in moisture and give rise to corrosion, and to inadequate sheathing of the piles. This conclusion seems inevitable when the proof of any serious storm or cataclysmic operation of the elements failed. No time is satisfactorily established when any serious injury to the foundation occurred. It was never overwhelmed by any unusual thing. There was simply a steady labefaction from wind and weather more rapid than usual because of structural defects. Such a deterioration can not reasonably be termed a casualty. (*Crystal Spring Distillery Co.* v. *Cox*, 49 Fed., 555; *Sorsdick* v. *Board of Supervisors of Quitman County*, 25 So., 294 (Miss.); *Eaton* v. *Glindeman*, 33 Idaho, 389.)

In *Shearer* v. *Anderson* (16 Fed. (2d), 995 [T. D. 3860, C. B. V–1, 239]), the taxpayer's automobile was overturned and damaged (while in the unauthorized possession of a chauffeur) because of the icy condition of the road, resulting from storms and freezing. We held that the loss was a "casualty" within the meaning of the Revenue Act and said that the word "casualty" expresses "rather the result than the cause of the damage, that is, the wreck itself rather than the lightning, storm or the negligence or fault of some person * * *." The loss there was, however, due to a sudden accident and to nothing resembling mere deterioration more rapid than usual. We do not suggest that the destruction of a building by an unusual storm would not be a "casualty" if the edifice was so badly constructed as to be readily destroyed. We simply hold that a loss due, as here, to progressive decay or corrosion, occurring without any unusual action by the elements, does not arise from a "casualty" within the meaning of the statute.

The order is affirmed.

SECTION 1005.—DATE ON WHICH BOARD'S DECISION BECOMES FINAL.

SECTION 1005. XI–48–5884
(Also Section 1106, Article 1341.) Ct. D. 604

INCOME AND EXCESS PROFITS TAXES—REVENUE ACTS OF 1918 AND 1926—DECISION OF COURT.

1. SUIT—TRANSFEREE—TRUST FUND DOCTRINE—FINALITY OF BOARD'S DECISION.

In a suit in equity against a transferee of the property of a taxpayer to enforce his liability under the trust fund doctrine for the amount of a deficiency of the taxpayer redetermined by the Board of Tax Appeals in an appeal pending without a hearing thereon at the time of the enactment of the Revenue Act of 1926, the decision of the Board as to the tax liability of the taxpayer as redetermined by the Board, which has become final, is final and conclusive and therefore the transferee can not avail himself of any defense to that liability which was not pleaded before the Board.

2. ASSESSMENT—DEFICIENCY—LIMITATION—APPEAL TO BOARD.

Where an appeal to the Board of Tax Appeals is pending without a hearing thereon 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 by the provisions of the Revenue Act of 1926 as in a case where the Commissioner determines that there is a deficiency imposed by the Revenue Act of 1926 and the taxpayer files a petition with the Board.

3. SPECIAL ASSESSMENT—REPRESENTATIVE CORPORATIONS—COMMISSIONER'S DISCRETION.

In computing the tax in the case of a special assessment under section 328 of the Revenue Act of 1918, the selection by the Commissioner as therein provided of the representative corporations engaged in a like or similar trade or business is an act of administrative discretion which is not reviewable by the courts.

DISTRICT COURT OF THE UNITED STATES FOR THE NORTHERN DISTRICT OF OHIO, EASTERN DIVISION.

United States of America, plaintiff, v. *Alfred A. Cohn, defendant.*

[July 9, 1932.]

OPINION.

WEST, J.: This is a suit in equity to enforce against the defendant, who was the sole stockholder of the Cohn-Goodman Co., the tax liability of the corporation as redetermined by the Board of Tax Appeals. Upon dissolution of the corporation shortly before the order became final, the entire assets of somewhat greater value than the amount of the tax, were taken by Mr. Cohn. The facts appear in a stipulation and exhibits thereto, one of which sets out the proceedings before the Board, including evidence taken.

The Government admits that on July 21, 1925, when the Commissioner mailed his 60-day letter, collection of the 1917 and 1918 taxes was barred, and the first question is whether the defendant can now avail himself of that defense. The appeal was filed with the Board on September 14, 1925, heard on November 30, 1926, findings of fact and opinion filed on June 23, 1927, and order of redetermination made on November 30, 1927. *Bowers* v. *New York & Albany Lighterage Co.* (273 U. S., 346 [T. D. 4009, C. B. VI–1, 268]) was decided February 21, 1927. Nowhere in the proceedings before the Board was the statute of limitations set up or mentioned. Nor is there any evidence in that record showing that it had run, or the date when the right to assess and collect expired, or that *prima facie* or probably such right had expired before July 21, 1925. The Board of Tax Appeals had absolutely no knowledge or information on that subject. See Exhibit E. On failure to file petition for review within six months after the decision, it became final on May 30, 1928. Had the situation been watched closely there was ample time after the decision of the Bowers case to have brought the question of limitation to the attention of the Board before it rendered either its final order or its opinion and findings. Refusal to consider the matter would then have constituted error. (*Guedcr Paeschke & Frey Co.* v. *Commissioner*, 41 F. (2d), 308 (C. C. A. 7) and *Alameda Park Co.* v. *Lucas*, 37 F. (2d), 805.) It was the taxpayer's duty to make the defense. (*Updike* v. *United States*, 8 F. (2d), 913, 916 (C. C. A. 8) [T. D. 3815, C. B. V–1, 312].) If, as defendant claims, section 1006(a), Revenue Act 1928 [section 1106(a), Revenue Act 1926] extinguished the liability for these taxes, still it was necessary, before the Board could be expected to so hold, to advise it in some fashion that the bar of the statute had fallen. A decision of the Board to that effect would be the equivalent of a decision of no deficiency. See 26 U. S. C., 1217. The jurisdiction of the Board over that subject, which Congress here expressly recognizes, could not be exercised unless properly invoked, and due to carelessness of the taxpayer and his counsel, it was not invoked, nor was there any attempt to invoke it. As the result the taxpayer waived the defense, even though its liability had by law been extinguished. For the facts on which the law operates were not brought to the attention of the Board, and there was nothing by way of allegation or proof to overcome the usual presumption that the taxes which had been assessed according to law, were valid.

The defendant was president of the corporation as well as sole stockholder, and verified the petition for appeal. I think he is bound by the proceedings and final order. (*Sanger* v. *Upton*, 91 U. S., 56; *U. S.* v. *Lam*, 26 F. (2d), 830 [T. D. 4119, C. B. VII–1, 275], and cases cited.) In my judgment and under the conceded facts, he is also the "taxpayer" and is bound as such, regardless of his connection with and membership in the corporation and primary taxpayer. (*United States* v. *Updike*, 281 U. S., 489 at 494 [Ct. D. 192, C. B. IX–1, 228]; *Routzahn* v. *Tyroler*, 36 F. (2d), 208 (C. C. A. 6).)

Counsel for the defendant contends that as the Board of Tax Appeals is not a court, and as a taxpayer who appeals to it may take an adverse decision to the circuit court of appeals for review; and may also by virtue of section 283(b) Revenue Act 1926 (26 U. S. C., 1064) pay the tax and then bring suit in the district court to recover it back, the orders of the Board are not final and conclusive. (See *Old Colony Trust Co.* v. *Commissioner*, 279 U. S., 716 [Ct. D. 80, C. B. VIII–2, 222].) In the present proceeding the Board held that it acquired jurisdiction under section 283(f) and not 283(b). But that seems not material to the point. I think it clear enough that if the Board's ruling on an appeal governed by either of the above subsections, is not final and conclusive on the parties, that can only be true in the instance which the statute contemplates, to wit, in an action brought in the district court to recover back the taxes paid; and this is not such an action. Considering the means provided through statutes and rules of the Board, for preventing and deciding issues before that tribunal, and the statutory methods for reviewing its decisions, it seems clear that except possibly in a few specified instances, Congress did not intend that a tax case once decided by the Board should be tried over again *de novo* by the courts. It may be that the right to produce to them a matter entirely omitted below is lost rather by waiver than by technical former adjudication. And I think that the defendant transferee is bound and concluded by the proceedings before the Board, to such extent that he can not now raise the question of limitation. *United States* v. *Updike* (281 U. S., 489) is relied on by the defendant, but it has no application, for no judgment of a court or order of the Board of Tax Appeals was involved. Plaintiff cites *United States* v. *Frommel & Bro.* (50 F. (2d), 73 (C. C. A. 2) [Ct. D. 378, C. B. X–2, 307]) where a judgment had been obtained against the primary taxpayer and the suit was to impress assets in the hands of a transferee. This is more like our case, though defendant thinks that there is no resemblance due to the difference between a court judgment and an order of the Board of Tax Appeals. The circuit court held the suit not controlled by the limitations applicable to an action for taxes. It would seem logical to apply the doctrine of *res adjudicata* to the orders of redetermination made by the Board under the Revenue Act of 1926. Except of course in situations such as are mentioned in the Old Colony Trust Co. case, supra. In the proceeding for direct review of such order, the circuit court of appeals deals with the record made before the Board, and as I understand it, would not have been free upon a review of this proceeding to enter upon a trial *de novo* of the claim that collection of the taxes was barred. As the record failed to show any reference to the point or to disclose any of the facts upon which such a claim must rest, the court, so far as that feature of the case was concerned, could only have affirmed. It could not have remanded for a rehearing, for that is done only when the decision is not according to law, and is therefore reversed or modified. (26 U. S. C., 1226.) This court should have no wider discretion than the one designated by law to review the order of the Board, and should be bound by the record just as that court is. The subject is treated in Klein Federal Income Taxation, pages 1410–1412. It is there said that under the Act of 1924 the determination of the Board was not binding on the taxpayer, as he could pay the deficiency and sue in the courts to recover. "The Act of 1926 in depriving the taxpayer of that right, made the decision of the Board *res adjudicata* as to the amount of the redetermined tax, and barred the defeated party from a suit *de novo*" and "With the amendment of 1926, definitely making the decision of the Board final as to the facts, and reviewable as to error by the circuit court of appeals, it seems reasonable to assume that findings of fact made under the Act of 1926 and subsequent thereto should be treated as *res adjudicata*." Defendant says the Cohn-Goodman Co. can now pay the assessments and sue for a refund. If by this he refers to the right to sue spoken of in the Old Colony case, supra, I should suppose that right lost by failure to have the decision of the Board reviewed by the circuit court, and permitting the order to become final prior to filing action in the district court. If not, as stated above, this is not an action to recover back, and it is only in such actions that the order of the Board is not conclusive. (See also *American Woolen Co.* v. *White*, 56 F. (2d), 716 [Ct. D. 413, C. B. X–2, 257] and *Bankers' Reserve Life Co.* v. *United States*, 44 F. (2d), 1000 [Ct. D. 303, C. B. X–1, 286].)

The taxes for 1919 and 1920 were assessed on July 14, 1928, and defendant says this was too late under the statute. And that as the 60-day letter was sent out under the Act of 1924, said Act and not the Act of 1926, controls the

assessment, including limitation. Section 283(b), Act 1926 (26 U. S. C., 1064) applies to assessments made after June 3, 1924, following appeals taken under the Act of 1924 and pending on February 26, 1926. It provides that in such cases the duties of the Commissioner and jurisdiction of the courts shall be determined as provided in subdivision (a). And section 283(a) provides that the amount to be assessed shall be computed as if the Act of 1926 had not been enacted, but shall be assessed, collected, and paid in the same manner and subject to the same provisions and limitations as in case of a deficiency in the tax imposed by this title. The time within which the assessment of the 1919 and 1920 taxes could be made was controlled by the Act of 1926.

Defendant's theory is that as the Act of 1924 applies, the decision of the Board became final on June 23, 1927. And that taking this as the day when the Commissioner was first permitted to make the assessment, he waited too long; and that even if November 30, 1927, be taken as the proper day, the assessment of the 1920 tax was barred 16 days before July 14, 1928. As the premise falls, these conclusions fall with it. The time did not begin to run until July 30, 1928 (section 277(b), Act of 1926; section 504, Revenue Act 1928).

It is also claimed that as to 1919 a waiver filed September 22, 1925, after service of the 60-day notice in July, was invalid. But see *Stange* v. *United States* (282 U. S., 270 [Ct. D. 274, C. B. X–1, 414]). Claim is also made that the waivers signed by the secretary of the corporation were not executed by one shown to be authorized. If there is anything defensive in these matters, it was waived so far as this case is concerned, just as the statute of limitations was waived, by not being pleaded or proven before the Board of Tax Appeals, and the finding and redetermination of that body is conclusive.

In the petition for appeal the Cohn-Goodman Co. complained that in the application of sections 327 and 328, Revenue Act 1918, the Commissioner used comparative data of corporations not truly comparable to the taxpayer's situation. Exhibit E, page 3; and the defendant urges that claim here. I am of opinion that this point is no more subject to judicial review than is the decision of the Commissioner as to propriety of the taxpayer's application for special assessment. (*Williamsport Wire Rope Co.* v. *United States*, 277 U. S., 551 [T. D. 4172, C. B. VII–2, 323]; *Brown's "Shamrock" Linens, Ltd.*, v. *Bowers*, 48 F. (2d), 103 (C. C. A. 2) [Ct. D. 322, C. B. X–1, 426]; *Diamond Alkali Co.* v. *Heiner*, unreported (C. C. A. 3); *Freeport Texas Co.* v. *United States*, unreported (Ct. of Claims); *Cleveland Auto. Co.* v. *United States*, unreported (this court by Jones, J.). I should say further that so far as I can see, no evidence was produced to support the taxpayer's claim that in applying the relief sections the Commissioner used improper comparatives. And in this connection, I can not agree with counsel that if the result of applying the so-called "relief" sections is not relief to the taxpayer in a reduction from what a normal computation would produce, then a misapplication of the section is demonstrated. No authority is cited for this "heads I win tails you lose" proposition.

If the court does have power to pass on the question raised before and decided by the Board of Tax Appeals, then it is clear that no mistake was made in this respect for any of the years.

I can do no better than to refer counsel to the findings of fact and opinion of the Board, found on pages 11 et seq. of Exhibit E. Some of the authorities not cited there which tend to support the conclusion of the Board, are *Zenith Milling Co.* v. *Commissioner* (41 F. (2d), 905 (C. C. A. 8)); *Chattanooga Savings Bank* v. *Brewer* (17 F. (2d), 79 (C. C. A. 6) [T. D. 3986, C. B. VI–1, 161]); *Spencer* v. *Lowe* (198 Fed., 961); and *Bulger Block Coal Co.* v. *United States* (48 F. (2d), 675). I have looked at these and other cases cited by plaintiff and feel that they represent the weight of authority and are applicable to the facts, rather than *Geo. Feick & Sons Co.* v. *Blair* (26 F. (2d), 540 (App. D. C.)); *Eaton* v. *English & Mersick Co.* (7 F. (2d), 54); and *Davidson & Case Lbr. Co.* v. *Motter* (14 F. (2d), 137), cited and relied on by defendant's counsel. In my judgment the statement of evidence, page 26, Exhibit E, leaves no doubt that the amounts which defendant claims were part of the invested capital of the Cohn-Goodman Co. really represented borrowed capital. Section 326(a), Revenue Act 1918.

Defendant complains of laches, but I think the court would be going entirely too far if the Government were held guilty of undue delay, when it commenced the suit in less than two years after conclusion of the taxpayer's appeal before the Board.

Decree will be entered for the plaintiff.

TITLE XI.—GENERAL ADMINISTRATIVE PROVISIONS.

SECTION 1106.—FINAL DETERMINATIONS AND ASSESSMENTS.

ARTICLE 1341: Final determination and assessment of tax or penalty.

REVENUE ACT OF 1926.

Limitations period not set up in proceedings before United States Board of Tax Appeals. (See Ct. D. 604, page 395.)

SECTION 1113.—LIMITATIONS UPON SUITS AND PROCEEDINGS BY THE TAXPAYER.

ARTICLE 1351: Suits for recovery of taxes erroneously collected. XI–30–5565 Ct. D. 520

INCOME TAX—REVENUE ACT OF 1926—DECISION OF COURT.

CLAIM FOR REFUND—SUFFICIENCY—AMENDED CLAIM—LIMITATION.

A claim for the refund of an overpayment of tax stating as the only basis for the same that "profits were credited to the claimant on the basis of erroneous profits ascribed to Hahlo Co. for the calendar year 1919" is not a sufficient claim under section 3226 of the Revised Statutes, and after the disallowance of the claim it can not be amended, after the statutory period for filing a claim for refund has expired, by setting forth a specific ground for recovery. Such amended claim filed in April, 1928, must be regarded as an original claim governed by the provisions of section 284(b) of the Revenue Act of 1926 and section 3228 of the Revised Statutes as amended.

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

Arthur Solomon v. *United States.*

Appeal from a judgment of the District Court for the Southern District of New York.

[April 4, 1932.]

OPINION.

CHASE, Circuit Judge: During 1919, the plaintiff was a salesman employed by a corporation called the Hahlo Co. under a contract in writing which provided for the payment of $25,000 to him as a salary plus 10 per cent of the net profits of the company for that year as additional compensation. After defining the term net profits for the purposes of the contract it was further agreed that:

"(a) The additional compensation may be adjusted in accordance with later adjustments of the net income for the year ended December 31, 1919, as finally adjusted by the Treasury Department of the United States."

The plaintiff filed his return upon an accrual basis and paid the tax upon his income computed in that way. The tax upon the part of his income so computed and derived from his so-called additional compensation is here involved.

His return was filed on March 15, 1920. His tax was paid in four installments during 1920. On March 6, 1925, a waiver was filed which extended

the time for making a claim for refund to March 6, 1926. On December 29, 1925, the Hahlo Co. filed its claim for refund of taxes for 1919 and as a result its claim was subsequently allowed on December 26, 1928, on the basis of a reduction of its net income from $736,004.81 to $609,446.70. On December 31, 1925, the plaintiff filed a claim for refund and assigned as the ground of his claim the following: "Profits were credited to the claimant on basis of erroneous profits ascribed to Hahlo Co. for the calendar year 1919. Brief will follow." No brief did follow and the plaintiff was notified on May 26, 1926, that "as no brief has been received and no information has been furnished to substantiate your statement, your claim will be rejected." The rejection appeared on the next schedule approved by the Commissioner. Thereafter nothing was done about it by the plaintiff until April 20, 1928, when he filed an application to reopen his claim for refund and then for the first time presented the facts concerning his contract of employment and the agreement about adjustment of net profits on which his claim was based. His application was refused on May 25, 1928, and this suit was brought the next day.

Although it does not appear that the 1919 income of this plaintiff as disclosed in his return filed was ever in fact adjusted on the basis of any reduction in the net profits of the Hahlo Co. and the contrary is indicated by the fact that he was paid the full amount in preferred stock of the company when it was reorganized in 1923, we think it is unnecessary to put anything upon that.

Before we can look to the merits, it is necessary to determine whether any claim has been filed which can be treated as a compliance with the statute (26 U. S. C. A., section 156) and the regulations promulgated thereunder. Article 1306 of Regulations 65 required that all facts relied upon in support of a claim should be clearly set forth under oath. Here the only basis of the claim stated was "profits erroneously ascribed to the Hahlo Co. for the calendar year 1919." Such a claim was insufficient. (*United States* v. *Felt & Tarrant Co.*, 283 U. S., 269, 51 S. Ct., 376 (9 Am. Fed. Tax Rep., 1416) [Ct. D. 336, C. B. X–1, 431].)

This being so, it was necessary, as the plaintiff apparently recognized, to amend the claim before bringing suit. He tried to do this by means of the application to reopen above noted. The application was denied and so the previous rejection of the claim stood unchanged in every respect. See, however, *McKesson & Robbins, Inc.*, v. *Edwards* (57 Fed. (2d), 147). The real question before us is whether the claimant has been deprived, by the refusal to reopen, of any right to amend after his claim had been rejected and the period for filing an original claim for refund had expired. The Court of Claims has several times held a claim for refund can not be amended after rejection but must be treated as a new claim which falls afoul the time limit of the statute if the time for filing has run. (*Mutual Life Ins. Co. of New York* v. *United States*, 49 Fed. (2d), 662, 664 (9 Am. Fed. Tax Rep., 1377) [Ct. D. 363, C. B. X–2, 292]; *Sugar Land Ry. Co.* v. *United States*, 48 Fed. (2d), 973, 976 (9 Am. Fed. Tax Rep., 1216) [Ct. D. 382, C. B. X–2, 309]; *New England Mutual Life Ins. Co.* v. *United States*, 52 Fed. (2d), 1006 [Ct. D. 440, C. B. XI–1, 315].) We agree that the Commissioner need not accept amendments after rejection, as will be noticed from what is said in *McKesson & Robbins, Inc.*, v. *Edwards*, supra. It seems that endless attempts to claim refunds would result if rejection had no effect upon the amendment of claims and the limitation of the statute would be of no practical effect. With all the freedom of amendment modern conceptions of just procedure permit, there can be no right to amend after the claim has been denied. Then the claimant, unless he still has time to file a new claim within the statutory period or the Commissioner sees fit to reconsider, must seek relief elsewhere on the basis of his claim as it was when rejected.

Judgment affirmed.

ARTICLE 1351: Suits for recovery of taxes erroneously collected. XI–33–5612 Ct. D. 538

FEDERAL TAXES—GRATUITOUS PAYMENT—DECISION OF COURT.

SUIT—GRATUITOUS DISCHARGE OF TAXPAYER'S LIABILITY.

Where a corporation, organized in 1919, before July 1 of that year, acting for a predecessor partnership, files a return of the partnership for the year 1918, computing the net income and in-

vested capital, in accordance with section 330 of the Revenue Act of 1918, as if the business had been carried on by a corporation in existence on and after January 1, 1918, the voluntary payment by the corporation of the tax shown on the return before its assessment is a gratuitous discharge of a liability of the partners and the corporation is not entitled to recover it. Section 3226, Revised Statutes, providing that a suit for a tax may be maintained though not paid under duress does not enlarge the liability of the United States when the payment of a tax is not only voluntary but made with full knowledge of the facts.

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

Clift & Goodrich, Inc., appellant, v. *United States of America, appellee.*

Upon appeal from a judgment of the District Court for the Southern District of New York.

[March 17, 1932.]

OPINION.

L. HAND, Circuit Judge: The petitioner was a corporation, the successor to a firm of the same name; it was organized on April 1, 1919, and took over the firm property on May 24 of that year in exchange for preferred stock issued to the partners. These had already on January 8 filed individual income tax returns for their shares in the firm income for the year 1918, and a firm return for excess-profits tax, and they paid the amounts returned on January 22. On August 15 the petitioner filed an excess profit and income tax return of the firm income for the year 1918, which was calculated as though it had been a corporation, as partners were allowed to do under section 330 of the Revenue Act of 1918. The amount so shown the petitioner paid in three installments during 1919, after unsuccessful efforts to secure a set-off of the sums paid by the partners in January. On January 2, 1920, the Commissioner assessed against the petitioner the sum returned and paid, and later, a deficiency which he afterwards abated on the ground that only the firm, and not the corporation, could be taxed. The sums paid by the partners were later refunded, but the petitioner's application for refund was refused, and this suit followed. All that is alleged regarding the relations between the petitioner and the partners as to the payment is as follows: "Each of said payments" (the three installments) "was charged on the books of the corporation to the tax account of the corporation, and not at that time, nor at any other time, charged either against the partnership or the individual members thereof." The return of August 15, 1919, was made in the name of "Clift & Goodrich (Partnership);" two of the schedules carried the same caption; the others, the name "Clift & Goodrich," not "Clift & Goodrich, Inc.," the corporation's title. The verification was by the president and treasurer of the corporation, who were two of the partners.

Section 330 of the Revenue Act of 1918 allowed partners, whose business had been taken over by a corporation organized before July 1, 1919, in circumstances here existing, to file their return for 1918 as though they were a corporation, treating distributions made during the year as dividends, and not subjecting undistributed profits as surtaxes. This made a difference of some $37,000, by which the partners have profited, even assuming that they bore the same proportion of the tax here in question as shareholders, that they would have borne as partners. The suit is based upon the theory that, as the Treasury officials treated the tax as that of the corporation without warrant of law, they have collected money which was really not due, since the partners should have paid it under a return made in accordance with section 330. If successful, the result will be that the partners will pay no taxes whatever for the year 1918. The judge dismissed the petition as demurrable and the petitioner appealed.

Any recovery must rest upon quasi contract, an implied promise to repay, raised ex aequo et bono because it was unconscionable for the respondent to keep the money. (*Cary* v. *Curtis*, 3 How., 236; *New York Life Ins. Co.* v. *Anderson*, 263 Fed. Rep., 527 (C. C. A. 2).) Had the petition alleged that the petitioner paid the tax under the mistaken belief that it was liable, the suit might perhaps succeed (*Meyer* v. *Mayor of New York*, 63 N. Y., 455; *Betz* v.

N. Y., 119 App. Div., 91; affd. 193 N. Y., 625), though even then there would be obstacles, for the old notion that a mistake of law will not serve in such a situation still prolongs its discreditable life; and it is moreover at least open to doubt whether there would not be a defense, if when the petition was filed, the period had already expired within which the partners could be assessed. But with these questions we need not concern ourselves, because the petition does not even intimate that the petitioner paid the tax under a mistaken belief that it was liable as a taxpayer. Indeed, it was not in existence during 1918, and it is entirely clear from the return itself that it was acting for the partners. The payment was no more therefore than a gratuitous discharge of the obligor's duty, and on what theory it can be recovered if that duty existed, we can not conceive. The tax was certainly due from the partners and the Treasury had the right to keep the money, unless it was inequitable to do so because it came from the corporation. An obligee is surely not bound in good conscience to repay such collections.

Besides, it sufficiently appears that the corporation had recourse over against the partners. Two of them made the return as officers of the petitioner; they at least were liable. As to the rest they procured refunds of what they had paid on January 22, 1919, because of the payment here in question, and that established an implied promise to reimburse the corporation, which they had no right to exploit. This is not affected by the allegation that they had never been charged with the tax on the corporate books. The right existed, and might well have been released by common consent, if the partners were the only shareholders. What they would receive as former partners would come out of their dividends as shareholders. Moreover, the whole issue is in any case irrelevant, for it was not material to the Treasury's right to retain the payment that the petitioner should have indemnity.

The officials apparently supposed for a reason that the corporation owed the tax, though they later receded from that position. No estoppel arises from this; it does not impugn the right of the Treasury to retain the money that its officers misconceived its basis, or their own powers. Had they coerced the payment, more might have been said, but all the installments were paid before assessment. Nor does it make a difference that they were not made until the Treasury had refused to accept the partners' payments of January in substitution for that due under the return. The petitioner was still not obliged to pay the tax; when it did so, it was either a mere interloper, or acting for the partners.

We do not forget that under section 156 of Title 260, United States Code, taxes may be recovered though not paid under duress. The section does not mean to enlarge the Treasury's liability when the payment is not only voluntary, but made with full knowledge of the facts. It leaves open for determination whether under principles applicable in general to such suits, there is any basis for the recovery; and since it would be wholly unwarranted to rescind such a transaction merely because one party pays another's tax actually due, with full knowledge of what he is doing, the section is pro tanto irrelevant.

Judgment affirmed.

ARTICLE 1351: Suits for recovery of taxes erroneously collected. XI-33-5613 Ct. D. 539

FEDERAL TAXES—RES JUDICATA—DECISION OF COURT.

RES JUDICATA—DISMISSAL WITHOUT PREJUDICE.

The dismissal of an action by a taxpayer against the United States by the journal entry "petition dismissed without prejudice" is limited by the motion filed in open court upon which the judgment is entered to a dismissal without prejudice only as to the taxpayer's right to again assert a claim to an overpayment credited to a tax for the year 1917, renders res judicata the issues raised in that case except that expressly reserved, and bars recovery in a later action by the taxpayer against the collector presenting an issue raised in the prior action and not so reserved.

DISTRICT COURT OF THE UNITED STATES, DISTRICT OF MASSACHUSETTS.

Paul J. Bertelsen, Receiver for Crowell & Thurlow Steamship Co., v. Thomas W. White, Collector of Internal Revenue for the District of Massachusetts.

[April 18, 1932.]

OPINION.

BREWSTER, J.: This is a suit against the collector of internal revenue for this district, to recover Federal income taxes amounting to $48,613.52, alleged to have been erroneously assessed upon and illegally collected from the Crowell & Thurlow Steamship Co. for the taxable year 1920. The case was heard without jury upon agreed statements of fact.

The defendant has interposed three defenses: (1) That this action is barred by a judgment entered in the Court of Claims upon the petition of this plaintiff against the United States; (2) that the tax for the year 1920 was legally assessed and collected; and (3) that if the tax was illegally exacted it can not be recovered in an action against this defendant.

The second defense is the one going to the merits of the controversy and involves the application of section 23 of the Merchant Marine Act of 1920 (46 U. S. C. A., 878) or its effect upon the Revenue Act of 1918.

If the first defense is good, the plaintiff has lost his rights to attach the validity of the assessment and collection of the 1920 tax, and the court in this suit can not be asked to again determine the legality of the collection. In that event, it will not be necessary to inquire whether the Commissioner of Internal Revenue erred in applying the provisions of section 23.

I will, therefore, consider first whether the plaintiff is concluded by the judgment entered upon a petition previously brought by this plaintiff in the Court of Claims.

Section 23 of the Merchant Marine Act, 1920, which was effective June 5, 1920 (46 U. S. C. A., 878), contains the following provisions:

"SEC. 878. *Deductions allowed owners of documented vessels of United States for income and excess-profits tax purposes.*—The owner of a vessel documented under the laws of the United States * * *, be allowed as a deduction for the purpose of ascertaining his net income subject to the war-profits and excess-profits taxes imposed by Title III of the Revenue Act of 1918 an amount equivalent to the net earnings of such vessel during such taxable year, determined in accordance with rules and regulations to be made by the board: *Provided*, That such owner shall not be entitled to such deduction unless during such taxable year he invested, or set aside under rules and regulations to be made by the board in a trust fund for investments, in the building in shipyards in the United States of new vessels of a type and kind approved by the board, an amount, to be determined by the Secretary of the Treasury and certified by him to the board, equivalent to the war-profits and excess-profits taxes that would have been payable by such owner on account of the net earnings of such vessels but for the deduction allowed under the provisions of this section: *Provided further*, That at least two-thirds of the cost of any vessel constructed under this paragraph shall be paid for out of the ordinary funds or capital of the person having such vessel constructed." (June 5, 1920, ch. 250, section 23, 41 Stat., 997.)

The essential facts are as follows:

The plaintiff is receiver of the Crowell & Thurlow Steamship Co. which, in 1920, was the owner of vessels documented under the laws of the United States and operating in foreign trade.

It complied with the provisions of section 23 of the Merchant Marine Act, and in determining the income tax for the year 1920 the Commissioner proceeded upon the assumption that the deductible credit of excess-profits tax was the amount actually paid by the steamship company rather than the amount that would have been imposed had the vessel not met the requirements of section 23.

The Commissioner, having determined that the 1918 tax had been overpaid to the amount of $243,599.46, took appropriate steps to apply this sum to the payment of taxes assessed for the years 1917, 1919 and 1920. This action is brought to recover $48,613.53 which was satisfied by crediting that amount from the 1918 overpayment. The plaintiff alleges that this sum was illegally exacted,

due to the refusal of the Commissioner to allow as a credit for the purposes of the income tax the amount of the excess-profits tax which would have been imposed had the steamship company not complied with section 23.

It is the contention of the defendant that the earlier proceedings in the Court of Claims involved the legality of the 1920 tax and that the judgment entered in that case finally settled all controversies respecting the tax for that year, including the controversy presented by the pleadings in the case at bar.

It appears that the plaintiff, on July 7, 1926, filed in the Court of Claims a petition to recover a portion of the 1918 overpayment. In the petition, among other things, it was alleged that $155,909.70 had been erroneously applied by the Commissioner as follows: $37,875.07 to taxes for 1917, $68,279.25 to those for 1919 and $49,752.39 for 1920, all of which taxes were alleged to have been unlawfully determined to be due on account of income and profits taxes for the respective years. We are only concerned with the allegations respecting the 1920 tax. These allegations were to the effect that the claimant denied the right of the Commissioner to apply said sum of $49,752.39 to the extinguishment of any alleged liability of claimant for the year 1920, or any sum in excess of $16,971.34 conceded to be due. While the petition does not state the grounds upon which the denial was based, it appears from a letter, written by the plaintiff's attorney to the General Counsel for the Bureau, that the dispute between the taxpayer and the Commissioner over the amount of the 1920 taxes involved the construction of section 23 of the Merchant Marine Act. The Government filed a general traverse denying all the allegations of the petition.

In December, 1927, and while these proceedings were pending in the Court of Claims, a settlement of all controversies involved in the suit was proposed on behalf of the taxpayer whereby the controversy respecting the 1917 taxes was to await the outcome of litigation pending in another tribunal. By the terms of the proposed settlement, the United States was to abate $68,279.12 of the 1919 taxes and $414.23 of the 1920 taxes, and the taxpayer was to consent to the application of the 1918 overpayment so far as necessary to the extinguishment of the remaining tax liability for the years 1917, 1919 and 1920. Appropriate adjustments of interest were to be made, and the agreement was to be final except that the taxpayer reserved the right to file a claim for refund with respect to the amount applied to the 1917 tax. This proposed settlement by its express terms included the application of $59,103.85 to the payment of the 1920 taxes, the amount of which I find to have been in issue before the Court of Claims.

The claimant was to deliver a motion to dismiss the suit in the Court of Claims without prejudice to again assert a claim with respect to the 1917 taxes. There was never any formal acceptance of this offer of settlement, but a letter, dated February 15, 1927, written by plaintiff's attorney, leaves no doubt that the proposal was agreed to by the Bureau of Internal Revenue. This letter is significant. It reads as follows:

"Further reference is made to the case No. F–206 in the Court of Claims, *Bertelsen, Receiver for Crowell & Thurlow Steamship Co., claimant*, v. *United States of America*, and to my letters to you dated December 9 and December 16 proposing a method of settlement of that suit.

"According to the arrangement outlined in said letters and agreed to by your office, there is transmitted herewith our motion to dismiss said suit in the Court of Claims without prejudice to our reassertion, by suit or otherwise, of our claim to receive the sums withheld and applied to the alleged underpayment of taxes for the year 1917.

"It is understood that this motion is to be held in escrow until payment of the refund, including interest duly computed, has been made."

The motion accompanying this letter was in the following terms:

IN THE COURT OF CLAIMS. No. F–206.

Paul J. Bertelsen, Receiver for Crowell & Thurlow Steamship Co., claimant, v. *The United States of America.*

IV. PLAINTIFF'S MOTION TO DISMISS WITHOUT PREJUDICE.

(Filed in open court February 28, 1928.)

Comes now the claimant in the above-entitled cause, by his attorney therein, and moves the court to dismiss the petition filed July 7, 1926, in said cause,

without prejudice, however, to the assertion by the claimant, by suit or otherwise, of its claim to receive the sums withheld and applied to the alleged underpayment by the claimant of taxes for the year 1917, for the reasons as he shows,

That, since the filing of said petition, all other matters have been satisfactorily adjusted between claimant and the United States.

[S.] DION S. BIRNEY,
Attorney for Claimant.

The Commissioner of Internal Revenue accordingly proceeded with a reconsideration of the 1918 tax, and on March 14, 1927, notified the taxpayer of an overassessment of 1919 taxes amounting to $68,279.25. He also found a small overassessment of 1920 taxes, resulting from the recomputation. The balance of the 1918 overpayment was in due course paid to the claimant.

The motion to dismiss was filed in the court February 28, 1928. The records of the court recite that the plaintiff's motion to dismiss without prejudice was filed and allowed in open court and "petition dismissed without prejudice." Does this dismissal of the earlier suit bar recovery in this action?

I am quite prepared to agree that the offer of settlement proposed by the plaintiff's counsel, although accepted and acted upon by the officials in the Bureau of Internal Revenue, did not comply with section 1106(b) of the Revenue Act of 1926 (*Loewy & Son, Inc.*, v. *Commissioner of Internal Revenue*, 31 F. (2d), 652) or with R. S. 3229 (26 U. S. C. A., 158) (*Botany Worsted Mills* v. *United States*, 278 U. S., 282 [Ct. D. 39, C. B. VIII–1, 279]) and that, therefore, the settlement by itself would not preclude the plaintiff from maintaining this action.

It is not the compromise agreement that is relied upon by the Government to defeat the rights of the plaintiff, but rather a judgment in a suit which had been entered upon a motion stating in substance that all matters involved in the suit had been satisfactorily adjusted between the claimant and the United States except the controversy respecting the 1917 taxes.

I am persuaded that the entry of "petition dismissed without prejudice" must be limited by the motion upon which the judgment was entered, with the result that the petition was dismissed without prejudice only as to the plaintiff's rights to again assert a claim to the overpayment applied to liquidate the 1917 taxes. I am convinced that the judgment rendered in the first action was final as to all other matters in issue in the Court of Claims.

In *United States* v. *Parker* (120 U. S., 89) the court points to the distinction between a nonsuit and a retraxit, the latter being an open, voluntary renunciation of the plaintiff's claim in court. It was held that "a judgment of dismissal, when based upon and entered in pursuance of the agreement of the parties, must be understood, in the absence of anything to the contrary expressed in the agreement and contained in the judgment itself, to amount to such an adjustment of the merits of the controversy, by the parties themselves through the judgment of the court, as will constitute a defense to another action afterwards brought upon the same cause of action."

To the same effect see *Conner* v. *Cornell* (32 F. (2d), 581); *Second National Bank of Saginaw* v. *United States* (66 Ct. Cls., 166 [T. D. 4238, C. B. VII–2, 356]); *Second National Bank of Saginaw* v. *Woodworth* (54 F. (2d), 672 [Ct. D. 470, C. B. XI–1, 331]).

The doctrine of res adjudicata applies to a case arising under the internal revenue laws as well as to any other civil action. (*Old Colony Trust Co.* v. *Commissioner*, 279 U. S., 716 [Ct. D. 80, C. B. VIII–2, 222]; *Greylock Mills* v. *White, Collector*, 55 F. (2d), 704 [Ct. D. 469, C. B. XI–1, 187].)

Nor does the fact that the first suit was against the United States, and the case at bar against the collector of internal revenue, avoid the bar of res adjudicata. (*Second National Bank of Saginaw* v. *Woodworth*, supra.)

It is the contention, however, of the plaintiff that if the dismissal of the petition by the Court of Claims was, in effect, a final judgment upon the merits of the controversy and rendered res adjudicata all issues raised in that case except those expressly reserved, still the judgment would not bar recovery in this action because the issue here raised was not before the Court of Claims. This contention is based, as I understand it, upon the fact that the suit in the Court of Claims was brought against the United States to recover an overpayment of 1918 taxes, whereas in this case, as the plaintiff argues, the suit is to recover from a collector of internal revenue 1920 taxes illegally exacted. It must be conceded upon the facts that the 1920 taxes were collected by the application of a part of the 1918 overpayment and, in the Court of Claims as

well as in this court, the legality of the acts of the Commissioner in determining the 1920 tax was in issue and was one of the important issues of the case.

While the principal controversy in the Court of Claims centered about the 1919 tax, the petitioner saw fit to bring to that court his dispute with respect to the 1920 tax. He admitted liability for $16,971.34 and challenged the right of the United States to exact any sum in excess of that amount. It is true as plaintiff points out, that in July, 1926, when the petition was filed in the Court of Claims, the Commissioner had under consideration claims for refund and abatement of 1920 income and profits tax, both original and additional, which claims contain no reference to the Merchant Marine Act; but in October, 1926, the petitioner was notified that a final audit revealed an overassessment of the 1920 taxes, and that the amount legally due for that year was $177,895.66. Thus it appears that the amount of the 1920 tax had been determined when the plaintiff proposed to settle all controversies respecting the 1917, 1918, 1919, and 1920 taxes or, to quote from the letter of December 9, 1926, written by plaintiff's attorney "the entire controversy involved in this suit" (in the Court of Claims). In this determination the Commissioner had deducted, as a credit against income only, $9,698.45 instead of $495,833.77, which the plaintiff now claims should have been deducted. It is also significant here that in the Bureau's letter of October 21, 1926, there was a computation of the profits tax which would have been payable on account of the net income but for the deduction allowed under section 23 of the Merchant Marine Act. These facts, in connection with the express reference to the Merchant Marine Act in the offer of settlement, leave no room for argument that the parties did not contemplate that the settlement would effectually bar any claim to further refund, or abatement, of the 1920 tax. Not only were the allegations of the petition broad enough to embrace any controversy relative to these taxes, but it appeared that, at the time of the proposal and the consummation of the settlement, the principal dispute over the 1920 taxes arose over the construction, or application, of section 23.

The purpose of the proceedings in the Court of Claims was to recover an overpayment which, as the petitioner alleged, had been credited upon taxes erroneously determined to be due, and I am unable to see how the case could have been disposed of in that court upon its merits without the necessity of determining the validity of the 1920 taxes, as well as those of the other years in dispute.

I can see no escape from the conclusion that the issue presented in the case at bar was included among the issues raised by the pleadings in the Court of Claims, and the judgment was a final determination of these issues, binding upon both parties to the action.

Furthermore, it is my opinion that, if the correctness of the amount of the 1920 tax was in any way in question in the proceedings before the Court of Claims, the plaintiff would not be entitled to prevail here, even if we assume that he now, for the first time in court, disputes the correctness of the 1920 tax on the ground that the Commissioner misconstrued section 23 of the Merchant Marine Act. The judgment in the Court of Claims concluded the parties, not only as to every matter which was offered to sustain the claim, but as to any other admissible matter which might have been offered for that purpose. The plaintiff may not "split up his demand and prosecute it by piecemeal, or present only a portion of the grounds upon which special relief is sought, and leave the rest to be presented in a second suit if the first fail." (Sanborn, J., in *Bowe-Burke Mining Co.* v. *Willcuts*, 45 F. (2d), 394 [Ct. D. 317, C. B. X–1, 428].)

The statutes provide that a final judgment against the claimant on a claim prosecuted in the Court of Claims shall forever bar any further claim or demand against the United States arising out of the matter involved in the controversy. (28 U. S. C. A., 286.) Having found that the judgment entered in the earlier case was a final judgment and that the claim sought to be enforced in the case at bar arose out of matters involved in the earlier controversy, it follows under the statute that this action is barred.

The plaintiff can not escape the effects of the final disposition of the proceedings brought in the Court of Claims by intimating that the compromise and the subsequent motion for judgment entered thereon were unauthorized. The United States has, in good faith, carried out the terms of the compromise by abating the 1919 tax and paying to the plaintiff the balance of the 1918 overpayment remaining after deducting the credits agreed to, and the plaintiff is now estopped from setting up the claim that the compromise was without authority.

The foregoing conclusions also render it unnecessary for me to consider whether the plaintiff has proceeded against the right party.

Judgment may be entered for the defendant.

ARTICLE 1351: Suits for recovery of taxes erroneously collected. XI–43–5806 Ct. D. 590

FEDERAL TAXES—SUIT AGAINST COLLECTOR—DECISION OF COURT.

SUIT—COLLECTOR—OVERPAYMENT CREDITED BY COLLECTOR.

Where an overassessment is paid to the predecessor of a collector, an action to recover the amount of the overassessment, which is credited against a tax for another year, can not be maintained against the collector even though the tax against which the credit is taken is barred from collection by the statute of limitations when the collector, pursuant to instructions of the Commissioner, performs the clerical and ministerial duty of entering the overpayment as a credit upon a schedule of overassessments and a schedule of refunds and credits and of certifying the schedules to the Commissioner.

UNITED STATES CIRCUIT COURT OF APPEALS, SIXTH CIRCUIT.

Carl Routzahn, United States Collector of Internal Revenue, appellant, v. *The Reeves Bros. Co., a Corporation, appellee.*

Appeal from the District Court for the Northern District of Ohio, Eastern Division.

[June 29, 1932.]

OPINION.

HICKS, Circuit Judge: This was an action to recover the sum of $61,218.13 as a part of appellee's 1917 income and excess profits taxes alleged to have been illegally collected by appellant after the running of the statute of limitations. Judgment was entered for plaintiff.

Appellant was a collector of internal revenue. Appellee overpaid its 1918 and 1919 income taxes in the sum of $26,453.87 and $34,764.20, respectively. These payments were made to Harry H. Weiss, appellant's predecessor in office, and were due to overassessments. When these overassessments were disclosed a deputy commissioner, following the practice described in *United States* v. *Swift & Co.* (282 U. S., 468 [Ct. D. 290, C. B. X–1, 283]), certified them to appellant upon a "schedule for overassessments" and accompanied the schedule with another schedule styled "Schedule of refunds and credits." Upon the schedule of overassessments was printed the "authorization of Commissioner" to the collector, found in the margin.[1] In response thereto,

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[1] Authorization of Commissioner.

To the Collector 18th District of Ohio:

The amounts listed in column 4 as overassessments (or reductions of tax liability) are hereby approved, and the related claims, if any, allowed in the respective amounts indicated by the "Certificates of overassessment" or "Notices of adjustment of refund" attached thereto.

You will immediately check such items against the accounts of the several taxpayers, and determine whether the amounts in which the tax liabilities have been reduced should be respectively abated, in whole or in part, and make such abatements as may be warranted by the condition of the taxpayers' accounts for the years involved.

If any part of any such item is found to be an overpayment, you will examine all accounts of the taxpayer for other periods and apply the overpayment as a credit against the taxes due, if any, making the appropriate entries in your accounts. (This applies only to income, war profits, and excess profits taxes.) Such credits will be entered in column 9, and placed in column 5 of a subsidiary schedule of refunds and credits (Form 7805–A).

The balance, if any, of the overpayment will be entered in column 12, and placed in column 4 of the subsidiary schedule (Form 7805–A) referred to above, and an appropriate *memorandum* made upon the taxpayers' account.

You will thereupon complete and certify this schedule and the schedule upon Form 7805–A, and return the necessary copies of each to the Commissioner of Internal Revenue.

D. H. BLAIR,
Commissioner of Internal Revenue.

(Date) March 29, 1924.

the collector checked the overassessment against the taxpayer's account in his possession, and found that appellee had overpaid its taxes for 1918 and 1919 to the extent thereof and entered the overpayments in credit column 9 of the schedule of overassessments as credits against an additional assessment made by the Commissioner for the year 1917 in the sum of $95,527.60. These credits he also entered in "amount credited" (column 5) of the "schedule of refunds and credits" and certified and returned both schedules to the Commissioner. Thereupon the Commissioner entered his certificate upon the schedule of refunds and credits to the effect that nothing was refundable.

Appellee claims that these entries by the collector were in effect the collection of or at least a participation by him in the collection of 1917 taxes then barred by the statute of limitations of five years fixed by section 250(d) of the Revenue Act of 1921 (ch. 136, 42 Stat., 227, 265). We may assume that the bar of the statute had fallen and that the Government was not entitled to credit these overpayments upon the uncollectible taxes for 1917. (*Bowers* v. *N. Y. & Albany Lighterage Co.*, 273 U. S., 346 [T. D. 4009, C. B. VI–1, 268].) We may further assume that appellee has complied with all procedural requirements incident to the prosecution of his action. We think we may confine ourselves to the crucial question, properly preserved in the record, whether appellee was entitled to recover against the collector.

The case was tried without the intervention of a jury. It was a personal action (*Sage* v. *U. S.*, 250 U. S., 33, 37) analogous to one for "money had and received" (*Cox* v. *Lott, Coll.*, 12 Wall., 204, 220; *Duffin* v. *Lucas*, 55 Fed. (2d), 786, 792 (C. C. A. 6)), but the appellant never exacted or received or had in his possession, officially or unofficially, any of the money which was ultimately applied to the payment of the 1917 taxes. These moneys were collected by and paid to appellant's predecessor in office as 1918 and 1919 taxes. The appellant merely made a bookkeeping entry pursuant to instructions of the Commissioner. The United States Government retained the money; the appellant did not. It is therefore not recoverable in an action against him. (*Smietanka, Coll.*, v. *Indiana Steel Co.*, 257 U. S., 1, 4 [Ct. D. 17, C. B. 5, 251]; *Union Trust Co.* v. *Wardell*, 258 U. S., 537, 542 [T. D. 3338, C. B. I–2, 310]; *Phila., H. & P. R. Co.* v. *Lederer*, 242 Fed., 492, 494 (C. C. A. 3); *Coffey, Coll.*, v. *Exchange Bank of Lennox*, 296 Fed., 807, 809 (C. C. A. 8) [T. D. 3574, C. B. III–1, 430].) In support of its contention appellee cites *U. S.* v. *Boston Buick Co.* (282 U. S., 468, 478 [Ct. D. 293, C. B. X–1, 335]), *Peerless Paper Box Mfg. Co.* v. *Routzahn, Coll.* (22 Fed. (2d), 459, 460 (D. C.)), *Logan Gregg Hdw. Co.* v. *Heiner* (26 Fed. (2d), 131 [T. D. 4186, C. B. VII–2, 315]), and also the opinion of the district court in *Routzahn* v. *Landesman-Hirsheimer Co.* (Prentice-Hall Tax Service for 1931, paragraph 499, page 645).

No doubt the procedure amounted to a "payment" of the 1917 taxes because upon the authority of the Commissioner's certificate the Treasury retained the overpayments in satisfaction of 1917 taxes (*Graham & Foster* v. *Goodcell*, 282 U. S., 409, 424 [Ct. D. 287, C. B. X–1, 191]), but as pointed out above, appellee's obstacle is that no part of these funds was paid to or exacted or received by appellant.

Appellee advances another and to us an inconsistent theory. It is that, regardless of whether appellant actually received the money, he is liable for entering the credits upon the schedules and certifying them to the Commissioner because he thereby deprived or aided in depriving appellee of the amounts thereof. The theory is that at the time the credits were entered and certified the bar of the statute had destroyed appellant's right to collect any 1917 taxes and that therefore his act in entering the credits was unauthorized and was in the nature of a conversion in that it deprived appellee of a refund to which it was entitled. The entry of the credits upon the schedules was not an allowance thereof. As an administrative provision the Commissioner, alone, was clothed with authority to determine whether the taxes for 1917 were due or whether they were barred and if they were not barred whether the overpayment should be credited against them. (See Title 26, sections 149 and 1065, U. S. C.; *U. S.* v. *Swift & Co.*, supra, at page 475; *Girard Trust Co.* v. *U. S.*, 270 U. S., 163, 169 [T. D. 3919, C. B. V–2, 209]; *U. S.* v. *Boston Buick Co.*, 35 Fed. (2d), 560, 562 (C. C. A. 1).)

It was not within the province of the *collector* to pass upon the effect of the statute of limitations. He was not authorized by the Commissioner to perform such duty. His duty was to obey the instructions of the Commissioner in accordance with the practice of the Bureau. This was a simple duty. He was

to check the overassessments against the accounts of appellee. If an overpayment resulted he was to apply it as a credit against any taxes appearing to be due, make the appropriate entries upon the accounts and certify the schedules, as extended, to the Commissioner. This duty was merely "clerical" and "ministerial." (*U. S.* v. *Swift & Co.*, supra.) It did not involve discretion. It was a duty that appellant owed to the Commissioner alone. Appellee could not require it of him. Appellant could not fail in a duty as to which he was not bound to the appellee, nor violate a right which did not exist. The moneys represented by the credits were in the Treasury. The Commissioner had sole dominion over them, appellant had none and undertook to exercise none.

We are not passing upon the question of whether the amount claimed is recoverable from the United States but solely upon the question whether it is recoverable from this collector of internal revenue who merely made a book entry. If the collection of the 1917 taxes was in fact barred at the time of the allowance and credit of the overpayments appellee has an appropriate remedy which is in no way affected by the action of the appellant in this case.

Judgment reversed.

ARTICLE 1351: Suits for recovery of taxes erroneously collected. XI–51–5935 Ct. D. 613

INCOME AND EXCESS PROFITS TAXES—REVISED STATUTES—DECISION OF COURT.

CLAIM FOR REFUND—SUFFICIENCY OF CLAIM.

A claim for refund stating solely that the excess profits tax should be assessed under the provisions of sections 327 and 328 of the Revenue Act of 1918 does not constitute a claim for refund under section 3226, Revised Statutes, as amended, which will support a suit based on the ground that the value of certain material should have been added to invested capital. This conclusion is not affected by the fact that in the claim for refund the Commissioner had called to his attention all the facts necessary to justify a reduction in its taxes on the basis of invested capital where the claim is not predicated on that ground.

UNITED STATES CIRCUIT COURT OF APPEALS, EIGHTH CIRCUIT.

Bemis Bro. Bag Co., a Corporation, appellant, v. *United States of America, appellee.*

Appeal from the District Court of the United States for the Eastern District of Missouri.

[August 29, 1932.]

OPINION.

NORDBYE, District Judge, delivered the opinion of the court.

This action was brought to recover income and excess profits taxes paid by appellant for the years 1918 and 1919. The collector to whom the taxes were paid having gone out of office, the action was brought directly against the United States. The action was tried to the court without a jury on an agreed statement of facts. The only question presented to the lower court was whether or not the plaintiff in its claim for refund, at any time before the running of the statute of limitations, stated the facts or grounds upon which it asserted its right to a refund.

Paragraph 18 of the stipulation provides as follows:

"If the appellant within the time provided by law, filed claims for refund for the years 1918 and 1919, respectively, which under the law were sufficient to be the required preliminary for the maintenance of this action on that ground, above stated, then appellant may be entitled to judgment for the year 1918 in the amount of $14,054.18, with interest, and for the year 1919 in the amount of $9,073.15, with interest.

"If the claims for refund filed by the appellant for the years 1918 and 1919, respectively, were not sufficient under the law to be the required preliminary

for the maintenance of this action on that ground, the appellee will be entitled to judgment dismissing this action."

The appellant on February 29, 1924, filed its claim for refund for 1918 of $1,270,907.97, and on December 12, 1924, its claim for refund for 1919 in the sum of $606,546.13. These claims for refund were based on the contention that the excess-profits tax and war-profits tax should be assessed under the provisions of sections 327 and 328 of the Revenue Act of 1918. These sections are relief statutes enacted for the purpose of relieving a taxpayer from an excessive tax. Provision is made in section 327 for cases where the Commissioner is unable to determine the invested capital of the taxpayer and in section 328 it is provided that "in the cases specified in section 327 the tax shall be the amount which bears the same ratio to the net income of the taxpayer (in excess of the specific exemption of $3,000) for the taxable year, as the average tax of representative corporations engaged in a like or similar trade or business, bears to their average net income (in excess of the specific exemption of $3,000) for such year."

In filing its claims for refund for the years 1918 and 1919, reference was made to a brief theretofore filed in support of the claim for refund for the 1917 taxes, and an additional brief was filed in support of the claims for refund for the years 1918 and 1919. The claim for refund for the year 1918 stated the following:

"Deponent verily believes that this application should be allowed for the following reasons; The excess-profits tax and war-profits tax against this company for the year 1918 should be assessed under the provisions of sections 327 and 328 of the Revenue Act of 1918.

"The facts and argument in support of this claim are contained in a brief, duly verified, which has been filed with the Commissioner of Internal Revenue, in support of a claim for refund made in connection with the company's return for 1917 and the tax paid thereon. The facts and circumstances which entitle the company to assessment under said sections for 1917 obtained also in 1918. In order to simplify matter and avoid repetition, the brief filed with the claim for refund for 1917 (a copy of which brief is attached hereto) by reference thereto is made a part of this claim."

The brief attached to the claim for refund and by reference made a part of it states as follows:

"In re: Claim of Bemis Bro. Bag Co. for refund of taxes for the year 1917 based upon right to special assessment.

"To the honorable COMMISSIONER OF INTERNAL REVENUE,
Washington, D. C.:

"Bemis Bro. Bag Co. has heretofore filed its claim for refund of taxes for the year 1917, based upon the right to assessment of its excess-profits taxes under section 210 of the Revenue Act of 1917. It now desires to elaborate and present in detail the reasons why its excess-profits tax for said year should be so determined.

"Statement.—The facts are hereafter stated in the order and under the subdivision above written.

"I. Reasons why the tax should be so determined and the facts upon which such reasons are based.

"V. Relief sought.

"Relying upon the sufficiency of the facts above recited to entitle it to the assessment of its excess-profits tax liability under the provisions of section 210 of the Revenue Act of 1917, Bemis Bro. Bag Co. has heretofore presented a claim for refund for the year 1917."

A similar statement and a similar reference to the 1917 brief was used in filing the claim for refund for the year 1919.

The appellant in filing its claim for refund for the years in question, in the brief above referred to, attempted to set forth in substantiation of its claim, the fact that injustice would be done if it were not permitted to receive the benefit of the special assessment provided in sections 327 and 328 of the 1918 Revenue Act. It proceeded to set forth in detail the various phases of its business which made it difficult to determine the values of the several classes of property that were paid in for stock. It is quite apparent that the appellant was concerned over the large tax it was required to pay to the Government, and felt that the relation of its income to its invested capital was strikingly abnormal. It set out a large number of reasons why it was entitled to a tax based on a compari-

son with representative corporations engaged in a like or similar business. Instances were cited of the accounting policy of the company in previous years where expenditures were charged to expense or profit and loss, when good accountancy would have justified the capitalization thereof. As an example of the conservative methods employed by the company, reference was made to certain printing plates which are used for the purpose of printing the various brands on the bags that are manufactured by the appellant. That is, the appellant is equipped to print upon the bags manufactured, the user's brands. During the years it has been in business, it has accumulated a large amount of printing sets for the printing of user's brands, which it contended were reasonably worth $851,375.50. The value was according to the taxpayer something more than the mere consideration of bare labor and material that went into the manufacture of the printing set. It represented the results of alert business solicitation and advertising with years of service that has been rendered by it to its customers; consequently, it contended in this presentation to the Commissioner, that the printing equipment represented an accumulation of years of good will, and although expense had been charged from year to year for the actual outlay for labor and material, no portion of this value had ever been added to the invested capital.

The facts concerning the original incorporation of the company and the early history of the corporation were presented to substantiate the failure on the part of the company to capitalize its good will in the proper amount. New plants, it was contended, had been obtained from time to time, and no good-will value was set up on the books for the different properties that were acquired in the long period of time that it had been engaged in the manufacturing business. Failure to properly capitalize certain patent rights was also set forth in the taxpayer's brief. Not all the various items which were incapable of proper valuation and which should have gone into capital were set forth. It was merely the intention of the taxpayer as disclosed by its brief, to throw some light upon what appeared to be abnormal profits upon which it was assessed; and it was contended by the taxpayer that the showing made entitled it to the special assessment that it requested. In other words, the various phases of the business of the taxpayer were set forth in order that the Commissioner would be convinced that the large taxes that had been assessed arose on account of undercapitalization, rather than excessive profits.

Section 156, Title 26, U. S. C. A., provides that:

"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 the law in that regard, and the regulations of the Secretary of the Treasury established in pursuance thereof * * *."

The statute of limitations applicable fixes the time for filing such claims at four years after the payment of any part of the taxes. The claims filed on February 29, 1924, and December 12, 1924, were timely, and were duly considered by the Commissioner on their merits. On October 30, 1926, a communication was sent by the Treasury Department to the taxpayer, a portion of which reads as follows:

"You are advised that after careful consideration and review your application under the provisions of section 327 of the Revenue Act of 1918 has been denied for the reason that the evidence presented fails to establish that your invested capital or net income is affected by abnormal conditions which would justify the Bureau in computing your tax under the provisions of section 328 of the above-mentioned Act.

"In accordance with the above conclusions, your claim for refund will be rejected in full."

On November 27, 1926, a second communication was sent by the Treasury Department to the taxpayer, a portion of which reads as follows:

"After careful consideration and review, your application under provisions of sections 210 and 327 of the Revenue Acts of 1917 and 1918 for assessment of your profits tax as prescribed in sections 210 and 328 of the above-mentioned Acts has been denied, inasmuch as the audit disclosed no exceptional hardship evidenced by gross disproportion between the tax computed by reference to representative concerns specified in sections 210 and 328.

