Treasury Department : : : : Internal Revenue Service

Internal Revenue Bulletin

Cumulative Bulletin 1955–2

JULY–DECEMBER 1955

AUTHENTICATED
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INFORMATION
GPO

INTERNAL REVENUE BULLETIN

CUMULATIVE BULLETIN 1955-

July–December 1955

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ABBREVIATIONS

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

A, B, C, etc.—The names of individuals.
A. T.—Alcohol and tobacco tax ruling.
B. T. A.—Board of Tax Appeals.
C. B.—Cumulative Bulletin.
C. F. R.—Code of Federal Regulations.
Ct. D.—Court Decision.
D. C.—Treasury Department circular.
E. O.—Executive Order.
E. T.—Estate and gift tax ruling.
Em. T.—Employment tax ruling.
F. A. A. A.—Federal Alcohol Administration Act.
F. R.—Federal Register.
G. C. M.—Chief Counsel's memorandum (formerly General Counsel's memorandum).
I. R. B.—Internal Revenue Bulletin.
IR-Mim.—Published IR-Mimeograph.
I. T.—Income Tax ruling.
M, N, X, Y, Z, etc.—The names of corporations, places or businesses according to context.
M. T.—Miscellaneous tax ruling.
Mim.—Published mimeograph.
O. D.—Office Decision.
P. L.—Public Law.
P. S.—Pension, profit-sharing, stock bonus, or annuity plan ruling.
Rev. Proc.—Revenue Procedure.
Rev. Rul.—Revenue Ruling.
Sol. Op.—Solicitor's Opinion.
S. P. R.—Statement of Procedural Rules.
S. T.—Sales tax ruling.
Stat.—Statutes at Large.
T. C.—The Tax Court of the United States.
T. D.—Treasury Decision.
U. S. C.—United States Code.
x and *y* used to represent certain numbers and when used with the word "dollars" represent sums of money.

INTRODUCTION

The Internal Revenue Bulletin is the authoritative instrument of the Commissioner of Internal Revenue for the announcement of official Internal Revenue rulings, and for the publication of Treasury Decisions, Executive orders, legislation, and court decisions pertaining to Internal Revenue matters.

It is the policy of the Service to publish in the Bulletin all substantive and procedural rulings of importance or general interest, the publication of which is considered necessary to promote a uniform application of the laws administered by the Service. It is also the policy to publish all rulings which revoke, modify, amend, or affect any published ruling. Rulings relating solely to matters of internal management are not published. The rulings are prepared in the various divisions of the National Office, including the Office of the Chief Counsel for the Internal Revenue Service. All published rulings have received the consideration and approval of the Chief Counsel.

Revenue Rulings and Revenue Procedures reported in the Bulletin do not have the force and effect of Treasury Department Regulations (including Treasury Decisions), but are published to provide precedents to be used in the disposition of other cases, and may be cited and relied upon for this purpose. However, since each published ruling represents the conclusion of the Service as to the application of the law to the entire state of facts involved, Revenue officers and others concerned are cautioned against reaching the same conclusion in other cases unless the facts and circumstances are substantially the same. In applying rulings published in the Bulletin, personnel of the Service will, of course, consider the effect of subsequent legislation, regulations, court decisions, and rulings.

Each ruling is designated as a "Revenue Ruling" and each published procedure is designated as a Revenue Procedure. These should be cited by reference to the Bulletin and page where reported. Thus, Revenue Ruling No. 55–450 should be cited as "Rev. Rul. 55–450, C. B. 1955–2, 653." Similarly, Revenue Procedure No. 55–1 should be cited as Rev. Proc. 55–1, C. B. 1955–2, 897. Rulings are keyed to the applicable sections of the Internal Revenue Code and regulations.

Internal Revenue Cumulative Bulletin 1955–2 contains all rulings, decisions, and legislation pertaining to Internal Revenue matters published in the weekly Internal Revenue Bulletins 27 to 52, inclusive, for the period July 1 to December 31, 1955. It also contains a cumulative list of announcements relating to decisions of The Tax Court of the United States, published in the Internal Revenue Bulletins during the entire year 1955.

FOREWORD

The Cumulative Bulletin is prepared in five parts. Part I includes rulings and decisions which are based on the application of provisions of the Internal Revenue Code of 1954 and, unless otherwise stated in the ruling or decision, are published without consideration as to any application of the provisions of the Internal Revenue Code of 1939 or related public laws. Part II includes rulings and decisions which are based on the application of provisions of the Internal Revenue Code of 1939 and related public laws and, unless otherwise noted therein, are published without consideration as to any application of the provisions of the Internal Revenue Code of 1954. Part III contains rulings and decisions pertaining to the various alcohol taxes. This part is subdivided into three subparts according to matters issued under the Internal Revenue Code of 1954 (Subpart A), the Internal Revenue Code of 1939 (Subpart B), and the Federal Alcohol Administration Act and related laws (Subpart C). Part IV contains tax legislation and treaties, including related Committee and Conference Reports. This part is subdivided into three subparts according to legislation (Subpart A), tax conventions, Treasury Decisions and Revenue Rulings issued with respect thereto (Subpart B), and Committee Reports (Subpart C). Part V is devoted to administrative and miscellaneous matters. The weekly Internal Revenue Bulletins contained Part VI, consisting of some items of general interest. Other than the disbarment list, which has been incorporated in Part V of this Bulletin, those items are not reproduced herein. The index contained in this Cumulative Bulletin reflects all items published in the Internal Revenue Bulletins during the entire year 1955.

THE TAX COURT OF THE UNITED STATES

CUMULATIVE LIST OF ANNOUNCEMENTS RELATING TO DECISIONS OF THE TAX COURT OF THE UNITED STATES PUBLISHED IN THE INTERNAL REVENUE BULLETIN FROM JANUARY 1, 1955, TO DECEMBER 31, 1955, INCLUSIVE

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

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Babbitt, Dean, et ux	41947 51516 51517 51518	23	850

[1] Nonacquiescence published in Cumulative Bulletin 1948-2, 5, is withdrawn. See Rev. Rul. 55-608, page 546 of this Bulletin.

[2] Nonacquiescence published in Cumulative Bulletin 1953-1, 7, is withdrawn.

[3] Acquiescence with respect to the issue of the separability, for purposes of section 107 of the 1939 Code, of the decedent's services as general counsel for the Missouri Pacific Railroad Company and those rendered as attorney representing the railroad in reorganization proceedings.

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[a] United States Board of Tax Appeals.
[4] Nonacquiescence published in Cumulative Bulletin 1945, 8, is withdrawn.
[5] Estate tax decision.
[6] Nonacquiescence published in Cumulative Bulletin 1947-2, 6, is withdrawn.
[7] Nonacquiescence published in Cumulative Bulletin X-2, 82 (1931), is withdrawn.
[8] Nonacquiescence published in Cumulative Bulletin 1947-1, 5, is withdrawn.
[9] Nonacquiescence published in Cumulative Bulletin XV-1, 29 (1936), is withdrawn.
[10] Acquiescence in issue No. 2 concerns the proper valuation in the gross estate of the decedent who transferred cash and securities to a trust after which such assets were commingled with other assets and ultimately sold or exchanged.

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Cury, Robert L., administrator of estate of George L. Cury	40703		
Cury, Robert Lee	40705		
Cury, Ruth, alleged transferee of estates of Dahar and Elizabeth Cury	34906 34907		
Cury, Ruth Agnes	40706		
Cury, Sol W., alleged transferee of estates of Dahar and Elizabeth Cury	34963 34964		
Cury, Sol W., alleged transferee of D. Cury's Inc	34970		
Cury, Sol W., and Ann C. Romanus, co-administrators of estate of Dahar Cury [11]	34961 34962 38412		
Cury's, D., Inc	34969		
Daggitt, Deloss E., et ux	38570	23	31
Dahlen, W. Ferd	44834	24	159
Davids, Beatrice Clary [12]	8907	8	1045
Davis, Harold S., estate of Davis, Mary, executrix of estate of Harold S. Davis	40005	22	807
Dial, Robert J	47332	24	117
Dial, Robert J., et ux	47333		
Dirksmeyer, Lafayette A	36074	23	208
Dittmar, Martin M., et ux	45442	23	789
Dolle, Walter P., Jr	45377		
Dolle, Walter P., Jr., et al., executors of estate of Walter P. Dolle, Sr., and Bessie H. Dolle, surviving wife Dolle, Walter P., Sr., estate of	45378	24	502
Drachman, Eda Q	32977		
Drachman, Fanchon	32976	23	558
Drachman, Richard M	32975		
Drybrough, F. W	40029	23	1105
Dunn, James A., executor of estate of W. D. Bartlett	38882	22	1228
Dyer, Myles P	44836	24	159
Ely, Elizabeth C., alleged transferee of estates of Dahar and Elizabeth Cury	34967 34968	23	305

[11] Estate tax decision in D. 38412.
[12] Nonacquiescence published in Cumulative Bulletin 1947-2, 6, is withdrawn.

ACQUIESCENCES—Continued

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Farr, Rena B	39335	24	350
Farrier, Mamie F	24540	15	277
Farrier, W. G., estate of (terminated)	24539		
Feagans, Frank T., et ux	35847	23	208
Feagans Paint Co	36075		
Ferncliff Cemetery Mausoleum Co., Inc	[a] 75137	35	1037
Fisher, Frank, et ux	49569	24	269
Fisher, Wilson John [13]	34413	23	218
Flory Milling Co., Inc.[14]	36105	21	432
Forbes, James H	44835	24	159
Fort Wharf Ice Co	45937	23	202
Fox, Maurice [15]	39458	20	1094
Fullerton, George I	38572	22	372
Fulton Bag & Cotton Mills	43796	22	1044
Gannett, Ella J., administratrix of estate of Thomas E. Gannett [16]	45409	24	654
Gannet, Thomas E., estate of [16]			
Gaynor News Co., Inc	45215	22	1172
Girard Trust Corn Exchange Bank	36015	22	1343
Goble, Helen	49121	23	593
Goldberger, Norman S., estate of	35388	18	1233
Goldsmith, Albert J	41831	22	1137
Goodman, Al, et ux	42715	23	288
Goodman Inc., Al	42714		
Greenbros, Inc	49636	23	226
Greenspon, Anna	39404	23	138
Greenspon, Louis	39405		
Greenspon, Louis, transferee	39403		
Greenspon Inc., Louis	39406		
Haggett, Susie C., estate of [16] [17]	16302	14	325
Hannegan, Irma P., et al., executors of estate of Robert H. Hannegan	44837	24	159
Hannegan, Robert H., estate of			
Heatbath Corporation [18]	17563	14	332
Heer-Andres Investment Co.[19]	46537	22	385
Henshaw, Paul A., et ux	48530	23	176
Henshaw, Walter A., et ux	48529		
Holahan, James T., et ux	36399	21	451
Hooks, Jeanette, independent executrix and surviving wife of estate of Pat E. Hooks	45676	22	502
Hooks, Pat E., estate of			
Howard, Lindsay C	41735	23	962
Howard, Lindsay C., et ux	41736		
Hurley, H. A	41210	22	1256
Hurley, H. A., et ux	41211		
Imburgia, Frank	38559	22	1002
Inglewood Park Cemetery Association [20]	[a] 3249	6	386

[a] United States Board of Tax Appeals.

[13] Acquiescence relates to issues involving amounts expended by a professional musician for formal clothing, accessories, and maintenance thereof, and for expenses covering entertainment in the course of employment; also, it relates to the determination of the fair market value of hotel room accommodations furnished in lieu of a higher money salary.

[14] Nonacquiescence published in Cumulative Bulletin 1954-2, 6, is withdrawn.

[15] Nonacquiescence published in Cumulative Bulletin 1954-1, 8, is withdrawn.

[16] Estate tax decision.

[17] Nonacquiescence published in Cumulative Bulletin 1950-2, 5 and 6, is withdrawn.

[18] Nonacquiescence published in Cumulative Bulletin 1950-2, with respect to the corporation's issuance of interest-bearing negotiable demand notes to its stockholder constituted payment within the meaning of section 23(c)(1) of the 1939 Code, is withdrawn. See Rev. Rul. 55-608, page 546 of this Bulletin.

[19] Acquiescence as to result only. The Commissioner, while disagreeing with the treatment by the court of the issue involved, will not file an appeal in this case.

[20] Nonacquiescence published in Cumulative Bulletin VII-1, 38 (1928), is withdrawn.

ACQUIESCENCES—Continued

Taxpayer	Docket No.	Report	
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Jackson, Howard A., et ux	47234	24	1
Jillson, Leon R., et ux.[21]	45371	22	1101
Joachim, Lina, estate of [22]	41637	22	875
Joachim, Richard H., beneficiary of estate of Lina Joachim [22]			
Jones, Warner L., et ux	49668	24	525
Joslyn, George R	38212	23	126
	38214		
Joslyn, George R., et ux	38213		
Kalech, Phil	42376	23	672
Kalech, Phil, et ux	42377		
Karagheusian, Miran, estate of [22] [23]	47159	23	806
Keizer, Lillian Gertrude, transferee	45016	24	256
Kelly, Daniel S. W	37943	23	682
Lake Eloise Groves, Inc	31896	20	136
Larsen, Leonard, et ux	37097	23	599
Lautenberger, Ida M	45017	24	256
Levin Foundation, Alan	44691	24	15
Lewis, A. B	45577	23	538
Lewis, Mary Frances	45576		
Lexmont Corporation	37759	20	185
Lias, William G	27264	24	280
Lias, William G., et ux	27762		
Lime Cola Co., et al	36249	22	593
Lindau, Miriam C	34244	21	911
Loewi & Co	36885	23	486
Mabon, Martha, alleged transferee of the assets of Lime Cola Co	36252	22	593
Marcus, Frances (formerly Frances Blumenthal)	35733	22	824
Martin, Sergeant Price, estate of [22]	42069	23	725
McBride, H. L	47338	23	901
	50139	23	926
McBride, Janet	50138		
McBride Refining Co., Inc	47339	23	901
Mid-State Products Co	24793	21	696
Mikelberg, Henry B	45525	23	342
Mikelberg, Henry B., et ux	45524		
Mikelberg, Rose R	45526		
Mill Lane Club, Inc	46759	23	433
Miller, Edward J.[24]	[a] 85083	37	830
Miller, William S., estate of	19505	14	657
Moore, R. E., former independent executor of estate of W. G. Farrier	24539	15	277
Morrell, John Edgerly, estate of [26]	[a] 103776	43	651
Murrin, James G., et ux	45376	24	502
National Bank of Topeka, Kans., administrator with the will annexed of John Edgerly Morrell estate [26]	[a] 103776	43	651
Newcomb, George M	44938	23	954

[a] United States Board of Tax Appeals.

[21] Acquiescence relates to the issue of the separability of compensation received for services rendered as counsel to trustees under a will and compensation received as a trustee under such will, to determine whether the compensation for the former meets the 80 percent requirement and entitles the taxpayer to the benefits of section 107(a) of the 1939 Code.

[22] Estate tax decision.

[23] Acquiescence in issue No. 2 concerns the proper valuation in the gross estate of the decedent who transferred cash and securities to a trust after which such assets were commingled with other assets and ultimately sold or exchanged.

[24] Nonacquiescence published in Cumulative Bulletin 1938–2, 51, is withdrawn.

[25] Nonacquiescence published in Cumulative Bulletin 1950–2, 6, is withdrawn.

[26] Nonacquiescence published in Cumulative Bulletin 1941–1, 17, is withdrawn.

ACQUIESCENCES—Continued

Taxpayer	Docket No.	Report	
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Noell, Louise	42434	24	329
Nonsuco Inc., Motor Vessel	33522	23	361
North, Ida Ringling, estate of, fiduciary of estate of John Ringling	35786	22	1307
North, John Ringling, executor of estate of Ida Ringling North, fiduciary of estate of John Ringling			
North, John Ringling, executor of estate of John Ringling	35787		
North, John Ringling, fiduciary of estate of John Ringling	35785		
North Star Woolen Mill Company	35430	22	1237
Northern Trust Co., former executor of estate of William S. Miller [27] [28]	19505	14	657
O'Brien, Martin Thomas, et ux.[29]	[a] 108648	47	561
Owens, Donovan, alleged transferee of the assets of Lime Cola Co	36251	22	593
Owens, Ellen P., alleged transferee of the assets of Lime Cola Co	36253		
Owens, Martha Donovan, alleged transferee of the assets of Lime Cola Co	36250		
Page, George A., et ux	49239	24	52
Paolozzi, Alice Spaulding [30]	46543	23	182
Parser, Emilie Polak	46222	21	953
Pasadena City Lines, Inc	42412	23	34
Pfau, Ellwood T	37796	22	284
Pierce, Marion B., estate of [31]	34006	24	95
Platt Trailer Company, Inc	40145	23	1065
Polak, Jacob	46220	21	953
Polak, Jacob and Eliseba	46221		
Polak's Frutal Works, Inc	30131		
	46219		
Pool, Elizabeth Sneed, et al., executors of estate of J. T. Sneed, Jr.[32]	27995	17	1344
Portable Industries, Inc	38640	24	571
Potson, Michael [33]	20024	22	912
Price, Philip, et al., executors of estate of Sergeant Price Martin [27]	42069	23	725
Rainwater, H. R., et ux	41225	23	450
Ray's Clothes, Inc	41759	22	1332
	45093		
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Reid, Joseph, et ux	38571	23	31
Reis & Co., Robert	36542	20	294
Ringling, John, estate of	35787	22	1307
Rockland Oil Co., transferee of estate of John Ringling	35784		
Romanus, Ann C., alleged transferee of estates of Dahar and Elizabeth Cury	34965	23	305
	34966		
Romanus, Ann Co., alleged transferee of D. Cury's Inc.	34971		
Rowe, Frederick E., et ux	50646	24	382

[a] United States Board of Tax Appeals.
[27] Estate tax decision.
[28] Nonacquiescence published in Cumulative Bulletin 1950-2, 6, is withdrawn.
[29] Nonacquiescence published in Cumulative Bulletin 1942-2, 30, is withdrawn.
[30] Gift tax decision.
[31] Acquiescence with respect to the issue of the separability, for purposes of section 107 of the 1939 Code, of the decedent's services as general counsel for the Missouri Pacific Railroad Company, and those rendered as attorney representing the railroad in reorganization proceedings.
[32] Nonacquiescence published in Cumulative Bulletin 1952-1, 6, is withdrawn.
[33] Acquiescence relates to the determination of the taxpayer's net income for the years 1936 through 1943; also, to the determination of the marital status which would entitle the taxpayer to the marital exemption for such years.

ACQUIESCENCES—Continued

Taxpayer	Docket No.	Report	
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Ruwitch, Lee	41543	22	1053
Ryan School Retirement Trust	49445	24	127
Safe Deposit & Trust Co., of Baltimore, executor of estate of Susie C. Haggett [34] [35]	16302	14	325
San Vincente, Inc., Steamship	33523	23	361
Seattle Trust & Savings Bank, trustee under trust agreements dated July 10, 1940, with Norton and Mary Clapp [34]	27403	22	1214
Security-First National Bank of Los Angeles, executor of estate of Chester H. Bowers [34]	37909	23	911
Selling, Fred M., et al., executors of estate of Julius Selling [34]	46830	24	191
Selling, Julius, estate of [34]			
Showell, Jack, et ux	48153	23	495
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Silberman, Frances	47886	22	1240
Silberman, Joseph	47888		
Silberman, Samuel	47887		
Simpson, L. N	40030	23	1105
Smith, Weldon D.[36]	27569	17	135
Smoky Mountains Beverage Co	21778	22	1249
	26761		
Sneed, J. T., Jr., estate of [37]	27995	17	1344
Snively, Sr., John A., transferee of Lake Eloise Groves, Inc	31896	20	136
SoRelle, A. W., estate of	36411	22	459
SoRelle, A. W., Jr., et al., executors of estate of A. W. SoRelle	36411		
SoRelle, Elsie	36218		
SoRelle, Mabel Ruth	39789		
Southwest Hardware Co	44927	24	75
Spreng, Dwight S	47334	24	117
Spreng, Dwight S., et ux	47335		
Stephan, John, et ux.[38]	8906	8	1045
Stewart, William Rhinelander, estate of [34] [39]	[a] 67776	31	201
Stewart, William Rhinelander, Jr., et al., executors of William Rhinelander Stewart estate [34] [39]			
Stierhout, Lois Kaiser	48832	24	483
Strauss, Leon, et ux.[40]	41549	22	140
Tauber, Celia	46839	24	179
Tauber, Rose	46838		
Tauber, Rudolph	49343		
Tauber, Rudolph, et ux	46840		
Tauber, Sheldon	46837		
Tauber, Sheldon, et ux	46841		
Thompson, Murray	25005	21	448
Trounstine, Adele, executrix of estate of Norman S. Goldberger	35388	18	1233
Tunningley, Melvin E	41354	22	1108
United Dressed Beef Co	30317	23	879
United Mercantile Agencies, Inc	40028	23	1105

[a] United States Board of Tax Appeals.

[34] Estate tax decision.

[35] Nonacquiescence published in Cumulative Bulletin 1950-2, 5 and 6, is withdrawn.

[36] Acquiescence relates to the deductibility of attorney's fees from proceeds of settlement payment of former employer in 1945 prior to allocation under section 107(d) of the 1939 Code. Nonacquiescence published in Cumulative Bulletin 1951-2, 5, withdrawn, with respect to this issue.

[37] Nonacquiescence published in Cumulative Bulletin 1952-1, 6, is withdrawn.

[38] Nonacquiescence published in Cumulative Bulletin 1947-2, 7, is withdrawn.

[39] Nonacquiescence published in Cumulative Bulletin XIV-1, 38 (1935), is withdrawn.

[40] See Rev. Rul. 55-170, Cumulative Bulletin 1955-1, 142.

ACQUIESCENCES—Continued

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Walter, Inc., John W	44002	23	550
Webb, Larry E., et ux	47948	23	1035
Weil, Henry, et al., executors of estate of Lionel Weil [41]	36237	22	1267
Weil, Lionel, estate of [41]			
Wolfner, Walter H. S	44857	24	159
Wynekoop, Marcia V., administrator of estate of William Walker Wynekoop [41]	47157	24	167
Wynekoop, William Walker, estate of			
York, Denny	48396	24	742

[41] Estate tax decision.

The Commissioner does NOT ACQUIESCE in the following decisions:

Taxpayer	Docket No.	Report	
		Volume	Page
Adams, Charles E.[1]	[a] 88274	39	387
Ammann, Jack Jordan, et ux	41050	22	1106
Atlas Oil & Refining Corp	40929	22	552
	40930		
Bradford, J. C., et ux.[2]	35990	22	1057
	36895		
Bridgeport Hydraulic Co	43322	22	215
Caulkins, George Peck [3]	108422	1	656
Corno, Walter J., et al., executors of estate of Miran Karagheusian [4] [5]	47159	23	806
Cortese, Clara	40633	22	293
Cristo, Joe	40632		
Fashion Park, Inc	37054	21	600
Gross, Alfred, et ux	46268	23	756
Gross, George M., et ux	46260		
Gross, Robert	46262		
Gross Trust, Gerald	46269		
Gross Trust, Jane	46270		
Gross Trust, Peter	46267		
Hawn, John David, et ux	40246	23	516
Holt, Harold	47636	23	469
Holt, Margaret K	47862		
Jillson, Leon R., et ux.[6]	45371	22	1101

[a] United States Board of Tax Appeals.

[1] Acquiescence published in Cumulative Bulletin 1939-1, 1, with respect to the inclusion in income of the difference between the fair market value and the price at which the taxpayer acquired shares of capital stock of a corporation through the exercise of rights granted under an option agreement, is withdrawn and nonacquiescence is substituted therefor.

[2] Nonacquiescence relates only to the nature of the tax treatment of subsequent collections made under Alabama Power Company contracts received by Eleanor A. Bradford upon redemption of preferred stock, i. e., whether capital gain or ordinary income. Acquiescence published in Cumulative Bulletin 1955-1, page 4, with respect to such matter, is withdrawn.

[3] Acquiescence published in Cumulative Bulletin 1944, 5, as to whether amounts received on "Accumulative Investment Certificates" in excess of amounts paid in, constitute capital gain rather than ordinary income, is withdrawn. See Rev. Rul. 55-136, C. B. 1955-1, 213.

[4] Estate tax decision.

[5] Nonacquiescence in issue No. 1 concerns the extent to which the proceeds of an insurance policy on the life of the decedent, applied for and placed in trust by decedent's wife, are includible in decedent's gross estate.

[6] Nonacquiescence relates to whether under section 107(a) of the 1939 Code, long-term compensation received in 1948 may be allocated between the taxpayer and wife in years prior to 1948, despite the fact that they filed separate returns for such years.

NONACQUIESCENCES—Continued

Taxpayer	Docket No.	Report	
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Karagheusian, Miran, estate of [7] [8]	47159	23	806
Kilpatrick, Lillian	37233	22	446
LoBue, Philip J [9]	41595	22	440
Mahler, Benjamin, et ux.[10]	45231	22	1180
Mammoth Coal Co	32295	22	571
Miller, Mary	40631	22	293
Morton, Alan	46261	23	756
Morton, James	46265		
Morton, Lawrence, et ux	46266		
Morton, Richard, et ux	46264		
Moses, Florence B	27160	18	1020
Newhouse, Norman, et ux	46263	23	756
Nordan, Lester A., et ux	42226	22	1132
North American Mortgage Co.[11]	[a] 15798	18	418
Paley, Jacob (Jay), et ux	40898	22	1236
Pennroad Corporation & Affiliated Companies	33309	21	1087
Peters, Isabel	40813	21	55
Rockford Screw Products Co	30712 37269	21	834
Rosenberg, Abraham, et ux.[12]	37719	20	5
Schwartz, Hymie, et ux	45571	22	717
Simmers, Mary E., executrix of estate of Ralph W. Simmers, and Mary E. Simmers, surviving wife	44724	23	869
Simmers, Ralph W., estate of			
Simmers, Ralph W., and Son, Inc	44725		
Tobacco Products Export Corp	33541	18 21	1100 625
Vargason, Velma B	44790	22	100

[a] United States Board of Tax Appeals.

[7] Estate tax decision.

[8] Nonacquiescence in issue No. 1 concerns the extent to which the proceeds of an insurance policy on the life of the decedent, applied for and placed in trust by decedent's wife, are includible in decedent's gross estate.

[9] Acquiescence published in Cumulative Bulletin 1954–2, 4, relative to the issue of the stock option granted on January 18, 1945, which gave proprietary interest in a corporation and did not result in taxable compensation, is withdrawn.

[10] Nonacquiescence relates to the issue of whether compensation received in 1948 and allocated to prior years 1942 through 1947, so as to recompute the 1948 tax under section 107(a) of the 1939 Code, may be further allocated to the petitioner's wife, despite the fact that they had filed separate returns for such prior years.

[11] In order to conform to the decision in the case of *Willard Helburn, Inc.*, 20 T. C. 740, affirmed (1954) 214 Fed. (2d) 815, acquiescence published in Cumulative Bulletin IX–2, 44 (1930), relative to a foreign exchange transaction in which dollars acquired in repayment of loans were reconverted to guilders at a profit due to a more favorable rate of exchange, is withdrawn.

[12] Acquiescence published in Cumulative Bulletin 1953–2, 6, as to whether the difference between the fair market value and the option price of corporate capital stock was compensation for personal services taxable as income in the year the taxpayer exercised the option and received the stock, is withdrawn and nonacquiescence is substituted therefor.

PART I

RULINGS AND DECISIONS UNDER THE INTERNAL REVENUE CODE OF 1954

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

SUBTITLE A.—INCOME TAXES

CHAPTER 1.—NORMAL TAXES AND SURTAXES

SUBCHAPTER A.—DETERMINATION OF TAX LIABILITY

PART I.—TAX ON INDIVIDUALS

SECTION 1.—TAX IMPOSED

Rev. Rul. 55–711

A "head of a household" status may not be obtained by a taxpayer by virtue of his nonresident alien wife. However, a taxpayer having a nonresident alien wife may qualify as "head of a household" if he can obtain such status by virtue of a dependent, an unmarried descendant, or unmarried stepchild.

Advice has been requested whether, in view of section 1(b)(3)(C) of the Internal Revenue Code of 1954, an individual qualifies as "head of a household" if he maintains as his home a household which constitutes for his taxable year the principal place of abode of his nonresident alien wife and no other individual.

Under the provisions of section 1(b)(2)(A) of the Code, a taxpayer, who is not married at the close of his taxable year and is not a surviving spouse, is a head of a household if, and only if, the individual by virtue of whom he claims such status meets the requirements of a dependent or is the taxpayer's unmarried descendant or unmarried stepchild.

Section 1(b)(3)(C) of the Code provides that "a taxpayer shall be considered as not married at the close of his taxable year if at any time during the taxable year his spouse is a nonresident alien."

Since a nonresident alien wife meets neither of these requirements, she alone cannot qualify her husband as a "head of household." The

fact that an individual has a nonresident alien wife, however, will not deprive him of the status of "head of a household" if he otherwise qualifies for such status by virtue of an unmarried descendant; unmarried stepchild; an individual who qualifies as his dependent (section 1(b)(2)(A)); or a United States citizen dependent parent of the taxpayer (section 1(b)(2)(B)), and meets other statutory requirements contained in subsection (2)(A) or (B) of section 1(b) of the 1954 Code.

The term "dependent" does not include any individual who is not a citizen of the United States unless such individual is a resident of the United States, of a country contiguous to the United States, of the Canal Zone, or of the Republic of Panama, (except certain children born or adopted in the Philippine Islands), and that such persons who are deemed dependents under subsections (a)(9) and (10) and (c) of section 152 of the Code are not considered dependents qualifying a taxpayer as a head of a household because of section 1(b)(4)(B).

On the other hand, a taxpayer may qualify as a "head of a household" by virtue of his unmarried descendants or unmarried stepchild, even though such descendant or stepchild is not a citizen of the United States, nor a resident of the United States or a contiguous country. As an example, a citizen of the United States residing abroad may claim the status of a "head of a household" by virtue of his nonresident alien wife's child by a former marriage.

PART IV.—CREDITS AGAINST TAX

SECTION 31.—TAX WITHHELD ON WAGES

(Also Sections 3101, 3201.) Rev. Rul. 55-690

An individual is not entitled to any credit against his income tax liability solely because of the payment of the employee tax under both the Railroad Retirement Tax Act and the Federal Insurance Contributions Act with respect to payments received by him of compensation subject to the Railroad Retirement Tax Act and of wages subject to the Federal Insurance Contributions Act during the same year.

An individual has requested the Internal Revenue Service for advice whether he is entitled to any credit against his income tax liability as a result of the payment of the employee tax under both the Railroad Retirement Tax Act and the Federal Insurance Contributions Act (chapters 22 and 21, respectively, subtitle C, Internal Revenue Code of 1954) with respect to payments received by him of compensation subject to the Railroad Retirement Tax Act and of wages subject to the Federal Insurance Contributions Act during the same year.

The individual is regularly employed by a railroad company and the employee tax imposed by the Railroad Retirement Tax Act is deducted from the compensation paid to him by the company. He also performs part-time services for another employer which constitute employment under the Federal Insurance Contributions Act and the employee tax imposed by that Act is deducted from the wages which he receives for such part-time employment.

The employee tax imposed by the Railroad Retirement Tax Act and the employee tax imposed by the Federal Insurance Contributions Act are separate and distinct taxes and liability may be incurred by an employee under both Acts by reason of separate employments, even though services may be performed for each of both employers during the same period. The employee tax imposed by section 3101 of the Federal Insurance Contributions Act applies to the first $4,200 of "wages," as defined in such Act, paid to an employee by an employer during any calendar year after 1954. The employee tax imposed by section 3201 of the Railroad Retirement Tax Act applies to the "compensation," as defined in such Act, not in excess of $350 earned by an employee in any month after 1954 from one "employer" or more than one. Therefore, the fact that the employee tax under the Railroad Retirement Tax Act is also being deducted from the individual's compensation by his railroad employer does not affect the liability he has incurred with respect to his part-time employment for the employee tax under the Federal Insurance Contributions Act. Conversely, the fact that the employee tax under the Federal Insurance Contributions Act is being deducted from his wages paid by his part-time employer does not affect his liability for the employee tax under the Railroad Retirement Tax Act on the compensation he receives from his railroad employer. Accordingly, it is held that the individual is not entitled to any credit against his income tax liability solely because of the payment of the employee tax under both of those Acts.

SECTION 34.—DIVIDENDS RECEIVED BY INDIVIDUALS

Credit against tax liability with respect to dividends received from an estate. See Rev. Rul. 55–728, page 36.

SECTION 37.—RETIREMENT INCOME

Rev. Rul. 55–597

In a community property State a spouse's share of the community earnings of the other spouse may serve to reduce the retirement income of the retired spouse for the purpose of the credit provided by section 37 of the Internal Revenue Code of 1954.

Advice has been requested whether, in applying section 37 of the Internal Revenue Code of 1954, the income earned by one spouse in a community property State, but attributable to the other spouse by reason of the community property law, shall be treated as earned income received by the other spouse.

In the instant case the taxpayers reside in California, a community property State. The wife who has not reached the age of 75 has retirement income and the husband is employed at a yearly salary in excess of $4,200.

Section 37 of the Internal Revenue Code of 1954 allows a qualified individual a credit against his tax on account of his retirement income. To qualify for the credit, subsection (a) provides that the individual must have previously received earned income.

Section 37 of the Code further provides, in part, as follows:

(b) INDIVIDUAL WHO HAS RECEIVED EARNED INCOME.—For purposes of subsection (a), an individual shall be considered to have received earned income if he has received, in each of any 10 calendar years before the taxable year, earned income (as defined in subsection (g)) in excess of $600 * * *

* * * * * * *

(d) LIMITATION ON RETIREMENT INCOME.—For purposes of subsection (a), the amount of retirement income shall not exceed $1,200 less—

(1) in the case of any individual, any amount received by the individual as a pension or annuity—

(A) under title II of the Social Security Act,

(B) under the Railroad Retirement Acts of 1935 or 1937, or

(C) otherwise excluded from gross income, and

(2) in the case of any individual who has not attained the age of 75 before the close of the taxable year, any amount of earned income * * * in excess of $900 received by the individual in the taxable year.

The above statute refers to an individual who has received earned income. This is the same language used in connection with the credit which was formerly allowed with respect to earned income. See section 25(a)(3) of the Internal Revenue Code of 1939 as enacted. In connection with that credit, it was held that, where a husband and wife were domiciled in a community property State, the wife was permitted to treat as earned income received by her, her share of the community income earned by her husband. See *Mrs. Ethel Hopkins McLarry* v. *Commissioner*, 30 Fed. (2d) 789; *Hallie Graham* v. *Commissioner*, 95 Fed. (2d) 174. By using the same language, Congress indicated its intent to adopt the construction which had already been given to it.

A literal construction of section 37 of the Code is further supported by the action of Congress in connection with the self-employment tax. Section 1402(a) of the Code of 1954 which defines net earnings from self-employment, under subsection (6) provides expressly how community income shall be treated for the purpose of such definition. Thus, for the purposes of the self-employment tax, Congress expressly limited the operation of the community property laws. It provided no such limitation in section 37 of the 1954 Code.

In view of the foregoing, it is the position of the Internal Revenue Service that where a husband and wife are domiciled in a community property State each spouse should treat his or her share of income earned by the other spouse as earned income received by him. This is consistent with the concept of treating the couple as a community. See *Burns Poe* v. *H. C. Seaborn*, 282 U. S. 101, Ct. D. 259, C. B. IX-2, 202 (1930). Thus, they would both become entitled to the credit as a result of the earnings of either. The husband should take into account his separate portion of the earnings of the wife in determining whether he is eligible for the retirement income credit and in computing the amount of his credit, and the wife should take into account her separate portion of the earnings of the husband in determining her eligibility and in computing her credit.

Accordingly, it is held that a spouse's share of the community earnings of the other spouse may serve to reduce the retirement income of the retired spouse for the purpose of the credit provided by section 37 of the Code.

Rev. Rul. 55-598

A husband and wife are domiciled in a community property State and their earnings have always constituted community income. The husband did not receive in each of 10 calendar years earned income of $600; however, his wife received earned income in excess of $1,200 for the 10 years preceding 1954. In 1954 the husband received social security benefits of $300 and his wife received a fully taxable pension from the State in the amount of $1,400. They have no other income. *Held*, for purposes of the retirement income credit, a spouse in a community property State should treat his share of income earned by the other spouse as earned income received by him. See Rev. Rul. 55-597, page 15, this Bulletin. Social security payments, as well as taxable pensions, attributable to earnings which constitute community income, are similarly handled for purposes of the credit. In the instant case, each spouse is entitled to a credit based on retirement income of $700 without any reduction for the social security payments since the retirement income of each spouse is not in excess of $1,200, less such payments. Should the combined earned income of both spouses not have exceeded $1,200 for each of 10 prior calendar years, neither spouse would have qualified for the retirement income credit. (Schedule K of Form 1040 for the year 1955 will reflect the proper retirement income of individuals with actual retirement income of less than $1,200.)

Rev. Rul. 55-636

Retirement income does not include royalty payments received by an author for the use of or for the privilege of using his copyrights. Such royalties do not constitute "earned income" as such term is used in section 37(d)(2) of the Internal Revenue Code of 1954. However, if the author has contracted with the publisher to furnish literary material on a certain subject for a stipulated fee, or a fee plus a percentage of the income derived from its publication, the payments received therefor constitute "earned income" for such purposes.

Advice has been requested whether royalty income received from the publication of a book is retirement income for a person over 65 and under 75 years of age and whether royalty income represents earned income for the purposes of section 37(d)(2) of the Internal Revenue Code of 1954.

Section 37(a) of the Internal Revenue Code of 1954 provides for a limited exemption to a qualified individual by means of a tax credit for all forms of retirement income. To qualify for the credit, such section provides that the individual must have received earned income in excess of $600 a year for each of any 10 prior calendar years. In the case of an individual who has attained the age of 65 years before the close of the taxable year, retirement income includes income from pensions and annuities, interests, rents and dividends to the extent included in gross income without reference to this section, but only to the extent such income does not represent compensation for personal services rendered during the taxable year.

Section 37 of the Code further provides, in part, as follows:

(d) LIMITATION ON RETIREMENT INCOME.—For purposes of subsection (a), the amount of retirement income shall not exceed $1,200—

(1) In the case of any individual, any amount received by the individual as a pension or annuity—

(A) Under title II of the Social Security Act,

(B) under the Railroad Retirement Acts of 1935 or 1937, or

(C) otherwise excluded from gross income, and

(2) in the case of any individual who has not attained the age of 75 before the close of the taxable year, any amount of earned income * * * in excess of $900 received by the individual in the taxable year.

Whether an author renders personal services or sells, leases, or rents his book to a publisher depends on the terms of the contract. G. C. M. 236, C. B. VI–2, 27 (1927), holds that if an author contracts to write articles for a given period or a book for a publisher who copyrights the literary material and pays the author a stipulated amount of cash, plus a percentage of the income derived therefrom, the consideration is for the author's personal services and constitutes earned income.

Where, however, royalties are derived from the sale, leasing, or renting of a book, they are not paid for personal services actually rendered but are paid for the use or sale of property and do not come within the meaning of the term "earned income" as used in section 37(d)(2) of the Code.

Accordingly, it is held that retirement income does not include royalty payments received by an author for the use of or for the privilege of using his copyrights. Such royalties do not constitute "earned income" as such term is used in section 37(d)(2) of the Internal Revenue Code of 1954. However, if the author has contracted with the publisher to furnish literary material on a certain subject for a stipulated fee, or a fee plus a percentage of the income derived from its publication, the payments received therefor constitute "earned income" for such purposes.

General treatment, for purposes of withholding of income tax at source, of pensions and retired pay. See Rev. Rul. 55–484, page 454.

SUBCHAPTER B.—COMPUTATION OF TAXABLE INCOME

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

SECTION 61.—GROSS INCOME DEFINED

(Also Part II, Section 22(a); Regulations 118, Section 39.22(a)–1.) Rev. Rul. 55–478

In the case of mutual savings banks not having capital stock represented by shares, as in the case of other insured banks, Federal Deposit Insurance Corporation credits under section 7(d) of the Federal Deposit Insurance Act, 64 Stat. 873, at 877, 12 U. S. C. 1817(d), received or accrued in a taxable year beginning after December 31,

1951, constitute income for Federal income tax purposes, full deduction being allowable for the future assessments against which such credits are allowable. Such amounts received or accrued do not represent recoveries of any particular expenditures made in years beginning prior to December 31, 1951, during which such institutions were exempt from Federal income tax, but constitute gross income subject to tax in a taxable year in which received or accrued. Compare Rev. Rul. 62, C. B. 1953–1, 71, as made applicable by Rev. Rul. 214, C. B. 1953–2, 140.

(Also Section 167.) Rev. Rul. 55-541
(Also Part II, Sections 22(a), 23(l); Regulations 118, Sections 39.22(a)–1, 39.23(l)–1.)

Where a corporation manufacturing office equipment leases certain items of such equipment to another corporation, the lease being in reality a transfer of equitable ownership of the equipment to the lessee, the sum of the payments properly allocable to the sale price constitutes proceeds from sale of the equipment by the manufacturing corporation. Such payments made or to be made by the lessee corporation constitute capital expenditures, recoverable through depreciation deductions over the estimated useful life of the equipment.

Advice has been requested as to the proper treatment for Federal income tax purposes of the following described transaction.

Corporation *P*, a lease broker, solicited from corporation *M* an order to lease certain office equipment manufactured by corporation *N* and having a manufacturer's list price of $100x$ dollars. Attached to the order was a "Personal Property Lease Agreement" which was entered into by corporation *M* and corporation *N*.

Under the order and the agreement, corporation *N* is to furnish the desired equipment to corporation *M* for a period of 36 months for a total consideration of $116x$ dollars payable in equal monthly installments. The agreement and the order both provide that the agreement can be renewed for 10 years, in one year renewals for $1x$ dollars per year. Corporation *M* is to pay as additional "rental" all taxes on the property, insurance, and the cost of keeping the equipment in good repair and working order.

Corporation *P* stated in its letter soliciting the order from corporation *M* that after the base lease period the "lessee" continues to use the equipment at one percent of its original invoice value, and, at all times during the term of the lease or use, the "lessee" has full trading privileges which would normally exist were he the owner of the property, thus giving him all the benefits of ownership without any of the hazards of depreciation or the resultant loss of working capital. Corporation *M* was also advised that the " lease" would be assigned to a bank or an insurance company and that all payments thereunder would be made to the assignee.

The agreement contains no provision whereby corporation *M* may acquire legal title to the equipment. It does, however, contain a provision for the return of the equipment to the "lessor" upon the expiration or termination of the lease.

In order to determine the proper method of reporting income and deductions for corporation *N* resulting from this transaction and the reporting of deductions for corporation *M*, it is necessary to ascer-

tain whether the agreement is, in fact, a lease, or whether it transfers the equitable title of the equipment to corporation *M*.

The absence of reference in an agreement to the transfer of legal title to the property to the user, while indicative of a lease, does not of itself classify the agreement as a lease. In all cases the entire agreement must be studied to ascertain the true intent of the parties.

Equipment of the type being acquired by corporation *M* has an estimated useful life of from 10 to 15 years. The agreement permits corporation *M* to have use of the equipment for 13 years, including all renewal periods. Thus corporation *M* has gained possession and will have use of the equipment for substantially its entire useful life, even though it may never acquire legal title to such property.

During the first three years of use, corporation *M* is required to pay $116x$ dollars, whereas during the remaining 10 years of use corporation *M* is required to pay only $1x$ dollars per year or $10x$ dollars. In order to have use and possession of the equipment for 13 years, it is required to pay, disregarding taxes, insurance, etc., a total of $126x$ dollars, over 90 percent of which is to be paid in less than a quarter of the time for which it is permitted use and possession of the equipment.

In the light of these facts, it is held that the agreement executed by corporation *M* and corporation *N* will transfer equitable ownership to corporation *M* as it will enjoy all of the benefits of ownership for substantially the entire useful life of the property.

It is held, further, that corporation *N* has realized proceeds from sale of the equipment measured by the sum of the payments properly allocable to the sales price. Corporation *M* must capitalize the amounts properly allocable to the purchase price of the equipment and recover such capitalized cost by appropriate depreciation deductions over the estimated useful life of the equipment.

See Rev. Rul. 55–540, page 39, this Bulletin.

(Also Section 262.) Rev. Rul. 55–555

It has long been the position of the Internal Revenue Service that a car pool arrangement in which the members share the responsibility for furnishing transportation to and from their places of work and each takes his turn at driving his own automobile is not an arrangement which gives rise to taxable income or deductible expenses. The Service has been asked whether the same rule applies to a car pool arrangement in which only one member uses his own automobile and his fellow members pay him a stated sum of money for transporting them to and from work.

It is the position of the Service that money received by an automobile owner from fellow employees for transporting them to and from work constitutes reimbursement by them for their share of the personal expenses incurred in the operation of the automobile for their mutual convenience. Such money is not includible in computing the gross income of the automobile owner for Federal income tax purposes. The automobile expenses incurred by him in commuting between his home and place of employment are personal expenses for which no deduction is allowed for Federal income tax purposes. However, this

Revenue Ruling is not intended to apply to the situation where a particular car owner has developed his car pool arrangements to the extent that he can be said to have established a trade or business of transporting workers for hire from which a profit is derived.

Rev. Rul. 55-652

Unemployment compensation payments made to Federal employees during unemployment periods by State or Federal agencies, as provided for by Title XV of the Social Security Act, as amended, do not constitute income to the recipients for Federal income tax purposes.

Advice has been requested whether unemployment compensation payments to Federal employees during unemployment periods, made pursuant to Title XV of the Social Security Act, as amended, 68 Stat. 1130, 42 U. S. C. 1361, constitute taxable income to the recipients.

Public Law 767, 83d Cong., C. B. 1954–2, 612, entitled "An Act to extend and improve the unemployment compensation program" amended the Social Security Act by adding Title XV which extended unemployment compensation benefits to Federal employees. Section 1502 of Title XV *supra*, authorizes the Secretary of Labor to enter into an agreement with any State, or with the agency administering the unemployment compensation law of the State, under which such agency will make payments to unemployed Federal employees after December 31, 1954, as agent of the United States. Such payments are to be in the same amount and subject to the same terms and conditions as if the Federal service were covered under the unemployment compensation law of the State. Section 1503 of Title XV, *supra*, provides in substance that in the absence of a State agreement, the Secretary of Labor is to make payments to unemployed Federal workers after December 31, 1954, in the same amounts and subject to the same terms and conditions as would be paid to such Federal workers if their Federal service had been covered by State law.

In I. T. 3230, C. B. 1938–2, 136, it was held that payments on account of unemployment paid by a State agency out of funds received from the Federal unemployment trust fund are not subject to Federal income tax in the hands of the recipients. The same principle is equally applicable to unemployment compensation payments made under Title XV of the Social Security Act, as amended. Accordingly, such payments are exempt from Federal income tax to the recipients.

(Also Section 451.) Rev. Rul. 55-691

A lump sum paid for the purchase of an annuity or paid to an irrevocable trust, for the purpose of relieving guarantors of their individual personal obligation for payment of corporate salary to an employee, constitutes taxable income to the employee for the year in which either the annuity is purchased or the amount is paid over to the trust for this purpose.

Advice has been requested relative to the taxability to an employee of an annuity purchased or an irrevocable trust formed by guarantors

of the employee's corporate salary for the purpose of relieving the guarantors of their individual personal obligation for payment of the salary to such employee.

A, in 1952, entered into an employment agreement with the *M* corporation which agreement was to continue for a period of years and provided for a salary of $50x$ dollars per year payable semimonthly. The contract was guaranteed by *B* and *C* as individuals.

Due to financial difficulties during the current year (1955), the corporation is unable to pay the full amount of the compensation and the actual salary being paid is about $3x$ dollars less per month than the amount payable under the contract. *B* and *C* are desirous of being relieved of their personal guaranty and are willing to pay $75x$ dollars therefor payable through an irrevocable trust in which *A* will be the beneficiary. The amount to be paid out of the trust will be $3x$ dollars per month which is the difference between what *A* receives from the corporation and what the contract calls for. As an alternative, *B* and *C* are considering purchasing a single premium annuity, with *A* as the beneficiary and which will pay *A* an amount not in excess of $3x$ dollars per month. It is not proposed that *A*'s right to receive distribution from the trust or payments under the annuity contract be contingent upon his continued performance of services under the employment agreement with the *M* corporation.

The specific question presented is, depending on whether the trust was formed or an annuity was purchased, whether *A* must include in his gross income the amount transferred to the trust or the consideration paid for the annuity in the year such amount is transferred or paid.

In this case the amount to be transferred to the trust or paid for the annuity, as the case may be, constitutes compensation paid for services within the meaning of section 61(a) of the Internal Revenue Code of 1954. Whether the amount is transferred to the irrevocable trust or paid for the purchase of an annuity with *A* as beneficiary, *A* will be deemed to have received an economic and financial benefit in the year of such transfer or payment and the total amount thereof will be taxable to *A* in such year. See Regulations 118, section 39.22(b)(2)–5, applicable under the 1954 Code by virtue of T. D. 6091, C. B. 1954–2, 47, and I. T. 4041, C. B. 1951–1, 5; also *Robert P. Hackett et al.* v. *Commissioner*, 159 Fed. (2) 121; *Elliott C. Morse* v. *Commissioner*, 202 Fed. (2d) 69; *J. Carlton Ward, Jr.* v. *Commissioner*, 159 Fed. (2d) 502; *J. Ferd Oberwinder et al.* v. *Commissioner*, 147 Fed. (2d) 255; *E. T. Sproull* v. *Commissioner*, 16 T. C. 244; *J. H. McEwen* v. *Commissioner*, 6 T. C. 1018; and *Renton K. Brodie et al.* v. *Commissioner*, 1 T. C. 275.

Accordingly, it is held that the contemplated transfer of $75x$ dollars to a trustee for the benefit of *A* or the purchase of an annuity contract in which *A* is the beneficiary will constitute taxable income to *A* in the year in which such transfer or purchase is made.

(Also Section 101.) Rev. Rul. 55-713
(Also Part II, Sections 22(a), 22(b); Regulations 118, Sections 39.22(a)-1, 39.22(b)(1)-1.)

Where an employer contracts with his employee to pay the annual premiums on insurance policies on the life of such employee to the extent of the annual increases in the cash surrender value of the policies, the employee paying the balance, and according to which the employer will at the death of the insured employee receive from the proceeds of the policy an amount equal to such cash surrender value, the balance of the proceeds being paid to the employee's beneficiary, such arrangement is regarded, for Federal income tax purposes, as though an interest-free loan is actually made by the employer to the employee in amounts equal to the annual increases in the cash surrender value of such policies. The mere making available of money does not result in realized income to the payee or a deduction to the payor. The respective portions of the proceeds of such policies payable upon the employee's death are excludable from the gross income of the employer and the employee's beneficiary under section 101(a)(1) of the Internal Revenue Code of 1954 and section 22(b)(1) of the Internal Revenue Code of 1939.

Advice has been requested as to whether the portion of insurance premiums paid by an employer, to the extent of the cash surrender value, under an insurance policy covering the life of an employee, constitutes additional income to the employee.

In the instant case, *Y* corporation entered into a contract with *B* to render services as its president for a period of 5 years in consideration of an annual salary together with stipulations for the payment of certain specified amounts in the event of his disability and upon his death to his designated beneficiaries. In order to protect itself against contingent liabilities resulting from the above agreement, *Y* corporation purchased as sole owner and beneficiary several policies of ordinary life insurance on the life of *B* in the amount of its total liability under the contract. Pursuant to a supplemental agreement, it was provided that *B* had the option to assist in the payment of premiums on one or more of the policies in return for a partial control over the distribution of death benefits thereunder. Under the agreement, the gross premium less the amount of any dividends would be paid in part by *Y* corporation to the extent of the increase in cash surrender value for any taxable year and the balance would be paid by *B*. Both the *Y* corporation and *B* would each have separate ownership rights during his lifetime with the right of *B* to designate the beneficiary under the policies for that part of the proceeds equal to the excess of the face amount payable under each policy over the cash surrender value. The *Y* corporation would continue to be the beneficiary under the policies to the extent of the cash surrender value which would be available for general corporate purposes. Upon termination of *B*'s employment, *Y* corporation agrees, upon *B*'s election, to (1) sell its ownership interest in the life insurance contracts to *B* for an amount equal to the larger of the gross premiums it has paid or the guaranteed cash values in its portion of the policies; or, (2) assign to *B* all of its ownership interest in such policies except an amount equal to the guaranteed cash surrender value at the date of the assignment, provided, however, if *B* defaults on any future premiums

the corporation may reassert its rights to ownership. *B* elected to share the cost of the life insurance policies.

Generally, for tax purposes premiums paid by an employer on the ordinary type of life insurance policy on the life of its employee who is permitted to designate the beneficiary under the policy constitutes taxable income to the employee. O. D. 627, C. B. 3, 104 (1920); G. C. M. 8432, C. B. IX-2, 114 (1930). Likewise, it has been held that it makes no difference whether the insured employee is entitled to designate the beneficiary under the policy the proceeds of which inure directly to the benefit of the employee's beneficiary or his estate. G. C. M. 16069, C. B. XV-1, 84 (1936).

In the instant case, the substance of the insurance arrangement between the parties is in all essential respects the same as if *Y* corporation makes annual loans without interest, of a sum of money equal to the annual increases in the cash surrender value of the policies of insurance taken out on the life of *B*. The mere making available of money does not result in realized income to the payee or a deduction to the payor.

In view of the foregoing, it is held that:

1. No realization of taxable income by *B* will result upon the payment of the portion of the premiums by *Y*, and *Y* will receive no deduction for such payment.

2. The portion of the proceeds of the policies payable upon the death of *B* to the *Y* corporation and to the designated beneficiary of *B* would not be included in the gross income of the *Y* corporation or of *B*'s beneficiary under the provisions of section 101(a) of the Internal Revenue Code of 1954 or section 22(b)(1) of the Interal Revenue Code of 1939.

(Also Section 6013.) Rev. Rul. 55–726

In Washington, in California and in all community property states having similar community property laws, the estate of a deceased spouse should not, for Federal income tax purposes, be regarded as embracing the whole of the comunity property; the surviving spouse is the proper taxable person with respect to one-half of the income therefrom.

In view of the decision in *United States* v. *R. D. Merrill*, 211 Fed. (2d)279, advice has been requested whether the estate of a deceased spouse in the State of Washington, in California, and in other states having similar community property laws, should be regarded as embracing the whole of the community property, or whether the surviving spouse is the proper taxable person with respect to one-half thereof.

In Washington (as in California), the State law provides that upon the death of either spouse the entire community property is subject to administration and to the community debts and expenses of administration. In both States, on the death of one member of the marital community, the surviving spouse continues to own a one-half share of the community property. Such share is not a part of the decedent's estate. See Remington's Revised Statutes of Washington, sections 1342, 1419; Deering's Civil Code of California, section 161a, and Deering's Probate Code of California, sections 201, 202; also see *Burns Poe* v. *H. G. Seaborn*, 282 U. S. 101, Ct. D. 259, C. B. IX-2, 202 (1930).

In the Merrill case, the United States Court of Appeals for the Ninth Circuit held that an executor's fee received by a surviving spouse for the administration of community property in the State of Washington should be allocated one-half to the decedent's estate and one-half to the survivor's interest in such property and the executor received no income from the one-half of the fee which was attributable to his community interest. In this case, the court was faced with the fact that in two similar factual situations (Washington and California cases) it had previously arrived at conflicting decisions. In the first of these, *Commissioner* v. *Rose B. Larson*, 131 Fed. (2d) 85, the court held that in the State of Washington, the "ownership" of the income from the community property during administration and liquidation thereof is in the executor or administrator, and that he should report such income in the income tax return of the estate and the surviving widow was not required to include in her income tax return one-half of the profit realized by her deceased husband's executor. However, in the California case, *Stella Wheeler Bishop* v. *Commissioner*, 152 Fed. (2d) 389, the same court, reviewing the decision of the Tax Court of the United States, 4 T. C. 588, stated:

"The Tax Court appears to have assumed, that upon decedent's death, petitioner's half of the community property ceased to be hers and became a part of the decedent's estate. The assumption is incorrect. Petitioner's half, like decedent's half, was subject to administration, but unlike his half, her half never became part of his estate."

In the Merrill case the court conceded "that there is no real difference between the law of California and that of Washington for purposes of the present problem," and also that "the *Larson* case was stripped of its force by the reasoning of the *Bishop* case and should not be followed."

It is accordingly held that in Washington and California and in all community property states having similar community property laws the estate of a deceased spouse should not, for Federal income tax purposes, be regarded as embracing the whole of the community property; the surviving spouse is the proper taxable person with respect to one-half of the income therefrom. See G. C. M. 25008, C. B. 1946-2, 49, to the same effect. See also Rev. Rul. 267, C. B. 1953-2, 32.

Rev. Rul. 55-727

Bonus payments received under contract by a professional baseball player for professional services to a club, whether or not performed, and for refraining from playing for any other baseball club during the period of the contract, even though the player entered the Armed Forces of the United States and performed no services under the contract, are taxable to him as ordinary income for the taxable year in which received.

Advice has been requested concerning the Federal income tax treatment of bonus payments made to a professional baseball player.

The taxpayer, a professional baseball player, entered into a one-year contract with a baseball club in which he agreed to render services as a ballplayer during the 1953 training season, playing season, exhibition games, and the World Series or any other official series in which the club might participate. Taxpayer further agreed that, while

under the contract and before the expiration of the club's right to renew the contract, he would not play baseball otherwise than for the club, except in post-season games under conditions prescribed in the major league rules. In addition to specified compensation for the season, the contract provided for a bonus to the player or his estate, payable one-half in January, 1954, and one-half in January, 1955, regardless of whether or not he was able for any reason to render services. During the latter half of the 1953 season, the taxpayer entered the Armed Forces of the United States and was unable to render any services to the club.

The payments to the taxpayer under the contract were for his promise to perform services, whether or not actually rendered to the club, and for the taxpayer's not exercising his privilege of playing for another baseball club.

In the case of *Estate of John D. Beals, et al.* v. *Commissioner*, 82 Fed. (2d) 268, Ct. D. 1140, C. B. XV-2, 227 (1936), the court stated:

"A promise not to work for others or for one's self is no more a conveyance of property than is a promise to enter the promisee's employ. Payment for either promise is income, not proceeds received on disposal of a capital asset."

Accordingly, it is held that bonus payments received under a contract by a professional baseball player for professional services to a club, whether or not performed, and for refraining from playing for any other baseball club during the period of the contract, even though the player entered the Armed Forces of the United States and performed no services under the contract, are taxable to him as ordinary income for the taxable year in which received.

Bonus payments received by any other individuals under circumstances similar to those in this Revenue Ruling would likewise be taxable as ordinary income to such individuals in the taxable year in which received.

Determination of gross income where capital gains and capital losses are involved. See Rev. Rul. 55–498, page 303.

Per diem allowances in lieu of subsistence and mileage allowances received by members of the uniformed services of the United States while traveling or on temporary duty. See Rev. Rul. 55–572, page 45.

Six months' gratuity pay received by dependent relative or relatives because of the death of a member of the Armed Forces. See Rev. Rul. 55–581, page 381.

SECTION 62.—ADJUSTED GROSS INCOME DEFINED

(Also Section 162). Rev. Rul. 55–637

The car mileage allowance received by a rural mail carrier for the maintenance of his automobile which is used in carrying on his employment as a rural mail carrier is includible in gross income for Federal income tax purposes. See I. T. 3541, C. B. 1942–1, 41. To the

extent, however, that a mail carrier uses his automobile for his transportation in delivering the mail, he is entitled, in arriving at adjusted gross income, to deduct the cost of operation, repair, and upkeep, as well as depreciation. I. T. 3541, *supra*, amplified.

PART II.—ITEMS SPECIFICALLY INCLUDED IN GROSS INCOME

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

(Also Part II, Section 22(b); Regulations 118, Section 39.22(b)(2)-5.) Rev. Rul. 55-427

A corporation maintained a nontrusteed retirement plan for its employees under which the participants contributed a percentage of salary less social security tax withheld. The company contributed an equal amount. Benefits were funded by the purchase of individual annuity policies on behalf of the participants. The company discontinued funding the plan by the purchase of individual annuity policies and immediately established a trust for the funding of benefits under the plan which will meet the requirements of section 401(a) of the Internal Revenue Code of 1954 (section 165(a) of the 1939 Code). Participants in the nontrusteed plan are eligible and required to participate in the trusteed plan. The insurer issuing the contracts under the nontrusteed plan required, as a condition of transferring any accumulation, the cancellation of all policies issued to participants and the transfer of all accumulations thereunder. The funds accumulated under the nontrusteed plan were transferred from the insurer to the trust forming a part of the trusteed plan. *Held*, The participants under the nontrusteed plan were not in receipt of income as a result of the transfer of the funds from the insurer to the trust.

SECTION 73.—SERVICES OF CHILD

26 CFR 1.73-1: Services of child. T. D. 6137 [1]
(Also Sections 74, 75, 76, 77; 26 CFR 1.74-1, 1.75-1, 1.76, 1.77-1.)

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

Regulations prescribed under section 73 to 77, inclusive, of the Internal Revenue Code of 1954.

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

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

On December 31, 1954, notice of proposed rulemaking with respect to sections 73 to 77, inclusive, of the Internal Revenue Code of 1954 was published in the Federal Register (19 F. R. 9401). After con-

[1] 20 F. R. 4982.

sideration of such relevant suggestions as were presented by interested parties regarding the proposed rules, the following regulations are hereby adopted. These regulations are effective for taxable years beginning after December 31, 1953, and ending after August 16, 1954, the date of enactment of the Internal Revenue Code of 1954.

SEC. 1.73. STATUTORY PROVISIONS; SERVICES OF CHILD.

SEC. 73. SERVICES OF CHILD.

(a) TREATMENT OF AMOUNTS RECEIVED.—Amounts received in respect of the services of a child shall be included in his gross income and not in the gross income of the parent, even though such amounts are not received by the child.

(b) TREATMENT OF EXPENDITURES.—All expenditures by the parent or the child attributable to amounts which are includible in the gross income of the child (and not of the parent) solely by reason of subsection (a) shall be treated as paid or incurred by the child.

(c) PARENT DEFINED.—For purposes of this section, the term "parent" includes an individual who is entitled to the services of a child by reason of having parental rights and duties in respect of the child.

(d) CROSS REFERENCE.—For assessment of tax against parent in certain cases, see section 6201(c).

SEC. 1.73-1. SERVICES OF CHILD.—(a) Compensation for personal services of a child shall, regardless of the provisions of State law relating to who is entitled to the earnings of the child, and regardless of whether the income is in fact received by the child, be deemed to be the gross income of the child and not the gross income of the parent of the child. Such compensation, therefore, shall be included in the gross income of the child and shall be reflected in the return rendered by or for such child. The income of a minor child is not required to be included in the gross income of the parent for income tax purposes. For requirements for making the return by such child, or for such child by his guardian, or other person charged with the care of his person or property, see section 6012.

(b) In the determination of taxable income or adjusted gross income, as the case may be, all expenditures made by the parent or the child attributable to amounts which are includible in the gross income of the child and not of the parent solely by reason of section 73 are deemed to have been paid or incurred by the child. In such determination, the child is entitled to take deductions not only for expenditures made on his behalf by his parent which would be commonly considered as business expenses, but also for other expenditures such as charitable contributions made by the parent in the name of the child and out of the child's earnings.

(c) For purposes of section 73, the term "parent" includes any individual who is entitled to the services of the child by reason of having parental rights and duties in respect of the child. See section 6201(c) and the regulations thereunder for assessment of tax against the parent in certain cases.

SEC. 1.74. STATUTORY PROVISIONS; PRIZES AND AWARDS.

SEC. 74. PRIZES AND AWARDS.

(a) GENERAL RULE.—Except as provided in subsection (b) and in section 117 (relating to scholarships and fellowship grants), gross income includes amounts received as prizes and awards.

(b) EXCEPTION.—Gross income does not include amounts received as prizes and awards made primarily in recognition of religious, charitable, scientific, educational, artistic, literary, or civic achievement, but only if—

(1) The recipient was selected without any action on his part to enter the contest or proceeding; and

(2) The recipient is not required to render substantial future services as a condition to receiving the prize or award.

SEC. 1.74–1. PRIZES AND AWARDS.—(a) *Inclusion in gross income.*—(1) Section 74(a) requires the inclusion in gross income of all amounts received as prizes and awards, unless such prizes or awards qualify as an exclusion from gross income under subsection (b), or unless such prize or award is a scholarship or fellowship grant excluded from gross income by section 117. Prizes and awards which are includible in gross income include (but are not limited to) amounts received from radio and television giveaway shows, door prizes, and awards in contests of all types, as well as any prizes and awards from an employer to an employee in recognition of some achievement in connection with his employment.

(2) If the prize or award is not made in money but is made in goods or services, the fair market value of the goods or services is the amount to be included in income.

(b) *Exclusion from gross income.*—Section 74(b) provides an exclusion from gross income of any amount received as a prize or award, if (1) such prize or award was made primarily in recognition of past achievements of the recipient in religious, charitable, scientific, educational, artistic, literary, or civic fields; (2) the recipient was selected without any action on his part to enter the contest or proceedings; and (3) the recipient is not required to render substantial future services as a condition to receiving the prize or award. Thus, such awards as the Nobel prize and the Pulitzer prize would qualify for the exclusion. Section 74(b) does not exclude prizes or awards from an employer to an employee in recognition of some achievement in connection with his employment.

(c) *Scholarships and fellowship grants.*—See section 117 and the regulations thereunder for provisions relating to scholarships and fellowship grants.

SEC. 1.75. STATUTORY PROVISIONS; DEALERS IN TAX-EXEMPT SECURITIES.

SEC. 75. DEALERS IN TAX-EXEMPT SECURITIES.

(a) ADJUSTMENT FOR BOND PREMIUM.—In computing the gross income of a taxpayer who holds during the taxable year a short-term municipal bond (as defined in subsection (b)(1)) primarily for sale to customers in the ordinary course of his trade or business—

(1) If the gross income of the taxpayer from such trade or business is computed by the use of inventories and his inventories are valued on any basis other than cost, the cost of securities sold (as defined in subsection (b)(2)) during such year shall be reduced by an amount equal to the amortizable bond premium which would be disallowed as a deduction for such year by section 171(a)(2) (relating to deduction for amortizable bond premium) if the definition in section 171(d) of the term "bond" did not exclude such short-term municipal bond; or

(2) If the gross income of the taxpayer from such trade or business is computed without the use of inventories, or by use of inventories valued at cost, and the short-term municipal bond is sold or otherwise disposed of during such year, the adjusted basis (computed without regard to this paragraph) of the short-term municipal bond shall be reduced by the amount of the adjustment which would be required under section 1016(a)(5) (relating to adjustment to basis for amortizable bond premium) if the definition in section 171 (d) of the term "bond" did not exclude such short-term municipal bond.

(b) DEFINITIONS.—For purposes of subsection (a)—

(1) The term "short-term municipal bond" means any obligation issued by a government or political subdivision thereof if the interest on such obligation is excludable from gross income; but such term does not include such an obligation if—

(A) It is sold or otherwise disposed of by the taxpayer within 30 days after the date of its acquisition by him, or

(B) Its earliest maturity or call date is a date more than 5 years from the date on which it was acquired by the taxpayer.

(2) The term "cost of securities sold" means the amount ascertained by subtracting the inventory value of the closing inventory of a taxable year from the sum—

(A) The inventory value of the opening inventory for such year, and

(B) The cost of securities and other property purchased during such year which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year.

SEC. 1.75–1. TREATMENT OF BOND PREMIUMS IN CASE OF DEALERS IN TAX-EXEMPT SECURITIES—(a) *In general.*—(1) Section 75 requires certain adjustments to be made by dealers in securities with respect to premiums paid on short-term municipal bonds which are held for sale to customers in the ordinary course of the trade or business. The adjustments depend upon the method of accounting used by the taxpayer in computing the gross income from the trade or business. See paragraphs (b) and (c) of this section.

(2) The term "short-term municipal bond" under section 75 means any obligation issued by a government or political subdivision thereof if the interest on the obligation is excludable from gross income under section 103. Such term, however, does not include an obligation the maturity or earliest call date of which is a date more than five years from the date of acquisition by the taxpayer, or an obligation sold or otherwise disposed of by the taxpayer within 30 days after the date of acquisition by him. A bond which is otherwise within the definition of "short-term municipal bond" is subject to the provisions of section 75 if held by the taxpayer for a period of more than 30 days, whether or not such period is entirely within one taxable year.

(3) The term "cost of securities sold" means the amount ascertained by subtracting the inventory value of the closing inventory of a taxable year from the sum of the inventory value of the opening inventory for such year and the cost of securities and other property purchased during such year which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year.

(b) *Inventories not valued at cost.*—(1) In the case of a dealer in securities who computes gross income from his trade or business by the use of inventories and values such inventories on any basis other than cost, the adjustment required by section 75 is the reduction of "cost of securities sold" by the amount equal to the amortizable bond premium which would be disallowed as a deduction under section 171(a)(2) with respect to the short-term municipal bond if the dealer were an ordinary investor holding such bond. Such amortizable bond premium is computed under section 171(b) by reference to the cost or other original basis of the bond on the date of acquisition (determined without regard to section 1013, relating to inventory value on a subsequent date).

(2) Subparagraph (1) may be illustrated by the following example:

Example.—*X*, a dealer in securities who values his inventories on a basis other than cost, makes his income tax returns on the calendar year basis. On July 1, 1954, he bought, for $1,060 each, three short-term municipal bonds (A, B, and C) having a face obligation of $1,000, and maturing on July 1, 1959. Bond A is sold on December 31, 1954, bond B is sold on December 31, 1955, and bond C is sold on June 30, 1956. For each bond the amortizable bond premium to maturity is $60, the period from date of acquisition to maturity is 60 months, and the amortizable bond premium per month is $1. The adjustment for each of the years 1954, 1955, and 1956 is as follows:

Bond	Date acquired	Date sold	Adjustment to "cost of securities sold" or:		
			1954	1955	1956
A	July 1, 1954	Dec. 31, 1954	$6.00		
B	July 1, 1954	Dec. 31, 1955	6.00	$12.00	
C	July 1, 1954	June 30, 1956	6.00	12.00	$6.00
		Total	$18.00	$24.00	$6.00

(c) *Inventories not used or inventories valued at cost.* (1) In the case of a dealer in securities who computes gross income from his trade or business without the use of inventories or by use of inventories valued at cost, the adjustment required by section 75 is a reduction of the adjusted basis of each short-term municipal bond sold or otherwise disposed of during the taxable year. The amount of such reduction is the amount by which the adjusted basis of such bond would be required to be reduced under section 1016(a)(5) were such bond subject to the amortizable bond premium provisions of section 171, that is, the amount of the amortizable bond premium which would be disallowed as a deduction under section 171(a)(2) if the taxpayer were an ordinary investor.

(2) Subparagraph (1) may be illustrated by the following example:

Example.—*Y*, a dealer in securities who values his inventories on the basis of cost, makes his income tax returns on the calendar year basis. On January 1, 1954, he buys, for $1,060 each, three short-term municipal bonds (D, E, and F) having a face obligation of $1,000, and maturing on January 1, 1959. Bond D is sold on December 31, 1954, Bond E is sold on June 30, 1955, and Bond F is sold on December 31, 1956. For each bond, the amortizable bond premium to maturity is $60, the period from the date of acquisition to maturity is 60 months, and the amortizable bond premium per month is $1.

Bond	Date acquired	Date sold	Adjustment for		
			1954	1955	1956
D	Jan. 1, 1954	Dec. 31, 1954	$12.00		
E	"	June 30, 1955	none	$18.00	
F	"	Dec. 31, 1956	none	none	$36.00

(d) *Bonds acquired before July 1, 1950.*—Under section 203(c) of the Revenue Act of 1950, adjustment is required for a short-term municipal bond acquired before July 1, 1950, only with respect to taxable years beginning on or after that date. Accordingly, if the short-term municipal bond was acquired before July 1, 1950, then for purposes of section 75 the amortizable bond premium under section 171 must be computed after adjusting the bond premium to the extent proper to reflect unamortized bond premium for so much of the holding period (as determined under section 1223) as precedes the first taxable year of the dealer beginning on or after July 1, 1950. Thus, in the examples in (b) and (c) of this section, the first taxable year beginning on or after July 1, 1950, is, for each dealer, the taxable year beginning January 1, 1951. If each dealer had purchased for $1,060 on April 1, 1950, a short-term municipal bond having a face obligation of $1,000 and maturing April 1, 1955, and had sold such bond on February 28, 1955, the adjustment under section 75 would be computed as follows:

	Dealer *X*	Dealer *Y*
Bond premium	$60	$60
Adjustment for holding period prior to January 1, 1951	9	9
Amortizable bond premium to maturity, as adjusted	51	51
Amortizable bond premium per month	1	1
Total adjustments under sec. 22(o), 1939 Code, for years 1951–1953	36	none
Adjustment under sec. 75 for 1954	12	none
Adjustment under sec. 75 for 1955	2	50

SEC. 1.76. STATUTORY PROVISIONS; MORTGAGES MADE OR OBLIGATIONS ISSUED BY JOINT-STOCK LAND BANKS.

SEC. 76. MORTGAGES MADE OR OBLIGATIONS ISSUED BY JOINT-STOCK LAND BANKS.

All income (except interest) derived from mortgages made, or obligations issued, after May 28, 1938, by a joint-stock land bank shall (notwithstanding section 26 of the Federal Farm Loan Act; 12 U. S. C. 931–3) be included in gross income.

SEC. 1.77. STATUTORY PROVISIONS; COMMODITY CREDIT LOANS.

SEC. 77. COMMODITY CREDIT LOANS.

(a) ELECTION TO INCLUDE LOANS IN INCOME. Amounts received as loans from the Commodity Credit Corporation shall, at the election of the taxpayer, be considered as income and shall be included in gross income for the taxable year in which received.

(b) EFFECT OF ELECTION ON ADJUSTMENTS FOR SUBSEQUENT YEARS.—If a taxpayer exercises the election provided for in subsection (a) for any taxable year, then the method of computing income so adopted shall be adhered to with respect to all subsequent taxable years unless with the approval of the Secretary or his delegate a change to a different method is authorized.

SEC. 1.77–1. ELECTION TO CONSIDER COMMODITY CREDIT CORPORATION LOANS AS INCOME.—A taxpayer who receives a loan from the Commodity Credit Corporation may, at his election, include the amount of such loan in his gross income for the taxable year in which the loan is received. If a taxpayer makes such an election (or has made such an

election under section 123 of the Internal Revenue Code of 1939 or under section 223(d) of the Revenue Act of 1939), then for subsequent taxable years he shall include in his gross income all amounts received during those years as loans from the Commodity Credit Corporation, unless he secures the permission of the Commissioner to change to a different method of accounting. Application for permission to change such method of accounting and the basis upon which the return is made shall be filed with the Commissioner of Internal Revenue, Washington 25, D. C., within 90 days after the beginning of the taxable year to be covered by the return.

SEC. 1.77-2. EFFECT OF ELECTION TO CONSIDER COMMODITY CREDIT LOANS AS INCOME.—(a) If a taxpayer elects or has elected under section 77, section 123 of the Internal Revenue Code of 1939, or section 223(d) of the Revenue Act of 1939, as amended, to include in his gross income the amount of a loan from the Commodity Credit Corporation for the taxable year in which it is received, then—

(1) No part of the amount realized by the Commodity Credit Corporation upon the sale or other disposition of the commodity pledged for such loan shall be recognized as income to the taxpayer, unless the taxpayer receives an amount in addition to that advanced to him as the loan, in which event such additional amount shall be included in the gross income of the taxpayer for the taxable year in which it is received, and

(2) No deductible loss to the taxpayer shall be recognized on account of any deficiency realized by the Commodity Credit Corporation on such loan if the taxpayer was relieved from liability for such deficiency.