"In accordance with the above conclusions, your claims for refund of $1,770,104.23 and $35,355.79 for 1917 and $1,270,907.97 for 1918 will be rejected in full."

It is clear that the claim for special assessment for the years 1918 and 1919 was rejected by these letters. On December 13, 1926, after the statute of limitations had run on these claims, the appellant sent to the Commissioner a communication referring to the rejection and among other things said:

"We protest against the rejection of said claims for refund for the following reasons:

"(a) The excess-profits tax against the company for the year 1917 should be determined under section 210 of the Revenue Act of 1917 and the excess-profits and war-profits taxes for the years 1918 and 1919 should be determined under section 328 of the Revenue Act of 1918. The denial of said right must be based upon the use of improper comparatives as representative.

"(b) If the assessment of the excess-profits taxes against the company in the manner claimed in the above subdivision is denied, then the items heretofore presented which have been improperly eliminated from invested capital should be restored to invested capital and the excess-profits tax recalculated on that basis."

Further communication was sent by the taxpayer under date of April 12, 1927. Under date of December 17, 1927, the Commissioner wrote advising that the claims for the years 1917, 1918, and 1919 had been reconsidered in connection with the taxpayer's protest, and the entire matter was then reviewed by the Commissioner, and the following is a portion of the communication so sent:

"In view of the above, your claim for the refund of $35,355.79, income and profits taxes for 1917, will be allowed for $32,675.42 and your claim for the refunding of $1,770,104.23 for 1917 will be rejected in full, in the next schedule to be approved by the Commissioner.

"Inasmuch as computation of your tax liability for 1918 and 1919 under the provisions of sections 327 and 328 of the Revenue Act of 1918 (provision for special assessment) is denied and your claim for the refunding of $1,270,907.97 for 1918 is confined to that point, it will be rejected in full in the next schedule to be approved by the Commissioner.

"Your claim for the computation of your tax liability for 1919 under the provisions of sections 327 and 328 has already been rejected.

"The overassessments indicated for 1918 and 1919 not being covered by proper claims are barred by the statute of limitations and can not be allowed."

In the review that was made by the Commissioner, the printing equipment items were considered, and it was determined by the Commissioner that the stereo metal used in producing the patterns and plates should be capitalized at cost in that it had a life of some years. The following is quoted from the Commissioner's letter of December 17, 1927:

"Your contention for the restoration of printing equipment charged to expense in the amount of $851,375.50, has been given careful consideration and it is found that all labor costs and material costs for patterns, plates, type and mats are charged directly to expense accounts in the current taxable years and it is believed such charges are proper. However, the stereo metal used in producing the patterns and plates inasmuch as it has a life of several years should be capitalized at cost. The average cost of such metal from 1905 to 1916, inclusive, is $0.0893 per pound. The average cost for a term of years prior to 1917 should be used instead of the average cost subsequent to that date, in determining the value of such metal on hand January 1, 1917."

The Commissioner then determined that the amount of $129,372.93 should be restored to printing equipment, and that the balance of the $851,375.50, or $722,002.57, should be disallowed for restoration to invested capital on the ground that it had been properly charged to expense. In making his computations, the Commissioner found that after restoring the amount of $129,372.93 to the printing equipment, there had been an overassessment of $14,054.18 in the tax paid for the year 1918, and $9,073.15 in the tax paid in the year 1919. The overassessments for the year 1917 were allowed; however, for the years 1918 and 1919 they were disallowed by the Commissioner because he contended that no proper claims had been filed before these claims were barred by the statute of limitations.

The fact that the Commissioner took it upon himself in considering the 1917, 1918, and 1919 taxes, to reconsider the entire application, would not be of any avail to the appellant if in truth and in fact, the claim for refund sued upon herein was not filed with the Commissioner within the statutory period. It is not seriously contended by the appellant that the Commissioner waived any rights of the Government by his communication of December 17, 1927. The Commissioner would have no authority to extend the statute of limitations after the expiration thereof. The letter of December 13, 1926, from the appellant to the Commissioner was written after the claims filed in 1924 were denied and after the statute of limitations had expired. The only question, therefore, presented to this court is whether or not the claims for refund filed by appellant on February 29, 1924, and December 12, 1924, were sufficient, under the law, to be the required preliminary for the maintenance of this action, which is based on overpayment of its taxes for 1918 and 1919 on the grounds that its invested capital is a larger amount than was set forth in its return for those years. The trial court held that the original application asked for a special assessment and in its application for special assessment, there was no indication that the taxpayer contended that it was entitled to a reduction of its taxes on the ground that there was certain printing material that should have been added to its invested capital. In other words, the trial court held that this action is based upon a new and inconsistent ground compared to the original application for tax refund, and that for the reason that the original claim for refund did not state the grounds which are the basis for this suit, that no recovery can be had herein.

In the case of *Tucker* v. *Alexander* (15 Fed. (2d), 356, 357 [T. D. 3973, C. B. VI–1, 287]), the court stated:

"Therefore, we think it is a required precedent or limitation that the action shall be upon the same grounds and only such as are presented in the claim. As no ground in this petition is stated in the claim for refund, we think this petition has no standing under the issues tendered by the petition."

In the case of *Red Wing Malting Co.* v. *Willcuts* (15 Fed. (2d), 626, 634 [T. D. 3980, C. B. VI–1, 225]), the court stated:

"The precise ground upon which the refund is demanded must be stated in the application to the Commissioner, and we think, if that is not done, a party can not base a recovery in the court upon an entirely different and distinct ground from that presented to the Commissioner."

In the case of *United States* v. *Felt & Tarrant Manufacturing Co.* (283 U. S., 269 [Ct. D. 336, C. B. X–1. 431]) the Supreme Court had a very similar question presented to it. In that case, the taxpayer filed a claim for refund asking for special assessment as in the instant case. This was denied and it brought suit on the basis that its gross income should be decreased by items of exhaustion or obsolescence of patents. The Supreme Court said on page 271:

"That section provides for a special method of assessment of excess profits taxes in any case where the Secretary of the Treasury is unable satisfactorily to determine the invested capital of the taxpayer. It has no relation to deductions from gross income on account of exhaustion or obsolescence of parents. In support of its claim, which was ultimately allowed in part, respondent prepared and filed a brief, and an oral argument was held in the office of the Commissioner; but neither in its claim for refund, its brief, nor at the hearing, was mention made of the deduction now claimed.

"The filing of a claim or demand as a prerequisite to a suit to recover taxes paid is a familiar provision of the revenue laws, compliance with which may be insisted upon by the defendant, whether the collector or the United States. (*Tucker* v. *Alexander*, 275 U. S., 228; *Maryland Casualty Co.* v. *United States*, 251 U. S., 342, 353, 354; *Kings County Institution* v. *Blair*, 116 U. S., 200; *Nichols* v. *United States*, 7 Wall., 122, 130.)

"One object of such requirements 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 (*Nichols* v. *United States*, supra, page 130), a purpose not accomplished with respect to the present demand by the bare declaration in respondent's claim that it was filed 'to protect all possible legal rights of the taxpayer.' The claim for refund, which section 1318 makes prerequisite to suit, obviously relates to the claim which may be asserted by the suit. Hence, quite apart from the provisions of the regulation, the statute is not satisfied by the filing of a paper 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.

"The Court of Claims, in allowing recovery, relied upon *Tucker* v. *Alexander*, supra, and upon the fact that at the time when respondent filed its return and its claim for refund, the Treasury had consistently refused to allow deductions from gross income for exhaustion of patents. Consequently it held that the filing of a demand which was certain to be refused was a futile and unnecessary act. But in *Tucker* v. *Alexander* the right of the Government to insist upon compliance with the statutory requirement was emphasized. Only because that right was recognized was it necessary to decide whether it could be waived. The court held that it could, and that in that case it had been waived by the stipulation of the collector filed in court. Here there was no compliance with the statute nor was there a waiver of its condition, since the Commissioner had no knowledge of the claim and took no action with respect to it.

"The necessity for filing a claim such as the statute requires is not dispensed with because the claim may be rejected. It is the rejection which makes the suit necessary. An anticipated rejection of the claim which the statute contemplates, is not a ground for suspending its operation. Even though formal, the condition upon which the consent to suit is given is defined by the words of the statute, and 'they mark the conditions of the claimant's right.' (*Rock Island R. R. Co.* v. *United States*, 254 U. S., 141, 143.) Compliance may be dispensed with by waiver, as an administrative act (*Tucker* v. *Alexander*, supra); but it is not within the judicial province to read out of the statute the requirement of its words. (*Rand* v. *United States*, 249 U. S., 503, 510.)"

The appellant takes the position that in its original claim for refund, the Commissioner had called to his attention all the facts necessary to justify a reduction in its taxes on the basis of increased capital. However, it seems clear that the reference to the printing equipment presented in the original claim for refund was merely used as an illustration of the inability to determine the values of the invested capital in order to substantiate the right of the claimant to have its taxes assessed under sections 327 and 328 of the Revenue Act of 1918. It was merely incidental. There is no particular similarity between a claim for refund based on a right of special assessment, and a claim for refund based on the right to have the invested capital increased. In fact, the appellant took the position, when its claim for refund was originally presented, that the facts regarding its invested capital and value of property paid in for its stock, could not be determined, and for that reason, it insisted that its tax should be assessed as the average tax of representative corporations engaged in a like or similar trade or business. It may be that there is some confusion between the terms "facts" and "grounds" as used with reference to claims for tax refund. But the purpose in setting out facts is to advise the Commissioner of the grounds for tax reduction, and the original claim was predicated solely upon the right of special assessment. Any reference in the claim to the status of its printing equipment was merely referred to in support of the taxpayer's right to special assessment. At least, one object of the requirement to set forth the facts in substantiation of the claim for refund is to advise the Commissioner so that there may be an orderly administration of the Revenue Department. (*United States* v. *Felt & Tarrant Mfg. Co.*, supra.) If the appellant had in mind that it was entitled to a tax reduction on account of increased invested capital, there would have been no difficulty whatsoever in setting forth such a statement and asking for a reduction on such specific ground. The only purpose evidenced by appellant in filing its claims was to obtain a special assessment in view of certain abnormal conditions and circumstances set forth in considerable detail in its brief in support of its claim. The Commissioner was asked to allow a special assessment. In view of these circumstances, no other claim was presented. The Commissioner's attention, before the claim was barred by the statute of limitations, was not called to any other claim for refund.

The court, in the case of *Mutual Life Insurance Co. of New York* v. *United States* (49 Fed. (2d), 662 [Ct. D. 363, C. B. X–2, 292]), seems to have had substantially this same question before it. On page 664 it said:

"Although the claim of August 2 stated certain facts with reference to the reserve funds at the beginning and end of the taxable year from which the 4 per cent of the mean of these reserve funds could be determined, they were stated, considered, and acted upon by the Commissioner for an entirely different purpose than that upon which the plaintiff now relies. No claim for refund

of the nature asserted in this suit was ever made to the Commissioner until the application for reconsideration long after he had rejected the claim and after the statute of limitation for filing a claim had expired."

The claim for refund was prepared by the attorneys for appellant with considerable care. Great pains were taken in presenting to the Commissioner a voluminous brief in support of its contention that it was entitled to a special assessment. The Commissioner considered appellant's application for some two years, and then formally denied it. If appellant intended to press a claim for refund before the statute of limitations expired on the grounds that its invested capital should be increased by certain printing equipment, there was no indication of any such intention prior to December 13, 1926. The target at which appellant was aiming was the consent of the Commissioner to have its tax assessed according to sections 327 and 328 of the Revenue Act of 1918. The fact that in aid of that objective certain facts appeared that might furnish grounds for a partial refund on an entirely different and inconsistent claim, could hardly be considered a preliminary requirement to a suit for such partial refund. (*Connell* v. *Hopkins*, 43 Fed. (2d), 773 [Ct. D. 248, C. B. IX–2, 407]; *Lucas* v. *Pilliod Lumber Co.*, 281 U. S., 245 [Ct. D. 266, C. B. IX–2, 396]; *Maas & Waldstein Co.* v. *United States*, 283 U. S., 583 [Ct. D. 353, C. B. X–1, 433].)

In accordance with the views herein expressed, the judgment of the lower court is affirmed.

ARTICLE 1351: Suits for recovery of taxes erroneously collected. (Also Section 206, Article 1621.)

XI–52–5953
Ct. D. 615

INCOME TAX—REVENUE ACT OF 1918—DECISION OF COURT.

1. CLAIM FOR REFUND—SUPPLEMENTAL CLAIM.

Where in its original claim for refund plaintiff sought special assessment it may not set up a new ground for refund after the rejection of its claim and after the expiration of the statutory period for filing refund claims.

2. CLAIM FOR REFUND—FILING—BURDEN OF PROOF.

Plaintiff has burden of alleging and proving timely filing of claim for refund.

3. DEDUCTIONS—NET LOSS—CONSOLIDATED CORPORATIONS.

Under the law of New York a consolidation of two corporations effects a dissolution of the constituent corporations and the creation of a new corporate entity. Net loss of such new corporate entity may not be deducted from net income of one constituent under section 204(b) of the Revenue Act of 1918.

UNITED STATES DISTRICT COURT, SOUTHERN DISTRICT OF NEW YORK.

Swedish Iron & Steel Corporation, plaintiff, v. *William H. Edwards, defendant.*

[August 27, 1932.]

OPINION.

GODDARD, District Judge: This action challenges the correctness of a tax assessed and collected for the fiscal year ending April 30, 1918. The tax was assessed against Swedish Iron & Steel Corporation, a New York corporation organized in 1907, which for convenience will hereafter be referred to as corporation No. 1. The plaintiff asserts that it is the same taxpayer as corporation No. 1 and contends, in reliance upon sections 200 and 204(b), Revenue Act of 1918, that it was overassessed for the year in question because the Commissioner refused to deduct a net loss incurred by the plaintiff for the calendar year 1919. The defendant denies that the plaintiff is the same taxpayer as corporation No. 1, and contends that in any event the year ending April 30, 1918, was not "the preceding taxable year" to that during which the net loss was incurred, within the meaning of the statute involved. In addition,

the defendant urges that the suit can not be maintained because plaintiff's claim for refund did not specify the ground for relief which is now relied upon.

For an understanding of these opposing contentions a further statement must be made of the facts established at the trial. By an agreement dated October 2, 1918, and filed in the office of the secretary of state of New York on October 8, 1918, between corporation No. 1 and Federal Tool & Alloy Steel Corporation, a New York corporation organized in 1917 and hereafter, for convenience, referred to as corporation No. 2, it was agreed to "merge and consolidate such corporations into a single corporation," and it was mutually covenanted that "the name of the corporation newly formed by said consolidation shall be Federal Tool & Alloy Steel Corporation," and that the "term of existence of such new corporation shall be fifty (50) years." The agreement also provided that the capital stock of "such new corporation" should be exchanged share for share for the outstanding certificates of "said constituent corporations," except that for the outstanding shares of corporation No. 1 (3,738.1125 in number) there should be exchanged an additional 1.8875 shares of the new corporation (a total of 3,740 shares) in order to avoid the issue of fractional shares. The outstanding shares of corporation No. 2 were 100 in number. The corporation resulting from this agreement subsequently changed its name to Swedish Iron & Steel Corporation and is the plaintiff in the present action. One of the points in dispute is whether the agreement effected only a merger of the two corporations pursuant to section 15 of chapter 61 of the stock corporation law (New York Laws of 1909) with the result that the plaintiff is the same legal entity as corporation No. 1, as the plaintiff contends, or whether it effected a technical consolidation pursuant to section 7 of chapter 12 of the business corporations law (New York Laws of 1909) and resulted in the creation of a new and different corporate entity, as the defendant contends.

Prior to executing the aforesaid agreement corporation No. 1 had filed a Federal tax return for its fiscal year ending April 30, 1918. Corporation No. 2 had never engaged in business and so filed no tax return. Subsequent to execution of the said agreement, corporation No. 1 filed another income tax return for the period from May 1 to October 10, 1918, and the plaintiff, in its then name of Federal Tool & Alloy Steel Corporation, filed a return for the period from October 10 to December 31, 1918, and a return for the calendar year 1919. The latter shows a net loss of some $36,000, which, as already stated, forms the basis of the present suit. The tax assessed against corporation No. 1 for its taxable year ending April 30, 1918, amounted to $78,625.06 and was paid in three installments, the first being paid on July 29, 1918, by corporation No. 1, and the last two, on January 6 and May 19, 1919, respectively, by the plaintiff. The last installment was $18,515.82. It is stipulated that if the plaintiff is entitled to a judgment, the amount thereof should be $14,150.82.

On February 28, 1923, plaintiff filed a claim for refund of the entire tax assessed against corporation No. 1 for the year ending April 30, 1918, on the ground that it was entitled to a special assessment under section 210 of the Revenue Act of 1918. By letter dated April 22, 1925 (Exhibit B), the Commissioner notified plaintiff of the rejection of its claim for refund. Thereafter by letters dated July 22 and September 29, 1925 (Exhibit 16), plaintiff asked for a reaudit and reconsideration of the taxes assessed for the year ending April 30, 1918, and claimed deduction of its net loss for the calendar year 1919. The Commissioner replied on October 26, 1925 (Exhibit 17), that the case would be reconsidered, and by letter of November 27, 1925 (Exhibit 15), notified plaintiff that the taxes as previously determined were correct. Within two years thereafter and in October, 1927, the present suit was brought.

The contention that the claim for refund presented to the Commissioner is insufficient to support the suit will be first considered. Revised Statutes, section 3226, as amended (45 Stat., 343), provides that "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 * * * 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."

Article 1036 of Regulations 62 was in effect when the plaintiff filed its claim for refund on February 28, 1923. The article provides—

"Claims by the taxpayer for the refunding of taxes and penalties erroneously or illegally collected should be made on Form 843. * * * All the facts relied upon in support of the claim should be clearly set forth under oath * * *."

The plaintiff's claim for refund filed on February 28, 1923, was made on Form 843 and was under oath, but it contained no suggestion that the claim was based on the right to deduct the net loss incurred by plaintiff in the calendar year 1919 and no inference to facts in support of such a claim. Hence the claim as originally filed was insufficient to give notice of the cause of action now sued upon. (See *United States* v. *Felt & Tarrant Co.*, 283 U. S., 269, 272 [Ct. D. 336, C. B. X–1, 431]; *Red Wing Malting Co.* v. *Willcuts*, 15 Fed. (2d), 626, 634 (C. C. A. Eighth Circuit) [T. D. 3980, C. B. VI–1, 225]; and numerous authorities cited in *Art Metal Const. Co.* v. *United States*, 47 Fed. (2d), 558, 561 (C. C. A. Second Circuit) [Ct. D. 300, C. B. X–1, 421].)

But the plaintiff contends that the claim for refund was amended to specify the proper ground by the letters of July 22 and September 29, 1925. This was subsequent to the Commissioner's letter of April 22, 1925, notifying the plaintiff of the rejection of its claim for refund. It was also more than six years after payment of the final installment of the tax on May 19, 1919. Section 1316 of the Revenue Act of 1921 (42 Stat., 314) and section 1012 of the Revenue Act of 1924 (43 Stat., 342) require a claim for refund to be presented within four years after payment of the tax. Assuming that the letters of July 22 and September 29, 1925, may be treated as an amendment of the claim as originally filed, although they do not profess to be such, but asked for a "reaudit and reconsideration" of the tax for the fiscal year ending April 30, 1918, the question arises whether an amendment setting up a new ground for refund may be received and considered by the Commissioner after the original claim has been rejected and after the statutory period for filing claims has run. That the Commissioner can not be required to receive an amendment under such circumstances was stated in *Solomon* v. *United States* (37 Fed. (2d), 150, 151 (C. C. A. Second Circuit) [Ct. D. 520, page 399, this bulletin]). In *McKesson & Robbins, Inc.*, v. *Edwards* (57 Fed. (2d), 147, 150 (C. C. A. Second Circuit)), it was held that an amendment might be made with the Commissioner's acquiescence after the period of limitation had run. There, however, the original claim contained a reference, though an insufficient one, to the ground of relief set forth in detail in the amendment; there was something to amend. Here the letters treated as an amendment set up an entirely new ground not in any way mentioned in the original claim. Strictly it was not an amendment at all but the presentation of an entirely new basis for relief. To allow an entirely new ground for relief to be presented after the statutory period has run appears to me no different than to allow the original and only claim for refund to be filed at that time. Clearly the latter is forbidden by the statute. In my opinion the former is also. (See *Mutual Life Insurance Co.* v. *United States*, 49 Fed. (2d), 662, 664 (Ct. Cl.) [Ct. D. 363, C. B. X–2, 292]; *Sugar Land Ry. Co.* v. *United States*, 48 Fed. (2d), 973 (Ct. Cl.) [Ct. D. 382, C. B. X–2, 309]; *New England Mutual Life Insurance Co.* v. *United States*, 52 Fed. (2d), 1006 (Ct. Cl.); *National Fire Insurance Co.* v. *United States*, 52 Fed. (2d), 1014, 1017 (Ct. Cl.); *Connell* v. *Hopkins*, 43 Fed. (2d), 773 (N. D. Texas); *Meinrath Brokerage Co.* v. *Crooks*, 28 Fed. (2d), 991 (W. D. Mo.).)

The plaintiff contends that the issue above discussed is not properly before the court because the defendant did not plead the statute of limitations. The point is not well taken. In its complaint the plaintiff alleged that on or about February 28, 1923, it filed a claim for refund; it alleged nothing as to the letters upon which it now relies as constituting an amendment. The defendant's amended answer sets up as a second defense that "in said claim for refund plaintiff did not set forth the cause of action which is not stated in its complaint." When the claim for refund (Exhibit 14) was offered in evidence, the defendant objected to its admission for the same reason. After the trial was concluded the letters in question (Exhibit 16) were put in by stipulation "subject to the objections and exceptions of defendant." Where the filing of a claim for refund "according to the provisions of law in that regard" is a condition of the plaintiff's right to maintain its suit, it would seem that the plaintiff would have the burden of alleging and proving timely filing of his claim, and that the defendant would not be required to plead and prove a late filing. In other words, I do not think this is a suit where the ordinary rules of pleading a statute of limitations are applicable. But if they were, I should allow the defendant, in view of the way the case was presented, to amend its answer to set up the statute. In my opinion, therefore, the defendant's contention that the amendment was too late is properly before me and presents a complete bar to the suit.

But even if this conclusion were wrong, there is another ground upon which the verdict must be directed for the defendant, namely, the lack of identity between the plaintiff and the taxpayer against whom the tax in question was assessed. Under the law of New York, as it existed when the agreement of October 2, 1918, was made, a consolidation of two corporations effects a dissolution of the constituent corporations and the creation of a new corporate entity. (*People* v. *Rice*, 57 Hun., 486, affirmed 128 N. Y., 591; *People* v. *N. Y. C. & S. L. R. Co.*, 129 N. Y., 474; *Matter of Bergdorf*, 149 N. Y. App. Div., 529, 532.) It seems perfectly clear that the agreement of October 22 contemplated a consolidation of the two constituents which I have referred to as corporation No. 1 and corporation No. 2. Each of the constituent corporations had a corporate life of unlimited duration. The agreement specifies the name of "the new corporation formed by said consolidation" and provides that its term of existence shall be 50 years. Section 7 of the business corporations law (ch. 12, New York Laws, 1909) expressly provided that an agreement for consolidation should prescribe the name of the "new corporation" and "the term of its existence, not exceeding 50 years." The agreement also specified the amount of the capital stock of the new corporation (as required by the statute) and provided for the issuance of the stock of the new corporation in exchange for the certificates of the constituent corporations. The use of the word "merge" in conjunction with "consolidation" is wholly insufficient to overcome this clear evidence of the creation of a new corporation by consolidation. Nor is the agreement consistent with an intent to merge corporation No. 2 into corporation No. 1. The merger statute (section 15, ch. 12, New York Laws, 1909) provides that the subsidiary corporation may be merged into the possessor corporation and thereupon the latter shall acquire all the rights, privileges and property of the former and control them "in its name." The agreement of October 2, 1918, contemplated nothing of this sort; corporation No. 1 was not to acquire and control in its name the rights of corporation No. 2, but a new corporation, of a different name and different term of corporate life, was to take the place of the two constituent corporations. And what was done after the agreement was executed is consistent only with this view. Corporation No. 1 filed a tax return for the period from May 1 to October 10, 1918, and the "new corporation" by its then name of Federal Tool & Alloy Steel Corporation filed its return for the period from October 10 to December 31, 1918, thereby clearly indicating its own understanding that it was a different taxpayer from corporation No. 1. Moreover, in a merger there is no exchange of stock such as took place under the agreement of October 2, 1918. Since the plaintiff is a different corporate entity from corporation No. 1, against which the tax in question was assessed, section 204(b) of the Revenue Act of 1918 has no application. That section requires that the net loss be incurred by the same taxpayer against whom a tax was assessed for the preceding taxable year.

For the foregoing reasons, I deny the plaintiff's motion for a directed verdict and direct a verdict for the defendant.

SECTION 1116.—INTEREST ON REFUNDS AND CREDITS.

ARTICLE 1371: Interest on refunds and credits. XI-36-5661
Ct. D. 553

FEDERAL TAXES—REVENUE ACT OF 1921—DECISION OF COURT.

INTEREST—REFUND OR CREDIT—SPECIFIC PROTEST—ARGUMENT FOR SPECIAL ASSESSMENT.

An argument by a taxpayer supporting the right to special assessment under section 210 of the Revenue Act of 1917 is 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 or credit is not allowable as provided therein.

COURT OF CLAIMS OF THE UNITED STATES. No. K–80.

Fulton Bag & Cotton Mills, a Corporation, v. *The United States.*

[May 2, 1932.]

OPINION.

WILLIAMS, Judge, delivered the opinion of the court.

The plaintiff, a Georgia corporation, during the year 1917, owned all the capital stock of the Fulton Bag & Cotton Mills of Brooklyn, N. Y., a New York corporation. The latter corporation was dissolved in January, 1918, and all its assets and liabilities were taken over by the plaintiff.

On March 27, 1918, the plaintiff filed with the collector of internal revenue at Brooklyn, N. Y., the income and excess-profits tax return for its subsidiary corporation for the year 1917, and on June 13, 1918, paid the collector the tax shown to be due thereon. On March 29, 1918, plaintiff filed its own income and excess-profits tax return for the year 1917, with the collector of internal revenue at Atlanta, Ga., and on June 15, 1918, paid the collector the tax shown to be due thereon.

The Commissioner of Internal Revenue, in 1923, granted the plaintiff the benefit special assessment under section 210 of the Revenue Act of 1917, which it had theretofore, on a claim dated September 5, 1922, requested. The Commissioner determined that the plaintiff had overpaid its income and excess-profits taxes for the year 1917 in the sum of $106,933.92, and that it had overpaid the taxes of its dissolved subsidiary in the sum of $48,801.75, making a total overpayment for the year, of $155,735.67. Of this amount $137,326.63 was refunded to the plaintiff and the balance, $18,409.04, was credited against taxes due the Government for the year 1922.

There is no controversy between the parties as to the correctness of the Commissioner's determination of the amount of the overpayment, or the manner in which it was refunded and credited. The controversy relates wholly to the amount of interest the plaintiff is entitled to receive on the overpayment.

The Commissioner allowed interest on the amount refunded, from six months after the filing of the claim for refund, to the date of the allowance of the refunds.

The plaintiff claims it paid the tax in question under specific protest within the requirements of clause (1), of section 1324(a) of the Revenue Act of 1921 (42 Stat., 316), and that interest was allowable from the date of payment of the tax. The Act provides:

"(a) 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, * * *."

At the time of the payment of its 1917 taxes, June 15, 1918, plaintiff filed with the collector of internal revenue at Atlanta, a letter protesting the payment on the ground that the tax was erroneous and illegal, especially that part of the tax relating to excess profits. The plaintiff concedes this letter was not a specific protest within the meaning of section 1324(a), and relies wholly upon certain oral representations made to the collector by plaintiff's legal adviser at the time of the payment of the tax, as constituting a specific protest.

It appears plaintiff is an old and conservatively managed corporation, the capital stock of which is closely held, being practically a one-family concern. Prior to 1917, proper adjustments in invested capital had not been made and the net earnings of the company for 1917, as shown by its books, on which it was required to pay taxes, were, in the opinion of officers of the company, excessive and placed plaintiff in the position of paying more taxes proportionately than other companies similarly situated whose books reflected the true invested capital. On the day the taxes were paid plaintiff's vice president accompanied by his legal adviser, called upon the collector and had a conversation with him about this situation of the plaintiff company. The collector was informed that the company's invested capital, as shown on its books, was largely understated, and that the taxes being collected were out of all proportion to the taxes paid by competitive corporations less conservatively

capitalized. The conversation between plaintiff's representative and the collector, which was characterized by plaintiff's witness as being "fussing and fuming," was somewhat extended, but the only protest made against the tax was that it was excessive because of the plaintiff's failure, in prior years, to make proper adjustments of its invested capital. These oral representations were not reported to the Commissioner of Internal Revenue by the collector.

It is not necessary to pass upon the plaintiff's contention that an oral protest, if otherwise satisfactory, meets the requirements of the statute, as, in our opinion the oral statements made to the collector, even if they had been made in writing, were not sufficient to constitute a specific protest. The legality of the tax is not challenged, and the right of the taxing officials to exact payment of the taxes shown to be due on the return, is not questioned in any way. In this respect the oral protest is lacking in the essential requirements of a specific protest. (*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].)

A protest is for the purpose of inviting attention of the taxing officers to the illegality of the collection, so that they may take remedial measures at once. (*Girard Trust Co.* v. *United States*, supra.)

The oral statements, relied upon as constituting a specific protest to the payment of the tax, amount, at most, to an argument justifying special assessment under section 210 of the Revenue Act of 1917. If, as has been held, a request for special assessment under section 210 is not a specific protest within the meaning of section 1324(a) (*Maas & Waldstein Co.* v. *United States*, 283 U. S., 583, and *Chestnut & Smith* v. *United States*, No. K–105 [Ct. D. 491, C. B. XI–1, 320], decided February 8, 1932), certainly an argument by a taxpayer supporting the right to special assessment can not be held to be a specific protest.

In *Maas & Waldstein*, supra, the taxpayer filed his income and excess-profits tax returns for the year 1917 in the same manner as did the plaintiff in the instant case. With the return the taxpayer sent a written communication stating "our tax is proportionately larger than that of other representative concerns in the same line of business," and "under paragraph 4, article 52, our invested capital when compared in the manner specified in the regulations is manifestly seriously disproportionate to the taxable income." On the payment of the taxes the taxpayer again wrote the Commissioner stating: "We filed a request dated March 28, for assessment in the manner provided for in article 52, referring also to articles 18 and 24, Regulations 41." The taxpayer contended these two letters were sufficient to meet the requirements of section 1324(a) as to "a specific protest setting forth in detail the basis of and the reasons for such protest." The Supreme Court, overruling the taxpayer's contention, through Mr. Justice McReynolds, said:

"The general purpose of the petitioner's communications to the Commissioner was to induce the latter to set on foot an investigation of the company's affairs to the end that, after ascertaining the circumstances and in the exercise of a proper discretion, he might make an assessment duly proportioned to those imposed upon others engaged in like business. There was no challenge of the Commissioner's right then to demand payment according to the general rule—no claim that in view of the facts then before him this would amount to an unlawful imposition. * * *

* * * * * * *

"We are unable to conclude that the petitioner's action amounted to a precise objection to an unauthorized exaction within the fair intendment of the statute. Meticulous compliance by the taxpayer with the prescribed conditions must appear before he can recover. (*Lucas* v. *Pilliod Lumber Co.*, 281 U. S., 245, 249 [Ct. D. 266, C. B. IX–2, 396].)"

The facts in the case at bar are in all essential respects similar to the facts in the case cited, except that the alleged specific protest in the instant case was made orally to the collector, while the protest in the former case was made in writing, and addressed to the Commissioner. Conceding, without deciding, that a specific protest within the requirements of section 1324(a) of the Revenue Act of 1917 can be made orally, the plaintiff in this case can not recover, as the statements relied upon are not sufficient to constitute a specific protest within the meaning of the section. There is no claim that in view of the facts then before the taxing officials the amount of tax shown to be

due on the plaintiff's return amounted to an unlawful imposition. The return upon which the tax was based was made out in the manner provided by law, and the amount of tax shown to be due was based on plaintiff's net earnings for the year as reflected by its books. Plaintiff's right to be relieved from the general application of the law, and to have its tax liability determined under the provisions of section 210, of the Revenue Act of 1917, was dependent entirely upon its ability to make the showing required in that section, and the granting of that privilege to the plaintiff, as the Commissioner subsequently did, does not make the original tax computed under the strict application of the law illegal, or its collection an unauthorized exaction.

The petition will, therefore, be dismissed. It is so ordered.

ARTICLE 1371: Interest on refunds and credits. XI-36-5662
Ct. D. 554

FEDERAL TAXES—REVENUE ACT OF 1921—DECISION OF COURT.

1. INTEREST ON REFUND—CLAIM FOR REFUND—SUFFICIENCY.

A report upon its taxes made by auditors employed by a taxpayer which is presented to the Commissioner but addressed to the taxpayer, is not sworn to, does not purport to be a claim for refund, makes no mention of such claim and is never recognized by the Commissioner as a claim, is not an informal or formal claim for refund within the meaning of section 1324(a) of the Revenue Act of 1921, which provides for the payment of interest on refunds, and a later report by the auditors which includes all the requirements for a claim for refund can not be considered as an amendment of the first report so as to validate it as a sufficient claim.

2. SUIT—INTEREST ON REFUND—LIMITATION.

Under section 1324(a) of the Revenue Act of 1921 the date of allowance of a claim for refund of a tax to which interest is payable is the date on which the Commissioner signs the schedule of refunds and credits in respect thereof, on which date a claim for the interest accrues, and a suit for such interest commenced more than six years after that date is barred by section 1069, Revised Statutes.

COURT OF CLAIMS OF THE UNITED STATES. No. L-151.

Colgate-Palmolive-Peet Co. (Successors to Peet Bros. Manufacturing Co.) v. *The United States.*

[May 2, 1932.]

OPINION.

GREEN, Judge, delivered the opinion of the court.

This is a suit to recover $23,949.07 alleged to be due as additional interest upon a refund paid to plaintiff of income and profits taxes collected for the fiscal year ending September 30, 1918. The defendant sets up two defenses: First, that all the interest due the plaintiff under the law has been paid; second (in a supplemental brief), that the action is barred by the statute of limitations. Under the first defense the case turns entirely upon the question of whether a certain auditors' report upon plaintiff's taxes for said year, which was presented to the Commissioner of Internal Revenue by the taxpayer on September 15, 1920, is to be treated as an informal claim for refund and interest allowed from six months after the date of filing such claim; or whether on the other hand no claim for refund, either formal or informal, was filed until December 20, 1922, when, through a further report of said auditors, it was stated to the Commissioner that the taxpayer was entitled to a refund. The Commissioner held that no refund claim was filed until the date last named above, and following the applicable provisions of the Revenue Act of 1921 allowed interest beginning with a date six months after the claim under his deci-

sion had been filed. The plaintiff claims that interest should have been allowed after six months from September 15, 1920.

We are of the opinion that the Commissioner was right. The first report made by the auditors and which, as recited above, was presented to the Commissioner of Internal Revenue was evidently made for the purpose of showing how the tax should be computed. It is true that this report showed that the taxpayer had largely overpaid its taxes and that it was presented to the Commissioner for the purpose of correcting what the taxpayer claimed to be an error. But it was not addressed to the Commissioner. It was addressed to the taxpayer and presented to the taxpayer for such use as the taxpayer might see fit. It did not purport to be a claim for refund and made no mention of such a claim. Moreover, as we have found, the Commissioner never recognized it as a claim for refund. He may have made use of this report in preparing the certificate of overassessment together with the second report filed, as shown above, December 20, 1922, in which there was a claim that plaintiff was entitled to a refund. But conceding that the Commissioner made such use of the first report, this fact would not make it a claim for a refund. Nor does the fact that reference was made thereafter in the correspondence between the parties to the first report as "our claim" by the taxpayer and "your claim" by the Commissioner make it a claim for a refund. The report did set out a "claim," but it was a claim for certain deductions and allowances to be made in the computation of the tax and the word "claim" was evidently used in that sense. The claim for refund was first made in the second report and interest was allowed and paid from six months after the date of its presentation. There is therefore nothing more due the plaintiff.

Plaintiff seems to rely on the case of *McKenney* v. *United States* (72 C. Cls., 195). In that case it appears that the Commissioner had allowed a refund and that the only basis for the allowance thereof was a certain document which the plaintiff in the case contended amounted to an informal claim for refund. Under the facts and circumstances presented to the court the plaintiff's contention was sustained, but we think the decision has no application to the case at bar. In that case the action of the Commissioner of Internal Revenue was held in effect to recognize the document or instrument as a claim for refund and this constituted an important feature of the case. The court held with reference to this document that "His (the Commissioner's) only authority for allowing and paying the refund was the claim filed by the partnership." In the instant case the Commissioner did not make his decision approving a schedule of overassessment with reference to the taxes in controversy from which resulted the refund subsequently paid to plaintiff, and upon which additional interest is now sought to be recovered, until after the second report making a claim for refund had been filed. In fact he never recognized the first auditors' report as a claim for refund.

It is argued that the second auditors' report, which was duly sworn to by authorized attorneys and included all the requirements for a claim for refund, should be considered as an amendment to the first report made by the auditors which is referred to in argument as an informal claim for a refund, but the original statement of the auditors possessed none of the requirements for a refund either formal or informal. While it was filed in the Commissioner's office, it was not even addressed to the Commissioner or the defendant, and it was not sworn to. As we have shown above, there was nothing about it that was in the nature of a claim for refund and, therefore, the second auditors' statement which did contain the claim for refund can not be considered as an amendment thereof.

Nor do we think the opinion in *Bonwit Teller & Co.* v. *United States* (283 U. S., 258 [Ct. D. 334, C. B. X–1, 328]) sustains plaintiff's contention. In that case also, the Commissioner held that a communication from the taxpayer constituted an informal claim for refund and the court said in substance that such a ruling in favor of the taxpayer was entitled to much weight. The facts in that case and the law applicable thereto made it necessary for the taxpayer to file a waiver before it could commence suit and the Supreme Court called attention to this fact, but this has no application to the time within which plaintiff in the case at bar was required to begin its action.

We are also of the opinion that the second defense must be sustained.

All questions relative to the interest to which plaintiff is entitled are controlled by section 1324(a) of the Revenue Act of 1921. The portion of this section upon which the question next to be considered turns reads as follows:

"SEC. 1324. (a) That upon the allowance of a claim for the refund of or credit for internal revenue taxes paid, interest shall be allowed and paid * * * from six months after the date of filing of such claim for refund or credit."

It will be observed that under this provision interest is not paid, except upon the allowance of a claim for refund, and when the refund is allowed then interest is paid from six months after the date of filing such claim for refund or credit. Both parties agree that a claim for refund was allowed. We think it clear under the statute that whenever the claim for refund was allowed the statute of limitations began to run. The findings show that on March 15, 1924, the Commissioner of Internal Revenue approved a schedule of overassessments in favor of the plaintiff, which was on March 28, 1924, signed and returned to the Commissioner by the collector of internal revenue with a schedule of refunds and credits showing a balance of $106,455.01 refundable. On April 24 the Commissioner authorized the clerk of the Treasury Department to issue a check for the amount so found to be refundable, and on May 15, 1924, the certificate of overassessment and a Treasury check dated May 12, 1924, for the amount found to be refundable, $106,455.01, were mailed to the plaintiff.

It should be kept in mind that plaintiff's case is based upon the provisions of the 1921 Act, and under this statute an action to recover interest can only be maintained upon "the allowance of a claim" for a refund or credit. There is therefore no basis for plaintiff's suit unless a claim for a refund was allowed. Counsel for plaintiff concede that a claim was allowed, a concession which must be made if the suit is to be maintained. It is contended on behalf of the defendant that the claim was allowed on April 24, 1924, when the Commissioner of Internal Revenue signed the schedule of overassessments, approved the collector's action pursuant to directions appearing thereon, and authorized the disbursing clerk of the Treasury to issue a warrant for the amount so determined to be refundable. We think this position is sound and that plaintiff's cause of action arose when the refund was allowed. This suit was not commenced until April 28, 1930. Not being commenced within six years from the time the cause of action accrued, the plaintiff's right to recover is barred under the general statute of limitations.

Counsel for plaintiff refer in their printed brief to two letters which it is said the Commissioner wrote the plaintiff. Based upon the statements contained in one of them, it is contended that the certification of overpayment made on April 24, 1924, did not in fact relate to any claim, and that the claim was not in fact allowed until the certificate of overassessment and check in payment of the refund were delivered to plaintiff on May 16, 1924. The contents of these letters are not referred to in the findings made by the commissioner of this court which were accepted by the plaintiff, and the letters do not appear to have been introduced in evidence. In any event, we think the Commissioner's action on April 24, 1924, as shown by the findings and set out above, amounted to an allowance of the claim which had been previously made. In *United States* v. *Magnolia Petroleum Co.* (276 U. S., 160 [T. D. 4153, C. B. VII-1, 287]) the Supreme Court said:

"The date of 'allowance' was October 11, 1923, when the Commissioner approved the refunds. (*Girard Trust Co.* v. *United States*, 270 U. S., 163, 169 [T. D. 3919, C. B. V-2, 209].) Under section 1324(a), 'upon the allowance' of the refunds, respondent became entitled to interest according to the rule then in force. (Cf. *Blair* v. *Birkenstock*, 271 U. S., 348, 350.) Computation and payment were all that remained to be done."

It is true that plaintiff had no knowledge of this allowance until nearly a month later, but the period of the statute of limitations can not be adjusted to meet every small variation in the circumstances to which it applies. In this case, after receiving the check for refund and being fully advised in the matter, the plaintiff had 5 years and 11 months in which to bring suit.

For the reasons above stated the petition of the plaintiff must be dismissed, and it is so ordered.

ARTICLE 1371: Interest on refunds and credits.

REVENUE ACT OF 1926.

The date on which a credit is allowed. (See Ct. D. 568, page 359.)

ARTICLE 1371: Interest on refunds and credits. XI-45-5839
Ct. D. 597

INCOME TAX—REVENUE ACTS OF 1921 AND 1924—DECISION OF COURT.

1. INTEREST—REFUND OR CREDIT—CLAIM—SUFFICIENCY.

Where the claim for a refund of or credit for a tax paid makes no mention whatever of the taxable period for which the tax is claimed to have been overpaid, it does not constitute a claim for a refund of or credit for a tax for that period and there can therefore be no allowance of the claim which is essential to the allowance of interest, under section 1324(a) of the Revenue Act of 1921, on a refund or credit allowed under that Act.

2. SAME—ILLEGAL ALLOWANCE OF REFUND OR CREDIT.

The allowance of a credit or refund of a tax after the statutory period for the allowance of the same without the filing of a claim therefor is illegal and therefore no interest is allowable under section 1019 of the Revenue Act of 1924 on a refund or credit so allowed under that Act.

COURT OF CLAIMS OF THE UNITED STATES.

Wilmington Trust Co., Administrator C. T. A. of the Estate of Hamilton M. Barksdale, Deceased, v. *The United States.*

[July 5, 1932.]

OPINION.

GREEN, Judge, delivered the opinion of the court.

The Wilmington Trust Co. is the administrator, with the will annexed, of the estate of Hamilton M. Barksdale, deceased, and seeks to recover interest under section 1019 of the Revenue Act of June 2, 1924, on $21,918.43, being the amount of an overpayment by the estate in respect of its income for the taxable period October 18 to December 31, 1918, subsequent to Barksdale's death; $20,843.42 of this overpayment was credited by the Commissioner against a part of a deficiency for 1915. The balance of $1,075.01 was refunded by Treasury check dated September 11, 1924.

Plaintiff bases its claim on the allegation that the credit and refund were allowed within the meaning of the Revenue Acts on August 28, 1924, when the Commissioner relisted the amounts on a "supplemental" schedule of refunds and credits after this item, numbered 5, had been "deleted" from a previous schedule of refunds and credits containing entries with respect to overpayments by a number of taxpayers which had been approved by the Commissioner May 27, 1924. Inasmuch as the date, August 28, 1924, was after the expiration of the period of limitation within which the Commissioner could legally allow an overpayment for the taxable period, October 18 to December 31, 1918, and credit or refund the same, plaintiff contends that the claim for credit filed March 9, 1922, was sufficient authority for the Commissioner's allowance beyond the statute of limitation and that the Commissioner in fact allowed the credit and refund for this taxable period on the basis of the claim for credit filed.

Counsel for the defendant resist plaintiff's claim for interest on the ground, first, that the claim for credit filed March 9, 1922, was not a claim for credit for the taxable period October 18 to December 31, 1918, inasmuch as it made no mention whatever of any overpayment for this period; that the claim specifically and definitely related to an overpayment of $56,107.56 paid in installments on March 15, June 15, September 15, and December 15, 1919, and on July 30, 1920, with respect to the tax on the income of the decedent, Barksdale, for the period prior to his death, January 1 to October 18, 1918, and an overpayment of $47,832.58 on January 13, 1920, with respect to the tax on the income of the estate of Barksdale for the year 1919; second, that if the credit of $20,843.42 and the refund of $1,075.01 were allowed by the Commissioner on August 28, 1924, when he relisted these items on a supplemental schedule, such allowance was beyond the period of limitation within which he could allow a credit or refund without a claim and was therefore illegal, since the claim for credit

filed by plaintiff was not a claim with respect to the overpayment for the period October 18 to December 31, 1918, on which interest is claimed.

We are of opinion that the defendant is correct in its contention that plaintiff filed no claim for credit with respect to the overpayment for the period October 18 to December 31, 1918, on which interest is claimed. The claim for credit relied upon by plaintiff set forth that an additional tax of $108,155.90 had been assessed for 1915 and claimed a credit against that amount of $103,940.14. The overpayments, for which credit was claimed, were payments totaling $56,107.56 made on March 15, June 15, September 15, and December 15, 1919, and on July 30, 1920, in respect of the tax on the income of the decedent prior to his death for the period from January 1 to October 18, 1918, and the payment of $47,832.58 made January 13, 1920, with respect to the tax on the income of the estate of Barksdale for the year 1919. No mention whatever was made by plaintiff in the claim with respect to any overpayment for the taxable period October 18 to December 31, 1918, and the total amount claimed as a credit did not include any amount with respect to the tax paid for that period. The document filed therefore gave the plaintiff no greater rights with respect to any overpayment for the period ending December 31, 1918, than if the claim had not been made. When the claim for credit was received by the Commissioner serial No. 332708 was placed thereon. In the course of his audits the Commissioner determined overassessments for the taxable period January 1 to October 18, 1918, the taxable period October 18 to December 31, 1918, and for the taxable year 1919. When the overassessments for the two taxable periods in 1918 were entered upon the schedule of overassessments, approved February 8, 1924, and upon the original and supplemental schedule of refunds and credits, the number placed by the Bureau on the claim for credit was entered in column 2 under the heading "Certificate of overassessment or claim number." Plaintiff insists, therefore, that by placing the serial number of the claim filed opposite the overassessment for the period October 18 to December 31, 1918, as shown on the schedule of overassessments, the Commissioner treated the claim filed as a claim for credit for the taxable period October 18 to December 31, 1918. The contents of the claim filed, however, show very plainly that it had no reference to the period ending December 31, 1918, and the mere fact that in the preparation of the schedules the serial number given to the claim filed was entered on the schedules opposite the entry of the assessment for the period involved, as well as the overassessment for the period January 1 to October 18, 1918, for which the claim was filed, does not establish that the Commissioner treated it as a claim for the period ending December 31, 1918, nor do we think that such a notation under the circumstances would be binding on the Government, since the claim did not purport to be for the period October 18 to December 31, 1918.

In view of our conclusion that no claim for credit was filed with respect to the taxable period involved, it is not necessary to discuss the question whether the credit of $20,843.42 and the refund of $1,075.01 were allowed on May 27, 1924, when the Commissioner signed the original schedule of refunds and credits, or on August 28, 1924, when he signed a supplemental schedule. If the allowance was made May 27, 1924, the Revenue Act of 1921 was then in force, and no interest would be payable under section 1324 of that Act unless a claim was filed therefor and allowed. If the allowance was made August 28, 1924, which was after the 1924 Act went into force, no interest may be recovered for the reason that on that date the allowance was barred by the statute of limitation.

The petition must be dismissed. It is so ordered.

SECTION 1118.—PAYMENT OF AND RECEIPTS FOR TAXES.

ARTICLE 1391: Payment of tax by Treasury certificates of indebtedness and Treasury notes. XI-33-5617 T. D. 4347

INCOME TAX.

Acceptance of Treasury certificates of indebtedness and Treasury notes in payment of income and profits taxes. Article 1391, Regulations 69, and article 1392, Regulations 69, amended.

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

To Collectors of Internal Revenue and Others Concerned:

Article 1391 of Regulations 69, approved August 28, 1926, is hereby amended to read as follows:

ART. 1391. *Acceptance of Treasury certificates of indebtedness and Treasury notes in payment of income and profits taxes.*—Collectors of internal revenue are authorized and directed to receive, at par, in payment of income and profits taxes payable at the maturity of the certificates or notes, respectively, Treasury certificates of indebtedness and Treasury notes, the maturity dates of which are the 15th day of any calendar month, and which according to the express terms of their issue are made acceptable in payment of income and profits taxes. Collectors are not authorized hereunder to receive in payment of income and profits taxes any Treasury certificates of indebtedness or Treasury notes not expressed to be acceptable in payment of income or profits taxes, nor any such certificates or notes which mature on a date other than the date on which the taxes are payable. When the taxes are due on Sunday, the certificates or notes in payment thereof may be accepted on the following day. Collectors are authorized to receive Treasury certificates of indebtedness and Treasury notes which are acceptable as herein provided in payment of income and profits taxes in advance of the respective tax-payment dates. All interest coupons attached to Treasury certificates of indebtedness and Treasury notes must be detached by the taxpayer before presentation to the collector and collected in ordinary course when due. Receipts given by collectors to taxpayers should show the amount and description of the certificates or notes received in payment of taxes. The amount, at par, of Treasury certificates of indebtedness or Treasury notes presented by any taxpayer in payment of income and profits taxes must not exceed the amount of the taxes to be paid by him, and collectors shall in no case pay interest on the certificates or notes, or accept them for an amount less or greater than their face value.

ARTICLE 1392: Procedure with respect to Treasury certificates of indebtedness and Treasury notes. XI-33-5618 T. D. 4347

* * * * * * *

Article 1392 of Regulations 69, approved August 28, 1926, is amended by omitting the fourth paragraph thereof.

DAVID BURNET,
Commissioner of Internal Revenue.

Approved August 9, 1932.

OGDEN L. MILLS,
Secretary of the Treasury.

TITLE XII.—GENERAL PROVISIONS.

SECTION 1208.—INSTALLMENT SALES.

SECTION 1208.

REVENUE ACT OF 1926.

Taxpayer entitled to benefits of section 212(d), Revenue Act of 1926, electing to report 1917 income on installment basis. (See Ct. D. 587, page 214.)

ESTATE TAX RULINGS.

TITLE III.—ESTATE TAX. (1926)

CREDITS AGAINST ESTATE TAX.

REGULATIONS 70(1929), ARTICLE 9(a): Credit for estate, inheritance, legacy, or succession taxes. XI-40-5761 Mim. 3971

Estate tax.—Credit for estate, inheritance, legacy, or succession taxes paid any State, Territory, or the District of Columbia.—Article 9(a), Regulations 70 (1929 edition), as amended.

TREASURY DEPARTMENT,
OFFICE OF COMMISSIONER OF INTERNAL REVENUE,
Washington, D. C., August 24, 1932.

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

In view of the decision of the United States Supreme Court in the case of the *First National Bank of Boston* v. *State of Maine* (52 S. Ct., 174), the following instructions are issued relative to credit against the Federal estate tax on account of State estate, inheritance, legacy, or succession taxes:

1. No credit will be allowed the estate of a decedent who was a resident of the United States for such taxes paid after the date of the decision, January 4, 1932, with respect to intangible property to a State other than that of decedent's domicile.

2. No credit will be allowed the estate of a decedent who was a nonresident of the United States for such taxes paid after the date of the decision, January 4, 1932, with respect to intangible property to a State other than the State within which the property had its legal situs.

3. If such taxes were paid prior to that date, the credit may be allowed if the estate submits evidence sufficient, in the opinion of the Bureau, to show that no refund which will affect the amount of such taxes can be made. The Bureau will consider any evidence submitted but such evidence may include the following:

(a) Statement of the proper State official containing such information as he is able to give relative to any possible refund including appropriate reference to the settled policy.

(b) Executor's affidavit showing whether, to his best knowledge, information, and belief, any refund can be made in view of such Federal decision. The affidavit should specifically refer to the decision and should state whether, if a refund is made, any estate tax due the Federal Government as a result of such refund will be paid.

(c) Evidence of the existence of any law of the State of decedent's domicile imposing an estate tax designed to give the State the benefit of the maximum credit allowable under the applicable Revenue Act, so that, if a refund of the tax paid to another State was made, the amount would be paid to the State of the domicile. This evidence may consist of a statement of the proper tax official in which there is set forth the practice, and in which there are also set forth the views of such official on the question as to whether the State would have the right to reopen the case, or whether it might be barred by limitation provisions or any other reason.

Correspondence in regard to the procedure outlined herein should refer to the number of this mimeograph and the symbols MT–ET.

DAVID BURNET, *Commissioner.*

TRANSFERS BY DECEDENT IN HIS LIFETIME.

REGULATIONS 70(1929), ARTICLE 16(1): Transfers made in contemplation of death. XI–36–5671 Ct. D. 556

ESTATE TAX—REVENUE ACT OF 1926—DECISION OF COURT.

TRANSFERS IN CONTEMPLATION OF DEATH.

Where a decedent at an advanced age sustains a stroke of paralysis while suffering from other infirmities and in that condition makes transfers of his property which are practically contemporaneous and closely connected with the execution of his will, the transfers are made in contemplation of death within the meaning of section 302(c) of the Revenue Act of 1926, although he contemplated making the transfers a considerable time before they were made.

UNITED STATES DISTRICT COURT, DISTRICT OF MINNESOTA, FIFTH DIVISION.

Victor H. Anneke, plaintiff, v. *Levi M. Willcuts, Individually and as Collector of Internal Revenue for the District of Minnesota, defendant.*

[July 16, 1932.]

OPINION.

CANT, District Judge: The underlying and controlling question in this case is whether the transfers by the deceased, upon which the disputed tax was computed, were made in contemplation of death. Without going into an exhaustive discussion of the evidence, pro and con, upon this question, or of the authorities which throw light thereon, the court is of the opinion that it is practically compelled to hold with the defendant. The stroke which Mr. Anneke had sustained, his other infirmities, and his rather advanced age, all warned him that, while death might not be imminent, still, in the ordinary course of nature, it might occur at any time, and could not long be delayed. Again, the fact that the transfers here involved were practically contemporaneous and closely connected with the execution of Mr. Anneke's will, makes it difficult, if not impossible, to reach any other conclusion than that, taken together, they were all of a testamentary character. The fact that, for a considerable time before the transfers were made, the deceased had contemplated the making thereof, is not especially persuasive, one way or the other. The question is what must be said of them, having in mind the circumstances under which they were finally made?

In any case where the evidence is substantially the same as here, the court would be bound to find that, within the meaning of the law, the transfers were made in contemplation of death. In analogous cases, the authorities so declare, and, as an original question, if it were such, the court would not be free to hold otherwise.

REGULATIONS 70(1929), ARTICLE 16(2): Transfers not admitted to have been made in contemplation of death. XI-30-5573 T. D. 4340

ESTATE TAX.

Articles 16 and 20 of Regulations 70 (1929 edition) amended.

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

To Collectors of Internal Revenue and Others Concerned:

Subdivision (2) of the second paragraph of article 16, Regulations 70 (1929 edition), approved March 23, 1929, is hereby amended to read as follows:

(2) *Transfers not admitted to have been made in contemplation of death.*—The executor is required to disclose in the return all transfers made by the decedent subsequent to September 8, 1916, of an amount or value of $5,000, or more. Any such transfer made within two years of the decedent's death, but before the effective date of the Revenue Act of 1926, and constituting a material part of decedent's property and in the nature of a final disposition or distribution thereof, is deemed to have been made in contemplation of death within the meaning of the statute. Where the executor contends that the transfer was not made in contemplation of death he must file with the return sworn statements, in duplicate, of all the material facts, including, among other things, the decedent's motive in making the transfers and his mental and physical condition at that time, and one copy of the death certificate.

REGULATIONS 70(1929), ARTICLE 20: Power relinquished in contemplation of death. XI-30-5574 T. D. 4340

* * * * * * *

Article 20 of Regulations 70 (1929 edition), approved March 23, 1929, is hereby amended to read as follows:

ART. 20. *Power relinquished in contemplation of death.*—Where property was transferred by the decedent, who reserved a power to alter, amend, or revoke the transfer, and such power was relinquished in contemplation of death, the value of the property should be included in the gross estate. (See article 16.)

DAVID BURNET,
Commissioner of Internal Revenue.

Approved July 15, 1932.

OGDEN L. MILLS,
Secretary of the Treasury.

TITLE III. PART I.—ESTATE TAX. (1924)

REGULATIONS 70, ARTICLE 10: Character of interests included. XI-46-5863 Ct. D. 599

ESTATE TAX—REVENUE ACT OF 1924—DECISION OF COURT.

1. GROSS ESTATE—CONSTITUTIONALITY.

Section 302(a) of the Revenue Act of 1924 as construed by the Supreme Court in *Crooks* v. *Harrelson et al.* (Ct. D. 271, C. B. X-1, 469) is constitutional.

2. GROSS ESTATE—REAL ESTATE LOCATED IN ILLINOIS.

The value of the interest of a decedent at the time of his death in real estate located in Illinois should be included in determining the value of his gross estate under section 302(a) of the Revenue Act of 1924.

DISTRICT COURT OF THE UNITED STATES, NORTHERN DISTRICT OF ILLINOIS, EASTERN DIVISION.

No. 39477. *Continental Illinois Bank & Trust Co., etc.*, v. *United States.*

No. 39375. *The Northern Trust Co. and Edward H. Bennett, etc.*, v. *United States.*

No. 39546. *William P. Dean, etc.*, v. *United States.*

[July 22, 1932.]

OPINION.

WOODWARD, District Judge: These causes were submitted to the court for trial without a jury on stipulations as to the facts.

In each case suit is brought to recover a tax paid under the estate tax law of 1924. The facts, so far as material to a determination of the issues involved, are briefly as follows:

Lawson Estate: Victor F. Lawson died testate August 19, 1925, a resident of Cook County, Ill. The return for the estate tax was filed August 19, 1926. It showed real estate in Illinois valued at $778,542.68 and real estate in Wisconsin valued at $484,500; and other property which, with the real estate, made a gross estate valued at $21,559,940.78. Deductions amounted to $15,397,133.12 leaving a net estate of $6,162,807.66 on which a tax of $655,546.15 was paid on August 19, 1926. Subsequently on demand a deficiency amounting to the sum of $18,612.55 and interest was paid on June 30, 1928. Included in the gross estate was an undivided one-third interest in what is known as the Iver Lawson property valued at $225,922.31 on which a tax of $8,472.09 was paid.

Bennett Estate: Catherine Bennett died testate May 21, 1925, a resident of Cook County, Ill. The decedent left a gross estate of $940,802.20, of which $170,000 consisted of real estate. Deductions amounted to $384,313.40, leaving a net estate of $556,488.80 on which a tax of $14,917 was paid. Thereafter a deficiency was demanded and paid amounting to $2,555.16.