(b) The application of paragraph (a) of this section may be illustrated by the following example:

Example.—A, a taxpayer who elected for his taxable year 1952 to include in gross income amounts received as loans from the Commodity Credit Corporation, received as loans $500 in 1952, $700 in 1953, and $900 in 1954. In 1956 all the pledged commodity was sold by the Commodity Credit Corporation for an amount $100 and $200 less than the loans with respect to the commodity pledged in 1952 and 1953, respectively, and for an amount $150 greater than the loan with respect to the commodity pledged in 1954. A, in making his return for 1956, shall include in gross income the sum of $150 if it is received during that year, but will not be allowed a deduction for the deficiencies of $100 and $200 unless he is required to satisfy such deficiencies and does satisfy them during that year.

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

T. COLEMAN ANDREWS,
Commissioner of Internal Revenue.

Approved July 6, 1955.

W. RANDOLPH BURGESS,
Acting Secretary of the Treasury.

(Filed by the Division of the Federal Register July 12, 1955, 8:48 a. m.)

SECTION 74.—PRIZES AND AWARDS

26 CFR 1.74–1: Prizes and awards.

Regulations under the Internal Revenue Code of 1954. See T. D. 6137, page 27.

Research, skill, and ability required over a period of time in winning prize. See Rev. Rul. 55–642, page 302.

SECTION 75.—DEALERS IN TAX-EXEMPT SECURITIES

26 CFR 1.75–1: Treatment of bond premiums in case of dealers in tax-exempt securities.

Regulations under the Internal Revenue Code of 1954. See T. D. 6137, page 27.

SECTION 76.—MORTGAGES MADE OR OBLIGATIONS ISSUED BY JOINT-STOCK LAND BANKS

Regulations under the Internal Revenue Code of 1954. See T. D. 6137, page 27.

SECTION 77.—COMMODITY CREDIT LOANS

26 CFR 1.77–1: Election to consider Commodity Credit Corporation loans as income.

Regulations under the Internal Revenue Code of 1954. See T. D. 6137, page 27.

PART III.—ITEMS SPECIFICALLY EXCLUDED FROM GROSS INCOME

SECTION 101. CERTAIN DEATH BENEFITS

Proceeds of a life insurance policy payable upon death of an employee where the employer has paid the premiums on such policy to the extent of the annual increases in the cash surrender value of the policy. See Rev. Rul. 55–713, page 23.

SECTION 102.—GIFTS AND INHERITANCES

(Also Section 2033.) Rev. Rul. 55–609
(Also Part II, Section 22(b)(3); Regulations 118, Section 39.22(b)(3)–1.)

A death gratuity payment specifically appropriated by the Third Supplemental Appropriation Act of 1952 or any other Act, or at any time made out of the contingent fund of the House of Representatives or of the Senate, is held to be a gift.

Advice has been requested with respect to the taxability of a death gratuity payment appropriated out of the contingent fund of the House of Representatives under Public Law 663, Eighty-third Congress, 2d Session, 48 Stat. 800.

Provision is made in the Third Supplemental Appropriation Act of 1952, 66 Stat. 101, that

> * * * any other death gratuity payment at any time specifically appropriated by this or any other Act or at any time made out of the contingent fund of the House of Representatives or of the Senate, shall be held to have been a gift.

Section 102 of the Internal Revenue Code of 1954 provides that gross income does not include the value of property acquired by gift, bequest, devise, or inheritance. (Also, see section 22(b)(3) of the 1939 Code to the same effect.)

Accordingly, it is held that a death gratuity payment, specifically authorized by Congress, which comes within the intendment of the Third Supplemental Appropriation Act of 1952, 66 Stat. 101, is a gift. Such gift is excludable from gross income of the recipient thereof for Federal income tax purposes and is not includible in the gross estate of the decedent for Federal estate tax purposes.

Rev. Rul. 55-638

The proceeds from a sweepstakes ticket acquired by gift before it became a winning ticket are includible in the gross income of the donee to the extent in excess of the value of the gift. The established selling price paid for the ticket by the donor constitutes the value of the gift which is excludable from gross income under section 102 of the Internal Revenue Code of 1954. See *Max Silver* v. *Commissioner*, 42 B. T. A. 461, acquiescence, C. B. 1940-2, 7.

SECTION 116.—PARTIAL EXCLUSION OF DIVIDENDS RECEIVED BY INDIVIDUALS

Rev. Rul. 55-476

For the purpose of section 116 of the Internal Revenue Code of 1954, relating to the partial exclusion of dividends received by individuals, a husband and wife, whether filing a joint return or separate returns, may each exclude from gross income up to $50 of his or her dividends from domestic corporations qualifying under such section of the Code, but one may not use any portion of the $50 exclusion not used by the other. Since dividends received by a husband and wife on stock held by them as tenants by the entirety or as joint tenants with equal rights of survivorship, are generally considered as being received one-half by each, one-half of the dividends received on such stock, along with other dividends, may be excluded by each spouse up to $50. For example, if dividends received by a husband and wife from jointly owned stock were $30 and other dividends received

separately by the husband were $70, the husband is entitled to exclude $50 and the wife is entitled to exclude $15. In this example, if a joint return is filed for the calendar year 1954, the exclusion shown on line 3 of Schedule J of Form 1040 would be $65.

(Also Section 34.) Rev. Rul. 55-728

The taxpayer's income includes dividends received from domestic corporations on stock owned individually by him and income received from the estate of his deceased wife, the greater part of which income consists of dividends from stock of domestic corporations held by the estate. *Held*, in determining the dividend exclusion from gross income as provided by section 116 of the Internal Revenue Code of 1954, a taxpayer is entitled to exclude from gross income dividends from domestic corporations only to the extent that the dividends received do not exceed $50, irrespective of the fact that such dividends are received from stock owned individually by him and also from stock held by an estate. The dividend income received from such estate which is included in gross income may be considered by the taxpayer in computing the credit against his tax liability allowed by section 34 of the Internal Revenue Code of 1954. Dividend income received from an estate retains the same character in the hands of a beneficiary as in the hands of the estate. Section 662(b) of the 1954 Code.

SECTION 117.—SCHOLARSHIPS AND FELLOWSHIP GRANTS

Rev. Rul. 55-554

The entire amount of a fellowship grant received by a taxpayer who is not a candidate for a degree must be included in his gross income to the extent that it exceeds the exclusion provided by section 117(a), as limited by section 117(b)(2), of the Internal Revenue Code of 1954, irrespective of the fact that the amount of such grant may be greater where the recipient has dependents.

Advice has been requested as to the exclusion from gross income by the recipient of a fellowship grant of an additional amount included in the fellowship grant due to the dependents of the recipient.

The taxpayer received from an organization, described in section 501(c)(3) which is exempt from tax under section 501(a) of the Internal Revenue Code of 1954, a fellowship grant for a 1-year period under which he studied preventive medicine. He was not a candidate for a degree. It is the practice of the grantor organization to take into consideration whether the recipient is married and has dependents and to fix the amount of the grant accordingly. The taxpayer's grant included an additional allowance for dependents and exceeded the amount of $300 times the number of months for which the grant was received, but he did not receive any separate allowance for expenses of the type which is excludable under section 117(a)(2) of the Code.

Section 117(a)(1) of the Code excludes from gross income amounts received as a scholarship or fellowship grant, subject to the limitations of section 117(b). In the case of a recipient who is not a candi-

date for a degree, section 117(b)(2) of the Code limits the amount excludable as a scholarship or fellowship grant under section 117(a)(1) to an amount equal to $300 times the number of months for which the recipient received amounts under the grant during the taxable year, limited to a maximum period of 36 months. In addition to the exclusion allowed by section 117(a)(1) of the Code, section 117(a)(2) provides for the exclusion of any amount received to cover expenses for (A) travel, (B) research, (C) clerical help, or (D) equipment, which are incident to a scholarship or fellowship grant, but only to the extent so expended by the recipient.

The allowable exclusions are clearly specified. There is no express additional exclusion for amounts received as an allowance for dependents and no such exclusion can be implied. Even though an allowance for dependents is taken into account in determining the amount of the grant, the total amount received from the grantor will be considered to be the amount of the fellowship grant and must therefore be included in gross income to the extent that it exceeds the limitation provided in section 117(b)(2) of the Code. In computing his taxable income, the taxpayer is of course entitled to such deductions for his spouse and dependents as are allowable under section 151 of the Code.

Accordingly, it is held that the entire amount of a fellowship grant received by a taxpayer who is not a candidate for a degree must be included in his gross income to the extent that it exceeds the exclusion provided by section 117(a), as limited by section 117(b)(2) of the Code, irrespective of the fact that the amount of such grant may be greater where the recipient has dependents.

SECTION 120.—STATUTORY SUBSISTENCE ALLOWANCE RECEIVED BY POLICE

(Also Section 3401.) Rev. Rul. 55–475

The police officers of a certain State, pursuant to a State statute, receive varying amounts, according to their rank, as reimbursement for expenses properly incurred in the performance of their official duties. Included in such reimbursement is an allowance for subsistence. *Held*, to the extent that this allowance for subsistence is not in excess of the statutory limitation of $5 a day, it is excludable from the gross income of the police officers under the provisions of section 120 of the Internal Revenue Code of 1954 and is excepted from withholding of income tax at the source within the purview of section 406.207(c) of Regulations 120 (relating to collection of income tax at source on wages), which is applicable under section 3401 of the 1954 Code by virtue of Treasury Decision 6091, C. B. 1954–2, 47. Although section 162(a)(2) of the Code provides a deduction for traveling expenses (including the entire amount expended for meals and lodging) while away from home in the pursuit of a trade or business, no deduction is allowable for subsistence expenses paid to the extent that the subsistence allowance is excludable from gross income under section 120 of the Code. But, if the subsistence allowance received is more than $5 a day, (1) the excess over $5 a day is includible in the gross income of

the officers and, (2) except for the portion of such excess that qualifies as an expenditure for subsistence which may be deductible as traveling expenses under section 162(a)(2) of the Code, such excess is subject to the withholding of income tax on wages at the source.

This Revenue Ruling has no effect upon the treatment of any amounts paid to such police officials as reimbursement for expenses other than subsistence.

PART V.—DEDUCTIONS FOR PERSONAL EXEMPTIONS

SECTION 152.—DEPENDENT DEFINED

Rev. Rul. 55–653

German students brought to the United States under the International Educational Exchange Service and placed in American homes for a temporary period of 1 year are not residents of the United States and, accordingly, may not be included in the term dependent within the purview of section 152(b)(3) of the Internal Revenue Code of 1954.

PART VI.—ITEMIZED DEDUCTIONS FOR INDIVIDUALS AND CORPORATIONS

SECTION 162.—TRADE OR BUSINESS EXPENSES

(Also part II, Section 23(a); Regulations 118, Section 39.23(a)-1.) Rev. Rul. 55–452

A calendar year cash or accrual basis taxpayer who makes a voluntary lump sum payment into the Wisconsin unemployment reserve fund, which payment effects a reduction in the unemployment insurance rate for the subsequent year, may deduct such payment as a business expense under section 162(a) of the Internal Revenue Code of 1954 (section 23(a) of the 1939 Code) in the taxable year paid. Where the payment for such purpose is made in January after the close of the calendar year and under Wisconsin law credited to the employer's account as of the preceding December 31, such amount is nevertheless deductible in the year paid irrespective of whether the taxpayer employs the cash or accrual basis of accounting

I. T. 3177, C. B. 1938–1, 119, supplemented.

Advice has been requested as to the taxable year in which to allow a deduction, for Federal income tax purposes, to a taxpayer employing either the cash or accrual basis of accounting, who makes a voluntary lump sum payment into the unemployment reserve fund of the State of Wisconsin.

I. T. 3177, C. B. 1938–1, 119, holds that a lump sum payment by an employer during the taxable year 1937 to the Wisconsin unemployment reserve fund, in accordance with the provisions of section 108.18(4) of the Unemployment Reserves and Compensation Act, as amended, Wisconsin Statutes, 1937, is deductible as an ordinary and necessary business expense for that year, regardless of whether his books of account are kept on the cash receipts and disbursements basis or on the accrual basis. Section 108.18(7) of the

Wisconsin Statutes, 1953, the provisions of which embody the current law on the question involved and is the counterpart of the aforesaid section 108.18(4), states that a payment to the fund, in excess of the statutory requirements, shall be credited as of the date paid, except that any such payment made during January shall be credited as of the immediately preceding computation date, i. e., December 31, the end of the calendar year, and shall be treated as having been required and irrevocably paid with respect to payrolls preceding the date as of which it is thus credited.

Accordingly, it is held that where a lump sum payment is made voluntarily into the Wisconsin unemployment reserve fund by a cash basis or accrual basis taxpayer to effect a reduction in the unemployment insurance rate, which reduction is applicable to the calendar year subsequent to the year in which paid, the amount thereof nevertheless, is deemed to have been incurred as a business expense in the taxable year in which paid and is deductible in such year, under section 162(a) of the Internal Revenue Code of 1954 (section 23(a) of the Internal Revenue Code of 1939). Where a payment, for accomplishing the stated purpose, is made in January after the close of a calendar year, even though it shall be credited to the employer's account as of the preceding December 31, and shall be considered as having been required, under the Wisconsin law, nevertheless the amount thereof will constitute an allowable deduction, for Federal income tax purposes, under either the cash or accrual basis of accounting, in the taxable year in which paid. I. T. 3177, *supra*, supplemented.

(Also Section 167.) Rev. Rul. 55-540
(Also Part II, Sections 23(a), 23(l); Regulations 118, Sections 39.23(a)-1, 39.23(a)-10, 39.23(l)-1.)

Guides to be used in determining the treatment, for Federal income tax purposes, of leases of equipment used in the trade or business of the lessee.

SECTION 1. PURPOSE.

The purpose of this Revenue Ruling is to state the position of the Internal Revenue Service regarding the income tax aspects of the purported leasing of equipment for use in the trade or business of the lessee. The issues and rules herein discussed are not all-inclusive, and as new questions of importance arise additional Revenue Rulings will be issued.

SEC. 2. BACKGROUND.

.01 Many new and unique types of agreements concerning the use and disposition of equipment have been developed to meet the needs and purposes of the users of industrial and business equipment. The lessor, in devising these agreements, is primarily interested in disposing of his wares to customers. (Here and elsewhere in this ruling the terms "lessor" and "lessee" are used for convenience, without intending to suggest the proper characterization of any agreement.) The lessee, on the other hand, may have one or more reasons for leasing instead of purchasing the equipment. He may have use for the equipment for only a comparatively short period of time. He may

wish to experiment with a new process or product which requires equipment he does not own. He may have insufficient capital or credit with which to make an outright purchase, or have other needs for his working capital. A significant motive may, in some cases, be the tax advantages which might result because of the different timing of the deductions for rent as compared to depreciation.

.02 The agreements are generally cast in the form of chattel leases and are as varied as the reasons for entering into such arrangements. An approximate pattern is discernible, however, and many of the agreements may be loosely defined and grouped as follows:

(a) Short-term agreements which usually concern mobile equipment or relatively small articles of equipment. The "compensation for use" provisions in these agreements are usually expressed in terms of an hourly, daily, or weekly rental, and the rental rates are relatively high in relation to the value of the article. There may be an option to purchase the equipment at a price fixed in advance which will approximate the fair market value of the equipment at the time of the election to exercise the option. In this type of agreement, all costs of repairs, maintenance, taxes, insurance, etc., are obligations of the lessor.

(b) Agreements entered into by taxpayers engaged in the business of leasing personal property to others either as their principal business activity or incidental thereto. Under the terms of these agreements the amounts payable, called rental rates, are ordinarily based on normal operations or use, plus a surcharge for operations in excess of the normal stated usage. In some instances the rental is based on units produced or mileage operated. Termination of the agreement at stated periods is provided upon due notice by either party. If the agreement includes an option to purchase, the option price has no relation to the amounts paid as rentals.

✓ (c) Agreements providing for a "rental" over a comparatively short period of time in relation to the life of the equipment. The agreed "rental" payments fully cover the normal purchase price plus interest. Title usually passes to the lessee upon the payment of a stated amount of "rental" or on termination of the agreement upon the payment of an amount which when added to the "rental" paid approximates the normal purchase price of the equipment plus interest.

(d) Agreements which provide for the payment of "rental" for a short original term in relation to the expected life of the equipment, with provision for continued use over substantially all of the remaining useful life of the equipment. During the initial term of the agreement, the "rental" approximates the normal purchase price of the equipment, plus interest, while the "rentals" during the remaining term or renewal period or periods are insignificant when compared to the initial rental. These agreements may or may not provide for an option to acquire legal title to the equipment upon the termination of the initial period or at any stated time thereafter.

(e) Agreements similar to the arrangement in (d) above, but with the added factor that the manufacturer of the equipment purports to sell it to a credit or finance company, which either

takes an assignment of such an existing agreement with the user or itself later enters into such an agreement with the user. In some instances, the lessor may be a trustee acting for or on behalf of the original vendor.

SEC. 3. NATURE OF THE PROBLEM.

.01 Section 162(a)(3) of the Internal Revenue Code of 1954 provides that there shall be allowed as a deduction all ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including rentals or other payments required to be made as a condition to the continued use or possession, for the purposes of the trade or business of the taxpayer, of property to which the taxpayer has not taken or is not taking title or in which he has no equity. Section 23(a)(1)(A) of the Internal Revenue Code of 1939 contains substantially the same language in respect to the allowance of a deduction for rental expense.

.02 In deciding whether a taxpayer is entitled to a deduction for any payments claimed to represent rentals under the provisions of the Code of 1954 or the Code of 1939, it is necessary to determine whether by virtue of the agreement the lessee has acquired, or will acquire, title to or an equity in the property. The determination of that question with respect to agreements of the type here involved will ordinarily depend upon whether the particular agreement should be treated as in reality a lease or a conditional sale contract.

SEC. 4. DETERMINATION WHETHER AN AGREEMENT IS A LEASE OR A CONDITIONAL SALES CONTRACT.

.01 Whatever interest is obtained by a lessee is acquired under the terms of the agreement itself. Whether an agreement, which in form is a lease, is in substance a conditional sales contract depends upon the intent of the parties as evidenced by the provisions of the agreement, read in the light of the facts and circumstances existing at the time the agreement was executed. In ascertaining such intent no single test, or any special combination of tests, is absolutely determinative. No general rule, applicable to all cases, can be laid down. Each case must be decided in the light of its particular facts. However, from the decisions cited below, it would appear that in the absence of compelling persuasive factors of contrary implication an intent warranting treatment of a transaction for tax purposes as a purchase and sale rather than as a lease or rental agreement may in general be said to exist if, for example, one or more of the following conditions are present:

(a) Portions of the periodic payments are made specifically applicable to an equity to be acquired by the lessee. See *Truman Bowen* v. *Commissioner*, 12 T. C. 446, acquiescence, C. B. 1951-2, 1.

(b) The lessee will acquire title upon the payment of a stated amount of "rentals" which under the contract he is required to make. See *Hervey* v. *Rhode Island Locomotive Works*, 93 U. S. 664 (1876); *Robert A. Taft* v. *Commissioner*, 27 B. T. A. 808; *Truman Bowen* v. *Commissioner*, *supra*.

(c) The total amount which the lessee is required to pay for a relatively short period of use constitutes an inordinately large

proportion of the total sum required to be paid to secure the transfer of the title. See *Truman Bowen* v. *Commissioner, supra.*

(d) The agreed "rental" payments materially exceed the current fair rental value. This may be indicative that the payments include an element other than compensation for the use of property. See *William A. McWaters et al.* v. *Commissioner*, Tax Court Memorandum Opinion, entered June 15, 1950; *Truman Bowen* v. *Commissioner, supra.*

(e) The property may be acquired under a purchase option at a price which is nominal in relation to the value of the property at the time when the option may be exercised, as determined at the time of entering into the original agreement, or which is a relatively small amount when compared with the total payments which are required to be made. See *Burroughs Adding Machine Co.* v. *Bogdon*, 9 Fed. (2d) 54; *Holeproof Hosiery Co.* v. *Commissioner*, 11 B. T. A. 547. Compare *H. T. Benton et al.* v. *Commissioner*, 197 Fed. (2d) 745.

(f) Some portion of the periodic payments is specifically designated as interest or is otherwise readily recognizable as the equivalent of interest. See *Judson Mills* v. *Commissioner*, 11 T. C. 25, acquiescence, C. B. 1949–1, 2.

.02 The fact that the agreement makes no provision for the transfer of title or specifically precludes the transfer of title does not, of itself, prevent the contract from being held to be a sale of an equitable interest in the property.

.03 Conditional sales of personal property are, in general, recordable under the various State recording acts if the vendor wishes to protect its lien against claims of creditors. However, the recording or failure to record such a sales contract is usually discretionary with the vendor and is not controlling insofar as the essential nature of the contract is concerned for Federal tax purposes. See *Hervey* v. *Rhode Island Locomotive Works, supra.*

.04 Agreements are usually indicative of an intent to rent the equipment if the rental payments are at an hourly, daily, or weekly rate, or are based on production, use, mileage, or a similar measure and are not directly related to the normal purchase price, provided, if there is an option to purchase, that the price at which the equipment may be acquired reasonably approximates the anticipated fair market value on the option date. Thus, agreements of the type described in section 2.02(a) and (b), above, will usually be considered leases, in the absence of other facts or circumstances which denote a passing of title or an equity interest to the lessee.

.05 In the absence of compelling factors indicating a different intent, it will be presumed that a conditional sales contract was intended if the total of the rental payments and any option price payable in addition thereto approximates the price at which the equipment could have been acquired by purchase at the time of entering into the agreement, plus interest and/or carrying charges. Agreements of the type described in section 2.02(c), above, will generally be held to be sales of the equipment.

.06 If the sum of the specified "rentals" over a relatively short part of the expected useful life of the equipment approximates the price

at which the equipment could have been acquired by purchase at the time of entering into the agreement, plus interest and/or carrying charges on such amount, and the lessee may continue to use the equipment for an additional period or periods approximating its remaining estimated useful life for relatively nominal or token payments, it may be assumed that the parties have entered into a sale contract, even though a passage of title is not expressly provided in the agreement. Agreements of the type described in section 2.02(d), and (e), above, in general, will be held to be sales contracts.

SEC. 5. REPORTING OF INCOME AND DEDUCTIONS BY A LESSOR OR A VENDOR.

.01 The amounts paid for the use of equipment under an agreement which is determined, under the foregoing principles, to be a lease will be held to be rental income to the lessor. Such lessor may deduct all ordinary and necessary expenses paid or incurred during the taxable year which are attributable to the earning of the income. In addition, the lessor will be allowed a deduction for depreciation determined pursuant to the provisions of section 167 of the Code of 1954. If the lessee under the contract pays to the lessor a stipulated rental, and in addition pays certain other expenses which are properly payable by the lessor, the lessor is deemed to have received as rental income not only the stipulated rental but also the amount of such other expenses paid by the lessee to, or for the account of, the lessor, except as provided in section 110 of the Code of 1954.

.02 If the agreement is determined to be a sale, the amounts received under the contract by the vendor will be considered to be payments on the sales price of the equipment to the extent such amounts do not represent interest or other charges.

SEC. 6. DEDUCTIONS ALLOWABLE TO LESSEE OR PURCHASER.

.01 If it is held, under the foregoing principles, that an agreement is a lease, the lessee may deduct the amount of rent paid or accrued, including all expenses which under the terms of the agreement the lessee is required to pay to, for, or on account of the lessor, except as provided by section 110 of the Code of 1954. If the payments are so arranged as to constitute advance rental, such payments will be duly apportioned over the lease term. In computing the term of the lease, all options to renew shall be taken into consideration if there is a reasonable expectation that such options will be exercised.

.02 If under the provisions of this Revenue Ruling the agreement is to be treated as a sale, the amounts paid to the vendor will be considered as payments for the purchase of the equipment to the extent such amounts do not represent interest or other charges. Expenditures treated as payments for the purchase of the equipment may be recovered over the life of the asset through appropriate depreciation deductions.

SEC. 7. ILLUSTRATIONS.

Revenue Rulings 55–25, C. B. 1955–1, 283, and 55–541 and 55–542, pages 19 and 59 of this Bulletin, illustrate the application of some of the foregoing principles.

Rev. Rul. 55-571

Members of the Armed Forces of the United States on permanent duty assignments at official stations overseas are not traveling "away from home" and may not deduct their expenses for meals and lodging at such locations, even though they are required to maintain homes in the United States for their families who are not allowed to accompany them.

I. T. 3474, C. B. 1941-1, 207, and I. T. 1497, C. B. I-2, 89 (1922), modified.

Advice has been requested whether a member of the Armed Forces of the United States on permanent duty at his official station overseas is considered to be traveling "away from home" for the reason that he is required to maintain a home in this country since his family has not been allowed to accompany him abroad. Stated otherwise, the question is whether the reasoning in I. T. 1497, C. B. I-2, 89 (1922), as modified by I. T. 3474, C. B. 1941-1, 207, is applicable to the instant case.

Section 162(a)(2) of the Internal Revenue Code of 1954 allows the deduction of expenses incurred for meals and lodging only while the taxpayer is traveling "away from home in the pursuit of a trade or business."

In I. T. 1497, *supra*, as modified by I. T. 3474, *supra*, the term "home" was defined as the taxpayer's dwelling place; the house in which one lives; the house in which one lives with his family. Consequently, naval officers on permanent duty afloat who maintained such homes ashore were considered to be traveling "away from home" for Federal income tax purposes and were allowed a tax deduction on account of their expenses for subsistence.

The meaning of the word "home" with reference to a taxpayer residing in one place and working in another has engendered much difficulty and litigation. *Commissioner* v. *J. N. Flowers*, 326 U. S. 465, Ct. D. 1659, C. B. 1946-1, 57. While a taxpayer's "home" for traveling expense purposes is occasionally construed in its ordinary sense as meaning a family residence or usual place of abode (see, for example, *Herman Martin* v. *Commissioner*, 44 B. T. A. 185; *Wilson John Fisher* v. *Commissioner*, 23 T. C. 218), his "home" is much more frequently held to be located at the place which constitutes his principal or regular post of duty. Despite such variations, however, it is now firmly established that expenses incurred by a taxpayer for meals and lodging at his principal or regular post of duty are not deductible, even though such place is located at a distance from his residence. Rev. Rul. 54-497, C. B. 1954-2, 75. Furthermore, it has consistently been held that such rule is not affected by reason of the fact that it is difficult or impossible for the taxpayer to maintain his family abode at his principal or regular place of business. See *Henry C. Warren* v. *Commissioner*, 13 T. C. 205; *Willard S. Jones* v. *Commissioner*, 13 T. C. 880.

In view of the foregoing, a naval officer on permanent duty afloat is not in a travel status while at the home port of his ship (which is comparable to the home terminal of a train, bus or airplane) because that location is ordinarily considered to be his principal or regular post of duty. However, such an officer is considered to be in a travel status, for Federal income tax purposes, while on a voyage requiring his absence from such home port of a minimum period which lasts

substantially longer than an ordinary day's work and during which his duties require him to obtain necessary sleep while away from such home port. See Rev. Rul. 55-235, C. B. 1955-1, 274.

Accordingly, it is held that members of the Armed Forces of the United States on permanent duty assignments at official stations overseas are not traveling "away from home" and may not deduct their expenses for meals and lodging at such locations, even though they are required to maintain homes in the United States for their families who are not allowed to accompany them.

I. T. 3474, C. B. 1941-1, 207, and I. T. 1497, C. B. I-2, 89 (1922), are modified to the extent that they are inconsistent with the foregoing conclusions concerning the meaning of the term "home" as contemplated by section 162(a)(2) of the Internal Revenue Code of 1954.

(Also Section 61.) Rev. Rul. 55-572

Per diem allowances in lieu of subsistence and mileage allowances received by members of the uniformed services of the United States (Army, Navy, Air Force, Marine Corps, Coast Guard, Coast and Geodetic Survey, and Public Health Service and all Regular and Reserve components thereof) while engaged in official travel status or on temporary assignment away from their permanent stations are includible in gross income of such members. Expenses of transportation, meals and lodging incurred by such members while in travel status for Federal income tax purposes, should not be offset by their nontaxable basic subsistence and quarters allowances in computing the amount of such expenses deductible under the provisions of sections 162(a)(2) and 62(2) of the Internal Revenue Code of 1954.

Mimeograph 3413, C. B. V-1, 29 (1926), and I. T. 3474, C. B. 1941-1, 207, as modified by Rev. Rul. 55-571, page 44, this Bulletin, modified.

The Internal Revenue Service has been requested to reconsider its position as to the tax status of the per diem allowances in lieu of subsistence and mileage allowances received by members of the uniformed services of the United States traveling on official business away from their designated post of duty; and to clarify its position with respect to whether or not, in computing allowable deductions for Federal income tax purposes, the basic subsistence and quarters allowances received by such members should be offset against expenses of transportation, meals and lodging incurred by them while in travel status.

As used in this Revenue Ruling, the term "member of the uniformed services" means a commissioned officer, commissioned warrant officer, warrant officer, flight officer or enlisted person of the Army of the United States, Navy, Air Force of the United States, Marine Corps, Coast Guard, Coast and Geodetic Survey, and Public Health Service and all Regular and Reserve components thereof. See section 102 of the Career Compensation Act of 1949, 63 Stat. 802, 37 U. S. C. 231.

Sections 301 and 302 of the Career Compensation Act of 1949, *supra*, as amended, 37 U. S. C. 251 and 252, provide for basic allowances for subsistence and quarters for members of the uniformed services. The basic allowance for subsistence is payable to all officers at a specified amount per month and to enlisted persons, when authorized, at a specified amount per day. The basic allowance for quarters payable to members who are not furnished quarters in kind varies in amount according to whether the member does or does not have dependents and as to the member's grade or rank. In addition to the

basic allowances, section 303 of the Act, as amended 37 U. S. C. 253, authorizes travel and transportation allowances for travel performed or to be performed under competent orders. Included in such allowances is a mileage allowance in lieu of cost of transportation and a per diem allowance in lieu of subsistence.

In *Clifford Jones* v. *United States*, 60 Ct. Cl. 552, T. D. 3724, C. B. IV–2, 136 (1925), the value of quarters furnished in kind to an officer, or commutation (money allowance paid) in lieu thereof, was held to be excludable from gross income. The theory underlying this position was that the officer was not paid a salary and furnished a house to live in for his services, but that he was paid a salary to live in the quarters furnished. The court in concluding that quarters or quarters allowances were not compensatory in nature and not taxable relied for its rationale on army regulations of long standing, which recognize the right of army officers to quarters or commutation in lieu thereof as a matter of public necessity.

In Mimeograph 3413, C. B. V–1, 29 (1926), the position holding quarters in kind or commutation in lieu thereof nontaxable was extended to exempt the basic money allowance for subsistence, and the per diem allowance in lieu of subsistence paid to officers traveling on official business away from their designated post of duty.

The exclusion of per diem allowances in lieu of subsistence paid to officers traveling on official business away from their designated post of duty does not come within the ambit of the Clifford Jones case. Furthermore, such position is contrary to existing regulations (Regulations 118, Section 39.23(a)–2(d), applicable under section 162 of the Internal Revenue Code of 1954 by virtue of T. D. 6091, C. B. 1954–2, 47).

In I. T. 3474, C. B. 1941–1, 207, which modified I. T. 1497, C. B. I–2, 89 (1922), it was held that a naval officer, who is on permanent duty afloat and who maintains a home elsewhere, can deduct as a business expense only that portion of the amount expended by him for subsistence as exceeds his money subsistence allowance, such allowance being tax exempt.

The basic allowances for subsistence and quarters are granted by law independently of whether the member is required to travel and are entirely unrelated to expenses incurred in travel. In other words, the expenses incurred for travel, meals and lodging are not allocable to the basic allowances for subsistence and quarters and have no relation to the member's statutory right to receive these basic allowances. Such members receive these basic allowances whether they are in travel status or not and the allowances are not considered as reimbursement for additional expenses incurred by reason of such travel. There appears to be no authority, therefore, for requiring members of the uniformed services to reduce their deductible travel expenses by the amount of such allowances in computing deductions for Federal income tax purposes.

In view or the foregoing, it is held that the per diem allowance in lieu of subsistence and the mileage allowance received by members of the uniformed services of the United States while in a travel status or on temporary duty away from their permanent stations are includible in the gross income of such members. Travel expenses incurred by such members which are deductible under the provisions of

sections 162(a)(2) and 62(2) of the Internal Revenue Code of 1954 may be deducted in full without the necessity of offsetting the amount of basic subsistence and quarters allowances received against such expenses. As indicated, this Revenue Ruling in no way disturbs the long established nontaxable status of the basic subsistence and quarters allowances received by the members.

Accordingly, Mimeograph 3413, C. B. V–1, 29 (1926), is modified to the extent it excludes the per diem allowance in lieu of subsistence from an officer's gross income. Also I. T. 3474, C. B. 1941–1, 207, as modified by Revenue Ruling 55–571, page 14, this Bulletin, is modified to the extent it requires a naval officer on permanent duty afloat to offset his (basic) subsistence allowance against any expenses incurred for subsistence while aboard ship before taking deductions therefor.

(Also Sections 167, 1231.) Rev. Rul. 55-579
(Also Part II, Section 23(a); Regulations 118, Section 39.23(a)–1.)

Postmasters who are required to furnish lock boxes or fixtures for the use of the public may, depending upon the circumstances, deduct such costs either as a current business expense or recover such costs through annual depreciation charges, provided they do not elect to use the optional standard deduction. Where the lock boxes or fixtures purchased by a postmaster are held in excess of six months, they qualify as "property used in trade or business" within the meaning of section 1231 of the Internal Revenue Code of 1954. Any gain or loss on the sale of such lock boxes or equipment to another postmaster or an outsider, or upon reimbursement therefor by the Post Office Department where the post office is discontinued, is subject to the treatment provided for in that section.

Advice has been requested as to the Federal income tax treatment of (1) expenditures which postmasters are required to make from their personal funds for the purchase or rental of lock boxes or fixtures; (2) the reimbursement for such expenditures where the post office is discontinued; and (3) the proceeds from the sale of such lock boxes or fixtures by a retiring postmaster.

Sections 27.2, 27.3 and 27.8 of the regulations of the Postal Service, 29 CFR (1949 edition), were embodied in Chapter X, Articles 1 and 20, of the Post Office Manual of the United States, July 1, 1954, edition. Article 1 provides, in part, as follows:

Where lock box equipment is not furnished by the Department, postmasters are required to furnish and keep in repair, at their own expense, such box equipment as may be necessary to provide satisfactory service to the public.

Article 20 provides in part:

Box rents are a part of the revenue of post offices and must be accounted for even when the box equipment is owned by the postmaster.

Section 27.7, 39 CFR, 1953 Supp. 1.3, provides that all box rentals collected, both current and advance payments, shall be accounted for as postal receipts on the dates collections are made.

Section 56 of Title 39 of the United States Code provides that gross postal receipts shall be counted for the purpose of determining the class of the post office or the compensation or allowances of postmasters or other employees, whose compensation or allowances are based on the annual receipts of such offices.

Since a postmaster is required to include box rentals in the gross postal receipts upon which his salary is based and to turn over to the Post Office Department all such receipts, it cannot be said that he, personally, derives any revenue from such fixtures or equipment. Therefore, since a postmaster is an employee of the Post Office Department, the increase in salary resulting from the inclusion of box rentals in gross postal receipts, upon which his salary is based, does not constitute a reimbursement of expenditures of the type contemplated in section 62(2)(A) of the Internal Revenue Code of 1954. Compare Rev. Rul. 55–288, C. B. 1955–1, 257.

Accordingly, with respect to the first question, it is held that, if the estimated useful life of the lock boxes or fixtures is not more than one year, the cost thereof constitutes an ordinary and necessary business expense and is deductible from adjusted gross income by the postmaster in computing his taxable income for Federal income tax purposes. However, where the lock boxes or fixtures have a useful life of more than one year, the postmaster is entitled to recover the cost thereof, less salvage, through deductions for depreciation, over the useful life of the respective assets. In those instances where the postmaster rents such lock boxes or fixtures, the rental expenses paid or incurred (depending upon the method of accounting employed), to the extent they are both ordinary and necessary, are deductible from adjusted gross income under section 162 of the Internal Revenue Code for the purpose of determining taxable income. These deductions may not be allowed if the postmaster elects to take the standard deduction provided in section 141 of the Code. See *J. Rene Harris* v. *Commissioner*, 22 T. C. 1118.

Article 1 of Chapter X of the regulations of the Postal Service also provides that:

> A postmaster who is required to furnish box equipment is not compelled to buy it from the retiring postmaster; however, he is required to provide proper box equipment before taking charge of the office, * * *. Where a postmaster uses his predecessor's box equipment, he is liable for a reasonable rental therefor from the date upon which he took charge of the post office.

The Act, approved August 23, 1954, 68 Stat. 766, 39 U. S. C. 69, which requires the Postmaster General to reimburse postmasters of discontinued post offices for equipment owned by the postmaster, states in part:

> That whenever a post office is discontinued, the Postmaster General shall reimburse the postmaster of such discontinued post office, * * * for any fixtures and equipment in use in such post office at the time of the discontinuance, which were furnished by such postmaster out of personal funds and which were necessary to the efficient operation of such post office.

Section 1231 of the Internal Revenue Code provides that where the recognized gains upon the sale or exchange of property used in a trade or business and held in excess of six months, plus the gains on certain other specified transactions, exceed the recognized losses, such gains and losses constitute long-term capital gains and losses. Where such gains do not exceed such losses, such gains and losses shall not be considered as gains or losses from the sale or exchange of capital assets.

It is evident from the foregoing that where the retiring postmaster disposes of his lock boxes or fixtures to an incoming postmaster or an outsider, for value, a sale will have been consummated. A sale will also be considered to have been consummated in those situations where

the postmaster is reimbursed (to the extent of the fair market value) for so much of the lock boxes or equipment that is usable and taken over by the Post Office Department. Title to that portion of the lock boxes or fixtures taken over is then vested in the Post Office Department. Any gain or loss to the postmaster on such lock boxes or equipment shall be measured by the difference between the amount of the reimbursement and the adjusted basis of such lock boxes or equipment. Any lock boxes or equipment not taken over by the Post Office Department will, of course, remain the property of the postmaster and be subject to his disposition.

Accordingly, with respect to questions (2) and (3) it is held that where such lock boxes and fixtures are held in excess of six months, they qualify as "property used in trade or business" within the meaning of section 1231 of the Internal Revenue Code of 1954, and any gain upon the sale thereof by a retiring postmaster to an outsider or to the incoming postmaster, or any gain realized upon reimbursement in cases where the post office is discontinued, must be included with the gains or losses with respect to certain other assets as provided in section 1231(a) of the Code. If the total gains exceed the total losses, then each gain or loss will constitute a long-term capital gain or loss. If the total losses exceed the gains then each gain or loss shall be treated as an ordinary loss or gain in computing adjusted gross income.

Rev. Rul. 55–604

An employee having two widely separated posts of duty cannot deduct the cost of his meals and lodging at his principal or regular post of duty, but he can deduct such expenses while his work requires him to be at his minor or temporary post of duty, even though he maintains his family residence at the latter location. Such a deduction is limited to that portion of the family expenses for meals and lodging which is properly attributable to the taxpayer's presence there in the actual performance of his duties.

Advice has been requested whether an employee having two widely separated posts of duty may deduct as traveling expenses the cost of his meals and lodging while working either at his principal post of duty or at his minor post of duty when he maintains his family residence at the latter location.

In the instant case the taxpayer has been employed for many years by a company which owns and operates several department stores. Prior to 1954, his only post of duty was at the company's headquarters and main store located in the city of *X*. Early in 1954, however, he was appointed by the company as the manager of a new store in the city of *Y*, which is about 100 miles from the city of *X*. Since receiving that assignment, he has rented a single room on a monthly basis in the city of *Y* and usually stays there from Monday evening until Saturday evening of each week. Each Saturday evening he returns to the city of *X* and stays at his family residence until the following Monday evening. The company requires the taxpayer to report at its headquarters each Monday for the purpose of discussing with company officials all important problems and developments connected with the operation of the new store.

Section 162 of the Internal Revenue Code of 1954 provides in part as follows:

(a) IN GENERAL.—There shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including—

* * * * * * *

(2) traveling expenses (including the entire amount expended for meals and lodging) while away from home in the pursuit of a trade or business; * * *

It is now well established that a taxpayer's "home" for traveling expense purposes is located at the place where he conducts his trade or business, unless he is so engaged at two or more distant localities, in which event his "home" is located at his principal or regular post of duty during the taxable year. Since the company directed the taxpayer to work in the city of *Y* five days a week and to be in the city of *X* only one day a week, it is clear that his principal or regular post of duty was transferred to the city of *Y*, notwithstanding the fact that the company's headquarters, the employee's family residence, and his minor or temporary post of duty all remained in the city of *X*. It is also obvious that after such transfer, the taxpayer retained his family residence in the city of *X* for personal reasons, and that his added expenses for meals and lodging in the city of *Y* were not occasioned by the exigencies of business but were motivated by the personal convenience and necessities of the taxpayer. Compare, *Commissioner* v. *J. N. Flowers*, 326 U. S. 465, Ct. D. 1659, C. B. 1946–1, 57. Accordingly, it is held that the taxpayer may not deduct the cost of his meals and lodging while discharging his duties in the city of *Y*, his principal or regular place of employment, even though such place is located at a distance from his family residence and his minor or temporary place of employment. This conclusion is in accord with the decisions in *Jerome M. Ney* v. *United States*, 171 Fed. (2d) 449; *Robert F. Green et ux.* v. *Commissioner*, 12 T. C. 656; and *S. M. R. O'Hara* v. *Commissioner*, 6 T. C. 841.

Under such circumstances, the Internal Revenue Service is unable to apply or agree with the dictum found in *Joseph H. Sherman, Jr., et ux.* v. *Commissioner*, 16 T. C. 332 at 337, to the effect that a taxpayer having two occupations or posts of duty which require him to spend a substantial amount of time in each of two cities may deduct his traveling expenses "incurred in connection with attendance upon the one removed from his residence." Although the Commissioner has acquiesced in the Sherman decision (C. B. 1951–2, 4), the above-quoted dictum does not represent the position of the Service and will not be regarded as a rule of law to be generally applied in other similar cases.

It is also clear that where a taxpayer is engaged in business at two widely separated locations, he may deduct his expenses for meals and lodging while discharging his duties at that location which is removed from his principal post of duty. This position is in accord with *Walter F. Brown* v. *Commissioner*, 13 B. T. A. 832, acquiescence, C. B. VIII–1, 6 (1929); *Joseph W. Powell* v. *Commissioner*, 34 B. T. A. 655, acquiescence, C. B. XV–2, 19 (1936); and the Sherman case, *supra*. Although the residence of each taxpayer considered in those cases was located at his principal or regular post of duty, the same conclusion was reached in Revenue Ruling 54–147, C. B. 1954–1, 51, and in Rev-

enue Ruling 54–497, C. B. 1954–2, 75, with respect to taxpayers who maintained their family residences at their minor or temporary posts of duty. Accordingly, it is held that an employee having two widely separated posts of duty may deduct the cost of his meals and lodging while his work requires him to be at his minor or temporary post of duty, even though he maintains his family residence at that location. In such cases the deduction is limited, of course, to that portion of the family expenses for meals and lodging which is properly attributable to the taxpayer's presence there in the actual performance of his duties.

Rev. Rul. 55–714

Premiums paid by one managing persons in the entertainment field on an insurance policy covering the life of one of his entertainers are not deductible for Federal income tax purposes where the manager is the beneficiary under the policy.

Advice has been requested whether a manager may claim as a deduction the premium which he pays on an insurance policy covering the life of a person for whom he is a manager.

In the instant case, the taxpayer is engaged in the business of managing various persons in the entertainment field for which he receives as compensation a certain percentage of the entertainers' gross income. To protect his interest in an entertainer's income, he procured an insurance policy on the life of the entertainer on which he pays the premium and under which he is the beneficiary.

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

In *Thomas B. Lilly and Helen W. Lilly* v. *Commissioner*, 343 U. S. 90, Ct. D. 1741, C. B. 1952–1, 16, it is stated:

Customs and actions of organized professional organizations have an appropriate place in determining in a factual sense what are ordinary and necessary expenses at a given time and place.

In the instant case, there are no customs prevalent in the particular trade or business by which the expenses in question may be considered ordinary and necessary business expenses within the meaning of section 162 of the Code.

Accordingly, it is held that premiums paid by one managing persons in the entertainment field on an insurance policy covering the life of one of his entertainers is not deductible for Federal income tax purposes where the manager is the beneficiary under the policy. See also Rev. Rul. 73, C. B. 1953–1, 63, denying a deduction to the principal member of a partnership for premiums paid on a life insurance policy taken out on his own life and naming his partners as beneficiaries in an effort to induce them to remain in the partnership.

Life insurance carried by farmers' cooperatives on members. See Rev. Rul. 55–558, page 270.

Automobile expenditures incurred by a rural mail carrier. See Rev. Rul. 55–637, page 26.

SECTION 165.—LOSSES

(Also Part II, Sections 23(e), 23(g); Regulations 118, Sections 39.23(e)-1, 39.23(g)-1.) Rev. Rul. 55-619

In view of the decisions in *Carl B. Tuttle* v. *United States* and *Commissioner* v. *Adam, Meldrum & Anderson Co.*, the Internal Revenue Service holds that an assessment paid on worthless, double-liability bank stock by a stockholder employing the cash method of accounting, constitutes a part of the original stock investment. The Internal Revenue Service will follow the Tuttle decision in respect of the "tax benefit doctrine" as set forth in section 111 of the Internal Revenue Code of 1954 (section 22 (b) (12) (D) of the 1939 Code), in cases where such stockholders effect recoveries on such investments.

I. T. 3351, C. B. 1940-1, 87, is revoked.

In view of the decisions in *Carl B. Tuttle* v. *United States*, 101 Fed. Supp. 532, and *Commissioner* v. *Adam, Meldrum & Anderson Co.*, 215 Fed. (2d) 166, certiorari denied, 348 U. S. 913, and other court decisions, reconsideration has been given to I. T. 3351, C. B. 1940-1, 87, which holds that payments by stockholders, employing the cash basis of accounting, of their statutory liability (so-called double liability) on bank stock which was determined to be worthless in a taxable year prior to 1938, constituted losses to which section 23(e) of the Revenue Act of 1938 applied and not losses within the purview of section 23(g)(1) or section 23(g)(2) of that Act.

Section 165 of the Internal Revenue Code of 1954 which embodies the similar provisions of the Internal Revenue Code of 1939 and the Revenue Act of 1938 reads, in part, as follows:

(a) GENERAL RULE.—There shall be allowed as a deduction any loss sustained during the taxable year and not compensated for by insurance or otherwise.

* * * * * * *

(c) LIMITATION ON LOSSES OF INDIVIDUALS.—In the case of an individual, the deduction under subsection (a) shall be limited to—

(1) losses incurred in a trade or business;

(2) losses incurred in any transaction entered into for profit, though not connected with a trade or business; * * *

* * * * * * *

(f) CAPITAL LOSSES.—Losses from sales or exchanges of capital assets shall be allowed only to the extent allowed in sections 1211 and 1212.

(g) WORTHLESS SECURITIES.—

(1) GENERAL RULE.—If any security which is a capital asset becomes worthless during the taxable year, the loss resulting therefrom shall, for purposes of this subtitle, be treated as a loss from the sale or exchange, on the last day of the taxable year, of a capital asset.

In *Carl B. Tuttle* v. *United States*, 101 Fed. Supp. 532, the U. S. Court of Claims held that the cost of the assessment was part of the original stock investment whether or not the stock was worthless at the time the assessment was paid and therefore considered the combined loss in applying the tax benefit rule. A similar position was taken in the *Estate of Fred T. Murphy et al.* v. *Commissioner*, 22 T. C. 242, *Estate of Mary B. Booth* v. *Commissioner*, T. C. Memo 1954-36, *Louise Weber O'Brien* v. *Commissioner*, 22 T. C. 661, and *Commissioner* v. *Adam, Meldrum & Anderson Co.*, 215 Fed. (2d) 166, certiorari denied, 348 U. S. 913.

In view of the above, the Internal Revenue Service now holds that an assessment paid on worthless, double-liability bank stock by a stockholder employing the cash method of accounting constitutes a part of the original stock investment and any loss sustained on the disposition thereof will constitute a capital loss subject to the provisions of section 165(f) of the Code. Furthermore, the Internal Revenue Service will now follow the Tuttle decision in respect of the "tax benefit doctrine" as set forth in section 111(b)(4) of the Internal Revenue Code of 1954 (section 22(b)(12)(D) of the 1939 Code) in cases where such stockholders effect recoveries on such investments.

I. T. 3351, C. B. 1940–1, 87, is revoked.

SECTION 167.—DEPRECIATION

Rev. Rul. 55–729

Expenditures, in connection with the development of a storage reservoir or hydro power project, for transmission line rights of way, flowage easements and clearance of a reservoir, including damages and necessary relocations of highways, bridges, utilities, cemeteries, villages, etc., constitute capital expenditures, whose usefulness depends on the life of the whole project rather than the life of the dam. Since reconstruction of the dam would not entail a recurrence of these expenditures, amortization of such costs will not be allowed over the useful life of the dam. The contrary position expressed in the case of *Union Electric Company of Missouri* v. *Commissioner*, 10 T. C. 802, affirmed, 177 Fed. (2d) 269, will not be accepted by the Internal Revenue Service as a precedent in the disposition of other cases involving similar factual situations. However, if the useful life of the project is reasonably susceptible of measurement, either now or in the future, or if it is possible to make a reasonable determination with respect to the abandonment of the project, these expenditures may be amortized over the remaining life of the project. See G. C. M. 9357, C. B. X–1, 385 (1931).

(Also Section 611.) Rev. Rul. 55–730

The cost of farm land with peat soils which by reliable estimate will subside to the extent of wide-scale abandonment within the next half century may not be recovered by depreciation or depletion allowances.

Advice has been requested whether a taxpayer who has purchased and cultivates a farm in Florida comprised of land with peat soils may recover the cost of the farm through allowances for depletion or depreciation.

The taxpayer's farm is located in Florida where peat soils are subject to subsidence as a result of oxidation, compaction and the lowering of the water level. After subsidence reaches a certain level, proper drainage becomes extremely difficult, if not impossible, and the abandonment of the use of these lands for farming has been forecast by competent authorities. This process is not a mining operation in which

minerals are extracted from the land, and the depletion provisions are not applicable.

Section 39.23 (1)-2 of Regulations 118, made applicable to section 167 of the 1954 Code by Treasury Decision 6091, C. B. 1954-2, 47, provides that the depreciation allowance applies to that which is subject to wear and tear, to decay or decline from natural causes, to exhaustion, and to obsolescence due to the normal progress of the art, as where machinery or other property must be replaced (1) by a new invention or (2) due to the inadequacy of the property to the growing needs of the business. It does not apply to inventories or to stock in trade, or to land as such.

Accordingly, it is held that the cost of farm land with peat soils, which by reliable estimate will subside to the extent of wide-scale abandonment of the use of the land within the next half century, may not be recovered by depreciation or depletion allowances.

Depreciation on industrial equipment and business machinery acquired through leasing transactions. See Rev. Rul. 55-540, page 39.

Depreciation on office equipment acquired through a leasing transaction. See Rev. Rul. 55-541, page 19.

Depreciation on business equipment acquired through a leasing transaction. See Rev. Rul. 55-542, page 59.

Depreciation of lock boxes and fixtures which postmasters are required to purchase with their own funds for the general use of the public. See Rev. Rul. 55-579, page 47.

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

Rev. Rul. 55-453

Contributions by an individual to Federal, State, or local governments, for the expansion, development, or creation of educational organizations or hospitals which are instrumentalities of such governments, will qualify for the additional deduction of 10 percent of adjusted gross income for certain charitable contributions provided by section 170(b)(1)(A) of the Internal Revenue Code of 1954. Such contributions in excess of 10 percent of adjusted gross income should be taken into account in computing the amount allowable as a deduction subject to the general limitation of 20 percent of adjusted gross income provided by section 170(b)(1)(B) of the Code.

Advice has been requested whether contributions to Federal, State or local governments for the expansion, development, or creation of government operated educational organizations and hospitals, will qualify for the additional deduction for certain charitable contributions of 10 percent of adjusted gross income provided by section 170(b)(1)(A) of the Internal Revenue Code of 1954.

Section 170(b)(1)(A) of the Code provides as follows:

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

* * * * * * *

(b) LIMITATIONS.—

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

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

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

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

(iii) a hospital referred to in section 503(b)(5), shall be allowed to the extent that the aggregate of such contributions does not exceed 10 percent of the taxpayer's adjusted gross income computed without regard to any net operating loss carryback to the taxable year under section 17.

Section 503(b)(2) of the Code relating to educational organizations and section 503(b)(5) relating to hospitals to which section 170(b)(1)(A)(ii) and (iii) refer, read as follows:

(2) an educational organization which normally maintains a regular faculty and curriculum and normally has a regularly enrolled body of pupils or students in attendance at the place where its educational activities are regularly carried on;

* * * * * * *

(5) an organization the principal purposes or functions of which are the providing of medical or hospital care or medical education or medical research or agricultural research.

Section 170(c) of the Code defines the term "charitable contribution" to include any contribution or gift to a State, Territory, a possession of the United States, or any political subdivision of the foregoing, or the United States, or the District of Columbia, but only if the contribution or gift is made for exclusively public purposes.

Accordingly, contributions to Federal, State, or local governments, for the expansion, development or creation of educational organizations or hospitals which are instrumentalities of such governments, will qualify for the additional deduction of 10 percent of adjusted gross income for certain charitable contributions provided by section 170(b)(1)(A) of the Code. Such contributions in excess of 10 percent of adjusted gross income should be taken into consideration in computing the amount allowable as a deduction subject to the general limitation of 20 percent of adjusted gross income provided by section 170(b)(1)(B) of the Code.

Rev. Rul. 55-514

An individual is the sole stockholder of a corporation engaged in the distribution of a product, packaged and sold under a trade name. In order to stimulate business a plan was adopted by the individual to make payments to charitable organizations incidental to the sale of the product. The plan was to attach to each parcel offered for sale a tag, coupon, or certificate, stipulating, in effect, that the customer could have a part in the contributions made by the sole stockholder to organizations, contributions to which are deductible for Federal income tax purposes, by sending the tag to any such organization. Instructions on the tag provide that, upon presentation of the tag by the charitable organization to the sole stockholder, a contribution will be made to the charitable organization in exchange for each tag in

the amount specified thereon. Held, the payments in question are not charitable contributions or gifts within the meaning of section 170 of the Internal Revenue Code of 1954 inasmuch as they are made by the stockholder in discharge of a legal obligation undertaken for his own economic benefit as sole stockholder of a corporation whose sales are expected to be increased in this manner. The consideration is the purchase of the product. Payments made for consideration are not generally considered contributions or gifts. See *Leroy J. Robertson* v. *United States*, 343 U. S. 711, Ct. D. 1746, C. B. 1952–2, 66.

Rev. Rul. 55–620

The taxpayer created an irrevocable trust, reserving the income to himself for life with remainder over at his death to a charitable organization which meets the requirements of section 170 of the Internal Revenue Code of 1954. The agreement provides that the corpus of the trust shall be invested in stock of regulated investment companies and that dividends received by the trustee which represent profits derived from the sale of securities owned by such companies may be considered as income and, as such, distributed to the donor or may be considered as principal and added to the corpus of the trust. *Held*, the present worth of the remainder interest passing to charity is deductible by the donor in the manner and to the extent provided in section 170 of the 1954 Code in the taxable year in which the property is transferred to the trustee, irrespective of whether the dividends representing profits realized from the sale of securities owned by the companies are distributed as income to the donor or added to the corpus of the trust. See I. T. 3707, C. B. 1945, 114, which held that the present value of the remainder interest of an irrevocable trust, with income reserved in the donor, passing to a charitable organization which meets the requirements of section 23(o) of the Internal Revenue Code of 1939 (corresponding to section 170 of the 1954 Code) is deductible by the donor.

SECTION 172.—NET OPERATING LOSS DEDUCTION

Adjustments for excess percentage depletion in the case of a consolidated net operating loss carryback from the taxable year 1954 to 1952 where subsidiaries change but the affiliated group is considered as remaining in existence in a subsequent loss year. See Rev. Rul. 55–499, page 379.

SECTION 176.—PAYMENTS WITH RESPECT TO EMPLOYEES OF CERTAIN FOREIGN CORPORATIONS

26 CFR 1.176: Statutory provisions; payments with respect to employees of certain foreign corporations.

Regulations relating to contract coverage of employees of foreign subsidiaries. See T. D. 6145, page 433.

PART VII.—ADDITIONAL ITEMIZED DEDUCTIONS FOR INDIVIDUALS

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

Rev. Rul. 55-479

Where a husband and wife reside in a community property State and file separate returns on a community property basis, amounts paid out of community funds for the medical care of one of the spouses should for the purpose of computing the medical expense deduction under section 213 of the Internal Revenue Code of 1954 be divided and one-half thereof considered as having been paid by each spouse. See O. D. 909, C. B. 4, 254 (1921), which holds generally that deductions properly chargeable against community income should be equally divided between husband and wife. See also *Mellie E. Stewart* v. *Commissioner*, 95 Fed. (2d) 821. Where the medical expenses are paid out of the separate funds of one spouse, only the spouse paying the medical expenses is entitled to a deduction therefor.

SECTION 216.—AMOUNTS REPRESENTING TAXES AND INTEREST PAID TO COOPERATIVE HOUSING CORPORATION

Rev. Rul. 55-556

In determining whether gross income from tenant-stockholders is 80 percent or more of a corporation's gross income for the taxable year during which it changed over to cooperative ownership, gross income means total gross income for its entire taxable year, both before and after the change over.

Advice has been requested whether the "80 percent of gross income" requirement of section 216(b)(1)(D) of the Internal Revenue Code of 1954 must be satisfied by a corporation with respect to its total gross income for the entire taxable year or merely for that portion of the total gross income applicable to the portion of its taxable year following the change to cooperative ownership.

A corporation which owned an apartment building and which reported its income, for Federal income tax purposes, on a calendar year basis changed on June 1 to a cooperative type of ownership. After the change, it possessed all of the qualifications of a "cooperative housing corporation" as defined in section 216(b)(1) of the Code. However, in the year in which the change was made, 50 percent of the total corporate gross income for the entire calendar year was derived from "tenant-stockholders" while for that portion of the year following the change over approximately 90 percent of the total corporate gross income was derived from "tenant-stockholders."

Section 216(b)(1) of the Code defines a corperative housing corporation. One of the requirements for a corporation to be so considered is that "80 percent or more of the gross income of which for the taxable year in which the taxes and interest described in subsection (a) are paid or incurred is derived from tenant-stockholders."

The corporation under consideration is on a calendar year basis and therefore the 80 percent requirement embodied in section 216(b)(1)(D) of the Code must be satisfied with respect to the total gross income for its entire taxable year. Since only 50 percent of the corporation's gross income for its entire taxable year was from tenant-stockholders, it does not meet the requirement of such section.

Accordingly, the corporation does not, for the year in which the change was made to cooperative ownership, qualify as a "cooperative housing corporation" within the meaning of section 216(b)(1) of the Code, and its "tenant-stockholders" are not entitled, under section 216(a) of the Code, to a deduction for their proportionate share of the interest and taxes paid or incurred by the corporation during such taxable year.

Rev. Rul. 55-654

Ownership of stock in a cooperative housing corporation by a stockholder other than an individual will not prevent the corporation from qualifying as a "cooperative housing corporation" within the purview of section 216 of the Internal Revenue Code of 1954, provided that 80 percent of its gross income is derived from tenant-stockholders who are individuals.

Advice has been requested whether the ownership of stock in a cooperative housing corporation by a stockholder who is not an individual will prevent the corporation from being considered as a cooperative housing corporation within the purview of section 216 of the Internal Revenue Code of 1954.

In the instant case, a corporation purchased a proprietary lease and shares of stock in a cooperative apartment house. The apartment obtained will be used for the temporary housing of certain of its officers and directors. The number of shares that were acquired is approximately nine percent of the total number of shares outstanding.

Section 216(b) provides in part as follows:

DEFINITIONS.—For the purposes of this section—

(1) COOPERATIVE HOUSING CORPORATION.—The term "cooperative housing corporation" means a corporation—

(A) having one and only one class of stock outstanding,

(B) each of the stockholders of which is entitled, solely by reason of his ownership of stock in the corporation, to occupy for dwelling purposes a house, or an apartment in a building, owned or leased by such corporation,

* * * * * * *

(D) 80 percent or more of the gross income of which for the taxable year in which the taxes and interest described in subsection (a) are paid or incurred is derived from tenant-stockholders.

(2) TENANT-STOCKHOLDER.—The term "tenant-stockholder" means an individual who is a stockholder in a cooperative housing corporation, * * *.

In view of the foregoing, it is held that if the ownership of stock in a corporation entitles a stockholder, solely by reason of such ownership, to occupy for dwelling purposes an apartment in a building owned or leased by such corporation and some of the stock is acquired by a person, as defined in section 7701(a)(1) of the Internal Revenue Code of 1954, other than an individual, such acquisition will not prevent the corporation from qualifying as a "cooperative housing corporation" within the purview of section 216 of the Code. How-

ever, in determining whether a cooperative housing corporation has derived 80 percent of its gross income from "tenant-stockholders," the income derived from stockholders who are not individuals cannot be included as income from tenant-stockholders. Compare Revenue Ruling 55–316, C. B. 1955–1, 312, with respect to what constitutes a cooperative apartment corporation within the meaning of section 23(z) of the 1939 Code.

PART IX.—ITEMS NOT DEDUCTIBLE

SECTION 262.—PERSONAL, LIVING, AND FAMILY EXPENSES

Automobile expenses incurred by an employee who transports fellow employees to and from work. See Rev. Rul. 55–555, page 20.

SECTION 263.—CAPITAL EXPENDITURES

(Also Section 167.) Rev. Rul. 55–542
(Also Part II, Sections 23(l), 24(a); Regulations 118, Sections 39.23(l)–1, 39.24(a)–2.)

Where the terms of a contract for the lease of certain equipment, together with a separate contract for financing payment to the lessor through an insurance company, clearly indicate an intent to transfer the ownership of the equipment to the lessee, the contract is considered, for Federal income tax purposes, to be a conditional sales contract. Quarterly payments made by the lessee under the contract are therefore capital expenditures, recoverable through deductions for depreciation over the period of the estimated useful life of the equipment purchased.

Advice has been requested whether the contract entered into by corporation *M* whereby it acquired the use of certain equipment manufactured by corporation *N* was a lease with option to purchase or whether the contract was a conditional sales contract.

Under the contract, *M* acquired the use of certain equipment and has agreed to pay $150x$ dollars in quarterly payments over a period of 15 years. Of this amount, $60x$ dollars is payable in the first five years, $52x$ dollars is payable in the second five years, and $38x$ dollars is payable in the final five-year period. In addition *M* is required to pay an amount equal to 3½ percent per annum of the amount of the unpaid quarterly amounts due under the contract. At the end of the 15-year period, title will pass to *M* upon the payment of the then depreciated value of the equipment.

In addition to the contract between corporation *M* and corporation *N*, there is a financing contract between corporation *N* and corporation *P* whereby *P*, an insurance company, agreed to remit to *N* the sum of $150x$ dollars as full payment of the purchase price of the equipment upon delivery to *M*. In return for such payment, *N* sells, assigns, transfers, and sets over to *P* all right, title, and interest of *N* in and to such equipment; and in and to any and all amounts (except freight and delivery charges) due or to become due or owing to *N*.

Evidence exists that the equipment could have been acquired by direct or outright purchase under an ordinary deferred payment contract at a cost of $152x$ dollars plus interest on such amount over a 15-year period of $40x$ dollars, or a total of $192x$ dollars. Under the adopted plan the amount to be paid as "rent" over the 15-year period is $150x$ dollars plus interest estimated to be $36x$ dollars, plus the estimated net depreciated value at the termination of the contract of 40x dollars, or a total cost of $226x$ dollars.

It is well established as a matter of fundamental law that contracts of the character here involved must be interpreted on the basis of the intent of the parties in the light of the facts and circumstances as they existed at the time the agreement was executed. Such intent cannot be determined by any single specific test and various factors must be considered in order to ascertain the reality of the contract. In these transactions the factors indicative of an intent to effect a conditional sale rather than a lease are found to be both convincing and numerous. Thus, the amount of payments by *M* required as "rentals" is approximately 82 percent of the total value of the equipment for a period of use of only 75 percent of the useful life of the equipment. The total "rentals" are substantially higher than the fair rental value for such equipment. Even more significant is the requirement that *M* pay interest on the "rental" balances, the payments of which had not yet become due. The contracts clearly contemplated disposition by *N* of all its interest in the equipment through the transfer to *P*. Furthermore, it seems unreasonable to assume that *P* intends to go into the business of owning and leasing equipment of this nature. It therefore seems wholly proper to conclude that the intention of the parties to the agreement was that *M* pay the required amount at the end of the "lease" period and keep the equipment.

Based on the foregoing facts and circumstances, it is held that corporation *M* has contracted to purchase the equipment under a conditional sales contract, and that the quarterly payments made by it are capital expenditures which can be recovered only through deductions for depreciation to the extent that such payments do not represent interest or other charges.

See Rev. Rul. 55-540, page 39, this Bulletin.

Rev. Rul. 55-557

The amount paid by a corporation to obtain release from an existing option, in order to present a clear and free title to its tangible assets and property in connection with its entering into a reorganization agreement, constitutes an additional cost of the tangible assets and property of such corporation and should be allocated among the various assets covered by the option.

Advice has been requested with respect to the treatment for Federal income tax purposes of an amount paid by a corporation to obtain release from an existing option in order to be able to convey good and marketable title for the purpose of reorganization proceedings.

The *M* company, in a nontaxable reorganization, acquired, in March 1954, all the assets of the *N* company. The agreement provided that the *N* company furnish clear and marketable title to its assets. Under a 20-year agreement between the *N* company and the *O* company, dated July 1938, the *O* company had acquired an option to purchase the tangible property of the *N* company at a price equal to the original

cost of such property, less depreciation. In 1954, the *N* and *O* companies cancelled the 20-year agreement for a stipulated amount and the *N* company paid such amount in February 1954.

Section 39.24(a)-2 of Regulations 118, applicable to section 263 of the 1954 Code pursuant to T. D. 6091, C. B. 1954-2, 47, provides in part that the cost of defending or perfecting title to property constitutes a part of the cost of the property and is not a deductible expense. Since the agreement between the companies which were parties to the reorganization was contingent upon the ability of the *N* company to convey good and marketable title to all the assets transferred to the *M* company, free and clear of all mortgages, liens and other encumbrances, except those, if any, subject to which the *M* company agreed to acquire them, it was necessary for the *N* company to obtain a release of the option held on its tangible property in order to perfect its marketable title thereto.

Accordingly, it is held that the amount paid by the *N* company for release from the option is an additional cost of the tangible assets and property of that company and should be allocated among the various assets covered by the option.

SECTION 264.—CERTAIN AMOUNTS PAID IN CONNECTION WITH INSURANCE CONTRACTS

Life insurance carried by farmers' cooperatives on members. See Rev. Rul. 55-558, page 270.

SUBCHAPTER C.—CORPORATE DISTRIBUTIONS AND ADJUSTMENTS

PART I.—DISTRIBUTIONS BY CORPORATIONS

SUBPART A.—EFFECTS ON RECIPIENTS

SECTION 301.—DISTRIBUTIONS OF PROPERTY

26 CFR 1.301-1: Rules applicable with respect to distributions of money and other property. T. D. 6152 [1]

TITLE 26—INTERNAL REVENUE, 1954.—CHAPTER I, SUBCHAPTER A, PART 1.—INCOME TAX: TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1953

Regulations prescribed under subchapter C, Parts I to IV, inclusive, and Part VI, of Chapter 1 of the Internal Revenue Code of 1954.

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

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

CORPORATE DISTRIBUTIONS AND ADJUSTMENTS

On December 11, 1954, notice of proposed rule making regarding the regulations under Parts I to IV, inclusive, and Part VI of Subchapter C of Chapter 1 of the Internal Revenue Code of 1954 was

[1] 20 F. R. 8875.

published in the Federal Register (19 F. R. 8237). After consideration of such relevant suggestions as were presented by interested persons regarding the proposals, the following regulations are hereby adopted:

Part I—Distributions by corporations. The rules in §§ 1.301 to 1.318–4 are to be applied in connection with the provisions of Part I, sections 301 through 318. For rules relating to the effective date of §§ 1.301 to 1.318–4 and to the application of §§ 1.301 to 1.318–4 to years subject to the Internal Revenue Code of 1939, see Part VI (§§ 1.391 to 1.395–1).

Part II—Corporate liquidations. The rules in §§ 1.331 to 1. 346–3 are to be applied in connection with the provisions of Part II, sections 331 through 346. For rules relating to the effective date of §§ 1.331 to 1. 346–3 and to the application of §§ 1.331 to 1.346–3 to years subject to the Internal Revenue Code of 1939, see Part VI (§§ 1.391 to 1.395–1).

Part III—Corporate organizations and reorganizations. The rules in §§ 1.351 to 1.368–3 are to be applied in connection with the provisions of Part III, sections 351 through 368. For rules relating to the effective date of §§ 1.351 to 1.368–3 and to the application of §§ 1.351 to 1.368–3 to years subject to the Internal Revenue Code of 1939, see Part VI (§§ 1.391 to 1.395–1).

Part IV—Insolvency reorganizations. The rules in §§ 1.371 to 1.373–3 are to be applied in connection with the provisions of Part IV, sections 371 through 373. For rules relating to the effective date of §§ 1.371 to 1.373–3 and to the application of §§ 1.371 to 1.373–3 to years subject to the Internal Revenue Code of 1939, see Part VI (§§ 1.391 to 1.395–1).

Part VI—Effective date of subchapter C. The rules in §§ 1.391 to 1.395–1 are to be applied in connection with the provisions of Part VI, sections 391 through 395.

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On December 11, 1954, notice of proposed rule making regarding the regulations under Parts I to IV, inclusive, and Part VI of Subchapter C of Chapter 1 of the Internal Revenue Code of 1954 was published in the Federal Register (19 F. R. 8237). After consideration of such relevant suggestions as were presented by interested persons regarding the proposals, the following regulations are hereby adopted:

CORPORATE DISTRIBUTIONS AND ADJUSTMENTS

DISTRIBUTIONS BY CORPORATIONS

EFFECTS ON RECIPIENTS

§ 1.301. STATUTORY PROVISIONS; DISTRIBUTIONS BY CORPORATIONS; DISTRIBUTIONS OF PROPERTY.

SEC. 301. DISTRIBUTIONS OF PROPERTY.

(a) IN GENERAL.—Except as otherwise provided in this chapter, a distribution of property (as defined in section 317(a)) made by a corporation to a shareholder with respect to its stock shall be treated in the manner provided in subsection (c).

(b) AMOUNT DISTRIBUTED.—

(1) GENERAL RULE.—For purposes of this section, the amount of any distribution shall be—

(A) Noncorporate Distributees.—If the shareholder is not a corporation, the amount of money received, plus the fair market value of the other property received.

(B) Corporate Distributees.—If the shareholder is a corporation, the amount of money received, plus whichever of the following is the lesser:

(i) The fair market value of the other property received; or

(ii) The adjusted basis (in the hands of the distributing corporation immedately before the distribution) of the other property received, increased in the amount of gain to the distributing corporation which is recognized under subsection (b) or (c) of section 311.

(2) REDUCTION FOR LIABILITIES.—The amount of any distribution determined under paragraph (1) shall be reduced (but not below zero) by—

(A) The amount of any liability of the corporation assumed by the shareholder in connection with the distribution, and

(B) The amount of any liability to which the property received by the shareholder is subject immediately before, and immediately after, the distribution.

(3) DETERMINATION OF FAIR MARKET VALUE.—For purposes of this section, fair market value shall be determined as of the date of the distribution.

(c) AMOUNT TAXABLE.—In the case of a distribution to which subsection (a) applies—

(1) AMOUNT CONSTITUTING DIVIDEND.—That portion of the distribution which is a dividend (as defined in section 316) shall be included in gross income.

(2) AMOUNT APPLIED AGAINST BASIS.—That portion of the distribution which is not a dividend shall be applied against and reduce the adjusted basis of the stock.

(3) AMOUNT IN EXCESS OF BASIS.—

(A) In General.—Except as provided in subparagraph (B), that portion of the distribution which is not a dividend, to the extent that it exceeds the adjusted basis of the stock, shall be treated as gain from the sale or exchange of property.

(B) Distributions Out of Increase in Value Accrued Before March 1, 1913.—That portion of the distribution which is not a dividend, to the extent that it exceeds the adjusted basis of the stock and to the extent that it is out of increase in value accrued before March 1, 1913, shall be exempt from tax.

(d) BASIS.—The basis of property received in a distribution to which subsection (a) applies shall be—

(1) NONCORPORATE DISTRIBUTEES.—If the shareholder is not a corporation, the fair market value of such property.

(2) CORPORATE DISTRIBUTEES.—If the shareholder is a corporation, whichever of the following is the lesser:

(A) The fair market value of such property; or

(B) The adjusted basis (in the hands of the distributing corporation immediately before the distribution) of such property, increased in the amount of gain to the distributing corporation which is recognized under subsection (b) or (c) of section 311.

(e) EXCEPTION FOR CERTAIN DISTRIBUTIONS BY PERSONAL SERVICE CORPORATIONS.—Any distribution made by a corporation, which was classified as a personal service corporation under the provisions of the Revenue Act of 1918 or the Revenue Act of 1921, out of its earnings or profits which were taxable in accordance with the provisions of section 218 of the Revenue Act of 1918 (40 Stat. 1070), or section 218 of the Revenue Act of 1921 (42 Stat. 245), shall be exempt from tax to the distributees.

(f) SPECIAL RULES.—

(1) For distributions in redemption of stock, see section 302.

(2) For distributions in partial or complete liquidation, see part II (sec. 331 and following).

(3) For distributions in corporate organizations and reorganizations, see part III (sec. 351 and following).

(4) For partial exclusion from gross income of dividends received by individuals, see section 116.

§ 1.301-1. RULES APPLICABLE WITH RESPECT TO DISTRIBUTIONS OF MONEY AND OTHER PROPERTY—(a) *General.*—Section 301 provides the general rule for treatment of distributions on or after June 22, 1954, of property by a corporation to a shareholder with respect to its stock. The term "property" is defined in section 317(a). Such distributions, except as otherwise provided in this chapter, shall be treated as provided in section 301(c). Under section 301(c), distributions may be included in gross income, applied against and reduce the adjusted basis of the stock, treated as gain from the sale or exchange of property, or (in the case of certain distributions out of increase in value accrued before March 1, 1913) may be exempt from tax. The amount of the distributions to which section 301 applies is determined in accordance with the provisions of section 301(b). The basis of property received in a distribution to which section 301 applies is determined in accordance with the provisions of section 301(d). Accordingly, except as otherwise provided in this chapter, a distribution on or after June 22, 1954, of property by a corporation to a shareholder with respect to its stock shall be included in gross income to the extent the amount distributed is considered a dividend under section 316. For examples of distributions treated otherwise, see sections 116, 301(c)(2), 301 (c)(3)(B), 301(e), 302(b), 303, and 305. See also part II (relating to distributions in partial or complete liquidation), part III (relating to corporate organizations and reorganizations), and part IV (relating to insolvency reorganizations) of subchapter C.