Bassett Estate: Robert J. Bassett died testate January 22, 1926, a resident of Cook County, Ill. Decedent left real estate in Illinois of the value of $358,277.26 and a gross estate of $361,992.05. Deductions amounting to $52,150 left a net estate for the purpose of taxation of $309,842.05. An estate tax of $5,920.26 was paid.

The first contention made by plaintiffs is that section 302(a) of the Revenue Act of 1924, as construed by the Supreme Court in *Crooks* v. *Harrelson* (282 U. S., 55 [Ct. D. 271, C. B. X–1, 469]), is unconstitutional and void. The court in the argument at the bar stated that it would hold section 302(a) of the Revenue Act of 1924 to be a constitutional enactment. The court, therefore, without further argument passes over this contention and holds the section referred to to be a valid enactment. It is then contended, and this contention is common to all three cases, that under the holding of the Supreme Court in the case of *Crooks* v. *Harrelson*, supra, real estate of a decedent situated in Illinois should not be included in the gross estate of the decedent in computing the Federal estate tax. In the case of *Crooks* v. *Harrelson*, supra, construing section 302(a) of the Revenue Act of 1924, the court held that the interest of the decedent to be included in the gross estate must be subject to the payment of charges against the decedent's estate, subject to the payment of the expenses of administration and subject to distribution as a part of the decedent's estate. That case involved the question of whether real estate situated in Missouri should be included in the gross estate of the decedent. Under the law of Missouri as construed by the court, real estate could not be sold for the purpose of paying administration expenses and that even where real estate has been

sold to pay the debts of the decedent, the proceeds of such sale may not be applied in payment of administration expenses.

The Illinois law, however, is materially different from that of Missouri. In Illinois, in case the personalty is insufficient to pay the debts of the decedent, decedent's real estate may be sold to pay such debts and also the cost of administration and the proceeds from the sale of the land are applied in payment of the debts and of the administration expenses. The Illinois law (paragraph 98, ch. 3, Callaghan's Illinois Statute) provides:

"When the executor or administrator has made a just and true account of the personal estate and debts to the county court, and it is ascertained that the personal estate of a decedent is insufficient to pay the just claims against his estate, and there is real estate to which such decedent had claim or title, such real estate, or such portion as may be necessary to satisfy the indebtedness of such decedent, and the expenses of administration, may be sold in the manner herein provided."

Three cases, namely, *Walker* v. *Diehl* (79 Ill., 473), *Fitzgerald* v. *Clancy* (49 Ill., 465), and *Darmon* v. *Tost* (13 Ill., 127), hold that real estate in Illinois may not be sold merely to pay expenses of administration where there are no claims against the estate. Where, however, there are claims against the estate and the personalty is not sufficient to pay the claims, real estate may be sold for the payment of those claims and for the payment of the expenses of administration. Where there is a deficiency of personalty to meet the claims, the purpose of selling the land is as much to pay administration expenses as it is to pay claims against the estate. The court holds, therefore, that the value of the real estate situated in Illinois was properly included as a part of the gross estate for the purpose of the estate tax in each of the cases now under consideration and that the action can not be maintained to recover any part of the taxes properly allocated to such real estate.

It was also contended in the Lawson estate that the value of the land in Wisconsin was improperly included in the gross estate of the decedent. This contention has been abandoned.

The Supreme Court of Illinois in the case of *Lawson* v. *Illinois Merchants Trust Co.* (337 Ill., 49) held that the undivided one-third interest of the decedent Victor F. Lawson in the Iver Lawson property did not pass to the decedent but passed to decedent's brother. The value of this property, therefore, was improperly included as a part of the gross value of the Lawson estate. The taxes paid in the Lawson estate on account of the Iver Lawson property may be recovered.

In No. 39477 the court finds the issues for the plaintiff in the sum of $8,472.09 with interest thereon at the rate of 6 per cent per annum from January 30, 1928, plus a proper proportionate amount of additional interest of $1,514.50 which was paid on January 30, 1928. Counsel for plaintiff will make the computations in order that a judgment may be entered for the correct sum.

In No. 39375 the court finds the issues for the defendant.

In No. 39546 the court finds the issues for the defendant.

TITLE IV.—ESTATE TAX. (1921)

REGULATIONS 70, ARTICLE 10: Character of interests included. XI–46–5864 Ct. D. 600

ESTATE TAX—REVENUE ACT OF 1921—DECISION OF COURT.

GROSS ESTATE—REAL ESTATE LOCATED IN NEBRASKA AND IOWA.

The value of the interest of a decedent at the time of his death in real estate located in Nebraska and the value of his interest at the time of his death in real estate located in Iowa should be included in determining the value of his gross estate under section 402(a) of the Revenue Act of 1921.

UNITED STATES CIRCUIT COURT OF APPEALS, EIGHTH CIRCUIT.

First Trust Co. of Omaha, William W. Hoagland, Frank P. Doolittle, Executors of the Estate of George A. Hoagland, Deceased, appellants, v. *A. B. Allen, Collector of Internal Revenue for the District of Nebraska, appellee.*

Appeal from the District Court of the United States for the District of Nebraska.

[July 29, 1932.]

OPINION.

BOOTH, Circuit Judge, delivered the opinion of the court.

This is an appeal from a judgment in so far as it denied recovery by appellants (plaintiffs below) of a refund of certain moneys alleged to have been wrongfully collected from them by the Commissioner of Internal Revenue as part of the Federal estate tax against the estate of George A. Hoagland, deceased.

The salient facts are as follows: Plaintiffs below were the executors of the will of George A. Hoagland, deceased, and as such executors commenced the present action. After the cause was lodged in this court, the First Trust Co. of Omaha was legally dissolved, and William W. Hoagland died. By leave of court, the appeal is now being prosecuted in the name of Frank P. Doolittle as sole surviving executor.

George A. Hoagland, a widower and resident of Omaha, Nebr., died testate on December 6, 1923. His executors duly filed with the Commissioner of Internal Revenue a Federal estate tax return showing a tax due of $212,843.70, which was paid December 2, 1924.

After an audit and review, the Commissioner determined the real and personal property of decedent's estate to be of the values following:

Personal property	$1,297,756.64
Real estate in Nebraska	1,536,789.43
Real estate in Iowa	18,100.00
Real estate in Missouri	2,000.00

The Commissioner determined a deficiency in the tax paid of $46,691.68, which sum the executors paid. Thereafter, they duly filed with the collector of internal revenue (appellee herein) a claim for refund containing several items; one of them being based on the ground that the value of the real property in the States of Nebraska, Iowa, and Missouri was erroneously included in decedent's gross estate under the provisions of the Revenue Act of 1921 (42 Stat., 227, 277–280). It was not claimed that the valuation placed upon the real property by the Commissioner was incorrect. The Commissioner rejected so much of the claim for refund as was based upon the alleged erroneous inclusion in the gross estate of the value of the real property above mentioned.

The present suit followed.

The complaint alleged the foregoing facts in substance; and also alleged that the decedent, at the time of his death, was the owner of personal property, the value of which greatly exceeded the amount of all charges against the estate and the expenses of administration.

The answer admitted substantially all the foregoing facts; but alleged in substance that in view of the statutes of the States of Nebraska and Iowa, decedent's real property in those States was, at the date of decedent's death, subject to the payment of charges against the estate, and the expenses of administration, and subject to distribution as part of the estate; that, therefore, the value of said real property was properly included in the gross estate of decedent. It was admitted in the answer that plaintiffs were entitled to recover so much of the tax as was based upon the inclusion in the gross estate of the value of the real property in Missouri.

Demurrer was interposed to the answer. The district court sustained plaintiffs' demurrer in part, holding that the value of the real property of the decedent located in Missouri was unlawfully included in his gross estate; but overruled the demurrer in part, holding that the value of the real property located in Nebraska and Iowa was lawfully included in his gross estate.

Plaintiffs elected to stand upon their petition and demurrer, and the court thereupon granted judgment on August 13, 1931, to the plaintiffs for $280, with

interest from September 26, 1925, on account of the erroneous inclusion in decedent's gross estate of the value of the real property situated in Missouri, and granted judgment to the defendant against plaintiffs dismissing their petition so far as it alleged that the value of the real property in Nebraska and Iowa was erroneously included.

Plaintiffs have appealed to this court from the judgment in so far as it denied them the recovery of any sum in excess of $280 with interest thereon.

The defendant has filed no cross appeal from the judgment for $280 in favor of the plaintiffs.

The sole question presented is, Was the value of real property situate in the States of Nebraska and Iowa, belonging to the decedent, George A. Hoagland, at the time of his death, which occurred on December 6, 1923, properly included in the gross estate of said decedent for the purposes of the Federal estate tax, under the provisions of section 402(a) of the Revenue Act of 1921?

The relevant portion of the section of the statutes referred to reads as follows:

"SEC. 402. That the value of the gross estate of the decedent shall be determined by including the value at the time of his death of all property, real or personal, tangible or intangible, wherever situated—

"(a) To the extent of the interest therein of the decedent at the time of his death which after his death is subject to the payment of the charges against his estate and the expenses of its administration and is subject to distribution as part of his estate."

In the case of *Crooks* v. *Harrelson* (282 U. S., 55 [Ct. D. 271, C. B. X–1, 469] (affirming 35 F. (2d), 416)), the Supreme Court had occasion to construe section 402(a) of the Revenue Act of 1918, which is identical in language with section 402(a) of the Revenue Act of 1921—the one here involved. In its opinion the Supreme Court said (page 58):

"The meaning of the provision in question, considered by itself, does not seem to us to be doubtful. The value of the interest of the decedent is not to be included unless it 'is subject to the payment of the charges against his estate *and* the expenses of its administration'—not one or the other, but both. We find nothing in the context or in other provisions of the statute which warrants the conclusion that the word 'and' was used otherwise than in its ordinary sense; and to construe the clause as though it said, 'to the payment of charges and expenses, *or either of them*,' as petitioner seems to contend, would be to add a material element to the requirement, and thereby to create, not to expound, a provision of law. Nor will it do to say that the words, '*charges* against his estate,' include expenses of administration, for plainly they are different and distinct things, generally so classified in the settlement of estates of decedents, and so regarded by Congress, as evidenced by the discriminating terms of the statute."

After citing and quoting from the case of *United States* v. *Field* (255 U. S., 257), the court further said (page 59):

"It seems clear enough that the Field case is decisive of the question and requires us to hold that if the value of the interest of the decedent now being considered is not subject, under the law of Missouri, to the expenses of administration, it forms no part of the gross estate for the purpose of the Federal estate tax."

As respects the case at bar, nothing further need be said as to the proper construction of section 402(a) of the Revenue Act of 1921.

We turn to the inquiry whether, under the law of Nebraska, the value of the interest of decedent in the real property owned by him in that State at the time of his death was subject to the expenses of administration, it being conceded that it was subject to the payment of charges against the estate and subject to distribution as part of the estate.

It is conceded that at common law, real estate can not be sold to pay expenses of administration; and that the rule of the common law is in effect in Nebraska unless changed by statute.

There are a number of statutory provisions in Nebraska having a more or less direct bearing upon the question here involved.

Section 30–233, Compiled Statutes of Nebraska, 1929, contains the following language:

"The estate, real or personal, given by will to any devisees or legatees, shall be held liable to the payment of the debts, expenses of administration, and

family expenses, in proportion to the amount of the several devises or legacies * * *."

Section 30–405 provides in part as follows:

"* * * If the goods, chattels, rights and credits in the hands of the executor or administrator shall not be sufficient to pay the debts of the deceased, and the expenses of administration, the whole of his real estate, except the widow's dower, or so much thereof as may be necessary, may be sold for that purpose by the executor or administrator * * *."

Section 30–406 reads:

"The executor or administrator shall have a right to the possession of all the real as well as the personal estate of the deceased, and may receive the rents, issues and profits of the real estate, until the estate shall have been settled, or until delivered over, by order of the county court, to the heirs or devisees, and shall keep in good tenantable repair all houses, buildings, and fences thereon which are under his control."

Section 30–413 provides:

"Any real estate so held by an executor or administrator, or which may be purchased by him as such, upon a sale on execution for the recovery of a debt due the estate, may be sold for the payment of debts or legacies and the charges of administration, in the same manner as if the deceased had died seized thereof * * *."

Section 30–1101 provides:

"When the personal estate of any deceased person, in the hands of his executors or administrators, shall be insufficient to pay all his debts, with the charges of administering his estate, such executors or administrators may sell his real estate for that purpose * * *."

Section 30–1109 provides:

"The proceeds of any real estate sold for the payment of debts, and charges of administration, as provided in this article, shall be deemed assets in the hands of the executor or administrator, in like manner as if the same had been originally part of the goods and chattels of the deceased * * *."

No decision of the Supreme Court of the State of Nebraska has been cited as holding directly that real estate may be sold under the foregoing statutory provisions to pay expenses of administration; but the language of the statutes plainly indicates that this may be done. Furthermore, several decisions of the Supreme Court of Nebraska inferentially, at least, lead to the same conclusion.

In *Alexander* v. *Alexander* (41 N. W., 1065 (Nebr.)), it was held that an heir or devisee can not maintain an action for partition until the debts, allowances and expenses against the estate have been paid or provided for, unless a bond be given to pay the same.

In *Reckewey* v. *Waltemath* (44 N. W., 659 (Nebr.)), the court referred to the Alexander case as follows:

"In *Alexander* v. *Alexander* (41 N. W. Rep., 1065), this court held that an heir or devisee of an estate can not maintain an action of distribution or partition until the debts, allowances, and expenses against the estate have been paid or provided for, unless he give a bond, with approved sureties, to pay the same. This, we think, is a correct statement of the law, as only the residue of an estate that remains after the debts and expenses against the estate have been paid will pass to the devisees or heirs."

Markle v. *Markle* (232 N. W., 770 (Nebr.)) follows the Alexander and Reckewey cases.

In re Miller (131 N. W., 226 (Nebr.)) expressly recognizes that real estate in Nebraska owned by a resident who dies intestate, descends subject to the debts and funeral expenses of the decedent.

In *Allen* v. *Henggeler* (32 F. (2d), 69 [Ct. D. 92, C. B. VIII–2, 387]), the question involved was whether a widow's one-third interest in the real estate of her deceased husband was liable to the Federal estate tax. This court, in discussing the character of the one-third interest of the widow, said (page 71):

"The wife's interest in both real and personal property is subject, first, to the payment of the debts of the husband's estate, which includes the cost of administration."

As opposed to the foregoing cases, appellants cite *Cooley* v. *Jansen* (74 N. W., 391 (Nebr.)); *Schick* v. *Whitcomb* (94 N. W., 1023 (Nebr.)); *Hughes* v. *Langdon* (199 N. W., 832 (Nebr.)).

In the Cooley case, the decedent at the time of his death was seized of certain lands which were occupied as a *homestead*. The question involved was whether the administrator had the right to take possession and lease the lands. The court held in the negative and said (page 392):

"The land in suit descended to the wife and heirs shorn of any liability for the debts of the deceased, and the administrator had no right of possession, or other right thereto or therein * * *."

In the Schick case, one of several joint devisees brought suit for partition against an executor and the other devisees. The time for filing claims had expired, but there had been no settlement of the estate. It was contended that the suit was premature and the Alexander case, supra, was cited. The court distinguished the case, saying (page 1026):

"There is nothing in that case inconsistent with the views hereinbefore expressed, but we do not consider it directly in point on the precise question under discussion. There the petition contained no allegation whatever in regard to the solvency of the estate, or of the sufficiency of the personal assets to meet the charges which the statute requires to be paid or provided for before a division or partition of the estate can be had. * * * But in this case the solvency of the estate, as well as the sufficiency of the personal assets to pay the debts against it, are alleged in the petition and conclusively established by the evidence. The distinction between the two cases, to our minds, is clear."

Hughes v. *Langdon*, supra, involved a suit upon a guardian's bond, and the questions discussed were, who was the "person entitled to bring such action," and whether the statute of limitations had run. We fail to see that the case has any application to the one at bar.

Our conclusion on this branch of the case is, in view of the provisions of the Nebraska statutes, and in view of the holdings in the Alexander, Reckewey, Miller and Markle cases, supra, that the value of the interest of the decedent Hoagland in the real property owned by him in Nebraska was subject to the expenses of administration. The value of such interest, therefore, was properly included in the value of the gross estate for the purpose of the Federal estate tax.

The question as to the Iowa lands depends, of course, upon the Iowa statutes and the decisions of the State supreme court of that State. It is conceded that the common law exists in Iowa except as modified by statute. The relevant statutes are found in the Code of Iowa, 1924, and are as follows:

"11933. *Sale or mortgage of real estate—application.*—If the personal effects are found inadequate to satisfy the debts and charges, a sufficient portion of the real estate may be ordered sold or mortgaged for that purpose, application therefor being made in the court granting administration, and only after a full statement of all the claims against the estate, and after rendering a full account of the disposition made of the personal estate.

"11969. *Expenses of funeral—allowance to widow.*—As soon as the executor or administrator is possessed of sufficient means over and above the expenses of administration, he shall pay off the charges of the last sickness and funeral of deceased, and next, any allowance made by the court for the maintenance of the widow and minor children.

"11907. (Relating to estates of absentees.) *Sale of real estate.*—Such administrator may, under the orders of the court, sell and dispose of all real estate and other property owned by such absentee, and after the payment of legal costs, expenses, and claims, make distribution of the proceeds thereof to the persons entitled thereto."

We have been cited to no decision of the Supreme Court of Iowa, and have found none, passing directly upon the question whether, under the provisions of the statutes quoted, real property of a decedent in that State is subject to the payment of expenses of administration. It becomes necessary, therefore, for us to construe the statute in order to determine the controversy in the instant case.

The provisions of the Iowa Code are not so explicit as those in the Nebraska statute; nevertheless, we think they are the same in legal effect so far as concerns the question here involved.

The meaning of the word "charges" in section 11933 is of vital importance. This word is used in contradistinction to the word "debts"; and has a different and a broader meaning than the same word "charges" where it occurs in section 402(a) of the Revenue Act of 1921. In the latter statute, the word is used in contradistinction to "expenses of administration." We think the word "charges" in the Iowa statute includes expenses of administration, and also other expenditures properly made by the administrator though not strictly expenses of administration, such as funeral expenses. Such broader meaning of the word "charges" is not unknown in probate law.

In an early case, *Goodwin* v. *Chaffee* (4 Conn., 163), under a statute which allowed the probate court to order the sale of real estate of a decedent when the debts and charges allowed by the court exceeded the value of the personal estate, the question arose whether a sale of real estate could be ordered to pay a legacy. The court in its opinion said:

"But when the personal estate has been exhausted, as in this case it was, and resort must be had to realty, it becomes an important question, whether, for the payment of a legacy, the court of probate has authority to order the sale of real estate. On this point, the case before the court must turn. For the 'debts and charges' against the estate, the law has imparted this authority; and, of consequence, imposed it on the judge as a duty; but a legacy is not a debt, nor is it a charge, within the meaning of the statute. *The latter word has, from familiar use, the precision of a technical term, and merely comprises the expenses incurred in the settlement of an estate.*" [Italics ours.]

The same meaning was given to the word "charges" in the later case, *Duffeld, Exr.*, v. *Pike* (71 Conn., 521).

In the case of *Cairns* v. *Smith* (49 S. W., 728) (Texas), application had been made by the executors of a will for leave to sell real estate to pay certain legacies. Cairns died intestate as to the real estate sought to be sold. The proceeds of the property covered by the will had been paid out by the executors. The question in the case was whether the legacies provided in the will were charges upon the real property sought to be sold. The court cited the Goodwin case with approval as to the meaning of the word "charges," and said (page 733):

"Our statute, in prescribing the requisites of an application by an executor or administrator to sell real estate, apparently uses the term 'charges' in the same sense."

The foregoing cases lend support to our view that the word "charges" in the Iowa statute, above quoted, includes expenses of administration. There are also decisions of the Supreme Court of Iowa which, we think, are of inferential value as pointing to the same conclusion.

In the case of *Conger* v. *Cook* (8 N. W., 784) (Iowa), the petitioner prayed for an order for the sale of real estate, alleging that the personal property was inadequate to pay the debts and expenses of administration. Demurrer was interposed to this petition. The court, in reference thereto, said (page 784):

"As another ground of demurrer, it is said that the petition is insufficient because it shows that there is something due the administrator as costs of administration, and the application is made in part to raise money to reimburse the administrator, and also to pay him his compensation. The defendant contends that the real estate can not be sold for such purpose. If this were true we do not think that it would constitute a ground of demurrer to the petition, which seeks an order of sale for the purpose of paying creditors. It was proper to grant an order of sale, though, of course, only for a legitimate purpose, and only for the sale of so much real estate as was necessary for such purpose. The petition, if objectionable upon the ground urged, should have been assailed, we think, by a motion to strike out the objectionable part. *We do not wish to be understood as intimating that we do not think that real estate can be sold to pay the administrator's costs and compensation where the proceeds of the personal property have been exhausted in properly paying creditors.*" [Italics ours.]

Foley v. *Broeksmit* (93 N. W., 344) (Iowa), involved a suit by an undertaker against the administrator for funeral expenses. In its opinion the court said:

"Such charges are not, strictly speaking, debts due from the deceased, but *charges* which the law out of decency imposes upon his estate. And, so far as these are reasonable in amount, they take legal priority of all such debts; as, likewise, do *the administration charges.*" [Italics ours.]

In *Crapo, Ex'r.*, v. *Armstrong* (17 N. W., 41) (Iowa), the court held that money paid for a tombstone for a decedent was a proper expenditure "as pertaining to the funeral expenses."

In the later case of *Mullinnix* v. *Brown* (131 N. W., 671) (Iowa), involving a similar question as well as a sale of real estate for such expense, the court said (page 674):

"Again, it is said that no order to sell should have been made because of lack of proof of the allowance of any claims save that for the monument which was secured upon order of court, and that there exists no authority in law for ordering a sale of real estate for the purpose of paying such claims. In this contention counsel are in error. The record does show the allowance of claims against the estate of the deceased for more than the amount of money and personal property in the hands of the administrator. Moreover, we think that real estate left by one deceased may be sold upon prior (proper) application for the payment of such debts as well as for the funeral expenses of one deceased. * * * The cost of a suitable monument for one deceased is as properly chargeable against his estate as are the funeral expenses; and that lands may be sold in the absence of a personal estate to meet such claims is entirely clear."

In the case of *In re Spicer's Estate* (203 Iowa, 393, 212 N. W., 689), the administratrix made report that a certain claim amounting to approximately $15,000 against the estate had been finally allowed by the Supreme Court of Iowa; and the report further stated: "That said claim and cost of closing said estate have not yet been paid, and that as shown above there is not enough personal property out of which to pay the same."

A petition to sell real estate belonging to the estate was also filed by the administratrix. This petition stated that it was necessary for the paying off of claims against the estate "and to close the estate to sell the real estate."

A demurrer was interposed to the petition. This was overruled; and the court entered an order reciting that it was "necessary to sell the real estate * * * in order to have sufficient funds to close said estate."

An appeal was taken from the judgment ordering the sale of the real estate, and the judgment was affirmed by the Supreme Court of the State of Iowa.

The question was not directly raised whether the real estate might be sold to pay the expenses of administration, but the clear inference from the case is that such was the practice in Iowa.

In view of the foregoing, our conclusion on this branch of the case is that the lands owned by decedent in Iowa were subject to be sold for the payment of the expenses of administration, in addition to being subject to the payment of the charges against the estate, and being subject to distribution as part of the estate. It follows that the value of such lands was properly included as part of the value of the gross estate.

A further contention of appellants is that the personal property of decedent was amply sufficient to pay all debts and expenses of administration; and that, therefore, the real property in Nebraska and Iowa was not subject to the expenses of administration; and, hence, the value of the interest of decedent in such real property was not properly included in the gross estate. We think there is no merit in this contention.

The test to determine whether the value of the interest of decedent in real property shall be included in the value of his gross estate is found in the words of the statute (section 402(a) of the Revenue Act of 1921) and not in speculative probabilities as to the necessity for selling the real property during administration.

We think the judgment of the trial court was right, and it is affirmed.

REGULATIONS 70, ARTICLE 10: Character of interests included. XI-48-5893 Ct. D. 605

ESTATE TAX—REVENUE ACT OF 1921—DECISION OF COURT.

GROSS ESTATE—COMMUNITY PROPERTY—CALIFORNIA—WIFE'S CONSENT TO WILL AND DISPOSITION THEREIN OF COMMUNITY PROPERTY.

In determining the value of the gross estate of a deceased husband under section 402 of the Revenue Act of 1921, there should be included the entire value of the community property acquired under the laws of the State of California, although at the time of execution of his will his wife signed a paper electing to acquiesce in and consent to the will and disposition of the community property therein and waived all claims to her share of the community property. This conclusion is not affected whether the will and the waiver constituted a binding contract or whether power of election remained in the widow to take either in pursuance of the will or in accordance with her community rights.

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT.

Title Insurance & Trust Co., a Corporation, Executor and Trustee under the Last Will and Testament of Emil Firth, Deceased, appellant, v. *Rex B. Goodcell, Collector of Internal Revenue for the Sixth District of California, appellee.*

Upon appeal from the District Court of the United States for the Southern District of California, Central Division.

[August 15, 1932.]

OPINION.

NORCROSS, District Judge: From a judgment for defendant in an action to recover the sum of $60,894.08 paid under protest as an estate tax, the plaintiff, Title Insurance & Trust Co., appeals.

Emil Firth, a resident of Los Angeles, Calif., died August 23, 1922, leaving him surviving his widow, Benveneda S. Firth, and a daughter and granddaughter. The decedent left a last will and testament, dated August 11, 1922, which was duly probated. Under this will the decedent devised and bequeathed all of the property then held by him, including the entire community estate. Substantially all of this property was placed in a trust, which provided for the payment of something less than one-half of the income therefrom to the decedent's wife, and gave her testamentary disposition of one-half of the corpus of the property. Coincident with the execution of the will, his said wife executed a paper containing, among other provisions, the following:

"* * * I hereby elect to and do accept, acquiesce in and consent to said will and all of its provisions, including disposition at the death of my said husband of all of our community property thereunder, and hereby waive all claims to my share of any community property, and any and all other claims, rights, interests and estates which I may have at the time of the demise of my said husband, upon or in all of his separate property and all of our community property, * * *."

The court found that the value of decedent's gross estate was $1,602,843.55 and the net value $1,361,537.33; that the entire estate was community property, except separate property of the value of $27,700.

The total tax upon the estate was $85,159.86, which was paid under protest and claim for refund in the amount of $60,894.08 filed therefor, which was rejected by the Commissioner of Internal Revenue. In the claim for refund filed, and upon which this action is predicated, appellant defined its position as follows:

"At the time of decedent's death, therefore, the widow had a vested interest and owned outright her community interest so that at the time of his death

decedent only owned and his estate then was only one-half of all the community property. The fact that the widow took her community one-half under the will with other benefits is immaterial for the reason that she can not thereby convey her interest to her spouse as of a time before or at the time of his death, the will not taking effect until after his death and for the further reason that even if her election did have the effect of transferring her interest to the estate, it did not augment decedent's property rights and title thereto, but effected only an increase of the estate for distribution left after his death and created equities between her and other beneficiaries only. In other words, decedent having passed this life, left seized of his community one-half only. The widow's election to leave her one-half in the estate augmented the estate's properties to which title had passed to testamentary beneficiaries, and not the decedent's properties.

"To hold otherwise would be to urge in effect that the widow's election on being exercised was carried back to a time before decedent's death, which contention answers itself, for the will was ineffectual until after the death of the decedent and there could be no election on her part until the will became effective."

In appellant's brief the contention is made that "under the law of the State of California the two documents, the will and the waiver, constitute a contract, supported by a consideration and binding upon both parties, by virtue of which the widow of Emil Firth received her portion of the estate in lieu of her rights in the community property." If the contention made in the brief may be regarded as a new or additional ground of recovery then it may not be considered upon this appeal, as only such grounds may be reviewed as are presented in the claim for refund. (*Red Wing Malting Co.* v. *Willcuts*, 15 F. (2d), 626, 634 [T. D. 3980, C. B. VI–1, 225]; *Greys Harbor Motorship Corporation* v. *United States*, 45 F. (2d), 259, 281.)

Conceding that the two documents, the will and the waiver, constituted a contract binding upon both parties and that the widow received her portion of the estate in lieu of her rights in the community property, it was the death of her husband which "brought into being or ripened for the survivor, property rights of such character as to make appropriate the imposition of a tax upon that result." (*Tyler* v. *United States*, 281 U. S., 497 [Ct. D. 190, C. B. IX–1, 383].)

If the widow be regarded as having the right of election upon the death of her husband to take her community interest freed from the trust and other provisions of the will and had so taken such community interest, such election would not have affected the validity of the tax. (*Talcott* v. *United States*, 23 F. (2d), 897 [T. D. 4137, C. B. VII–1, 319]; *Henshaw* v. *Commissioner*, 31 F. (2d), 946; *Gwinn* v. *Commissioner*, 54 F. (2d), 728.)

Whether the will and the waiver constituted a binding contract of whether power of election remained in the widow to take either in pursuance of the will or in accordance with her community rights, the liability for the tax is not affected, for, in either case, property rights are "brought into being or ripened for the survivor" which before could not be exercised. (*Tyler* v. *United States*, supra, 281 U. S., 497.)

Judgment affirmed.

TRANSFERS BY DECEDENT IN HIS LIFETIME.

REGULATIONS 70(1929), ARTICLE 16(1): Transfers made in contemplation of death. XI–31–5584 Ct. D. 527

ESTATE TAX—REVENUE ACT OF 1921—DECISION OF COURT.

TRANSFER IN CONTEMPLATION OF DEATH.

The evidence proves that the thought of his death was the controlling motive of the decedent in effecting transfers of his property and that in the circumstances shown they were made in contemplation of death within the meaning of section 402(c) of the Revenue Act of 1921.

COURT OF CLAIMS OF THE UNITED STATES. No. K-470.

Elizabeth M. Kengel, Executrix of John A. Kengel, Deceased; and Frank H. Kengel, individually and in their capacity as beneficiaries of the estate of Joseph Kengel, v. *The United States.*

[May 2, 1932.]

OPINION.

BOOTH, Chief Justice, delivered the opinion of the court.

On May 29, 1925, the plaintiffs paid to the Commissioner of Internal Revenue $93,994.35 Federal estate taxes assessed by the Commissioner against the estate of Joseph Kengel, deceased. On June 1, 1925, the plaintiffs paid a small deficiency assessment of $5.58. Of the total amount of estate taxes paid $91,255.53 was assessed and paid because the Commissioner included in the estate tax assessment the then value of certain real property in the city of Detroit deeded by the decedent to his two sons, John A. and Frank H. Kengel, on May 12, 1924, the property being valued at $1,300,000, the Commissioner contending that decedent transferred said property to his sons in contemplation of death. This suit is for recovery of the tax paid as above.

No jurisdictional question is involved. We cite the provisions of the Revenue Act applicable, as follows:

"SEC. 401. That, in lieu of the tax imposed by Title IV of the Revenue Act of 1918, a tax equal to the sum of the following percentages of the value of the net estate (determined as provided in section 403) is hereby imposed upon the transfer of the net estate of every decedent dying after the passage of this Act, whether a resident or nonresident of the United States:

* * * * * * *

"10 per centum of the amount by which the net estate exceeds $1,000,000 and does not exceed $1,500,000;

* * * * * * *

"SEC. 402. That the value of the gross estate of the decedent shall be determined by including the value at the time of his death of all property, 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, or with respect to which he has at any time created a trust, in contemplation of or intended to take effect in possession or enjoyment at or after his death (whether such transfer or trust is made or created before or after the passage of this Act), except in case of a bona fide sale for a fair consideration in money or money's worth. 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 without such a consideration, shall, unless shown to the contrary, be deemed to have been made in contemplation of death within the meaning of this title." (Revenue Act of 1921, 42 Stat., 227, 277, 278.)

The Treasury regulations in force and applicable are articles 17 and 18 of Regulations 63, and contain the following provisions:

"ART. 17. *Nature and time of transfer.*—A transfer made by the decedent at any time, and in any manner, is taxable when made in contemplation of or intended to take effect in possession or enjoyment at or after his death, provided it was not a *bona fide* sale for a fair consideration in money or money's worth. To constitute such a sale it must have been made in good faith, and the price must have been a fair equivalent, and reducible to a money value. * * *

"ART. 18. *Nature of transfer.*—The words 'in contemplation of death' do not mean, on the one hand, a general expectation of death such as all persons entertain, nor, on the other, is the meaning limited to an expectation of immediate death. A transfer, however, is made in contemplation of death wherever the person making it is influenced to do so by such an expectation of death, arising from bodily or mental conditions, as prompts persons to dispose of their property to those whom they deem proper objects of their bounty. Such a transfer is taxable, although the decedent parts absolutely and immediately with his title to and possession and enjoyment of the property. * * *"

The case is one of fact. (*United States* v. *Wells*, 283 U. S.. 102 [Ct. D. 340, C. B. X-1, 475], and *Heiner* v. *Donnan*, decided by the Supreme Court March 21, 1932 [Ct. D. 473, C. B. XI-1, 324].) It was said in the Wells case:

"It is apparent that there can be no precise delimitation of the transactions embraced within the conception of transfers in 'contemplation of death,' as there can be none in relation to fraud, undue influence, due process of law, or other familiar legal concepts which are applicable to many varying circumstances. There is no escape from the necessity of carefully scrutinizing the circumstances of each case to detect the dominant motive of the donor in the light of his bodily and mental condition, and thus give effect to the manifest purpose of the statute." (Page 119.)

Joseph Kengel, a naturalized citizen of the United States, was born in Germany on August 15, 1831; he came to this country in his early twenties, taking up a permanent residence in Detroit, Mich., in the year 1854. A few years later he established in Detroit a carriage business and thereby laid the foundation of his subsequent fortune. In 1865 the decedent began to purchase real estate in the city and at the time of his death owned contiguous parcels of the same which came to be known as the Library Park Hotel property, valued at $1,300,000. Toward the development, care, and management of this property Mr. Kengel gave almost his exclusive attention, and in its ownership manifested conscious pride and concern. In 1895 Mrs. Kengel, the wife of the decedent, died at their home in Detroit, and soon thereafter Mr. Kengel retired from the carriage business and removed from Detroit to a country home he constructed on Lake St. Clair at Grosse Pointe, near Mount Clemens, Mich., some 20 miles from Detroit. On May 31, 1924, Joseph Kengel died intestate at his country home, having attained the age of 92 years 9 months and 16 days. He left surviving him two sons, John A. Kengel, since deceased, and Frank H. Kengel, and certain grandchildren—children of a deceased son and daughter—as his heirs at law. Joseph Kengel, the plaintiffs' father, enjoyed remarkably good health; he was rarely ever ill, and his mental faculties remained unimpaired. He was active in the management of his business affairs, devoting much time thereto until within a few months of his death. On March 5, 1924, the decedent contracted a heavy cold which confined him to his house, an illness which at its beginning did not alarm him or his family. In a few days, however, his unimproved condition caused his housekeeper to call in a doctor to see him, and on March 9, 1924, the doctor found him in bed suffering from an inguinal hernia of the right side, as the physician then diagnosed the case, which, notwithstanding his enfeebled appearance and condition, the doctor did not regard as dangerous. On March 17, 1924, this same doctor called again and reported decedent's condition as not alarming. On March 29, 1924, the doctor reported his patient as suffering from bronchitis, weak heart, and severe pains in his left side, which because of his advanced age might prove serious. During the early days of April, 1924, the decedent's bronchitis improved but his physical condition indicated intense weakness, and he was confined to his bed continuously. On May 12, 1924, decedent's son, Frank Kengel, and an intimate friend, a Mr. Church, consulted two eminent surgeons, and the following day, accompanied by one of them, a Doctor Allen, drove out to his father's home. Doctor Allen found the decedent in a very serious condition, both physically and mentally, i. e., drowsiness and an indisposition to be disturbed characterized his mentality, and physically he was very weak. The doctor diagnosed his case as cancer of the stomach, an affliction which in the doctor's opinion had existed for at least six months and for which he could propose no remedy, saying he would probably not survive for more than two or three weeks.

Without going into additional details, it is sufficient at this point to observe that on May 31, 1924, Joseph Kengel died. On May 5, 1924, Frank Kengel caused two deeds to be drawn up, conveying to him and his brother, John A. Kengel, an undivided one-half interest in the Library Park Hotel property, the realty involved in this litigation. On the same day and date Frank Kengel, in company with Mr. Church, visited Joseph Kengel at his home to secure the execution of the deeds. Joseph Kengel, the father, declined at this time to sign the deeds, saying he wished a few days to think the matter over. While the record contains testimony contrary to the facts just stated the witnesses do fix the date of May 5, 1924, as the date when the deeds were finally executed, another witness, a trained nurse in charge on that date, fixes the same definitely, and this testimony is corroborated by a sworn answer filed by John A. and

Frank Kengel in a chancery proceeding brought against them by the grandchildren of the decedent, in which the date May 5, 1924, is expressly fixed as stated in this opinion and May 12, 1924, given as the date of execution. In addition to this, the record indisputably establishes that the deeds were not executed on the date of the son's first visit to his father and that the father declined at first to sign them; and while the deeds bear a notarial acknowledgment as of May 5, 1924, they were not recorded until May 28, 1924, three days prior to the father's death, and we think from the record were in fact signed on May 12, 1924. The matter is not one of such vital importance as the plaintiffs accord it, for aside from all other facts there can be no doubt that the sons regarded the father on the date when the deeds were signed as rapidly approaching his demise.

Preceding May 12, 1924, and on April 3, 1924, at a time when Joseph Kengel was fatally ill, he transferred by deed to his son, Frank, certain other parcels of land located in the States of Michigan and Missouri, with instructions then given to Frank to distribute the lands deeded equally among his grandchildren, and in a court proceeding Frank A. Kengel admitted the above facts.

There can be no doubt that the relations between Joseph Kengel and his two sons were cordial, intimate, and confidential. The father had expressed a desire for his sons to have the Library Park Hotel property, and there is evidence in the record that he contemplated deeding it to them, but he never did so until his final illness, notwithstanding a man of his unusually advanced age, in full possession of his faculties, must have known and appreciated the seriousness of even slight illness. The way was open by either will or deed to accomplish his desire. It is abundantly proved that Joseph Kengel was a frugal and astute business man; he knew full well the value of property and the consequences which might follow his parting irrevocably with title to the same. Real estate constituted practically all his estate and during all the years of his long life he retained title to it in his own name, and as we view it must have appreciated what it meant to him to deed it to another; a transaction of such consequences to such an active, careful and prudent man justifies the inference, to say the least, that the time had arrived when he confidently believed he would have no further use for it.

The findings, we think, accurately reflect the facts of the case. We will not discuss them in all their relationship to the transaction involved. It is sufficient to say that the deeding of the property included by the Commissioner in the decedent's estate under the circumstances and at the time it was deeded exacts of the court the necessity, as was said in the Wells case (supra), "of carefully scrutinizing the circumstances of each case to detect the dominant motive of the donor in the light of his bodily and mental condition." Subjecting the facts to the rule thus established, we find an unusually elderly man who all his life exerted a maximum of industry and intelligence in the acquirement of large and extremely valuable real estate holdings, maintaining watchful care in the management and control of the same by personal supervision, never parting with the title or making any disposition whatever of it during his life to his heirs, and finally, when over 92 years of age, fatally ill, confined to bed, and under the care of doctors, deeds to his sons realty constituting 86 per cent of his entire estate, and to his grandchildren additional realty of a value not shown. This is, we think, clearly evidentiary that the transfers were made in contemplation of death, and that the "dominant motive" in thus without other consideration than love and affection in making said transfers, was his consciousness that he was afflicted with a fatal malady. A man of the type and mental sturdiness of Joseph Kengel did not need to be told that he was fatally ill. We think the petition should be dismissed. It is so ordered.

REGULATIONS 70(1929), Article 99: Claim for refund. XI–40–5762 Ct. D. 579

ESTATE TAX—ERRONEOUS REFUND—DECISION OF COURT.

1. ERRONEOUS REFUND—LIABILITY OF EXECUTORS.

Where an estate of a decedent is administered under the jurisdiction of a California court and the executors of the estate derive their authority from their appointment by the court, and where they are obligated by a decree of distribution to turn the

property of the estate over to those to whom it is distributed by the decree of the court and have no authority to retain any of the property after the decree, the executors having received an erroneous refund of a tax upon the estate are not obligated to repay the same where in pursuance of an order of the court previously entered the erroneous refund received by them in their representative capacity has been distributed by them to those entitled thereto under the decree of distribution in the estate of the deceased.

2. SAME—LIABILITY OF DISTRIBUTEES.

Where an erroneous refund of an estate tax received by the executors of the estate of a decedent is distributed to two persons in proportion to their respective interests therein in accordance with the terms of the decrees of distribution of the estate of the decedent and the estate of a deceased legatee under his will, each is severally and personally obligated to pay to the United States the part of the refund he received.

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT.

Curtis Lindley, jr., and Josephine Lindley Rood, Individually, and Curtis Lindley, jr., Josephine Lindley Rood, and D. A. Mendenhall, as Executors of the Estate of Curtis Holbrook Lindley, Deceased, appellants, v. *United States of America, appellee.*

Appeal from the District Court of the United States for the Northern District of California, Southern Division.

[May 23, 1932.]

OPINION.

WILBUR, Circuit Judge: The facts involved in this action were stipulated and are in part as follows:

Curtis Holbrook Lindley, a resident of the city and county of San Francisco, State of California, died in said city and county on the 20th day of November, 1920, and left an estate consisting of real and personal property situated in the State of California and within the jurisdiction of this court. In pursuance of the petition of defendants, letters testamentary were issued to them upon said estate of Curtis Holbrook Lindley, deceased, and defendants duly qualified as executors of said estate and thereafter at all times acted as such and continued so to act at the time of commencement of this action. After receiving their appointment and qualifying as executors of said estate, in pursuance with the provisions of an Act of Congress, defendants as executors of the estate of said decedent on or about the 15th day of November, 1921, filed with the collector of internal revenue for the first district of California, a return for estate tax purposes in due form, which set forth that the amount of the estate taxes due from said estate was the sum of $2,051.32, and said amount was duly paid by defendants as said executors, to the collector of internal revenue of the first district of California on the 30th day of November, 1921.

Subsequent to the filing of the estate tax return as aforesaid, the Commissioner of Internal Revenue assessed additional taxes against said estate in the sum of $8.51, which said sum was duly paid by the defendants as executors on the 20th day of November, 1922.

Thereafter, the defendants as said executors on or about the 8th day of December, 1922, filed with the collector of internal revenue for the first district of California, a claim for refund of estate taxes in the amount of $1,813.94, which said claim was based on the ground that the entire gross estate returned was community property and that under the decision by the Circuit Court of Appeals for the Ninth Circuit, in the case of *Blum* v. *Wardell* (276 Fed., 226), only one-half of such community property was subject to estate tax. Said claim was audited and reviewed under the direction of the Commissioner of Internal Revenue and was allowed by him in the amount of $1,669.87 and rejected in the amount of $144.07 and said amount so allowed resulted entirely from the reduction in tax attributable to reducing the estate by one-half of said

alleged community property. Thereafter this said claim for refund was certified to the disbursing clerk of the Treasury Department for payment in the principal sum of $1,669.87, together with interest in the amount of $336.86, or a total of $2,006.73, which said total sum was duly paid to and received by the defendants as said executors on April 23, 1925.

Thereafter, pursuant to the decision of the Supreme Court of the United States in the case of *United States* v. *Robbins* (269 U. S., 315 [T. D. 3817, C. B. V-1, 188]), holding in the opinion of the Attorney General that the community property interest of a surviving spouse of a decedent residing in California, in the property of said decedent, was subject to the Federal estate tax under the Internal Revenue Act of 1918 above referred to, the Commissioner of Internal Revenue redetermined the estate tax upon the said estate of Curtis Holbrook Lindley, deceased, and determined that the sum of $2,006.73 previously refunded had been erroneously refunded and that additional tax was due and unpaid from said estate in the amount of $2,006.73, together with interest from the date of refund. Notice of said redetermination and demand for repayment was mailed to defendants on the 19th day of November, 1926, and received by them on the 20th day of November, 1926. The defendants have neglected, refused and still refuse to pay the same.

Under the terms of the will of said decedent, Curtis Holbrook Lindley, an undivided one-half interest in his property was left to his widow, Elizabeth Mendenhall Lindley, an undivided one-sixth interest to his son, the defendant, Curtis Lindley, jr., and an undivided one-third interest to his daughter, the defendant, Josephine Lindley Rood. Pursuant to a decree of statement of accounts and final distribution duly made and entered on the 1st day of December, 1921, by the Superior Court of the State of California in and for the City and County of San Francisco, said estate was immediately thereafter and prior to the date of commencement of this action, distributed in accordance with the said provisions of said will.

Thereafter, on the 28th day of January, 1925, Elizabeth Mendenhall Lindley, the widow of said decedent, Curtis Holbrook Lindley, died intestate. Prior to her decease, said Elizabeth Mendenhall Lindley had created a trust in which had been placed all of the property received by her from her husband, Curtis Holbrook Lindley, upon distribution of his estate as aforesaid. Under the terms of said trust, the defendants Curtis Lindley, jr., and Josephine Lindley Rood individually and in their own rights, respectively, received at the death of said Elizabeth Mendenhall Lindley, one-half each of said property. Said defendants Curtis Lindley, jr., and Josephine Lindley Rood as the sole heirs and next of kin of the said Elizabeth Mendenhall Lindley, under the statutes of distribution and descent of the State of California, also received all other property both real and personal of the said Elizabeth Mendenhall Lindley by decree of the probate court entered February 23, 1926. In accordance with the terms of the decrees of distribution of the estates of both said decedents, the amount of $2,006.73, paid as aforesaid by the disbursing clerk of the Treasury Department to the defendants Curtis Lindley, jr., Josephine Lindley Rood, and D. A. Mendenhall as executors, was distributed to the defendants Curtis Lindley, jr., and Josephine Lindley Rood, individually, in their respective interests on and prior to the 23d day of February, 1926.

On the 24th day of September, 1925, the defendants Curtis Lindley, jr., and Josephine Lindley Rood caused to be paid to the United States collector of internal revenue at San Francisco, Calif., the sum of $624.58, representing the tax on said securities (which she had received as her half of the community property), and thereby depleted the amount which said defendants received from said estate of Elizabeth Mendenhall Lindley, deceased, by said sum of $624.58. Said tax was paid on said securities in the estate of Elizabeth Mendenhall Lindley, deceased, which had been previously taxed within five years, in the estate of her deceased husband, as aforesaid, because the tax on the said community interest of said widow in her husband's estate had been refunded on the 28th day of April, 1925, as hereinabove mentioned.

In support of the judgment we assume that the executors of the estate of Curtis Lindley acted upon the theory that the decree of distribution in the estate of Curtis Lindley, disposed of all property of the decedent subsequently discovered (see *Heydenfeldt* v. *Osmont*, 178 Cal., 768; 12 Cal. Jur., 196, section 939), and that the deed of trust from the widow likewise disposed of her half

of the assets of Curtis Lindley, deceased, including the refund, and justified a distribution by them directly to the son and daughter, as the beneficiaries of the trust, which had terminated at her death (see section 1678, Cal. Code Civ. Proc., in effect in 1921 and to 1930). In short, that the defendant executors acted upon the theory that the decree of distribution in the estate of Curtis Lindley, deceased, required them to pay 5/12 of the refund to the son and 7/12 to the daughter, and that nothing was paid by the executors of Curtis Lindley to the administrators of the estate of Elizabeth Lindley, as such.

This action was brought against the three executors of the estate of Curtis Lindley in their representative capacity and against two of them, that is, the two children, in their individual capacity, to recover the amount of the erroneous refund. That the Government is entitled to recover money erroneously repaid by its officers under mistake of law similar to that involved here is well established and is not denied by the appellant. (*Talcott* v. *United States*, 23 F. (2d), 897 [T. D. 4137, C. B. VII–1, 319]; *Kelley* v. *United States*, 30 F. (2d), 193; *United States* v. *Pusey*, 47 F. (2d), 22.)

The Government contends that the executors of the estate of Curtis Lindley having received the erroneous refund are obligated to repay the same notwithstanding the fact that in pursuance of an order of the court previously entered the money received by them in their representative capacity has been distributed by them to those entitled thereto under the decree of distribution in the estate of Curtis Lindley, deceased.

Whatever may be the rule in other jurisdictions wherein the relation of the parties to an estate is different from that in California, we think that under the California rule, where an estate is administered under the jurisdiction of the court and the executors derive their authority from their appointment by the court (11 Cal. Jur., 214 (section 6)), and where they are obligated by a decree of distribution to turn the property over to those to whom it is distributed by the decree of the court and have no authority to retain any of that property after the decree, such a decree being enforceable against the executors by contempt proceedings if they neglect to distribute the property in accordance with the terms of the decree (12 Cal. Jur., 222 (section 955)) the authority of the executors over the funds of the estate thus distributed ceases upon distribution (12 Cal. Jur., 199 (section 940)) and that having disposed of the property in accordance with the requirements of the law under which they act, they can not be subsequently held in their representative capacities to repay moneys which they have collected for and on behalf of any paid to the distributees although that collection may have been erroneously made. The money did not belong to the executors. They had no authority to withhold it from the legatees upon the theory that the Government might subsequently seek to reclaim it. Their full duty was performed when they turned it over to the distributees. We conclude that in so far as the judgment is against the executors of Curtis Lindley in their representative capacities it is erroneous and should be reversed.

It remains to consider whether the judgment against the appellants, the two children, as legatees and grantees of a legatee under the will of Curtis Lindley, deceased, can be sustained. We see no reason to doubt that they are thus liable. The collection was made on their behalf by the executors who were in effect their representatives. The money was received for them and paid to them.

The Government has not appealed from the allowance of the set-off of $624.58. We conclude, therefore, that as to the refund which they received as legatees, and as grantees of a legatee, of Curtis Lindley the judgment against them as individuals is proper for their proportionate share, that is, seven-twelfths thereof from the daughter and five-twelfths thereof from the son.

The judgment against the appellants in their representative capacity is reversed. The judgment against the appellants as individuals is modified so that there will be a several judgment against Josephine Lindley Rood for seven-twelfths ($835.52) and against Curtis Lindley, jr., for five-twelfths ($596.80) of the amount of the balance of the refund, $1,432.32, both with interest at 6 per cent per annum from September 24, 1925.

SALES TAX RULINGS.

TITLE IV.—MANUFACTURERS' EXCISE TAX. (1932)

SECTION 601.—EXCISE TAXES ON CERTAIN ARTICLES.

LUBRICATING OILS.

REGULATIONS 44, ARTICLE 11: Scope of tax. XI–30–5567
T. D. 4339

Tax on lubricating oils—Section 601(c)1, Revenue Act of 1932.—Article 11, Regulations 44, amended.

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

To Collectors of Internal Revenue and Others Concerned:

Article 11 of Regulations 44 is amended to read as follows:

ART. 11. *Scope of tax.*—The tax imposed under section 601(c)1 attaches to the sale by the manufacturer of lubricating oils. Lubricating oils imported into the United States are subject to a tax of 4 cents a gallon upon importation under section 601(c)4, but the importer's sale thereof is not taxed under section 601(c)1.

"Lubricating oils" are all oils sold as such and all oils sold or used for lubrication. A particular oil having both lubricating and nonlubricating uses is taxable unless (1) it is put into a channel of consumption or distribution for a use other than that of lubrication, under a name identifying it for such use, and (2) the manufacturer obtains from the purchaser a certificate to the effect that the oil will be used by the purchaser for a stated purpose other than that of lubrication or resold by him only to a person who in turn furnishes a similar certificate. A blanket certificate covering all orders between given dates (for a period not exceeding a month) may be accepted from the purchaser. Such certificates and proper records of invoices, orders, etc., relative to tax-free sales must be retained as provided in article 50. Where upon inspection it is discovered that a manufacturer's records with respect to any sale claimed to be tax-free do not contain a proper certificate, with supporting invoice and such other evidence as may be necessary to establish the character of the sale, tax shall be payable by the manufacturer on such sale.

Examples of oils not subject to tax when sold (otherwise than as lubricating oil) for purposes other than lubrication, as prescribed in the preceding paragraph, are: Road oil, cordage oil, agricultural spray oil, cotton softener oil, ink oil, medicinal white oil, and oil used as a component material in the manufacture of nontaxable oils, paint, insecticides, soap stock, grease, etc.

The term "lubricating oils" does not include products of the type commonly known as grease. Oleaginous substances are classed as grease and not subject to the tax only if (1) of a worked consistency of less than 390 penetration units, or an unworked consistency of less than 360 penetration units, by the method of test of the American Society for Testing Materials D–217–27–T and (2) free from oil or comprising oil and a soap or a mixture of soaps or of soaps and other substances.

Effective August 16, 1932, no lubricating oil shall be sold tax-free for further manufacture under section 620 to any person (other than a refiner of crude petroleum) unless the exemption certificate furnished pursuant to article 7

shows the registration number of the purchaser. Each manufacturer or producer of lubricating oils (other than a refiner of crude petroleum) will be granted a registration number upon application to the collector for the district in which is located his principal place of business (or, if he has no principal place of business in the United States, to the collector at Baltimore, Md.). Such numbers shall be in a separate series, beginning with the number 1, for each district. Applications for registration numbers shall state the name and place or places of business of the applicant and the nature of the processes of manufacture or production in which he is engaged.

A person who merely blends taxable lubricating oils is not a manufacturer or producer, and such a blender may not purchase lubricating oils for blending tax-free under section 620 (see article 7). A person who produces lubricating oils by a process of compounding involving more than the mere mixing of taxable oils, is a manufacturer or producer, and may be granted a registration number.

A person who produces lubricating oil by reclaiming used lubricating oil, irrespective of the process used and whether or not new lubricating oil is added thereto, is a manufacturer or producer, and the tax attaches to oil so produced when sold or used by him for lubrication.

DAVID BURNET,
Commissioner of Internal Revenue.

Approved July 16, 1932.

OGDEN L. MILLS,
Secretary of the Treasury.

REGULATIONS 44, ARTICLE 11: Scope of tax. XI-37-5683
(Also Section 617, Article 43.) S. T. 486

Tax liability of broker who has storage facilities for oils and gasoline.

Advice is requested regarding several questions with respect to the taxes on lubricating oil and gasoline under the Revenue Act of 1932. The questions and answers are as follows:

Is a broker that has storage facilities for storing oil classed any differently than a broker who does nothing but purchase and sell oils?

There is no difference in the classification.

A broker buys oils from a manufacturer under a contract prior to May 1, 1932, putting the oil into his own storage facilities. Under a similar contract with another manufacturer, he sells the oil and the manufacturer purchasing the oil refuses to pay the tax. These two contracts are based on a price that does not include the tax. Is the original manufacturer selling the oil responsible for the payment of the tax?

Liability for payment of the tax is dependent upon the provisions of the contract. If the contract does not permit the addition of the tax to the contract price and does not provide that the vendor shall pay the tax, the tax is payable by the vendee to the vendor at the time of sale and must be returned and paid to the collector by the vendor.

Where because of a contract dated prior to May 1, 1932, the original manufacturer can receive exemption from the payment of tax, making the broker responsible, can the broker, also with a contract dated prior to May 1, in turn receive exemption, making the purchasing manufacturer responsible for the tax?

A broker who is liable for the payment of a tax may not in turn receive exemption, thereby making the purchasing manufacturer re-

sponsible for the tax. However, there is no provision in the Act which prohibits a taxpayer from passing the tax on to his purchaser. The question is one between such taxpayer and purchaser over which the Bureau has no jurisdiction.

REGULATIONS 44, ARTICLE 11: Scope of tax. XI–39–5727
S. T. 505

Cutting oils and water soluble oils used for lubricating purposes held taxable.

Advice is requested whether cutting oils and water soluble oils are lubricating oils and subject to the tax under section 601(c)1 of the Revenue Act of 1932.

Under Treasury Decision 4339, issued July 16, 1932 [see on page 446], any oil having both lubricating and nonlubricating uses is taxable when sold or used for lubrication.

Cutting oils and water soluble oils, used in cutting and machining operations on metals, are used for lubricating purposes and are therefore held to be taxable under section 601(c)1 of the Revenue Act of 1932, when sold by the manufacturer or producer.

REGULATIONS 44, ARTICLE 11: Scope of tax. XI–43–5807
S. T. 540

Taxability as lubricating oil of fatty oils of vegetable, animal, fish, or marine origin.

Advice is requested whether the tax imposed under section 601(c)1 of the Revenue Act of 1932 upon sales of lubricating oils applies to sales of fatty oils of vegetable, animal, fish, or marine origin. Advice is also requested with respect to furnishing exemption certificates on tax-free sales of such oils when put into channels of consumption or distribution for uses other than that of lubrication.

In order to determine the necessity of filing a certificate to the effect that the particular oil sold will be used by the purchaser for a stated purpose other than that of lubrication, it must first be determined whether the fatty oils in question are "lubricating oils" within the meaning of section 601(c)1 of the Revenue Act of 1932 and article 11 of Regulations 44, as amended by Treasury Decision 4339 [see on page 446]. If the fatty oils in question are not sold as lubricating oils in their natural state by the manufacturer or producer, and are not sold or used for lubrication in such state but must be mixed with other oils before being sold or used for lubrication, sales of such oils are not subject to the tax on lubricating oils and certificates for the exemption of sales thereof are not required. The fact that such fatty oils are used to some extent by manufacturers of lubricating oils as material in the manufacture or production of taxable lubricating oils does not, in itself, require the manufacturer of such fatty oils to obtain from the purchaser a certificate

in order to secure exemption of the sales of the so-called fatty oils from the tax imposed under section 601(c)1 of the Act, unless such fatty oils are themselves lubricating oils within the definition laid down in Treasury Decision 4339, supra.

On the other hand, if a particular oil has both lubricating and nonlubricating uses, sales thereof are subject to the tax, unless (1) it is put into a channel of consumption or distribution for a use other than that of lubrication, under a name identifying it for such use, and (2) the manufacturer obtains from the purchaser a certificate to the effect that the oil will be used by the purchaser for a stated purpose other than that of lubrication, or resold by him only to a person who in turn furnishes a similar certificate.

A strict application of the foregoing rules to sales of each of the fatty oils of vegetable, animal, fish, or marine origin will fix the taxability of sales of the particular product and indicate whether the manufacturer must obtain from the purchaser a certificate as required under Treasury Decision 4339.

REGULATIONS 44, ARTICLE 11: Scope of tax. XI–43–5808
S. T. 541

Taxability of reclaimed lubricating oil.

The M Railroad Co. purchases large quantities of lubricating oils which are used for saturating packing in the journal boxes of railroad cars. After being so used this oil is reclaimed by a process somewhat as follows: The dirty and oil-soaked packing is taken from the journal boxes and placed in a centrifugal cylinder. The revolving of this cylinder separates the oil from the packing. The oil is then collected and placed in a tank and an application of soda ash is spread over the top of the oil. This ash sinks to the bottom of the tank, carrying with it all foreign matter. The clear oil is then drawn off and is again ready for journal-box lubrication.

If, under the provisions of section 622 of the Revenue Act of 1932 a person produces a taxable article and uses it, he is liable to tax in the same manner as though the article were sold by him. Section 622 makes no distinction with respect to the source of the material used in the production of a taxable article, and the liability imposed under the section is not limited to those persons engaged in the production of the taxable article as a principal business.

The process employed by the M Railroad Co. in reclaiming such used lubricating oils changes an article, the lubricating value of which is exhausted, into one which is suitable for lubricating purposes. The company thus becomes a producer of lubricating oils within the meaning of article 11, Regulations 44, of the Revenue Act of 1932, as amended by Treasury Decision 4339 [see on page 446]. The company is, therefore, subject to the tax imposed under section 601(c)1 of the Revenue Act of 1932, with respect to the use of all lubricating oil which it reclaims by the process described.

REGULATIONS 44, ARTICLE 11: Scope of tax. XI–44–5823
S. T. 548

Distinction between a compounder and a blender of lubricating oils.

Advice is requested concerning the distinction between a compounder and a blender of lubricating oils, as those terms are used in Treasury Decision 4339 [see on page 446].

The necessity for distinguishing between a blender and a compounder of lubricating oils arises in the application of section 620 of the Revenue Act of 1932, relating to the sales of taxable articles for further manufacture. This section provides, in effect, that an article subject to tax under the Revenue Act of 1932, with certain exceptions not here material, may be sold tax-free where such article is sold for use as material in the manufacture or production of, or for use as a component part of, an article to be produced by the vendee which will be subject to tax.

In determining the application of section 620 it is necessary that consideration be given to the question of what constitutes further manufacture in the case of lubricating oils. The Bureau has reached the conclusion that a person who merely blends taxable lubricating oils—that is to say, one who merely mixes two or more varying grades of lubricating oils—is not a manufacturer or producer of lubricating oil, and, consequently, may not buy lubricating oils tax-free for the purpose of such blending. However, a person who by means of a process of compounding or other manipulation involving substantially more than the mere mixing of taxable oils, or one who mixes taxable oils with other substances, is a manufacturer or producer of lubricating oil, and may buy lubricating oils tax-free where such oils are to be used in the compounding or production of other articles subject to tax.

REGULATIONS 44, ARTICLE 11: Scope of tax. XI–45–5840
S. T. 558

Taxability of buffing oil, burning oil, concrete form oil, core oil, floor oil, harness oil, leather oil, quenching oil, slushing oil, tempering oil, transformer oil, lard oil, and neatsfoot oil.

Advice is requested whether certain oils when sold otherwise than for lubricating purposes are subject to tax under section 601(c)1 of the Revenue Act of 1932.

It is held that buffing oil, burning oil, concrete form oil, core oil, floor oil, harness oil, leather oil, quenching oil, slushing oil, tempering oil, transformer oil, lard oil, and neatsfoot oil, are not subject to tax when sold under a name identifying such oils for purposes other than lubrication, or when used as the component material in the manufacture of other articles which are taxable under Title IV of the Revenue Act of 1932, provided the manufacturer obtains from the purchaser a certificate to the effect that the oil will not be used for lubrication. The fact that an oil is sold under a name identifying it for use for a purpose other than that of lubrication will not exempt the sale thereof from tax if the oil is actually used for lubricating purposes.

REGULATIONS 44, ARTICLE 11: Scope of tax. XI–47–5871
S. T. 571

Lubricating oil is not a component part of an automobile and is subject to tax when sold to a manufacturer of automobiles.

Advice is requested whether lubricating oil sold by a manufacturer or producer thereof to a manufacturer of automobiles, who furnishes this oil in the crank case of automobiles when sold to the consumer, is taxable under section 601 of the Revenue Act of 1932.

Section 620 of the Revenue Act of 1932 provides that a taxable article under Title IV of the Act may be sold tax-free by virtue of that section when it is used by the purchaser as *component material* in the manufacture of another article which is also taxable under Title IV of the Act.

The term "component material," as used in the law, signifies a substance which comprises an integral part of an article, one which may not be easily separated from the article and which may not be replenished. Oil placed in the crank case of an automobile may be drained at will and a new supply furnished. Such oil is not a component material of the automobile. Consequently, all lubricating oil sold by a manufacturer, or producer thereof, to a manufacturer of automobiles for the purpose of placing it in the crank cases of automobiles sold is taxable under section 601(c)1 of the Revenue Act of 1932.

REGULATIONS 44, ARTICLE 11: Scope of tax. XI–48–5885
S. T. 580

Taxability of lubricating oil sold for use on a foreign steamship.

Advice is requested concerning the tax imposed by section 601(c)1 of the Revenue Act of 1932 as applied to sales of lubricating oil to foreign steamships at a domestic port, the oil being used by the ships on their return journey to a foreign country.

Articles which are not actually transported to and delivered at a foreign destination for the purpose of entering into the commerce of such country are not exported within the meaning of the internal revenue laws and regulations.

While it appears that the lubricating oil in question is sold to a foreign company, yet it is delivered to ships of the purchaser for consumption in their operation and not for transportation to a foreign country as articles of commerce. It is held that such sales are taxable under section 601(c)1 of the Revenue Act of 1932, since the lubricating oil is not sold for export and in due course so exported.

REGULATIONS 44. ARTICLE 11: Scope of tax. XI–48–5886
S. T. 581

Taxability of lubricating oils sealed in the crank case of mechanical refrigerators.

Advice is requested whether lubricating oil sold for use in the manufacture of compressors for mechanical refrigerators is subject to the tax imposed under section 601(c)1 of the Revenue Act of 1932 and whether it may be sold tax-free to manufacturers under section 620 of the Revenue Act of 1932.

It is held that oil which is sealed in the crank case of the compressor of a mechanical refrigerator is a component material in the manufacture of such compressor. Therefore, lubricating oil purchased for use in the manufacture of compressors for taxable refrigerators (the household type) may be purchased tax-free by virtue of section 620.

However, lubricating oil sold for use as a component part of compressors on nontaxable refrigerators (commercial) may not be sold tax-free under the provisions of Treasury Decision 4339 (see on page 446).

REGULATIONS 44, ARTICLE 11: Scope of tax. XI-49-5901
S. T. 588

Taxability of sales of lubricating oils purchased for resale.

Advice is requested concerning the application of the tax imposed under section 601(c)1 of the Revenue Act of 1932 to sales of lubricating oil purchased solely for resale.

A certificate of registration has been issued to the X Corporation under the provisions of article 11 of Regulations 44, as amended by Treasury Decision 4339 (see on page 446), classifying it as a manufacturer or producer of lubricating oils. The corporation desires to purchase lubricating oil tax-free for resale in the same form in which purchased.

The primary purpose of section 620 of the Revenue Act of 1932 is to prevent the pyramiding of taxes where taxable articles are purchased for use in the manufacture of other articles which are also taxable when sold. Where a person purchases articles tax-free by virtue of section 620 and for some reason does not use all of such articles in the manufacture of his own products, he is permitted to resell such articles in the same form as purchased by him, in which event he becomes liable for the tax on such sales.

The provisions of section 620 are not, however, applicable to sales of lubricating oils when purchased for the sole purpose of resale in the same form in which purchased, and, consequently, sales for that purpose may not properly be made free of tax.

BREWER'S WORT, LIQUID MALT, MALT SIRUP, AND MALT EXTRACT.

REGULATIONS 44, ARTICLE 15: Labeling containers. XI-31-5582
T. D. 4341

Tax on brewer's wort, liquid malt, malt sirup, and malt extract—section 601(c)2 of the Revenue Act of 1932—and tax on grape concentrate, etc.—Section 601(c)3 of the Revenue Act of 1932.—Articles 15 and 19, Regulations 44, amended.

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

To Collectors of Internal Revenue and Others Concerned:

Article 15 of Regulations 44 is hereby amended to read as follows:

Labeling containers.—Each separate can, keg, or other container in which any of the articles enumerated in section 601(c)2 is sold by the manufacturer

must have plainly shown thereon the true name and address of the manufacturer, except that if the articles are sold by the manufacturer for resale the label may show the name of the vendee, instead of the manufacturer, preceded by the words "Packed for" or "Distributed by" or some equivalent phrase.

MALT SIRUP.

REGULATIONS 44, ARTICLE 16: Rate of tax. (Also Article 14: Exempt sales.) XI–38–5704 S. T. 495

Held that malt products sold to jobbers and resold by them to bakeries are taxable.

Advice is requested concerning the taxability of malt sirup sold to bakeries by jobbers.

It is stated that some manufacturers are adding the tax of 3 cents per pound to the selling price of malt shipped to jobbers and resold to bakeries.

The tax under section 601(c)2 of the Revenue Act of 1932 is imposed upon the sales of malt products by the manufacturer. All such sales are taxable unless sold to a baker for use in baking or to a manufacturer or producer of malted milk, etc.

Under Regulations 44, article 14, the manufacturer, in order to establish the right to exemption on sales to bakers, must obtain from the purchaser a certificate to the effect that he is a baker and that the products sold are to be used in baking. Resales of malt products by a dealer or jobber are not taxable and there is no way by which either may claim exemption on resales to a baker. The fact that the dealer has reimbursed the manufacturer for the tax is a matter between the two parties concerned and is one over which the Bureau of Internal Revenue has no jurisdiction.

GRAPE CONCENTRATES, ETC.

REGULATIONS 44, ARTICLE 19: Labeling containers. XI–31–5583 T. D. 4341

* * * * * * *

Article 19 of Regulations 44 is hereby amended to read as follows:

Labeling containers.—Each separate can, bottle, or other container in which any of the articles enumerated in section 601(c)3 is sold by the manufacturer must have plainly shown thereon the true name and address of the manufacturer, except that if the articles are sold by the manufacturer for resale the label may show the name of the vendee, instead of the manufacturer, preceded by the words "Packed for" or "Distributed by" or some equivalent phrase.

DAVID BURNET,
Commissioner of Internal Revenue.

Approved July 20, 1932.

OGDEN L. MILLS,
Secretary of the Treasury.

SECTION 602.—TIRES AND INNER TUBES.

REGULATIONS 46, ARTICLE 14: Exchanges, etc. XI–52–5954
S. T. 613

Where defective articles are replaced by the manufacturer under a guaranty contract, and the manufacturer receives no consideration for the new article except the original article which is defective, the transaction is not a sale and is not subject to the tax imposed by section 602 of the Revenue Act of 1932. This is true irrespective of whether the original article was sold before or after the effective date of the Act, provided the original article is replaced in kind.

REGULATIONS 46, ARTICLE 19: Scope of tax. XI–34–5632
S. T. 465

The term "tires" as used in section 602 of the Revenue Act of 1932 includes all kinds of rubber casings, rubber hoops, and rubber strips or bands designed and shaped or built to form the tread of a wheel or to fit a wheel, and commonly or commercially known as tires. The test of taxability of tires used on children's toys is whether they are real or imitation. If they are real tires, they are taxable; if mere imitations, they are not subject to tax.

An opinion is requested with respect to the taxes on tires and toys as applied to certain articles under the Revenue Act of 1932.

Section 602 of the Revenue Act of 1932 imposes certain taxes on tires and inner tubes. The term "tires" as used in section 602 of the above-mentioned Act includes all kinds of rubber casings, rubber hoops, and rubber strips or bands designed and shaped or built to form the tread of a wheel or to fit a wheel if these articles have reached such a state of manufacture that they constitute articles commonly or commercially known as tires, but does not include raw material used in the manufacture of tires. Tires of either the solid or pneumatic type are subject to tax irrespective of whether they are designed for use on wheels for automotive vehicles, carriages, bicycles, wheel chairs, wagons or other vehicles, hand trucks, scooters, tricycles, etc.

The term "tires" does not include solid rubber wheels, or mere representations of tires which are not capable of use in the same manner as the original tire imitated. Tires on doll carriages, on the other hand, are real tires, and are subject to the tax.

If a toy manufacturer has on hand a supply of finished tires or tubings which was purchased from another manufacturer before June 21, 1932, he will not be liable for any tax thereon if he uses them on toys sold after that date.

The sale of tubing in lengths is not taxable but the cutting up thereof into sizes for use is held to be a manufacturing process. When these sizes are fitted to taxable articles the manufacturer (i. e., the one who cuts them up) is liable for the tax on his sales.

The Bureau has no suggestions to make as to how the tax on tires may be passed on by the manufacturer. He has the choice of "absorbing" the tax, of billing the tax separately from the selling price of the articles, or of including the tax in the selling price

without separate billing. The Bureau will interpose no objection to any of these methods.

It is stated that there is some conflict between the terms of article 19 of Regulations 46, providing that tires used on children's toys are taxable, and article 56 of these regulations, providing that children's toys are not taxable. The test of taxability of tires used on children's toys is whether they are real or imitation. If they are real tires, they are taxable; if mere imitations, they are not subject to tax.

REGULATIONS 46, ARTICLE 19: Scope of tax. XI-38-5705
S. T. 496

Held that rentals received from the lease of tires and inner tubes are taxable on delivery of articles.

Advice is requested whether rentals received from the lease of tires and inner tubes are taxable under section 602 of the Revenue Act of 1932.

Section 618 of the Revenue Act of 1932 provides that, for the purposes of this title, the lease of tires and tubes shall be considered the sale of such articles.

The tax on tires and tubes supplied under a mileage contract is incurred at the time when such tires and tubes are delivered by the tire manufacturer to his customer and should be computed on the full weight of such articles.

However, no tax is due on tires and tubes delivered prior to June 21, 1932, under leases covering mileage contracts.

SECTION 603.—TOILET PREPARATIONS, ETC.

REGULATIONS 46, ARTICLE 8: Basis of tax on sales generally. XI-37-5684
S. T. 487

Where three plants are operated under one ownership, held that no tax is due on transfers of goods from one plant to another but should be computed on first sales to outside interests.

Advice is requested on certain questions relating to the tax imposed by section 603 of the Revenue Act of 1932. The questions and rulings are given below in the order in which presented.

1. A manufacturer who operates three plants, one located in Pennsylvania, one located in Illinois, and a third located in New York, all of which sell their products to the retail druggist and to the wholesale druggist, asks three questions:

(a) Where the branch plant in Pennsylvania sells to the branch plant in Illinois a taxable toilet article which is a completed package and is intended for resale by the plant in Illinois to either retail or the wholesale trade, who is supposed to pay the tax—the plant in Pennsylvania on the basis of price charged to the Illinois plant, or the plant in Illinois on the basis at which it will sell this particular toilet article?

The three plants referred to are a part of one manufacturing corporation. When one plant ostensibly "sells" to another the trans-

action is not a bona fide sale but merely represents a transfer from one part of the corporation to another. Under these circumstances the manufacturing corporation should pay tax on the price at which the Illinois branch sells the articles to outside interests.

(b) The plant in Pennsylvania sells a shaving lotion in bulk to the branch plant in New York, shipping 50 gallons of this material to that plant and makes a fair price charge of $1 per gallon for this shaving lotion to that plant. Is the plant in Pennsylvania liable to the 10 per cent tax on this toilet article, or is the New York plant supposed to pay the tax upon the bottled shaving lotion which it packages from the bulk material received from Pennsylvania?

The tax would attach to the sale price by the New York plant.

(c) One of these plants sells the other plant an article of toilet water, which toilet water is bottled at the one plant and shipped to the other plant unlabeled. Which plant is supposed to pay the tax—the plant which supplies this article unlabeled, or the plant which eventually places the label onto the container?

The tax attaches to the price for which the labeled article is sold.

REGULATIONS 46, ARTICLE 22: Scope of tax. XI–36–5663
S. T. 478

Articles produced by druggists pursuant to bona fide prescriptions of physicians and dentists are not considered taxable as toilet articles except where a prescription specifies that it is for toilet purposes.

An opinion is requested as to whether the tax imposed by section 603 of the Revenue Act of 1932 on toilet preparations, etc., will attach where the druggist fills prescriptions of physicians and dentists. Certain cases referred to are those in which the finished article or preparation is similar in nature and susceptible of the same uses as in the case of articles enumerated in the statute which are prepared or manufactured on a commercial basis by manufacturers of toilet preparations and cosmetics.

It is contended that the absence of any tax on medicine, and the universal recognition of physicians' prescriptions as medicinal in character, afford ground for the conclusion that the articles produced pursuant to physicians' prescriptions are not taxable as toilet articles. It is also contended that preparations covered by physicians' and dentists' prescriptions are always for medicinal and never for toilet use.

By the terms of section 603 of the Revenue Act of 1932 its application is limited to articles "used or applied or intended to be used or applied for toilet purposes." Whether articles are used or intended to be used for toilet purposes is a question of fact. A prescription written for a toilet purpose, as distinguished from a medicinal preparation, is no doubt a rarity. It is the opinion of this office that *bona fide* prescriptions of physicians and dentists licensed under the laws of the State or other appropriate governmental entity should be considered as written for medicinal purposes, and that druggists may treat preparations compounded thereunder as exempt except where the physician or dentist writing the prescription specifies on its face that it is for a toilet purpose.

REGULATIONS 46, ARTICLE 22: Scope of tax. XI–37–5685
S. T. 488

Taxability of manufacturer's sales of permanent wave solutions and pads used as accessories to permanent wave machines and treatments.

Advice is requested whether the tax imposed by section 603 of the Revenue Act of 1932 applies to a manufacturer's sale of permanent wave solutions and pads used as accessories to permanent wave machines and treatments.

It is stated that the permanent wave solutions are applied to pads which in turn are applied to the hair and heated by wave machines, thereby imparting so-called "permanent waves" to the hair.

The permanent wave pads used as accessories to permanent wave machines and the accompanying permanent wave solution are not taxable under section 603 of the Revenue Act of 1932. However, substances or preparations applied directly to the hair in producing "finger waves" or "wave sets" are taxable under the law when sold by the manufacturer, producer, or importer.

REGULATIONS 46, ARTICLE 22: Scope of tax. XI–38–5706
S. T. 497

Styptic pencils held not taxable.

Advice is requested whether styptic pencils are subject to the tax imposed on toilet preparations, etc., under section 603 of the Revenue Act of 1932.

Styptic pencils are advertised and sold as efficacious in healing cuts quickly; in stopping the flow of blood at once; and in strengthening a tender skin. They are also represented as being a remedy for canker, sore mouth, fever blisters, and insect bites.

It is held that styptic pencils are not toilet articles and are not subject to the tax imposed under section 603 of the Revenue Act of 1932.

REGULATIONS 46, ARTICLE 22: Scope of tax. XI–39–5728
S. T. 506

Cocoa butter, if labeled or advertised as a toilet preparation, is taxable under section 603 of the Revenue Act of 1932.

The question is presented whether cocoa butter is subject to the tax imposed on toilet preparations under section 603 of the Revenue Act of 1932.

Cocoa butter is not taxable under section 603 of the Revenue Act of 1932, *unless* it is labeled or advertised for toilet purposes, or prepared in sticks or cakes similar to cakes of soap, or is sold in such other forms as to indicate that it is intended to be used for toilet purposes. If the product is so prepared, advertised, or sold, it is taxable under section 603 of the Revenue Act of 1932.

REGULATIONS 46, ARTICLE 22: Scope of tax. XI–40–5751
G. C. M. 10960

Articles intended for application to the human skin to cover birthmarks held taxable.

An opinion is requested whether an article resembling paint, intended for application to the human skin to cover birthmarks, is taxable as a toilet preparation or cosmetic under section 603 of the Revenue Act of 1932.

Whether an article is taxable as a cosmetic depends upon the purpose for which it is sold or used. It is contended that the article in question should be exempt from tax because it is a necessity. There is no legal basis for distinction between cosmetic necessities and cosmetic luxuries. If an article is a cosmetic it is taxable, whether it be a necessity or a luxury. The Bureau has considered the question of whether this article is a cosmetic, and whether there is a basis for distinguishing, as to cosmetic properties, between articles which, like the ordinary cosmetic, are primarily used to ornament or beautify, and an article used not so much to ornament or beautify as to hide or neutralize a disfigurement or deformity. In other words, whether any distinction should be made between articles commonly used to improve or beautify the normal and an article commonly used to neutralize the abnormal.

It is held that there is no substantial ground for a distinction. The ordinary use of cosmetics is to beautify or ornament the normal, but such is not their only use. The word cosmetics is used to denote substances of diverse origin scientifically compounded and used (1) to cleanse, (2) to allay skin troubles, (3) to cover up imperfections, and (4) to beautify. Among the articles regarded as cosmetics are bath preparations; dental preparations, comprising tooth powders and pastes together with liquid dentifrices; hair preparations, including bay rum, hair tonics, shampoos, and depilatories; lip sticks; manicure preparations; rouges; shaving preparations; skin creams, and soaps. (See Encyclopedia Britannica, 14th Edition, volume 6, page 485.)

A substance used for covering imperfections is indicated by the definition of a cosmetic. It can hardly be disputed that the use of an article for the purpose of hiding minor skin blemishes such as freckles, sunburn, warts, and eruptions would be a cosmetic use. The use of rouge or powder to cover a small birthmark would likewise hardly be questioned as a cosmetic use. The extent of the disfigurement should make no difference in principle. If it did it would be difficult to draw a line of demarcation between blemishes of different sizes. Neither can it make any difference in principle that the article under consideration is a liquid, whereas cosmetics designed for beautification are usually in the form of powders or pastes. In so far as the tax is concerned, there is little difference between a so-called liquid powder applied to hide undue redness of the skin and a similar article used to cover birthmarks.

That it was the intention of the lawmakers that the tax on toilet articles should be extensive in its scope is shown by the imposition of the tax not merely on the articles specifically mentioned but also on all similar articles "by whatsoever name known or distinguished."

This comprehensive provision seems to remove any ground that might otherwise exist for the making of fine distinctions, provided the article under consideration meets the test of being similar to one or more of the articles specifically named in the law.

It is the opinion of this office that the article in question is taxable under section 603 of the Revenue Act of 1932.

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

REGULATIONS 46, ARTICLE 22: Scope of tax. XI–45–5841
S. T. 559

Taxability of cigarette cases and vanity cases as containers of cosmetics.

A ruling is requested concerning the application of section 603 of the Revenue Act of 1932 to cigarette cases and vanity cases used as containers for cosmetics.

Section 619 of the Revenue Act of 1932 provides that in determining the price for which an article is sold there shall be included any charge for coverings and containers of whatever nature.

The cigarette and vanity cases submitted for a ruling were of considerable value, the manufacturer's price being x dollars per dozen and higher. Most of the cases contain a small metal plate with a coating of rouge. Some of the articles have receptacles for face powder.

The mere fact that a small quantity of cosmetics of negligible value is placed in a valuable case does not warrant the conclusion that the latter is a container within the meaning of section 619. The only real consideration for the price paid is the value of the case and not the comparatively negligible value of the cosmetic which is included to display or set-off the case. Therefore, such cases are not containers for the cosmetics, within the meaning of section 619.

A person who purchases cosmetics and places them in such cases is not deemed to be a manufacturer or producer of cosmetics. The tax under section 603 is imposed upon the sale of the cosmetics to him by the manufacturer and not upon the sale of the assembly by him. A person who manufactures cosmetics and places them in such cases for sale should compute the tax on the price of the cosmetics alone and bill the same to the purchaser as a separate item.

However, if the cosmetic inserted in a compact, vanity case, or similar container is substantial in amount and the fair manufacturers' selling price of a like amount of cosmetic bears a substantial relation to the sale price of the completed assembly the principal article sold is the cosmetic, and the tax under section 603 of the Revenue Act of 1932 applies to the total amount for which both the cosmetic and the container are sold.

It should be borne in mind that if vanity cases or cigarette cases such as those referred to hereinbefore are made of, or ornamented, mounted or fitted with, precious metals or imitations thereof or ivory, they may be subject to the tax on jewelry, etc., imposed by section 605 of the Revenue Act of 1932.

SECTION 604.—FURS.

REGULATIONS 46, ARTICLE 24: Scope of tax. XI-35-5646
S. T. 470

Dyed and processed lambskin and sheepskin taxable as fur.

Dyed and processed lambskin or sheepskin are considered fur and articles made therefrom or of which such lambskin or sheepskin is the component material of chief value are held to be taxable under section 604 of the Revenue Act of 1932.

REGULATIONS 46, ARTICLE 24: Scope of tax. XI-38-5707
S. T. 498

Interpretation of the term "exclusive of labor charges for manufacturing or producing the article."

Advice is requested concerning the meaning of the term "exclusive of labor charges for manufacturing or producing the article," used in article 24 of Regulations 46, relating to the tax on furs under section 604 of the Revenue Act of 1932.

The words "labor charges for manufacturing or producing the article" were used to make it clear that in computing the cost of the materials used in a fur article in order to ascertain whether such an article is taxable, such charges can not be considered as "material" within the meaning of the law. The following examples will make this interpretation clearer:

Example 1: Where articles used in a garment consist of fur costing $20; cloth costing $10; buttons costing $5; and findings, etc., costing $3, the garment is taxable on the entire price for which sold because no one of the other materials exceeds in value the cost of the fur used in the article. If labor charges in the sum of $25 should be added for manufacturing, the article would still be taxable on its selling price because the labor charge is not a factor in determining whether tax is due. The cost of the fur would still exceed in value the cost of any of the other component materials and this fact alone would render the finished garment taxable.

Example 2: Where the fur in a garment costs $20, the cloth $25, the buttons $5, and the findings $3, the article would not be taxable because one single material, the cloth, exceeds in value the fur used.

REGULATIONS 46, ARTICLE 24: Scope of tax. XI-39-5729
S. T. 507

Method of computing the tax.

In deciding whether fur is the component material of chief value used in making fur-trimmed cloth coats, the manufacturer may use the cost of the fur set or fur trimmings and exclude any tax actually paid thereon under section 604 of the Revenue Act of 1932.

Where more than one purchase of fur is used in making up a line of fur-trimmed coats and the various fur purchases were made at different prices, with the result that the value of the fur used on two

coats of the same style and quality differs, the cost of the fur in each garment may be averaged, provided a separate calculation sheet using averaged prices is made for each model of coat. For example, the cost of fur and of cloth used in making different styles of fur-trimmed coats in misses and stout models may not be averaged. The plan must be restricted to sizes of a single model.

The manufacturer who sells both fur-trimmed and untrimmed coats must keep adequate records showing the number of each kind manufactured by him and to whom sold. Similar records must be maintained by a coat manufacturer who buys for resale the coats of other manufacturers. A wholesaler who claims that he is not a manufacturer within the meaning of section 604 of the Revenue Act of 1932 must keep adequate records to support his claim.

In view of the provisions of section 619(b) of the Revenue Act of 1932, where a manufacturer of articles made of fur or of which fur is the component material of chief value transfers such articles to a selling subsidiary and the sale is not an arm's length transaction, the fair market price forming the basis of the tax will ordinarily be the price at which such articles are sold at wholesale in the open market by the subsidiary. If the subsidiary makes no sales at wholesale, the price at which articles of a like grade and quality are sold at wholesale by manufacturers in the ordinary course of trade may be used as the basis for determining a fair market price.

If manufacturers sell at a list price, with the understanding that the purchaser may take a discount of a certain agreed percentage in the event he pays within a given time, the tax must be returned on the basis of the list price as billed. However, if the payment has been received and the discount taken before the return for the month in which the sale took place is prepared, the net amount may be used as the basis for tax payment. If the goods are billed at the net price, deducting the discount, and if there is no agreement or understanding that the amount to be paid will be more than the net billed price, the tax will attach to the net price for which sold.

The prices shown on the buyer's order are not conclusive as to the sale price. In the usual sale for resale the tax will be based on the price for which the manufacturer sells the goods.

SECTION 605.—JEWELRY.

REGULATIONS 46, ARTICLE 28: Scope of tax. XI-36-5664
T. D. 4351

Tax on jewelry—Section 605 of the Revenue Act of 1932.—Article 28 of Regulations 46 amended.

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

To Collectors of Internal Revenue and Others Concerned:

Article 28 of Regulations 46 is hereby amended to read as follows:

ART. 28. *Scope of tax.*—Under section 605 there is imposed a tax on sales by the manufacturer of certain articles classified as follows:

(1) All articles commonly or commercially known as jewelry, whether real or imitation;

(2) Pearls, precious and semiprecious stones and imitations thereof;
(3) All other articles made of, ornamented, mounted, or fitted with precious metals or imitations thereof, or ivory; and
(4) Articles specifically mentioned in the Act, such as watches, clocks, parts for watches or clocks sold for more than 9 cents each; opera glasses; lorgnettes; marine glasses; field glasses; and binoculars.

The tax does not apply to any of the foregoing sold for less than $3, except parts for watches or clocks.

Effective October 1, 1932, none of the articles subject to tax under section 605 may be sold tax-free for further manufacture in accordance with the provisions of section 620 unless the purchaser has registered as a manufacturer or producer and has been issued a registration certificate (Form No. 632) by a collector of internal revenue. Each person qualifying as a manufacturer or producer of articles taxable under section 605 (whether selling at wholesale or retail) will be granted a registration certificate bearing an identifying number, upon application to the collector of internal revenue for the district in which is located the principal place of business of such manufacturer or producer (or if he has no principal place of business in the United States, to the collector at Baltimore, Md.). Registration numbers shall be in separate series, beginning with the number 1, for each district. Any exemption certificate furnished pursuant to article 7 of these regulations must show the registration number of the purchaser.

The Commissioner is authorized to cancel the registration certificate and to deny the right to purchase articles tax-free for further manufacture in any case where he is satisfied that the registrant is not a bona fide manufacturer or producer or that tax-free purchases are being made for the purposes of resale in the form in which purchased.

Among the articles or parts of articles coming within the scope of section 605 which may be purchased tax-free for further manufacture by a manufacturer or producer who complies with the registration provisions, are (1) all mountings made of or ornamented, mounted or fitted with precious metals or imitations thereof, or ivory; (2) pearls, precious and semiprecious stones and imitations thereof, whether uncut or cut and ready for use but not mounted; (3) watch cases, watch movements or mechanisms, parts for watches and clocks, etc., and (4) other similar incomplete or unfinished articles subject to tax under section 605. Parts for watches or clocks selling for more than 9 cents each may not be purchased tax-free under an exemption certificate when such parts are to be used in the manufacture of a watch or clock selling for less than $3.

DAVID BURNET,
Commissioner of Internal Revenue.

Approved August 30, 1932.

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

REGULATIONS 46, ARTICLE 28: Scope of tax. XI–37–5686
S. T. 489

Held, that certain articles mounted or fitted with precious metals used in the practice of dentistry are not taxable.

Advice is requested whether the provisions of section 605 of the Revenue Act of 1932 are applicable to the use of precious metals in the practice of dentistry.

The tax imposed by section 605 of the Revenue Act of 1932 on "articles made of, or ornamented, mounted or fitted with precious metals or imitations thereof or ivory * * *" does not apply to removable dental bridges containing gold; gold crowns and crowns containing gold; partial upper palatal bars, containing precious metals; partial lower lingual bars, containing precious metals; fixed dental bridgework, containing precious metals; or orthodontic appliances, containing precious metals.

REGULATIONS 46, ARTICLE 28: Scope of tax. XI–42–5792
S. T. 531

Taxability of articles of jewelry used in repairs.

Advice is requested concerning the taxability under section 605 of the Revenue Act of 1932 of articles sold for use in making repairs to jewelry.

The M Company is a manufacturer of jewelry. It also repairs jewelry. In making repairs it frequently uses articles which, if used in the manufacture of jewelry sold, would unquestionably be taxable. For example, in repairing a brooch from which several jewels are missing new jewels are supplied.

If taxable articles are manufactured and used by the company in making repairs, the tax imposed under section 605 of the Revenue Act of 1932 attaches to the price for which the same or similar articles are sold in the ordinary course of trade by other manufacturers, producers, or importers. Since jewels are added by the company in repairing the brooch, the amount charged for such jewels is subject to the tax imposed under section 605 of the Revenue Act of 1932, provided the jewels so used were manufactured, produced, or imported by the company or purchased tax-free from other manufacturers, producers, or importers, under section 620 of the Revenue Act of 1932.

REGULATIONS 46, ARTICLE 28: Scope of tax. XI–45–5842
S. T. 560

Taxability of diamonds and mountings when assembled and sold.

Advice is requested concerning certain questions which have arisen relating to the tax imposed on jewelry under section 605 of the Revenue Act of 1932.

Where a diamond and mounting were purchased by a retail jeweler prior to June 21, 1932, and were sold separately on or after such date in the same form in which they were purchased, no tax thereon is due under section 605 of the Revenue Act of 1932. However, if those articles were assembled by the retailer, either before or after that date, such retailer is deemed to be a manufacturer or producer within the meaning of the law and is liable for tax on the price for which the complete assembly is sold. In the event that the assembly is sold at retail, the tax should be computed on the price for which the same or similar articles are sold in the ordinary course of trade by the manufacturers, producers, or importers thereof.

If a customer brings a diamond to a dealer to be mounted and the mounting was manufactured, produced, imported, or further manufactured by the dealer prior to the sale, or was purchased tax free under an exemption certificate from the manufacturer, producer, or importer thereof, the dealer is liable for the tax on the price for which the mounting is sold, unless it is sold at retail, in which event the tax should be computed on the price for which the same or a similar mounting is sold in the ordinary course of trade by the manufacturer, producer, or importer. Where a diamond is sold by the dealer which was not manufactured, produced, imported, or further

manufactured by him, or purchased tax free under an exemption certificate, no tax is due on the sale of such stone by him.

In the event taxable articles are manufactured, produced, or imported by retail jewelers, the tax imposed under section 605 of the Revenue Act of 1932 attaches when such articles are sold on and after June 21, 1932, even though they were manufactured, produced, or imported prior to such date. If customers bring mountings and diamonds to a retailer for the sole purpose of being assembled, the assembling of such articles is not a sale by the manufacturer, producer, or importer, and no tax will be due from the assembler on the amount charged for merely assembling the articles.

Under section 622 of the Revenue Act of 1932, the use of a taxable article is subject to tax in the same manner as if such article were sold. The assembly of taxable articles is deemed to be a manufacturing or producing process. Customers who have taxable articles assembled by others for their own use are deemed to be manufacturers or producers within the meaning of the law and are liable for the tax imposed under section 605 of the Revenue Act of 1932, based on the price for which the same or similar articles are sold in the ordinary course of trade by the manufacturers, producers, or importers thereof. Where taxable articles are assembled for customers the person who does the assembling should report to the collector the name and address of such customers, prior to the delivery of the articles, together with such information as will show the price for which the same or similar articles are sold in the ordinary course of trade by manufacturers, producers, or importers.

In computing the tax due on the sale of the complete articles, credit may be taken for any tax previously paid to the manufacturers, producers, or importers of the parts so assembled.

REGULATIONS 46, ARTICLE 29: Jewelry. XI–44–5824
S. T. 549

Taxability of emblems for colleges, schools, and clubs.

Advice is requested concerning the taxability of emblems for colleges, schools, and clubs under section 605 of the Revenue Act of 1932 imposing a tax on jewelry.

It is held that college, school, club, fraternity, sorority, and hospital pins, rings, buttons, charms, emblems, and guards, and athletic awards in the form of pins, buttons, medals, and charms, when made of, ornamented, mounted, or fitted with precious metals or imitations thereof, or ivory, are taxable as jewelry under section 605 of the Revenue Act of 1932, when sold by the manufacturer, producer, or importer for $3 or more.

Trophies and cups are not taxable under section 605 unless made of, or ornamented, mounted, or fitted with precious metals (except silver-plated ware) or imitations thereof, or ivory.

Although section 605 specifically exempts from tax silver-plated ware, yet this exemption does not apply to silver-plated articles commonly or commercially known as jewelry, whether real or imitation.

REGULATIONS 46, ARTICLE 31: Articles other than jewelry, made of, or ornamented, mounted, or fitted with, precious metals or imitations thereof, or ivory. XI–35–5650 S. T. 472

Fountain pens fitted or ornamented with precious metals or imitations thereof held taxable.

An opinion is requested relative to the application of the tax imposed under section 605 of the Revenue Act of 1932 to fountain pens ornamented or fitted with precious metals or imitations thereof.

These fountain pens have four parts which are made of precious metals or imitations thereof, namely, the gold pen point, the lever, the clip, and the band at the bottom of the cap.

Section 605 of the Act imposes a tax on all "articles made of, or ornamented, mounted or fitted with, precious metals or imitations thereof or ivory * * *."

It is held that the fountain pens above described are within the scope of the statute and are subject to the tax imposed under section 605 of the Revenue Act of 1932 at the rate of 10 per cent of the price for which sold, provided they are sold for $3 or more.

REGULATIONS 46, ARTICLE 32: Watches and clocks. (Also Sections 606, 607, 619, 620, 622, and 626.) XI–38–5708 S. T. 499

Taxability of watches and clocks and clock parts.

Request is made for an interpretation of various provisions of the Revenue Act of 1932, in their application to the sale of clocks and clock parts. The questions raised, followed by the answers, are set forth hereinafter.

Question: Section 605 of the Revenue Act of 1932 provides that watches, clocks, and parts for watches or clocks sold for more than 9 cents each are taxable at 10 per cent of the price for which so sold. The same section definitely states that "No tax shall be imposed under this section on * * * any article (other than watch parts or clock parts) sold for less than $3." Does this mean that if the parts are used for a clock sold for less than $3, if they are sold for more than 9 cents they are still taxable?

Answer: Section 605 of the Revenue Act of 1932, being specific in its application to parts for watches and clocks, is deemed to be controlling in computing the taxes due on the sale of such articles, irrespective of the $3 exemption appearing elsewhere in the section. In other words, all sales of parts for watches or clocks are subject to the tax when sold for more than 9 cents each.

Question: Section 620 of the Revenue Act of 1932 covers the sale of articles for further manufacture and provides as follows:

Under regulations prescribed by the Commissioner with the approval of the Secretary, no tax under this title shall be imposed upon any article * * * sold for use as material in the manufacture or production of, or for use as a component part of, an article to be manufactured or produced by the vendee which will be taxable under this title or sold free of tax by virtue of this section. If the vendee resells an article sold to him free of tax under this section, then for the purpose of this title he shall be considered the manufacturer or producer of such article.

Does this mean that if a manufacturer sells watch or clock movements and those movements are incorporated in a case; or sells watch or clock parts and those parts are used in the further manufacture of a watch or clock; or sells automobile clocks that are accessories to an automobile; or sells stove range clocks to turn on and turn off stoves that are component parts of the electric range to which they are to be attached; or that they sell radio clocks that are component parts of the radio set on which they are placed, the manufacturer is not required to pay any tax on these under section 605 of the Revenue Act of 1932?

Answer: A distinction is drawn between sales of parts of clocks or watches to manufacturers of cases and sales of automobile clocks to manufacturers of automobiles. If the parts of clocks or watches are sold for more than 9 cents each and if the watches in which those parts are used are sold for less than $3, no tax would be due on the finished product and, consequently, the credit provisions in the law could not be applied. It follows that the tax must be paid under such conditions by the person who manufactures and sells the parts. If the parts are sold to manufacturers for use in the manufacture of watches or clocks selling for more than $3, the parts could be sold tax-free under an exemption certificate and the second manufacturer could pay tax on his finished product or, if preferred, the first manufacturer could pay the tax and the second manufacturer, on selling his taxable products in which the tax-paid parts have been incorporated, could compute the tax on his sale price and take credit on his return covering these sales for the tax previously paid on such parts.

A manufacturer or producer may sell his clocks tax-free under exemption certificates for use as material in the manufacture or production of other articles taxable under Title IV of the Act. If the second manufacturer incorporates the clocks in a taxable article produced by him, he should compute tax on his sale of the article or assembly at the rate of tax applicable to his product. Where, for any reason, he sells the clocks which he acquired tax-free (except to another manufacturer of taxable articles), without using them as material in the manufacture or production of, or as a component part of, his product, he must pay tax on such resale at the rate of 10 per cent, as required by section 605 of the Revenue Act of 1932, provided the clocks are sold by him for $3 or more.

Question: Are clock movements sold to manufacturers of time switches and incorporated in time switches taxable under section 605 in view of the provisions of section 620?

Answer: The tax should be paid on the sale of the clock movements.

Question: Are parts that are exported out of the country and assembled in a foreign plant owned by a manufacturer and subsequently sold taxable? Are clocks that are exported or parts that are exported subject to tax?

Answer: Articles sold for export and in due course exported are not taxable. If manufactured abroad and later imported into this country, the sale in this country of the parts or of the completed watch or clock by the importer would be subject to the tax.

Question: Should the clock companies who have assembly plants, say, in Canada, and who ship parts from the United States pay a

10 per cent tax on these parts going to Canada, if valued at more than 9 cents, even though they might enter into clocks sold for less than $3? Canada has a protective tariff against complete clocks and most American manufacturers ship their parts into Canada and assemble them there. How will this business be affected by this particular law? If an American company assembles clocks in Canada and sells them in Canada, are they still subject to the 10 per cent tax levied under section 605 of the Revenue Act of 1932?

Answer: The tax is imposed upon articles sold in this country by the manufacturer, producer, or importer. If parts of clocks or watches are exported to Canada by the manufacturer or importer and sold there, no tax could be imposed on this procedure by the United States. However, if the articles should later be imported into this country their sale or use by the importer would be taxable.

Question: Section 606 of the Revenue Act of 1932 covers automobile clocks. Automobile clocks are a fair portion of the total clock business. On what basis will automobile clocks be taxed? These clocks are built especially for automobile use and are known in the trade as automobile accessories, but still they are clocks. If they are sold to a distributor and incorporated in a car, on what basis will they be taxed and on what basis will the tax be paid on the sale of the car with the automobile clock? Section 607 of the Revenue Act of 1932. Clocks are used to a large extent in radio sets. On what basis will clocks so used be taxed?

Answer: The test of taxability of clocks for automobiles or radios is whether they are primarily clocks or whether by their special construction or design they are primarily parts or accessories for automobiles or radios. If they are primarily clocks, they are subject to the tax on the sale of clocks at the 10 per cent rate imposed by the law. If, however, their primary or chief use is that of parts or accessories, they may be sold tax-free to manufacturers of automobiles or radio apparatus under exemption certificates. Sales of clocks to distributors or dealers who sell to owners and not to manufacturers as original equipment, are taxable under the same general rule, depending entirely upon whether they are clocks for general use, in which event their sale would be taxable at the 10 per cent rate, or whether designed primarily for use on an automobile or radio, in which event their sale would be taxable at the lower rate.

Question: Section 619 of the Revenue Act of 1932. Can the transportation and delivery costs be deducted from the selling price to ascertain the tax? How can the amount of such costs be established to the satisfaction of the Commissioner?

Answer: Charges for transportation, delivery, insurance, installation, and other charges which have no connection whatever with the manufacturing process are to be excluded in computing the tax. The law provides that there shall be included in the price for which an article is sold any charge for coverings and containers of whatever nature and any charge incident to placing the article in condition packed ready for shipment. No particular method of establishing this right to deduction has been prescribed. Any convincing evidence on this point will be accepted.

Question: Can a consumer who imports articles direct escape any manufacturers' excise tax, or is it the purpose of section 622 of the Revenue Act of 1932 to prevent this?

Answer: Under section 622 an importer who uses a taxable article imported by him is subject to tax to the same extent as if the article were sold by him.

Question: Do the regulations promulgated under section 621(b) of the Revenue Act of 1932 allow the exchange of merchandise which is frequently necessary to facilitate trade—that is, give a credit for goods returned and allow a substitution for other articles in the same class?

Answer: Where an untaxed article is returned to the manufacturer for adjustment, replacement, or exchange, and a new article subject to tax is given in its stead, free of charge or at a reduced price, the tax should be computed on the trade-in allowance of the first article plus the payment, if any, for the second article. If the returned article was tax-paid and returned to the manufacturer thereof for adjustment, replacement, or exchange, under a guaranty as to quality or service, and a new article is given pursuant to the guaranty, free of charge or at a reduced price, the tax should be computed on the actual amount, if any, paid to the manufacturer for the new article.

Question: Under section 626 of the Revenue Act of 1932 does the tax of 10 per cent have to be paid on the basis that it is collected at the time that it is billed and added to the invoice of the manufacturer?

Answer: The tax attaches at the time when the article is sold and it is immaterial, from the standpoint of the revenue, whether the sale is made for cash or on credit. Return should be filed and the tax paid to the collector on or before the end of the month following that in which the sale occurred, even though the manufacturer does not receive payment until afterwards.

REGULATIONS 46, ARTICLE 32: Watches and clocks. XI–46–5854
(Also Article 69.) S. T. 565

Every manufacturer must keep accurate records of taxable transactions.

Article 69 of Regulations 46, Revenue Act of 1932, provides that every person required to file a return and pay tax on the sale or use of an article shall keep on file at his principal place of business, or at some other convenient or safe location, accurate records and accounts of all taxable transactions. The records must be of such a character as will enable investigating officers to identify each taxable article in stock. For example, records kept by a dealer in watches must show the watch movement numbers, the case numbers, the name or names of the manufacturers, producers, or importers from whom such articles were purchased, and whether they were purchased separately or as complete watches. In the event such articles were purchased separately the records must also show whether they were purchased tax-paid or tax-free under an exemption certificate from the manufacturers, producers, or importers. Records pertaining to parts for watches or clocks must show whether the parts were purchased tax-free under an exemption certificate or purchased tax-paid, as well as the name or names of the manufacturers, producers, or importers from whom they were purchased.

REGULATIONS 46, ARTICLE 32: Watches and clocks. XI–46–5855
S. T. 566

Taxability of synchronized timing devices.

Advice is requested concerning the taxability, under section 605 of the Revenue Act of 1932, of electric timing devices.

A synchronized system of timing devices is often sold for use in public school buildings, colleges, and other large buildings. This apparatus consists of a clock, known as a master clock, which contains the mechanism of the ordinary clock and, in addition, is connected by electric wires with small magnetic devices in clock cases, mounted in separate rooms, which receive impulses from the master clock and register the time. The individual mechanisms in the separate rooms have no power of mechanical operation except as the electric impulses are transmitted to them from the central master clock and can not operate independently of the master clock.

As the tax under section 605 of the Revenue Act of 1932 is imposed on clocks, irrespective of the operating mechanism, and as the secondary clocks serve the purpose of indicating the time of day in the same manner as any other clocks operated by their own mechanisms, it is held that the tax attaches not only to the amount charged for the master clocks but also to the amount charged for the secondary clocks. Parts for both the primary and the secondary clocks, if sold for more than 9 cents each, are subject to the tax imposed on clock parts. Such parts, however, may be purchased tax-free for the further manufacture of taxable clocks under the provisions of section 620 of the Revenue Act of 1932, if the manufacturer is registered as provided by Treasury Decision 4351 (see on page 461).

The tax in question does not attach to sales of clocks to States or political subdivisions thereof for use in the exercise of an essential governmental function, provided such sales are made direct by the manufacturer, producer, or importer to a State or political subdivision thereof without any intervening sale to a dealer or distributor. However, the tax applies to all such articles sold to the United States Government.

REGULATIONS 46, ARTICLE 32: Watches and clocks. XI–47–5872
S. T. 572

Taxability of timing devices attached to thermostats.

Advice is requested by the X Company concerning the taxability of timing devices attached to thermostats under section 605 of the Revenue Act of 1932.

The article in question is a patented device designed, intended, and used for the purpose of automatically controlling the temperature in the structure in which it is installed. Embodied in the thermostat is a special timing device, the mechanical function of which is to change the temperature to a desired degree at a fixed time. The timing device contains a complete clock movement as well as additional parts not ordinarily considered clock parts. Attached to the thermostat is a clock dial, hands, and case identical with those of the ordinary clock and upon which the time of day is indicated. It is contended by the X Company that the clock face or time indicating portion of the thermostat is not necessary to its

successful operation; that the clock face is attached to the thermostat only to make it slightly more attractive; and that users prefer the instrument with the clock face to the unadorned metal case which would otherwise be used.

Section 605 of the Revenue Act of 1932 imposes a tax on clocks when sold by the manufacturer, producer, or importer for $3 or more. The timing device attached to the thermostat is a clock and subject to the tax imposed if the sum attributable to the clock portion equals $3 or more. In billing these thermostats to purchasers, the amount apportioned to the sale of the clock and the tax thereon should be shown separately from the amount charged for the thermostat.

REGULATIONS 46, ARTICLE 32: Watches and clocks. XI–50–5918
S. T. 597

Taxability of certain instruments containing watch or clock parts.

Advice is requested relative to the taxability under section 605 of the Revenue Act of 1932 of recording thermometers, recording pressure gauges, recording barometers, time switches, bank locks, recording volt meters, flow meters, demand meters, etc.

The instruments do not serve the purpose of clocks, although some of the parts used therein are the same as those used in the manufacture of clocks.

Section 605 of the Revenue Act of 1932 imposes a tax on clocks when sold by the manufacturer, producer, or importer for $3 or more, and upon parts for watches or clocks sold for more than 9 cents.

As the instruments in question can not be used for indicating time, they can not be classified as either watches or clocks and, therefore, are not subject to the tax imposed on those articles.

Some of the parts used in the manufacture of these instruments, of the same character as those used in the manufacture of watches and clocks, are purchased primarily as parts for these nontaxable instruments. Under such circumstances they are not sold by the manufacturer as parts for watches or clocks and may be sold tax free. However, in order to establish the right to the exemption, the manufacturer making a tax-free sale must obtain and retain in his possession a certificate from the purchaser to the effect that the purchaser is a manufacturer and will use the parts in the manufacture of articles other than taxable watches or clocks. If a manufacturer's records do not contain certificates covering such tax-free sales, with supporting invoices, the tax shall be payable by him.

REGULATIONS 46, ARTICLE 34: Exemptions. XI–38–5709
S. T. 500

Held that the taxability of such articles as crucifixes, rosaries, medals, and crosses is dependent upon the primary purpose for which they are to be used.

Advice is requested whether certain articles which may be used for religious purposes are taxable as jewelry under section 605 of the Revenue Act of 1932.

It is held that articles such as crucifixes, rosaries, and medals designed, inscribed, engraved, or stamped so as to indicate that they are primarily intended to be used for religious purposes are not subject to tax under section 605 of the Revenue Act of 1932.

However, plain gold crosses; crosses made of black onyx, ornamented with pearls or diamonds; crosses made of gold, ornamented with semiprecious stones and pearls; and diamond crosses are deemed to be articles of personal adornment and taxable as jewelry under section 605 of the Revenue Act of 1932.

REGULATIONS 46, ARTICLE 34: Exemptions. XI–49–5902
S. T. 589

Taxability of jewelry manufactured or produced by Indians.

Section 624 of the Revenue Act of 1932 provides that no tax shall be imposed under Title IV of that Act on any article of native Indian handicraft manufactured or produced by Indians on Indian reservations, or in Indian schools, or by Indians under the jurisdiction of the United States Government in Alaska.

Since some Indians manufacture silver articles, including a number of articles commonly known as jewelry, the question is raised whether the sales of such articles manufactured by Indians living on allotments of land come within the terms of the law.

All Navajo Indians on allotments of land adjacent to the Navajo Reservation, who are subject to the supervision, control, and jurisdiction of the respective Navajo Indian agencies as well as those on the reservation proper, are considered, for the purpose of section 624 of the Revenue Act of 1932, as "Indians on Indian reservations." Therefore, all articles of native Indian handicraft manufactured or produced by the Indians living on allotments of land of the character indicated are exempt from the tax imposed by section 605 of the Revenue Act of 1932.

SECTION 606.—AUTOMOBILES, ETC.

REGULATIONS 46, ARTICLE 36: Scope of tax. XI–35–5647
S. T. 468

An opinion is requested regarding the taxability of a tank which is installed on auto trucks for the transportation of oil and gasoline in commercial quantities.

It is held that the manufacturer of this oil or gasoline tank is liable for the tax of 2 per cent on the sales price thereof under section 606(a) of the Revenue Act of 1932. This tank constitutes a body and as such comes within the provisions of the Act.

REGULATIONS 46, ARTICLE 36: Scope of tax. XI–40–5752
S. T. 514

Taxability of secondhand motor cycles.

Advice is requested relative to the taxability of secondhand motor cycles under section 606(b) of the Revenue Act of 1932.

Where manufacturer "A" accepts as a "trade-in" a used motor cycle made by manufacturer "B," the resale by manufacturer "A" is not taxable because it is not a sale by the manufacturer, producer, or importer. However, in the event that used motor cycles are so materially changed before being resold as to lose their original identity, the resale of such machines is subject to the tax imposed by section 606(b) of the Revenue Act of 1932.

If any such machines are acquired by the manufacturer and resold by him to the trade after June 21, 1932, either as new machines or as rebuilt machines, they are taxable. Likewise, if a manufacturer, prior to June 21, 1932, used taxable articles of his manufacture in connection with his own business, and subsequent to June 20, 1932, sells such articles, the sales are taxable. Where a manufacturer repossesses his products and rescinds a sale, a subsequent resale is subject to the tax imposed by section 606(b) of the Revenue Act of 1932.

REGULATIONS 46, ARTICLE 36: Scope of tax. XI–48–5887
S. T. 582

Repairs on automobiles performed in a repair shop, such as painting, upholstering, changes in, or replacements of, woodwork, and repairs to fenders and bodies are deemed to be in the nature of general repair work, rather than articles sold, and are not subject to tax under section 606 of the Revenue Act of 1932.

REGULATIONS 46, ARTICLE 41: Definition of parts or accessories. XI–37–5687
S. T. 490
(Also Section 620, Regulations 46, Article 7.)

Held that engines and certain articles used in gasoline engine power units are subject to tax as automobile parts or accessories.

Advice is requested by the X Company relative to the taxability of certain gasoline power units which consist of an engine and all necessary accessories mounted on the same base and assembled in a self-contained self-inclosed unit which is used as a source of power for industrial purposes and never used in automobiles.

Such power units as those described are not subject to the tax imposed by section 606 of the Revenue Act of 1932. However, the engines and certain articles used on or in connection therewith are automobile parts or accessories and are under section 606(c) subject to tax at the rate of 2 per cent when sold by the company, except as hereinafter provided.

The X Company may sell its engines and parts therefor to a manufacturer of truck or other automobile chassis tax-free, provided such manufacturer attaches to his order a certificate such as that prescribed in article 7 of Regulations No. 46.

The X Company may also sell its engines and parts or accessories therefor (except spark plugs, storage batteries, coils, and timers which are suitable for use on or in connection with, or as component parts of automobile truck chassis, other automobile chassis, and motor

cycles) tax-free for use in the manufacture of nontaxable articles, provided the purchaser attaches to his order a statement that the engines or parts and accessories will be used on or in connection with an article other than an automobile truck chassis, other automobile chassis, or motor cycle.

REGULATIONS 46, ARTICLE 41: Definition of parts or accessories. XI–38–5710 S. T. 501

Held that incandescent electric bulbs primarily designed and adapted for use on automobiles are taxable.

Advice is requested whether incandescent electric bulbs when manufactured for use on automobiles are taxable under section 606(c) of the Revenue Act of 1932.

Incandescent electric bulbs primarily designed and adapted for use on or in connection with automobiles are parts or accessories and subject to the tax imposed under section 606(c) of the Revenue Act of 1932.

REGULATIONS 46, ARTICLE 41: Definition of parts or accessories. XI–47–5873 S. T. 573

Taxability of various articles as automobile parts or accessories.

Advice is requested with respect to the taxability of several articles used in connection with automobiles, etc., under section 606 of the Revenue Act of 1932.

Automobile tools are not taxable when sold separately. However, where tools are assembled into a kit which is recommended for use in connection with a particular make of automobile, the tax attaches on the manufacturer's sale price of the kit.

Wrecking cranes sold for mounting on trucks, towing cradles used in connection with service trucks, reboring machines, valve refacing machines, valve regrinders, air compressors, and paint spraying equipment are not considered as parts or accessories and are not subject to tax.

Bushings, ball bearings, waterproof cement, automobile paints, lacquers, and gasket cement are not subject to tax. However, the tax attaches to battery cables and ignition cable sets, battery box hold-downs, and ignition wires when cut into prepared lengths.

The tax also attaches to rebabbitted connecting rods and reclaimed brake drums in which new steel bands have been inlaid where they are placed in stock to be sold as parts and accessories. However, where these articles are reconditioned in connection with an immediate repair job the tax does not attach.

Spool cable, linoleum, victorite, ignition wires, and similar articles when sold in bulk are not taxable. However, if a person prepares these articles to fit particular automobiles he is considered the manufacturer of an automobile part or accessory and is liable for the tax imposed under section 606(c) of the Revenue Act of 1932.

Semifinished pistons are taxable if they have reached such a stage that they constitute articles commonly or commercially known as parts and accessories for automobiles or motor cycles, regardless of

the fact that fitting operations may be required in connection with installation.

Piston pins particularly designed for tractors and piston rings and pins smaller than those used in motor cycles and larger than those used in automobile trucks and buses are not taxable.

Spark plugs, storage batteries, leaf springs, coils, timers, and tire chains specifically mentioned in section 606(c) of the Revenue Act of 1932 are taxable as automobile parts or accessories if suitable for use on, in connection with, or as component parts of automobile trucks, other automobile chassis, or motor cycles, even though they are sold for use in the manufacture of nontaxable articles.

Parts or accessories, other than those specifically mentioned in section 606(c), may be sold tax-free for use in the manufacture of nontaxable articles, provided the purchaser attaches to his order a statement that the parts or accessories are to be used by him in the manufacture of nontaxable articles.

REGULATIONS 46, ARTICLE 41: Definition of parts or accessories. XI-50-5919 G. C. M. 11249

Taxability of certain automobile repair parts.

An opinion is requested concerning the taxability under section 606(c) of the Revenue Act of 1932 of repair parts for timers and coils suitable for use on automobiles or automobile trucks.

Section 606 provides that automobile and automobile truck chassis and bodies and parts or accessories for such chassis or bodies are subject to tax. Section 606(c) provides that spark plugs, storage batteries, leaf springs, coils, timers, and tire chains suitable for use in connection with automobiles or automobile trucks, whether or not primarily adapted for such use, shall be considered as such parts or accessories.

An automobile consists of a number of major parts and each major part consists of a number of minor or subparts. A subpart is as much a part of an automobile as it is a part of a major part. Therefore, as Congress indicated that certain articles are parts of automobiles, it follows that parts of the designated articles should also be regarded as automobile parts. This view is supported by the decision of the Supreme Court in the case of *Universal Battery Co. et al.* v. *United States* (281 U. S., 580 [C. B. IX-2, 422]). In that case the court said:

> In No. 351 the articles sold were gears, flexible shafts, and flexible housings, all being replacement parts for speedometers used on motor vehicles. It is conceded that speedometers are accessories; but it is insisted that parts of a speedometer can not be such. We think they can. * * * A speedometer consists of distinct and separate parts, and we perceive no reason why one or more of these, when manufactured and sold for the purpose shown by the finding, should not take the same classification as speedometers. * * *
>
> In No. 352, the tax was laid on sales of bars, brackets, and fittings for use as replacement parts for bumpers on automobiles. They were designed, manufactured, and sold for such use, and were not adapted for any other. It is said that, while bumpers are accessories these parts can not be so regarded. We think they are on the same plane as the parts of speedometers just dealt with. * * *

The rule stated by the court is in no degree less applicable where the statute specifically classifies articles as parts or accessories. The

same rule must apply whether the articles to which repair parts pertain are parts or accessories by virtue of their inherent nature or by virtue of their statutory classification.

It is therefore the opinion of this office that parts of parts and parts of accessories for automobiles or automobile truck chassis and bodies, as well as the parts and accessories themselves, are subject to the tax.

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

REGULATIONS 46, ARTICLE 41: Definition of parts or accessories. XI–51–5936 S. T. 605

Taxability of automobile glass.

Advice is requested concerning the taxability as parts or accessories, under section 606 of the Revenue Act of 1932, of automobile glass.

Where the X Company purchases windshield glass cut to size by the manufacturer of such glass, such manufacturer is liable for the tax and no tax is due on the sale by the X Company of the same article.

Where the X Company purchases windshield glass in large sizes and cuts such glass to fit places provided in particular makes of automobiles, which glass is kept in stock for sale as occasion demands, the X Company is held to be the producer of a taxable article and subject to tax on its sale.

Wind wing brackets are subject to tax when sold by the manufacturer, being considered parts or accessories for an automobile within the meaning of section 606(c) of the Act.

Nonshatterable windshield glass cut to size to fit particular makes of automobiles, to be installed by the automobile owner, is subject to tax whether used to replace an ordinary plate windshield, to repair a broken ordinary plate windshield, or to repair a nonshatterable plate windshield.