(b) *Time of inclusion in gross income and of determination of fair market value.*—A distribution made by a corporation to its shareholders shall be included in the gross income of the distributees when the cash or other property is unqualifiedly made subject to their demands. However, if such distribution is a distribution other than in cash, the fair market value of the property shall be determined as of the date of distribution without regard to whether such date is the same as that on which the distribution is includible in gross income. For example, if a corporation distributes a taxable dividend in property (the adjusted basis of which exceeds its fair market value on December 31, 1955) on December 31, 1955, which is received by, or unqualifiedly made subject to the demand of, its shareholders on January 2, 1956,

the amount to be included in the gross income of the shareholders will be the fair market value of such property on December 31, 1955, although such amount will not be includible in the gross income of the shareholders until January 2, 1956.

(c) *Application of section to shareholders.*—Section 301 is not applicable to an amount paid by a corporation to a shareholder unless the amount is paid to the shareholder in his capacity as such.

(d) *Distributions of property to corporate shareholders.*—If property (other than money and other than the obligations of the distributing corporation) is distributed in kind to a shareholder which is a corporation and the fair market value of such property is greater than the adjusted basis in the hands of the distributing corporation, only the adjusted basis of such property (determined immediately before the distribution and increased for any gain recognized to the distributing corporation under section 311(b) and (c)) shall be taken into account under section 301(c). Thus, in such a case, the amount of such a dividend in kind under section 301(c)(1) may not exceed such adjusted basis. Similarly, in such cases where the distribution is not out of earnings and profits, the amount of the reduction in basis of the shareholder's stock and the amount of any gain resulting from such distribution are determined by reference to the adjusted basis of the property distributed. If the property distributed is money, the amount of the distribution shall be the amount of such money. If the property distributed consists of the obligations of the distributing corporation, or stock of the distributing corporation treated as property under section 305(b), or rights to acquire such stock treated as property under section 305(b), the amount of such distribution shall be an amount equal to the fair market value of such obligations, stock, or rights. For special rule as to certain distributions of property received by a domestic corporation from a foreign corporation, see section 902(d).

(e) *Adjusted basis.*—In determining the adjusted basis of property distributed in the hands of the distributing corporation immediately before the distribution for purposes of section 301(b)(1)(B)(ii) and (d)(2)(B), the basis to be used shall be the basis for determining gain upon a sale or exchange.

(f) *Examples.*—The application of section 301 may be illustrated by the following examples:

Example (1). On January 1, 1955, A, an individual, owned all of the stock of Corporation M with an adjusted basis of $2,000. During 1955, A received distributions from Corporation M totaling $30,000, consisting of $10,000 in cash and listed securities having a basis in the hands of Corporation M and a fair market value on the date distributed of $20,000. Corporation M's taxable year is the calendar year. As of December 31, 1954, Corporation M had earnings and profits accumulated after February 28, 1913, in the amount of $26,000, and it had no earnings and profits and no deficit for 1955. Of the $30,000 received by A, $26,000 will be treated as an ordinary dividend; the remaining $4,000 will be applied against the adjusted basis of his stock; the $2,000 in excess of the adjusted basis of his stock will either be treated as gain from the sale or exchange of property (under section 301(c)(3)(A)) or, if out of increase in value accrued before March 1, 1913, will (under section 301(c)(3)(B)) be exempt from tax.

If A subsequently sells his stock in Corporation M, the basis for determining gain or loss on the sale will be zero.

Example (2). The facts are the same as in Example 1 with the exceptions that the sole shareholder of Corporation M is Corporation W and that the securities which were distributed had an adjusted basis to Corporation M of $15,000. The distribution received by Corporation W totals $25,000 consisting of $10,000 in cash and securities with an adjusted basis of $15,000. The total $25,000 will be treated as a dividend to Corporation W since the earnings and profits of Corporation M ($26,000) are in excess of the amount of the distribution.

Example (3). Corporation X owns timber land which it acquired prior to March 1, 1913, at a cost of $50,000 with $5,000 allocated as the separate cost of the land. On March 1, 1913, this property had a fair market value of $150,000 of which $135,000 was attributable to the timber and $15,000 to the land. All of the timber was cut prior to 1955 and the full appreciation in the value thereof, $90,000 ($135,000−$45,000), realized through depletion allowances based on March 1, 1913, value. None of this surplus from realized appreciation had been distributed. In 1955, Corporation X sold the land for $20,000 thereby realizing a gain of $15,000. Of this gain, $10,000 is due to realized appreciation in value which accrued before March 1, 1913 ($15,000−$5,000). Of the gain of $15,000, $5,000 is taxable. Therefore, at December 31, 1955, Corporation X had a surplus from realized appreciation in the amount of $100,000. It had no accumulated earnings and profits and no deficit at January 1, 1955. The net earnings for 1955 (including the $5,000 gain on the sale of the land) were $20,000. During 1955, Corporation X distributed $75,000 to its stockholders. Of this amount, $20,000 will be treated as a dividend. The remaining $55,000, which is a distribution of realized appreciation, will be applied against and reduce the adjusted basis of the shareholders' stock. If any part of the $55,000 is in excess of the adjusted basis of a shareholder's stock, such part will be exempt from tax.

(g) *Reduction for liabilities.*—For the purpose of section 301(a), the amount of any distribution shall be reduced by—

(1) The amount of any liability of the corporation assumed by the shareholder in connection with the distribution, and

(2) The amount of any liability to which the property received by the shareholder is subject immediately before and immediately after the distribution.

Such reduction, however, shall not cause the amount of the distribution to be reduced below zero.

(h) *Basis.*—The basis of property received in the distribution to which section 301 applies shall be—

(1) If the shareholder is not a corporation, the fair market value of such property;

(2) If the shareholder is a corporation—

(i) In the case of a distribution of the obligations of the distributing corporation or of the stock of such corporation or rights to acquire such stock (if such stock or rights are

treated as property under section 305(b)), the fair market value of such obligations, stock, or rights;

(ii) In the case of the distribution of any other property, whichever of the following is the lesser—

(*a*) The fair market value of such property; or

(*b*) The adjusted basis (in the hands of the distributing corporation immediately before the distribution) of such property increased in the amount of gain to the distributing corporation which is recognized under section 311(b) (relating to distributions of LIFO inventory) or under section 311(c) (relating to distributions of property subject to liabilities in excess of basis).

(j) *Transfers for less than fair market value.*—If property is transferred by a corporation to a shareholder which is not a corporation for an amount less than its fair market value in a sale or exchange, such shareholder shall be treated as having received a distribution to which section 301 applies. In such case, the amount of the distribution shall be the difference between the amount paid for the property and its fair market value. If property is transferred in a sale or exchange by a corporation to a shareholder which is a corporation, for an amount less than its fair market value and also less than its adjusted basis, such shareholder shall be treated as having received a distribution to which section 301 applies, and—

(1) Where the fair market value of the property equals or exceeds its adjusted basis in the hands of the distributing corporation the amount of the distribution shall be the excess of the adjusted basis over the amount paid for the property;

(2) Where the fair market value of the property is less than its adjusted basis in the hands of the distributing corporation, the amount of the distribution shall be the excess of such fair market value over the amount paid for the property.

In all cases, the earnings and profits of the distributing corporation shall be decreased by the excess of the basis of the property in the hands of the distributing corporation over the amount received therefor. In computing gain or loss from the subsequent sale of such property, its basis shall be the amount paid for the property increased by the amount of the distribution.

(k) *Application of rule respecting transfers for less than fair market value.*—The application of paragraph (j) of this section may be illustrated by the following example:

Example. On January 1, 1955, A, an individual shareholder of Corporation X, purchased property from that corporation for $20. The fair market value of such property was $100, and its basis in the hands of Corporation X was $25. The amount of the distribution determined under section 301(b) is $80. If A were a corporation, the amount of the distribution would be $5, the excess of the basis of the property in the hands of Corporation X over the amount received therefor. The basis of such property to Corporation A would be $25. If the basis of the property in the hands of Corporation X were $10, the corporate shareholder, A, would not receive a distribution. The basis of

such property to Corporation A would be $20. Whether or not A is a corporation, the excess of the amount paid over the basis of the property in the hands of Corporation X ($20 over $10) would be a taxable gain to Corporation X.

(l) *Transactions treated as distributions.*—A distribution to shareholders with respect to their stock is within the terms of section 301 although it takes place at the same time as another transaction if the distribution is in substance a separate transaction whether or not connected in a formal sense. This is most likely to occur in the case of a recapitalization, a reincorporation, or a merger of a corporation with a newly organized corporation having substantially no property. For example, if a corporation having only common stock outstanding, exchanges one share of newly issued common stock and one bond in the principal amount of $10 for each share of outstanding common stock, the distribution of the bonds will be a distribution of property (to the extent of their fair market value) to which section 301 applies, even though the exchange of common stock for common stock may be pursuant to a plan of reorganization under the terms of section 368(a)(1)(E) (recapitalization) and even though the exchange of common stock for common stock may be tax free by virtue of section 354.

(m) *Cancellation of indebtedness.*—The cancellation of indebtedness of a shareholder by a corporation shall be treated as a distribution of property.

(n) *Cross references.*—For certain rules relating to adjustments to earnings and profits and for determining the extent to which a distribution is a dividend, see sections 312 and 316 and regulations thereunder.

§ 1.302 STATUTORY PROVISIONS; DISTRIBUTIONS IN REDEMPTION OF STOCK.

SEC. 302. DISTRIBUTIONS IN REDEMPTION OF STOCK.

(a) GENERAL RULE.—If a corporation redeems its stock (within the meaning of section 317(b)), and if paragraph (1), (2), (3), or (4) of subsection (b) applies, such redemption shall be treated as a distribution in part or full payment in exchange for the stock.

(b) REDEMPTIONS TREATED AS EXCHANGES.—

(1) REDEMPTIONS NOT EQUIVALENT TO DIVIDENDS.—Subsection (a) shall apply if the redemption is not essentially equivalent to a dividend.

(2) SUBSTANTIALLY DISPROPORTIONATE REDEMPTION OF STOCK.—

(A) IN GENERAL.—Subsection (a) shall apply if the distribution is substantially disproportionate with respect to the shareholder.

(B) LIMITATION.—This paragraph shall not apply unless immediately after the redemption the shareholder owns less than 50 percent of the total combined voting power of all classes of stock entitled to vote.

(C) DEFINITIONS.—For purposes of this paragraph, the distribution is substantially disproportionate if—

(i) The ratio which the voting stock of the corporation owned by the shareholder immediately after the redemption bears to all of the voting stock of the corporation at such time, is less than 80 percent of—

(ii) The ratio which the voting stock of the corporation owned by the shareholder immediately before the redemption bears to all of the voting stock of the corporation at such time.

For purposes of this paragraph, no distribution shall be treated as substantially disproportionate unless the shareholder's ownership of the common stock of the corporation (whether voting or nonvoting) after and before redemption also meets the 80 percent requirement of the preceding sentence. For purposes of the preceding sentence, if there is more than one class of common stock, the determinations shall be made by reference to fair market value.

(D) SERIES OF REDEMPTIONS.—This paragraph shall not apply to any redemption made pursuant to a plan the purpose or effect of which is a series of redemptions resulting in a distribution which (in the aggregate) is not substantially disproportionate with respect to the shareholder.

(3) TERMINATION OF SHAREHOLDER'S INTEREST.—Subsection (a) shall apply if the redemption is in complete redemption of all of the stock of the corporation owned by the shareholder.

(4) STOCK ISSUED BY RAILROAD CORPORATIONS IN CERTAIN REORGANIZATIONS.—Subsection (a) shall apply if the redemption is of stock issued by a railroad corporation (as defined in section 77(m) of the Bankruptcy Act, as amended) pursuant to a plan of reorganization under section 77 of the Bankruptcy Act.

(5) APPLICATION OF PARAGRAPHS.—In determining whether a redemption meets the requirements of paragraph (1), the fact that such redemption fails to meet the requirements of paragraph (2), (3), or (4) shall not be taken into account. If a redemption meets the requirements of paragraph (3) and also the requirements of paragraph (1), (2), or (4), then so much of subsection (c)(2) as would (but for this sentence) apply in respect to the acquisition of an interest in the corporation within the 10-year period beginning on the date of the distribution shall not apply.

(c) CONSTRUCTIVE OWNERSHIP OF STOCK.—

(1) IN GENERAL.

Except as provided in paragraph (2) of this subsection, section 318 (a) shall apply in determining the ownership of stock for purposes of this section.

(2) FOR DETERMINING TERMINATION OF INTEREST.

(A) In the case of a distribution described in subsection (b)(3), section 318(a)(1) shall not apply if—

(i) Immediately after the distribution the distributee has no interest in the corporation (including an interest as officer, director, or employee), other than an interest as a creditor,

(ii) The distributee does not acquire any such interest (other than stock acquired by bequest or inheritance) within 10 years from the date of such distribution, and

(iii) The distributee, at such time and in such manner as the Secretary or his delegate by regulations prescribes, files an agreement to notify the Secretary or his delegate of any acquisition described in clause (ii) and to retain such records as may be necessary for the application of this paragraph.

If the distributee acquires such an interest in the corporation (other than by bequest or inheritance) within 10 years from the date of the distribution, then the periods of limitation provided in sections 6501 and 6502 on the making of an assessment and the collection by levy or a proceding in court shall, with respect to any deficiency (including interest and additions to the tax) resulting from such acquisition, include one year immediately following the date on which the distributee (in accordance with regulations prescribed by the Secretary or his delegate) notifies the Secretary or his delegate of such acquisition; and such assessment and collection may be made notwithstanding any provision of law or rule of law which otherwise would prevent such assessment and collection.

(B) Subparagraph (A) of this paragraph shall not apply if—

(i) Any portion of the stock redeemed was acquired, directly or indirectly, within the 10-year period ending

on the date of the distribution by the distributee from a person the ownership of whose stock would (at the time of distribution) be attributable to the distributee under section 318(a), or

(ii) Any person owns (at the time of the distribution) stock the ownership of which is attributable to the distributee under section 318(a) and such person acquired any stock in the corporation, directly or indirectly, from the distributee within the 10-year period ending on the date of the distribution, unless such stock so acquired from the distributee, is redeemed in the same transaction.

The preceding sentence shall not apply if the acquisition (or, in the case of clause (ii), the disposition) by the distributee did not have as one of its principal purposes the avoidance of Federal income tax.

(d) REDEMPTIONS TREATED AS DISTRIBUTIONS OF PROPERTY.—Except as otherwise provided in this subchapter, if a corporation redeems its stock (within the meaning of section 317(b)), and if subsection (a) of this section does not apply, such redemption shall be treated as a distribution of property to which section 301 applies.

(e) CROSS REFERENCES.—For special rules relating to redemption—

(1) DEATH TAXES.—Of stock to pay death taxes, see section 303.

(2) SECTION 306 STOCK.—Of section 306 stock, see section 306.

(3) LIQUIDATIONS.—Of stock in partial or complete liquidation, see section 331.

§ 1.302-1. GENERAL.—(a) Under section 302(d), unless otherwise provided in subchapter C, a distribution in redemption of stock shall be treated as a distribution of property to which section 301 applies if the distribution is not within any of the provisions of section 302(b). A distribution in redemption of stock shall be considered a distribution in part or full payment in exchange for the stock under section 302(a) provided paragraph (1), (2), (3) or (4) of section 302(b) applies. Section 318(a) (relating to constructive ownership of stock) applies to all redemptions under section 302 except that in the termination of a shareholder's interest certain limitations are placed on the application of section 318(a)(1) by section 302(c)(2). The term "redemption of stock" is defined in section 317(b). Section 302 does not apply to that portion of any distribution which qualifies as a distribution in partial liquidation under section 346. For special rules relating to redemption of stock to pay death taxes see section 303. For special rules relating to redemption of section 306 stock see section 306. For special rules relating to redemption of stock in partial or complete liquidation see section 331.

(b) If, in connection with a partial liquidation under the terms of section 346, stock is redeemed in an amount in excess of the amount specified by section 331(a)(2), section 302(b) shall first apply as to each shareholder to which it is applicable without limitation because of section 331(a)(2). That portion of the total distribution which is used in all redemptions from specific shareholders which are within the terms of section 302(a) shall be excluded in determining the application of sections 346 and 331(a)(2). For example, Corporation X has $50,000 which is attributable to the sale of one of two active businesses and which, if distributed in redemption of stock, would qualify as a partial liquidation under the terms of section 346(b). Corporation X distributes $60,000 to its shareholders in redemption of stock, $20,000 of which is in redemption of all of the stock of shareholder A within the meaning of section 302(b)(3). The $20,000 dis-

tributed in redemption of the stock of shareholder A will be excluded in determining the application of sections 346 and 331(a)(2). The entire $60,000 will be treated as in part or full payment for stock ($20,000 qualifying under section 302(a) and $40,000 qualifying under sections 346 and 331(a)(2)).

§ 1.302-2. REDEMPTIONS NOT TAXABLE AS DIVIDENDS.—(a) The fact that a redemption fails to meet the requirements of paragraph (2), (3) or (4) of section 302(b) shall not be taken into account in determining whether the redemption is not essentially equivalent to a dividend under section 302(b)(1). See, however, paragraph (b) of this section. For example, if a shareholder owns only nonvoting stock of a corporation which is not section 306 stock and which is limited and preferred as to dividends and in liquidation, and one-half of such stock is redeemed, the distribution will ordinarily meet the requirements of paragraph (1) of section 302(b) but will not meet the requirements of paragraph (2), (3) or (4) of such section. The determination of whether or not a distribution is within the phrase "essentially equivalent to a dividend" (that is, having the same effect as a distribution without any redemption of stock) shall be made without regard to the earnings and profits of the corporation at the time of the distribution. For example, if A owns all the stock of a corporation and the corporation redeems part of his stock at a time when it has no earnings and profits, the distribution shall be treated as a distribution under section 301 pursuant to section 302(d).

(b) The question whether a distribution in redemption of stock of a shareholder is not essentially equivalent to a dividend under section 302(b)(1) depends upon the facts and circumstances of each case. One of the facts to be considered in making this determination is the constructive stock ownership of such shareholder under section 318(a). All distributions in pro rata redemptions of a part of the stock of a corporation generally will be treated as distributions under section 301 if the corporation has only one class of stock outstanding. However, for distributions in partial liquidation, see section 346. The redemption of all of one class of stock (except section 306 stock) either at one time or in a series of redemptions generally will be considered as a distribution under section 301 if all classes of stock outstanding at the time of the redemption are held in the same proportion. Distributions in redemption of stock may be treated as distributions under section 301 regardless of the provisions of the stock certificate and regardless of whether all stock being redeemed was acquired by the stockholders from whom the stock was redeemed by purchase or otherwise. In every case in which a shareholder transfers stock to the corporation which issued such stock in exchange for property, the facts and circumstances shall be reported on his return except as provided in § 1.331-1(d). See sections 346(a) and 6043 for requirements relating to returns by corporations.

(c) In any case in which an amount received in redemption of stock is treated as distribution of a dividend, proper adjustment of the basis of the remaining stock will be made with respect to the stock redeemed. The following examples illustrate the application of this rule:

Example (1). A, an individual, purchased all of the stock of Corporation X for $100,000. In 1955 the corporation redeems

half of the stock for $150,000, and it is determined that this amount constitutes a dividend. The remaining stock of Corporation X held by A has a basis of $100,000.

Example (2). H and W, husband and wife, each own half of the stock of Corporation X. All of the stock was purchased by H for $100,000 cash. In 1950 H gave one-half of the stock to W, the stock transferred having a value in excess of $50,000. In 1955 all of the stock of H is redeemed for $150,000, and it is determined that the distribution to H in redemption of his shares constitutes the distribution of a dividend. Immediately after the transaction, W holds the remaining stock of Corporation X with a basis of $100,000.

Example (3). The facts are the same as in Example (2) with the additional facts that the outstanding stock of Corporation X consists of 1,000 shares and all but 10 shares of the stock of H is redeemed. Immediately after the transaction, H holds 10 shares of the stock of Corporation X with a basis of $50,000, and W holds 500 shares with a basis of $50,000.

§ 1.302–3. SUBSTANTIALLY DISPROPORTIONATE REDEMPTION. (a) Section 302(b)(2) provides for the treatment of an amount received in redemption of stock as an amount received in exchange for such stock if—

(1) Immediately after the redemption the shareholder owns less than 50 percent of the total combined voting power of all classes of stock as provided in section 302(b)(2)(B).

(2) The redemption is a substantially disproportionate redemption within the meaning of section 302(b)(2)(C), and

(3) The redemption is not pursuant to a plan described in section 302(b)(2)(D).

Section 318(a) (relating to constructive ownership of stock) shall apply both in making the disproportionate redemption test and in determining the percentage of stock ownership after the redemption. The requirements under section 302 (b)(2)shall be applied to each shareholder separately and shall be applied only with respect to stock which is issued and outstanding in the hands of the shareholders. Section 302(b)(2) only applies to a redemption of voting stock or to a redemption of both voting stock and other stock. Section 302(b)(2) does not apply to the redemption solely of nonvoting stock (common or preferred). However, if a redemption is treated as an exchange to a particular shareholder under the terms of section 302(b)(2), such section will apply to the simultaneous redemption of nonvoting preferred stock (which is not section 306 stock) owned by such shareholder and such redemption will also be treated as an exchange. Generally, for purposes of this section, stock which does not have voting rights until the happening of an event, such as a default in the payment of dividends on preferred stock, is not voting stock until the happening of the specified event. Subsection 302(b)(2)(D) provides that a redemption will not be treated as substantially disproportionate if made pursuant to a plan the purpose or effect of which is a series of redemptions which result in the aggregate in a distribution

which is not substantially disproportionate. Whether or not such a plan exists will be determined from all the facts and circumstances.

(b) The application of paragraph (a) of this section is illustrated by the following example:

Example. Corporation M has outstanding 400 shares of common stock of which A, B, C and D each own 100 shares or 25 percent. No stock is considered constructively owned by A, B, C or D under section 318. Corporation M redeems 55 shares from A, 25 shares from B, and 20 shares from C. For the redemption to be disproportionate as to any shareholder, such shareholder must own after the redemptions less than 20 percent (80 percent of 25 percent) of the 300 shares of stock then outstanding. After the redemptions, A owns 45 shares (15 percent), B owns 75 shares (25 percent), and C owns 80 shares (26⅔ percent). The distribution is disproportionate only with respect to A.

§ 1.302–4. Termination of Shareholder's Interest. Section 302(b)(3) provides that a distribution in redemption of all of the stock of the corporation owned by a shareholder shall be treated as a distribution in part or full payment in exchange for the stock of such shareholder. In determining whether all of the stock of the shareholder has been redeemed, the general rule of section 302(c)(1) requires that the rules of constructive ownership provided in section 318(a) shall apply. Section 302(c)(2), however, provides that section 318(a)(1) (relating to constructive ownership of stock owned by members of a family) shall not apply where the specific requirements of section 302(c)(2) are met. The following rules shall be applicable in determining whether the specific requirements of section 302(c)(2) are met:

(a) The agreement specified in section 302(c)(2)(A)(iii) shall be in the form of a separate statement in duplicate signed by the distributee and attached to his return timely filed for the year in which the distribution described in section 302(b)(3) occurs. The agreement shall recite that the distributee has not acquired any interest in the corporation (as described in section 302(c)(2)(A)(i)) since such distribution, and that he agrees to notify the district director of internal revenue for the district in which such return is filed of any acquisition of such an interest in the corporation within 30 days after such acquisition if such acquisition occurs within 10 years from the date of such distribution.

(b) The distributee who files an agreement under section 302(c)(2)(A)(iii) shall retain copies of income tax returns and any other records indicating fully the amount of tax which would have been payable had the redemption been treated as a distribution subject to section 301.

(c) If stock of a parent corporation is redeemed, subparagraph (A) relating to acquisition of an interest in the corporation within 10 years after termination shall be applied with reference to an interest both in the parent corporation and any subsidiary of such parent corporation. If stock of a parent corporation is sold to a subsidiary in a transaction described in section 304, subpara-

graph (A) shall be applicable to the acquisition of an interest in such subsidiary corporation or in the parent corporation. If stock of a subsidiary corporation is redeemed, subparagraph (A) shall be applied with reference to an interest both in such subsidiary corporation and its parent. Such subparagraph shall also be applied with respect to an interest in a corporation which is a successor corporation to the corporation the interest in which has been terminated.

(d) For the purpose of section 302(c)(2)(A)(i), a person will be considered to be a creditor only if the rights of such person with respect to the corporation are not greater or broader in scope than necessary for the enforcement of his claim. Such claim must not in any sense be proprietary and must not be subordinate to the claims of general creditors. An obligation in the form of a debt may thus constitute a proprietary interest. For example, if under the terms of the instrument the corporation may discharge the principal amount of its obligation to a person by payments, the amount or certainty of which are dependent upon the earnings of the corporation, such a person is not a creditor of the corporation. Furthermore, if under the terms of the instrument the rate of purported interest is dependent upon earnings, the holder of such instrument may not, in some cases, be a creditor.

(e) In the case of a distributee to whom section 302(b)(3) is applicable, who is a creditor after such transaction, the acquisition of the assets of the corporation in the enforcement of the rights of such creditor shall not be considered an acquisition of an interest in the corporation for purposes of section 302(c)(2) unless stock of the corporation, its parent corporation, or, in the case of a redemption of stock of a parent corporation, of a subsidiary of such corporation is acquired.

(f) In determining whether an entire interest in the corporation has been terminated under section 302(b)(3), under all circumstances paragraphs (2), (3), and (4) of section 318(a) (relating to constructive ownership of stock) shall be applicable.

(g) Section 302(c)(2)(B) provides that section 302(c)(2)(A) shall not apply—

> (1) If any portion of the stock redeemed was acquired directly or indirectly within the 10-year period ending on the date of the distribution by the distributee from a person, the ownership of whose stock would (at the time of distribution) be attributable to the distributee under section 318(a), or
>
> (2) If any person owns (at the time of the distribution) stock, the ownership of which is attributable to the distributee under section 318(a), such person acquired any stock in the corporation directly or indirectly from the distributee within the 10-year period ending on the date of the distribution, and such stock so acquired from the distributee is not redeemed in the same transaction,

unless the acquisition (described in (1) above) or the disposition by the distributee (described in (2) above) did not have as one of its principal purposes the avoidance of Federal income tax.

A transfer of stock by the transferor, within the 10-year period ending on the date of the distribution, to a person whose stock would be attributable to the transferor shall not be deemed to have as one of its principal purposes the avoidance of Federal income tax merely because the transferee is in a lower income tax bracket than the transferor.

§ 1.303. STATUTORY PROVISIONS; DISTRIBUTIONS IN REDEMPTION OF STOCK TO PAY DEATH TAXES.

SEC. 303. DISTRIBUTION IN REDEMPTION OF STOCK TO PAY DEATH TAXES.

(a) IN GENERAL.—A distribution of property to a shareholder by a corporation in redemption of part or all of the stock of such corporation which (for Federal estate tax purposes) is included in determining the gross estate of a decedent, to the extent that the amount of such distribution does not exceed the sum of—

(1) The estate, inheritance, legacy, and succession taxes (including any interest collected as a part of such taxes) imposed because of such decedent's death, and

(2) The amount of funeral and administration expenses allowable as deductions to the estate under section 2053 (or under section 2106 in the case of the estate of a decedent nonresident, not a citizen of the United States),

shall be treated as a distribution in full payment in exchange for the stock so redeemed.

(b) LIMITATIONS ON APPLICATION OF SUBSECTION (a)—

(1) PERIOD FOR DISTRIBUTION.—Subsection (a) shall apply only to amounts distributed after the death of the decedent and—

(A) Within the period of limitations provided in section 6501(a) for the assessment of the Federal estate tax (determined without the application of any provision other than section 6501(a)), or within 90 days after the expiration of such period, or

(B) If a petition for redetermination of a deficiency in such estate tax has been filed with the Tax Court within the time prescribed in section 6213, at any time before the expiration of 60 days after the decision of the Tax Court becomes final.

(2) RELATIONSHIP OF STOCK TO DECEDENT'S ESTATE—

(A) IN GENERAL.—Subsection (a) shall apply to a distribution by a corporation only if the value (for Federal estate tax purposes) of all of the stock of such corporation which is included in determining the value of the decedent's gross estate is either—

(i) More than 35 percent of the value of the gross estate of such decedent, or

(ii) More than 50 percent of the taxable estate of such decedent.

(B) SPECIAL RULE FOR STOCK OF TWO OR MORE CORPORATIONS.—For purposes of the 35 percent and 50 percent requirements of subparagraph (A), stock of two or more corporations, with respect to each of which there is included in determining the value of the decedent's gross estate more than 75 percent in value of the outstanding stock, shall be treated as the stock of a single corporation For the purpose of the 75 percent requirement of the preceding sentence, stock which, at the decedent's death, represents the surviving spouse's interest in property held by the decedent and the surviving spouse as community property shall be treated as having been included in determining the value of the decedent's gross estate.

(c) STOCK WITH SUBSTITUTED BASIS.—If—

(1) A shareholder owns stock of a corporation (referred to in this subsection as "new stock") the basis of which is determined by reference to the basis of stock of a corporation (referred to in this subsection as "old stock").

(2) The old stock was included (for Federal estate tax purposes) in determining the gross estate of a decedent, and

(3) Subsection (a) would apply to a distribution of property to such shareholder in redemption of the old stock.

then, subject to the limitation specified in subsection (b) (1), subsection (a) shall apply in respect of a distribution in redemption of the new stock.

§ 1.303–1. GENERAL.—Section 303 provides that in certain cases a distribution in redemption of stock, the value of which is included in determining the value of the gross estate of a decedent, shall be treated as a distribution in full payment in exchange for the stock so redeemed.

§ 1.303–2. REQUIREMENTS.—(a) Section 303 applies only where the distribution is with respect to stock of a corporation the value of whose stock in the gross estate of the decedent for Federal estate tax purposes is an amount in excess of (1) 35 percent of the value of the gross estate of such decedent, or (2) 50 percent of the taxable estate of such decedent. For the purposes of such 35 percent and 50 percent requirements, stock of two or more corporations shall be treated as the stock of a single corporation if more than 75 percent in value of the outstanding stock of each such corporation is included in determining the value of the decedent's gross estate. For the purpose of the 75 percent requirement, stock which, at the decedent's death, represents the surviving spouse's interest in community property shall be considered as having been included in determining the value of the decedent's gross estate.

(b) For the purpose of section 303(b)(2)(A)(i), the term "gross estate" means the gross estate as computed in accordance with section 2031 (or, in the case of the estate of a decedent nonresident not a citizen of the United States, in accordance with section 2103). For the purpose of section 303(b)(2)(A)(ii), the term "taxable estate" means the taxable estate as computed in accordance with section 2051 (or, in the case of the estate of a decedent nonresident not a citizen of the United States, in accordance with section 2106).

(c) (1) In determining whether the estate of the decedent is comprised of stock of a corporation of sufficient value to satisfy the percentage requirements of section 303(b)(2)(A) and section 303(b)(2)(B), the total value, in the aggregate, of all classes of stock of the corporation includible in determining the value of the gross estate is taken into account. A distribution under section 303(a) may be in redemption of the stock of the corporation includible in determining the value of the gross estate, without regard to the class of such stock.

(2) The above may be illustrated by the following example:

Example. The gross estate of the decedent has a value of $1,000,000, the taxable estate is $700,000, and the sum of the death taxes and funeral and administration expenses is $275,000. Included in determining the gross estate of the decedent is stock of

three corporations which, for Federal estate tax purposes, is valued as follows:

Corporation A	
Common stock	$100,000
Preferred stock	$100,000
Corporation B	
Common stock	$50,000
Preferred stock	$350,000
Corporation C	
Common stock	$200,000

The stock of Corporation A and Corporation C included in the estate of the decent constitutes all of the outstanding stock of both corporations. The stock of Corporation A and the stock of Corporation C, treated as the stock of a single corporation under section 303(b)(2)(B), has a value in excess of $350,000 (35 percent of the gross estate or 50 percent of the taxable estate). Likewise, the stock of Corporation B has a value in excess of $350,000. The distribution by one or more of the above corporations, within the period prescribed in section 303(b)(1), of amounts not exceeding, in the aggregate, $275,000, in redemption of preferred stock or common stock of such corporation or corporations, will be treated as in full payment in exchange for the stock so redeemed.

(d) If stock includible in determining the value of the gross estate of a decedent is exchanged for new stock, the basis of which is determined by reference to the basis of the old stock, the redemption of the new stock will be treated the same under section 303 as the redemption of the old stock would have been. Thus, section 303 shall apply with respect to a distribution in redemption of stock received by the estate of a decedent (1) in connection with a reorganization under section 368, (2) in a distribution or exchange under section 355 (or so much of section 356 as relates to section 355), (3) in an exchange under section 1036 or (4) in a distribution to which section 305 (a) applies. Similarly, a distribution in redemption of stock will qualify under section 303, notwithstanding the fact that the stock redeemed is section 306 stock to the extent that the conditions of section 303 are met.

(e) Section 303 applies to distributions made after the death of the decedent and (1) before the expiration of the 3-year period of limitations for the assessment of estate tax provided in section 6501(a) (determined without the application of any provisions of law extending or suspending the running of such period of limitations), or within 90 days after the expiration of such period, or (2) if a petition for redetermination of a deficiency in such estate tax has been filed with the Tax Court within the time prescribed in section 6213, at any time before the expiration of 60 days after the decision of the Tax Court becomes final. The extension of the period of distribution provided in section 303(b)(1)(B) has reference solely to bona fide contests in the Tax Court and will not apply in the case of a petition for redemption of a deficiency which is initiated solely for the purpose of extending the period within which section 303 would otherwise be applicable.

(f) While section 303 will most frequently have application in the case where stock is redeemed from the executor or administrator of an estate, the section is also applicable to distributions in redemption of stock included in the decedent's gross estate and held at the time

of the redemption by any person who acquired the stock by any of the means comprehended by part III, subchapter A, chapter 11 of subtitle B, including the heir, legatee, or donee of the decedent, a surviving joint tenant, surviving spouse, appointee, or taker in default of appointment, or a trustee of a trust created by the decedent. Thus, section 303 may apply with respect to a distribution in redemption of stock from a donee to whom the decedent has transferred stock in contemplation of death where the value of such stock is included in the decedent's gross estate under section 2035. Similarly, section 303 may apply to the redemption of stock from a beneficiary of the estate to whom an executor has distributed the stock pursuant to the terms of the will of the decedent. However, section 303 is not applicable to the case where stock is redeemed from a stockholder who has acquired the stock by gift or purchase from any person to whom such stock has passed from the decedent. Nor is section 303 applicable to the case where stock is redeemed from a stockholder who has acquired the stock from the executor in satisfaction of a specific monetary bequest.

(g) The total application of section 303 with respect to stock included in the gross estate of any decedent can never exceed the sum of the amount of the estate, inheritance, legacy, and succession taxes (including any interest collected as a part of such taxes) imposed because of the decedent's death and the amount of funeral and administration expenses allowable as deductions to the estate. In determining whether the total distributions in redemption of such stock made within the period of time prescribed in section 303(b)(1) exceed the amount of such taxes, interest, and expenses, account shall be taken of all such distributions without regard to whether any distribution would be treated as a dividend were it not for section 303.

(h) For the purpose of section 303, the Federal estate tax or any other estate, inheritance, legacy, or succession tax shall be ascertained after the allowance of any credit, relief, discount, refund, remission or reduction of tax.

§ 1.303–3. Application of Other Sections.—(a) The sole effect of section 303 is to exempt from tax as a dividend a distribution to which such section is applicable when made in redemption of stock includible in a decedent's gross estate. Such section does not, however, in any other manner affect the principles set forth in sections 302 and 306. Thus, if stock of a corporation is owned equally by A, B, and the C Estate, and the corporation redeems one-half of the stock of each shareholder, the determination of whether the distributions to A and B are essentially equivalent to dividends shall be made without regard to the effect which section 303 may have upon the taxability of the distribution to the C Estate.

(b) See section 304 relative to redemption of stock through the use of related corporations.

§ 1.304. Statutory Provisions; Redemption Through Use of Related Corporations.

SEC. 304. REDEMPTION THROUGH USE OF RELATED CORPORATIONS.

(a) Treatment of Certain Stock Purchases.—

(1) Acquisition by related corporation (other than subsidiary).—For purposes of sections 302 and 303, if—

(A) One or more persons are in control of each of two corporations, and

(B) In return for property, one of the corporations acquires stock in the other corporation from the person (or persons) so in control,

then (unless paragraph (2) applies) such property shall be treated as a distribution in redemption of the stock of the corporation acquiring such stock. In any case, the stock so acquired shall be treated as having been transferred by the person from whom acquired, and as having been received by the corporation acquiring it, as a contribution to the capital of such corporation.

(2) ACQUISITION BY SUBSIDIARY.—For purposes of sections 302 and 303, if—

(A) In return for property, one corporation acquires from a shareholder of another corporation stock in such other corporation, and

(B) The issuing corporation controls the acquiring corporation,

then such property shall be treated as a distribution in redemption of the stock of the issuing corporation.

(b) SPECIAL RULES FOR APPLICATION OF SUBSECTION (a).—

(1) RULE FOR DETERMINATIONS UNDER SECTION 302(b).—In the case of any acquisition of stock to which subsection (a) of this section applies, determinations as to whether the acquisition is, by reason of section 302(b), to be treated as a distribution in part or full payment in exchange for the stock shall be made by reference to the stock of the issuing corporation. In applying section 318(a) (relating to constructive ownership of stock) with respect to section 302(b) for purposes of this paragraph, section 318(a)(2)(C) shall be applied without regard to the 50 percent limitation contained therein.

(2) AMOUNT CONSTITUTING DIVIDEND.—

(A) Where Subsection (a)(1) Applies.—In the case of any acquisition of stock to which paragraph (1) (and not paragraph (2)) of subsection (a) of this section applies, the determination of the amount which is a dividend shall be made solely by reference to the earnings and profits of the acquiring corporation.

(B) Where Subsection (a)(2) Applies.—In the case of any acquisition of stock to which subsection (a)(2) of this section applies, the determination of the amount which is a dividend shall be made as if the property were distributed by the acquiring corporation to the issuing corporation and immediately thereafter distributed by the issuing corporation.