Rear vision mirrors are subject to tax as automobile parts or accessories when sold by the manufacturer thereof. The X Company is liable for the tax on sales of rear vision mirrors of its own manufacture.

Headlight lenses cut from plain glass are not subject to tax, because not primarily adapted for use on an automobile. On the other hand, headlight lenses having antiglare or beam refracting characteristics, being primarily designed for automobile use, are taxable when sold by the manufacturer.

Cutting and installing operations in connection with glass furnished by the owner, glass shop, or repair shop, are not subject to tax.

The Revenue Act of 1932 is effective as to all sales made by the manufacturer on and after June 21, 1932, regardless of when the article was manufactured. Consequently, if the X Company had on hand on June 21, 1932, any windshield glass which it had purchased cut to size, sales of such glass would not be subject to tax.

Where windshield glass is sold and cut to size for installation in connection with an immediate repair or replacement job, irrespective of the reason for the repair or the replacement, the transaction is deemed to be more in the nature of general repair work than a sale and is not taxable.

The X Company may also sell articles manufactured by it tax-free for further manufacture, provided it obtains from the purchaser the exemption certificates outlined in article 7 of Regulations 46.

REGULATIONS 46, ARTICLE 41: Definition of parts or accessories. XI–51–5937 S. T. 606

Taxability of taximeters.

Advice is requested relative to the taxability of taximeters under section 606(c) of the Revenue Act of 1932.

Taximeters are automobile accessories and are taxable under section 606(c) of the Revenue Act of 1932. Small parts used in taximeters, such as bushings, pins, levers, and gears, which are commercial commodities not specially designed for use in taximeters, are not taxable when sold separately.

No tax is due upon the sale of rebuilt or secondhand taximeters under section 606(c) of the Revenue Act of 1932, provided they are not rebuilt or refinished to the extent that they lose their original identity.

Where a taximeter is repossessed by the manufacturer for nonpayment of the purchase price and the sale rescinded, the tax will attach to the price at which the article is resold by the manufacturer, but if a tax was paid on the first transaction, a credit or refund may be claimed in the amount of that part of the tax paid which is proportionate to the part of the sale price which is refunded or credited to the first purchaser.

SECTION 607.—RADIO RECEIVING SETS, ETC., AND PHONOGRAPH RECORDS.

REGULATIONS 46, ARTICLE 45: Radio apparatus. XI–35–5651 S. T. 473

Taxability of bezels and escutcheons used on radio cabinets.

An opinion is requested as to whether the tax imposed by section 607 of the Revenue Act of 1932 is applicable to bezels or escutcheons sold to radio manufacturers.

The particular articles referred to are the ornamental metal pieces which are placed on the front of a radio cabinet around the window in which the dial appears.

It is held that no tax will attach to the sales of such articles to a manufacturer of radio cabinets. However, if such ornamental metal pieces are sold by the radio cabinet manufacturer on or in connection with the sale of a radio cabinet they are subject to the tax imposed by section 607 of the Revenue Act of 1932.

REGULATIONS 46, ARTICLE 46: Phonograph records. XI-44-5825
S. T. 550

Electrical transcriptions used for broadcasting purposes are taxable as phonograph records.

Advice is requested concerning the taxability of electrical transcriptions as phonograph records.

Article 46 of Regulations 46, Revenue Act of 1932, provides that "all phonograph records are subject to tax regardless of the substance of which made or the manner in which used."

Electrical transcriptions used by broadcasting systems are phonograph records and are taxable as such under section 607 of the Revenue Act of 1932, when sold by the manufacturer.

SECTION 608.—MECHANICAL REFRIGERATORS AND REFRIGERATOR COMPONENTS.

REGULATIONS 46, ARTICLE 48: Scope of tax. XI-41-5773
S. T. 523

Taxability of household type refrigerators and refrigerator components.

Advice is requested relative to the application of section 608 of the Revenue Act of 1932 to household type of refrigerators and refrigerator components.

Refrigerator parts or units, designed primarily and solely used for commercial purposes, are exempt from tax. These include ice cream cabinets, ice cream cabinet units, water coolers, lens chillers, and refrigerating units for commercial transportation equipment.

For purposes of the tax refrigerator parts and accessories are divided into three groups, viz:

(1) Household and interchangeable parts.

(2) Commercial parts.

(3) Standard purchase parts (commercial commodities not primarily designed for use on or in connection with refrigerators).

Any of these parts are taxable if sold on or in connection with or with the sale of household type refrigerators or refrigerator components, but if sold separately no tax attaches. as, for example, sales to dealers for repair of refrigerator components.

Refrigerator gas, coiled copper tubing, and similar items are exempt from the tax under section 608(b) of the Revenue Act of 1932, because these articles belong to the general class of standard merchandise used in many industries. The producer or importer of the lubricating oil which is sealed into certain types of mechanical refrigerators may sell such oil tax-free, under certificate, to manufacturers of household type mechanical refrigerators for such use.

When goods are shipped prior to June 21, 1932, by bill of lading consigned to either the seller or to the buyer and the bill of lading with draft attached is sent to the bank for collection, but the draft remains unpaid on June 21, 1932, the goods are subject to tax.

In the foregoing cases of shipment by bill of lading, if the bill of lading was, prior to June 21, 1932, indorsed and discounted with a bank, acceptance company, or discount company, title passed to the transferee prior to that date and, consequently, the shipment was not subject to tax.

Any merchandise returned must be conclusively identified as having been tax-paid before any refund or credit of the tax can be secured.

In billing to a distributor or dealer a manufacturer often adds a specific charge for advertising and service guarantee. Such additional charges may be excluded from the selling price upon which the tax is computed if it can be established that the value of the services equals or exceeds the amount collected from the customer. If it is less than the amount collected, a tax must be paid upon the difference. In any event, such items must be shown separately on the invoices before they may be excluded in computing the tax. All national advertising is an expense of the manufacturer and must be borne by him and not made chargeable against the customer's advertising reserve. Charges to customers for advertising should cover only local advertising.

SECTION 609.—SPORTING GOODS.

REGULATIONS 46, ARTICLE 53: Scope of tax. XI–36–5665
S. T. 480

Held, that a vending machine converted into a game of chance is taxable as a game.

Advice is requested relative to the taxability of certain vending machines or games of chance.

It is held that the ordinary penny machine in which the operator deposits a coin and receives in return either merchandise or service, such as his correct weight, is not taxable under section 609 of the Revenue Act of 1932.

However, where the operator of a machine upon inserting a coin receives in return a printed card which calls for the payment in cash in the amount of two, four, or eight times the amount originally inserted, the vending machine is converted into a game of chance and is taxable as a game under section 609 of the Revenue Act of 1932.

REGULATIONS 46, ARTICLE 53: Scope of tax. XI–40–5753
S. T. 515

Bladders designed for use in a taxable ball such as a football, basket ball, soccer ball, etc., are taxable.

Advice is requested relative to the taxability of bladders under section 609 of the Revenue Act of 1932.

Bladders designed for use in a taxable ball, such as a football, basket ball, soccer ball, etc., are taxable as sporting goods under section 609 of the Revenue Act of 1932. Such bladders when sold for use in the further manufacture of a taxable article or for use as a

component part of a taxable article, may be sold tax-free under a tax-exemption certificate.

Bladders sold for use in making repairs or replacements are subject to the tax imposed by section 609 of the Revenue Act of 1932.

REGULATIONS 46, ARTICLE 54: Sporting goods. XI-30-5568
S. T. 461

Fishing tackle, such as fishing nets, lines, hooks, baits, flies, etc.

An opinion has been requested as to whether the tax imposed by the applicable portion of section 609 of the Revenue Act of 1932 is limited to fishing rods and reels or whether fishing tackle, such as fishing nets, lines, hooks, baits, flies, etc., may be properly taxed.

Section 609 of the Revenue Act of 1932, in so far as applicable to the issue presented, provides:

> There is hereby imposed upon the following articles, sold by the manufacturer, producer, or importer, a tax equivalent to 10 per centum of the price for which so sold: * * * *fishing rods and reels* * * * and all similar articles commonly or commercially known as sporting goods. [Italics supplied.]

The italicized portion of section 609 hereinbefore quoted specifically refers to fishing rods and reels. No mention is made of fishing nets, lines, hooks, baits, flies, etc.

Subdivision 5 of section 900 of the Revenue Act of 1918 contains language that is practically identical to the above-quoted portion of section 609 of the Revenue Act of 1932. In April, 1919, it was determined that, under the provisions of subdivision 5 of section 900 of the Revenue Act of 1918, only fishing rods and reels were taxable within the purview of that section. In view of the similarity of the sections referred to above, it follows that fishing nets, lines, hooks, baits, flies, etc., ordinarily known as fishing tackle, are held not to be subject to the tax imposed under section 609 of the Revenue Act of 1932.

REGULATIONS 46, ARTICLE 54: Sporting goods. XI-36-5666
S. T. 481

Taxability of uniforms.

Advice is requested relative to taxability of uniforms under section 609 of the Revenue Act of 1932.

It is held that all uniforms specially designed for or commonly used in athletic contests or games are subject to the tax under section 609 of the Act. However, uniforms worn by employees of hotels, theaters, street railways, policemen, firemen, American Legion drill teams, Salvation Army officers, bandsmen, Army and Navy officers, members of fraternal orders, chauffeurs, deliverymen, bus drivers, and letter carriers are not subject to the tax under that section.

If any of those uniforms are trimmed with fur they are taxable under section 604 of the Revenue Act of 1932, if such fur is the component material of chief value in the uniform.

REGULATIONS 46, ARTICLE 54: Sporting goods. XI–38–5711
S. T. 502

Held that cheek pads and hand protectors used in hunting are not taxable.

Advice is requested whether cheek pads and hand protectors used by hunters on guns and rifles are taxable under section 609 of the Revenue Act of 1932.

It is held that articles such as cheek pads, used to protect the cheeks while the stock of a shotgun is being raised, and hand protectors, used to protect the hands from a heated rifle barrel, are not taxable under section 609 of the Revenue Act of 1932.

REGULATIONS 46, ARTICLE 54: Sporting goods. XI–39–5730
S. T. 508

Held that certain articles are not taxable as sporting goods.

Advice is requested whether riding crops, cartridge belts, holsters, gun cases, skate straps, shoe laces, creel harnesses or fishing basket straps, hunting license holders, and duck hobbles are taxable.

None of the articles specified are taxable as sporting goods under section 609 of the Revenue Act of 1932.

REGULATIONS 46, ARTICLE 54: Sporting goods. XI–42–5793
S. T. 532

Handball gloves are taxable.

Advice is requested whether handball gloves are subject to tax under section 609 of the Revenue Act of 1932.

Inasmuch as handball gloves are used in a well-recognized sport, it is held that they are sporting goods and subject to tax as such under section 609 of the Revenue Act of 1932.

REGULATIONS 46, ARTICLE 54: Sporting goods. XI–43–5809
(Also Article 56.) S. T. 542

Taxability of parts of uniforms.

If a part of a uniform is by its construction and design susceptible for use in any contest or game and is not customarily used for general wear, it is subject to the tax imposed by section 609 of the Revenue Act of 1932, when sold. For example, such articles as football pants, baseball shirts and pants, and basketball pants, are subject to the tax, but sweaters, athletic underwear, hose, belts, etc., are not taxable unless actually sold as a part of a uniform. Furthermore, articles such as plain basketball shirts and football jerseys are not taxable articles in themselves, but if emblems, padding, numerals, or other special features are attached to these articles by the manufacturer they become articles subject to the tax.

REGULATIONS 46, ARTICLE 54: Sporting goods. XI-47-5874
S. T. 574

An ice skate and a skate shoe when sold as a combination held taxable.

An ice skate and a skate shoe when sold as a combination are subject to the tax imposed by section 609 of the Revenue Act of 1932. The manufacturer of the combination—that is, the assembler of the skate and the skate shoe—may purchase the skate or the skate shoe from the manufacturer thereof tax free under a tax exemption certificate. If the assembler of the combination does not purchase the skate shoe and the skate tax free under tax exemption certificates, he may take a credit for any tax paid by him to reimburse the prior manufacturer of the skate and the skate shoe against the tax the assembler pays upon his sale of the combination.

REGULATIONS 46, ARTICLE 55: Games. XI-42-5794
S. T. 533

Taxability of pool tables.

Advice is requested relative to the taxability of pool tables under section 609 of the Revenue Act of 1932.

Section 609 of the Revenue Act of 1932 imposes a tax on pool tables, without regard to size, but exempts children's toys and games. There are on the market certain articles usually made of metal which are fashioned in the semblance of pool tables but are not susceptible for use in playing the game of pool or any similar game. These articles are not pool tables within the meaning of the law and are not capable of use as such but are merely imitations and are chiefly used by children. Just when an article is a pool table and when an imitation is a question of fact. As a general rule the size of an article is not the only test in determining whether it is a mere imitation or an original. However, it is impossible to inspect every article placed on the market and advertised as a pool table, and the Bureau, in order to secure uniformity in the enforcement of the law with respect to such articles, holds that any article constructed in the semblance of a pool table, in substantially the usual proportions of such a table and of similar characteristics, which is more than 30 inches long (outside measurement) is a pool table within the meaning of section 609 of the Revenue Act of 1932, and taxable as such. Tables less than 30 inches long will not be regarded as pool tables.

REGULATIONS 46, ARTICLE 55: Games. XI-46-5856
S. T. 567

Taxability of jig saw puzzle as a game.

Advice is requested concerning the taxability, under section 609 of the Revenue Act of 1932, of jig saw puzzles as games.

The word "games," as used in section 609 of the Revenue Act of 1932, does not mean the games themselves but the instrumentalities

used in playing them. (See *Baltimore Talking Board Co.* v. *Miles*, 280 Fed., 658, T. D. 3401, C. B. I–2, 297.) Under the strict interpretation of that word all picture puzzles could be classified as games and held to be taxable. However, children's games are specifically exempted from the tax. It would follow that if the picture puzzles, or games, are of the type ordinarily designed for the use of children, they are not taxable.

A jig saw puzzle containing comparatively few pieces may properly be considered as one so simple as to warrant classification as a children's game and exempt from the tax. Where such puzzles contain many pieces they become more complex and are taxable on the ground that they are designed for use by adults. For revenue purposes, it is held that if the jig saw puzzle contains 50 pieces or less, it is a children's game and not subject to the tax. If the jig saw puzzle contains more than 50 pieces it is subject to the tax as a game under section 609 of the Revenue Act of 1932.

REGULATIONS 46, ARTICLE 55: Games. XI–50–5920
S. T. 598

Taxability of portable bowling alley.

Advice is requested relative to the taxability of a portable bowling alley under section 609 of the Revenue Act of 1932.

Section 609 of the Revenue Act of 1932 imposes a tax on the sale by the manufacturer of games and parts of games.

In the case of the *Baltimore Talking Board Co.* v. *Miles* (280 Fed., 658, certiorari denied, 259 U. S., 587 [C. B. I–1, 445]) the court was concerned with an interpretation of that portion of section 900, subdivision 5, of the Revenue Act of 1918, which relates to games and parts of games. The court held that the word "games," as used in the statute, did not mean the games themselves "but the instrumentality used in playing them."

When Congress enacted section 609 of the Revenue Act of 1932 it adopted the identical language the court was dealing with in the Baltimore Talking Board case. It is proper to presume that Congress had knowledge of and approved the court's definition of the word "game."

Bowling is recognized in America as an indoor game played upon an alley with wood or composition balls and maple pins. A bowling alley is defined as "a long narrow planked space for playing at ten pins, having at one end a pit to receive the balls and overturned pins." (Funk & Wagnall's New Standard Dictionary.) Bowling is a play or sport for amusement. The word "games," as used in the statute, is the instrumentality rather than the contest. In the instant case there is a specially built and designed instrumentality. It is held out and sold as a device used in playing the game known as bowling. It is a device upon which a play for sport or amusement takes place. It is an instrumentality absolutely necessary to play the game of bowling.

In view of the foregoing it is held that a sale by the manufacturer of a portable bowling alley is taxable.

SECTION 610.—FIREARMS, SHELLS, AND CARTRIDGES.

REGULATIONS 46, ARTICLE 58: Scope of tax. XI–39–5731
S. T. 509

Held that air pistols or air rifles are not taxable as firearms.

Advice is requested whether air pistols or air rifles are taxable under section 610 of the Revenue Act of 1932.

Air pistols or air rifles are not firearms and are not taxable under section 610 of the Revenue Act of 1932.

REGULATIONS 46, ARTICLE 58: Scope of tax. XI–44–5826
S. T. 551

Shells and cartridges sold or used in testing firearms are taxable.

Advice is requested concerning the taxability, under section 610 of the Revenue Act of 1932, of shells and cartridges when used or sold for testing firearms.

To be exempt from tax under section 620 of the Revenue Act of 1932, the article must be sold, (1) for use as material in the manufacture or production of a taxable article, or (2) for use as a component part of a taxable article to be produced by the vendee.

Shells and cartridges sold by a manufacturer for use in testing guns do not meet these conditions and are not exempt from the tax imposed under section 610 of the Revenue Act of 1932.

Under section 622 of the Revenue Act of 1932, a manufacturer of firearms, shells, and cartridges is liable for the tax on all shells and cartridges used by him in testing firearms.

REGULATIONS 46, ARTICLE 58: Scope of tax. XI–45–5843
S. T. 561

Taxability of component parts of shells and cartridges.

The tax imposed by section 610 of the Revenue Act of 1932 does not attach to the sale of component parts of ammunition consisting of cartridge cases, primers, bullets, and powder by manufacturers for use as material in the manufacture or production of a taxable article.

SECTION 611.—CAMERAS.

REGULATIONS 46, ARTICLE 61: Scope of tax. XI–40–5754
S. T. 516

Taxability of cameras when sold with or without lens.

Advice is requested concerning the taxability of cameras sold with or without a lens, under section 611 of the Revenue Act of 1932.

The A Corporation manufactures motion-picture cameras. It does not manufacture lenses but purchases most of the lenses used in these

cameras from a lens manufacturing company. The A Corporation also imports some lenses which are admittedly subject to the tax upon their sale. No work is done by the A Corporation in connection with any of the lenses purchased, and in many cases the lenses do not go through the A Corporation factory. The price list furnished to the trade quotes cameras both with and without lenses. Due to the difference in the quality of the lenses, the selling price varies. A camera selling for $75 is sometimes equipped with a lens costing as much as $35.

The questions, together with the answers thereto, are as follows:

Question: Where a lens is sold by the A Corporation, the tax having been paid by the manufacturer on the sale to the A Corporation, is there any tax to be paid by the A Corporation on its resale?

Answer: The tax imposed by section 611 does not attach to the resale. In such a case the A Corporation is neither a manufacturer, producer, nor importer of the lens. However, the transaction whereby the A Corporation obtains the lens must be bona fide and at a fair market price for the article purchased.

Question: Where the A Corporation sells a camera manufactured by it, and at the same time sells a lens on which the manufacturer thereof has paid the tax, is there any tax to be paid by the A Corporation on the sale of this lens?

Answer: No tax is due on the resale of the lens, provided it is billed as a separate item and at a price for which such lenses are generally sold.

Question: Where the A Corporation sells a box or camera complete, except for the lens, is this article taxable as a camera under the law?

Answer: The tax is due even though the camera is sold without a lens.

SECTION 613.—CANDY.

REGULATIONS 46, ARTICLE 63: Scope of tax. XI–35–5652
S. T. 474

The dipping of fruits, nuts, jellies, etc., in chocolate constitutes a manufacturing process and renders the product taxable as candy at 2 per cent.

Advise is requested relative to the tax imposed by section 613 of the Revenue Act of 1932 on the sale of candy by a manufacturer as applied to a concern which purchases fruits, nuts, jellies, etc., and dips these materials into chocolate.

It is held that such dipping constitutes a manufacturing process and that the article produced is taxable as candy at 2 per cent of the selling price under section 613 of the Revenue Act of 1932.

REGULATIONS 46, ARTICLE 63: Scope of tax. XI–47–5875
S. T. 575

Taxability of candy sold in fancy containers.

Advice is requested concerning the tax imposed under section 613 of the Revenue Act of 1932 as applied to candy sold in fancy containers, such as bon bon dishes, cedar chests, glove boxes, etc.

Subdivision (a) of section 619 of the Revenue Act of 1932 provides that in determining the price for which an article is sold, there shall be included any charge for coverings and containers of whatever nature.

Therefore, the basis of tax on candy sold in fancy containers is the sale price of the combination, unless the price of the candy and the ordinary container are segregated from the price of the fancy type package. If the sale prices are so segregated the tax will attach to the sale price of the candy, plus the ordinary container only.

REGULATIONS 46, ARTICLE 63: Scope of tax. XI–50–5921
S. T. 599

Taxability of chocolate coating and sweet chocolate as candy.

Advice is requested concerning the taxability of chocolate coating and sweet chocolate as candy under section 613 of the Revenue Act of 1932.

There are several classes of chocolate coating which have a higher content of cocoa butter than the ordinary sweet chocolate. This coating is used by confectioners for dipping purposes. It is usually melted and the candy manufacturer dips the unfinished center or confection in the melted coating to make the completely manufactured confection. It is also used by bakers and ice cream manufacturers for manufacturing purposes. Coating is produced by the manufacturer in large cakes for the sole purpose of use in further manufacture and is not intended for use as candy in the form in which sold. Chocolate coating may, therefore, be sold without liability for the tax imposed upon candy by section 613.

Ordinary sweet chocolate, as distinguished from chocolate coating, has a lower cocoa butter content. If sweet chocolate is sold to distributors or retailers, irrespective of the size of the cake, it may not be sold tax free, because it is candy in the form in which sold by the manufacturer and is taxable as such. If it is sold to candy manufacturers for further manufacture, it may be sold tax free under an exemption certificate, as provided by article 7 of Regulations 46.

Sweet chocolate, as distinguished from chocolate coating, may also be sold tax free to ice cream manufacturers for use in manufacturing ice cream, provided the purchaser, prior to or at the time of sale, furnishes a certificate to the effect that such chocolate is to be used by him in the manufacture of ice cream, and that if such chocolate should be sold by him in the form in which purchased he will make return and pay tax upon such sales.

If manufacturers' records do not contain certificates covering tax free sales of sweet chocolate, as distinguished from chocolate coating, to ice cream manufacturers, with supporting invoices, the tax shall be payable by the manufacturer.

SECTION 615.—SOFT DRINKS AND CARBONIC ACID GAS.

REGULATIONS 44, ARTICLE 23: Registration. XI–31–5589
T. D. 4343

Tax on soft drinks—Registration—Section 615(c), Revenue Act of 1932.—Article 23, Regulations 44, amended.

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

To Collectors of Internal Revenue and Others Concerned:

The first paragraph of article 23 of Regulations 44 is hereby amended to read as follows:

Every manufacturer of cereal beverages; of unfermented grape juice; of unfermented fruit juices or imitations thereof; of still drinks; of natural or artificial mineral waters or table waters, or imitations thereof; of finished or fountain sirups; of carbonic acid gas who sells such gas to a manufacturer of carbonated beverages, or to a person conducting a soda fountain, ice cream parlor, or other similar place of business; of carbonic acid gas who uses such gas in the production of carbonated beverages; of carbonated beverages made with concentrates, essences, or extracts; of carbonated beverages made by use of finished or fountain sirups manufactured by such manufacturer; every dealer in carbonic acid gas who sells such gas to any of the manufacturers named above; and every person conducting a soda fountain, ice cream parlor, or other similar place of business who manufactures any sirups of the kind mentioned in article 37, shall, on or before August 1, 1932, or within 10 days after commencing business, and thereafter on or before July 1 of each year, make application for registry to the collector in whose district his place of business is located.

DAVID BURNET,
Commissioner of Internal Revenue.

Approved July 27, 1932.
OGDEN L. MILLS,
Secretary of the Treasury.

REGULATIONS 44, ARTICLE 23: Registration. XI–36–5673
T. D. 4352

Tax on soft drinks—Registration—Section 615(c), Revenue Act of 1932.—Article 23, Regulations 44, amended.

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

To Collectors of Internal Revenue and Others Concerned:

The first paragraph of article 23 of Regulations 44, approved June 18, 1932, as amended by Treasury Decision 4343 [above], approved July 27, 1932, is further amended to read as follows:

Every manufacturer of cereal beverages; of unfermented grape juice; of unfermented fruit juices or imitations thereof; of still drinks; of natural or artificial mineral waters or table waters, or imitations thereof; of finished

or fountain sirups; of carbonic acid gas who sells such gas to a manufacturer of carbonated beverages, or to a person conducting a soda fountain, ice cream parlor, or other similar place of business; of carbonic acid gas who uses such gas in the production of carbonated beverages; of carbonated beverages made with concentrates, essences, or extracts; of carbonated beverages made by use of finished or fountain sirups manufactured by such manufacturer; every dealer in carbonic acid gas who sells such gas to any of the manufacturers named above; and every person conducting a soda fountain, ice cream parlor, or other similar place of business who manufactures any sirups of the kind mentioned in article 37, shall, on or before October 1, 1932, or within 10 days after commencing business, and thereafter on or before July 1 of each year, make application for registry to the collector in whose district his place of business is located.

DAVID BURNET,
Commissioner of Internal Revenue.

Approved August 29, 1932.

JAMES H. DOUGLAS,
Acting Secretary of the Treasury.

REGULATIONS 44, ARTICLE 24: Scope of tax. XI–52–5955
S. T. 614

Taxability of cereal beverages given away.

In order to promote sales a certain company offers 10 cases of cereal beverage free of charge with each 100 cases purchased. Inquiry is made whether the Bureau will require payment of a tax on the 10 cases of cereal beverage for which no charge is made.

The tax on cereal beverages is based upon the quantity of the product sold. Therefore, the tax must be collected upon the total quantity of the shipment even though a portion consists of a bonus or so-called free goods.

It is held that a manufacturer is liable for a tax of 1¼ cents per gallon on the total quantity of the cereal beverages in the shipment, including the quantity for which no specific charge is made.

REGULATIONS 44, ARTICLE 28: Scope of tax. XI–41–5774
S. T. 524

Taxability of nonalcoholic articles.

Advice is requested whether the following articles are subject to tax under section 615(a) (3) or (6) of the Revenue Act of 1932, viz: Nonalcoholic Almond Sirup, nonalcoholic Grenadine, nonalcoholic Creme de Menthe, nonalcoholic Benedictine, nonalcoholic Chartreuse, nonalcoholic Vermouth, nonalcoholic Manhattan Cocktails, nonalcoholic Martini, nonalcoholic Creme d'Apricot, nonalcoholic Kummel, nonalcoholic London Dry, and nonalcoholic Creme de Cerises (Cherry).

None of the products mentioned are unfermented fruit juices or finished fountain sirups within the meaning of the Revenue Act of 1932 and, consequently, none of them are subject to the tax.

REGULATIONS 44, ARTICLES 28 AND 32: Scope of tax. XI-39-5734 S. T. 511

Held that tomato juice is not taxable as a fruit juice or as a still drink.

Advice is requested whether tomato juice is taxable under the provisions of section 615(a) of the Revenue Act of 1932.

A tomato is a vegetable and not a fruit. Not being a fruit, tomato juice is not subject to the tax imposed by section 615(a)3 of the Revenue Act of 1932. It is also held that tomato juice is not a beverage within the meaning of section 615(a)4 of that Act, imposing a tax on still drinks.

REGULATIONS 44, ARTICLE 32: Scope of tax. XI-36-5667 S. T. 482

Pure orange juice, lime juice, lemon juice, and grapefruit juice held subject to tax as still drinks.

Advice is requested whether natural fruit juices, such as orange juice, lime juice, lemon juice, and grapefruit juice, served at soda fountains as a beverage and at restaurants as a part of a meal, to which no sugar or water has been added, are subject to the tax imposed under section 615 of the Revenue Act of 1932.

Section 615(a)3 specifies a class of fruit juices adapted to dilution. Section 615(a)4 specifies a class of beverages not adapted to dilution. In section 615(a)3 the phrase is: "* * * fruit juices * * * intended for consumption as beverages with the addition of water or water and sugar, * * *." In section 615(a)4 the phrase is: "* * * still drinks * * * intended for consumption as beverages in the form in which sold * * *." These words were used upon the assumption that fruit juices, like still drinks, are intended for beverage use.

It is held that pure orange juice, lime juice, lemon juice, and grapefruit juice, such as are sold at soda fountains as a beverage and at restaurants as a part of a meal without the addition of sugar or sugar and water, are still drinks and subject to the tax of 2 cents per gallon imposed under section 615(a)4 of the Revenue Act of 1932.

REGULATIONS 44, ARTICLE 32: Scope of tax. XI-39-5732 S. T. 510

Grapefruit juice packed in cans in its natural state, with or without the addition of sugar, and intended for consumption as a beverage in such form, is taxable as a still drink.

Advice is requested whether the tax imposed upon unfermented fruit juices under section 615(a)3 of the Revenue Act of 1932 will apply to grapefruit juice packed in cans in its natural state, without the addition of sugar, and whether the addition of sugar will make any difference in the application of the tax.

Section 615(a)3 imposes a tax upon unfermented fruit juices intended for consumption as beverages with the addition of water

or water and sugar. Section 615(a)4 imposes a tax upon all still drinks intended for consumption as beverages in the form in which sold. The rate of tax in both cases is 2 cents per gallon.

While it is true that section 615(a)4 does not specifically refer to fruit juices, yet there is little doubt that it was intended to cover such articles. The specific exemption of grape juice and apple cider, both being fruit juices, suggests that Congress regarded section 615(a)4 as covering fruit juices. The term "intended for consumption as beverages in the form in which sold" also indicates that the provision covers fruit juice used without dilution, in contrast with the fruit juice adapted to dilution covered by section 615(a)3.

Grapefruit juice packed in cans in its natural state, with or without the addition of sugar, is therefore held to be subject to the tax of 2 cents per gallon imposed by section 615(a)4 of the Revenue Act of 1932.

REGULATIONS 44, ARTICLE 32: Scope of tax. XI–40–5755
S. T. 517

"Frozen suckers" not subject to tax.

Advice is requested whether the tax imposed by section 615(a)4 of the Revenue Act of 1932 is applicable to the manufacture and sale of frozen suckers.

The M Company manufactures frozen suckers by using fruit gelatine, sugar, and water. This mixture is placed in molds and frozen.

It is held that the finished product, commonly known as "frozen suckers," is not subject to any of the taxes imposed under section 615 of the Revenue Act of 1932.

REGULATIONS 44, ARTICLE 32: Scope of tax. XI–43–5810
(Also Article 37.) S. T. 543

Chocolate milk and other milk drinks are not taxable, but finished or fountain sirups used in their manufacture are subject to tax.

Chocolate milk and other flavored milk drinks are not subject to tax as soft drinks, irrespective of the form in which prepared or the manner in which sold.

However, finished or fountain sirups used in the preparation of such drinks are taxable at 6 cents per gallon, under section 615(a)6 of the Revenue Act of 1932, payable by the manufacturer of such sirups.

REGULATIONS 44, ARTICLE 35: Scope of tax. XI–48–5888
S. T. 583

Taxability of natural or artificial mineral waters.

Bottles, jugs, kegs, barrels, demijohns, carboys, and all similar articles are classed as closed containers within the meaning of section 615(a)5 of the Revenue Act of 1932. The sale by the producer

of mineral waters in such containers is taxable, regardless of whether the container is owned by the vendor or the vendee.

Buckets, pails, and similar articles are not closed containers and, therefore, the sale of mineral waters in such receptacles is not taxable under that section.

REGULATIONS 44, ARTICLE 37: Scope of tax. XI–35–5644
S. T. 471

Definition of a finished or fountain sirup.

An opinion is requested concerning the interpretation of section 615(a)6 of the Revenue Act of 1932 imposing a tax upon finished or fountain sirups.

It is contended that a finished or fountain sirup is "a sirup which is possible of dilution with simple sirup in a ratio of 3 or 4 parts of simple sirup to 1 part of fountain sirup." It is also urged that a retail dealer should not be considered as being a manufacturer within the meaning of the law because of the addition of simple sirup to the finished or fountain sirup. Careful consideration has been given to all aspects of the problem, and the interpretation contended for, while it would materially simplify the task of collecting the tax, can not be acceded to by the Bureau.

The question turns upon the definition of "finished or fountain sirups" as used in section 615(a)6 of the Revenue Act of 1932. By this section the tax is imposed upon all finished or fountain sirups of the kinds used in mixing or compounding drinks commonly known as soft drinks. In article 37 of Regulations 44 the term "finished or fountain sirup" has been defined to include the kind of sirup used in compounding the drink at the soda fountain. This sirup is ready to serve, requiring no further dilution with simple sirup, and is ordinarily used in the ratio of 1 part sirup to approximately 5 or 6 parts of water in order to make a finished drink. This ruling is consistent with the position taken by the Bureau under the Revenue Act of 1921.

It is held that if any person conducting a soda fountain, ice cream parlor, or other similar place of business produces a sirup, either by using a concentrate, essence, or extract, or by diluting a concentrated sirup with simple sirup, he becomes a manufacturer or producer of a finished or fountain sirup and is subject to a tax of 6 cents per gallon on each gallon so manufactured and used in the preparation of the soft drink.

REGULATIONS 44, ARTICLE 37: Scope of tax. XI–37–5688
S. T. 491

Chocolate sirup sold to dairies or milk dealers for use in chocolate milk held taxable.

Advice is requested whether chocolate sirup sold to dairies or milk dealers for use with milk sold in bottles is taxable under section 615 of the Revenue Act of 1932.

Section 615(a)6 of the Act imposes a tax upon the sale by the manufacturer, producer, or importer of all finished or fountain sirups

of the kinds commonly used in compounding soft drinks at a soda fountain. The sirup subject to tax is one which is ready to serve, requiring no further dilution with simple sirup and is ordinarily used in the ratio of 1 part sirup to approximately 5 or 6 parts of water in order to make a finished drink.

Where a dairy uses a finished or fountain chocolate sirup in the production of chocolate milk, the manufacturer, producer, or importer of such sirup who sells the same is liable for a tax of 6 cents per gallon on each gallon of sirup sold.

Where a dairy produces its own sirup to be used in the production of chocolate milk or where a concentrated sirup is purchased and reduced to a finished or fountain sirup for use in making chocolate milk, the dairy becomes the manufacturer and is liable for a tax of 6 cents per gallon on all sirup so produced and used.

REGULATIONS 44, ARTICLE 37: Scope of tax. XI-51-5938
S. T. 607

Taxability of finished fountain sirups manufactured prior to June 21, 1932, and used after that date.

Advice is requested relative to the taxability of finished or fountain sirups under section 615(a)6 of the Revenue Act of 1932, when manufactured prior to June 21, 1932, and used after that date in the production of carbonated beverages.

Section 622 provides that a person who manufactures and uses a taxable article shall be liable for tax under the law in the same manner as if such article was sold by him. It has been suggested that this language is prospective in its scope, and that as the term is conjunctive it follows that both the manufacture and the use must occur after the effective date of the law. This language must, however, be read in connection with that which follows. Reading the section as a whole, it is clear that Congress intended to tax the use of an article by a manufacturer in the same manner as if the article was sold by him. Reverting to the wording of section 615(a)6, the tax is imposed upon the articles specified sold in the United States by the manufacturer. The tax is thus clearly levied on the sale. It has been consistently held that the tax becomes due when the article is sold by the manufacturer, even though it was produced before the law became effective. Under section 622 the use is made subject to tax in the same manner as if sold. The use being clearly the complement of the sale, the rule applied to the sale must also be applied to the use. The tax thus becomes due upon the use of an article by the manufacturer after the effective date of the law, irrespective of when it was manufactured.

REGULATIONS 44, ARTICLE 40: Rates of tax. XI-42-5795
S. T. 534

Method of computing and paying taxes by chain stores.

Advice is requested relative to the methods which should be adopted in computing taxes payable by the M Company under section 615 of the Revenue Act of 1932.

The M Company operates a chain of stores located throughout the United States. Soda fountains, where soft drinks are sold, are maintained in the majority of these stores. All of the stores are supplied with concentrated sirup, for use at their soda fountains, through a central plant of the company. When a store needs a supply of finished sirup the one in charge of the fountain of the particular store compounds and mixes 1 gallon of concentrated sirup, furnished by the M Company, with approximately 3 gallons of simple sirup. Thus every gallon of concentrated sirup shipped from the central plant is made into 4 gallons of finished or fountain sirup by the branch store.

It is proposed to keep inventories of all concentrated sirup on hand and in transit to stores on June 21, 1932, and to pay a tax of 24 cents on each gallon of concentrated sirup shipped to the branch stores. Such a procedure, it is stated, would not only benefit the company, in that it would relieve the soda fountain clerks of branch stores from the task of keeping detailed records for use in making tax payments, but would also be beneficial to the Government in that it would insure collection of the total amount of tax due.

Where branch stores purchase locally all of the oranges, lemons, and limes used in connection with the manufacture of the beverage taxed under section 615(a) (3) and (4) of the Revenue Act of 1932, a daily report of the quantity of fruits so purchased is submitted to the company's central office. For tax purposes it is permissible to have a preliminary test made in a number of representative stores in order to ascertain the average number of gallons of taxable beverages manufactured out of each case of oranges, lemons, or limes. The tax imposed by section 615(a) (3) and (4) will then be computed on the basis of the number of cases of oranges, lemons, and limes used in all stores.

The procedure proposed with respect to the payment of tax under section 615(a) (3), (4), and (6) of the Revenue Act of 1932 is approved by the Bureau. The company will be permitted to pay the tax on concentrated sirup and still drinks in the manner indicated, provided it furnishes the Bureau with an affidavit to the effect that all sirups used by the branch stores are supplied from the central plant, and that each gallon of concentrated sirup shipped from the distribution center will not be used to make more than 4 gallons of finished or fountain sirup. There must also be submitted a waiver, to be approved by the Bureau, to the effect that this procedure will never be used as the basis of a claim for refund of taxes.

REGULATIONS 44, ARTICLE 41: Scope of tax. XI-35-5653
S. T. 475

"Dry ice," while chemically the same as gaseous or liquid carbon dioxide, is not "carbonic acid gas" within the meaning of section 615(a)7, and is not taxable.

An opinion is requested relative to the tax imposed upon carbonic acid gas under section 615(a)7 of the Revenue Act of 1932.

The tax imposed by section 615(a)7 attaches at the rate of 4 cents per pound to the sale of carbonic acid gas by the manufacturer, pro-

ducer, or importer, or by a dealer in such gas, to a manufacturer of any carbonated beverages, or to any person conducting a soda fountain, ice cream parlor, or other similar place of business, and to the use of carbonic acid gas by the manufacturer in the preparation of soft drinks.

It is stated that solid carbon dioxide, or "dry ice" as it is commonly known, is manufactured by compressing carbon dioxide (carbonic acid gas) to liquid form and then cooling it to a solidified snowlike substance which is compressed into blocks in imitation of ice and used largely for refrigeration purposes. It is contended that solid carbon dioxide is not sold in a form suitable for use in carbonating beverages. It is necessary, in order to use it for that purpose, to subject it to a further process which reconverts it back to a liquid form. The position taken is that the person so reconverting "dry ice" becomes the manufacturer of carbonic acid gas and should be held liable for the tax. This would exclude "dry ice" entirely from the scope of articles subject to tax under section 615(a)7 of the Revenue Act of 1932.

This office is of the opinion that "dry ice," while chemically the same as the gaseous or liquid carbon dioxide, is not "carbonic acid gas" within the meaning of section 615(a)7. The intent of the statute is obviously to tax the commodity commonly known and sold as carbonic acid gas and suitable for use in the manufacture of carbonated beverages. "Dry ice" is not commonly so known and sold, and it not suitable for use in the manufacture of carbonated beverages until it has been converted by a process of manufacture into the liquid form of carbon dioxide commonly known and sold as carbonic acid gas.

It is therefore held that the sale of "dry ice" is not taxable under section 615(a)7. However, any person who converts "dry ice" into carbonic acid gas and sells it to a manufacturer of carbonated beverages, or to any person conducting a soda fountain, ice cream parlor, or other similar place of business, or uses it in the preparation of soft drinks, must pay tax under section 615(a)7 as the manufacturer or producer of the carbonic acid gas.

REGULATIONS 44, ARTICLE 41: Scope of tax. (Also Sections 620 and 621.)

XI-46-5857
S. T. 568

A person producing soft drinks subject to tax under section 615(a)1, 3, or 5 of the Revenue Act of 1932 may, in computing tax on his sales of such products, take credit for the amount of the tax imposed by section 615(a)7 which he has reimbursed to a manufacturer or dealer in carbonic acid gas.

Advice is requested whether a producer of soft drinks which are subject to tax under section 615(a)1, 3, or 5 of the Revenue Act of 1932 may, in computing tax on his sales of such products, take credit for the amount of the tax imposed by section 615(a)7 of the Revenue Act of 1932 which he has reimbursed to a manufacturer or dealer in carbonic acid gas.

It is held that if a manufacturer of soft drinks which are taxable under section 615(a)1, 3, or 5 of the Revenue Act of 1932 has reim-

bursed the manufacturer of, or dealer in, carbonic acid gas for the tax imposed by section 615(a)7 of the Revenue Act of 1932, he may take credit against the tax paid on the complete taxable beverages in the amount of the tax paid on the carbonic acid gas used in such beverages by reason of the provisions of section 621(a)1 of the Revenue Act of 1932. In taking such a credit the provisions of the first paragraph of article 52 of Regulations 44 must be observed.

It is also held that a manufacturer of beverages taxable as described above may, by reason of the provisions of section 620 of the Revenue Act of 1932, purchase carbonic acid gas from the manufacturer of, or dealer in, such gas tax-free under an exemption certificate, in the manner outlined in article 7 of Regulations 44, for use in the further manufacture of such beverages.

A person purchasing carbonic acid gas under an exemption certificate must keep an accurate record of the amount used in the manufacture of taxable beverages, available for inspection by revenue officers, and he must file returns and pay the tax of 4 cents per pound on all such gas not used as material in the manufacture or production of his taxable beverages.

REGULATIONS 44, ARTICLE 41: Scope of tax. XI–51–5939
S. T. 608

Taxability of carbonic acid gas sold for pressure purposes in drawing beverages from receptacles.

Advice is requested regarding the taxability of carbonic acid gas when sold for pressure purposes in drawing so-called near beer or cereal beverages from receptacles. Section 615(a)7 of the Revenue Act of 1932 imposes a tax of 4 cents per pound upon all carbonic acid gas sold to a manufacturer of any carbonated beverages or to any person conducting a soda fountain, ice cream parlor, or other similar place of business, and upon all carbonic acid gas used by the manufacturer, producer, or importer in the preparation of soft drinks.

The words "other similar places of business" refer primarily to the character of the business transacted. Whether a person selling soft drinks is conducting a place of business similar to a soda fountain or ice cream parlor depends upon the facts in each particular case. Sales of carbonic acid gas to a person conducting a soda fountain are clearly taxable. An ice cream parlor is almost invariably equipped with a soda fountain. Consequently, a place of business similar to that of a person conducting a soda fountain or ice cream parlor is one which is equipped with a soda fountain. This is true whether a place so equipped is an ice cream parlor, hotel, restaurant, cafeteria, lunch room, or clubhouse. It is also true where a soda fountain is operated in connection with the sale of a substantial article of food as part of a meal and where service from the soda fountain is made by way of the kitchen.

Consequently, hotels, restaurants, cafeterias, lunch rooms, or clubhouses serving carbonated beverages from a soda fountain are similar places of business within the meaning of section 615(a)7. On the other hand, a place of business equipped with one or more beer

pumps and not equipped with a soda fountain is not a place of business similar to a soda fountain or ice cream parlor. Manufacturers of, or dealers in, carbonic acid gas are not subject to a tax on sales of the gas to such places.

SECTION 616.—ELECTRICAL ENERGY.

REGULATIONS 42, ARTICLE 40: Scope of tax. XI-28-5545
T. D. 4337

TAX ON ELECTRICAL ENERGY—SECTION 616, REVENUE ACT OF 1932.

Articles 40 and 41, Regulations 42, amended.

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

To Collectors of Internal Revenue and Others Concerned:

The first paragraph of article 40 of Regulations 42 is hereby amended to read as follows:

The tax applies to the amount paid for all electrical energy furnished for domestic or commercial consumption, either by a privately or publicly owned electrical power company.

REGULATIONS 42, ARTICLE 40: Scope of tax. XI-31-5586
T. D. 4342

Tax on electrical energy—Section 616(a) of the Revenue Act of 1932.—Articles 40 and 41 of Regulations 42, amended.

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

To Collectors of Internal Revenue and Others Concerned:

Article 40 of Regulations 42 is amended to read as follows:

The tax applies to the amount paid for all electrical energy furnished for domestic or commercial consumption by any person or agency (whether private, public or quasi public) irrespective of whether such person or agency produces the energy so furnished. (For definition of the word "person," see section 1111 of the Act.)

All electrical energy furnished the consumer is taxable except (1) electrical energy furnished for industrial consumption, e. g., that used in manufacturing, processing, mining, refining, shipbuilding, building construction, etc., and (2) that furnished for other uses which likewise can not be classed as domestic or commercial, such as used by public utilities, waterworks, irrigation companies, telegraph, telephone, and radio communication companies, railroads, other common carriers, educational institutions not operated for private profit, churches, and charitable institutions. However, electrical energy is subject to tax if consumed in the commercial phases of industrial or other businesses, such as in office buildings, sales and display rooms, retail stores, etc.

Where electrical energy is supplied to a single consumer for two or more purposes, the specific use for which the energy is furnished, i. e., whether for domestic or commercial consumption, or for other consumption, shall determine its taxable status. Where the consumer has all the electrical

energy used at a given location furnished through one meter, the predominant character of the business carried on at such location shall determine the classification of electrical consumption for the purposes of this tax.

The tax does not apply with respect to sales of electrical energy other than sales for consumption. Every person purchasing electrical energy for resale shall apply for a registration number to the collector for the district in which is located his principal place of business (or, if he has no principal place of business in the United States, to the collector at Baltimore, Md.). The application shall state the name and place or places of business of the applicant. Registration numbers shall be in a separate series, beginning with the number 1, for each district. Electrical energy furnished for resale shall be exempt from tax only when the vendee furnishes to the vendor a certificate showing the vendee's registration number and stating that the energy is to be resold by him.

Where electrical energy is sold through one meter to a person for both resale and consumption, the certificate furnished by the vendee pursuant to the preceding paragraph shall show the portion of the energy which is consumed by him for domestic or commercial purposes, and the vendor shall collect the tax on such portion of the amount paid for all the energy. The vendee shall in turn collect from the person to whom he resells the energy the tax under section 616, based on the price for which the energy is resold.

The tax attaches to all amounts paid for electrical energy for domestic or commercial consumption irrespective of whether any of the energy paid for is actually used. In other words, the tax is due on all such payments whether in the form of a minimum charge, a flat charge, or otherwise.

Where a discount is deductible from the gross charge for electrical energy if payment therefor is made within a prescribed period or where an additional amount is added for failure to make payment within a prescribed period, the tax attaches to the amount actually paid.

REGULATIONS 42, ARTICLE 40: Scope of tax. XI–31–5588
S. T. 463

Is tax on electrical energy applicable when furnished to power or steam laundries?

Advice has been requested whether the tax on electrical energy is applicable when furnished to power or steam laundries.

Section 616 of the Revenue Act of 1932 imposes a tax equivalent to 3 per cent of the amount paid on or after June 21, 1932, for electrical energy for domestic or commercial consumption furnished after such date and before July 1, 1934. The law provides that the tax so imposed shall be paid by the person paying for such electrical energy and shall be collected by the vendor.

It is held that electrical energy furnished to a power or steam laundry for consumption in the laundry plant itself is not furnished for domestic or commercial consumption, and is not taxable under section 616. However, the use of electrical energy in branch offices or agencies of such a laundry is a commercial use and electrical energy so used is subject to the tax.

REGULATIONS 42, ARTICLE 40: Scope of tax. XI–33–5616
S. T. 464

Electrical energy for outdoor advertising is commercial, and subject to tax.

The question is presented for advice whether electrical energy used in the outdoor advertising business is subject to the tax imposed by section 616 of the Revenue Act of 1932.

The section mentioned imposes a tax equivalent to 3 per cent of the amount paid on or after June 21, 1932, for electrical energy for domestic or commercial consumption furnished after such date and before July 1, 1934.

Electrical energy for outdoor advertising is commercial in its scope and is subject to the tax imposed by section 616 of the Revenue Act of 1932.

REGULATIONS 42, ARTICLE 40: Scope of tax. XI–35–5643
S. T. 466

An opinion is requested relative to the taxability under the Revenue Act of 1932 of electrical energy consumed by motion picture theaters.

Section 616 of the Revenue Act of 1932 imposes a tax of 3 per cent of the amount paid for electrical energy for domestic or commercial consumption to be paid by the person paying for such electrical energy and to be collected by the vendor. Electrical energy for industrial consumption does not come within the provision of the Act and amounts paid therefor are not subject to the tax.

It is held that electrical energy consumed by a motion picture theater in the projection of motion pictures; in the lighting of signs and display boards, and also in the lighting of the building, etc., is furnished for commercial consumption. All amounts paid for electrical energy so furnished are therefore subject to the tax.

REGULATIONS 42, ARTICLE 40: Scope of tax. XI–36–5668
S. T. 483

Electrical energy furnished to railroad docks for use in loading and unloading ships held not subject to tax.

Advice is requested whether the tax on electrical energy is applicable to that furnished for dock operations.

It is stated that the docks and equipment are owned by certain railroads. The docks and equipment are used in loading and unloading ships and the charges made for the services are listed in the tariffs of such railroads. It is also stated that these docks are facilities of the railroads, being an integral part of their transportation system for bulk freight, and that the electrical energy used by the docks is furnished for the industrial service of transportation.

It is held that electrical energy furnished for operation of the dock facilities used by railroads in loading and unloading ships is not furnished for "domestic or commercial consumption" and that amounts paid for such electrical energy are not subject to tax under the provisions of section 616 of the Revenue Act of 1932.

REGULATIONS 42, ARTICLE 40: Scope of tax. XI–37–5689
S. T. 492

Held, that tax on electrical energy furnished by privately or municipally owned plants can not be absorbed but must be collected in every case as a separate item on bill rendered to consumer.

Advice is requested whether the Federal Government will require a privately or municipally owned electric company to show the tax on

electrical energy as a separate item on the bills rendered to the consumer.

Section 616 of the Revenue Act of 1932, which imposes a tax on electrical energy, provides that such tax shall be paid by the person paying for such energy and that the tax shall be collected by the person furnishing the electrical energy for consumption.

Every person receiving payments for electrical energy furnished for domestic or commercial consumption will be required under the provisions of the law to collect the tax imposed on such payments and to make proper returns of the tax to the collector of internal revenue.

There is no provision in the law whereby a privately or a municipally owned electric company may absorb the tax or may be relieved of the obligation of collecting the tax and of billing the same as a separate item to the consumer.

REGULATIONS 42, ARTICLE 40: Scope of tax. XI–39–5735
S. T. 512

Held that electrical energy generated by the owner of a building and furnished to his tenants is taxable when a charge is made for such energy.

Advice is requested relative to the taxability of electrical energy under section 616 of the Revenue Act of 1932 where the owner of a building generates the electrical energy consumed in the building.

The tax imposed by section 616 of the Revenue Act of 1932 applies only where a charge is made for energy furnished. No tax is due merely by reason of its production. The provisions of section 622 are not applicable with respect to the tax imposed under section 616(a). (See section 616(b).)

The tax attaches only when an amount is paid for the electrical energy furnished. Where the owner of a building generates the energy consumed therein, no tax applies unless a charge is made therefor. If the charge is included in the rent, the tax is due on such part of the rent as may properly be allocated as a charge for the energy furnished. The vendor will be required to determine and collect the tax on a reasonable basis and return the same to the collector.

REGULATIONS 42, ARTICLE 40: Scope of tax. XI–40–5756
S. T. 518

Electrical energy furnished bottling works, milk companies, or creameries for manufacturing purposes held not taxable.

Advice is requested whether electrical energy furnished bottling works, milk companies, and creameries is taxable under section 616 of the Revenue Act of 1932.

Electrical energy furnished for consumption by bottling works, milk companies, or creameries engaged in the pasteurization and bottling of milk, and in the manufacture of butter, buttermilk, chocolate milk, and cottage cheese, is not furnished for domestic or commercial consumption and is not subject to the tax imposed

by section 616 of the Revenue Act of 1932. However, the use of electrical energy in branch offices or agencies of such industries is a commercial use and electrical energy so used is subject to the tax.

REGULATIONS 42, ARTICLE 40: Scope of tax. XI–41–5775
S. T. 525

Taxability of electrical energy furnished to branch houses owned and operated by meat packing companies.

Advice is requested whether the tax on electrical energy is applicable when furnished to branch houses owned and operated by meat packing companies.

Where electrical energy is furnished to branch houses owned and operated by a meat packing company for the processing of meat products, such as curing and smoking meats, manufacturing sausages, frankfurters, etc., it is regarded as used for industrial purposes and is not subject to the tax imposed under section 616 of the Revenue Act of 1932. However, electrical energy furnished for refrigeration, storing, so-called ageing of fresh meats, or distributing the company's products is commercial in its scope and is subject to the tax. Where both operations are carried on at the same location and the electrical energy is furnished through one meter, the predominant character of the business carried on at such location determines the classification of electrical energy for the purposes of this tax.

REGULATIONS 42, ARTICLE 40: Scope of tax. XI–41–5776
S. T. 526

Held that all payments for electrical energy for domestic or commercial consumption even though in the form of or inclusive of fixed charges, such as transformer charges, minimum charges, flat charges, service charges, and maintenance charges, are taxable.

Advice is requested whether the tax imposed under section 616 of the Revenue Act of 1932 on the consumption of electrical energy is due on all payments for domestic or commercial consumption, whether in the form of a minimum charge, a flat charge, or otherwise.

It is held that all payments for electrical energy for domestic or commercial consumption even though in the form of or inclusive of fixed charges, such as transformer charges, minimum charges, flat charges, service charges, and maintenance charges, are subject to the tax imposed by section 616 of the Revenue Act of 1932.

REGULATIONS 42, ARTICLE 40: Scope of tax. XI–41–5777
S. T. 527

Taxability of electrical energy furnished grain elevators.

Advice is requested whether electrical energy furnished to grain elevators is taxable under section 616 of the Revenue Act of 1932.

The tax imposed under section 616 of the Revenue Act of 1932 is applicable to electrical energy furnished for domestic or commercial consumption, as distinguished from that furnished for industrial consumption. Electrical energy for industrial purposes is deemed to include that used generally for manufacturing, processing, mining, and similar industries.

Where the predominant character of a grain elevator business is the purchasing of grain for resale and the storage of grain for the account of the producer, and where no processing of a substantial nature is carried on, electrical energy furnished to the elevator is held to be for commercial consumption and subject to tax under section 616 of the Revenue Act of the 1932. However, electrical energy consumed in a grain elevator for purposes of cleaning, drying, grinding, and bleaching grain, as distinguished from the mere handling, storing, and distribution of grain, is considered industrial consumption and is not subject to the tax. Where both operations are carried on at the same location and the electrical energy is furnished through one meter, the predominant character of the business carried on at such location determines the classification of electrical energy for purposes of this tax.

REGULATIONS 42, ARTICLE 40: Scope of tax. XI–42–5796
S. T. 535

Taxability of electrical energy used by institutions operating on a nonprofit basis in promotion of knowledge and science in industry.

Held that the consumption of electrical energy by an institution operating on a nonprofit basis and engaged in the promotion of knowledge and science in industry is neither domestic nor commercial consumption, within the meaning of the law, and that, therefore, such electrical energy is not subject to the tax imposed by section 616 of the Revenue Act of 1932.

REGULATIONS 42, ARTICLE 40: Scope of tax. XI–43–5811
S. T. 544

Taxability of electrical energy furnished cathedrals, churches, rectories, and convents.

Electrical energy furnished cathedrals, churches, and convents is not for domestic or commercial consumption and is not subject to the tax imposed under section 616(a) of the Revenue Act of 1932. However, electrical energy furnished a rectory is for domestic consumption and is subject to the tax.

REGULATIONS 42, ARTICLE 40: Scope of tax. XI–43–5812
S. T. 545

Taxability of electrical energy furnished bus companies.

Electrical energy furnished for direct consumption by bus companies in their operations as a common carrier, and electrical energy used in the operation of garages and service stations which are con-

ducted by a bus company for the sole purpose of servicing the buses used in its operation as a common carrier, is not subject to the tax imposed under section 616 of the Revenue Act of 1932. The taxability of electrical energy furnished to bus stations or depots depends upon the predominant character of the business carried on at such stations or depots. If the predominant purpose is the maintenance of a waiting room and other facilities to patrons of the bus line, it is free from the tax. Otherwise, it is taxable under the law.

REGULATIONS 42, ARTICLE 40: Scope of tax. XI-44-5828
S. T. 553

Amounts paid in monthly installments for the extension of an electrical transmission line to a rural subdivision are not taxable as amounts paid for electrical energy.

Advice is requested concerning the application of the tax on electrical energy imposed by section 616 of the Revenue Act of 1932, under the following circumstances:

A power company extends a transmission line to a rural subdivision under an agreement with the consumers of electricity that the expense of such extension shall be repaid in monthly installments. The installments are billed with the regular charges for electrical energy in the monthly statements issued to the consumers by the power company.

The amounts received by the power company which represent charges to the consumers for the cost of extending the transmission line, since these charges are solely for the cost of the extension and are separate and distinct from the charges for electrical energy, are not subject to tax under section 616 of the Revenue Act of 1932.

REGULATIONS 42, ARTICLE 40: Scope of tax. XI-45-5844
S. T. 562

Taxability of electrical energy furnished for consumption by hospitals.

Electrical energy furnished for consumption by hospitals which are not organized or operated for profit and no part of the net earnings of which inure to the benefit of any private stockholder or individual is not subject to the tax imposed by section 616 of the Revenue Act of 1932. However, the use of electrical energy in hospitals which are operated for profit will be subject to the tax.

REGULATIONS 42, ARTICLE 40: Scope of tax. XI-46-5858
(Also Article 41.) S. T. 569

Taxability of electrical energy furnished a company operating under a contract with a municipality.

Advice is requested whether a company operating under a contract with a municipality for the removal and disposition of ashes, garbage, rubbish, and street cleanings is liable for the tax on electrical energy imposed by section 616 of the Revenue Act of 1932.

The consumer contends that by acting solely under a contract with the municipality in the performance of a city function, its use of electrical energy is neither domestic nor commercial and is not, therefore, subject to the tax imposed by section 616 of the Revenue Act of 1932.

It is held that a company which is operating under a contract with a city for the removal and disposition of ashes, garbage, rubbish, and street sweepings is engaged in a commercial enterprise. Consequently, electrical energy furnished to a company so operating is for commercial consumption and is subject to the tax imposed by section 616 of the Revenue Act of 1932. The electrical energy so used is not furnished to a political subdivision of a State within the meaning of section 616(c) of the law.

REGULATIONS 42, ARTICLE 40: Scope of tax. XI–46–5859
S. T. 570

Taxability of electrical energy consumed by agricultural fairs.

Advice is requested whether electrical energy consumed by agricultural fairs is subject to the tax imposed under section 616 of the Revenue Act of 1932.

If the fair qualifies strictly as an agricultural fair conducted by a nonprofit association, no part of the net earnings of which inures to the benefit of any private stockholder or other individual, it is held that the electrical energy consumed in the operation of the fair is not purchased for domestic or commercial consumption and that amounts paid for such electrical energy are not subject to the tax imposed under section 616 of the Revenue Act of 1932.

REGULATIONS 42, ARTICLE 40: Scope of tax. XI–47–5876
S. T. 576

Taxability of electrical energy used by radio broadcasting stations and educational institutions.

Advice is requested whether electrical energy consumed by broadcasting stations and educational institutions is subject to tax under section 616 of the Revenue Act of 1932.

Electrical energy consumed by broadcasting stations operated for commercial or entertainment purposes is subject to the tax. However, where a broadcasting station is owned and operated by an educational or religious institution and is used exclusively for the purpose of broadcasting educational or religious programs in connection with such institutions, electrical energy consumed in such operations is not subject to the tax.

Electrical energy furnished schools, colleges, and universities for consumption in connection with the regular activities of such institutions not operated for private gain is not subject to the tax imposed under section 616 of the Revenue Act of 1932.

REGULATIONS 42, ARTICLE 40: Scope of tax. XI-48-5889
S. T. 584

Taxability of electrical energy lost in remetering.

Advice is requested whether the tax on electrical energy imposed by section 616 of the Revenue Act of 1932 applies to such energy as is lost in remetering to tenants of a building.

The taxpayer purchases electrical energy for resale. However, there is a loss of energy due to line resistance, grounds, shorts, leakages, etc., between the meters through which the energy is originally received and the resale meters.

The tax imposed by section 616 attaches to all amounts paid for electrical energy furnished for domestic or commercial consumption, irrespective of whether any of the energy paid for is actually used. Under the provisions of Treasury Decision 4342 (see on page 495), the only electrical energy which may be purchased tax free is that which is purchased for resale and actually resold by a registered owner or agent of an office building. The balance of the electrical energy is furnished for domestic or commercial consumption in the operations of the office building itself and as such is subject to the tax imposed by section 616 of the Revenue Act of 1932, regardless of the fact that some portion of it may be lost after its receipt.

REGULATIONS 42, ARTICLE 40: Scope of tax. XI-49-5903
S. T. 590

Taxability of electrical energy furnished closed industrial plants.

Advice is requested concerning the application of the tax on electrical energy imposed by section 616 of the Revenue Act of 1932 under the following circumstances:

The X Company owns a number of idle manufacturing plants which are equipped with transformers, thereby incurring a minimum charge in excess of the regular charge for electrical energy actually consumed by these plants during their period of inactivity.

Electrical energy furnished for industrial consumption is not subject to the tax but where such energy is furnished to a plant during a period of time when its industrial activities have temporarily or permanently ceased, the electrical energy so furnished is deemed to be commercial in its scope, irrespective of whether any of the energy paid for is actually used, and the charge paid therefor is subject to the tax imposed by section 616 of the Revenue Act of 1932.

REGULATIONS 42, ARTICLE 40: Scope of tax. XI-51-5940
S. T. 609

Taxability of electrical energy included in rent. S. T. 512 (see on page 498) reconsidered and modified.

Reconsideration is requested of the ruling published as S. T. 512 (which see on page 498), which holds that where the cost of electrical energy is included in the amount paid as rent, office building owners or managers will be responsible for the collection of the tax

imposed by section 616 of the Revenue Act of 1932 on that portion of the rent that is attributable to such energy.

The tax imposed by section 616(a) of the Revenue Act of 1932 is based upon the amount paid for electrical energy furnished for domestic or commercial consumption, and is to be paid by the person paying for such energy and collected by the vendor.

The Bureau has reconsidered S. T. 512 and now holds that where the owner of a building purchases or generates electrical energy and furnishes such energy to the tenants without a charge other than the amount charged as rent, or without submetering it, no tax will attach to energy so furnished tenants, because there is no practical method by which the charge to, or the amount of energy consumed by, them can be accurately determined. S. T. 512 is modified accordingly.

On the other hand, electrical energy furnished by a power company to a building renting space to tenants, for use in its operations as such, is commercial in its scope and is subject to the tax. Under this construction all electrical energy purchased by the building, which it does not submeter or resell for a specific charge, is deemed to be furnished for use in its operations as such and is subject to the tax, regardless of the purpose for which the energy may be used by the tenants. It follows that the building company is liable, under such circumstances, for the tax on all energy purchased by it and must pay the tax thereon at the time when payment for such energy is made to the power company.

The conclusion herein reached does not in any way affect the responsibility of owners or managers of office buildings or apartment houses to collect the tax on payments made for electrical energy when such energy is submetered to the tenants or when a specific charge is made, whether in the form of a minimum charge or a flat charge.

REGULATIONS 42, ARTICLE 40: Scope of tax. XI-52-5956
S. T. 615

Electrical energy furnished to cold storage warehouses for use in the production of refrigeration for storage purposes is commercial in its scope and is subject to the tax imposed by section 616 of the Revenue Act of 1932.

REGULATIONS 42, ARTICLE 41: Exemptions. XI-28-5546
T. D. 4337

* * * * * * *

The second paragraph of article 41 of Regulations 42 is hereby amended to read as follows:

This exemption does not apply to payments for electrical energy for domestic or commercial consumption furnished by governmentally or municipally owned electrical power companies.

RALPH E. SMITH,
Acting Commissioner of Internal Revenue.

Approved June 30, 1932.

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

REGULATIONS 42, ARTICLE 41: Exemptions. XI-31-5587
T. D. 4342

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The fourth and fifth paragraphs of article 41 of Regulations 42 are amended to read as follows:

Persons claiming exemption on the ground that the energy furnished is not for domestic or commercial consumption must submit to the person furnishing the energy satisfactory evidence showing that it was used for purposes other than domestic or commercial.

DAVID BURNET,
Commissioner of Internal Revenue.

Approved July 26, 1932.

OGDEN L. MILLS,
Secretary of the Treasury.

REGULATIONS 42, ARTICLE 41: Exemptions. XI-44-5827
S. T. 552

Insolvent banks are not taxable for electrical energy consumed where payment of the tax would diminish the funds necessary for the full payment of depositors.

Advice is requested whether electrical energy consumed by insolvent banks is taxable under section 616 of the Revenue Act of 1932.

Where electrical energy is furnished for the use of an insolvent bank and collection of the tax would diminish the assets necessary for the full payment of all its depositors, the electrical energy so used is not subject to the tax imposed under section 616 of the Revenue Act of 1932, by reason of the exemption granted in section 22 of the Act of March 1, 1879. (Section 570, Title 12, United States Code.)

In all such cases the person in charge of the insolvent bank must claim exemption from tax under the terms of that law and furnish to the person receiving payment for such electrical energy a statement to the effect that, in his opinion, payment of tax on its use would diminish the assets necessary for the full payment of all its depositors. If it should later transpire that the assets are sufficient to pay the tax due, or any portion thereof, without diminishing the sums due the depositors, payment of the tax, in whole or in part, as the case may be, should be made promptly to the collector.

REGULATIONS 42, ARTICLE 41: Exemptions. XI-47-5877
S. T. 577

A vendee who purchases electrical energy for resale must furnish the power company an exemption certificate each month.

Advice is requested concerning the tax on electrical energy where such energy is furnished for resale.

Section 616 of the Revenue Act of 1932 imposes a tax on electrical energy furnished for domestic or commercial consumption and pro-

vides that such tax shall be paid by the person paying for such energy and collected by the person furnishing the electrical energy for consumption.

It is held (1) that the vendee who purchases electrical energy for resale must give the power company an exemption certificate each month, and (2) that the first vendee shall make the certificate to cover as nearly as possible the same period as the bill of the first vendor.

REGULATIONS 42, ARTICLE 43: Rate of tax. XI–50–5922
S. T. 600

Taxability of electrical energy received through a master meter and remetered.

Advice is requested concerning the tax on electrical energy under section 616 of the Revenue Act of 1932 where it is remetered and sold to tenants of a building.

It is stated that a certain building consumes electrical energy received through its master meter amounting in all to 23,420 kilowatt hours, the cost of which, at the power company's rates, is $533.40. Of the total amount of energy received 11,040 kilowatt hours is remetered and sold to tenants and 12,380 kilowatt hours is consumed for building operation. The power company delivering the energy makes its charges according to the following rates:

500 kilowatt hours, at $0.05.
500 kilowatt hours, at $0.04.
4,000 kilowatt hours, at $0.03.
Balance, $0.02.

Request is made for information concerning the method of computing the tax.

It is held that the tax will attach to the actual amount paid to the power company for the energy which is used in the operations of the building itself.

Where the power company has a schedule of rates which vary according to the number of kilowatt hours used, the tax due on the energy consumed in operating the building should be determined by applying to the total charge the percentage which the number of kilowatt hours consumed in such operation bears to the total number of hours purchased during the month in question.

The cost of the total kilowatt hours consumed in this instance is $533.40. The tax will be computed as follows:

Cost of 23,420 kilowatt hours	$533.40
3 per cent tax on $533.40	16.00
$\frac{12,380}{23,420} \times 16$ tax	8.46

In the example given, the power company should collect and pay to the collector of internal revenue a tax of $8.46 upon that portion of the electrical energy which is consumed in the operation of the building and the owner of the building should collect and pay to the collector of internal revenue a tax of 3 per cent on the amounts paid by the tenants for energy furnished them for domestic or commercial consumption.

SECTION 617.—GASOLINE.

REGULATIONS 44, ARTICLE 5: When tax attaches. XI–42–5797
S. T. 536

No refund of tax can be made where gasoline has been lost or destroyed.

Advice is requested whether a wholesaler who has suffered a loss of gasoline in an electrical storm which wrecked one of the storage tanks filled with gasoline purchased tax-paid from the refiner, may properly file a claim with the Commissioner for the refund of tax reimbursed to the producer on the gasoline that was lost.

The tax under section 617 of the Revenue Act of 1932 is imposed upon, and accrues at the time of, the sale by the importer or by a producer of gasoline. The subsequent use or final disposition of such gasoline has no bearing on the tax. Therefore, no refund of tax may properly be made where gasoline has been lost through fires or other causes.

REGULATIONS 44, ARTICLE 43: Scope of tax.

Tax liability of broker who has storage facilities for oils and gasoline. (See S. T. 486, page 447.)

REGULATIONS 44, ARTICLE 44: Use of terms. XI–35–5645
S. T. 467

Advice is requested as to whether the tax imposed by section 617 of the Revenue Act of 1932 attaches to such articles as ordinary kerosene, tractor distillate, technical naphtha, and crude naphtha.

It is held that ordinary kerosene, tractor distillate, technical naphtha and crude naphtha, the chief use of which is *not* as fuel for the propulsion of motor vehicles, motor boats, or aeroplanes, is not taxable as gasoline under section 617 of the Revenue Act of 1932.

REGULATIONS 44, ARTICLE 44: Use of terms. XI–44–5829
S. T. 554

Taxability of motor benzol and industrial benzol.

Advice is requested relative to the application of the tax imposed by section 617 of the Revenue Act of 1932 to benzol sold by the importer or by a producer.

Section 617 of the Revenue Act of 1932 provides, in part, as follows:

(c) (2) the term "gasoline" means gasoline, benzol, and any other liquid the chief use of which is as a fuel for the propulsion of motor vehicles, motor boats, or aeroplanes.

It appears from the information submitted that there are two distinct grades of the commercial product benzol, namely, motor benzol and industrial benzol, and that they differ substantially in physical and chemical characteristics as well as in their use. It is understood that motor benzol, as the name implies, is a fuel for

motor vehicles, while industrial benzol is not suitable for use as a fuel for the propulsion of motor vehicles, motor boats, or aeroplanes.

Under these circumstances, all sales of motor benzol by the importer or producer are subject to the tax on gasoline imposed by section 617 of the Revenue Act of 1932, and sales of industrial benzol are not subject to the tax.

If, however, any portion of industrial benzol sold tax-free is further processed, manufactured, blended, or compounded until it becomes suitable for use as a fuel for the propulsion of motor vehicles, motor boats, or aeroplanes, sales and uses by the producer of the product so further manufactured, compounded, blended, or processed will be subject to the tax.

REGULATIONS 44, ARTICLE 44: Use of terms. XI–48–5890
S. T. 585

Taxability of Diesel oil.

The chief use of Diesel oil at the present time is not for the propulsion of motor vehicles, motor boats, or aeroplanes, but for the propulsion of ocean-going vessels and ferries and for the operation of stationary engines. Therefore, sales of Diesel oil by the manufacturer, producer, or importer are not now taxable under section 617 of the Revenue Act of 1932.

REGULATIONS 44, ARTICLE 44: Use of terms. XI–49–5904
S. T. 591

The X Company mixes approximately 5 gallons of gasoline with 1½ pints of lubricating oil, not for the purpose of producing a new product but for the purpose of lubricating the cylinder walls of a motor in which the gasoline is being used.

Such operation by the X Company does not make it a producer of gasoline within the meaning of section 617 of the Revenue Act of 1932.

SECTION 619.—SALE PRICE.

REGULATIONS 46, ARTICLE 8: Basis of tax on sales generally. XI–36–5669
S. T. 484

Where a manufacturer bills goods at his regular price and in addition ships certain quantities of the same goods "free," held that the transaction is not a gift of any portion of the goods but is merely a reduction in the regular price charged for the entire lot.

Advice is requested relative to the application of section 603 of the Revenue Act of 1932 to so-called "free goods" delivered by manufacturers and in certain instances delivered by jobbers from tax-paid stock.

It is held that where a manufacturer bills goods at his regular price and in addition ships certain quantities of the same goods "free" the transaction is not a gift of any portion of the goods but

is merely a reduction in the regular price charged for the entire lot. Assuming that this is a sale at wholesale, the tax will attach to the price actually charged for the entire shipment.

Inquiry is also made relative to the liability incurred where a manufacturer sells goods at his regular wholesale price and pays tax on such sales, but thereafter authorizes the purchaser to offer "free" a given quantity of such merchandise in cases where orders are received for a stated quantity. It is understood that upon authorizing the jobber to make such an offer the manufacturer agrees to credit the jobber with that portion of the original purchase price which applies to any goods delivered "free" on such an offer.

Section 621(a)2 of the Revenue Act of 1932 provides in part that a credit or refund may be allowed or made to any person who has paid tax under Title IV with respect to an article, when the price on which the tax was based is readjusted by a bona fide discount, rebate, or allowance, in the amount of that part of the tax proportionate to the part of the price which is refunded or credited.

In the event that the manufacturer allows the jobber a rebate for "free goods," on which tax has been paid, delivered by the jobber in connection with an offer sponsored by the manufacturer, the manufacturer is entitled to claim a credit on his tax return for the month in which the rebate is allowed, or in any succeeding month, for that part of the tax which is proportionate to that part of the price rebated.

REGULATIONS 46, ARTICLE 8: Basis of tax on sales generally. XI-49-5905 S. T. 592

Taxability of and methods of determining sale price in cases of free goods, trial packages, replacements, samples, and bonus goods.

For purposes of the following rulings the word "manufacturer" includes a producer or importer. The questions propounded and the answers thereto are as follows:

Question 1. Where samples of taxable articles are distributed by the manufacturer free of charge to the consumer for advertising purposes, is a tax liability incurred and how is it determined?

Answer. No tax liability is incurred.

Question 2. Is a tax liability incurred where a manufacturer makes gifts of taxable articles to charitable institutions or for other charitable purposes?

Answer. No tax liability is incurred.

Question 3. With the sale of taxable articles the manufacturer gives to the purchaser without charge an additional amount of so-called "free goods" of the same taxable class; does the tax attach in the case of the so-called "free goods"?

Answer. The tax attaches and should be computed upon the price charged the purchaser for the entire order or shipment. See question No. 10, relating to sales of products taxed according to weight or liquid measure.

Question 4. Does the tax attach in the case of a manufacturer who sells trial size packages of taxable articles for a nominal sum ascribed as the cost of postage, packing, etc.?

Answer. The manufacturer is liable for tax based on the actual sales price of the articles.

Question 5. A manufacturer sells to his agents or representatives taxable articles for use as samples, exhibits, or displays. Is there a tax liability in connection with this transaction; and if so, what is the basis for the tax?

Answer. Such a transaction is taxable. The tax must be based upon the sale price of the articles, unless such price is less than the fair market price. If the articles are sold at less than the fair market price, the tax must be based on the price for which such articles are sold in the ordinary course of trade by manufacturers or producers, subject to approval by the Commissioner.

Question 6. A manufacturer supplies taxable articles to his agents or representatives, without charge, for the purpose of replacing articles which have been used as samples or exhibits and which have been lost, destroyed, or rendered unfit as samples or exhibits. Is a tax liability incurred?

Answer. No tax liability is incurred.

Question 7. A manufacturer sells a quantity of taxable articles "A" for $15 and gives the purchaser as a "bonus" or "free goods" a quantity of taxable articles "B" with an ordinary selling price of $5. Articles "A" and "B" are taxable at different rates. How should the tax be computed?

Answer. The tax must be based upon the sale price of the entire order or shipment and allocated to the sale prices of the respective articles. The sale of both classes of articles for $15 represents a reduction in the customary selling price covering both articles of $5, or one-fourth. The actual sale price of the shipment is therefore three-fourths of the ordinary selling price. This fraction should be applied equally to each article to determine the actual selling price. Thus the sale price of article "A" is $11.25 and of article "B" $3.75. The tax must be based upon the respective prices as so determined and at the respective rates provided by the law. Allocations of tax are subject to review by the Commissioner.

Question 8. A manufacturer sells taxable articles and gives the purchaser as a "bonus" or "free goods" certain nontaxable articles. How should the tax be computed?

Answer. The sale price of the entire order or shipment must be allocated between the taxable and nontaxable articles. The tax is imposed only on the sale price attributable to the taxable articles. Assume the sale price of the shipment to be $15 and the normal selling price to be $20, of which $15 is attributable to taxable articles and $5 to nontaxable articles. The sale thus involves a reduction in price of one-fourth. The tax should, therefore, be based on three-fourths of $15, or $11.25, and should be computed at the rate provided by law.

Question 9. A manufacturer sells nontaxable articles and gives the purchaser as a "bonus" or "free goods" certain taxable articles. What, if any, tax is imposed and how should it be computed?

Answer. The sale price of the entire order or shipment should be allocated between the taxable and nontaxable articles. The tax is imposed only on the sale price attributable to the taxable articles. Assume the sale price of the shipment to be $15 and the ordinary selling price $20, of which $5 is attributable to the taxable articles

and $15 to nontaxable articles. This sale thus involves a reduction in price of one-fourth, resulting in the sale price of the taxable articles at three-fourths of $5 or $3.75. The tax is based upon the last-named price and at the rate provided by law.

Question 10. With the sale of articles taxed by liquid measurement, such as lubricating oils, grape concentrate, brewer's wort, etc., and articles taxed by weight the manufacturer gives the purchaser an additional quantity free of charge, as a "bonus" or so-called "free goods." How should the tax be computed?

Answer. Where the tax is based upon the weight or quantity of the product which is sold, the tax is imposed upon the total weight or quantity of the order or shipment, whether or not a portion of the order or shipment consists of a "bonus" or so-called "free goods."

REGULATIONS 46, ARTICLE 8: Basis of tax on sales generally. XI–49–5906 S. T. 593

Methods of determining sale price.

In determining the basis of the tax under section 619 of the Revenue Act of 1932 the amount of tax imposed must be excluded, whether or not billed as a separate item. There are two methods by which manufacturers may bill their goods, (1) tax included, or (2) tax excluded. For example, if an article taxable at 10 per cent of the sales price sells at $100 it may be billed at $110, tax included, or the selling price may be billed as $100 and the tax, $10, as a separate item. If billed at $110, tax included, the amount of tax must be computed by taking $\frac{1}{11}$ of such amount, namely, $10.

REGULATIONS 46, ARTICLE 12: Exclusion of charges for transportation, delivery, etc. XI–39–5736 S. T. 513

Held that transportation or delivery charges excluded in computing the sales price of an article must be supported by adequate records.

Advice is requested relative to the exclusion of transportation and delivery charges in computing the sale price of an article under section 619 of the Revenue Act of 1932.

Various conditions under which goods are sold by a manufacturer and a conclusion with respect to the question of how tax shall be computed in each case, in so far as a transportation or delivery charge is involved, are as follows:

1. A manufacturer sells goods f. o. b. factory or point of origin.

The tax in this case is on the manufacturer's selling price without reference to any freight charges which may be paid by the purchaser to secure delivery of the goods.

2. (a) A manufacturer prepays the transportation charges on goods sold. The same charge is made for the goods in all parts of the United States without reference to the amount of transportation charge which may be involved.

(b) The same situation as (a) with the exception that the manufacturer makes a higher charge for goods delivered to points west of the Mississippi River than is charged for the same goods delivered east of the Mississippi River.

In the cases described under (a) and (b) the price upon which the tax is to be computed is that amount which the manufacturer receives for the taxable article, less the amount of any transportation charges paid by him to effect delivery. In other words, the basic price upon which the tax is to be computed is the difference between the amount the manufacturer receives from its customer (or the invoice price) and the cost of transportation and delivery to the customer.

3. A manufacturer sells taxable merchandise "freight deductible" or "freight allowed." The purchaser, at the time of remitting, deducts from the amount of the invoice any freight charges he may have paid to secure delivery of the goods from the place of manufacture to the purchaser's place of business.

The price upon which the tax should be computed in this case is the amount which the purchaser remits after deducting the transportation costs permitted in accordance with the terms of the sales agreement.

4. A manufacturer located in Bridgeport, Conn., sells goods to a dealer in Kansas City, Mo., f. o. b. Bridgeport, Conn. However, in order to equalize competitive conditions, the manufacturer credits the dealer, as an allowance against the invoice price, with an amount equivalent to the difference between the transportation cost from Bridgeport to Kansas City and the transportation cost from Indianapolis, Ind. (the nearest competing point), to Kansas City.

In this case tax is to be computed upon the invoice price less the amount of the special allowance for the freight differential, provided it does not exceed the amount actually paid by the manufacturer as a transportation charge. In other words, the net return to the manufacturer is the basic sales price for purposes of the tax.

5. A question has arisen in connection with the deduction of drayage charges.

Where a definite amount is paid by a manufacturer of goods to another person performing a transportation service by motor truck, or otherwise, in order to secure delivery of goods at a customer's place of business located in a city other than that in which the manufacturer is located, the amount of such transportation or delivery charges is to be excluded from the price upon which the tax is computed.

No transportation or delivery charges may be excluded in computing the sales price of an article for the purpose of determining the basis of the tax, unless the manufacturer can support the same by adequate records, freight bills, and other evidence of the amount of transportation and delivery charges incurred. The records must be so prepared that a revenue officer may readily determine whether the amount of transportation and delivery charges claimed as a deduction has actually been paid.

REGULATIONS 46, ARTICLE 13: Discounts and adjustments. XI-52-5957 S. T. 616

Method of handling cash discounts.

Advice is requested concerning the proper method of handling cash discounts under the provisions of section 619 of the Revenue Act of 1932.

The taxpayer contends that when an invoice is made out with the amount of the tax figured on the transaction it makes no difference whether the bill is to be discounted or not. He concludes that since the cash discount is not earned until payment is made, the discount can not properly be deducted from the value of the invoice. However, his customer contends that the cash discount should be deducted before computing the tax.

Where goods are offered for sale at a price on which a cash discount will be allowed if and when payment is made within a specified period, the tax should be computed upon the gross amount. The reason for this is that a manufacturer has no way of knowing in advance whether a customer will take advantage of the discount offer. If the customer does take advantage of the offer, the tax should then be computed on the net invoice price. In all cases the tax must be computed upon the gross invoice unless the discount is actually allowed at the time of the sale. If no discount is allowed during the month in which the sale was made but is allowed in a subsequent month, the difference in tax may be adjusted by taking credit therefor in the return for the month in which the allowance is made. When a cash discount is allowed on the price, the amount of the tax should likewise be correspondingly reduced to the purchaser.

REGULATIONS 46, ARTICLE 15: Fair market price in case of retail sales, consignments, etc. XI–52–5958 S. T. 617

Taxability of radio tubes sold by one corporation to another in an affiliated group. Consolidated sales tax returns not authorized.

Advice is requested concerning the basis for computing taxes, under section 619 of the Revenue Act of 1932, where sales of radio tubes are made by one corporation to another in the same affiliated group.

Sales of radio tubes are made by the X Production Corporation to the Y Manufacturing Co. and thence to the Z Company, Inc. The X Production Corporation furnishes all materials entering into the manufacture of the tubes and manufactures them under its own patents or licenses.

Under section 607 of the Act a tax is imposed upon sales made by the manufacturer and under section 619 a method is provided for ascertaining the fair market price upon which the tax shall be computed in those cases where the interests of the vendor and vendee may be the same. Section 619(b)3 is undoubtedly intended to prevent the avoidance of taxes which would easily be possible without its presence in the law. Congress apparently foresaw the probability of the creation of corporations having identical interests, one as the manufacturer and the other as the distributing agency, and sought to impose the tax on the full manufacturer's sales price where the manufacturing corporation sold to the distributing corporation at a nominal price. There are numerous other instances where similar mutual interests could operate to the disadvantage of the Government. Viewing the statute in this light, it must be presumed that Congress did not intend to have two or more affiliated corporations recognized as a single entity for manufacturers' excise tax purposes.

If it had so intended it seems reasonable to believe that some provision would have been made in the statute for such recognition. That no such provision was made, coupled with the fact that transactions not at arm's-length are specifically provided for, leads to the conclusion that the intent was to impose a tax on all sales between such corporations.

That Congress had full knowledge of the conditions existing with reference to affiliated corporate groups is further established by the fact that in the income tax law special provisions appear relating to such groups, under which they are authorized to file consolidated returns. The general laws recognize corporations as separate entities and in the absence of special legislation, such as is incorporated in the income tax provisions of the Act relating to affiliated groups, each corporation, as a separate legal entity, must file a separate return for the purpose of the excise tax.

The contention that the statute should be interpreted to mean the "economic manufacturer," rather than the legal entity, can not be supported either by the language of this particular statute or by the general law relating to corporations. In the absence of specific provisions to the contrary, wherever a statute has spoken of a corporation it has always been interpreted to mean a single legal entity.

The X Production Corporation manufactures the tubes under licenses and patents acquired by the issuance of its stock and apparently does not make the tubes under the specifications, licenses, or patents of the Y Manufacturing Co. nor does it appear that the Y Manufacturing Co. furnishes any of the materials entering into the manufacture of the tubes. But even if it could be held that the Y Manufacturing Co. was the manufacturer, the ruling would not serve the purpose desired. In that case, the tax would have to be imposed on sales to the Z Company, Inc., and thus the tax would attach before a sale to outside interests, it being certain that the Y Manufacturing Co. can not, as a result of the various contracts, be considered the agent of the Z Company, Inc.

For these reasons it is held that the X Production Corporation is the manufacturer within the meaning of the Act. Accordingly, the tax should be computed on the price for which similar radio tubes are sold in the ordinary course of trade by the manufacturers or producers thereof.

SECTION 620.—SALE OF ARTICLES FOR FURTHER MANUFACTURE.

REGULATIONS 44 AND 46, ARTICLE 7: Sales for further manufacture. XI-30-5566 S. T. 460

Advice is requested relative to the provisions of section 601(c)1 and section 620 of the Revenue Act of 1932.

It is stated that some manufacturers of articles such as automobiles, brewer's wort, matches, soft drinks, etc., are insisting that because these articles are taxable under Title IV of the Revenue Act of 1932 the manufacturers thereof are entitled under section

620 of the Act to buy lubricating oil and gasoline, used in the manufacturing processes, tax-free.

Section 620 of the Revenue Act of 1932 provides in part that:

> Under regulations prescribed by the Commissioner with the approval of the Secretary, no tax under this title shall be imposed upon any article (other than a tire or inner tube, or an article taxable under section 604, relating to the tax on furs) sold for use as material in the manufacture or production of, or for use as a component part of, an article to be manufactured or produced by the vendee which will be taxable under this title or sold free of tax by virtue of this section.

It will be noted that under the provisions of section 620 an article may be sold tax-free by virtue of that section, if such article is to be used as material in the manufacture of or as a component part of an article which will be subject to tax under Title IV of the Revenue Act of 1932.

As interpreted the language of section 620 has reference to articles which become a tangible part of a finished product, as, for example, automobile parts and accessories which maintain their form and substance in the structure of the automobile.

It is therefore held that the provisions of section 620 are not applicable to the sales of lubricating oil and gasoline which are expended or consumed in manufacturing processes and which do not become a component material of a finished product subject to the tax under Title IV of the Revenue Act of 1932.

SECTION 621.—CREDITS AND REFUNDS.

REGULATIONS 44, ARTICLE 52: Credits and refunds. XI–46–5860 T. D. 4357

Credits and refunds—Section 621 of the Revenue Act of 1932.—Article 52, Regulations 44, amended.

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

To Collectors of Internal Revenue and Others Concerned:

The first paragraph of article 52, Regulations 44, is hereby amended to read as follows:

ART. 52. *Credits and refunds.*—A credit against tax under Title IV or a refund may be allowed or made to a manufacturer in the amount of any tax under Title IV which has been paid by any person with respect to the sale of any article purchased and used by such manufacturer as material in the manufacture or production of, or as a component part of, an article with respect to which tax under Title IV has been paid, or which has been sold free of tax by virtue of section 620, relating to sales for further manufacture. (See article 7.) The claim for refund must be supported by evidence showing (1) the name and address of the person who paid to the United States the tax for which refund is claimed, (2) the date of payment, (3) the amount of such tax, and (4) the fact that the article was so used. A credit must be supported by evidence of the same character. If it is impossible to furnish such evidence at the time when the credit is taken, a statement to that effect must be submitted with the return in which the credit is taken. The evidence supporting such credit must be filed with the collector within 30 days after the date on which the return is filed. If the required evidence is not so filed within that

period, the amount of the credit will be disallowed and assessment of the tax resulting from the disallowance will be made on the current assessment list.

DAVID BURNET,
Commissioner of Internal Revenue.

Approved November 4, 1932.

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

REGULATIONS 46, ARTICLE 71: Credits and refunds. XI–46–5861 T. D. 4358

Credits and refunds—Section 621 of the Revenue Act of 1932.—Article 71, Regulations 46, amended.

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

To Collectors of Internal Revenue and Others Concerned:

The first paragraph of article 71, Regulations 46, is hereby amended to read as follows:

ART. 71. *Credits and refunds.*—A credit against tax under Title IV or a refund may be allowed or made to a manufacturer in the amount of any tax under Title IV which has been paid by any person with respect to the sale of any article (other than a tire or inner tube) purchased and used by such manufacturer as material in the manufacture or production of, or as a component part of, an article with respect to which tax under Title IV has been paid, or which has been sold free of tax by virtue of section 620, relating to sales for further manufacture. (See article 7.) The claim for refund must be supported by evidence showing (1) the name and address of the person who paid to the United States the tax for which refund is claimed, (2) the date of payment, (3) the amount of such tax, and (4) the fact that the article was so used. A credit must be supported by evidence of the same character. If it is impossible to furnish such evidence at the time when the credit is taken, a statement to that effect must be submitted with the return in which the credit is taken. The evidence supporting such credit must be filed with the collector within 30 days after the date on which the return is filed. If the required evidence is not so filed within that period, the amount of the credit will be disallowed and assessment of the tax resulting from the disallowance will be made on the current assessment list.

DAVID BURNET,
Commissioner of Internal Revenue.

Approved November 4, 1932.

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

SECTION 626.—RETURN AND PAYMENT OF MANUFACTURERS' TAXES.

REGULATIONS 46, ARTICLE 73: Penalties and interest. XI–44–5830 S. T. 555

(Also Section 1114, Revenue Act of 1926.)

Manufacturer liable for tax on goods shipped on consignment to a jobber or dealer and for penalties and interest due to delinquencies of latter.

Advice is requested whether the X Company (a manufacturer) or the jobber or dealer to whom goods are sold on consignment is liable

for the penalties imposed by section 1114 of the Revenue Act of 1926, where the jobber or dealer fails to report sales to the X Company.

Article 15 of Regulations 46 provides that where a manufacturer consigns taxable articles to a jobber or dealer, retaining ownership in them until they are disposed of by the jobber or dealer, title does not pass and the tax does not attach until sold by such jobber or dealer. The relation between the manufacturer and the jobber or dealer is, therefore, in substance that of principal and agent. The manufacturer, accordingly, is responsible not only for the tax due on the sales of such articles but also for any penalty or interest arising from delinquency on the part of the jobber or dealer in failing to report to him his sales for the month.

Section 1114 of the Revenue Act of 1926 does not apply to the jobber or dealer, because he is not the person liable for the tax. It is, therefore, incumbent upon the manufacturer to secure monthly reports of sales from jobbers or dealers who have goods on consignment. In the event a jobber or dealer willfully fails to report his sales monthly to the manufacturer, the latter should clearly state such facts on his monthly return, and show that the tax returned is incomplete. The manufacturer should agree to file an amended return and pay the tax due as soon as reports of the sales are received from the jobber, and not later than 30 days after the monthly return is made. Failure to do so will subject the manufacturer to liability for penalties and interest provided by law.

In all such cases liability for tax by the manufacturer must be based on his fair market price and not on the price for which the articles are sold at retail.

SECTION 627 (SECTION 1121, ACT OF 1926).—EXPORTS, AND SHIPMENTS TO POSSESSIONS OF THE UNITED STATES.

REGULATIONS 46, ARTICLE 75: Proof of exportation. XI–35–5655 S. T. 477

Requirements in parcel post shipments.

An opinion is requested relative to proof of exportation on parcel post shipments.

It is held that in connection with exportation made by parcel post, the manufacturer should have a form prepared to be used with each package exported on which should be shown such information as the destination, order or invoice number, the contents of the package, the name of the vendee, etc. Upon mailing the package described in the form, he should have the form stamped by the local postmaster as evidence of said package having been received by him for exportation by parcel post.

REGULATIONS 46, ARTICLE 77: Misrepresentation of tax. XI–30–5569 S. T. 462

Dealers in articles of classes taxable free to fix prices at which they sell goods.

An opinion has been requested as to whether there is any provision of law to prevent holders of merchandise on which no tax has been

paid from increasing prices to the purchaser on the ground that the tax renders necessary such advances.

Dealers in articles of the classes taxable under the Revenue Act of 1932 are, of course, free to fix the prices at which they sell those articles. However, section 1123 of the Revenue Act of 1926, which under section 627 of the Revenue Act of 1932 is applicable to the taxes imposed by Title IV of that Act, provides as follows:

> Whoever in connection with the sale or lease, or offer for sale or lease, of any article, or for the purpose of making such sale or lease, makes any statement, written or oral, (1) intended or calculated to lead any person to believe that any part of the price at which such article is sold or leased, or offered for sale or lease, consists of a tax imposed under the authority of the United States, or (2) ascribing a particular part of such price to a tax imposed under the authority of the United States, knowing that such statement is false or that the tax is not so great as the portion of such price ascribed to such tax, shall be guilty of a misdemeanor and upon conviction thereof shall be punished by a fine of not more than $1,000 or by imprisonment not exceeding one year, or both.

Under section 1123 it is a criminal offense for a dealer who increases the price of merchandise in his hands on June 21, 1932, in order to take advantage of the competitive situation arising out of the imposition of the taxes under the Revenue Act of 1932, to represent falsely in any way that the increase is due to a tax paid on the merchandise.

GENERAL PROVISIONS

REGULATIONS 46. XI-35-5648
S. T. 469

Articles imported on which duty has been paid.

An opinion is requested as to whether duty paid on imported articles may be deducted from tax due on sale price.

It is held that when a duty has been paid upon ingredients and component parts imported and later assembled in the United States as a complete article, the duty may not be deducted from any tax due on the sale price of the manufactured article.

TITLE V.—MISCELLANEOUS TAXES. (1932)

SECTION 701.—TELEGRAPH, TELEPHONE, RADIO, AND CABLE FACILITIES.

REGULATIONS 42, ARTICLE 2: Transmission. XI-36-5670
S. T. 485

Test of taxability of messages sent from a pharmacy.

Advice is requested concerning the taxability of messages transmitted via pharmacy telephone lines to the Y Telegraph Co.

It is held that where the pharmacy is an agent of the Y Telegraph Co. and a message is delivered to it by a sender and transmitted by use of a telephone line to the telegraph office and from there by use of telegraph lines to the addressee, and a single charge is made for such combined service, there is one message and one transmission, which is taxable at the rate of 5 per cent of the total amount charged therefor.

Where, however, the pharmacy is not the agent of the Y Telegraph Co., and the sender uses its telephone line to reach a tele-

graph office to secure the transmission of the telegraph message, and a separate charge is made for each service, the transmission of the telegraph message begins at the telegraph office. In this case there are two distinct messages, one transmitted by the use of telephone facilities and the other by the use of telegraph facilities. If the amount charged for the telephone message is 50 cents or more, it is taxable at the rates prescribed in section 701(a)1(A). The telegraph message is taxable at the rate of 5 per cent of the amount charged therefor, as prescribed in section 701(a)1(B).

REGULATIONS 42, ARTICLE 3: Basis and rate of tax. XI-39-5733 T. D. 4356

Tax on telegraph, telephone, radio, and cable facilities—Section 701, Revenue Act of 1932.—Article 3, Regulations 42, amended.

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

To Collectors of Internal Revenue and Others Concerned:

Article 3 of Regulations 42 is amended by inserting after the fourth paragraph thereof a new paragraph as follows:

Radiophone conversations originating in the United States are subject to tax as telephone conversations at the rates imposed under section 701(a)1(A). Overland radio dispatches and messages and overland radiograms are taxable as telegraph dispatches and messages at the rate of 5 per centum of the charge therefor, regardless of the amount of the charge. Radiograms in marine service, including service on the Great Lakes and the Gulf of Mexico, are subject to tax as cable and radio dispatches and messages at the rate of 10 cents for each dispatch or message transmitted for which a charge is made.

DAVID BURNET,
Commissioner of Internal Revenue.

Approved September 21, 1932.

OGDEN L. MILLS,
Secretary of the Treasury.

REGULATIONS 42, ARTICLE 9: Basis and rate of tax. XI-49-5907 S. T. 594

Taxability of wires and instruments leased to a person who has exclusive use thereof.

Advice is requested relative to the application of the tax on telegraph, telephone, radio, and cable facilities imposed by section 701 of the Revenue Act of 1932.

It appears that the M Board of Trade owns an office building, rents offices therein, and operates a grain exchange. Telephones have been installed with wires running directly from the trading floor of the exchange to individual offices in the building. These wires and instruments are leased to members at a rental of a certain sum per month. No telephone exchange is operated in connection with them. A person desiring to use the telephone simply removes

the receiver from the hook and a signal flashes in the office with which the telephone is connected, and vice versa.

It is held that in such a case, where wires and instruments are leased to a person and he has exclusive use thereof, the amount paid therefor is taxable under section 701(a)2 of the Revenue Act of 1932 as a leased wire or talking circuit special service, even though the facilities in question are confined to the building in which the lessee's office is located. The tax is payable by the person making payment for the service furnished.

Under those circumstances the M Board of Trade is performing the functions of a telephone company and is entitled to exemption on the amount paid to other telephone companies for so much of a leased wire or talking circuit special service as is utilized in the conduct of its business as a telephone company. The M Board of Trade will be required to collect and report such tax to the collector of internal revenue, in accordance with the provisions of Chapter VI of Regulations 42.

REGULATIONS 42, ARTICLE 20: Public press. XI-32-5603
T. D. 4345

Tax on telegraph, telephone, radio, and cable facilities—Section 701 of the Revenue Act of 1932.—Article 20, Regulations 42, amended.

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

To Collectors of Internal Revenue and Others Concerned:

The last paragraph of article 20 of Regulations 42 is hereby amended to read as follows:

The exemption from tax authorized with respect to any payment received for services or facilities of this character applies only to amounts charged to newspapers or press associations for messages from one newspaper or press association to another newspaper or press association or to or from their bona fide correspondents which deal exclusively with the collection of news for the public press or with the dissemination of news through the public press.

RALPH E. SMITH,
Acting Commissioner of Internal Revenue.

Approved August 4, 1932.

OGDEN L. MILLS,
Secretary of the Treasury.

REGULATIONS 42, ARTICLE 44: Duty to collect, return, and pay tax. XI-29-5558
T. D. 4338

Tax on telegraph, telephone, cable, and radio facilities.—Section 701, Revenue Act of 1932.

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

To Collectors of Internal Revenue and Others Concerned:

Article 44 of Regulations 42 is amended by inserting after the first paragraph thereof a new paragraph as follows:

Every person transmitting any telegraph, telephone, cable, or radio dispatch, message, or conversation "collect" to a point outside the United States, and

receiving, whether from a connecting carrier or otherwise, any payment for the transmission, shall collect the tax and make return thereof in accordance with article 46.

DAVID BURNET,
Commissioner of Internal Revenue.

Approved July 12, 1932.

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

REGULATIONS 42, ARTICLE 44: Duty to collect, return, and pay tax. XI–44–5831 S. T. 556

A telegraph company is liable for collection of tax for messages collected and delivered by its agent to the telegraph company for transmission.

Advice is requested relative to who is liable for the collection of the tax imposed by section 701 of the Revenue Act of 1932 on the transmission of dispatches by telegraph under the following circumstances:

The X Company has an arrangement or contract with the Y Telegraph Co. whereby the X Company is paid a commission on all telegraph business which the X Company originates with its telephone subscribers. The X Company accepts the Y Telegraph Co's. messages from its subscribers, delivers them to the Y Telegraph Co. for transmission, and collects the full amount of the charge for the entire service. Monthly statements are made by the Y Telegraph Co. to the X Company in which the X Company is billed for the amount of the business originated by the X Company less commissions thereon.

It is understood that the dispatches and messages are limited to those to be transmitted by telegraph, and, accordingly, the X Company is acting merely as an agent for the Y Telegraph Co. Therefore, the Y Telegraph Co. is the party which renders the taxable service under the circumstances and is liable for the collection and return of the tax on the amount paid by the senders for such messages. If a telephone toll message originates on the X Company line, that company will be responsible for the collection and return of the tax on such telephone toll message.

SECTION 711.—ADMISSIONS.

REGULATIONS 43, ARTICLE 1: Basis, rate, and computation of tax. XI–40–5757 S. T. 519

Taxability of reduced rate admission charge for whole family.

Advice is requested relative to the taxability under section 711 of the Revenue Act of 1932 of an admission charge of 50 cents which covers admission for a whole family.

On one night of each week the motion-picture theater admits a whole family for 50 cents, and if there is a single admission ticket sold to an individual the charge is 35 cents.

If the established price of admission to the theater on that night is only 35 cents, such admission charge, being less than 41 cents, is not subject to the tax. The reduced rate of admission of 50 cents for an entire family is, therefore, not subject to tax, since it covers the admission for two or more persons, and since the single admission is only 35 cents.

REGULATIONS 43, ARTICLE 12: Admissions to which exemption applies. XI–45–5845 S. T. 563

Taxability of student activity fee and of season tickets sold to students and members of the faculty.

Advice is requested relative to the liability of certain universities for collection of tax on admissions imposed by section 500 of the Revenue Act of 1926, as amended by section 711 of the Revenue Act of 1932, on certain payments made by students.

In the X University the students are required to pay a certain sum for nontransferable student books entitling them to admission to all athletic games and other events during a specified period. In this case and in other cases where the fee so required from students is collected in addition to the regular tuition fees, the payment is deemed to be in the nature of a student activity fee rather than a charge for admission and is not, therefore, subject to the tax in question.

In the Y University, however, there is no student activity fee and regular season tickets are sold to members of the faculty and to students or others, the purchase being a purely voluntary transaction. The amount paid for such tickets may not properly be classified as a "student activity fee" and is taxable. Likewise, the amount paid for season tickets by members of the faculty of the X University or by its alumni is subject to the tax.

REGULATIONS 43, ARTICLE 29: Requirements applicable to tickets XI–41–5778 S. T. 528

Passes used to gain admission to a theater are considered tickets of admission and must show the established price of admission and the amount of tax where the established price of admission exceeds 40 cents.

Advice is requested concerning the taxability under section 711(a) of the Revenue Act of 1932 of passes issued by theater owners and whether these passes must show the established price of admissions, especially where such price is less than 41 cents.

If the passes issued constitute tickets of admission and are used by the holder to gain admission to the theater, they are subject to the requirements imposed by Regulations 43, article 29, as to the printing of admission tickets. If the established price of admission exceeds 40 cents, the passes must show the amount of tax due based on the established price of admission. If the established price of admission is less than 41 cents, the passes need not show such data. In the event that any passes given are in effect orders for tickets and may not be used to gain admission but must be exchanged for regular

admission tickets, no printing of established price and tax on such passes is necessary, but the regular admission tickets for which these passes are exchanged must show such information if the established price exceeds 40 cents.

REGULATIONS 43, ARTICLE 29: Requirements applicable to tickets. XI–50–5923 S. T. 601

Method of computing tax on a ticket of admission sold for $1, including tax.

Advice is requested concerning the tax due, and the proper form in which the ticket should be printed, where a ticket of admission is sold for the total sum of $1, including tax.

The form of ticket suggested shows "admission 90 cents, Federal tax 10 cents, total admission $1." The tax due on an admission charge of 90 cents is 9 cents and it is not permissible to collect a tax of 10 cents on an admission charge in that amount.

In the event that the established price of admission is 91 cents, the tax due will be 10 cents (1 cent for each 10 cents or fraction thereof), making a total of $1.01. In such a case, however, the Bureau has approved the following method of collecting the tax and printing the admission tickets:

Admission 91 cents, tax 10 cents, total $1.01, reduced price $1.

In such a case, the tax of 10 cents must be paid on each admission ticket.

SECTION 722.—ISSUES OF STOCK, ETC.

REGULATIONS 71, ARTICLE 25: Basis of tax. XI–51–5941 S. T. 610

Taxability of issues of stock in connection with a merger of corporations.

Advice is requested whether, in the case of a statutory merger of two or more companies, the issue of stock representing only the excess of the combined capital of the corporations is subject to the tax imposed by section 722 of the Revenue Act of 1932.

One question involved is whether a statutory consolidation or a statutory merger is effected. Where two or more corporations combine and continue business through a newly created corporation, a consolidation is effected. Where two or more corporations combine under the amended charter of one of the corporations, which is a party to the agreement and is to continue, a merger is effected.

From the evidence submitted in the instant case, it is apparent that the X Steel Corporation was organized to take over the assets and assume the liabilities of the Y Steel Co. and the Z Steel Co. Therefore, a new entity was created and the entire issue of stock by the new corporation was subject to tax.

Where a statutory merger is effected the stock issued to the stockholders of the merging corporations represents an original issue of stock and is subject to tax as such.

SECTION 723.—SALES AND TRANSFERS OF STOCK.

REGULATIONS 71, ARTICLE 32: Rate of taxation. XI-51-5942
S. T. 611

Taxability of stocks when changed from no par value to par value of $5 each.

Advice is requested relative to the stamp tax liability imposed by section 723(a) of the Revenue Act of 1932, on the following transaction:

The shares of capital stock of a corporation have been changed by amendment of its certificate of incorporation from shares of no par value to shares of the par value of $5 each, share for share. All certificates issued on transfers of its stock since such amendment became effective have the new $5 par value indicated thereon. Its outstanding no par certificates have not been called in for exchange or for the stamping of the new $5 par value thereon.

The particular question presented is whether the corporation was correct in advising its stockholders that the stamp tax applying to the sale or transfer of the shares should be based on the new $5 par value, regardless of whether the certificate they delivered on such sale or transfer is one of its no par value certificates or a certificate having the new $5 par value indicated thereon.

Where the no par value certificates are transferred after the date when the charter was amended, the tax should be measured by the value of the stock as disclosed by the amended charter of the corporation and not by the value printed on the certificates themselves. In the case of the *Goodyear Tire & Rubber Co.* v. *United States* (273 U. S., 100) the Supreme Court concluded that the statements in the certificate of incorporation, as amended, and not those appearing on the face of the stock certificates should control.

In view of this decision, the tax on the transfer of a certificate of stock of the corporation, whether the certificate transferred is one of no par value or one having the new $5 par value indicated thereon, should be computed at the rate of 4 cents on each $100 of face value, or fraction thereof, if the stock is selling for less than $20 per share, or at the rate of 5 cents on each $100 of face value, or fraction thereof, if selling for $20 or more per share. However, if the assignment of an old certificate was made prior to the date when the charter was amended, the tax should be computed on the no par value basis.

REGULATIONS 71, ARTICLE 34(w): Loans of shares or certificates of stock, including intraoffice borrowings. XI-46-5862
G. C. M. 11096

Taxability of loaned or borrowed stock.

An opinion is requested concerning the interpretation of Schedule A-3 of Title VIII of the Revenue Act of 1926, as amended by section 723(a) of the Revenue Act of 1932, in its application to loans of stock. Advice is also requested in this connection as to whether Treasury Decision 3249 is in force in its entirety.

Treasury Decision 3249, approved November 18, 1921, in so far as hereto pertinent, reads as follows:

In Treasury Decision 2685, approved March 30, 1918, this office held, in accordance with an opinion of the Attorney General, that stamp tax applied to transfers of shares or certificates of stock made by a person loaning stock to another borrowing the stock to effect a sale and to the transfer of shares or certificates of stock from a borrower returning them to a lender in fulfillment of the borrower's obligation to buy in and return stock.

In accordance with the rulings therein made, it is further held that the stamp tax applies to all transfers of legal title involved in the practice of so-called intraoffice borrowing, with the exception of such borrowing and returning as is rendered necessary in effecting delivery on a bona fide sale of long stock, where the seller or client broker promptly deposits the stock or certificates in the mails at a point so far removed from the point of delivery as to make actual delivery of said stock or certificates so sold impossible within the prescribed period of time. The ruling in O. D. 105 (S. T. 4-21-220) is modified in conformity herewith.

On November 23, 1921, five days after this Treasury decision was promulgated, the Revenue Act of 1921 became a law. Schedule A-3 under Title XI of that Act exempted from the stock transfer tax "mere loans of stock" and "the return of stock so loaned." This virtually made ineffective the Treasury decision in so far as it related to the borrowing or loaning of stock under the circumstances set forth in its second paragraph. The exemption from tax on transfers involved in making loans of stock was not authorized by the law which was in force when Treasury Decision 3249 was promulgated, namely Schedule A-4 of Title XI of the Revenue Act of 1918. That this is so was made clear by the decision of the Supreme Court in the case of *Provost et al.* v. *U. S.* (269 U. S., 443, T. D. 3811, C. B. V-1, 417), where the court, in referring to the tax on transfers of stock under the Revenue Act of 1917 and the Revenue Act of 1918, said that the plain purpose of the statute was to extend the taxing provisions to all transfers of legal title to shares or certificates. The language of the Revenue Act of 1932 is substantially the same, in this regard, as that incorporated in the Revenue Acts of 1917 and 1918, except for the exemption of transfers involved in returning stock loaned.

The exemption in the Revenue Act of 1921, referred to hereinbefore, was continued in the Revenue Acts of 1924 and 1926. The Revenue Act of 1928 made no change in this respect. The Revenue Act of 1926 was amended by the Revenue Act of 1932 as to the imposition of the tax on transfers of stock, etc. (Section 723, Revenue Act of 1932.) The exemption clauses in the new law, in so far as pertinent to the question under consideration, read as follows:

* * * *Provided further*, That it is not intended by this title to impose a tax upon an agreement evidencing a deposit of certificates as collateral security for money loaned thereon, which certificates are not actually sold, nor upon the delivery or transfer for such purpose of certificates so deposited nor upon the return of stock loaned: *Provided further*, That the tax shall not be imposed upon deliveries or transfers to a broker for sale, nor upon deliveries or transfers by a broker to a customer for whom and upon whose order he has purchased same, but such deliveries or transfers shall be accompanied by a certificate setting forth the facts: *Provided further*, That the tax shall not be imposed upon deliveries or transfers from a fiduciary to a nominee of such fiduciary, or from one nominee of such fiduciary to another, if such shares or certificates continue to be held by such nominee for the same purpose for which they would be held if retained by such fiduciary, or from the nominee to such fiduciary, but such deliveries or transfers shall be accompanied by a certificate setting forth the facts: * * *.

Article 34(w) of Regulations 71 reads as follows:

The following are examples of transactions subject to the tax:
(w) Loans of shares or certificates of stock, including intraoffice borrowings.

From a consideration of section 723 of the Revenue Act of 1932, omitting the exemption in the Revenue Act of 1926 "upon mere loans of stock," it is apparent that Congress intended to impose the tax upon such loans. Mere loans of stock are not, therefore, now exempt from the tax although the return of stock loaned is exempt. A transfer where the stock is deposited as collateral security for money loaned thereon is also exempt. If a loan of stock, be it of whatsoever nature, does not meet this strict requirement, it does not fall within the exemption and the transaction is taxable. It would be contrary to the intent of the law to extend the exemption further than Congress intended, by allowing intraoffice loans of stock to be exempt from tax.

When House Bill No. 10236, which became the Revenue Act of 1932, passed the House and was sent to the Senate, there was eliminated from the bill the exemption theretofore accorded to "mere loans of stock" but there was retained therein the exemption as to the "return of stock loaned." The Senate Finance Committee amended the bill by restoring the eliminated words so that the clause read: "upon mere loans of stock nor upon the return of stock so loaned."

In its report on this bill the Senate Finance Committee, with respect to this change, explained its position as follows (Report No. 665, May 9, 1932, page 46):

The House bill eliminated the provision of existing law exempting loans of stock. Your committee has restored this exemption, since the *loaning of stock is essential to the carrying out of many legitimate transactions, such as the sale of stock by those living at a distance from the stock exchange.* [Italics supplied.]

When the House bill, as so amended, came up for consideration in the Senate, the amendment proposed by the Finance Committee was rejected. (Congressional Record, May 30, 1932, page 11890.) In the course of the discussion on this amendment proposed by the Finance Committee Senator Reed said, in part (Congressional Record, May 30, 1932, page 11884):

Under the rules of the New York Stock Exchange delivery must always be made by 15 minutes after 2 o'clock of the day following a sale. It is obviously impossible for a security holder living more than 24 hours from New York to sell there on telegraphic order and complete the transaction by 2.15 of the following day. One result, therefore, of the adoption of the motion of the Senator from Montana would be to make it cost every American who lives more than 24 hours from New York twice as much as it costs a New Yorker to perform the same action. We would be putting a penalty upon the country; we would be giving a further advantage to the man who lives in New York City. We would let the New Yorker perform exactly the same act performed by the man living at a distance for just one-half the cost. It did not seem to the committee that that would be fair.

From the action of the Senate and from the discussion on the amendment proposed by the Senate Finance Committee in endeavoring to restore the exemption of loans, it is obvious that situations such as were contemplated in the second paragraph of Treasury Decision 3249, supra, were also considered by Congress in the enactment of the Revenue Act of 1932. The fact that Congress had such

situations in mind when the exemption on loans was denied indicates very clearly that the exemption accorded by the second paragraph of Treasury Decision 3249, supra, was not approved by Congress, but that, on the contrary, Congress intended to tax all transfers involved in making loans of that kind.

It has been contended, however, that so-called "intraoffice borrowings" or "intraoffice loans" are, in most cases, not loans at all. Whether a so-called "intraoffice loan" is taxable or not depends on whether there is actually a "loan" of stock to the selling customer. The conclusion to be reached necessarily depends upon the circumstances of each case. If the selling customer indorses his certificate and delivers it to a branch house or agent of the broker at a point beyond the 24-hour limit, such delivery (being a delivery to an agent of the broker) is equivalent to a delivery to the broker. As shares of stock are fungible. the broker may use any available certificates in his possession to make delivery on the sale, and such action would not constitute a loan of stock to the customer. Or if a selling customer at a distance indorses his certificates and delivers it to a client broker of the broker or to a correspondent of the broker, and such client broker or correspondent has to his credit with the broker at the exchange shares sufficient to make delivery on the sale made by the selling customer, such delivery does not involve a loan of stock.

In all other cases where a selling customer or a client broker or a correspondent has not made available to the delivering broker sufficient shares wherewith to make delivery under the sale, but stock is secured elsewhere and delivery is made under the rules of the exchange, such delivery necessarily involves a loan of stock which is taxable.

For the foregoing reasons this office is of the opinion that Treasury Decision 3249 is no longer in force as an entirety, but that, on the contrary, the portion thereof which exempts an actual loan of stock has been revoked by reason of the provisions of section 723 of the Revenue Act of 1932, as construed in the light of the opinion of the Supreme Court in the Provost case, supra, and in view of the promulgation of article 34(w) of Regulations 71.

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

Regulations 71, Article 35: Sales or transfers not subject to tax. XI–48–5891 S. T. 586

The surrender by a corporate stockholder of certificates of stock in exchange for new certificates for the sole purpose of reflecting a mere change in the name of the corporate stockholder is not a sale or transfer subject to tax under section 723 of the Revenue Act of 1932.

Regulations 71, Article 35: Sales or transfers not subject to tax. XI–49–5908 S. T. 595

Taxability of transfers of stocks to a trustee in bankruptcy.

Advice is requested whether a tax liability is incurred under section 723 of the Revenue Act of 1932 where stock standing in the name

of a bankrupt stockholder is transferred to the name of his trustee in bankruptcy.

Upon his appointment and qualification, a trustee of the estate of a bankrupt becomes vested by operation of law with the title of the bankrupt.

Consequently, transfers of the stock into the name of the trustee in bankruptcy will not incur the transfer tax imposed by Schedule A–3 of Title VIII of the Revenue Act of 1926, as amended by section 723(a) of the Revenue Act of 1932.

SECTION 724.—STAMP TAX ON TRANSFER OF BONDS, ETC.

REGULATIONS 71, ARTICLE 120: Basis of tax. XI–40–5758
S. T. 520

Taxability of sale or transfer of bonds purchased for client.

Advice is requested relative to the stamp tax liability, imposed by section 724 of the Revenue Act of 1932, incurred on the sale of bonds under the following described circumstances:

A customer gives an order to buy a $1,000 bond at 80 net to him. The bond is purchased from another bond dealer at 78 and when the bond is received the memorandum of sale accompanying it has affixed one 40-cent documentary stamp. The bond is delivered to the customer at 80, without placing another stamp either on the bond or on the memorandum of sale. The memorandum of sale received from the bond dealer bearing the canceled stamp is then placed in the purchaser's tax file.

The transaction includes both a purchase and a sale and, consequently, the bond may not properly be delivered to the customer on the single stamped memorandum of sale executed by the bond dealer from whom the purchase was made. The transfer to the name of the customer incurs a second transfer tax and it will be necessary to execute a second memorandum of sale, to which the stamps should be affixed, covering the resale of the bond to the customer. The stamped memorandum of sale should accompany the bond when it is presented to the transfer agent for transfer, or delivered to the customer.

REGULATIONS 71, ARTICLE 120: Basis of tax. XI–41–5779
S. T. 529

Taxability of bonds surrendered for retirement and cancellation.

Advice is requested whether it is necessary to affix stamps on bonds which are surrendered to a trustee for retirement and cancellation under the terms of a corporate mortgage.

Where bonds are surrendered to a trustee acting under a trust indenture, or to the issuing corporation, for immediate cancellation, the transfer tax imposed by section 724 of the Revenue Act of 1932 is not incurred. If, however, the bonds are not canceled but are retained for resale, the surrender of the bonds constitutes a taxable transaction.

REGULATIONS 71, ARTICLE 120: Basis of tax. XI-42-5798
S. T. 537

Taxability of bonds delivered to a broker for sale.

Advice is requested whether bond sales made through brokers and agents are taxable on each transaction under section 724 of the Revenue Act of 1932.

Under the provisions of section 724 of the Revenue Act of 1932 the tax on the transfer of bonds is not imposed upon deliveries or transfers to a broker for sale, or upon deliveries or transfers by a broker to a customer for whom and upon whose orders he has purchased the same, provided such deliveries or transfers are accompanied by a certificate setting forth such facts. This exemption, however, does not apply to deliveries or transfers to banks, trust companies, or investment bankers.

If the A Company merely acts as agent for a purchaser and at the time of the sale instructs the broker to transfer the bonds to the name of the purchaser, only one transfer tax is incurred. However, where the A Company purchases bonds for its own account and later resells them to purchasers, two transfer taxes will be incurred.