(c) CONTROL.—

(1) IN GENERAL.—For purposes of this section, control means the ownership of stock possessing at least 50 percent of the total combined voting power of all classes of stock entitled to vote, or at least 50 percent of the total value of shares of all classes of stock. If a person (or persons) is in control (within the meaning of the preceding sentence) of a corporation which in turn owns at least 50 percent of the total combined voting power of all stock entitled to vote of another corporation, or owns at least 50 percent of the total value of the shares of all classes of stock of another corporation, then such person (or persons) shall be treated as in control of such other corporation.

(2) CONSTRUCTIVE OWNERSHIP.—Section 318(a) (relating to the constructive ownership of stock) shall apply for purposes of determining control under paragraph (1). For purposes of the preceding sentence, section 318(a)(2)(C) shall be applied without regard to the 50 percent limitation contained therein.

§ 1.304–1. GENERAL.—Section 304 is applicable where a shareholder sells stock of one corporation to a related corporation as defined in section 304. Such sales shall be treated as redemptions subject to sections 302 and 303.

§ 1.304–2. Acquisition by Related Corporation (Other Than Subsidiary).—(a) If a corporation, in return for property, acquires stock of another corporation from one or more persons and the person or persons from whom the stock was acquired were in control of both such corporations before the acquisition, then such property shall be treated as received in redemption of stock of the acquiring corporation. The stock received by the acquiring corporation shall be treated as a contribution to the capital of such corporation and shall have the same basis in its hands as it had in the hands of the transferor. The transferor's basis for his stock in the acquiring corporation shall be increased by the basis of stock surrendered by him. (But see below for subsequent reductions of basis in certain cases). As to each person transferring stock, the amount received shall be treated as a distribution of property under section 302(d), unless as to such person such amount is to be treated as received in exchange for the stock under the terms of section 302(a) or section 303. In applying section 302(b), reference shall be had to the shareholder's ownership of stock in the issuing corporation and not to his ownership of stock in the acquiring corporation (except for purposes of applying section 318(a)). In determining control and applying section 302(b), section 318(a) (relating to the constructive ownership of stock) shall be applied without regard to the 50 percent limitation in section 318(a)(2)(C). A series of redemptions referred to in section 302(b)(2)(D) shall include acquisitions by either of the corporations of stock of the other and stock redemptions by both corporations. If section 302(d) applies to the surrender of stock by a shareholder, his basis for his stock in the acquiring corporation after the transaction (increased as above stated) shall not be decreased except as provided in section 301. If section 302(d) does not apply, the property received shall be treated as received in a distribution in payment in exchange for stock of the acquiring corporation under section 302(a), which stock has a basis equal to the amount by which the shareholder's basis for his stock in the acquiring corporation was increased on account of the contribution to capital as provided for above. Accordingly, such amount shall be applied in reduction of the shareholder's basis for his stock in the acquiring corporation. Thus, the basis of each share of the shareholder's stock in the acquiring corporation will be the same as the basis of such share before the entire transaction. The holding period of the stock which is considered to have been redeemed shall be the same as the holding period of the stock actually surrendered.

(b) In any case in which two or more persons, in the aggregate, control two corporations, section 304(a)(1) will apply to sales by such persons of stock in either corporation to the other (whether or not made simultaneously) provided the sales by each of such persons are related to each other. The determination of whether the sales are related to each other shall be dependent upon the facts and circumstances surrounding all of the sales. For this purpose, the fact that the sales may occur during a period of one or more years (such as in the case of a series of sales by persons who together control each of such corporations immediately prior to the first of such sales and immediately subsequent to the last of such sales) shall be disregarded, provided the other facts and circumstances indicate related transactions.

(c) The application of section 304(a)(1) may be illustrated by the following examples:

Example (1). Corporation X and Corporation Y each have outstanding 100 shares of common stock. One-half of the stock of each corporation is owned by an individual, A, and one-half by another individual, B, who is unrelated to A. A sells 40 shares of Corporation X stock to Corporation Y for $50,000, such stock having an adjusted basis of $10,000 to A. After the sale, A is considered as owning Corporation X stock as follows:

(i) 10 shares directly

(ii) 45 shares constructively since by virtue of his 50 percent ownership of Y, he constructively owns 50 percent of the 40 shares owned directly by Corporation Y, and 50 percent of the 50 shares attributed to Corporation Y because they are owned by Y's stockholder, B.

Since after the sale A owns a total of more than 50 percent of the voting power of all the outstanding stock of Corporation X, the transfer is not "substantially disproportionate" as to him as provided in section 302(b)(2). Under these facts, section 302(b)(1) is not applicable and the entire $50,000 is, therefore, treated as a dividend to A to the extent of the earnings and profits of Corporation Y. The basis of the Corporation X stock to Corporation Y is $10,000, its adjusted basis to A. The amount of $10,000 is added to the basis of the stock of Corporation Y in the hands of A.

Example (2). Corporation X and Corporation Y each have outstanding 100 shares of common stock. A, an individual, owns one-half the stock of each corporation, B owns one-half the stock of Corporation X, and C owns one-half the stock of Corporation Y. A, B, and C are unrelated. A sells 30 shares of the stock of Corporation X to Corporation Y for $50,000, such stock having an adjusted basis of $10,000 to him. After the sale, A is considered as owning 35 shares of the stock of Corporation X (20 shares directly and 15 constructively because one-half of the 30 shares owned by Corporation Y are attributed to him). Since before the sale, he owned 50 percent of the stock of Corporation X and after the sale he owned directly and constructively only 35 percent of such stock, the redemption is substantially disproportionate as to him pursuant to the provisions of section 302(b)(2). He, therefore, realizes a gain of $40,000 ($50,000 minus $10,000). If the stock surrendered is a capital asset, such gains is long-term or short-term capital gain depending on the period of time that such stock was held. The basis to A for the stock of Corporation Y is not changed as a result of the entire transaction. The basis to Corporation Y for the stock of Corporation X is $10,000, the basis of the transferor.

Example (3). Corporation X and Corporation Y each have outstanding 100 shares of common stock. H, an individual, W, his wife, S, his son, and G, his grandson, each own 25 shares of stock of each corporation. H sells all of his 25 shares of stock of Corporation X to Corporation Y. Since both before and after the transaction H owned directly and constructively 100 percent of the stock of Corporation X, the amount received by him for his

stock of Corporation X is treated as a dividend to him to the extent of the earnings and profits of Corporation Y.

§ 1.304–3. ACQUISITION BY A SUBSIDIARY.—(a) If a subsidiary acquires stock of its parent corporation from a shareholder of the parent corporation, the acquisition of such stock shall be treated as though the parent corporation had redeemed its own stock. For the purpose of this section, a corporation is a parent corporation if it meets the 50 percent ownership requirements of section 304(c). The determination whether the amount received shall be treated as an amount received in payment in exchange for the stock shall be made by applying section 303, or by applying section 302(b) with reference to the stock of the issuing parent corporation. If such distribution would have been treated as a distribution of property (pursuant to section 302(d)) under section 301, the entire amount of the selling price of the stock shall be treated as a dividend to the seller to the extent of the earnings and profits of the parent corporation determined as if the distribution had been made to it of the property that the subsidiary exchanged for the stock. In such cases, the transferor's basis for his remaining stock in the parent corporation will be determined by including the amount of the basis of the stock of the parent corporation sold to the subsidiary.

(b) Section 304(a)(2) may be illustrated by the following example:

Example. Corporation M has outstanding 100 shares of common stock which are owned as follows: B, 75 shares, C, son of B, 20 shares, and D, daughter of B, 5 shares. Corporation M owns the stock of Corporation X. B sells his 75 shares of Corporation M stock to Corporation X. Under section 302(b)(3) this is a termination of B's entire interest in Corporation M and the full amount received from the sale of his stock will be treated as payment in exchange for this stock, provided he fulfills the requirements of section 302(c)(2) (relating to an acquisition of an interest in the corporations).

§ 1.305. STATUTORY PROVISIONS; DISTRIBUTIONS OF STOCK AND STOCK RIGHTS.

SEC. 305. DISTRIBUTIONS OF STOCK AND STOCK RIGHTS.

(a) GENERAL RULE.—Except as provided in subsection (b), gross income does not include the amount of any distribution made by a corporation to its shareholders, with respect to the stock of such corporation, in its stock or in rights to acquire its stock.

(b) DISTRIBUTIONS IN LIEU OF MONEY.—Subsection (a) shall not apply to a distribution by a corporation of its stock (or rights to acquire its stock), and the distribution shall be treated as a distribution of property to which section 301 applies—

(1) To the extent that the distribution is made in discharge of preference dividends for the taxable year of the corporation in which the distribution is made or for the preceding taxable year; or

(2) If the distribution is, at the election of any of the shareholders (whether exercised before or after the declaration thereof), payable either—

(A) In its stock (or in rights to acquire its stock), or

(B) In property.

(c) CROSS REFERENCES.—For special rules—

(1) Relating to the receipt of stock and stock rights in corporate organizations and reorganizations, see part III (sec. 351 and following).

(2) In the case of a distribution which results in a gift, see section 2501 and following.

(3) In the case of a distribution which has the effect of the payment of compensation, see section 61 (a) (1).

§ 1.305–1. STOCK DIVIDENDS.—Under section 305, a distribution made by a corporation to its shareholders in its stock or in rights to acquire its stock shall not be included in gross income except as provided in section 305(b). If the distribution of stock or rights to acquire stock is received in discharge of preference dividends, to the extent that such distribution is not taxable pursuant to section 305, such stock, whether or not preferred stock, or such rights may be section 306 stock within the meaning of section 306(c). A distribution made by a corporation to its shareholders in its stock or rights to acquire its stock which would not otherwise be included in gross income by reason of section 305 shall not be so treated merely because such distribution was made out of treasury stock or consisted of rights to acquire treasury stock. A right to acquire stock is an option to buy unissued or treasury stock of the corporation issuing the right. See section 307 for rules as to basis of stock and stock rights acquired in a distribution.

§ 1.305–2. ELECTION OF SHAREHOLDERS AS TO MEDIUM OF PAYMENT.—(a) If any shareholder has the right to an election or option with respect to whether a distribution shall be made either in money or any other property, or in stock or rights to acquire stock of the distributing corporation, then, with respect to all shareholders, the distribution of stock or rights to acquire stock shall be considered as a distribution of property to which section 301 applies regardless of—

(1) Whether the distribution is actually made in whole or in part in stock or in stock rights;

(2) Whether the election or option is exercised or exercisable before or after the declaration of the distribution;

(3) Whether the declaration of the dividend provides that payment will be made in one medium unless the shareholder specifically requests payment in the other; or

(4) Whether all or part of the shareholders have the election.

(b) The application of the above rule may be illustrated by the following example:

Example. Corporation X declared a dividend payable in additional shares of its common stock to the holders of its outstanding common stock on the basis of two additional shares for each share held on the record date but with the provision that, at the election of any shareholder made within a specified period prior to the distribution date, he may receive one additional share for each share held on the record date plus $12 principal amount of securities of Corporation Y owned by Corporation X. The fair market value of the stock of Corporation X on the distribution date was $10 per share. The fair market value of $12 principal amount of securities of Corporation Y on the distribution date was $11 but such securities had a cost basis to Corporation X of $9. The distribution of the second share of stock of Corporation X to those shareholders who do not elect to receive securities of Corporation Y will constitute a distribution of property to which section 301 applies whether such shareholders are

individuals or corporations. The amount of the distribution to which section 301 applies will be $10 per share of stock of Corporation X held on the record date (the fair market value of the stock of Corporation X on the distribution date). The distribution of securities of Corporation Y in lieu of the second share of stock of Corporation X to the shareholders of Corporation X, whether individuals or corporations, who elect to receive such securities, will also constitute a distribution of property to which section 301 applies. Thus, in the case of the individual shareholders of Corporation X who elect to receive such securities, the amount of the distribution to which section 301 applies will be $11 per share of stock of Corporation X held on the record date (the fair market value of $12 principal amount of securities of Corporation Y on the distribution date). In the case of the corporate shareholders of Corporation X electing to receive such securities, the amount of the distribution to which section 301 applies will be $9 per share of stock of Corporation X held on the record date (the basis of the securities of Corporation Y in the hands of Corporation X). The receipt by either an individual or corporate shareholder of the one additional share of stock of Corporation X (with respect to which no election applies) for each share held will not result in a distribution of property to such shareholder to which section 301 is applicable.

§ 1.305–3. DISTRIBUTIONS IN DISCHARGE OF PREFERENCE DIVIDENDS.—A distribution made by a corporation to its shareholders in its stock or in rights to acquire its stock shall be treated as a distribution of property to which section 301 applies to the extent that the distribution is made in discharge of preference dividends for the taxable year of the corporation in which the distribution is made or for the preceding taxable year.

§ 1.306. STATUTORY PROVISIONS; DISPOSITIONS OF CERTAIN STOCK.

SEC. 306. DISPOSITIONS OF CERTAIN STOCK.

(a) GENERAL RULE.—If a shareholder sells or otherwise disposes of section 306 stock (as defined in subsection (c))—

(1) DISPOSITIONS OTHER THAN REDEMPTIONS.—If such disposition is not a redemption (within the meaning of section 317(b))—

(A) The amount realized shall be treated as gain from the sale of property which is not a capital asset. This subparagraph shall not apply to the extent that—

(i) The amount realized, exceeds

(ii) Such stock's ratable share of the amount which would have been a dividend at the time of distribution if (in lieu of section 306 stock) the corporation had distributed money in an amount equal to the fair market value of the stock at the time of distribution.

(B) Any excess of the amount realized over the sum of—

(i) The amount treated under subparagraph (A) as gain from the sale of property which is not a capital asset, plus

(ii) The adjusted basis of the stock, shall be treated as gain from the sale of such stock.

(C) No loss shall be recognized.

(2) REDEMPTION.—If the disposition is a redemption, the amount realized shall be treated as a distribution of property to which section 301 applies.

(b) EXCEPTIONS.—Subsection (a) shall not apply—

(1) Termination of shareholder's interest—

(A) Not in Redemption.—If the disposition—

(i) Is not a redemption;

(ii) Is not, directly or indirectly, to a person the ownership of whose stock would (under section 318(a)) be attributable to the shareholder; and

(iii) Terminates the entire stock interest of the shareholder in the corporation (and for purposes of this clause, section 318(a) shall apply).

(B) In Redemption.—If the disposition is a redemption and section 302(b)(3) applies.

(2) LIQUIDATIONS.—If the section 306 stock is redeemed in a distribution in partial or complete liquidation to which part II (sec. 331 and following) applies.

(3) WHERE GAIN OR LOSS IS NOT RECOGNIZED.—To the extent that, under any provision of this subtitle, gain or loss to the shareholder is not recognized with respect to the disposition of the section 306 stock.

(4) TRANSACTIONS NOT IN AVOIDANCE.—If it is established to the satisfaction of the Secretary or his delegate—

(A) That the distribution, and the disposition or redemption, or

(B) In the case of a prior or simultaneous disposition (or redemption) of the stock with respect to which the section 306 stock disposed of (or redeemed) was issued, that the disposition (or redemption) of the section 306 stock,

was not in pursuance of a plan having as one of its principal purposes the avoidance of Federal income tax.

(c) SECTION 306 STOCK DEFINED—

(1) IN GENERAL.—For purposes of this subchapter, the term "section 306 stock" means stock which meets the requirements of subparagraph (A), (B), or (C) of this paragraph.

(A) Distribution to Seller.—Stock (other than common stock issued with respect to common stock) which was distributed to the shareholder selling or otherwise disposing of such stock if, by reason of section 305(a), any part of such distribution was not includible in the gross income of the shareholder.

(B) Received in a Corporate Reorganization or Separation.—Stock which is not common stock and—

(i) Which was received, by the shareholder selling or otherwise disposing of such stock, in pursuance of a plan of reorganization (within the meaning of section 368(a)), or in a distribution or exchange to which section 355 (or so much of section 356 as relates to section 355) applied, and

(ii) With respect to the receipt of which gain or loss to the shareholder was to any extent not recognized by reason of part III, but only to the extent that either the effect of the transaction was substantially the same as the receipt of a stock dividend, or the stock was received in exchange for section 306 stock.

For purposes of this section, a receipt of stock to which the foregoing provisions of this subparagraph apply shall be treated as a distribution of stock.

(C) Stock Having Transferred or Substituted Basis.—Except as otherwise provided in subparagraph (B), stock the basis of which (in the hands of the shareholder selling or otherwise disposing of such stock) is determined by reference to the basis (in the hands of such shareholder or any other person) of section 306 stock.

(2) EXCEPTION WHERE NO EARNINGS AND PROFITS.—For purposes of this section, the term "section 306 stock" does not include any stock no part of the distribution of which would have been a dividend at the time of the distribution if money had been distributed in lieu of the stock.

(d) STOCK RIGHTS.—For purposes of this section—

(1) Stock rights shall be treated as stock, and

(2) Stock acquired through the exercise of stock rights shall be treated as stock distributed at the time of the distribution of the stock rights, to the extent of the fair market value of such rights at the time of the distribution.

(e) CONVERTIBLE STOCK.—For purposes of subsection (c)—

(1) If section 306 stock was issued with respect to common stock and later such section 306 stock is exchanged for common stock in the same corporation (whether or not such exchange is pursuant to a conversion privilege contained in the section 306 stock), then (except as provided in paragraph (2)) the common stock so received shall not be treated as section 306 stock; and

(2) Common stock with respect to which there is a privilege of converting into stock other than common stock (or into property), whether or not the conversion privilege is contained in such stock, shall not be treated as common stock.

(f) SOURCE OF GAIN.—The amount treated under subsection (a) (1) (A) as gain from the sale of property which is not a capital asset shall, for purposes of part I of subchapter N (sec. 861 and following, relating to determination of sources of income), be treated as derived from the same source as would have been the source if money had been received from the corporation as a dividend at the time of the distribution of such stock. If under the preceding sentence such amount is determined to be derived from sources within the United States, such amount shall be considered to be fixed or determinable annual or periodical gains, profits, and income within the meaning of section 871(a) or section 881(a), as the case may be.

(g) CHANGE IN TERMS AND CONDITIONS OF STOCK.—If a substantial change is made in the terms and conditions of any stock, then, for purposes of this section—

(1) The fair market value of such stock shall be the fair market value at the time of the distribution or at the time of such change, whichever such value is higher;

(2) Such stock's ratable share of the amount which would have been a dividend if money had been distributed in lieu of stock shall be determined as of the time of distribution or as of the time of such change, whichever such ratable share is higher; and

(3) Subsection (c) (2) shall not apply unless the stock meets the requirements of such subsection both at the time of such distribution and at the time of such change.

(h) STOCK RECEIVED IN DISTRIBUTIONS AND REORGANIZATIONS TO WHICH 1939 CODE APPLIED. If stock—

(1) Was received in a distribution or reorganization to which the Internal Revenue Code of 1939 (or the corresponding provisions of prior law) applied,

(2) Such stock would have been section 306 stock if this Code applied to such distribution or reorganization, and

(3) Such stock is disposed of or redeemed on or after June 22, 1954,

then the foregoing subsections of this section shall not apply in respect of such disposition or redemption. The extent to which such disposition or redemption shall be treated as a dividend shall be determined as if the Internal Revenue Code of 1939 (as modified by the provisions of this Code other than the foregoing subsections of this section) continued to apply in respect of such disposition or redemption.

§ 1.306-1. GENERAL.—(a) Section 306 provides, in general, that the proceeds from the sale or redemption of certain stock (referred to as "section 306 stock") shall be treated either as gain from the sale of property which is not a capital asset, or as a distribution of property to which section 301 applies. Section 306 stock is defined in section 306(c) and is usually preferred stock received either as a nontaxable dividend or in a transaction in which no gain or loss is

recognized. Section 306(b) lists certain circumstances in which the special rules of section 306(a) shall not apply.

(b)(1) If a shareholder sells or otherwise disposes of section 306 stock (other than by redemption or within the exceptions listed in section 306(b)), the entire proceeds received from such disposition shall be treated as gain from the sale of property not a capital asset to the extent that the fair market value of the stock sold, on the date distributed to the shareholder, would have been a dividend to such shareholder had the distributing corporation distributed cash in lieu of stock. Any excess of the amount received over the sum of the amount treated as ordinary income plus the adjusted basis of the stock disposed of, shall be treated as gain from the sale of a capital asset or noncapital asset as the case may be. No loss shall be recognized. While the amount of earnings and profits at the time of the distribution is one of the measures of the amount to be treated as ordinary income, no reduction of earnings and profits results from any disposition of stock other than a redemption. The term "disposition" under section 306(a)(1) includes, among other things, pledges of stock under certain circumstances, particularly where the pledgee can look only to the stock itself as its security.

(2) Section 306(a)(1) may be illustrated by the following examples:

Example (1). On December 15, 1954, A and B owned equally all of the stock of Corporation X which files its income tax return on a calendar year basis. On that date Corporation X distributed pro rata 100 shares of preferred stock as a dividend on its outstanding common stock. On December 15, 1954, the preferred stock had a fair market value of $10,000. On December 31, 1954, the earnings and profits of Corporation X were $20,000. The 50 shares of preferred stock so distributed to A had an allocated basis to him of $10 per share or a total of $500 for the 50 shares. Such shares had a fair market value of $5,000 when issued. A sold the 50 shares of preferred stock on July 1, 1955, for $6,000. Of this amount $5,000 will be treated as gain from the sale of property which is not a capital asset; $500 ($6,000 minus $5,500) will be treated as gain from the sale of a capital or noncapital asset as the case may be.

Example (2). The facts are the same as in example 1 except that A sold his 50 shares of preferred stock for $5,100. Of this amount $5,000 will be treated as gain from the sale of property which is not a capital asset. No loss will be allowed. There will be added back to the basis of the common stock of Corporation X with respect to which the preferred stock was distributed, $400, the allocated basis of $500 reduced by the $100 received.

Example (3). The facts are the same as in example 1 except that A sold 25 of his shares of preferred stock for $2,600. Of this amount $2,500 will be treated as gain from the sale of property which is not a capital asset. No loss will be allowed. There will be added back to the basis of the common stock of Corporation X with respect to which the preferred stock was distributed, $150, the allocated basis of $250 reduced by the $100 received.

(c) The entire amount received by a shareholder from the redemption of section 306 stock shall be treated as a distribution of property under section 301. In the case of a redemption, the amount of the earnings and profits of the distributing corporation at the time the section 306 stock was distributed is immaterial. See also section 303 (relating to distribution in redemption of stock to pay death taxes).

§ 1.306-2. EXCEPTIONS.—(a) If a shareholder terminates his entire stock interest in a corporation,

(1) By a sale or other disposition within the requirements of section 306(b)(1)(A), or

(2) By redemption under section 302(b)(3), (through the application of section 306(b)(1)(B)),

the amount received from such disposition shall be treated as an amount received in part or full payment for the stock sold or redeemed. In the case of a sale, only the stock interest need be terminated. In determining whether an entire stock interest has been terminated under section 306(b)(1)(A), all of the provisions of section 318(a) (relating to constructive ownership of stock) shall be applicable. In determining whether a shareholder has terminated his entire interest in a corporation by a redemption of his stock under section 302(b)(3), all of the provisions of section 318(a) shall be applicable unless the shareholder meets the requirements of section 302(c)(2) (relating to termination of all interest in the corporation). If the requirements of section 302(c)(2) are met, section 318(a)(1) (relating to members of a family) shall be inapplicable. Under all circumstances paragraphs (2), (3), and (4) of section 318(a) shall be applicable.

(b) Section 306(a) does not apply to—

(1) Redemptions of section 306 stock pursuant to a partial or complete liquidation of a corporation to which part II (section 331 and following) applies,

(2) Exchanges of section 306 stock solely for stock in connection with a reorganization or in an exchange under section 351, 355, or section 1036 (relating to exchanges of stock for stock in the same corporation) to the extent that gain or loss is not recognized to the shareholder as the result of the exchange of the stock (see § 1.306-3 (d) relative to the receipt of other property), and

(3) A disposition or redemption, if it is established to the satisfaction of the Commissioner that the distribution, and the disposition or redemption, was not in pursuance of a plan having as one of its principal purposes the avoidance of Federal income tax. However, in the case of a prior or simultaneous disposition (or redemption) of the stock with respect to which the section 306 stock disposed of (or redeemed) was issued, it is not necessary to establish that the distribution was not in pursuance of such a plan. For example, in the absence of such a plan and of any other facts the first sentence of this subparagraph would be applicable to the case of dividends and isolated dispositions of section 306 stock by minority shareholders. Similarly, in the absence of such a plan and of any other facts, if a shareholder received a distribution of 100 shares of section 306 stock on his holdings of 100 shares of voting common stock in a corporation and sells his voting common

stock before he disposes of his section 306 stock, the subsequent disposition of his section 306 stock would not ordinarily be considered a disposition one of the principal purposes of which is the avoidance of Federal income tax.

§ 1.306-3. SECTION 306 STOCK DEFINED.—(a) For the purpose of Subchapter C the term "section 306 stock" means stock which meets the requirements of section 306(c)(1). Any class of stock distributed to a shareholder in a transaction in which no amount is includible in the income of the shareholder or no gain or loss is recognized may be section 306 stock, provided the distributing corporation has earnings and profits at the time of distribution and for this purpose the total amount of the earnings and profits is immaterial. However, except as provided in section 306(g), if the distributing corporation has no earnings and profits at the time of distribution, pursuant to section 306(c)(2), the stock distributed will not constitute section 306 stock.

(b) For the purpose of section 306, rights to acquire stock shall be treated as stock. Such rights shall not be section 306 stock if no part of the distribution would have been a dividend if money had been distributed in lieu of such rights. If money distributed in lieu of such rights would have been a dividend, the amount referred to in section 306(a)(1)(A)(ii) shall be determined as of the time of the distribution of such rights. When stock is acquired by the exercise of rights which are section 306 stock, the stock acquired is section 306 stock, and the amount referred to in section 306(a)(1)(A)(ii) is determined by reference to the date of distribution of the rights.

(c) Section 306(c)(1)(A) provides that section 306 stock is any stock (other than common issued with respect to common) distributed to the shareholder selling or otherwise disposing thereof if, under section 305(a) (relating to distributions of stock and stock rights) any part of the distribution was not included in the gross income of the distributee. Common stock received as a stock dividend will not be considered as section 306 stock unless such dividend is (1) distributed with respect to stock which is not common stock, and (2) is not taxable upon receipt. For example, common stock distributed in payment of arrearages on preferred stock dividends may be section 306 stock unless the common stock is taxable under section 305(b)(1). Thus, where part of the distribution is in payment of the dividends for the current and preceding year on preferred stock and part of the distribution relates to arrearages on such stock, only that part of the distribution applying to arrearages will be treated as section 306 stock. For example, if 100 shares of common stock are distributed in payment of all dividends due on preferred stock, one-tenth of such stock applying to the current and immediately preceding year's dividends and nine-tenths to arrearages, only nine-tenths of each share may be section 306 stock.

(d) Section 306(c)(1)(B) includes in the definition of section 306 stock any stock except common stock, which is received by a shareholder in connection with a reorganization under section 368 or in a distribution or exchange under section 355 (or so much of section 356 as relates to section 355) provided the effect of the transaction is substantially the same as the receipt of a stock dividend, or the stock is received in exchange for section 306 stock. If, in a trans-

action to which section 356 is applicable, a shareholder exchanges section 306 stock for stock and money or other property, the entire amount of such money and of the fair market value of the other property (not limited to the gain recognized) shall be treated as a distribution of property to which section 301 applies. Common stock received in exchange for section 306 stock in a recapitalization shall not be considered section 306 stock. Ordinarily, section 306 stock includes stock which is not common stock received in pursuance of a plan of reorganization (within the meaning of section 368(a)) or received in a distribution or exchange to which section 355 (or so much of section 356 as relates to section 355) applies if cash received in lieu of such stock would have been treated as a dividend under section 356(a)(2) or would have been treated as a distribution to which section 301 applies by virtue of section 356(b) or section 302(d). The application of the preceding sentence is illustrated by the following examples:

Example (1). Corporation A, having only common stock outstanding, is merged in a statutory merger (qualifying as a reorganization under section 368(a)) with Corporation B. Pursuant to such merger, the shareholders of Corporation A received both common and preferred stock in Corporation B. The preferred stock received by such shareholders is section 306 stock.

Example (2). X and Y each own one-half of the 2,000 outstanding shares of preferred stock and one-half of the 2,000 outstanding shares of common stock of Corporation C. Pursuant to a reorganization within the meaning of section 368(a)(1)(E) (recapitalization) each shareholder exchanges his preferred stock for preferred stock of a new issue which is not substantially different from the preferred stock previously held. Unless the preferred stock exchanged was itself section 306 stock the preferred stock received is not section 306 stock.

(e) Section 306(c)(1)(C) includes in the definition of section 306 stock any stock (except as provided in section 306(c)(1)(B)) the basis of which in the hands of the person disposing of such stock, is determined by reference to section 306 stock held by such shareholder or any other person. Under this subparagraph common stock can be section 306 stock. Thus, if a person owning section 306 stock in Corporation A transfers it to Corporation B which is controlled by him in exchange for common stock of Corporation B in a transaction to which section 351 is applicable, the common stock so received by him would be section 306 stock and subject to the provisions of section 306(a) on its disposition. In addition, the section 306 stock transferred is section 306 stock in the hands of Corporation B, the transferee. Section 306 stock transferred by gift remains section 306 stock in the hands of the donee. Stock received in exchange for section 306 stock under section 1036(a) (relating to exchange of stock for stock in the same corporation) or under so much of section 1031(b) as relates to section 1036(a) becomes section 306 stock and acquires, for purposes of section 306, the characteristics of the section 306 stock exchanged. The entire amount of the fair market value of the other property received in such transaction shall be considered as received upon a disposition (other than a redemption)

to which section 306(a) applies. Section 306 stock ceases to be so classified if the basis of such stock is determined by refrence to its fair market value on the date of the decedent-stockholder's death or the optional valuation date under section 1014.

(f) If section 306 stock which was distributed with respect to common stock is exchanged for common stock in the same corporation (whether or not such exchange is pursuant to a conversion privilege contained in section 306 stock), such common stock shall not be section 306 stock. This subparagraph applies to exchanges not coming within the purview of section 306(c)(1)(B). Common stock which is convertible into stock other than common stock or into property, shall not be considered common stock. It is immaterial whether the conversion privilege is contained in the stock or in some type of collateral agreement.

(g) If there is a substantial change in the terms and conditions of any stock, then, for the purpose of this section—

(1) The fair market value of such stock shall be the fair market value at the time of distribution or the fair market value at the time of such change, whichever is higher;

(2) Such stock's ratable share of the amount which would have been a dividend if money had been distributed in lieu of stock shall be determined as of the time of distribution or as of the time of such change, whichever ratable share is higher; and

(3) Section 306(c)(2) shall be inapplicable if there would have been a dividend to any extent if money had been distributed in lieu of the stock either at the time of the distribution or at the time of such change.

(h) When section 306 stock is disposed of, the amount treated under section 306(a)(1)(A) as gain from the sale of property which is not a capital asset will, for the purposes of Part I of Subchapter N, be treated as derived from the same source as would have been the source if money had been received from the corporation as a dividend at the time of the distribution of such stock. If the amount is determined to be derived from sources within the United States, the amount shall be considered to be fixed or determinable annual or periodic gains, profits, and income within the meaning of section 871(a) or section 881(a), relating, respectively, to the tax on nonresident alien individuals and on foreign corporations not engaged in business in the United States.

(i) Section 306 shall be inapplicable to stock received before June 22, 1954, and to stock received on or after June 22, 1954, in transactions subject to the provisions of the 1939 Code. See § 1.391–1.

§ 1.307. Statutory Provisions; Basis of Stock and Stock Rights Acquired in Distribution.

SEC. 307. BASIS OF STOCK AND STOCK RIGHTS ACQUIRED IN DISTRIBUTION

(a) General Rule.—If a shareholder in a corporation receives its stock or rights to acquire its stock (referred to in this subsection as "new stock") in a distribution to which section 305(a) applies, then the

basis of such new stock and of the stock with respect to which it is distributed (referred to in this section as "old stock"), respectively, shall, in the shareholder's hands, be determined by allocating between the old stock and the new stock the adjusted basis of the old stock. Such allocation shall be made under regulations prescribed by the Secretary or his delegate.

(b) EXCEPTION FOR CERTAIN STOCK RIGHTS.—

(1) IN GENERAL.—If—

(A) A corporation distributes rights to acquire its stock to a shareholder in a distribution to which section 305(a) applies, and

(B) The fair market value of such rights at the time of the distribution is less than 15 percent of the fair market value of the old stock at such time.

then subsection (a) shall not apply and the basis of such rights shall be zero, unless the taxpayer elects under paragraph (2) of this subsection to determine the basis of the old stock and of the stock rights under the method of allocation provided in subsection (a).

(2) ELECTION.—The election referred to in paragraph (1) shall be made in the return filed within the time prescribed by law (including extensions thereof) for the taxable year in which such rights were received. Such election shall be made in such manner as the Secretary or his delegate may by regulations prescribe, and shall be irrevocable when made.

(c) CROSS REFERENCE.—For basis of stock and stock rights distributed before June 22, 1954, see section 1052.

§ 1.307-1 GENERAL.—(a) If a shareholder receives stock or stock rights as a distribution on stock previously held and under section 305 such distribution is not includible in gross income then, except as provided in section 307(b) and § 1.307-2, the basis of the stock with respect to which the distribution was made shall be allocated between the old and new stocks or rights in proportion to the fair market values of each of the date of distribution. If a shareholder receives stock or stock rights as a distribution on stock previously held and pursuant to section 305 part of the distribution is not includible in gross income, then (except as provided in section 307(b) and § 1.307-2) the basis of the stock with respect to which the distribution is made shall be allocated between (1) the old stock and (2) that part of the new stock or rights which is not includible in gross income, in proportion to the fair market values of each on the date of distribution. The date of distribution in each case shall be the date the stock or the rights are distributed to the stockholder and not the record date. The general rule will apply with respect to stock rights only if such rights are exercised or sold.

(b) The application of paragraph (a) of this section is illustrated by the following example:

Example. A taxpayer in 1947 purchased 100 shares of common stock at $100 per share and in 1954 by reason of the ownership of such stock acquired 100 rights entitling him to subscribe to 100 additional shares of such stock at $90 a share. Immediately after the issuance of the rights, each of the shares of stock in respect of which the rights were acquired had a fair market value, ex-rights, of $110 and the rights had a fair market value of $19 each. The basis of the rights and the common stock for the purpose of determining the basis for gain or loss on a subsequent sale or exercise of the rights or a sale of the old stock is computed as follows:

100 (shares) × $100 = $10,000, cost of old stock (stock in respect of which the rights were acquired).
100 (shares) × $110 = $11,000, market value of old stock.
100 (rights) × $19 = $1,900, market value of rights.

11,000/12,900 of $10,000 = $8,527.13, cost of old stock apportioned to such stock.

1,900/12,900 of $10,000 = $1,472.87, cost of old stock apportioned to rights.

If the rights are sold, the basis for determining gain or loss will be $14.7287 per right. If the rights are exercised, the basis of the new stock acquired will be the subscription price paid therefor ($90) plus the basis of the rights exercised ($14,7287 each) or $104.7287 per share. The remaining basis of the old stock for the purpose of determining gain or loss on a subsequent sale will be $85.2713 per share.

§ 1.307-2. EXCEPTION.—The basis of rights to buy stock which are excluded from gross income under section 305(a), shall be zero if the fair market value of such rights on the date of distribution is less than 15 percent of the fair market value of the old stock on that date, unless the shareholder elects to allocate part of the basis of the old stock to the rights as provided in § 1.307-1 (a). The election shall be made by a shareholder with respect to all the rights received by him in a particular distribution in respect of all the stock of the same class owned by him in the issuing corporation at the time of such distribution. Such election to allocate basis to rights shall be in the form of a statement attached to the shareholder's return for the year in which the rights are received. This election, once made, shall be irrevocable with respect to the rights for which the election was made. Any shareholder making such an election shall retain a copy of the election and of the tax return with which it was filed, in order to substantiate the use of an allocated basis upon a subsequent disposition of the stock acquired by exercise.

EFFECTS ON CORPORATION

§ 1.311. STATUTORY PROVISIONS; TAXABILITY OF CORPORATION ON DISTRIBUTION.

SEC. 311. TAXABILITY OF CORPORATION ON DISTRIBUTION.

(a) GENERAL RULE. Except as provided in subsections (b) and (c) of this section and section 453(d), no gain or loss shall be recognized to a corporation on the distribution, with respect to its stock, of—

(1) Its stock (or rights to acquire its stock), or

(2) Property.

(b) LIFO INVENTORY.—

(1) RECOGNITION OF GAIN.—If a corporation inventorying goods under the method provided in section 472 (relating to last-in, first-out inventories) distributes inventory assets (as defined in paragraph (2)(A)), then the amount (if any) by which—

(A) The inventory amount (as defined in paragraph (2)(B)) of such assets under a method authorized by section 471 (relating to general rule for inventories), exceeds

(B) The inventory amount of such assets under the method provided in section 472,

shall be treated as gain to the corporation recognized from the sale of such inventory assets.

(2) DEFINITIONS.—For purposes of paragraph (1)—

(A) Inventory Assets.—The term "inventory assets" means stock in trade of the corporation, or other property of a kind which would properly be included in the inventory of the corporation if on hand at the close of the taxable year.

(B) Inventory Amount.—The term "inventory amount" means, in the case of inventory assets distributed during a taxable year, the amount of such inventory assets determined as if the taxable year closed at the time of such distribution.

(3) METHOD OF DETERMINING INVENTORY AMOUNT.—For purposes of this subsection, the inventory amount of assets under a method authorized by section 471 shall be determined—

(A) If the corporation uses the retail method of valuing inventories under section 472, by using such method, or

(B) If subparagraph (A) does not apply, by using cost or market, whichever is lower.