SECTION 725.—STAMP TAX ON CONVEYANCES.

REGULATIONS 71, ARTICLE 77: Tax, how computed. XI-38-5714
S. T. 503

Held, that where the purchase price for property is paid in installments, some payments being made before June 21, 1932, and some after that date, the tax should be based on entire purchase price.

Advice is requested concerning the application of the stamp tax on conveyances to a deed conveying real property under the following circumstances:

A purchased an acre of land in 1927, purchase price of which was $1,250. He paid $250 cash and assumed a contract to pay $12.50 per month. When all subsequent payments, together with taxes and interest, have been made, he is entitled to a deed to the property. On June 21, 1932, he still owes a balance of $125, but wishes to pay the balance so that he may obtain his deed.

Held, that the tax should be computed on the total amount of the consideration passing for the transfer of the property, namely $1,250.

REGULATIONS 71, ARTICLE 80: Deed dated prior to June 21, 1932, but acknowledged and delivered after that date. XI-50-5924
S. T. 602

A deed delivered after June 21, 1932, is taxable.

A deed is not effective unless and until it is delivered. The tax accrues upon delivery of the deed to the grantee or his agent on or after June 21, 1932, regardless of the fact that the contract of sale might have been entered into and a part of the consideration paid prior to that date.

REGULATIONS 71, ARTICLE 82: Deeds conveying property sold under foreclosure or execution. XI-42-5799 S. T. 538

Taxability of deeds conveying property sold under foreclosure or execution.

Advice is requested concerning the taxability of certain deeds of conveyance under the provisions of section 725 of the Revenue Act of 1932.

Paragraph 8, added to Schedule A, Title VIII, of the Revenue Act of 1926, by section 725 of the Revenue Act of 1932, imposes a tax on any instrument by which realty sold is conveyed to the purchaser and the consideration involved is in excess of $100. The tax accrues upon delivery of the instrument to the grantee or his agent. Deeds executed by masters in chancery, sheriffs, clerks of court, etc., to cover transfers of property sold under a foreclosure or execution, are subject to tax. The grantee or vendee may be required to pay the tax or the cost of revenue stamps may be included in the expenses of a foreclosure sale.

If, under the laws of a State, the certificate of sale operates to vest title to realty, the delivery of this instrument to the grantee on and after June 21, 1932, the effective date of the stamp tax provisions of the Revenue Act of 1932, is taxable, and stamps in evidence of the payment of the tax should be affixed to such instrument and canceled. The deed required to be executed and delivered at the expiration of 15 months from the date of sale, being simply confirmatory, would not be subject to the tax.

If, on the other hand, title to the property is actually conveyed for the first time by a deed executed and delivered 15 months after the sale, stamps should be affixed to such deed delivered on and after June 21, 1932.

REGULATIONS 71, ARTICLE 98: Deed to building and loan association. XI-52-5959 S. T. 618

An explanation is requested concerning article 98 of Regulations 71 under the Revenue Act of 1932, which reads as follows:

A deed transferring title to property to a building and loan association for the purpose of securing a loan on the property so conveyed, which property is immediately reconveyed to its owner, is not subject to tax, the deed of reconveyance being likewise exempt.

The question raised is how a deed can secure a loan if the property is immediately reconveyed to the borrower.

The article referred to applies where the borrower conveys realty by warranty deed to the lender, and where the lender, in turn, reconveys it to the borrower. These transactions establish the relation of vendor and purchaser between lender and borrower, respectively, with security for the loan in the form of a vendor's lien on the realty.

Under such circumstances neither deed constitutes a conveyance of realty within the meaning of section 725(a) of the Revenue Act of 1932. The conveyances, taken together, accomplish the same result in securing the debt as does a real estate mortgage executed by the borrower in favor of the lender.

SECTION 731.—TRANSPORTATION OF OIL BY PIPE LINE.

REGULATIONS 42, ARTICLE 26: Basis of tax. XI-40-5759
S. T. 521

Transportation of gasoline by pipe line, similar to movements which pipe-line carriers usually undertake and perform, held taxable under section 731 of the Revenue Act of 1932.

Advice is requested whether the tax imposed by section 731 of the Revenue Act of 1932 applies under the following circumstances:

The X Company owns and operates a 2-inch pipe line from its gasoline plant to a city approximately 29 miles away. The line connects the gasoline plant and the loading dock at the city and is used exclusively by the X Company in transporting its own product. At the dock the gasoline is loaded into tank cars and transported to the consignee.

The movement is not merely local or incidental to the production or refinement of gasoline. It is substantially similar to movements which pipe-line carriers usually undertake and perform with respect to delivery service to tank cars through loading racks.

It is held that the movement of gasoline under the circumstances above set out is taxable under section 731 of the Revenue Act of 1932.

REGULATIONS 42, ARTICLE 26: Basis of tax. XI-45-5846
S. T. 564

Transportation of natural or casing head gasoline by pipe line is taxable.

Natural or casing head gasoline is a liquid product of crude petroleum, within the meaning of section 731 of the Revenue Act of 1932, and the transportation thereof by pipe line is subject to the tax imposed by that section of the law. (See *Wemple* v. *Producers' Oil Co.*, 145 La., 1031, 83 So., 232; *Locke* v. *Russell*, 75 W. Va., 602, 84 S. E., 948; *Livingston Oil Corporation* v. *Waggoner*, 273 S. W., 903; *Connellee et al.* v. *Magnolia Petroleum Co.*, 279 S. W., 597; *Gilbreath* v. *States Oil Corporation*, 4 Fed. (2d), 232; *Twin Hills Gasoline Co.* v. *Bradford Oil Corporation*, 264 Fed., 440.)

REGULATIONS 42, ARTICLE 26: Basis of tax. XI-51-5943
S. T. 612

Transportation of oil by pipe line to destinations inside and outside the United States.

Advice is requested relative to the tax imposed by section 731 of the Revenue Act of 1932 on oil received for transportation to destinations inside the United States and on oil received for transportation and consigned to, and moving to, a destination outside the United States.

No tax attaches to the continuous transportation of oil by pipe line to foreign ports or places. Oil is in course of exportation when it has been started on its final voyage or delivered to a carrier for

continuous transportation from its point of origin to points beyond the boundaries of the United States.

The test of tax exemption on transportation of oil intended for exportation is the continuity of the movement from the point of origin in the United States to its foreign destination. The mere intent of the shipper or the contents of the shipping document are not conclusive on this point. For instance, it may be that the shipper intends that the oil moving in commerce ultimately will go into export trade, but before exporting the oil he intends to subject it to further manufacture. He may consider the movement from the point of origin to point of manufacture a part of the exportation movement, but if there is a stoppage in transit for a manufacturing process the transportation to the place of manufacture is domestic only and subject to tax. In other words, the movement must be continuous. In case there is a break or coming to rest of the property at any point in transit to a foreign destination, it is held that there are two separate and distinct movements—one being from the point of origin to the stopping point, which is a complete domestic movement and taxable; and the second being from the stopping point to the port of exportation, which is an export movement and not taxable, provided the property is actually delivered to its foreign destination without any further break in the movement.

In all such cases the person normally liable for the tax must retain, accessible for inspection, evidence of the export character of the oil transportation. This evidence must establish that at the time the oil started from the point of origin, a contract order or other evidence of intention to export the oil for delivery at a place beyond the boundaries of the United States existed, as well as evidence of delivery of the oil to its foreign consignees in a continuous and unbroken movement.

REGULATIONS 42, ARTICLE 44: Duty to collect, return, and pay tax. XI-47-5878 S. T. 578

Joint owners of pipe lines must make separate monthly returns.

Advice is requested relative to who should file returns and pay the tax imposed under section 731(a) of the Revenue Act of 1932 on the transportation of oil by pipe line under the following circumstances: The X Pipe Line Co. and the Y Pipe Line Co. render a joint service covering a continuous movement over two lines. Question arises as to whether one company should report the tax on the entire movement and collect the proportionate sum from the other company, or whether each company should report the tax due on the movement over its line separately.

The tax imposed under section 731(a) of the Revenue Act of 1932 is to be paid by the person furnishing the transportation service. Article 44 of Regulations 42 provides that every person required by the Act to pay any tax on the transportation of crude petroleum and liquid products thereof by pipe line shall make a monthly return and pay the tax due, in accordance with the provisions of article 46.

Where a taxable joint service is rendered by two or more carriers of oil by pipe line, each carrier must return and pay the tax on the particular portion of the service rendered by it, based on the portion of the charge received by it for such service.

SECTION 741.—LEASES OF SAFE DEPOSIT BOXES.

REGULATIONS 42, ARTICLE 30: Effective date. XI–38–5712
S. T. 504

Held that the amount paid for the use of a safe deposit box after June 21, 1932, is subject to tax where both payment and use are after that date.

Advice is requested whether the amount paid for the use of a safe deposit box when both payment and use occur after June 21, 1932, is subject to the tax imposed under section 741 of the Revenue Act of 1932.

It is stated that the renewal of the safe deposit box fee was due during the month of May, 1932; that it was not paid until the month of August, 1932; and that the lessee was required by the bank to pay the tax on the rental charge.

Under section 741(a) of the Revenue Act of 1932 the tax attaches to any amount collected after the effective date of that section for the use after such date of any safe deposit box. Consequently, that portion of the rental charge paid in August which covered the use of the box for the period on and after June 21, 1932, is subject to a tax of 10 per cent of such amount.

REGULATIONS 42, ARTICLE 33: Adjustment. XI–50–5925
S. T. 603

Taxability of rentals for safe deposit boxes where a larger box is leased.

Advice is requested concerning several questions which have arisen relative to the tax imposed by section 741 of the Revenue Act of 1932 on leases of safe deposit boxes. The questions and answers are as follows:

Question. A person leases a safe deposit box on March 1, 1932, for a period of one year, at an annual rental of $15, the full amount for such lease having been paid by the lessee in advance. On November 1, 1932, he leases a larger box, not in excess of 40 cubic feet capacity, at an annual rental of $25, surrendering the old box. The accounting system of the safe deposit company shows that a check was received from the lessee for the payment of $25. The safe deposit company refunds to the lessee an amount of $5 due on the unexpired portion of the original lease. The question is whether the tax of 10 per cent is to be based on the full charge of $25 or on the net amount paid, $20.

Answer. It is held that the tax should be collected on the $25 payment. The provisions of section 772(c) of the Revenue Act of 1932 have no application to payments on which no tax has been collected.

Question. Where a person leases a safe deposit box of 40 cubic feet capacity, or less, subsequent to June 21, 1932, but after that date, upon application, the safe deposit company rents the lessee a larger box than the one originally rented, but of less than 40 cubic feet capacity, and additional rent is collected for the larger space, on what basis is the tax to be computed?

Answer. Where during the period of a lease of a safe deposit box entered into after June 21, 1932, the lessee takes a new lease for another safe deposit box of not more than 40 cubic feet capacity, at a higher rate, and is given credit for the amount paid on the first lease, an additional tax should be collected only upon the additional amount paid under the new lease.

SECTION 751.—CHECKS, ETC.

REGULATIONS 42, CHAPTER IV: Tax on checks, etc. XI–32–5601
T. D. 4344

Chapter IV of Regulations 42, amended.

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

To Collectors of Internal Revenue and Others Concerned:

Chapter IV of Regulations 42 is hereby amended to read as follows:

CHAPTER IV.

TAX ON CHECKS, ETC.

SECTION 751(a) OF THE REVENUE ACT OF 1932.

(a) There is hereby imposed a tax of 2 cents upon each of the following instruments, presented for payment on or after the fifteenth day after the date of the enactment of this Act and before July 1, 1934: Checks, drafts, or orders for the payment of money, drawn upon any bank, banker, or trust company; such tax to be paid by the maker or drawer.

ART. 34. *Effective period.*—The tax attaches to all instruments specified in section 751 when presented for payment to a bank, banker, or trust company on or after June 21, 1932, and before July 1, 1934.

ART. 35. *Use of terms.*—Checks, drafts, and orders for the payment of money include any order in writing, drawn upon a bank, banker, or trust company, requiring the person upon whom drawn to pay a sum certain in money, whether on demand, at sight, or at a fixed or determinable future time.

The term "bank, banker, or trust company" includes any person or institution carrying on the business of, or maintaining an establishment for, the custody, loan, exchange, or issue of money, the transmission of funds by checks, or the acceptance or payment of drafts or orders for the payment of money. The fact that the banking facilities afforded are incidental to any other business carried on will not avoid liability to the tax.

ART. 36. *Scope of tax.*—The tax imposed under section 751 attaches to all instruments of the kind described in article 35 presented for payment within the effective period of the section. It is immaterial whether the instrument is made or drawn in this country or abroad, but in order to be subject to the tax it must be drawn on, payable by, and presented for payment to, a bank, banker, or trust company in the United States.

Instructions given by mail, telephone, telegraph, cable, or radio directly to a bank, banker, or trust company for the transfer or payment of funds are not subject to the tax, since they do not constitute instruments which are presented for payment within the meaning of the Act.

A draft in form drawn upon the drawer, or upon any officer of the drawer, and made payable at or through a designated bank is an order for the payment of money and subject to the tax, unless the bank is under no obligation to the drawer direct or implied to pay such instrument *and* is without authority to charge the amount thereof against an account of the drawer. The instrument would not be subject to the tax in the absence of both such obligation and such authority.

Travel or traveler's checks are subject to the tax.

A check drawn by a cashier or other officer of a bank upon the bank of which he is such officer, is subject to the tax.

Coupons relating to bearer bonds, although payable at a designated bank in the United States, are not "checks, drafts, or orders for the payment of money."

The tax does not attach to the withdrawal of money (1) from a savings account where the item is reflected as an entry on a pass book held by the depositor or (2) from a checking account, provided in either case the withdrawal is evidenced only by a receipt personally tendered to the bank by the depositor.

The checks, drafts, or orders drawn by officers of the United States or of a State, county, or municipality, or of a foreign government, in their official capacities, against public funds standing to their official credit and in furtherance of duties imposed upon them by law, are not subject to the tax.

If an instrument is not paid by the bank, banker, or trust company upon whom or which it is drawn, the tax does not attach.

LIABILITY TO TAX.

SECTION 751 OF THE REVENUE ACT OF 1932.

(a) There is hereby imposed a tax of 2 cents upon each of the following instruments, * * * such tax to be paid by the maker or drawer.

(b) Every person paying any of the instruments mentioned in subsection (a) as drawee of such instrument shall collect the amount of the tax imposed under such subsection by charging such amount against any deposits to the credit of the maker or drawer of such instrument, and shall on or before the last day of each month make a return, under oath, for the preceding month, and pay such taxes to the collector of the district * * *. Every person required to collect any tax under this section is hereby indemnified against the claims and demands of any person for the amount of any payments made in accordance with the provisions of this section.

ART. 37. *Liability.*—Under the terms of the Act the tax is payable by the maker or drawer of the instrument. Every bank, banker, or trust company who pays the instrument as drawee shall collect the amount of the tax by charging the amount of the tax against any deposits to the credit of the maker or drawer of the instrument. (See article 44.)

ART. 38. *Rate of tax.*—The tax attaches at the rate of 2 cents to every check, draft, or order for the payment of money, presented for payment and paid by a bank, banker, or trust company within the effective period of section 751.

DAVID BURNET,
Commissioner of Internal Revenue.

Approved July 29, 1932.

OGDEN L. MILLS,
Secretary of the Treasury.

REGULATIONS 42, ARTICLE 36: Scope of tax. XI-35-5654
S. T. 476

Certain forms of trade acceptances and promissory notes held taxable as orders for the payment of money.

An opinion is requested relative to the applicability of the tax imposed by section 751 of the Revenue Act of 1932 to certain forms of trade acceptances and promissory notes.

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Both the promissory notes and the acceptances printed on the face of the drafts are made payable at a designated bank. An acceptance made payable at a designated bank must be treated, for the purpose of the Federal check tax, as a separate instrument from the draft upon the face of which it is printed. The printed acceptances as well as the promissory notes, when presented to the bank at maturity, are treated by the bank just as checks would be and are debited to the account of the acceptor or maker.

Both the promissory notes and the acceptances are in legal effect written orders for the payment of money. Being directed to a bank, they are orders drawn upon a bank within the meaning of the Act. Accordingly, they are held to be instruments subject to the Federal check tax as imposed by section 751 of the Revenue Act of 1932.

REGULATIONS 42, ARTICLE 36: Scope of tax. XI–40–5760
S. T. 522

Checks issued by a State officer before the effective date of the Revenue Act of 1932, in settlement of rates on fire insurance policies, and presented after the law took effect, are subject to tax.

An opinion is requested whether certain checks issued by the commissioner of insurance of a certain State, in settlement of rates on fire insurance policies, are subject to the tax on checks imposed by section 751 of the Revenue Act of 1932.

The checks in question were impounded pursuant to a court decision and were distributed to policyholders pursuant to a State law. They were issued in October, 1930, and in the months of February, June, and September, 1931. They were issued by a State official but are not State warrants. They are payable through a certain bank. Many of the checks are still unpaid and will probably be presented for payment for some time to come. Any unclaimed checks will revert to the general fund of the State. The State official is of the opinion that because of this fact any tax collected on the checks will eventually be borne by the State.

Under section 751 the presentation of a check for payment after the effective date of the law is one of the tests of taxability. Consequently, the mere fact that the checks in question bear dates in 1930 and 1931 does not warrant exemption from the tax if the checks are presented for payment after the law became effective.

Under a long line of Supreme Court decisions the instrumentalities, means, and operations whereby States engage in the exercise of essential governmental functions are exempt from taxation by the United States. (*Collector* v. *Day*, 11 Wall., 113; *Indian Motocycle Co.* v. *United States*, 283 U. S., 570.) However, where a State departs from its usual governmental functions and engages in other activities, the immunity from taxation does not apply. (*South Carolina* v. *United States*, 199 U. S., 437; Mim. 3838, C. B. IX–2, 137.)

Applying those principles to the facts presented, there is no reason why the distribution of impounded insurance money should be viewed as an essential governmental function warranting tax immunity. The fact that payment of the taxes on checks would serve to

diminish the amount which will be eventually received by the State from unclaimed checks is insufficient to warrant exemption. It is, therefore, held that exemption from the tax on the checks in question, presented on or after June 21, 1932, is not warranted.

REGULATIONS 42, ARTICLE 36: Scope of tax. XI–41–5780
S. T. 530

Taxability of certain instruments.

Advice is requested relative to the application to certain specified instruments of the tax on checks imposed under section 751 of the Revenue Act of 1932.

The tax is imposed upon certain "instruments presented for payment," namely, "checks, drafts, or orders for the payment of money," drawn upon a bank, banker, or trust company. "Checks" and "drafts" are terms which have a well-established meaning. "Orders for the payment of money," intended to be taxed under this section, are such as have some similarity to "checks" and "drafts," at least to the extent that they are capable of being classified as "instruments" and of being "presented for payment." The phrase "presented for payment" implies that the instrument must be capable of having a holder—that is, a person who, by reason of his possession of the instrument, is entitled to receive payment of the sum of money specified therein. Moreover, the instrument must, according to its terms or effect, call for the payment of money. An order or authorization merely to charge a book account does not constitute an order subject to the tax. If the instrument is in fact an order for the payment of money, it is none the less taxable because the payment of money may, in a particular case or even in a number of cases, be accomplished through a book entry.

Where depositors file with a savings bank what is known as a "permanent dividend order," which authorizes the bank to send to the depositor all dividends declared from time to time, neither the continuing authorization nor the separate entries made pursuant thereto are taxable.

Where a depositor borrows from a bank, uses his pass book as collateral, signs a promise to pay to the bank the sum borrowed, and authorizes the bank to charge his account with the amount of the loan, the authorization is subject to the tax.

An order signed by one depositor having a joint account authorizing the transfer of funds to him personally or to himself jointly with another person is not subject to the tax.

An order signed by a trustee authorizing the transfer of funds to the beneficiary of an account which was opened in the name of one person as trustee for another is not subject to the tax.

The tax does not attach to the withdrawal of money (1) from a savings account where the item is reflected as an entry on a pass book held by the depositor, or (2) from a checking account, provided in either case the withdrawal is evidenced only by a receipt personally tendered to the bank by the depositor or by an officer of the depositor, if a corporation or association.

Article 36 of Regulations 42, as amended by Treasury Decision 4344 (see on page 534), provides that:

A check drawn by a cashier or other officer of a bank upon the bank of which he is such officer, is subject to the tax.

In view of this provision, checks issued by the bank in payment of Christmas savings accounts or other similar club funds are subject to the tax.

REGULATIONS 42, ARTICLE 36: Scope of tax. XI–42–5800
S. T. 539

Charitable organizations are subject to tax on checks.

Advice is requested whether checks drawn by charitable organizations engaged in emergency work and by relief bureaus are subject to the tax on bank checks imposed under section 751 of the Revenue Act of 1932.

It is stated that these emergency work agencies and relief bureaus act as agents of emergency unemployment relief committees, and disburse only the donations received to relieve unemployment.

Section 751(a) of the Revenue Act of 1932 imposes a tax of 2 cents upon each check, draft, or order for the payment of money drawn upon any bank, banker, or trust company, and no provision is made for exempting from the tax checks issued by charitable or philanthropic organizations.

Charitable organizations are, therefore, subject to the tax on checks.

REGULATIONS 42, ARTICLE 36: Scope of tax. XI–43–5813
S. T. 546

Taxability of checks, etc., drawn by National Guard units.

Advice is requested whether checks drawn by a National Guard unit are taxable under section 751 of the Revenue Act of 1932, under the following circumstances:

Funds for the support of the unit, furnished by the Federal Government or by a State, or both, are deposited in A Bank. Funds contributed by local organizations, etc., for support of the unit are deposited in B Bank.

Inasmuch as the funds deposited in the A Bank are public funds, within the meaning of the regulations, and as the maintenance of the National Guard is an essential governmental function, checks drawn on funds in the A Bank are not subject to the check tax. The funds contributed and deposited in the B Bank are not public funds and checks drawn thereon are taxable.

REGULATIONS 42, ARTICLE 36: Scope of tax. XI–44–5832
S. T. 557

A stock broker who maintains facilities for marginal trading for his clients; permits them to draw drafts against their marginal accounts, or on credit balances on deposit with the broker; and who

pays such checks at his cashier's window on presentation, is a bank, banker, or trust company within the meaning of section 751 of the Revenue Act of 1932.

REGULATIONS 42, ARTICLE 36: Scope of tax. XI–47–5879
S. T. 579

Taxability of checks transferring funds.

Advice is requested whether the tax imposed under section 751 of the Revenue Act of 1932 applies to checks transferring funds from a depository to a regular disbursing agency.

A transfer of funds by a depositor in one bank to an account in another bank is subject to the tax if the transfer is evidenced by an instrument in the nature of a check, draft, or order for the payment of money. A mere bookkeeping entry transferring funds from one account to another, without the issue of a check, draft, or order for the payment of money, is not taxable.

REGULATIONS 42, ARTICLE 36: Scope of tax. XI–48–5892
S. T. 587

Checks issued by church treasurers or other church officers in settlement of church obligations are subject to the tax imposed by section 751 of the Revenue Act of 1932.

REGULATIONS 42, ARTICLE 37: Liability. XI–50–5926
S. T. 604

Method of securing taxes on checks collected by a bank which becomes insolvent before paying same over to the collector.

Advice is requested whether taxes on checks imposed by section 751 of the Revenue Act of 1932, collected by the X Bank, now insolvent, are Federal funds; and if so, what steps should be taken toward securing such funds from the State bank commissioner.

Section 751 of the Revenue Act of 1932 imposes a tax on checks. It provides that the maker of the check shall pay the tax due thereon and that the bank, banker, or trust company shall collect the amount of the tax "by charging such amount against any deposits to the credit of the maker * * * of such instrument." Thus the maker of the check is the taxpayer and the bank is charged with the duty of collecting the taxes in the manner indicated and of paying them over to the collector of the district.

In the case under consideration it appears that the bank collected the taxes on checks in the manner prescribed by the law, but is now insolvent and can not pay them over to the collector by reason of the fact that it is in charge of a State bank examiner. It is contended that the relation between the bank and the United States is that of bailee and bailor rather than that of debtor and creditor, and that,

therefore, the United States can hold the State bank examiner personally liable for the payment of such tax to the Government without regard to the amounts due the creditors.

Substantially this same question was considered by the Supreme Court in the case of *United States* v. *Johnston* (268 U. S., 220 [C. B. IV–1, 313]). In that case one Johnston was convicted on the charge of failing to pay over to the Government taxes collected by him from persons who paid such taxes on admission charges to certain boxing matches. He was also charged with embezzling the amounts so collected. In the course of its opinion the court said:

* * * it seems to us that under this law the person required to pay over the tax is a debtor and not a bailee. The money paid for the tax is not identified at the outset but is paid with the price of the ticket that belongs to the owner of the show. We see no ground for requiring the ticket office of a theater to create a separate fund by laying aside the amount of the tax on each ticket and to keep it apart, either in a strong box or as a separate deposit in a bank. Reports are required only once a month, sections 802, 502, which does not look as if the Government were dealing with these people otherwise than with others answerable for a tax. Further argument seems unnecessary upon this point.

The person who pays for admission is the one who pays the taxes due thereon, just as the one who draws the check is the taxpayer of the check tax. The theater which collects the taxes on admissions is comparable to the bank which collects the taxes on checks. As the Supreme Court held that the theater was a debtor and not a bailee, so it must also be held in the instant case that the bank is not a bailee but a debtor, and that it and its representative must be dealt with as persons answerable for a debt under sections 3466 and 3467, Revised Statutes.

SECTION 761.—TAX ON USE OF BOATS.

REGULATIONS 72, ARTICLE 5: Boats taxable. XI–37–5690
S. T. 493

Taxability of the use of racing shells, motor launches, and sail boats by colleges for racing purposes.

Advice is requested relative to the taxability under section 761 of the Revenue Act of 1932 of the use of certain racing shells, motor boats, and sail boats, by colleges for racing purposes. The questions and answers are as follows:

Is the use of racing shells over 28 feet over-all length, similar to those used in colleges for racing purposes, taxable?

If the racing shells have no means of self-propulsion, either by engine or sail, no tax would be incurred on the use of such boats.

Is the use of motor launches by colleges exclusively in connection with racing taxable?

If the launches have an over-all length of more than 28 feet, the tax will be incurred on the use of such boats.

Is the use of sail boats over 28 feet over-all length exclusively for racing taxable?

Yes.

REGULATIONS 72, ARTICLE 6: Boats not subject to tax. XI–37–5691 S. T. 494

Substantial use held to be determining factor whether boat is taxable.

Advice is requested whether boats operated by certain oceanographic institutions are subject to tax.

It is stated that an institution has two boats, one 143 feet and the other 45 feet in length; that these vessels are operated entirely for purposes of scientific investigation; and that such data as are obtained are also of interest to the United States Government.

Any boat which is used exclusively during the entire year in connection with any activity which constitutes a person's business, occupation, profession, or means of livelihood, is exempt from the tax. Casual employment at irregular intervals for convenience of the owner or his family, not exceeding such casual employment as is usual for boats maintained or employed in trade or other activity, will not cause the tax to attach. However, where a boat is used in a substantial manner for the pleasure of an owner or his family, such boat will be subject to tax. In other words, substantial use determines whether the boat is taxable.

In view of the circumstances and conditions in connection with the use of the boats by such institutions as those mentioned, it is held that the use of the boats as set forth above will not render such institutions liable for the special tax imposed by section 761 of the Revenue Act of 1932.

TITLE VIII.—STAMP TAX (1926), AMENDED BY TITLE V, REVENUE ACT OF 1932.

SECTIONS 723, 724, 725.—STOCKS, BONDS, DEEDS OF CONVEYANCE.

REGULATIONS 71, ARTICLES 31 AND 120: Basis of tax. XI–43–5814 S. T. 547

Where stocks or bonds are transferred or real estate is conveyed by insolvent banks having assets insufficient to pay their depositors in full, no liability for stamp tax on the transfers or conveyances involved will be incurred by the parties to the transaction.

Advice is requested whether, under the provisions of section 22 of the Act of March 1, 1879, relieving insolvent banks from liability for the payment of Federal taxes, the collection of which would operate to diminish the assets thereof necessary for full payment of depositors, transferees of stocks or bonds or grantees of real estate are subject to the stamp tax imposed by the Revenue Act of 1932 on transfer of stocks and bonds and on conveyances of real estate where the stocks or bonds are transferred or the real estate is conveyed by the secretary of banking of the State of —— and constitute assets of closed banks in his possession having assets insufficient to pay their depositors in full.

Section 22 of the Act of March 1, 1879 (20 Stat., 351, 12 U. S. C. A., 570), provides as follows:

Insolvent banks as exempt from tax.—Whenever and after any bank has ceased to do business by reason of insolvency or bankruptcy, no tax shall be assessed or collected, or paid into the Treasury of the United States, on account of such bank, which shall diminish the assets thereof necessary for the full payment of all its depositors; and such tax shall be abated from such national banks as are found by the Comptroller of the Currency to be insolvent; and the Commissioner of Internal Revenue, when the facts shall so appear to him, is authorized to remit so much of said tax against insolvent State and savings banks as shall be found to affect the claims of their depositors. (March 1, 1879, ch. 125, section 22, 20 Stat., 351; March 3, 1883, ch. 121, section 1, 22 Stat., 488.)

The conclusion has been reached that the taxes in question, although imposed on the transferee as well as the transferor, and on the grantee as well as the grantor, are without application where the transferor or grantor is relieved from liability therefor by section 22 of the Act of March 1, 1879. This conclusion is based on the view that the statutory provision referred to is remedial in character and is to be liberally construed. Its manifest purpose is to relieve depositors from the burden of the tax. To tax the transferee or grantee in such case would be in effect, through the shifting of the burden of the tax to the transferor or grantor, to tax the insolvent bank and thus defeat the purpose of the statute.

It is held accordingly that where the secretary of banking of the State of —— is the transferor of stocks or bonds or the grantor of real estate constituting assets of closed banks in his possession having assets insufficient to pay their depositors in full, no liability for the tax on the transfers or conveyances involved will be incurred by the parties to the transaction, provided such transfers and conveyances are accompanied by an exemption certificate in substantially the following form:

Date _____

This is to certify that the attached (bond/share of stock)_____
(describe fully)
(is) (are) being transferred,[1] conveyance _____
_____
(give date of deed and names of grantor and grantee)
(is) (are) being made[1] pursuant to the liquidation of the _____, an insolvent bank, the assets of which are insufficient for the full payment of depositors. The Commissioner of Internal Revenue has ruled that under section 22 of the Act of March 1, 1879, no stamp tax liability will be incurred by the parties to such transaction. No Federal stamps are therefore attached.

_____
Secretary of Banking of the State of _____.
By _____
Special Deputy in Charge of the Liquidation.

NOTE.—For fraudulent use $10,000 fine and imprisonment. (See section 1114, Revenue Act of 1926.)

The above exemption certificate should be used only where the secretary of banking of the State of —— has determined that the assets of the bank in his possession will be insufficient to pay its depositors in full. If an exemption certificate has been used and it later appears that the closed bank has sufficient assets to pay its depositors in full, the secretary of banking must promptly notify the collector of internal revenue and pay the tax due.

[1] Strike out words inapplicable.

An exemption certificate must not be used where stocks or bonds or real estate, held as collateral or security for a loan, are transferred or conveyed, unless the secretary of banking believes that the loan will not be paid in full. If an exemption certificate has been used and it later appears that the loan will be paid in full, the secretary of banking must promptly notify the collector of internal revenue and pay the tax due.

This ruling is also applicable to insolvent national banks.

TITLE II.—MISCELLANEOUS TAXES. (1928)

DUES AND INITIATION FEES.

REGULATIONS 43(1928), ARTICLE 40: Dues or membership fees. XI-28-5547 Ct. D. 515

TAX ON DUES—REVENUE ACT OF 1928—DECISION OF COURT.

1. "DUES"—VOLUNTARY ASSESSMENT IN PLACE OF INCREASE IN DUES.

Amounts voluntarily paid to a sporting club by its members as assessments in place of an increase of dues are included in the term "dues" in accordance with section 413(d) of the Revenue Act of 1928.

2. "INITIATION FEES"—AMOUNTS IN ADDITION TO INITIATION FEES AND ALSO IN ADDITION TO BACK DUES.

An amount paid by an applicant for a membership in a sporting club in addition to the initiation fee and an amount paid in addition to back dues by a member who had resigned and was readmitted are included in the term "initiation fees" in accordance with section 413(d) of the Revenue Act of 1928.

UNITED STATES DISTRICT COURT, EASTERN DISTRICT OF NEW YORK.

The Garden City Golf Club, plaintiff, v. *Walter E. Corwin, Individually and as Collector of Internal Revenue of the First District of New York, defendant.*

[February 15, 1932.]

OPINION.

INCH, J.: The plaintiff, Garden City Golf Club, has brought this action against Walter E. Corwin, individually and as collector of internal revenue, to recover the sum of $5,530, with interest, paid April 16, 1931, and representing a 10 per cent tax assessed and collected in accordance with the provisions of section 413 of the Revenue Act of 1928, entitled tax on club dues or fees (Title 26, U. S. C. A., section 872). Plaintiff claims this tax was erroneous and illegal and that the amount so paid by it should be returned.

A jury has been duly waived. The facts have been duly stipulated. (Plaintiff's Exhibit 1.) The sole question represented is one of law.

The function of our Government and the intent of Congress is not to tax as much as possible but to tax as little and as reasonably as necessity requires.

For that reason where a doubt exists as to the meaning of a tax statute the taxpayer should receive the benefit of such doubt. (*Shwab, etc.*, v. *Doyle*, 258 U. S., 529 [T. D. 3339, C. B. I-2, 312]; *Smietanka* v. *First Trust, etc.*, 257 U. S., 602 [T. D. 3321, C. B. I-1, 210]; *United States* v. *Merriam*, 263 U. S., 179 [T. D. 3535, C. B. II-2, 87].)

At the trial, bearing the above in mind, the argument of counsel for plaintiff impressed the court as having weight so far as the greater portion of this tax was concerned, but careful consideration of the facts and the law has com-

pelled me, I confess against my own inclination because of the great usefulness of such clubs for health and necessary recreation, to decide that the tax was properly imposed.

The plaintiff is a membership corporation, duly incorporated, over 30 years ago, under the laws of the State of New York. It has since maintained a golf club and course at Garden City, Long Island, and is one of the oldest and most highly esteemed golf clubs in the United States.

By the constitution, by-laws, etc., of the club, the control and management of the club is vested in a board of governors consisting of 12 members. There are, in addition, the usual officers and committees. There are several classes of members, regular, associate, life, honorary and absentee. The latter class are those who may be continuously absent from the United States for a period exceeding one year. The honorary class are those who have achieved distinction in any field of endeavor. The life and associate class are limited to 35 and 25 in number, respectively, while the regular membership is limited to 350.

It is thus seen that the source of revenue for the upkeep of this club is limited. This limitation is further increased by the fact that the initiation fees and dues are moderate, the annual dues of the regular members being $200, while the initiation fee is $500.

An examination of the charter, constitution, by-laws and rules of plaintiff reveals no authority in the board of governors to impose an "assessment."

So far as I have been able to find from the few authorities on the subject it would seem that if such assessment had been resisted in this State, by any member, such resistance would have been successful. (*Thompson* v. *Wyandanch Club*, 127 N. Y. Supp., 195, 70 Misc. Rep., 299.)

The above was the situation when it became advisable, on or about January 3, 1930, for the board of governors to consider the necessity of raising a considerable sum of money for the purpose of closing a road through the property of the club and the substitution of a new one, together with changes in the location and erection of buildings which this would entail or make advisable, together with several other necessary expenditures for the comfort of the members and the better financing of the club.

Accordingly a meeting of the board of governors was held on said date at which eight of the members of the board were present and four were excused from attendance. The question discussed was how to raise this necessary money.

We may pause here to set forth the appropriate section of the tax statute about which this controversy has arisen.

STATUTE INVOLVED.

Section 413 of the Revenue Act of 1928 (Title 26, U. S. C. A., 872) provides:

"SEC. 413. *Club dues tax.*—(a) Section 501 of the Revenue Act of 1926 is amended to read as follows:

"'SEC. 501. (a) There shall be levied, assessed, collected, and paid a tax equivalent to 10 per centum *of any amount paid*—

"'(1) *As dues* or membership fees to any social, athletic, or sporting club or organization, if the dues or fees of an active resident annual member are in excess of $25 per year; or

"'(2) *As initiation fees* to such a club or organization, if such fees amount to more than $10, or if the dues or membership fees, not including initiation fees, of an active resident annual member are in excess of $25 per year.

* * * * * * *

"'(d) *As used in this section, the term "dues" includes any assessment irrespective of the purpose for* which made; and the term "initiation fees," includes any payment, contribution, or loan required as a condition precedent to membership, whether or not any such payment, contribution, or loan is evidenced by a certificate of interest or indebtedness or share of stock, and irrespective of the person or organization to whom paid, contributed, or loaned.'" [Italics mine.]

Bearing this law in mind we return to the meeting of the board of governors. The president after reporting these various items requiring money, made the following recommendation among others:

"That the club undertake to raise the necessary amount by *permissive assessment* on the part of the membership. That a *permissive assesement* on

the membership be requested at the rate of $150, from each member, *or*, a general meeting be called *to increase the dues* to meet this past and prospective necessary expenditure."

He also called attention to the fact that:

"*The dues* of the members of the Garden City Golf Club *are at present the lowest* of any club around New York of equal standing and that these necessary expenditures must be met if the club is to continue to give the members what they want and have a right to expect."

The board thereupon, after due consideration, duly passed a motion by which the president was "authorized to prepare a letter to the members in which the above matter should be explained for their information and *assent requested to an assessment of $150, from each member.*"

Pursuant to this motion, on March 20, 1930, the president sent to the members (except the honorary members) a letter which set forth all the facts and this necessity for raising the gross sum of $52,500. This letter closed with the following:

"As all our present income is needed for operative expenses *two courses seem available* to enable the board of governors to obtain this sum namely *to increase our present annual dues* of $200—the lowest of any club of equal rank—*or to ask the members to submit to an assessment of $150* each.

"The board has decided on the latter course and invites the cooperation of the members to safeguard the links and to maintain the club's high standard.

"A blank indicating how the *assessment* may be paid is inclosed for the convenience of the members."

This blank in substance was as follows:

"I accept the assessment of $150, for the purpose stated in the president's letter of March 20, 1930."

A large majority of the regular members paid this proportion in full. A few members paid a lesser sum. The honorary members paid their share as well while a few members refused or omitted to pay anything. No steps were taken nor indicated that any penalty of any sort for nonpayment were taken or even contemplated. In addition this $150 was added to the requirements for admission to membership of certain applications pending.

Thereupon the Government, under the provisions of the law already set forth, imposed a tax of 10 per cent on this sum so raised making a tax of $5,530. This action was duly commenced by plaintiff to recover this tax so paid.

Plaintiff claims that this tax was erroneously assessed and illegal in that the fund so collected was not an assessment, for the reason, first, that the corporation had no power under the laws of the State of New York to levy any such assessment. Second, that Congress did not intend to include in the term "assessment" as used in this tax statute, a voluntary payment by members under such circumstances as here shown.

The Government contends, on the contrary, that the argument that the board was without authority to levy an "assessment," even if correct in law, is without merit. That what happened in this case was exactly what Congress had in mind when it amended the Act in question by the words: "*The term 'dues' includes any assessment irrespective of the purpose for which made.*"

It must be conceded that there is a difference between the term "dues" and the term "assessment." Dues referring to "stated amounts" which the members must pay periodically for the continuing privilege of membership.

However, "Cases might be imagined in which it might be difficult to distinguish between 'dues and assessment.' (*Thompson* v. *Wyandanch Club*, 127 N. Y. Supp., 195–201.) See also for various definitions, 5 Corpus Juris, 814–815–816 (and cases there cited).

"The term 'assessment' may have different meanings according to its use and must be construed according to the context." (5 Corpus Juris, 816, and cases cited.)

While, generally speaking, "dues of a club, initiation fees and assessments," are associated, in the public's mind, with the continued right of membership, an "assessment" by a club may be a specific demand or request by the club upon its membership, as a whole or as a class, for a certain sum of money, the proportion to be paid by each member being stated.

The penalty for nonpayment, while also oftentimes a part of the contract of membership, is not absolutely essential, in all cases, to the creation of an

assessment of this character. Notice of a penalty need not necessarily accompany the demand or request. Such penalty, even if its imposition was contemplated, may be and not infrequently is waived or rendered unnecessary by prompt payment.

The question before this court is not as to the power of Congress to tax this fund but whether or not Congress has in fact taxed it lawfully.

Therefore bearing in mind the different meanings of the term "assessment" and construing it in accordance with the context of the tax statute in question we follow the rule of construction that is, of course, well known and was only recently applied by the Supreme Court (*United States* v. *Ryan*, 284 U. S., 167):

"All laws are to be given a sensible construction. A literal application of a statute which would lead to absurd consequences is to be avoided whenever a reasonable application can be given *which is consistent with the* legislative purpose. (*United States* v. *Katz*, 271 U. S., 354; *United States* v. *Jin Fuey Moy*, 241 U. S., 394; *United States* v. *Palmer*, 3 Wheat., 610, 631.)

"Notwithstanding the broad language of the section, *we think it may be given a reasonable construction*, and *the one most consistent with its apparent purpose*, by the application of the principle noscitur a sociis. * * * *By reason and analogy, as well as by context*, we conclude that the general words 'all personal property whatsoever' were intended to include chattels other than the specified tools and implements, but to be restricted to those which, like tools or implements, are related to one or the other of the principal things, or *incident* to their intended use or disposition in fraud of the revenue." [Italics mine.]

Section 501 of the Revenue Act of 1926 created a tax "equivalent to 10 per centum of any amount *paid* * * * (a) as *dues* or membership fees."

In 1928 Congress amended this section 501, by section 413(a) of the Revenue Act of 1928, as follows:

"(d) As used in this section, the term '*dues*' *includes any* '*assessment*' irrespective of the purpose for which made."

The purpose of Congress in making this amendment is shown in the Journals of Congress and its committees and they may be consulted. (*McLean* v. *United States*, 226 U. S., 374; *Buttfield* v. *Stranshan*, 192 U. S., 470.)

The Committee on Ways and Means of the House made a report in respect to this proposed amendment (report, Seventieth Congress, page 26, first session, December 7, 1927). In this report this committee states:

"It has been found *that the tax on 'dues' is being evaded by the device of lowering the amount of dues and collecting the money by 'assessment.'*"

The Committee on Finance of the Senate (May 1, 1928, Seventieth Congress, first session) likewise made a report in which it states:

"The House bill amends the existing law to *take care of the situation which has arisen from the prevalent use of the device of lowering the amount of club 'dues' and collecting the required money by 'assessment'* instead as a means of evading the club *dues tax*."

It is thus plainly shown that, while the tax is upon *club dues paid*, the *purpose* of Congress, in including under this head "assessments," was to endeavor to overcome the efforts of those who would avoid the tax on "dues" by properly claiming that the necessary money had been raised by "assessment." Therefore Congress enacted that where such substitution for "dues" was shown the fund so raised by "assessment" was to be taxed under the provision for tax on "dues," the term "dues" to include the term "assessment" for any purpose.

Applying this statute, with its said purpose, to the facts of this case, we find that a considerable sum of money was necessary to be raised by plaintiff. The president of the club stated to the board of governors the financial requirements and urged that there were but two courses open, one to raise the dues sufficiently to meet the expenditures, the other to "assess" the members $150 each. The board of governors decided upon the "assessment." Accordingly, a letter was sent to the members, by the president, setting forth these two ways of raising the money, and, realizing that there was no power to legally assess, asking each member to voluntarily accept such assessment.

If the board of governors had decided on the method of raising the money by raising the dues, or, if the members had refused to accept the assessment and had agreed to an increase of dues, this fund so raised would present no question as to the correctness of the tax. Instead the opposite course was taken and instead of raising the dues the money has been raised by a voluntary assessment.

This was exactly what Congress had in mind in enacting the amendment.

Needless to say, no member of the board of governors or any of the members of the club had the slightest idea or desire to evade any tax.

The Government concedes that this effort by the board of governors, in its appeal to the membership, was not a "device" to evade the tax.

The question of intent however is not material if what was actually done was reasonably within the purpose of Congress in so amending the statute. (*Weiss* v. *Stearn*, 265 U. S., 242–254 [T. D. 3609, C. B. III–2, 51].)

While the mere name is not too important, both the board of governors and the members (excepting the few that refused to sign) have expressly called the method pursued an "assessment."

I agree with the Government that it appears here that if the amount had not been raised by this voluntary assessment the other alternative presented to the membership was a corresponding increase in their dues.

The tax is on the amount paid whether by dues or assessment.

This is not a controversy between a member and his club as to its right to assess him. The members have paid the assessment, preferring to waive any legal rights in this regard. With this choice the Government is not concerned. Apparently it would be an insufficient objection even if the question of the legality of the assessment was to be considered. (*U. S.* v. *Emery, etc.*, 237 U. S., 28; *Boston* v. *U. S.*, 265 Fed., 578; *Sullivan* v. *U. S.*, 15 F. (2d), 809; *U. S.* v. *Sullivan*, 274 U. S., 259 [T. D. 4028, C. B. VI–2, 177].)

The fund has been paid in by an assessment in place of an increase of dues. The tax thereon was proper and the amount paid can not be recovered.

There remains but the question of the "initiation fee." This was also increased by the amount of this "assessment" and paid by the applicants. This additional amount so paid was, in my opinion, a part of the initiation fee. This also applies to a certain member who had resigned in 1927 and who subsequently was readmitted on the payment of back dues and this sum. These payments required were conditions to be met in order to become a member. (*Munn* v. *Bowers*, 47 F. (2d), 204, cert. denied, 51 Sup. Ct., 492 [Ct. D. 283, C. B. X–1, 436].)

The burden of proof was on the plaintiff to show that it was entitled to recover this tax.

In my opinion the proof shows that the tax was properly imposed both as to the club dues, a term which includes the assessment voluntarily paid and such as here took place, and on the initiation fees. Judgment must be given for the defendant.

The objections of plaintiff to the materiality and relevancy of certain of the stipulated facts are each overruled and exception granted.

Findings of fact should be submitted. The order for judgment should be settled on notice.

SCHEDULE A–5 OF TITLE VIII OF THE REVENUE ACT OF 1926, AS AMENDED BY SECTION 442 OF THE REVENUE ACT OF 1928.

REGULATIONS 71, ARTICLE 53: Passage tickets. XI–49–5909
S. T. 596

Taxability of passage tickets issued to foreign consuls.

Advice is requested concerning the application of the tax imposed by Schedule A–5 of Title VIII of the Revenue Act of 1926, as

amended by section 442 of the Revenue Act of 1928, to passage tickets issued to foreign consuls.

Under recognized principles of international law, duly accredited diplomatic representatives of foreign governments are not subject to the stamp tax imposed by Schedule A–5 on the sale of passage tickets. This exemption is, however, confined to representatives having a diplomatic status and since consular officers, as such, do not have a diplomatic status, they are subject to the tax unless they are entitled to exemption under the provisions of a treaty between the country they represent and the United States.

Claims of consuls for exemption from the stamp tax on passage tickets should be submitted to the Commissioner for determination.

STAMP TAX ON PASSAGE TICKETS.

REGULATIONS 71, ARTICLE 58: Passage tickets to ports not in the United States, Canada, Mexico, or Cuba. XI–41–5781 G. C. M. 10894

The sale in the United States of two tickets, one to and the other from Bermuda, constitutes the sale of a round trip ticket subject to tax.

An opinion is requested relative to the amount of tax which should be paid on passage tickets sold under the following conditions:

A steamship company sells a ticket "No. 1" for a passage to Bermuda and at the same time sells a separate ticket "No. 2" for return from Bermuda to the United States. Ticket "No. 2" has printed thereon the words "issued in connection with ticket No. 1." The price of tickets No. 1 and No. 2, which are sold together, is $80.

The price of each ticket is $40. A tax of $3 is paid on ticket No. 1 for passage to Bermuda. No tax is paid on ticket No. 2 for passage from Bermuda to the United States on the ground that the ticket was sold for a passage to the United States from a foreign port.

Schedule A–5, Title VIII of the Revenue Act of 1926, as amended by section 442 of the Revenue Act of 1928, imposes a stamp tax on passage tickets as follows:

5. Passage ticket, one way or round trip, for each passenger, sold or issued in the United States for passage by any vessel to a port or place not in the United States, Canada, Mexico, or Cuba, if costing not exceeding $30, $1; costing more than $30 and not exceeding $60, $3; costing more than $60, $5. This subdivision shall not apply to passage tickets costing $10 or less.

It is clear that under the law passage tickets costing more than $10, either for one way or a round trip, are subject to the tax in question when sold or issued in the United States for passage to a port or place not in the United States, Canada, Mexico, or Cuba.

The particular question to be decided is whether the sale of the two tickets, No. 1 and No. 2, is the sale of a round trip ticket in the United States, within the meaning of the law, or whether the transaction is twofold in its operation and constitutes the sale of two

tickets, one to Bermuda—subject to tax—and the other from Bermuda to the United States—not subject to tax.

In deciding the question whether the two tickets sold under the circumstances recited are subject to tax as a round trip ticket, there are several facts to be considered. Both tickets were evidently sold at the same time, at the same place, and to the same person. This person bought the tickets for a return journey. The ticket No. 2 for the return from Bermuda to the United States showed that it was issued in connection with ticket No. 1. Thus the two tickets were connected as having reference to one and the same trip. Doubtless the purchaser received the usual benefit of reduction in price through his payment for the return passage at the time when he secured his outward bound ticket. It is evident that the purchase of these two tickets formed a single transaction and for a single purpose, namely, a round trip. It is immaterial, so far as the tax is concerned, that two tickets were issued for the journey instead of one. After all, the purchaser, in effect, bought a passage ticket for a round trip.

It is, therefore, the opinion of this office that the two tickets in question should be considered as a round trip ticket, within the meaning of the law, and held subject to the stamp tax in question.

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

REGULATIONS 71, ARTICLE 58: Passage tickets to ports not in the United States, Canada, Mexico, or Cuba. XI–52–5960 S. T. 619

Advice is requested whether a passage ticket sold under the following circumstances is subject to the stamp tax imposed by Schedule A–5 of Title VIII of the Revenue Act of 1926, as amended by section 442 of the Revenue Act of 1928, viz:

Recently, agents of a company at Shanghai, China, advised the company to get in touch with a certain person in the United States and inform her to call at the company's office in this country and secure a ticket covering a trip from New York to Shanghai. The mother of this person, residing in Shanghai, paid for the passage, making it unnecessary for the said person to pay anything to the company in the United States.

The fare will be sent by the agents in Shanghai to the owners of the vessel at Copenhagen and no part of it will reach the company's office in America.

Schedule A–5 of Title VIII of the Revenue Act of 1926, as amended, imposes a tax on tickets sold or issued in the United States for passage by any vessel to a port or place not in the United States, Canada, Mexico, or Cuba.

While the passage money in this case was paid to the agent in Shanghai, yet the ticket covering passage from New York to Shanghai was issued in this country, and this fact alone is sufficient to make it subject to the tax.

TITLE XI.—GENERAL ADMINISTRATIVE PROVISIONS. (1926)

SECTION 1121.—EXPORTS, AND SHIPMENTS TO POSSESSIONS OF THE UNITED STATES.

REGULATIONS 44, ARTICLE 55: Sales for export. XI-39-5738
T. D. 4354

Sales for export—Proof of exportation.—Articles 55 and 56 of Regulations 44.

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

To Collectors of Internal Revenue and Others Concerned:

Articles 55 * * * of Regulations 44 are amended to read as follows:

ART. 55. *Sales for export.*—In order for a sale to be exempt from tax under section 1121 it is necessary that two conditions be met, namely, (1) that the article must be identified as having been sold for export and (2) that it must have been exported in due course.

An article will be regarded as having been sold for export if the manufacturer has in his possession at the time title passes or at the time of shipment (whichever is prior), (a) a written order or contract of sale showing that the manufacturer is to ship the article to a foreign destination; or (b) where delivery by the manufacturer is to be made within the United States, a sworn statement from the purchaser showing (1) that the article is purchased to fill existing or future orders for delivery to a foreign destination; or that the article is purchased for resale to another person engaged in the business of exporting who will export the article, and (2) that such article will be transported to its foreign destination in due course prior to use or further manufacture and prior to any resale except for export.

In these cases the manufacturer, for a period of six months from the date when title passes or the date of shipment (whichever is prior), is excused from paying tax on the article sold. If within such period the manufacturer has not received and attached to the order or contract proper "proof of exportation" (see article 56), then the temporary exemption ceases and the manufacturer shall include the tax on the sale of such article in his return for the month in which such 6-month period expires.

REGULATIONS 44, ARTICLE 56: Proof of exportation. XI-39-5739
T. D. 4354

* * * * * * *

Articles * * * 56 of Regulations 44 are amended to read as follows:

ART. 56. *Proof of exportation.*—Exportation may be evidenced by (1) a copy of the export bill of lading, or (2) a certificate by the agent or representative of the export carrier showing actual exportation of the article, or (3) a certificate of landing signed by a customs officer of the foreign country to which the article is exported, or (4) where such foreign country has no customs administration, a sworn statement of a foreign consignee covering receipt of the article.

In any case where the manufacturer is not the exporter, such manufacturer must have in his possession an affidavit from the person to whom he sold the

article stating that the article was in fact exported in due course or was sold to another person who in due course exported the article. This affidavit must state what evidence is available which will show that the article was in fact exported in due course prior to use or further manufacture and prior to resale in the United States other than for export. Such evidence must be that referred to under either (1), (2), (3), or (4) above, and the affidavit must show where such evidence is readily available for inspection by Government officers.

In all cases the sales records together with the evidence of the proof of exportation must be preserved by the manufacturer for a period of at least four years from the last day of the month following the sale, and must be readily accessible for inspection by internal-revenue officers.

In any case where the manufacturer does not have in his possession within the 6-month period proof of exportation as outlined herein, the manufacturer must pay the tax involved. If proof of exportation later becomes available, a claim for refund of any tax paid may be filed on Form 843, or a credit may be taken upon any subsequent monthly return, but such action must be taken within the 4-year period of limitation prescribed by section 3228, United States Revised Statutes, as amended.

DAVID BURNET,
Commissioner of Internal Revenue.

Approved September 20, 1932.

OGDEN L. MILLS,
Secretary of the Treasury.

REGULATIONS 46, ARTICLE 74: Sales for export. XI-39-5740
T. D. 4355

Sales for export—Proof of exportation.—Articles 74 and 75 of Regulations 46.

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

To Collectors of Internal Revenue and Others Concerned:

Articles 74 * * * of Regulations 46 are amended to read as follows:

ART. 74. *Sales for export.*—In order for a sale to be exempt from tax under section 1121 it is necessary that two conditions be met, namely, (1) that the article must be identified as having been sold for export and (2) that it must have been exported in due course.

An article will be regarded as having been sold for export if the manufacturer has in his possession at the time title passes or at the time of shipment (whichever is prior), (a) a written order or contract of sale showing that the manufacturer is to ship the article to a foreign destination; or (b) where delivery by the manufacturer is to be made within the United States, a sworn statement from the purchaser showing (1) that the article is purchased to fill existing or future orders for delivery to a foreign destination; or that the article is purchased for resale to another person engaged in the business of exporting who will export the article, and (2) that such article will be transported to its foreign destination in due course prior to use or further manufacture and prior to any resale except for export.

In these cases the manufacturer, for a period of six months from the date when title passes or the date of shipment (whichever is prior), is excused from paying tax on the article sold. If within such period the manufacturer has not received and attached to the order or contract proper "proof of exportation" (see article 75), then the temporary exemption ceases and the manufacturer shall include the tax on the sale of such article in his return for the month in which such 6-month period expires.

REGULATIONS 46, ARTICLE 75: Proof of exportation. XI–39–5741 T. D. 4355

* * * * * * *

Articles * * * 75 of Regulations 46 are amended to read as follows:

ART. 75. *Proof of exportation.*—Exportation may be evidenced by (1) a copy of the export bill of lading, or (2) a certificate by the agent or representative of the export carrier showing actual exportation of the article, or (3) a certificate of landing signed by a customs officer of the foreign country to which the article is exported, or (4) where such foreign country has no customs administration, a sworn statement of a foreign consignee covering receipt of the article.

In any case where the manufacturer is not the exporter, such manufacturer must have in his possession an affidavit from the person to whom he sold the article stating that the article was in fact exported in due course or was sold to another person who in due course exported the article. This affidavit must state what evidence is available which will show that the article was in fact exported in due course prior to use or further manufacture and prior to resale in the United States other than for export. Such evidence must be that referred to under either (1), (2), (3), or (4) above, and the affidavit must show where such evidence is readily available for inspection by Government officers.

In all cases the sales records together with the evidence of the proof of exportation must be preserved by the manufacturer for a period of at least four years from the last day of the month following the sale, and must be readily accessible for inspection by internal-revenue officers.

In any case where the manufacturer does not have in his possession within the 6-month period proof of exportation as outlined herein, the manufacturer must pay the tax involved. If proof of exportation later becomes available, a claim for refund of any tax paid may be filed on Form 843, or a credit may be taken upon any subsequent monthly return, but such action must be taken within the 4-year period of limitation prescribed by section 3228, United States Revised Statutes, as amended.

DAVID BURNET,
Commissioner of Internal Revenue.

Approved September 20, 1932.

OGDEN L. MILLS,
Secretary of the Treasury.

TITLE V.—TAX ON ADMISSIONS AND DUES. (1924)

TAX ON DUES.

REGULATIONS 43–II, ARTICLE 5: Social clubs. XI–37–5692 Ct. D. 561

TAX ON DUES—REVENUE ACTS OF 1921 AND 1924—DECISION OF COURT.

SOCIAL CLUB—CHARACTER OF ORGANIZATION.

The social activities of the Town Club of St. Louis, which has 52 social affairs and 97 educational, civic, or artistic functions, constitute a material part of the club's functions and it is a social club within the meaning of section 801 of the Revenue Act of 1921 and section 501 of the Revenue Act of 1924, the dues to which are taxable under those sections.

DISTRICT COURT OF UNITED STATES IN AND FOR THE EASTERN DIVISION OF THE EASTERN JUDICIAL DISTRICT OF MISSOURI. CONSOLIDATED CAUSE NO. 9179.

The Town Club of St. Louis, plaintiff, v. *United States of America, defendant, and The Town Club of St. Louis, plaintiff,* v. *Louis J. Becker, Collector of Internal Revenue, defendant.*

[June 19, 1932.]

OPINION.

FARIS, J.: Plaintiff sues in two separate actions at law to recover a total amount of $16,803.98. Of the latter sum $6,281.84 is sought to be recovered for taxes paid to a collector of the United States, who is not now in office, for taxes alleged to have been illegally collected, and which accrued between April 9, 1924, and December 19, 1925, both inclusive.

The sum of $10,522.14, hereby sought to be recovered, is for taxes alleged to have been illegally collected from the plaintiff, and which accrued between January 16, 1926, and March 3, 1928.

The above sums were paid by plaintiff to the respective collectors in office at the time of such payments. Demand for refund thereof was made and refund refused.

The controlling facts in the two cases being precisely similar, the two actions were by consent consolidated for trial, and a jury being waived, were submitted to the court on the pleadings and proof.