(c) LIABILITY IN EXCESS OF BASIS.—If—

(1) A corporation distributes property to a shareholder with respect to its stock,

(2) Such property is subject to a liability, or the shareholder assumes a liability of the corporation in connection with the distribution, and

(3) The amount of such liability exceeds the adjusted basis (in the hands of the distributing corporation) of such property,

then gain shall be recognized to the distributing corporation in an amount equal to such excess as if the property distributed had been sold at the time of the distribution. In the case of a distribution of property subject to a liability which is not assumed by the shareholder, the amount of gain to be recognized under the preceding sentence shall not exceed the excess, if any, of the fair market value of such property over its adjusted basis.

§ 1.311-1. GENERAL.—(a) Except as provided in subsections (b) and (c) of section 311 and section 453(d) (relating to installment obligations) no gain or loss is recognized to a corporation on the distribution, with respect to its stock, of stock, or rights to acquire its stock, or property (regardless of the fact that such property may have appreciated or depreciated in value since its acquisition by the corporation). However, the proceeds of the sale of property in form made by a shareholder receiving such property in kind from the corporation may be imputed to the corporation if, in fact, the corporation made the sale. Moreover, where property is distributed by a corporation, which distribution is in effect an anticipatory assignment of income, such income may be taxable to the corporation. The term "distributions with respect to its stock" includes distributions made in redemption of stock (other than distributions in complete or partial liquidations). See, however, paragraph (e) for distributions to which section 311 does not apply. For the rule respecting the taxation of a corporation making a distribution of property in partial or complete liquidation, see section 336.

(b) In any case in which a corporation distributes with respect to its stock assets which have been a part of an inventory, the value of which has been computed for income tax purposes under the method provided in section 472 (relating to last-in, first-out inventories), such corporation shall—

(1) Compute the amount of its inventory under the method provided in section 472 immediately prior to the distribution and immediately after such distribution;

(2) Compute the difference betwen the two amounts described in (1) above;

(3) Compute the amount of its inventory under the method authorized by section 471 (relating to general rule for inventories) immediately prior to the distribution and immediately after such distribution;

(4) Compute the difference between the two amounts determined under (3) above.

If the amount computed under (4) above is in excess of the amount computed under (2) above, then such excess shall be included in the income of the corporation for the year in which such distribution occurs. In any case in which a corporation distributes assets which have been a part of an inventory whose value has been computed for income tax purposes under the method provided in section 472, such corporation shall on the date of distribution record a specific statement of the amount of its inventory under each of the applicable methods for use in the determination of the amount of income includible under section 311.

(c) The following example illustrates the application of section 311(b):

Example. Corporation R, a manufacturing corporation inventorying goods under the method provided in section 472, distributes 200 units of its inventory assets to its shareholders on November 15, 1955. Immediately before the distribution, the corporation held 300 identical inventory units at the following basis determined by reference to the value computed by using the LIFO method and the value computed by using the FIFO method, in the order of acquisition:

Number of units	Basis LIFO	Number of units	Basis FIFO
a. 100	$1,000	100	$4,000
b. 100	2,000	50	2,500
c. 50	1,000	50	2,500
d. 50	2,000	100	6,000

The amount includible in income pursuant to section 311(b) is $4,000 computed as follows:

(1) Inventory before distribution under FIFO method (a, b, c, and d)	$15,000	
(2) Inventory under FIFO method immediately after distribution (d)	6,000	
(3) Difference (FIFO basis of inventory distributed)		$9,000
(4) Inventory before distribution under LIFO method (a, b, c and d)	$6,000	
(5) Inventory under LIFO method immediately after distribution (a)	1,000	
(6) Difference (LIFO basis of inventory distributed)		$5,000
(7) Amount includible in income under section 311(b)		$4,000

(d) Section 311(c) provides in general for the inclusion in the income of a corporation, on a distribution of property by such corporation to its shareholders, of an amount equal to the excess of a liability over the basis of the property distributed. Thus, section 311(c) applies where the property distributed is subject to a liability or where the shareholder assumes a liability of the corporation in connection with the distribution. For example, if property which is a capital asset having an adjusted basis to the distributing corporation of $100 and a fair market value of $1,000 (but subject to a liability of $900) is distributed to a shareholder, such distribution is taxable (as long-term or short-term gain, as the case may be) to the corporation to the extent of the excess of the liability ($900) over the adjusted basis ($100) or $800. However, if in the preceding example the fair market value of the property distributed were $800, the amount taxable to the corporation is limited to the excess of the fair market value of the property ($800) over its adjusted basis ($100) or $700. If the property subject to a liability were not a capital asset in the hands of the distributing corporation, the gain would be taxable as gain from the sale of a noncapital asset. The holding period of asset so distributed shall be determined as if such property were sold on the date of the distribution.

(e) (1) Section 311 is limited to distributions which are made by reason of the corporation-stockholder relationship. Section 311 does not apply to transactions between a corporation and a shareholder in his capacity as debtor, creditor, employee, or vendee, where the fact that such debtor, creditor, employee, or vendee is a shareholder is incidental to the transaction. Thus, if the corporation receives its own stock as consideration upon the sale of property by it, or in satisfaction of indebtedness to it, the gain or loss resulting is to be computed in the same manner as though the payment had been made in any other property.

(2) The following examples illustrate the application of subparagraph (1):

Example (1). Corporation A has a claim against Corporation B for damages for loss of profits due to patent infringement. Corporation B satisfies such claim by surrendering shares of the stock of Corporation A to Corporation A. The fair market value of such stock is includible in the gross income of Corporation A.

Example (2). Corporation C, a corporation engaged in the manufacture and sale of automobiles, sells an automobile to individual X, and receives in payment therefor shares of the stock of Corporation C. The transaction will be treated in the same manner as if an amount of cash equal to the fair market value of such stock had been received by Corporation C.

§ 1.312. Statutory Provisions; Effect on Earnings and Profits.

SEC. 312. EFFECT ON EARNINGS AND PROFITS.

(a) General Rule.—Except as otherwise provided in this section, on the distribution of property by a corporation with respect to its stock, the earnings and profits of the corporation (to the extent thereof) shall be decreased by the sum of—

(1) The amount of money,

(2) The principal amount of the obligations of such corporation, and

(3) The adjusted basis of the other property, so distributed.

(b) CERTAIN INVENTORY ASSETS.—

(1) IN GENERAL.—On the distribution by a corporation, with respect to its stock, of inventory assets (as defined in paragraph (2) (A)) the fair market value of which exceeds the adjusted basis thereof, the earnings and profits of the corporation—

(A) Shall be increased by the amount of such excess; and

(B) Shall be decreased by whichever of the following is the lesser:

(i) The fair market value of the inventory assets distributed, or

(ii) The earnings and profits (as increased under subparagraph (A)).

(2) DEFINITIONS—

(A) Inventory Assets.—For purposes of paragraph (1), the term "inventory assets" means—

(i) Stock in trade of the corporation, or other property of a kind which would properly be included in the inventory of the corporation if on hand at the close of the taxable year;

(ii) Property held by the corporation primarily for sale to customers in the ordinary course of its trade or business; and

(iii) Unrealized receivables or fees, except receivables from sales or exchanges of assets other than assets described in this subparagraph.

(B) Unrealized Receivables or Fees.—For purposes of subparagraph (A) (iii), the term "unrealized receivables or fees" means, to the extent not previously includible in income under the method of accounting used by the corporation, any rights (contractual or otherwise) to payment for—

(i) Goods delivered, or to be delivered, to the extent that the proceeds therefrom would be treated as amounts received from the sale or exchange of property other than a capital asset, or

(ii) Services rendered or to be rendered.

(c) ADJUSTMENTS FOR LIABILITIES, ETC.—In making the adjustments to the earnings and profits of a corporation under subsection (a) or (b) proper adjustment shall be made for—

(1) The amount of any liability to which the property distributed is subject,

(2) The amount of any liability of the corporation assumed by a shareholder in connection with the distribution and

(3) Any gain to the corporation recognized under subsection (b) or (c) of section 311.

(d) CERTAIN DISTRIBUTIONS OF STOCK AND SECURITIES—

(1) IN GENERAL.—The distribution to a distributee by or on behalf of a corporation of its stock or securities, of stock or securities in another corporation, or of property, in a distribution to which this Code applies, shall not be considered a distribution of the earnings and profits of any corporation—

(A) If no gain to such distributee from the receipt of such stock or secuirties, or property, was recognized under this Code, or

(B) If the distribution was not subject to tax in the hands of such distributee by reason of section 305(a).

(2) PRIOR DISTRIBUTIONS.—In the case of a distribution of stock or securities, or property, to which section 115(h) of the Internal Revenue Code of 1939 (or the corresponding provision of prior law) applied, the effect on earnings and profits of such distribution shall be determined under such section 115(h), or the corresponding provision of prior law, as the case may be.

(3) STOCK OR SECURITIES.—For purposes of this subsection, the term "stock or securities" includes rights to acquire stock or securities.

(e) SPECIAL RULE FOR PARTIAL LIQUIDATIONS AND CERTAIN REDEMPTIONS.—In the case of amounts distributed in partial liquidation (whether before, on, or after June 22, 1954) or in a redemption to which section 302(a) or 303 applies, the part of such distribution which is properly chargeable to capital account shall not be treated as a distribution of earnings and profits.

(f) EFFECT ON EARNINGS AND PROFITS OF GAIN OR LOSS AND OF RECEIPT OF TAX-FREE DISTRIBUTIONS—

(1) EFFECT ON EARNINGS AND PROFITS OF GAIN OR LOSS.—The gain or loss realized from the sale or other disposition (after February 28, 1913) of property by a corporation—

(A) For the purpose of the computation of the earnings and profits of the corporation, shall (except as provided in subparagraph (B)) be determined by using as the adjusted basis the adjusted basis (under the law applicable to the year in which the sale or other disposition was made) for determining gain, except that no regard shall be had to the value of the property as of March 1, 1913; but

(B) For purposes of the computation of the earnings and profits of the corporation for any period beginning after February 28, 1913, shall be determined by using as the adjusted basis the adjusted basis (under the law applicable to the year in which the sale or other disposition was made) for determining gain.

Gain or loss so realized shall increase or decrease the earnings and profits to, but not beyond, the extent to which such a realized gain or loss was recognized in computing taxable income under the law applicable to the year in which such sale or disposition was made. Where, in determining the adjusted basis used in computing such realized gain or loss, the adjustment to the basis differs from the adjustment proper for the purpose of determining earnings and profits, then the latter adjustment shall be used in determining the increase or decrease above provided. For purposes of this subsection, a loss with respect to which a deduction is disallowed under section 1091 (relating to wash sales of stock or securities), or the corresponding provision of prior law, shall not be deemed to be recognized.

(2) EFFECT ON EARNINGS AND PROFITS OF RECEIPT OF TAX-FREE DISTRIBUTIONS.—Where a corporation receives (after February 28, 1913), a distribution from a second corporation which (under the law applicable to the year in which the distribution was made) was not a taxable dividend to the shareholders of the second corporation, the amount of such distribution shall not increase the earnings and profits of the first corporation in the following cases:

(A) No such increase shall be made in respect of the part of such distribution which (under such law) is directly applied in reduction of the basis of the stock in respect of which the distribution was made; and

(B) No such increase shall be made if (under such law) the distribution causes the basis of the stock in respect of which the distribution was made to be allocated between such stock and the property received (or such basis would, but for section 307 (b), be so allocated).

(g) EARNINGS AND PROFITS—INCREASE IN VALUE ACCRUED BEFORE MARCH 1, 1913.

(1) If any increase or decrease in the earnings and profits for any period beginning after February 28, 1913, with respect to any matter would be different had the adjusted basis of the property involved been determined without regard to its March 1, 1913, value, then, except as provided in paragraph (2), an increase (properly reflecting such difference) shall be made in that part of the earnings and profits consisting of increase in value of property accrued before March 1, 1913.

(2) If the application of subsection (f) to a sale or other disposition after February 28, 1913, results in a loss which is to be applied

in decrease of earnings and profits for any period beginning after February 28, 1913, then, notwithstanding subsection (f) and in lieu of the rule provided in paragraph (1) of this subsection, the amount of such loss so to be applied shall be reduced by the amount, if any, by which the adjusted basis of the property used in determining the loss exceeds the adjusted basis computed without regard to the value of the property on March 1, 1913, and if such amount so applied in reduction of the decrease exceeds such loss, the excess over such loss shall increase that part of the earnings and profits consisting of increase in value of property accrued before March 1, 1913.

(h) EARNINGS AND PROFITS OF PERSONAL SERVICE CORPORATIONS.—In the case of a personal service corporation subject for any taxable year to supplement S of the Internal Revenue Code of 1939, an amount equal to the undistributed supplement S net income of the personal service corporation for its taxable year shall be considered as paid in as of the close of such taxable year as paid-in surplus or as a contribution to capital, and the accumulated earnings and profits as of the close of such taxable year shall be correspondingly reduced, if such amount or any portion thereof is required to be included as a dividend in the gross income of the shareholders.

(i) ALLOCATION IN CERTAIN CORPORATE SEPARATIONS.—In the case of a distribution or exchange to which section 355 (or so much of section 356 as relates to section 355) applies, proper allocation with respect to the earnings and profits of the distributing corporation and the controlled corporation (or corporations) shall be made under regulations prescribed by the Secretary or his delegate.

(j) DISTRIBUTION OF PROCEEDS OF LOAN INSURED BY THE UNITED STATES.—

(1) IN GENERAL.—If a corporation distributes property with respect to its stock, and if, at the time of the distribution—

(A) There is outstanding a loan to such corporation which was made, guaranteed, or insured by the United States (or by any agency or instrumentality thereof), and

(B) The amount of such loan so outstanding exceeds the adjusted basis of the property constituting security for such loan,

then the earnings and profits of the corporation shall be increased by the amount of such excess and (immediately after the distribution) shall be decreased by the amount of such excess. For purposes of subparagraph (B) of the preceding sentence, the adjusted basis of the property at the time of distribution shall be determined without regard to any adjustment under section 1016(a)(2) (relating to adjustment for depreciation, etc.). For purposes of this paragraph, a commitment to make, guarantee, or insure a loan shall be treated as the making, guaranteeing, or insuring of a loan.

(2) EFFECTIVE DATE.—Paragraph (1) shall apply only with respect to distributions made on or after June 22, 1954.

§ 1.312–1. ADJUSTMENT TO EARNINGS AND PROFITS REFLECTING DISTRIBUTIONS BY CORPORATIONS. (a) In general, on the distribution of property by a corporation with respect to its stock, its earnings and profits (to the extent thereof) shall be decreased by—

(1) The amount of money,

(2) The principal amount of the obligations of such corporation issued in such distribution, and

(3) The adjusted basis of other property.

For special rule with respect to distributions to which section 312 (e) applies, see § 1.312–5.

(b) The adjustment provided in section 312(a)(3) and (a)(3) of this section with respect to a distribution of property (other than money or its own obligations) shall be made notwithstanding the fact

that such property has appreciated or depreciated in value since acquisition.

(c) The application of paragraphs (a) and (b) of this section may be illustrated by the following examples:

Example (1). Corporation A distributes to its sole shareholder property with a value of $10,000 and a basis of $5,000. It has $12,500 in earnings and profits. The reduction in earnings and profits by reason of such distribution is $5,000. Such is the reduction even though the amount of $10,000 is includible in the income of the shareholder (other than a corporation) as a dividend.

Example (2). The facts are the same as in example (1) above except that the property has a basis of $15,000 and the earnings and profits of the corporation are $20,000. The reduction in earnings and profits is $15,000. Such is the reduction even though only the amount of $10,000 is includible in the income of the shareholder as a dividend.

(d) In the case of a distribution of stock or rights to acquire stock a portion of which is includible in income by reason of section 305(b), the earnings and profits shall be reduced by the fair market value of such portion. No reduction shall be made if a distribution of stock or rights to acquire stock is not includible in income under the provisions of section 305.

(e) No adjustment shall be made in the amount of the earnings and profits of the issuing corporation upon a disposition of section 306 stock unless such disposition is a redemption.

§ 1.312-2. Distributions of Inventory Assets.—Section 312(b) provides for the increase and the decrease of the earnings and profits of a corporation which distributes, with respect to its stock, inventory assets as defined in section 312(b)(2), where the fair market of such assets exceeds their adjusted basis. The rules provided in section 312(b) (relating to distributions of certain inventory assets) shall be applicable without regard to the method used in computing inventories for the purpose of the computation of taxable income. Section 312(b) does not apply to distributions described in section 312(e).

§ 1.312-3. Liabilities.—The amount of any reduction in earnings and profits described in section 312(a) or (b) shall be (a) reduced by the amount of any liability to which the property distributed was subject and by the amount of any other liability of the corporation assumed by the shareholder in connection with such distribution, and (b) increased by the amount of gain recognized to the corporation under section 311(b) or (c).

§ 1.312-4. Examples of Adjustments Provided in Section 312(c).—The adjustments provided in section 312(c) may be illustrated by the following examples:

Example (1). On December 2, 1954, Corporation X distributed to its sole shareholder, A, an individual, as a dividend in kind a vacant lot which was not an inventory asset. On that date, the lot had a fair market value of $5,000 and was subject to a mortgage of $2,000. The adjusted basis of the lot was $3,100. The

amount of the earnings and profits was $10,000. The amount of the dividend received by A is $3,000 ($5,000, the fair market value, less $2,000, the amount of the mortgage) and the reduction in the earnings and profits of Corporation X is $1,100 ($3,100, the basis, less $2,000, the amount of mortgage).

Example (2). The facts are the same as in example (1) above with the exception that the amount of the mortgage to which the property was subject was $4,000. The amount of the dividend received by A is $1,000, and there is no reduction in the earnings and profits of the corporation as a result of the distribution (disregarding such reduction as may result from an increase in tax to Corporation X because of gain resulting from the distribution). There is a gain of $900 recognized to Corporation X, the difference between the basis of the property ($3,100) and the amount of the mortgage ($4,000), under section 311(c) and an increase in earnings and profits of $900.

Example (3). Corporation A, having accumulated earnings and profits of $100,000, distributed in kind to its shareholders, not in liquidation, inventory assets which had a basis to it on the "Life" method (section 472) of $46,000 and on the basis of cost or market (section 471) of $50,000. The inventory had a fair market value of $55,000 and was subject to a liability of $35,000. This distribution results in a net decrease in earnings and profits of Corporation A of $11,000, (without regard to any tax on Corporation A) computed as follows:

"Fifo" basis of inventory	$50,000	
Less: "Lifo" basis of inventory	46,000	
Gain recognized—addition to earnings and profits (section 311(b))		$4,000
Adjustment to earnings and profits required by section 312(b)(1)(A):		
Fair market value of inventory	$55,000	
Less: "Life" basis plus adjustment under section 311 (b)	50,000	
		5,000
Total increase in earnings and profits		$9,000
Decrease in earnings and profits under section 312(b)(1)(B)(i)	$55,000	
Less: Liability assumed	35,000	
Net amount of distribution (decrease in earnings)		$20,000
Net decrease in earnings and profits		$11,000

§ 1.312-5. SPECIAL RULE FOR PARTIAL LIQUIDATIONS AND CERTAIN REDEMPTIONS.—The part of the distribution properly chargeable to capital account within the provisions of section 312(e) shall not be considered a distribution of earnings and profits within the meaning of section 301 for the purpose of determining taxability of subsequent distributions by the corporation.

§ 1.312-6. EARNINGS AND PROFITS.—(a) In determining the amount of earnings and profits (whether of the taxable year, or accumulated since February 28, 1913, or accumulated before March 1, 1913) due consideration must be given to the facts, and, while mere bookkeeping entries increasing or decreasing surplus will not be conclusive, the

amount of the earnings and profits in any case will be dependent upon the method of accounting properly employed in computing taxable income (or net income, as the case may be). For instance, a corporation keeping its books and filing its income tax returns under subchapter E on the cash receipts and disbursements basis may not use the accrual basis in determining earnings and profits; a corporation computing income on the installment basis as provided in section 453 shall, with respect to the installment transactions, compute earnings and profits on such basis; and an insurance company subject to taxation under section 831 shall exclude from earnings and profits that portion of any premium which is unearned under the provisions of section 832(b)(4) and which is segregated accordingly in the unearned premium reserve.

(b) Among the items entering into the computation of corporate earnings and profits for a particular period are all income exempted by statute, income not taxable by the Federal Government under the Constitution, as well as all items includible in gross income under section 61 or corresponding provisions of prior revenue acts. Gains and losses within the purview of section 1002 or corresponding provisions of prior revenue acts are brought into the earnings and profits at the time and to the extent such gains and losses are recognized under that section. Interest on State bonds and certain other obligations, although not taxable when received by a corporation, is taxable to the same extent as other dividends when distributed to shareholders in the form of dividends.

(c) (1) In the case of a corporation in which depletion or depreciation is a factor in the determination of income, the only depletion or depreciation deductions to be considered in the computation of the total earnings and profits are those based on cost or other basis without regard to March 1, 1913, value. In computing the earnings and profits for any period beginning after February 28, 1913, the only depletion or depreciation deductions to be considered are those based on (i) cost or other basis, if the depletable or depreciable asset was acquired subsequent to February 28, 1913, or (ii) adjusted cost or March 1, 1913, value, whichever is higher, if acquired before March 1, 1913. Thus, discovery or percentage depletion under all revenue acts for mines and oil and gas wells is not to be taken into consideration in computing the earnings and profits of a corporation. Similarly, where the basis of property in the hands of a corporation is a substituted basis, such basis, and not the fair market value of the property at the time of the acquisition by the corporation, is the basis for computing depletion and depreciation for the purpose of determining earnings and profits of the corporation.

(2) The application of subparagraph (1) of this paragraph may be illustrated by the following example:

Example. Oil producing property which A had acquired in 1949 at a cost of $28,000 was transferred to Corporation Y in December 1951, in exchange for all of its capital stock. The fair market value of the stock and of the property as of the date of the transfer was $247,000. Corporation Y, after four years' operation, effected in 1955 a cash distribution to A in the amount of $165,000. In determining the extent to which the earnings

and profits of Corporation Y available for dividend distributions have been increased as the result of production and sale of oil, the depletion to be taken into account is to be computed upon the basis of $28,000 established in the nontaxable exchange in 1951 regardless of the fair market value of the property or of the stock issued in exchange therefor.

(d) A loss sustained for a year before the taxable year does not affect the earnings and profits of the taxable year. However, in determining the earnings and profits accumulated since February 28, 1913, the excess of a loss sustained for a year subsequent to February 28, 1913, over the undistributed earnings and profits accumulated since February 28, 1913, and before the year for which the loss was sustained, reduces surplus as of March 1, 1913, to the extent of such excess. If the surplus as of March 1, 1913, was sufficient to absorb such excess, distributions to shareholders after the year of the loss are out of earnings and profits accumulated since the year of the loss to the extent of such earnings.

(e) With respect to the effect on the earnings and profits accumulated since February 28, 1913, of distributions made on or after January 1, 1916, and before August 6, 1917, out of earnings or profits accumulated before March 1, 1913, which distributions were specifically declared to be out of earnings and profits accumlated before March 1, 1913, see section 31(b) of the Revenue Act of 1916, as amended by section 1211 of the Revenue Act of 1917.

§ 1.312-7. Effect on Earnings and Profits of Gain or Loss Realized After February 28, 1913.—(a) In order to determine the effect on earnings and profits of gain or loss realized from the sale or other disposition (after February 28, 1913) of property by a corporation, section 312(f)(1) prescribes certain rules for—

(1) The computation of the total earnings and profits of the corporation of most frequent application in determining invested capital; and

(2) The computation of earnings and profits of the corporation for any period beginning after February 28, 1913, of most frequent application in determining the source of dividend distributions.

Such rules are applicable whenever under any provision of subtitle A it is necessary to compute either the total earnings and profits of the corporation or the earnings and profits for any period beginning after February 28, 1913. For example, since the earnings and profits accumulated after February 28, 1913, or the earnings and profits of the taxable year, are earnings and profits for a period beginning after February 28, 1913, the determination of either must be in accordance with the rules herein prescribed for the ascertainment of earnings and profits for any period beginning after February 28, 1913. Under subparagraph (1) of this paragraph, such gain or loss is determined by using the adjusted basis (under the law applicable to the year in which the sale or other disposition was made) for determining gain, but disregarding value as of March 1, 1913. Under subparagraph (2) of this paragraph, there is used such adjusted basis for determining gain, giving effect to the value as of March 1, 1913, whenever appli-

cable. In both cases the rules are the same as those governing depreciation and depletion in computing earnings and profits (see § 1.312–6). Under both subparagraphs (1) and (2) of this paragraph, the adjusted basis is subject to the limitations of the third sentence of section 312(f)(1) requiring the use of adjustments proper in determining earnings and profits. The proper adjustments may differ under (A) and (B) of the first sentence of section 312(f)(1) depending upon the basis to which the adjustments are to be made. If the application of (B) of the first sentence of section 312(f)(1) results in a loss and if the application of (A) of such sentence to the same transaction reaches a different result, then the loss under (B) of such first sentence will be subject to the adjustment thereto required by section 312(g)(2). (See § 1.312–9.)

(b)(1) The gain or loss so realized increases or decreases the earnings and profits to, but not beyond, the extent to which such gain or loss was recognized in computing taxable income (or net income, as the case may be) under the law applicable to the year in which such sale or disposition was made. As used in this paragraph, the term "recognized" has reference to that kind of realized gain or loss which is recognized for income tax purposes by the statute applicable to the year in which the gain or loss was realized. For example, see section 356. A loss (other than a wash sale loss with respect to which a deduction is disallowed under the provisions of section 1091 or corresponding provisions of prior revenue laws) may be recognized though not allowed as a deduction (by reason, for example, of the operation of sections 267 and 1211 and corresponding provisions of prior revenue laws) but the mere fact that it is not allowed does not prevent decrease in earnings and profits by the amount of such disallowed loss. Wash sale losses, however, disallowed under section 1091 and corresponding provisions of prior revenue laws, are deemed nonrecognized losses and do not reduce earnings or profits. The "recognized" gain or loss for the purpose of computing earnings and profits is determined by applying the recognition provisions to the realized gain or loss computed under the provisions of section 312(f)(1) as distinguished from the realized gain or loss used in computing taxable income (or net income, as the case may be).

(2) The application of subparagraph (1) of this paragraph may be illustrated by the following examples:

Example (1). Corporation X on January 1, 1952, owned stock in Corporation Y which it had acquired from Corporation Y in December 1951, in an exchange transaction in which no gain or loss was recognized. The adjusted basis to Corporation X of the property exchanged by it for the stock in Corporation Y was $30,000. The fair market value of the stock in Corporation Y when received by Corporation X was $930,000. On April 9, 1955, Corporation X made a cash distribution of $900,000 and, except for the possible effect of the transaction in 1951, had no earnings or profits accumulated after February 28, 1913, and had no earnings or profits for the taxable year. The amount of $900,000 representing the excess of the fair market value of the stock of Corporation Y over the adjusted basis of the property exchanged therefor was not recognized gain to Corporation X under the

provisions of section 112 of the Internal Revenue Code of 1939. Accordingly, the earnings and profits of Corporation X are not increased by $900,000, the amount of the gain realized but not recognized in the exchange, and the distribution was not a taxable dividend. The basis in the hands of Corporation Y of the property acquired by it from Corporation X is $30,000. If such property is thereafter sold by Corporation Y, gain or loss will be computed on such basis of $30,000, and earnings and profits will be increased or decreased accordingly.

Example (2). On January 2, 1910, Corporation M acquired nondepreciable property at a cost of $1,000. On March 1, 1913, the fair market value of such property in the hands of Corporation M was $2,200. On December 31, 1952, Corporation M transfers such property to Corporation N in exchange for $1,900 in cash and all Corporation N's stock, which has a fair market value of $1,100. For the purpose of computing the total earnings and profits of Corporation M, the gain on such transaction is $2,000 (the sum of $1,900 in cash and stock worth $1,100 minus $1,000, the adjusted basis for computing gain, determined without regard to March 1, 1913, value), $1,900 of which is recognized under section 356, since this was the amount of money received, although for the purpose of computing net income the gain is only $800 (the sum of $1,900 in cash and stock worth $1,100, minus $2,200, the adjusted basis for computing gain determined by giving effect to March 1, 1913, value). Such earnings and profits will therefore be increased by $1,900. In computing the earnings and profits of Corporation M for any period beginning after February 28, 1913, however, the gain arising from the transaction, like the taxable gain, is only $800, all of which is recognized under section 112(c) of the Internal Revenue Code of 1939, the money received being in excess of such amount. Such earnings and profits will therefore be increased by only $800 as a result of the transaction. For increase in that part of the earnings and profits consisting of increase in value of property accrued before, but realized on or after March 1, 1913, see § 1.312-9.

Example (3). On July 31, 1955, Corporation R owned oil-producing property acquired after February 28, 1913, at a cost of $200,000, but having an adjusted basis (by reason of taking percentage depletion) of $100,000 for determining gain. However, the adjusted basis of such property to be used in computing gain or loss for the purpose of earnings and profits is, because of the provisions of the third sentence of section 312(f)(1), $150,000. On such day Corporation R transferred such property to Corporation S in exchange for $25,000 in cash and all of the stock of Corporation S, which had a fair market value of $100,000. For the purpose of computing taxable income, Corporation R has realized a gain of $25,000 as a result of this transaction, all of which is recognized under section 356. For the purpose of computing earnings and profits, however, Corporation R has realized a loss of $25,000, none of which is recognized owing to the provisions of section 356(c). The earnings and profits of Corporation R are therefore neither increased nor decreased as a result

of the transaction. The adjusted basis of the Corporation S stock in the hands of Corporation R for purposes of computing earnings and profits, however, will be $125,000 (though only $100,000 for the purpose of computing taxable income), computed as follows:

Basis of property transferred	$200,000
Less money received on exchange	25,000
Plus gain or minus loss recognized on exchange	None
Basis of stock	$175,000
Less adjustments (same as those used in determining adjusted basis of property transferred)	50,000
Adjusted basis of stock	$125,000

If, therefore, Corporation R should subsequently sell the Corporation S stock for $100,000, a loss of $25,000 will again be realized for the purpose of computing earnings and profits, all of which will be recognized and will be applied to decrease the earnings and profits of Corporation R.

(e) (1) The third sentence of section 312(f)(1) provides for cases in which the adjustments, prescribed in section 1016, to the basis indicated in (A) or (B), as the case may be, of the first sentence of section 312(f)(1), differ from the adjustments to such basis proper for the purpose of determining earnings or profits. The adjustments provided by such third sentence reflect the treatment provided by § 1.312-6 relative to cases where the deductions for depletion and depreciation in computing taxable income (or net income, as the case may be) differ from the deductions proper for the purpose of computing earnings and profits.

(2) The effect of the third sentence of section 312(f)(1) may be illustrated by the following examples:

Example (1). Corporation X purchased on January 2, 1931, an oil lease at a cost of $10,000. The lease was operated only for the years 1931 and 1932. The deduction for depletion in each of the years 1931 and 1932 amounted to $2,750, of which amount $1,750 represented percentage depletion in excess of depletion based on cost. The lease was sold in 1955 for $15,000. Under section 1016(a)(2), in determining the gain or loss from the sale of the property, the basis must be adjusted for cost depletion of $1,000 in 1931 and percentage depletion of $2,750 in 1932. However, the adjustment of such basis, proper for the determination of earnings and profits, is $1,000 for each year, or $2,000. Hence, the cost is to be adjusted only to the extent of $2,000, leaving an adjusted basis of $8,000 and the earnings and profits will be increased by $7,000, and not by $8,750. The difference of $1,750 is equal to the amount by which the percentage depletion for the year 1932 ($2,750) exceeds the depletion on cost for that year ($1,000) and has already been applied in the computation of earnings and profits for the year 1932 by taking into account only $1,000 instead of $2,750 for depletion in the computation of such earnings and profits. (See § 1.316-1.)

Example (2). If, in example (1), above, the property, instead of being sold, is exchanged in a transaction described in section

1031 for like property having a fair market value of $7,750 and cash of $7,250, then the increase in earnings and profits amounts to $7,000, that is, $15,000 ($7,750 plus $7,250) minus the basis of $8,000. However, in computing taxable income of Corporation X, the gain is $8,750, that is, $15,000 minus $6,250 ($10,000 less depletion of $3,750), of which only $7,250 is recognized because the recognized gain cannot exceed the sum of money received in the transaction. See section 1031(b) and the corresponding provisions of prior revenue laws. If, however, the cash received was only $2,250 and the value of the property received was $12,750, then the increase in earnings and profits would be $2,250, that amount being the gain recognized under section 1031.

(d) For adjustment and allocation of the earnings and profits of the transferor as between the transferor and the transferee in cases where the transfer of property by one corporation to another corporation results in the nonrecognition in whole or in part of gain or loss, see § 1.312-10; and see section 381 for earnings and profits of successor corporations in certain transactions.

§ 1.312-8. Effect on Earnings and Profits of Receipts of Tax-Free Distributions Requiring Adjustment or Allocation of Basis of Stock.—(a) In order to determine the effect on earnings and profits, where a corporation receives (after February 28, 1913) from a second corporation a distribution which (under the law applicable to the year in which the distribution was made) was not a taxable dividend to the shareholders of the second corporation, section 312(f) prescribes certain rules. It provides that the amount of such distribution shall not increase the earnings and profits of the first or receiving corporation in the following cases: (1) No such increase shall be made in respect of the part of such distribution which (under the law applicable to the year in which the distribution was made) is directly applied in reduction of the basis of the stock in respect of which the distribution was made and (2) no such increase shall be made if (under the law applicable to the year in which the distribution was made) the distribution causes the basis of the stock in respect of which the distribution was made to be allocated between such stock and the property received (or such basis would but for section 307(b) be so allocated). Where, therefore, the law (applicable to the year in which the distribution was made, as, for example, a distribution in 1934 from earnings and profits accumulated before March 1, 1913) requires that the amount of such distribution shall be applied against and reduce the basis of the stock with respect to which the distribution was made, there is no increase in the earnings and profits by reason of the receipt of such distribution. Similarly, where there is received by a corporation a distribution from another corporation in the form of a stock dividend and the law applicable to the year in which such distribution was made requires the allocation, as between the old stock and the stock received as a dividend, of the basis of the old stock (or such basis would but for section 307(b) be so allocated), then there is no increase in the earnings and profits by reason of the receipt of such stock dividend even though such stock dividend constitutes income within the meaning of the sixteenth amendment to the Constitution.

(b) The principles set forth in paragraph (a) of this section may be illustrated by the following examples:

Example (1). Corporation X in 1955 distributed to Corporation Y, one of its shareholders, $10,000 which was out of earnings or profits accumulated before March 1, 1913, and did not exceed the adjusted basis of the stock in respect of which the distribution was made. This amount of $10,000 was, therefore, a tax-free distribution and under the provisions of section 301(c)(2) must be applied against and reduce the adjusted basis of the stock in respect of which the distribution was made. The earnings and profits of Corporation Y are not increased by reason of the receipt of this distribution.

Example (2). Corporation Z in 1955 had outstanding common and preferred stock of which Corporation Y held 100 shares of the common and no preferred. The stock had a cost basis to Corporation Y of $100 per share, or a total cost of $10,000. In December of that year it received a dividend of 100 shares of the preferred stock of Corporation Z. Such distribution is a stock dividend which, under section 305, was not taxable and was accordingly not included in the gross income of Corporation Y. The original cost of $10,000 is allocated to the 200 shares of Corporation Z none of which has been sold or otherwise disposed of by Corporation Y. See section 307 and § 1.307–1. The earnings and profits of Corporation Y are not increased by reason of the receipt of such stock dividend.

§ 1.312–9. ADJUSTMENTS TO EARNINGS AND PROFITS REFLECTING INCREASE IN VALUE ACCRUED BEFORE MARCH 1, 1913.—(a) In order to determine, for the purpose of ascertaining the source of dividend distributions, that part of the earnings and profits which is represented by increase in value of property accrued before, but realized on or after, March 1, 1913, section 312(g) prescribes certain rules.

(b)(1) Section 312(g)(1) sets forth the general rule with respect to computing the increase to be made in that part of the earnings and profits consisting of increase in value of property accrued before, but realized on or after, March 1, 1913.

(2) The effect of section 312(g)(1) may be illustrated by the following examples:

Example (1). Corporation X acquired nondepreciable property before March 1, 1913, at a cost of $10,000. Its fair market value as of March 1, 1913, was $12,000 and it was sold in 1955 for $15,000. The increase in earnings and profits based on the value as of March 1, 1913, representing earnings and profits accumulated since February 28, 1913, is $3,000. If the basis is determined without regard to the value as of March 1, 1913, there would be an increase in earnings and profits of $5,000. The difference of $2,000 ($5,000 minus $3,000) represents the increase to be made in that part of the earnings and profits of Corporation X consisting of the increase in value of property accrued before, but realized on or after, March 1, 1913.

Example (2). Corporation Y acquired depreciable property in 1908 at a cost of $100,000. Assuming no additions or betterments, and that the depreciation sustained before March 1, 1913,

was $10,000, the adjusted cost as of that date was $90,000. Its fair market value as of March 1, 1913, was $94,000 and on February 28, 1955, it was sold for $25,000. For the purpose of determining gain from the sale, the basis of the property is the fair market value of $94,000 as of March 1, 1913, adjusted for depreciation for the period subsequent to February 28, 1913, computed on such fair market value. If the amount of the depreciation deduction allowed after February 28, 1913, and properly allowable for each of such years to the date of the sale in 1955 is the aggregate sum of $81,467, the adjusted basis for determining gain in 1955 ($94,000 less $81,467) is $12,533 and the gain would be $12,467 ($25,000 less $12,533). The increase in earnings and profits accumulated since February 28, 1913, by reason of the sale, based on the value as of March 1, 1913, adjusted for depreciation, is $12,467. If the depreciation since February 28, 1913, had been based on the adjusted cost of $90,000 ($100,000 less $10,000) instead of the March 1, 1913, value of $94,000, the depreciation sustained from that date to the date of sale would have been $78,000 instead of $81,467 and the actual gain on the sale based on the cost of $100,000 adjusted by depreciation on such cost to $12,000 ($100,000 reduced by the sum of $10,000 and $78,000) would be $13,000 ($25,000 less $12,000). If the adjusted basis of the property was determined without regard to the value as of March 1, 1913, there would be an increase in earnings and profits of $13,000. The difference of $533 ($13,000 minus $12,467) represents the increase to be made in that part of the earnings and profits of Corporation Y consisting of the increase in value of property accrued before, but realized on or after, March 1, 1913 (assuming that the proper increase in such surplus had been made each year for the difference between depreciation based on cost and the depreciation based on March 1, 1913, value). Thus, the total increase in that part of earnings and profits consisting of the increase in value of property accrued before, but realized on or after, March 1, 1913, is $4,000 ($94,000 less $90,000).