The taxes whereof refund is sought were assessed and collected under the provisions of section 801 of the Revenue Act of 1921, which reads as follows:

"That from and after January 1, 1922, there shall be levied, assessed, collected, and paid, in lieu of the taxes imposed by section 801 of the Revenue Act of 1918, a tax equivalent to 10 per centum of any amount paid on or after such date, for any period after such date, (a) as dues or membership fees (where the dues or fees of an active resident annual member are in excess of $10 per year) to any social, athletic, or sporting club or organization; or (b) as initiation fees to such a club or organization, if such fees amount to more than $10, or if the dues or membership fees (not including initiation fees) of an active resident annual member are in excess of $10 per year; such taxes to be paid by the person paying such dues or fees: *Provided*, That there shall be exempted from the provisions of this section all amounts paid as dues or fees to a fraternal society, order, or association, operating under the lodge system. In the case of life memberships a life member shall pay annually, at the time for the payment of dues by active resident annual members, a tax equivalent to the tax upon the amount paid by such a member, but shall pay no tax upon the amount paid for life membership."

The above quoted section of the taxing statute was carried into the Revenue Acts of 1924 and 1926, without any material change. So, the law of the case is found in section 801, supra, above quoted.

The sole question presented, in the view I take of the case, is whether plaintiff was, during the time and periods wherein the taxes were exacted, a "social, athletic or sporting club or organizattion," or whether its functions were civic and/or educational. If the former, it is conceded the taxes collected from it are legal and can not be recovered; if the latter, these taxes were unlawfully exacted and collected and plaintiff may recover. There is, or should be, but little dispute about the law. It seems to be fairly well settled, in the cases of *Fleming* v. *Reinecke* (52 Fed. (2d), 449); *Women's University Club* v. *United States* (50 Fed. (2d), 469 [Ct. D. 389, C. B. X–2, 402]); *Women's University Club of Seattle* v. *United States* (52 Fed. (2d), 447); *Army and Navy Club* v. *United States* (53 Fed. (2d), 377 [Ct. D. 421, C. B. X–2, 401]).

The above cases dealt with facts which induced the conclusion that the several organizations were entities wherein social features and activities constituted material parts of their activities. *Per contra*, the cause of *Cosmos Club* v. *United States* (42 Fed. (2d), 321); *City Club of Los Angeles* v. *Welch* (44 Fed. (2d), 239); *Houston Club* v. *United States* (Court of Claims); *Builders Club of Chicago* v. *United States* (Court of Claims), were cases wherein the facts warranted the conclusion of law reached, that the activities of the respective organizations were predominantly business, commercial,

artistic or educational, and that the social features, though present, were not material part of such activities.

The oral evidence of the case at bar preponderantly disclosed that the activities of plaintiff were predominantly civic and educational, as contradistinguished from social. But this evidence came, for the most part, from officers of plaintiff who have had occasion to be wholly and closely familiar with plaintiff's activities only since 1928, or later; whereas, the period from April 9, 1924, and up to March 3, 1928, is the period involved in these controversies.

To make its contentions respecting the activities during the period between April 9, 1924, and March 3, 1928, the defendant offered many, if not all, of the issues of "The Informant" (plaintiff's official publication), as also many, perhaps all, programs embodying plaintiff's activities between the dates last above mentioned. None of these publications by plaintiff, subsequent to March, 1928, was offered, for the very simple reason that the club's activities for the latter period were not in dispute nor in issue here. I have, however, carefully examined the programs of the club as issued by it between the years 1924 and 1928. These show that within the period named there were given, or seemingly fostered by the club, that is given under its auspices, 10 dances, 5 musicals, 2 picnics, 9 swimming parties, 5 teas, 14 card parties, 2 shows, 5 miscellaneous parties, luncheons, etc., and 11 other functions which may or may not have been either education or social or mixed.

During the same period there were a total of 97 functions which, in my opinion, were educational, artistic, or civic.

So, the totals stand, 52 clearly social, 97 clearly educational or civic or artistic, and 11 doubtful or mixed.

The club had a lounge, used also as a library; a piano—perhaps three; a swimming pool, and maintains, and maintained, large well-furnished quarters, including a kitchen and dining rooms, wherein meals are served to members and their guests. These latter things are, of course, not decisive here either way, and not inconsistent with the activities of a nontaxable entity. But they may be considered in connection with the social features above recited.

The club was organized and incorporated under the laws of Missouri relating to "benevolent, religious, scientific, educational and miscellaneous associations." (Article 10, chapter 33, R. S. of Mo., 1909.)

The articles of association of the club *inter alia* in article 4 thereof say:

"ART. 4. The object and purpose of the association shall be for the discussion of questions of commercial, industrial, civic, and social interest; for the encouragement of good reading and the cultivation of art and literature and rational social amusement; to aid and assist the industrial, commercial, civic and social development of the city of St. Louis, and more especially as they pertain to women; to provide, establish, and maintain a clubhouse or club rooms with library and other facilities appropriate and convenient for the entertainment of its members and their guests; and for the lawful and rational out-of-door play games and exercises: Provided, however, that the association as such shall have no connection with partisan politics or partisan organizations, nor shall it ever be committed to the indorsement of any particular measure or measures."

The constitution of the club, in article 2 thereof, provides that:

"The object of this association shall be to provide and maintain an organized center for the investigation, discussion and improvement of the civic, business and social affairs of the city of St. Louis and more especially as they pertain to women, and to provide club room, library and other conveniences for its members: provided that the organization as such shall never be committed to the indorsement of any particular measure."

So, it will be observed that both the articles of the association, or incorporation, and club's constitution, give the same prominence to the social phase that they give to educational and civic phases. It is, of course, to be granted that, standing alone, the club would not be concluded by either its articles of incorporation, or its constitution, especially in a case, as here, wherein more than one object of the club is set out and wherein certain activities would render it taxable, and other nontaxable. In short, the club could, if it had chosen to do so, have devoted its activities to those things set forth in its charter, which are not within the taxing statute, and refrained from carrying on those activities which render it taxable under the statute. The reason for the rule is too obvious to render exposition necessary.

The legal rule laid down in the ruled cases fairly follows the construction of the taxing statute laid down by the Revenue Department. If the rule is correct, its origin is immaterial, even though such a rule, constituting as it does a judicial interpretation of a statute by a nonjudicial body, might otherwise invade a prerogative committed alone to the coordinate judicial branch of Government. It is obviously necessary that a field force of the Revenue Department shall have promulgated, for its guidance, rules for application of taxing statutes. To this extent regulations are necessary, even if such regulations impinge, as here, upon statutory interpretation, not at all a function of an executive bureau; but the point I stress is, that such an interpretation does not bind the judicial body. If it happens that the interpretation put upon the statute be correct, or that the inaptitude or the indolence of the courts induce acceptance of the departmental interpretation, it then becomes a judicial rule and a judicial interpretation, and should be followed. Thus here, because the courts have accepted it, and so the rule is that "any organization which maintains quarters or arranges periodical dinners or meetings for the purpose of affording an opportunity of congregating for social intercourse is a social club or organization within the meaning of the Act (section 801, Revenue Acts of 1918 and 1921) unless its social features are not a material purpose of the organization, but are subordinate and merely incidental to the active furtherance of different and predominant purpose, but if the social features are a material purpose of the organization, then it is a social club."

Confessedly, I find a difficulty with the above interpretation because of the use of the terms "material purpose" and a "predominant purpose" in the same instance, the former referring to the social activities and the latter to the business, educational, etc., activities. The word "material" is obviously not predominant; "material" connotes less than half, and "predominant" more than half. There might well be a predominant purpose, but a diametrically different actual practice. Purpose might well be deduced from the articles of association or the constitution, while practice would be found from functions performed and activities engaged in. If purpose alone shall be the test, activities could vary from purpose infinitely, and yet taxation be escaped.

So, I think the rule of the Department intends, and the proper construction of the statute is, that if any material, that is, important substantial part of the club's activities (but not necessarily as much as a moiety thereof) are social, as contradistinguished from the remaining nonsocial activities, it is taxable; otherwise, of course, it is not taxable.

As said already, thoroughgoing reliance can not be put on the language of either the articles of association or the constitution, or both. But both of these instruments may be considered in connection with the actual functions and activities of the plaintiff.

So here, not only do the articles of association and constitution of the club prescribe as among its objects the providing and maintenance of "an organized center for investigation, discussion and improvement of the social affairs of the city of St. Louis as they pertain to women and to provide club rooms, library, and other conveniences for its members," but the programs and publications promulgated by the club show that during the period here in controversy, either 39 per cent or 58 per cent, approximately (according to whether the 11 doubtful activities of the club are allocated to the one side or to the other), constituted matters which were social rather than civic, artistic or educational.

I am not able to say that such a per cent of total activities does not constitute a material part of the club's functions. Of course, the mathematical predominance of nontaxable activities is obvious, but, nevertheless, the taxable functions are so numerous as to constitute, in my opinion, a material part of the club's performed functions. I do not attempt to contrast, except mathematically, the relative importance of these dual activities. There is no evidence on which to weigh one as against the other; neither do I think relative importance, even if it could be found, enters into the legal equation to an extent which makes it material or relevant. These views render it unnecessary to pass on the question of the statute of limitations.

So it follows, that judgment in the consolidated case should be for defendant, that it go hence and recover its costs and so it is ordered.

These findings and conclusions may be taken in lieu of a formal finding of facts and conclusions of law, but if counsel shall deem further findings and conclusions necessary, I shall pass on and settle any findings and conclusions which may be, in 10 days, submitted by counsel on either or both sides.

TITLE VIII.—TAX ON ADMISSIONS AND DUES. (1921)

REGULATIONS 43–II, ARTICLE 9: Dues or membership fees. XI–38–5713 Ct. D. 567

TAX ON DUES—REVENUE ACT OF 1921—DECISION OF COURT.

DUES—MONTHLY GREEN FEES.

Monthly green fees paid by a particular class of membership in a golf club for use of the club's golf course, in addition to regular annual dues, which represent a recurring contractural obligation extending over an indefinite period of time regardless of the desire of members to use the greens are incidental to the particular class of membership and are dues within the meaning of section 801 of the Revenue Act of 1921.

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT.

Frank J. Foran, appellant, v. *John P. McLaughlin, Collector of Internal Revenue, appellee.*

Upon appeal from the District Court of the United States for the Northern District of California, Southern Division.

[May 23, 1932.]

OPINION.

SAWTELLE, Circuit Judge: The appellant brought this action to recover a 10 per cent tax exacted by the appellee upon certain payments that the appellant made to the Olympic Club, of San Francisco, during 1923. The appellee claimed that the payments to the club, amounting to $52 constituted dues, which were subject to a 10 per cent tax of $5.20 under section 801 of the Revenue Act of 1921. The appellant contends that the payments in question were not dues, but, on the contrary, green fees that he paid to the club monthly at a flat monthly rate, in lieu of the daily green fees exacted for the daily use of the club's golf courses.

These green fees that were taxed had been paid by the appellant to the club in addition to his regular monthly dues of $6 as an active resident member. The appellant contends that these monthly green fees were not incidental to membership and therefore were not dues, but were special charges paid for the use of a special facility of the club.

The question presented, therefore, is whether these monthly "green fees" were or were not "dues" within the meaning of section 801 of the Revenue Act of 1921. Admittedly daily green fees are not taxable. Therefore, the only question on this appeal is whether such "green fees," when paid monthly as fixed and recurring obligations that carried with them rigid contractural liability, lost their character as casual green fees and became "dues."

A jury having been waived by written stipulation, the action was tried by the court. William F. Humphrey, president of the Olympic Club, was the only witness called by either party. At the conclusion of the evidence, the plaintiff-appellant moved the court for judgment in his favor upon the pleadings and the evidence. Thereupon the defendant-appellee moved the court for judgment in his favor, and both parties requested special findings. The court granted the defendant-appellee's motion for judgment and adopted the findings of fact and conclusions of law proposed by the defendant-appellee. From the order and judgment on the findings the taxpayer appealed.

The facts of the case are in brief as follows:

In 1922, the problem of financing the purchase of the properties of the Lakeside Golf Club, a corporation owning lands in San Mateo and San Francisco Counties, was presented to the board of directors of the Olympic Club. The latter club had also purchased other property and was planning to construct two 18-hole golf courses and to improve the clubhouse. To finance all these projects, the board of directors of the Olympic Club devised a plan whereby there would be "created" a "class to be known as 'contributing members,' which class will be limited to 850 Olympians." Any active, life, or nonresident

member who contributed to the capital of the club the sum of $275 in cash, or $300 in monthly installments, became entitled to receive, at his option, either a class "A" privilege or a class "B" privilege, or, in the case of a nonresident contributor, he had the option of accepting a class "A," "B," or "C" privilege. Only members of the Olympic Club in good standing could acquire any of these privileges.

In 1922, at the time of the creation of the "privileges," the appellant contributed the sum of $275 in cash to the club, and became the owner of a class "A" privilege. Members holding this privilege were entitled to use the golf links as often as they desired, on paying, in lieu of the daily green fees, a flat "monthly green fee" in an amount to be fixed by the board of directors. Furthermore, holders of class "A" privileges were entitled to extend the courtesy of the golf courses to their guests, upon payment of the regular daily green fee for each time that such guest used the course. Such members were also privileged to extend the use of the golf courses to their wives, on payment of an additional contribution to capital, and payment of additional monthly green fees for the wives, who were not, however, thereby given membership in the club. The by-laws of the club limited the membership to white males. The monthly green fee for the wife was charged against her husband, who was the member of the Olympic Club.

Members of the club who did not contribute to the fund used in purchasing the country property had equal obligations, rights and privileges as to all the property and facilities of the club, including golf courses, as compared to members who did contribute and who therefore received class "A," "B," or "C" privileges, with the following exceptions:

1. Members holding class "A" privileges were obliged to pay the specified monthly green fee. The club member having such class "A" privilege had the "option" of paying the fees and retaining the privilege, or of disposing of it at any time, either to the club itself, or to any other member of the club in good standing. The club had a standing offer to purchase for $600 each, all such golf privileges as might be offered for sale.

2. Class "A" members had the "right" to extend the courtesy of the courses to their wives and guests, on payment of additional sums.

The tax that the appellant seeks to recover was collected under section 801 of the Revenue Act of 1921, which reads as follows:

"That from and after January 1, 1922, there shall be levied, assessed, collected, and paid, in lieu of the taxes imposed by section 801 of the Revenue Act of 1918, a tax equivalent to 10 per centum of any amount paid on or after such date, for any period after such date, (a) as dues or membership fees (where the dues or fees of an active resident annual member are in excess of $10 per year) to any social, athletic, or sporting club or organization; or (b) as initiation fees to such a club or organization, if such fees amount to more than $10, or if the dues or membership fees (not including initiation fees) of an active resident annual member are in excess of $10 per year; such taxes to be paid by the person paying such dues or fees: *Provided*, That there shall be exempted from the provisions of this section all amounts paid as dues or fees to a fraternal society, order, or association, operating under the lodge system. In the case of life memberships a life member shall pay annually, at the time for the payment of dues by active resident annual members, a tax equivalent to the tax upon the amount paid by such a member, but shall pay no tax upon the amount paid for life membership."

Counsel agree that the terms "dues" and "membership fees," as used in the statute, are "synonymous" and "convertible." Likewise, conceding that the terms "dues," "green fees," "memberships" and "privileges" were used loosely and interchangeably by members and officers of the club, counsel are in accord on the fundamental principle "that the actual, true nature and character of a right, or of a thing, is determined by its essential characteristics and not by the name by which it is called."

In other words, because of the inapt language used by officers of the Olympic Club, in the instant case this court must be guided chiefly not by what was *said*, but by what was *done*. Nevertheless, in construing an alleged membership of a club, human language can not be altogether disregarded. Infelicity in its use merely complicates the task.

An example of such infelicity of expression as to an important element is found in the circular letter sent out by the Olympic Club to its various members, under date of June 12, 1922. On one page of the record we find the statement:

"To finance the purchase of the property, the construction of the two golf courses and improvements to the clubhouse, it is planned to *create a class to be known as 'contributing members,'* which class will be limited to 850 Olympians."

But on the next page we read:

"By the proposed plan there is no initiation fee, *as no new membership is created,* but every contributor will have the right to sell the rights acquired by his contribution to an Olympian and retain half the proceeds of the sale."

We have underscored the seemingly contradictory passages.

At the threshold of our inquiry, it is necessary to ascertain the meaning of the terms "dues" and "membership fees" as used in the statute.

In *Whitman* v. *Oxford National Bank* (176 U. S., 559, 562) the court said:

"The word 'dues' is one of general significance, and includes all contractual obligations."

Citing the Whitman case, supra, the Circuit Court of Appeals for the First Circuit, in *Ward* v. *Joslin* (105 F., 224, 227), continued:

"We refer, also, to Bouv. Law Dict. 'Due,' showing that the word may signify 'what ought to be paid—what may be demanded'; and to Judge Story's observation in *Carver* v. *Manufacturing Co.* (2 Story, 432, 449, Fed. Cas. No. 2,485), on the words 'debts' and 'dues,' that 'dues' is broader than 'debts.'"

The appellant quotes in its entirety the decision in *Weld* v. *Nichols, Collector* (D. C. Mass.) (9 F. (2d), 977–978). That case involved an "additional fee" of $7.50 for the privilege of playing golf for six months, on which fee a tax of 75 cents was assessed. The report of the case does not disclose whether the club member holding the golf privilege was or was not compelled to pay the "additional fee" for another six months at the close of the first 6-month period. It is not shown whether the member would have been absolved from paying the 6-month fee in case he had decided he did not desire to play golf during the ensuing semester. In other words, the printed record of the Weld case, supra, is silent as to whether or not the member's obligation to pay the fee was a fixed and *recurring* one, and one that carried with it contractual liability. As will be seen presently, the appellant's obligation was of this latter kind.

But even in the Weld case we find the following significant language:

"Presumably the same expression is used in the same sense throughout the section. If so, the words 'dues or membership fees,' in clause (a), were meant to cover only fixed and definite charges applicable to all members of *each particular class of membership.* This seems to me to be the underlying intention of the section." [Italics our own.]

In *Thompson* v. *Wyandanch Club* (127 N. Y. S., 195, 200) the court said:

"With reference to clubs and other membership corporations, the meaning of the word 'dues' is settled. It means the obligation into which the members enter to pay a sum to be fixed, usually by by-laws, at recurring intervals, for the maintenance of the organization."

Reverting to the Supreme Court's definition of "dues" as including "all contractual obligations," we may examine the record in the instant case, in the effort to ascertain whether the appellant's obligation to pay the alleged "dues" for his class A privilege or membership was in fact and in law contractual.

We do not desire to burden this opinion with copious citations from the record tending to show the rigor with which the appellant's fellow-members were being held to their obligation to pay monthly green fees. A few instances, however, will be quoted as typical, from the minutes of the golf committee:

"Letter dated January 24 from Paul T. Carroll, class 'A' member, wherein he advised that he and his wife are planning to leave this city and will be absent for approximately six months and for this reason request a leave of absence from the Olympic Country Club covering that period; it was the sense of the meeting that, under the present ruling, i. e., that members of class 'A' must continue therein for a period of at least one year, Mr. Carroll's request be denied.

"Letter dated January 15, from D. D. Madden, class 'A' member of the Olympic Country Club, wherein he asks that his wife, Mrs. D. D. Madden, be withdrawn from the monthly green fee, but (?) inasmuch as she has only played golf twice during the past year; it was the sense of the meeting that, under the present ruling, i. e., that members of the Women's Golf Annex must continue therein for a period of at least one year, Mr. Madden's request be denied.

"Note from Dr. Hartland Law asking that his monthly green fee of $4 be discontinued; it was the sense of the meeting that his request be denied for the reason that compliance therewith would be contrary to the rules now and heretofore in effect at the Olympic Club, i. e., that members of class 'A' must continue therein for at least one year."

The foregoing excerpts from the minutes clearly indicate that, by whatever name these class "A" memberships were called, they entailed upon their holders a fixed, contractual liability to pay monthly green fees, regardless of their desire to continue to use the greens. Assuredly, then, these so-called "fees" were not for a single, casual and occasional privilege—like a chance meal at the country club dining room—but represented a *recurring, contractual* obligation, extending over an indefinite period of time, and, in the language of the Weld case, supra, "incidental" to a "particular class of membership." We therefore believe that these "fees" were properly taxed.

Judgment affirmed.

TITLE V.—TAX ON TRANSPORTATION AND OTHER FACILITIES. (1918)

PAYMENTS, COLLECTIONS, RETURNS, AND PENALTIES.

REGULATIONS 49, ARTICLE 110: Payment of taxes. XI-41-5782
Ct. D. 585

TAX ON TRANSPORTATION—REVENUE ACTS OF 1917 AND 1918—DECISION OF COURT.

LIABILITY FOR TAX—BY WHOM PAID.

Where a vendor, who has engaged to sell and deliver lumber to a county at a designated point in the county f. o. b. at a stated price, ships the lumber by rail to that point preparatory to there effecting the required delivery and forwards the bills of lading to the county, and the latter, conformably to the vendor's intention, surrenders the bills of lading to the carrier, pays its transportation charges, receives the lumber from it, deducts from the f. o. b. price at destination the transportation charges paid to the carrier and remits the balance to the vendor, the transportation services are rendered to the vendor and the vendor is the "person" who paid for the services rendered within the meaning of section 501 of the Revenue Act of 1917 and section 501(a) of the Revenue Act of 1918 and is liable for the tax on transportation imposed by those acts.

COURT OF CLAIMS OF THE UNITED STATES. No. E-567.

Wheeler Lumber Bridge & Supply Co. of Des Moines, Iowa, v. *The United States.*

[June 6, 1932.]

OPINION.

GREEN, Judge, delivered the opinion of the court.

The plaintiff in this case seeks to recover the sum of $1,833.89 with interest, being the amount of transportation taxes together with penalties and interest thereon collected from it by reason of certain shipments of lumber which it had made during the years 1918, 1919, 1920, and 1921, to parties having bought the same.

There is no dispute as to the facts in the case as reported by the Commissioner. It appears that the shipments in question were made at the time when the Revenue Act of 1917 imposed a tax on the amount paid for transportation by rail, and the plaintiff caused to be shipped to certain counties in the States of Iowa and Nebraska consignments of lumber which in each instance was needed and used by the purchasing county in the construction or repair of bridges along public highways within the county under an agreement that the lumber was to be delivered at stated points within the purchasing county f. o. b. at stated prices. The shipping was done by railroad under bills of lading calling for delivery by the carrier to the plaintiff, or on its order, at destination. Plaintiff forwarded the bills of lading to the county clerk, and, when the shipments reached their destination, the county clerk, acting for the county and conforming to the plaintiff's intention, presented the bills of lading to the carrier, paid the freight charges, accepted the lumber, and deducted the transportation charges from the stipulated f. o. b. price and remitted the balance to the plaintiff. The defendant did not collect any taxes on account of these shipments at the time they were made, but later assessed and collected from plaintiff the amount of taxes which it now seeks to recover in the manner as stated in the findings of fact.

The contentions made by plaintiff in support of its case may be summarized as follows:

First, that the tax was laid upon the sale, and the transaction was both under the statute and the Constitution exempt.

Second, that in any event the plaintiff under the statute was not liable for the tax.

The question involved in the issue first above stated was certified to the Supreme Court for determination. The form thereof is set out in the opinion of the Supreme Court in *Wheeler Lumber Bridge & Supply Co.* v. *United States* (281 U. S., 572 [Ct. D. 196, C. B. IX–2, 417]). It is sufficient to say here that in that case the Supreme Court held in substance that the tax was not upon the sale, and that the case did not come under the rule laid down in *Panhandle Oil Co.* v. *Mississippi* (277 U. S., 218); also that the transportation under consideration was not a service rendered to the county which would be exempt under section 502 of the Revenue Act of 1917, or section 500(h) of the Revenue Act of 1918, but was "a service rendered to the vendor," and that it was "measured by the transportation charges." In short, the Supreme Court ruled against the plaintiff on the question certified which included the plaintiff's claim of exemption and unconstitutionality of the tax.

There remains for consideration the question of whether the plaintiff was in any event liable for the tax. It is contended on behalf of the plaintiff that the law imposed a liability for the tax directly upon the person from whom the carrier collected the charges; and it is argued that under the facts in the case, as the carrier did not directly collect the taxes from the plaintiff, it was not liable for the tax.

In support of this proposition a provision of section 501 of the 1917 Act is quoted as follows:

"That the taxes * * * shall be paid by the person * * * paying for the services or facilities rendered."

Plaintiff's counsel also cited Treasury Regulations No. 49 (revised) promulgated January 17, 1920, which provided, by article 110 thereof, that—

"All taxes imposed by section 500 shall be paid by the person from whom or from which the carrier collects the charges for the services or facilities rendered. The method of adjusting transportation expenses between the buyer and seller, or the consignor and the consignee, is a matter of private contract over which the Government has no jurisdiction."

If this contention of the plaintiff is to be sustained then the person who turned over to the railroad the money, checks, or whatever is used to pay the transportation charges, by reason of this act becomes liable for the tax. We do not think this is a reasonable construction of the statute. As the Supreme Court says in its opinion, the transportation services were rendered for the plaintiff. Being so rendered the plaintiff was liable therefor. It is true that the county clerk paid the freight charge to the railway company, but he paid it for the plaintiff and out of funds belonging to the plaintiff in the manner in

which plaintiff intended. The plaintiff was in fact the "person" who paid for the service or facilities rendered. The case of the *City of Wichita Falls* v. *United States* (62 C. Cls., 239 [T. D. 3899, C. B. V–2, 218]) is somewhat different in its facts from the case at bar, and an altogether different question was involved. We do not think that anything said in the opinion thereon sustains the position of either party to the case at bar.

The agreement made by plaintiff to deliver the lumber f. o. b. at stated points was in effect an agreement to pay the railway charges and the county, or the county clerk acting for it, could have refused to pay the freight or the tax if it had been demanded, and could have called upon plaintiff to make payment thereof in accordance with its agreement. The plaintiff then, in order to complete its contract with the county, would have been obliged to pay the freight and the tax if demanded—in fact it could not have obtained the lumber to deliver to the purchaser without paying for the transportation and thus making itself liable for the tax. We think the situation in that event would have been no different in principle from what finally resulted from a payment of the freight out of money belonging to the plaintiff.

It follows that plaintiff's petition must be dismissed and it is so ordered.

MISCELLANEOUS TAX RULINGS.

TITLE IV.—TAX ON CIGARS, TOBACCO, AND MANUFACTURES THEREOF. (1926)

REGULATIONS 8 (1928), ARTICLE 76: Subdivision packages. XI–38–5716 T. D. 4353

CIGARS—SUBDIVISION PARCELS.

Packing of not more than 10 large cigars in lightweight cardboard parcels with cut-out windows or open at one end as subdivisions of statutory packages authorized. Regulations No. 8, article 76, amended.

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

To Collectors of Internal Revenue and Others Concerned:

Article 76 of Regulations No. 8, approved April 24, 1928, is hereby amended to read as follows:

ART. 76. *Subdivision parcels.*—The statutory number of cigars weighing more than 3 pounds per thousand, contained in the box, may be subdivided by the use of paper or ribbon bands, or separated into parcels of not more than 10 cigars each by inclosure in foil, wax paper, cellophane, or lightweight cardboard with cut-out windows or open at one end.

The caution notice label (article 84), factory brand (article 85), and classification label (article 86), must not appear on any subdivision or parcel of a statutory package but must appear only on the statutory package on which the requisite stamp is affixed.

Cigars so subdivided into parcels must remain in the stamped statutory box until they are sold and delivered direct to the consumer, and the whole number of cigars packed in each box must correspond to the denomination of the stamp affixed to the box.

DAVID BURNET,
Commissioner of Internal Revenue.

Approved September 14, 1932.

OGDEN L. MILLS,
Secretary of the Treasury.

TITLE VIII.—STAMP TAXES. (1926)

BONDS, DEBENTURES, AND CERTIFICATES OF INDEBTEDNESS.

REGULATIONS 71, ARTICLE 19: Certificates of indebtedness. XI-30-5570 Ct. D. 523

STAMP TAXES—REVENUE ACT OF 1926—DECISION OF COURT.

"CORPORATE SECURITIES"—FACE VALUE.

Instruments in registered form issued by a corporation, each of which certifies that in consideration of the payment of a specified amount annually in advance during the period of 10 years from the date of the instrument the corporation promises to pay to a designated person at the expiration of said period a specified sum, which are assignable upon certain conditions but have no surrender or cash value so far as the corporation is concerned until 18 months after the date of issue and which specifically fixes the time of payment subject to the performance of the conditions named in the certificate, come within the classification "corporate securities" that are taxable under section 800, Title VIII, Schedule A-1 of the Revenue Act of 1926. The face value of each certificate, which is the basis of the tax, is the maturity value.

UNITED STATES CIRCUIT COURT OF APPEALS, EIGHTH CIRCUIT.

L. M. Willcuts, as United States Collector of Internal Revenue for the Collection District of Minnesota, appellant, v. *Investors Syndicate, appellee.*

Appeal from the District Court of the United States for the District of Minnesota.

[March 22, 1932.]

OPINION.

BOOTH, Circuit Judge, delivered the opinion of the court.

This is an action at law brought by the Investors Syndicate against Willcuts, collector, to recover the amount of Federal stamp taxes collected by him from said corporation for the period from January 1 to June 30, 1928.

Trial by jury was waived, and the case was submitted to the trial court on a stipulation of facts. The court found in favor of the plaintiff.

The stamp taxes in question were claimed by the collector to be due, and were collected, upon certain accumulative installment certificates issued by the Investors Syndicate during the period in question. The syndicate claimed that the certificates were not taxable. No question of amount is involved.

The first page of the certificate is set out in the margin.[1]

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[1] See following certificate.

Dollars. ---------

Number. ---------

Founded 1894.

INVESTORS SYNDICATE.

Incorporated under the Laws of the State of Minnesota,

Minneapolis, Minnesota.

Accumulative Installment Certificate.

This is to certify that in consideration of the payment of _____ dollars, annually in advance during the period of 10 years from date hereof, the Investors Syndicate, first party, hereinafter referred to as the company, hereby promises to pay to _____, hereinafter referred to as the second party, at the expiration of said period, upon presentation and surrender of this certificate to the company at its office in the city of Minneapolis, Minn., the sum of ____ dollars.

This certificate is subject to the privileges, terms and conditions on the second, third and fourth pages hereof which are hereby referred to and made a part hereof, as fully, as if set forth in the face of this certificate.

In witness whereof the company has caused this certificate to be executed in its corporate name at Minneapolis, Minn., this __ day of _____ 19__.

INVESTORS SYNDICATE.
By J. R. RIDGEWAY, *President.*
Countersigned by
_____

Attest:
E. M. RICHARDSON,
Secretary.

5½%

Among the privileges, terms and conditions are provisions as to cash and loan values after 18 months; also the following:

"ASSIGNMENT. This certificate if in force and uncanceled on the books of the company may be assigned, but the assignment of transfer hereof shall not be valid without the consent in writing indorsed hereon by the company and a transfer fee of $1 paid to the company * * *.

"CASH IN FULL GUARANTEED AT MATURITY. Anything in this certificate to the contrary notwithstanding, the second party shall at the time of maturity be entitled to receive, and the company guarantees then to pay in cash the face amount hereof less any indebtedness due the company."

The following facts were stipulated relative to the issuance of certificates and the keeping of records regarding the same:

"The said so-called 'accumulative installment certificates' * * * were issued by the plaintiff herein in the following manner, and information concerning the same kept as herein stated.

"A person desiring to become a holder of a so-called 'accumulative installment certificate' made an application therefor on the basis of such annual payments as the applicant may have desired to make. All such applications were made on a form identical with the copy thereof attached to plaintiff's complaint, * * *.

"If the syndicate accepted the application, a certificate in form and substance identical with * * * (the one) attached to plaintiff's complaint, was issued by said plaintiff to the applicant, and the applicant was given a pass book, a copy of which is attached to plaintiff's complaint * * *.

"At the same time, a ledger card, a copy of which is attached to plaintiff's complaint * * * was filled in with the (holder's) name, his address, the name of the sales manager, the name of the salesman, the date of the issuance of the certificate, the amount to be paid at the maturity of said certificate, the consecutive number of the said certificate, and the method of payment of installments elected by the holder.

"As payments were made and are made they were and are recorded in the said pass book and were and are credited to the holder upon the said ledger card, subject to the terms and conditions of said certificate.

"The number representing the certificate number was placed upon the ledger card, application blank, cross reference card * * * and pass book, upon which appears the name of the owner of the certificate. The ledger cards are the permanent records of the plaintiff corporation and are filed numerically."

It was further stipulated:

"That from on or about the 1st day of January, 1928, until on or about the 30th day of June, 1928, plaintiff * * * had from time to time issued so-called 'accumulative installment certificates' the total sums to be paid at the maturity of which would equal the sum of $30,745,500 (if and providing the installment payments have been and are paid and all other conditions performed in accordance with the terms and provisions of each and all of the same), each of said so-called 'accumulative installment certificates' having been in substance and form exactly similar to Exhibit 'A' attached to plaintiff's complaint and made a part thereof, except that upon the issuance of each of the so-called 'accumulative installment certificates' the blanks appearing thereon were appropriately filled in with words and figures denoting the amount to be paid at maturity, the consecutive number and order of issue, the name of the holder, his address, and the date of the issuance thereof. The amount of the contemplated annual payments was set out in the body of the certificate on the first page thereof, following the words 'of the payment of' and preceding the words 'dollars,' being a sum in dollars at the rate of $74 per thousand of the amount to be paid at the maturity of said certificate. The amount to be paid at maturity (and alleged by the Commissioner to be the face value of the certificate) was stated in figures underneath the word 'Dollars' appearing in the upper left corner of the certificate and was also stated in words immediately following the words 'the sum of' and preceding the word 'dollars' set out in the body of the certificate, all on the first page thereof."

The relevant statutes are as follows:

Section 800, Title VIII, of the Revenue Act of 1926:

"SEC. 800. On and after the expiration of 30 days after the enactment of this Act there shall be levied, collected, and paid, for and in respect of the

several bonds, debentures, or certificates of stock and of indebtedness, and other documents, instruments, matters, and things mentioned and described in Schedule A of this title, or for or in respect of the vellum, parchment, or paper upon which such instruments, matters, or things, or any of them, are written or printed, by any person who makes, signs, issues, sells, removes, consigns or ships the same, or for whose use or benefit the same are made, signed, issued, sold, removed, consigned, or shipped, the several taxes specified in such schedule. The taxes imposed by this section shall, in the case of any article upon which a corresponding stamp tax is now imposed by law, be in lieu of such tax."

Section 801 makes certain exemptions.

Schedule A–1, referred to in section 800, reads as follows:

"Bonds of indebtedness: On all bonds, debentures, or certificates of indebtedness issued by any corporation, and all instruments, however termed, issued by any corporation with interest coupons or in registered form, known generally as corporate securities, on each $100 of face value or fraction thereof, 5 cents: *Provided*, That every renewal of the foregoing shall be taxed as a new issue: *Provided further*, That when a bond conditioned for the repayment or payment of money is given in a penal sum greater than the debt secured, the tax shall be based upon the amount secured."

The trial court held that the certificates came within the classification "corporate securities" mentioned in the schedule, but that they had no face value at the time of their issue and during the period in question, and hence were not taxable.

Two questions are involved in the case:

First, whether the accumulative installment certificates came within the general class of "corporate securities" made taxable;

Second, whether they had a face value so that the tax could be computed.

In our opinion, the intention of Congress was that the statute involved should be broad and comprehensive. This intent is evidenced by the language used in the sections quoted; and it is further shown by the fact that in section 801 certain exemptions were specifically mentioned.

It is to be noted first of all that the tax imposed was not a property tax; nor was it a tax upon transactions. It was a stamp tax.

The statute contains the provision:

" * * * there shall be levied * * * or in respect of the vellum, parchment, or paper upon which such instruments * * * are written or printed * * * the several taxes specified in such schedule."

As respects this kind of taxes, the liability to pay a stamp duty, as well as the amount, is to be determined by the form and face of the instrument. (*United States* v. *Isham*, 17 Wall., 496.) The case *Goodyear Tire & Rubber Co.* v. *United States* (273 U. S., 100 [T. D. 3992, C. B. VI–1, 332]) is to be distinguished. In that case a transfer tax was involved, not a documentary tax.

Provisions of the taxing law are to be reasonably construed in order to carry out the intent of Congress.

In *Fidelity Trust Co.* v. *Lederer* (276 F., 51), involving car trust certificates, the district court, in construing a somewhat similar statute, said:

"All forms of so-called securities or investments issued by corporations, whether expressive of indebtedness or shares in anything the corporation possesses, are without doubt taxed, as are also all forms of instruments expressive of the indebtedness of any person to the holder."

In affirming this decision, the Supreme Court said (267 U. S., 17, 21):

"As a matter of common speech, to which the statute refers, we have no doubt that these instruments would be known as corporate securities. They would be called so more accurately than some other documents which we believe also would be known generally by that name. Their purpose, as stated in the agreement of the trustee with the railroad, is to secure payment to the holder with interest. They do nothing else. We do not regard the precise limits of the Trust company's undertaking as important. If it were only to collect and pay money received by the company under the secured contract of the railroad, it would be a security for money payment."

These decisions were made in construing the Act of February 24, 1919, Title XI, section 1100, and Schedule A–1 (40 Stat., 1057, 1133, 1135)—a different statute from the one in the case at bar; but the 1919 statute levied taxes on

certain instruments "known generally as corporate securities" as did the statute in the case at bar, so that the language quoted is pertinent.

The words "securities" and "certificates" and "corporate securities" were not technical, but were in common use at the time of the passage of the Revenue Act of 1926, and should be construed in accordance with their ordinary significance. A corporate security is simply a means adopted by the corporation to secure funds which it can employ in its business; and by making a larger return on the funds so secured, it is enabled to pay its obligation under the corporate security issued, and also secure an income for itself.

The documents issued by the Investors Syndicate in the case at bar have the earmarks of corporate securities. They are printed in the form of corporate securities, and on paper used generally for such securities. The purpose of the issue of the certificates was the same as the purpose ordinarily involved in issuing corporate securities; namely, to secure the money of others for use in the corporate business. The operations of the plaintiff in selling these certificates were subject to the scrutiny of the State authorities having supervision over the selling of corporate securities. (*In re Investors Syndicate*, 147 Minn., 217.) The certificates in question were issued in large numbers and in large amounts in the period in question, and were sold throughout the United States and foreign countries. Some $30,745,500 of such certificates were issued between January 1 and June 30, 1928; and the initial collections thereon were $458,424. It is true that according to the terms of these certificates, they had no surrender or cash value so far as the Investors Syndicate was concerned until 18 months had elapsed after the issue; but it can not be doubted that from the very moment of issue, the certificates had an actual value based upon the amount that was paid as the initial installment. The time of maturity payment by the Investors Syndicate is specifically fixed subject to the performance of the conditions named in the certificate. The document is in form registered. It has a number assigned to it. This number is kept by the Investors Syndicate to enable it to identify the particular certificate. The certificates are also assignable upon certain conditions. The syndicate undertakes to keep on hand first mortgages on improved real estate or other security to insure the payment of these certificates. A liability of the company from the moment of issue exists, and it is specifically stated as to amount after the certificate has been issued for 18 months.

The fact that there was not an absolute unconditional liability for the full maturity value at the time of issuing the certificate is immaterial. There was a conditional obligation to pay the full amount at maturity. The statute makes no distinction for taxing purposes between absolute and conditional obligations to pay; the latter as well as the former are taxed. This is conclusively shown by the second proviso of Schedule A–1, which expressly provides for a tax on an instrument of conditional liability. It is also shown by the taxes on certain policies of insurance provided for in Schedule A–7.

We hold that the face value of the certificates in question was the maturity value, for purposes of taxation under the statute, and that the tax was properly assessed and collected.

The only direct authority cited by either side is the case of *National Thrift Corporation of America* v. *Welch, Collector*. That case was tried in the District Court for the Southern District of California, Central Division. The certificates involved were substantially the same as the certificates involved in the case at bar. The court held that the certificates were corporate securities; and also "that the face value of said collateral trust thrift certificates was the amount appearing on the face thereof as being due at maturity." Appeal is pending in the Circuit Court of Appeals for the Ninth Circuit.

Our conclusion in the case at bar is that the judgment of the court below should be reversed, and the case remanded for further proceedings. It is so ordered.

MISCELLANEOUS RULINGS.

TOBACCO.

REGULATIONS 8 (1928), ARTICLE 116: Redemption of stamps. XI–33–5619 T. D. 4346

TOBACCO TAX—REDEMPTION OF STAMPS—ACT OF MARCH 3, 1931.

Destruction of stamps by deputy collectors permitted where removal intact from packages is practically impossible without soaking or steaming. Article 116 of Regulations 8, approved April 24, 1928, as amended by Treasury Decision 4330 [C. B. XI–1, 368], amended.

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

To Collectors of Internal Revenue and Others Concerned:

Article 116 of Regulations No. 8, approved April 24, 1928, as amended by Treasury Decision 4330, approved December 31, 1931, is further amended by changing the fourth, fifth and seventh paragraphs of subdivision (b) to read, respectively, as follows:

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. Removal of the stamps from the packages will not be required in those cases where the stamps are so securely affixed that it is practically impossible to remove the stamps intact without soaking or steaming them, for example, stamps affixed to caddies of tobacco and to other packages made of wood or tin. In such cases, the deputy will supervise the destruction of the packages with the stamps affixed and the contents, by burning or other approved method. A separate schedule and claim shall be made in respect to stamps which are not removed from the packages but are destroyed under supervision of the deputy. 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 the manufacturer as prescribed in subdivision (a) of this article.

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 were destroyed or will be transmitted direct to the Commissioner. The schedule delivered by the deputy will be held by the collector until the claim is received and will be transmitted therewith to the Commissioner.

RALPH E. SMITH,
Acting Commissioner of Internal Revenue.

Approved August 9, 1932.

OGDEN L. MILLS,
Secretary of the Treasury.

OLEOMARGARINE.

XI–28–5548
MS. 128

Schedule of oleomargarine produced and materials used during the month of May, 1932, as compared with May, 1931.

	May, 1932.	May, 1931.
	Pounds.	*Pounds.*
Total production of uncolored oleomargarine	[1] 14,016,070	[2] 14,566,645
Total withdrawn tax-paid	14,013,848	
Ingredient schedule for uncolored oleomargarine:		
Butter	1,178	33,413
Cocoanut oil	8,403,799	8,357,552
Corn oil	5,508	
Cottonseed oil	1,084,365	1,163,024
Derivative of glycerine	21,613	11,892
Lecithin	261	442
Milk	3,422,197	3,638,780
Mustard oil		1,539
Neutral lard	607,828	510,719
Oleo oil	877,705	1,234,272
Oleo stearine	321,862	374,799
Oleo stock	16,616	55,785
Palm oil	3,325	99,727
Peanut oil	197,958	310,034
Salt	871,622	1,127,489
Sesame oil		1,150
Soda (benzoate of)	4,820	4,114
Soya bean oil	240	10,331
Total	15,840,897	16,985,062
Total production of colored oleomargarine	[3] 321,748	[4] 345,288
Total withdrawn tax-paid	84,930	
Ingredient schedule for colored oleomargarine:		
Butter		258
Cocoanut oil	93,408	108,725
Color	192	380
Cottonseed oil	52,715	37,406
Derivative of glycerine	68	10
Milk	89,566	101,722
Neutral lard	25,164	27,743
Oleo oil	55,118	84,014
Oleo stearine	10,239	4,030
Oleo stock	2,936	6,324
Palm oil	19,819	12,760
Peanut oil	2,586	4,396
Salt	28,317	29,426
Soda (benzoate of)	78	15
Total	380,206	417,209

[1] Of the amount produced, 18,887 pounds were reworked.
[2] Of the amount produced, 42,876 pounds were reworked.
[3] Of the amount produced, 416 pounds were reworked.
[4] Of the amount produced, 1,540 pounds were reworked.

XI–32–5600
MS. 129

Schedule of oleomargarine produced and materials used during the month of June, 1932, as compared with June, 1931.

	June, 1932.	June, 1931.
	Pounds.	*Pounds.*
Total production of uncolored oleomargarine	[1] 11,850,720	[2] 12,248,815
Total withdrawn tax-paid	12,028,172	
Ingredient schedule for uncolored oleomargarine:		
Butter	11,524	5,141
Cocoanut oil	7,093,105	7,013,374
Corn oil	872	
Cottonseed oil	946,980	964,114
Derivative of glycerine	17,928	8,710
Lecithin	206	352
Milk	2,814,939	3,332,569
Neutral lard	492,769	509,058
Oleo oil	733,843	991,309
Oleo stearine	288,141	396,964
Oleo stock	34,709	53,281
Peanut oil	155,767	319,850
Palm oil	8,140	14,508
Salt	774,595	925,394
Sesame oil		20,635
Soda (benzoate of)	3,921	4,791
Soya bean oil	240	2,105
Total	13,377,679	14,564,155
Total production of colored oleomargarine	[3] 260,558	[4] 387,270
Total withdrawn tax-paid	56,982	
Ingredient schedule for colored oleomargarine:		
Butter	125	360
Cocoanut oil	87,609	91,703
Color	238	436
Cottonseed oil	39,226	47,600
Derivative of glycerine	50	2
Milk	74,738	99,625
Neutral lard	20,277	30,688
Oleo oil	46,847	83,267
Oleo stearine	8,829	5,480
Oleo stock	1,375	7,684
Palm oil	15,668	16,003
Peanut oil	2,715	3,698
Salt	25,076	30,454
Soda (benzoate of)	9	22
Total	322,782	417,022

[1] Of the amount produced, 16,010 pounds were reworked.
[2] Of the amount produced, 31,950 pounds were reworked.
[3] Of the amount produced, 806 pounds were reworked.
[4] Of the amount produced, 2,658 pounds were reworked.

XI–37–5693
MS. 130

Schedule of oleomargarine produced and materials used during the month of July, 1932, as compared with July, 1931.

	July, 1932.	July, 1931.
	Pounds.	*Pounds.*
Total production of uncolored oleomargarine	[1] 11,223,272	[2] 10,959,348
Total withdrawn tax-paid	11,341,635	
Ingredient schedule for uncolored oleomargarine:		
Butter	1,034	2,185
Cocoanut oil	6,831,677	6,081,909
Corn oil	1,093	
Cottonseed oil	899,607	845,389
Derivative of glycerine	19,446	9,499
Lecithin	151	537
Milk	2,727,195	2,843,737
Neutral lard	444,466	546,345
Oleo oil	611,707	1,012,284
Oleo stearine	242,561	367,296
Oleo stock	66,852	85,132
Palm oil	6,200	8,175
Peanut oil	119,771	266,520
Salt	684,749	814,575
Sesame oil		37,900
Soda (benzoate of)	3,981	2,612
Soya bean oil	330	1,640
Total	12,660,820	12,930,735
Total production of colored oleomargarine	[3] 185,143	[4] 311,843
Total withdrawn tax-paid	43,938	
Ingredient schedule for colored oleomargarine:		
Butter		60
Cocoanut oil	48,877	86,757
Color	257	444
Cottonseed oil	30,958	30,689
Derivative of glycerine	6	16
Milk	53,880	94,350
Neutral lard	17,428	30,696
Oleo oil	35,705	83,632
Oleo stearine	5,717	5,190
Oleo stock	475	9,218
Palm oil	10,500	8,330
Peanut oil	1,887	6,451
Salt	15,648	28,879
Soda (benzoate of)	2	9
Total	221,340	384,721

[1] Of the amount produced, 14,129 pounds were reworked.
[2] Of the amount produced, 23,271 pounds were reworked.
[3] Of the amount produced, 874 pounds were reworked.
[4] Of the amount produced, 2,743 pounds were reworked.

XI–41–5783
MS. 131

Schedule of oleomargarine produced and materials used during the month of August, 1932, as compared with August, 1931.

	August, 1932.	August, 1931.
	Pounds.	*Pounds.*
Total production of uncolored oleomargarine	[1] 15,678,807	[2] 15,760,052
Total withdrawn tax-paid	15,437,038	
Ingredient schedule for uncolored oleomargarine:		
Butter	200	2,595
Cocoanut oil	9,533,823	9,382,520
Corn oil	13,000	5,600
Cottonseed oil	1,188,307	883,159
Derivative of glycerine	27,767	12,514
Lecithin	171	439
Milk	3,694,860	4,101,384
Neutral lard	720,690	681,792
Oleo oil	961,793	1,208,238
Oleo stearine	318,437	377,052
Oleo stock	82,816	94,152
Palm oil	11,470	7,200
Peanut oil	209,565	409,004
Salt	922,160	1,126,377
Sesame oil		50,275
Soda (benzoate of)	5,169	7,121
Soya bean oil		3,710
Total	17,690,228	18,353,132
Total production of colored oleomargarine	[3] 336,734	[4] 314,834
Total withdrawn tax-paid	38,958	
Ingredient schedule for colored oleomargarine:		
Butter		120
Cocoanut oil	87,545	90,613
Color	354	426
Cottonseed oil	52,276	26,848
Derivative of glycerine	10	7
Milk	97,286	97,462
Neutral lard	22,900	24,530
Oleo oil	68,747	85,548
Oleo stearine	11,192	5,140
Oleo stock	3,605	6,069
Palm oil	10,837	5,510
Peanut oil	2,959	5,796
Salt	28,514	27,604
Soda (benzoate of)	8	43
Soya bean oil		15
Total	386,233	375,731

[1] Of the amount produced, 17,538 pounds were reworked.
[2] Of the amount produced, 5,536 pounds were reworked.
[3] Of the amount produced, 212 pounds were reworked.
[4] Of the amount produced, 2,019 pounds were reworked.

XI–45–5847
MS. 132

Schedule of oleomargarine produced and materials used during the month of September, 1932, as compared with September, 1931.

	September, 1932.	September, 1931.
	Pounds.	*Pounds.*
Total production of uncolored oleomargarine	[1] 16,918,812	[2] 18,428,460
Total withdrawn tax-paid	16,840,421	
Ingredient schedule for uncolored oleomargarine:		
Butter	225	2,721
Cocoanut oil	10,345,092	10,834,927
Corn oil	13,997	6,160
Cottonseed oil	1,265,694	1,113,485
Derivative of glycerine	24,963	19,812
Lecithin	124	509
Milk	3,993,078	4,739,272
Neutral lard	789,044	875,930
Oleo oil	1,049,776	1,531,774
Oleo stearine	328,559	429,627
Oleo stock	47,514	103,230
Palm oil	5,391	27,214
Peanut oil	178,152	412,078
Salt	988,926	1,363,362
Sesame oil		62,374
Soda (benzoate of)	5,704	7,480
Soya bean oil		1,572
Total	19,036,239	21,531,467
Total production of colored oleomargarine	[3] 208,888	[4] 407,162
Total withdrawn tax-paid	43,094	
Ingredient schedule for colored oleomargarine:		
Butter		60
Cocoanut oil	80,103	112,372
Color	283	568
Cottonseed oil	25,806	40,380
Derivative of glycerine	5,056	29
Milk	60,706	109,801
Neutral lard	20,657	42,599
Oleo oil	37,014	116,947
Oleo stearine	2,841	9,890
Oleo stock	605	10,545
Palm oil	3,200	11,820
Peanut oil	2,109	6,995
Salt	17,056	35,777
Soda (benzoate of)	15	33
Soya bean oil		225
Total	255,451	498,041

[1] Of the amount produced, 7,043 pounds were reworked.
[2] Of the amount produced, 20,591 pounds were reworked.
[3] Of the amount produced, 88 pounds were reworked.
[4] Of the amount produced, 948 pounds were reworked.

XI–50–5927
MS. 133

Schedule of oleomargarine produced and materials used during the month of October, 1932, as compared with October, 1931.

	October, 1932.	October, 1931.
	Pounds.	*Pounds.*
Total production of uncolored oleomargarine	[1] 19,358,643	[2] 23,439,119
Total withdrawn tax-paid	19,500,840	
Ingredient schedule for uncolored oleomargarine:		
Butter	11,505	2,329
Cocoanut oil	11,854,848	13,721,855
Corn oil	1,094	27,182
Cottonseed oil	1,253,055	1,416,012
Derivative of glycerine	31,039	22,289
Lecithin	68	595
Milk	4,595,522	5,976,072
Neutral lard	943,422	1,263,421
Oleo oil	1,207,594	1,849,834
Oleo stearine	271,259	473,280
Oleo stock	30,167	51,968
Palm oil	9,100	20,771
Peanut oil	204,194	484,814
Salt	1,163,992	1,612,775
Sesame oil		52,710
Soda (benzoate of)	6,539	8,115
Soya bean oil		1,315
Whale oil		150
Total	21,583,398	26,985,427
Total production of colored oleomargarine	[3] 168,943	[4] 526,324
Total withdrawn tax-paid	48,852	
Ingredient schedule for colored oleomargarine:		
Butter	125	40
Cocoanut oil	64,994	136,691
Color	163	739
Cottonseed oil	16,787	63,562
Derivative of glycerine	3	43
Milk	50,449	165,604
Mustard oil		187
Neutral lard	16,346	60,954
Oleo oil	36,075	149,971
Oleo stearine	1,590	6,601
Oleo stock	745	9,415
Palm oil	4,650	15,600
Peanut oil	2,684	7,082
Salt	11,305	45,390
Soda (benzoate of)	6	29
Whale oil		117
Total	205,922	662,225

[1] Of the amount produced, 9,942 pounds were reworked.
[2] Of the amount produced, 10,491 pounds were reworked.
[3] Of the amount produced, 228 pounds were reworked.
[4] Of the amount produced, 935 pounds were reworked.

MISCELLANEOUS.

XI–30–5571

Rate of interest on judgments and overpayments.

Section 319 of the Legislative Appropriation Act for the fiscal year ending June 30, 1933, reads as follows:

SEC. 319. Hereafter the rate of interest to be allowed or paid shall be 4 per centum per annum whenever interest is allowed by law upon any judgment of whatsoever character against the United States and/or upon any overpayment in respect of any internal revenue tax. All laws or parts of laws in so far as inconsistent herewith are hereby repealed.

XI–33–5614

H. R. 12280. PUBLIC, NO. 304, SEVENTY-SECOND CONGRESS.

An Act to create Federal home loan banks, to provide for the supervision thereof, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That this Act may be cited as the "Federal Home Loan Bank Act."

* * * * * * *

EXEMPTION FROM TAXATION.

SEC. 13. Any and all notes, debentures, bonds, or other such obligations issued by any bank shall be exempt both as to principal and interest from all taxation (except surtaxes, estate, inheritance, and gift taxes) now or hereafter imposed by the United States, by any Territory, dependency, or possession thereof, or by any State, county, municipality, or local taxing authority. The bank, including its franchise, its capital, reserves, and surplus, its advances, and its income shall be exempt from all taxation now or hereafter imposed by the United States, by any Territory, dependency, or possession thereof, or by any State, county, municipality, or local taxing authority; except that any real property of the bank shall be subject to State, Territorial, county, municipal, or local taxation to the same extent according to its value as other real property is taxed. * * *

Approved July 22, 1932.

[1] XI–52–5961

Disbarments and suspensions from practice before Treasury Department of attorneys and agents.[2]

DISBARMENTS.

The Secretary of the Treasury, after due notice and opportunity for hearing, has ordered the disbarment from further practice before the Treasury Department of the following-named attorneys and agents:

Name.	Address.	Date of disbarment.	Cause.
Beal, Henry W	Boston, Mass	Sept. 29, 1932	Charged with having been disbarred by the Superior Court of Suffolk County, Mass., for misappropriation of client's funds. Charges found proven.
Behrendt, Henry A	Detroit, Mich	Dec. 5, 1932	Charged with having been disbarred from practice as an attorney in courts of Michigan. Charges found proven.
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.
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.
Ellis, F. L	Council Bluffs, Iowa.	July 11, 1932	Charged with preparing false articles of copartnership showing five partners when there were but two and preparing false returns for such taxpayers. Charges found proven.
Everett, S. H	Formerly Valdosta, Ga., later Orlando, Fla.	Oct. 27, 1932	Charged with defrauding numerous persons by issuing worthless checks and drafts. 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.
Fox, Maurice	Formerly New York, N. Y., now Brooklyn, N. Y.	June 22, 1932	Charged with having been convicted in the United States district court for unlawfully obtaining money from a taxpayer in a tax matter. Charges found proven.

[1] This ruling (5961) includes also rulings Nos. 5539, 5549, 5557, 5572, 5585, 5602, 5615, 5629, 5649, 5672, 5694, 5715, 5737, 5763, 5784, 5801, 5815, 5833, 5848, 5853, 5880, 5894, 5910, 5928, and 5944. 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 December 31, 1932, and all suspensions in effect during the 6-month period July 1–December 31, 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.
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.
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.
Moore, J. Edward.	New Bedford, Mass.	Sept. 29, 1932	Charged with having unlawfully attempted to extort a large fee from a client by threats of disclosure. 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.
Quereau, Edward E.	Formerly Cincinnati, Ohio, later St. Louis, Mo.	June 21, 1932	Charged with making a Federal income return for a taxpayer and receiving a check for the amount of tax due from the taxpayer; that he failed to file such return and appropriated the amount of such check to his own use and benefit; also charged with issuing bad checks; also charged with embezzling funds of a corporation of which he was secretary. Charges found proven.
Ransom, Don E.	Formerly Wichita, Kans., later Fort Worth, Tex.	Sept. 28, 1932	Charged with knowingly preparing a false offer of compromise in a tax matter. 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.
Sandler, Alvin M.	Formerly Tampa, Fla.	Dec. 5, 1932	Charged with having been convicted of a criminal offense in United States district court and disbarred as an attorney by such court. Charges found proven.
Saydman, Davis.	New York, N. Y.	June 23, 1932	Charged with offering money to a revenue agent to make a favorable report on the examination of the books and records of a taxpayer. 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.
Stone, Ralph W.	Formerly Chicago, Ill., now Middletown, Ill.	Nov. 2, 1932	Charged with giving money to prohibition officers to procure the approval of applications for permits for withdrawal of wine. 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.
Van Riper, Harold.	Formerly New York, N. Y.	Nov. 30, 1932	Charged with conviction in a criminal case in the United States district court. Charges found proven.
Weinstein, Harry H.	Formerly New York, N. Y., now Brooklyn, N. Y.	June 29, 1932	Charged with filing false income tax returns for himself. 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.

SUSPENSIONS.

The Secretary of the Treasury, after due notice and opportunity for hearing, has ordered the suspension from practice before the Treasury Department for the period stated in each case of the following-named attorneys and agents:

Name.	Address.	Period of suspension.	Cause.
Coleman, Claude D.	Formerly Sarasota, Fla., later Decatur, Ala.	3 months, from July 11, 1932.	Charged with making false income tax returns for taxpayers. Charges found proven.
Hormuth, Frank	Milwaukee, Wis.	3 months, from June 14, 1932.	Charged with mailing a circular letter to Federal taxpayers containing a statement that the respondent was formerly employed in the Internal Revenue Bureau and soliciting employment in Federal tax matters. Charges found proven.
Newmark, Morris	New York, N. Y.	6 months, from June 28, 1932.	Charged with failure to make income tax returns and with filing false delinquent returns for himself. Charges found proven.
Wilhelm, R. L.	Formerly Dallas, Tex., now Los Angeles, Calif.	30 days, from June 22, 1932.	Charged with proposing a questionable plan to a taxpayer for the reduction of Federal income taxes and procuring a cash retainer and a contingent fee contract of employment on such plan. Charges found proven.

Resignations from enrollment to practice before the Treasury Department.

The following-named persons tendered their resignation from enrollment to practice before the Treasury Department. By direction of the Secretary of the Treasury their resignations were accepted and their names ordered stricken from the roll of attorneys and agents enrolled to practice before the Treasury Department. They are therefore no longer entitled to practice before the Treasury Department.

Name.	Address.	Designation.	Date of acceptance.
Ellenberger, I. W.	Washington, D. C.	Agent	Oct. 10, 1932
McClure, Samuel	Philadelphia, Pa.	Agent	Oct. 24, 1932

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