(c)(1) Section 312(g)(2) is an exception to the general rule in section 312(g)(1) and also operates as limitation on the application of section 312(f). It provides that, if the application of part (B) of the first sentence of section 312(f)(1) to a sale or other disposition after February 28, 1913, results in a loss which is to be applied in decrease of earnings and profits for any period beginning after February 28, 1913, then, notwithstanding section 312(f) and in lieu of the rule provided in section 312(g)(1), the amount of such loss so to be applied shall be reduced by the amount, if any, by which the adjusted basis of the property used in determining the loss, exceeds the adjusted basis computed without regard to the fair market value of the property on March 1, 1913. If the amount so applied in reduction of the loss exceeds such loss, the excess over such loss shall increase that part of the earnings and profits consisting of increase in value of property accrued before, but realized on or after March 1, 1913.

(2) The application of section 312(g)(2) may be illustrated by the following examples:

Example (1). Corporation Y acquired nondepreciable property before March 1, 1913, at a cost of $8,000. Its fair market value as of March 1, 1913, was $13,000, and it was sold in 1955 for $10,000. Under (B) of the first sentence of section 312(f)(1) the adjusted basis would be $13,000 and there would be a loss of $3,000. The application of (B) of the first sentence of section 312(f)(1) would result in a loss from the sale in 1955 to be applied in decrease of earnings and profits for that year. Section 312(g)(2), however, applies and the loss of $3,000 is reduced by the amount by which the adjusted basis of $13,000 exceeds the cost of $8,000 (the adjusted basis computed without regard to the value on March 1, 1913), namely, $5,000. The amount of the loss is, accordingly, reduced from $3,000 to zero and there is no decrease in earnings and profits of Corporation Y for the year 1955 as a result of the sale. The amount applied in reduction of the decrease, namely, $5,000, exceeds $3,000. Accordingly, as a result of the sale the excess of $2,000 increases that part of the earnings and profits of Corporation Y consisting of increase in value of property accrued before, but realized on or after March 1, 1913.

Example (2). Corporation Z acquired nondepreciable property before March 1, 1913, at a cost of $10,000. Its fair market value as of March 1, 1913, was $12,000, and it was sold in 1955 for $8,000. Under (B) of the first sentence of section 312(f)(1) the adjusted basis would be $12,000 and there would be a loss of $4,000. The application of (B) of the first sentence of section 312(f)(1) would result in a loss from the sale in 1955 to be applied in decrease of earnings and profits for that year. Section 312(g)(2), however, applies and the loss of $4,000 is reduced by the amount by which the adjusted basis of $12,000 exceeds the cost of $10,000 (the adjusted basis computed without regard to the value on March 1, 1913), namely, $2,000. The amount of the loss is, accordingly, reduced from $4,000 to $2,000 and the decrease in earnings and profits of Corporation Z for the year 1955 as a result of the sale is $2,000 instead of $4,000. The amount applied in reduction of the decrease, namely, $2,000, does not exceed $4,000. Accordingly, as a result of the sale there is no increase in that part of the earnings and profits of Corporation Z consisting of increase in value of property accrued before, but realized on or after, March 1, 1913.

§ 1.312-10 Allocation of Earnings in Certain Corporate Separations.—(a) If one corporation transfers part of its assets constituting an active trade or business to another corporation in a transaction to which section 368(a)(1)(D) applies and immediately thereafter the stock and securities of the controlled corporation are distributed in a distribution or exchange to which section 355 (or so much of section 356 as relates to section 355) applies, the earnings and profits of the distributing corporation immediately before the transaction shall be allocated between the distributing corporation and the controlled corporation. In the case of a newly created controlled corporation, such allocation generally shall be made in proportion to the fair market value of the business or businesses (and interests in any other properties) retained by the distributing corporation and the business or busi-

nesses (and interests in any other properties) of the controlled corporation immediately after the transaction. In a proper case, allocation shall be made between the distributing corporation and the controlled corporation in proportion to the net basis of the assets transferred and of the assets retained or by such other method as may be appropriate under the facts and circumstances of the case. The term "net basis" means the basis of the assets less liabilities assumed or liabilities to which such assets are subject. The part of the earnings and profits of the taxable year of the distributing corporation in which the transaction occurs allocable to the controlled corporation shall be included in the computation of the earnings and profits of the first taxable year of the controlled corporation ending after the date of the transaction.

(b) If a distribution or exchange to which section 355 applies (or so much of section 356 as relates to section 355) is not in pursuance of a plan meeting the requirements of a reorganization as defined in section 368(a)(1)(D), the earnings and profits of the distributing corporation shall be decreased by the lesser of the following amounts:

(1) The amount by which the earnings and profits of the distributing corporation would have been decreased if it had transferred the stock of the controlled corporation to a new corporation in a reorganization to which section 368(a)(1)(D) applied and immediately thereafter distributed the stock of such new corporation or,

(2) The net worth of the controlled corporation. (For this purpose the term "net worth" means the sum of the bases of all of the properties plus cash minus all liabilities.)

If the earnings and profits of the controlled corporation immediately before the transaction are less than the amount of the decrease in earnings and profits of the distributing corporation (including a case in which the controlled corporation has a deficit) the earnings and profits of the controlled corporation, after the transaction, shall be equal to the amount of such decrease. If the earnings and profits of the controlled corporation immediately before the transaction are more than the amount of the decrease in the earnings and profits of the distributing corporation, they shall remain unchanged.

(c) In no case shall any part of a deficit of a distributing corporation within the meaning of section 355 be allocated to a controlled corporation.

§ 1.312-11 Effect on Earnings and Profits of Certain Other Tax-Free Exchanges and Tax-Free Distributions.—(a)(1) If property is transferred by one corporation to another corporation within the provisions of section 351, no allocation of earnings and profits shall be made between the transferor and transferee by reason of such transfer. The preceding sentence may not apply when such transfer immediately follows or immediately precedes either a reorganization under section 368 or a liquidation under section 332 to which section 334(b)(2) does not apply. See § 1.312-10 for allocation of earnings and profits upon the distribution of the stock of a controlled corporation in a transaction subject to section 355 or so much of section 356 as relates to section 355.

(2) The following example will illustrate the application of paragraph (a)(1) of this section:

Example. Corporation A transfers half of its assets subject to half of its liabilities to Corporation B in exchange for all of its stock. Such stock is not distributed by Corporation A. The transaction is not followed or preceded by a reorganization or a liquidation. No allocation of earnings and profits from Corporation A to Corporation B shall be made.

(b) The general rule provided in section 316 that every distribution is made out of earnings or profits to the extent thereof and from the most recently accumulated earnings or profits does not apply to:

(1) The distribution, in pursuance of a plan of reorganization, by or on behalf of a corporation a party to the reorganization, or in a transaction subject to section 355, to its shareholders—

(i) Of stock or securities in such corporation or in another corporation a party to the reorganization in any taxable year beginning before January 1, 1934, without the surrender by the distributees of stock or securities in such corporation (see section 112(g) of the Revenue Act of 1932); or

(ii) Of stock (other than preferred stock) in another corporation which is a party to the reorganization without the surrender by the distributees of stock in the distribution corporation if the distribution occurs after October 20, 1951, and is subject to section 112(b)(11) of the Internal Revenue Code of 1939; or

(iii) Of stock or securities in such corporation or in another corporation a party to the reorganization in any taxable year beginning before January 1, 1939, or on or after such date, in exchange for its stock or securities in a transaction to which section 112(b)(3) of the Internal Revenue Code of 1939 was applicable; or

(iv) Of stock or securities in such corporation or in another corporation in exchange for its stock or securities in a transaction subject to section 354 or 355,

if no gain to the distributees from the receipt of such stock or securities was recognized by law.

(2) The distribution in any taxable year (beginning before January 1, 1939, or on or after such date) of stock or securities, or other property or money, to a corporation in complete liquidation of another corporation, under the circumstances described in section 112(b)(6) of the Revenue Act of 1936, the Revenue Act of 1938, of the Internal Revenue Code of 1939, or section 332.

(3) The distribution in any taxable year (beginning after December 31, 1939), of stock or securities, or other property or money, in the case of an exchange or distribution described in section 371 of the Internal Revenue Code of 1939 or in section 1081 (relating to exchanges and distributions in obedience to orders of the Securities and Exchange Commission), if no gain to the distributee from the receipt of such stock, securities, or other property or money was recognized by law.

(4) A stock dividend which was not subject to tax in the hands of the distributee because either it did not constitute income to him

within the meaning of the sixteenth amendment to the Constitution or because exempt to him under section 115(f) of the Revenue Act of 1934 or a corresponding provision of a prior revenue act, or section 305.

(5) The distribution, in a taxable year of the distributee beginning after December 31, 1931, by or on behalf of an insolvent corporation, in connection with a section 112(b)(10) reorganization under the Internal Revenue Code of 1939, or in a transaction subject to section 371, of stock or securities in a corporation organized or made use of to effectuate the plan of reorganization, if under section 112(l) of the Internal Revenue Code of 1939 or section 371 no gain to the distributee from the receipt of such stock or securities was recognized by law.

(c) A distribution described in subparagraph (1), (2), (3), (4), or (5) of paragraph (b) does not diminish the earnings or profits of any corporation. In such cases, the earnings or profits remain intact and available for distribution as dividends by the corporation making such distribution, or by another corporation to which the earnings or profits are transferred upon such reorganization or other exchange. In the case, however, of amounts distributed in liquidation (other than a tax-free liquidation or reorganization described in subparagraph (1), (2), (3), or (5), of paragraph (b)) the earnings or profits of the corporation making the distribution are diminished by the portion of such distribution properly chargeable to earnings or profits accumulated after February 28, 1913, after first deducting from the amount of such distribution the portion thereof allocable to capital account.

(d) For the purposes of this section, the terms "reorganization" and "party to the reorganization" shall, for any taxable year beginning before January 1, 1934, have the meanings assigned to such terms in section 112 of the Revenue Act of 1932; for any taxable year beginning after December 31, 1933, and before January 1, 1936, have the meanings assigned to such terms in section 112 of the Revenue Act of 1934; for any taxable year beginning after December 31, 1935, and before January 1, 1938, have the meanings assigned to such terms in section 112 of the Revenue Act of 1936; for any taxable year beginning after December 31, 1937, and before January 1, 1939, have the meanings assigned to such terms in section 112 of the Revenue Act of 1938; and for any taxable year beginning after December 31, 1938, and ending before June 22, 1954, providing no election is made under section 393(b)(2) of the Internal Revenue Code of 1954, have the meanings assigned to such terms in section 213(b) of the Revenue Act of 1939.

§ 1.312-12. DISTRIBUTIONS OF PROCEEDS OF LOANS GUARANTEED BY THE UNITED STATES.—(a) The provisions of section 312(j) are applicable with respect to a loan, any portion of which is guaranteed by an agency of the United States Government without regard to the percentage of such loan subject to such guarantee.

(b) The application of section 312(j) is illustrated by the following example:

Example. Corporation A borrowed $1,000,000 for the purpose of construction of an apartment house, the cost and adjusted basis of which was $900,000. This loan was guaranteed by an agency

of the United States Government. One year after such loan was made and after the completion of construction of the building (but before such corporation had received any income) it distributed $100,000 cash to its shareholders. The earnings and profits of the taxable year of such corporation are increased (pursuant to section 312(j)) by $100,000 immediately prior to such distribution and are decreased by $100,000 immediately after such distribution. Such decrease, however, does not reduce the earnings and profits below zero. Two years later, it has no accumulated earnings and has earnings of the taxable year of $100,000. Before it has made any payments on the loan, it distributes $200,000 to its shareholders. The earnings and profits of the taxable year of the corporation ($100,000) are increased by $100,000, the excess of the amount of the guaranteed loan over the adjusted basis of the apartment house (calculated without adjustment for depreciation). The entire amount of each distribution is treated as a distribution out of earnings and profits and, accordingly, as a taxable dividend.

DEFINITIONS; CONSTRUCTIVE OWNERSHIP OF STOCK

§ 1.316. Statutory Provisions; Dividend Defined.

SEC. 316. DIVIDEND DEFINED.

(a) General Rule.—For purposes of this subtitle, the term "dividend" means any distribution of property made by a corporation to its shareholders—

(1) Out of its earnings and profits accumulated after February 28, 1913, or

(2) Out of its earnings and profits of the taxable year (computed as of the close of the taxable year without diminution by reason of any distribution made during the taxable year), without regard to the amount of the earnings and profits at the time the distribution was made.

Except as otherwise provided in this subtitle, every distribution is made out of earnings and profits to the extent thereof, and from the most recently accumulated earnings and profits. To the extent that any distribution is, under any provision of this subchapter, treated as a distribution of property to which section 301 applies, such distribution shall be treated as a distribution of property for purposes of this subsection.

(b) Special Rules.—

(1) Certain insurance company dividends. The definition in subsection (a) shall not apply to the term "dividend" as used in sections 803(e), 821(a)(2), 823(2), and 832(c)(11) (where the reference is to dividends of insurance companies paid to policyholders.)

(2) Distributions by personal holding companies.—In the case of a corporation which—

(A) Under the law applicable to the taxable year in which the distribution is made, is a personal holding company (as defined in section 542), or

(B) For the taxable year in respect of which the distribution is made under section 563(b) (relating to dividends paid after the close of the taxable year), or section 547 (relating to deficiency dividends), or the corresponding provisions of prior law, is a personal holding company under the law applicable to such taxable year,

the term "dividend" also means any distribution of property (whether or not a dividend as defined in subsection (a)) made by

the corporation to its shareholders, to the extent of its undistributed personal holding company income (determined under section 545 without regard to distributions under this paragraph) for such year.

§ 1.316-1. DIVIDENDS.—(a) (1) The term "dividend" for the purpose of subtitle A (except when used in section 803(e), section 821(a)(2), section 823(2), and section 832(c)(11) where the reference is to dividends of insurance companies paid to policyholders) comprises any distribution of property as defined in section 317 in the ordinary course of business, even though extraordinary in amount, made by a domestic or foreign corporation to its shareholders out of either—

(i) Earnings and profits accumulated since February 28, 1913, or

(ii) Earnings and profits of the taxable year computed without regard to the amount of the earnings and profits (whether of such year or accumulated since February 28, 1913) at the time the distribution was made.

The earnings and profits of the taxable year shall be computed as of the close of such year, without diminution by reason of any distributions made during the taxable year. For the purpose of determining whether a distribution constitutes a dividend, it is unnecessary to ascertain the amount of the earnings and profits accumulated since February 28, 1913, if the earnings and profits of the taxable year are equal to or in excess of the total amount of the distributions made within such year.

(2) Where a corporation distributes property to its shareholders on or after June 22, 1954, the amount of the distribution which is a dividend to them may not exceed the earnings and profits of the distributing corporation.

(3) The rule of (2) above may be illustrated by the following example:

Example. X and Y, individuals, each own one-half of the stock of Corporation A which has earnings and profits of $10,000. Corporation A distributes property having a basis of $6,000 and a fair market value of $16,000 to its shareholders, each shareholder receiving property with a basis of $3,000 and with a fair market value of $8,000 in a distribution to which section 301 applies. The amount taxable to each shareholder as a dividend under section 301(c) is $5,000.

(b) In the case of a corporation which, under the law applicable to the taxable year in which a distribution is made, is a personal holding company or which, for the taxable year in respect of which a distribution is made under section 563 (relating to dividends paid within 2½ months after the close of the taxable year), or section 547 (relating to deficiency dividends), or corresponding provisions of a prior income-tax law, was under the applicable law a personal holding company, the term "dividend", in addition to the meaning set forth in the first sentence of section 316, also means a distribution to its shareholders as follows: A distribution within a taxable year of the corporation, or of a shareholder, is a dividend to the extent of the corporation's undistributed personal holding company income (determined under section 545 without regard to distributions under section

316(b)(2)) for the taxable year in which, or, in the case of a distribution under section 563 or section 547, the taxable year in respect of which, the distribution was made.

(c) Except as provided in section 316(b)(1), the term "dividend" includes any distribution of property to shareholders to the extent made out of accumulated or current earnings and profits. See, however, section 331 (relating to distributions in complete or partial liquidation), section 301(e) (relating to distributions by personal service corporations), section 302(b) (relating to redemptions treated as amounts received from the sale or exchange of stock), and section 303 (relating to distributions in redemption of stock to pay death taxes). See also section 305(b) for certain distributions of stock or stock rights treated as distributions of property.

(d) The application of section 316 may be illustrated by the following examples:

Example (1). At the beginning of the calendar year 1955, Corporation M had an operating deficit of $200,000 and the earnings and profits for the year amounted to $100,000. Beginning on March 16, 1955, the corporation made quarterly distributions of $25,000 during the taxable year to its shareholders. Each distribution is a taxable dividend in full, irrespective of the actual or the pro rata amount of the earnings and profits on hand at any of the dates of distribution, since the total distributions made during the year ($100,000) did not exceed the total earnings and profits of the year ($100,000).

Example (2). At the beginning of the calendar year 1955, Corporation N, a personal holding company, had no accumulated earnings and profits. During that year it made no earnings and profits but, due to the disallowance of certain deductions, its undistributed personal holding company income (determined under section 545 without regard to distributions under section 316(b)(2)) was $16,000. It distributed to shareholders on December 15, 1955, $15,000, and on February 1, 1956, $1,000, the latter amount being claimed as a deduction under section 563 in its personal holding company schedule for 1955 filed with its return for 1955 on March 15, 1956. Both distributions are taxable dividends in full, since they do not exceed the undistributed personal holding company income (determined without regard to such distributions) for 1955, the taxable year in which the distribution of $15,000 was made and with respect to which the distribution of $1,000 was made. It is immaterial whether Corporation N is a personal holding company for the taxable year 1956 or whether it had any income for that year.

Example (3). In 1959, a deficiency in personal holding company tax was established against Corporation O for the taxable year 1955 in the amount of $35,500 based on an undistributed personal holding company income of $42,000. Corporation O complied with the provisions of section 547 and in December 1959 distributed $42,000 to its stockholders as "deficiency dividends." The distribution of $42,000 is a taxable dividend since it does not exceed $42,000 (the undistributed personal holding company income for 1955, the taxable year with respect to which the distribu-

tion was made). It is immaterial whether Corporation O is a personal holding company for the taxable year 1959 or whether it had any income for that year.

Example (4). At the beginning of the taxable year 1955, Corporation P, a personal holding company had a deficit in earnings and profits of $200,000. During that year it made earnings and profits of $90,000. For that year, however, it had an undistributed personal holding income (determined under section 545 without regard to distributions under section 316(b)(2)) of $80,000. During such taxable year it distributed to its shareholders $100,000. The distribution of $100,000 is a taxable dividend to the extent of $90,000 since its earnings and profits for that year, $90,000, exceed $80,000, the undistributed personal holding company income determined without regard to such distribution.

§ 1.316-2. SOURCES OF DISTRIBUTION IN GENERAL.—(a) For the purpose of income taxation every distribution made by a corporation is made out of earnings and profits to the extent thereof and from the most recently accumulated earnings and profits. In determining the source of a distribution, consideration should be given first, to the earnings and profits of the taxable year; second, to the earnings and profits accumulated since February 28, 1913, only in the case where, and to the extent that, the distributions made during the taxable year are not regarded as out of the earnings and profits of that year; third, to the earnings and profits accumulated before March 1, 1913, only after all the earnings and profits of the taxable year and all the earnings and profits accumulated since February 28, 1913, have been distributed; and fourth, to sources other than earnings and profits only after the earnings and profits have been distributed.

(b) If the earnings and profits of the taxable year (computed as of the close of the year without diminution by reason of any distributions made during the year and without regard to the amount of earnings and profits at the time of the distribution) are sufficient in amount to cover all the distributions made during that year, then each distribution is a taxable dividend. See § 1.316-1. If the distributions made during the taxable year consist only of money and exceed the earnings and profits of such year, then that proportion of each distribution which the total of the earnings and profits of the year bears to the total distributions made during the year shall be regarded as out of the earnings and profits of that year. The portion of each such distribution which is not regarded as out of earnings and profits of the taxable year shall be considered a taxable dividend to the extent of the earnings and profits accumulated since February 28, 1913, and available on the date of the distribution. In any case in which it is necessary to determine the amount of earnings and profits accumulated since February 28, 1913, and the actual earnings and profits to the date of a distribution within any taxable year (whether beginning before January 1, 1936, or, in the case of an operating deficit, on or after that date) cannot be shown, the earnings and profits for the year (or accounting period, if less than a year) in which the distribution was made shall be prorated to the date of the distribution not counting the date on which the distribution was made.

(c) The provisions of the section may be illustrated by the following example:

Example. At the beginning of the calendar year 1955, Corporation M had $12,000 in earnings and profits accumulated since February 28, 1913. Its earnings and profits for 1955 amounted to $30,000. During the year it made quarterly cash distributions of $15,000 each. Of each of the four distributions made, $7,500 (that portion of $15,000 which the amount of $30,000, the total earnings and profits of the taxable year, bears to $60,000, the total distributions made during the year) was paid out of the earnings and profits of the taxable year; and of the first and second distributions, $7,500 and $4,500, respectively, were paid out of the earnings and profits accumulated after February 28, 1913, and before the taxable year, as follows:

Distributions during 1955		*Portion out of earnings and profits of the taxable year*	*Portion out of earnings accumulated since Feb. 28, 1913, and before the taxable year*	*Taxable amount of each distribution*
Date	*Amount*			
Mar. 10	$15,000	$7,500	$7,500	$15,000
June 10	15,000	7,500	4,500	12,000
Sept. 10	15,000	7,500	----------	7,500
Dec. 10	15,000	7,500	----------	7,500
Total amount taxable as dividends				$42,000

(d) Any distribution by a corporation out of earnings and profits accumulated before March 1, 1913, or out of increase in value of property accrued before March 1, 1913 (whether or not realized by sale or other disposition, and, if realized, whether before, on, or after March 1, 1913), is not a dividend within the meaning of subtitle A.

(e) A reserve set up out of gross income by a corporation and maintained for the purpose of making good any loss of capital assets on account of depletion or depreciation is not a part of surplus out of which ordinary dividends may be paid. A distribution made from a depletion or a depreciation reserve based upon the cost or other basis of the property will not be considered as having been paid out of earnings and profits, but the amount thereof shall be applied against and reduce the cost or other basis of the stock upon which declared. If such a distribution is in excess of the basis, the excess shall be taxed as a gain from the sale or other disposition of property as provided in section 301(c)(3)(A). A distribution from a depletion reserve based upon discovery value to the extent that such reserve represents the excess of the discovery value over the cost or other basis for determining gain or loss, is, when received by the shareholders, taxable as an ordinary dividend. The amount by which a corporation's percentage depletion allowance for any year exceeds depletion sustained on cost or other basis, that is, determined without regard to discovery or percentage depletion allowances for the year of distribution or prior years, constitutes a part of the corpo-

ration's "earnings and profits accumulated after February 28, 1913," within the meaning of section 316, and, upon distribution to shareholders, is taxable to them as a dividend. A distribution made from that portion of a depletion reserve based upon a valuation as of March 1, 1913, which is in excess of the depletion reserve based upon cost, will not be considered as having been paid out of earnings and profits, but the amount of the distribution shall be applied against and reduce the cost or other basis of the stock upon which declared. See section 301. No distribution, however, can be made from such a reserve until all the earnings and profits of the corporation have first been distributed.

§ 1.317. STATUTORY PROVISIONS; OTHER DEFINITIONS.

SEC. 317. OTHER DEFINITIONS.

(a) PROPERTY.—For purposes of this part, the term "property" means money, securities, and any other property; except that such term does not include stock in the corporation making the distribution (or rights to acquire such stock).

(b) REDEMPTION OF STOCK.—For purposes of this part, stock shall be treated as redeemed by a corporation if the corporation acquires its stock from a shareholder in exchange for property, whether or not the stock so acquired is cancelled, retired, or held as treasury stock.

§ 1.317-1. PROPERTY DEFINED.—The term "property", for purposes of Part 1 of subchapter C, means any property (including money, securities, and indebtedness to the corporation) other than stock, or rights to acquire stock, in the corporation making the distribution.

§ 1.318. STATUTORY PROVISIONS; CONSTRUCTIVE OWNERSHIP OF STOCK.

SEC. 318. CONSTRUCTIVE OWNERSHIP OF STOCK.

(a) GENERAL RULE.—For purposes of those provisions of this subchapter to which the rules contained in this section are expressly made applicable—

(1) MEMBERS OF FAMILY.—

(A) In General.—An individual shall be considered as owning the stock owned, directly or indirectly, by or for—

(i) His spouse (other than a spouse who is legally separated from the individual under a decree of divorce or separate maintenance), or

(ii) His children, grandchildren and parents.

(B) Effect of Adoption.—For the purposes of subparagraph treated as a child of such individual by blood.

(2) PARTNERSHIPS, ESTATES, TRUSTS, AND CORPORATIONS.—

(A) Partnerships and Estates.—Stock owned, directly or indirectly, or by or for a partnership or estate shall be considered as being owned proportionately by its partners or beneficiaries. Stock owned, directly or indirectly, by or for a partner or a beneficiary of an estate shall be considered as being owned by the partnership or estate.

(B) Trusts.—Stock owned, directly or indirectly, by or for a trust shall be considered as being owned by its beneficiaries in proportion to the actuarial interest of such beneficiaries in such trust. Stock owned, directly or indirectly, by or for a beneficiary of a trust shall be considered as being owned by the trust, unless such beneficiary's interest in the trust is a remote contingent interest. For purposes of the preceding sentence, a contingent interest of a beneficiary in a trust shall be considered remote if, under the maximum exercise of discretion by the

trustee in favor of such beneficiary, the value of such interest, computed actuarially, is 5 percent or less of the value of the trust property. Stock owned, directly or indirectly, by or for any portion of a trust of which a person is considered the owner under subpart E of Part I of subchapter J (relating to grantors and others treated as substantial owners) shall be considered as being owned by such person; and such trust shall be treated as owning the stock owned, directly or indirectly, by or for that person. This subparagraph shall not apply with respect to any employees' trust described in section 401(a) which is exempt from tax under section 501(a).

(C) Corporations.—If 50 percent or more in value of the stock in a corporation is owned, directly or indirectly, by or for any person, then—

(i) Such person shall be considered as owning the stock owned, directly or indirectly, by or for that corporation, in that proportion which the value of the stock which such person so owns bears to the value of all the stock in such corporation; and

(ii) Such corporation shall be considered as owning the stock owned, directly or indirectly, by or for that person.

(3) OPTIONS.—If any person has an option to acquire stock, such stock shall be considered as owned by such person. For purposes of this subparagraph, an option to acquire such an option, and each one of a series of such options, shall be considered as an option to acquire such stock.

(4) CONSTRUCTIVE OWNERSHIP AS ACTUAL OWNERSHIP.—

(A) In General.—Except as provided in subparagraph (B), stock constructively owned by a person by reason of the application of paragraph (1), (2), or (3) shall, for purposes of applying paragraph (1), (2), or (3), be treated as actually owned by such person.

(B) Members of Family.—Stock constructively owned by an individual by reason of the application of paragraph (1) shall not be treated as owned by him for purposes of again applying paragraph (1) in order to make another the constructive owner of such stock.

(C) Option Rule in Lieu of Family Rule.—For purposes of this paragraph, if stock may be considered as owned by an individual under paragraph (1) or (3), it shall be considered as owned by him under paragraph (3).

(b) GROSS REFERENCES.—For provisions to which the rules contained in subsection (a) apply, see—

(1) Section 302 (relating to redemption of stock);

(2) Section 304 (relating to redemption by related corporations);

(3) Section 306(b)(1)(A) (relating to disposition of section 306 stock);

(4) Section 334(b)(3)(C) (relating to basis of property received in certain liquidations of subsidiaries); and

(5) Section 382 (a) (3) (relating to special limitations on net operating loss carryovers).

§ 1.318-1. CONSTRUCTIVE OWNERSHIP OF STOCK—INTRODUCTION.—(a) For the purposes of certain provisions of subchapter C, section 318(a) provides that stock owned by a taxpayer includes stock constructively owned by such taxpayer under the rules set forth in such section. An individual is considered to own the stock owned, directly or indirectly, by or for his spouse (other than a spouse who is legally separated from the indivdual under a decree of divorce or separate maintenance), and by or for his children, grandchildren, and parents. Under section 318(a)(2) constructive ownership rules are established for partnerships and partners, estates and beneficiaries, trusts and beneficiaries, and corporations and stockholders. If any

person has an option to acquire stock, such stock is considered as owned by such person. The term "option" includes an option to acquire such an option and each of a series of such options. The rules of section 318(a) are applicable to the following sections:

(1) Section 302 (relating to redemption of stock);
(2) Section 304 (relating to redemption by related corporations);
(3) Section 306(b)(1)(A) (relating to disposition of section 306 stock);
(4) Section 334(b)(3)(C) (relating to basis of property received in certain liquidations of subsidiaries); and
(5) Section 382(a)(3) (relating to special limitations on net operating loss carryovers).

Stock constructively owned by a person by reason of the application of paragraph (1), (2), or (3) of section 318(a) is, for purposes of applying paragraph (1), (2), or (3) treated as actually owned by such person, except as provided in section 318(a)(4)(B) and § 1.318-4.

(b) In applying section 318(a) to determine the stock ownership of any person for any one purpose—

(1) A corporation shall not be considered to own its own stock by reason of section 318(a)(2)(C)(ii),
(2) In any case in which an amount of stock owned by any person may be included in the computation more than one time—
(i) Such stock shall be used in such computation only once, and
(ii) Such stock shall be used in such computation in the manner in which it will impute to the person concerned the largest total stock ownership, and
(3) In determining the 50 percent requirement of section 318(a)(2)(C) all of the stock owned actually and constructively by the person concerned shall be aggregated.

§ 1.318-2. Application of General Rules.—(a) The application of paragraph (b) of § 1.318-1 may be illustrated by the following examples:

Example (1). H, an individual, owns all of the stock of Corporation A. Corporation A is not considered to own the stock owned by H in Corporation A.

Example (2). A owns 40 percent of the Brown Corporation and 50 percent of the Green Corporation. Under section 318(a)(2)(C), the stock ownership of A in the Brown Corporation will be limited to 40 percent of such stock. No amount of the stock of the Brown Corporation considered to be owned by the Green Corporation under section 318(a)(2)(C)(ii) will be considered as owned by A under section 318(a)(2)(C)(i) since, under § 1.318-1(b)(2)(i), the same stock shall not be taken into account twice in the same computation, and pursuant to § 1.318-1(b)(2)(ii), the amount of stock must be computed as if actually owned by A since this will impute to him the largest total stock ownership. The same result will follow if A is a fifty percent beneficiary of a trust or a fifty percent partner in a

partnership rather than a 50 percent shareholder of the Green Corporation.

Example (3). Two unrelated individuals, A and B, own stock of a corporation, and are also the beneficiaries of a trust or estate or the members of a partnership. In determining the stock constructively owned by A, the trust, estate or partnership is considered as actually owning the stock owned by B.

Example (4). H, an individual, his wife, W, and his son, S, each own one-third of the stock of the Green Corporation. For purposes of determining the amount of stock owned by H, W, or S for the purpose of section 318(a)(2)(C), the amount of stock held by the other members of the family shall be added pursuant to § 1.318–1(b)(3) above in applying the 50 percent requirement of such section. H, W, or S, as the case may be, is for this purpose deemed to own 100 percent of the stock of the Green Corporation.

(b) The application of section 318(a)(1), relating to members of a family, may be illustrated by the following example:

Example. An individual, H, his wife, W, his son, S, and his grandson (S's son), G, own the 100 outstanding shares of stock of a corporation, each owning 25 shares. H, W, and S are each considered as owning 100 shares. G is considered as owning only 50 shares, that is, his own and his father's.

(c) The application of section 318(a)(2) relating to partnerships, trusts and corporations may be illustrated by the following examples:

Example (1). A, an individual, has a 50 percent interest in a partnership. The partnership owns 50 of the 100 outstanding shares of stock of a corporation, the remaining 50 shares being owned by A. The partnership is considered as owning 100 shares. A is considered as owning 75 shares.

Example (2). A testamentary trust owns 25 of the outstanding 100 shares of stock of a corporation. A, an individual, who holds a vested remainder in the trust having a value, computed actuarially equal to 4 percent of the value of the trust property, owns the remaining 75 shares. Since the interest of A in the trust is a vested interest rather than a contingent interest (whether or not remote), the trust is considered as owning 100 shares. A is considered as owning 76 shares.

Example (3). The facts are the same as in (2), above, except that A's interest in the trust is a contingent remainder. A is considered as owning 76 shares. However, since A's interest in the trust is a remote contingent interest, the trust is not considered as owning any of the shares owned by A.

Example (4). A and B, unrelated individuals, own 70 percent and 30 percent, respectively, in value of the stock of Corporation M. Corporation M owns 50 of the 100 outstanding shares of stock of Corporation O, the remaining 50 shares being owned by A. Corporation M is considered as owning 100 shares of Corporation O, and A is considered as owning 85 shares.

Example (5). A and B, unrelated individuals, own 70 percent and 30 percent, respectively, of the stock of Corporation M. A, B and Corporation M all own stock of Corporation O. Since B

owns less than 50 percent in value of the stock of Corporation M, neither B nor Corporation M constructively owns the stock of Corporation O owned by the other. However, for the purpose of sections 304(b)(1), 304(c)(2), and 382(a)(3), section 318(a)(2)(C) is applied without regard to the 50 percent limitation contained therein, and for such purposes, B constructively owns the stock of Corporation O owned by Corporation M, and Corporation M constructively owns the stock of Corporation O owned by B. Therefore, for such purpose, in determining the stock constructively owned by A, Corporation M is treated as actually owning the stock of Corporation O owned by B.

§ 1.318-3. ESTATES, TRUSTS, AND OPTIONS.—(a) For the purpose of applying section 318(a) relating to estates, property of a decedent shall be considered as owned by his estate if such property is subject to administration by the executor or administrator for the purpose of paying claims against the estate and expenses of administration notwithstanding that, under local law, legal title to such property vests in the decedent's heirs, legatees or devisees immediately upon death. The term "beneficiary" includes any person entitled to receive property of a decedent pursuant to a will or pursuant to laws of descent and distribution. A person shall no longer be considered a beneficiary of an estate when all the property to which he is entitled has been received by him, when he no longer has a claim against the estate arising out of having been a beneficiary, and when there is only a remote possibility that it will be necessary for the estate to seek the return of property or to seek payment from him by contribution or otherwise to satisfy claims against the estate or expenses of administration. When, pursuant to the preceding sentence, a person ceases to be a beneficiary, stock owned by him shall not thereafter be considered owned by the estate, and stock owned by the estate shall not thereafter be considered owned by him. The application of section 318(a) relating to estates may be illustrated by the following examples:

Example (1). A decedent's estate owns 50 of the 100 outstanding shares of stock of Corporation X. The remaining shares are owned by three unrelated individuals, A, B, and C, who together own the entire interest in the estate. A owns 12 shares of stock of Corporation X directly and is entitled to 50 percent of the estate. B owns 18 shares directly and has a life estate in the remaining 50 percent of the estate. C owns 20 shares directly and also owns the remainder interest after B's life estate. Under these circumstances, the estate is considered as owning 80 shares of the stock of Corporation X; 50 shares directly, 12 shares constructively through A, and 18 shares constructively through B. A is considered as owning 46 shares of the stock of Corporation X; 12 shares directly and 34 shares constructively (50 percent of the 50 shares owned directly by the estate and 50 percent of the 18 shares owned constructively by the estate through B). B is considered as owning 49 shares of the stock of Corporation X; 18 shares directly and 31 shares constructively (50 percent of the 50 shares owned directly by the estate and 50 percent of the 12

shares owned constructively by the estate through A). C is considered as owning 20 shares directly and no shares constructively. C is not considered a beneficiary of the estate under section 318 (a) since he has no direct present interest in the property held by the estate nor in the income produced by such property.

Example (2). Under the will of A, Blackacre is left to B for life, remainder to C, an unrelated individual. The residue of the estate consisting of stock of a corporation is left to D. B and D are beneficiaries of the estate under section 318(a). C is not considered a beneficiary since he has no direct present interest in Blackacre nor in the income produced by such property. The stock owned by the estate is considered as owned proportionately by B and D.

(b) For the purpose of section 318(a)(2)(B) stock owned by a trust will be considered as being owned by its beneficiaries only to the extent of the interest of such beneficiaries in the trust. Accordingly, the interest of income beneficiaries, remainder beneficiaries, and other beneficiaries will be computed on an actuarial basis. Thus, if a trust owns 100 percent of the stock of Corporation A, and if, on an actuarial basis, W's life interest in the trust is 15 percent, Y's life interest is 25 percent, and Z's remainder interest is 60 percent, under this provision W will be considered to be the owner of 15 percent of the stock of Corporation A, Y will be considered to be the owner of 25 percent of such stock, and Z will be considered to be the owner of 60 percent of such stock.

(c) The application of section 318(a) relating to options may be illustrated by the following example:

Example. A and B, unrelated individuals, own all of the 100 outstanding shares of stock of a corporation, each owning 50 shares. A has an option to acquire 25 of B's shares and has an option to acquire a further option to acquire the remaining 25 of B's shares. A is considered as owning the entire 100 shares of stock of the corporation.

§ 1.318-4 Constructive Family Ownership. An exception concerning the treatment of constructive ownership as actual ownership is provided in section 318(a)(4)(B) with respect to stock constructively owned by reason of ownership by a member of a family. This exception is intended to make clear that unless the stock is directly attributable to the individual whose stock ownership is in question, the constructive ownership rules of section 318(a)(1) are not applicable. Thus, for example, if F and his two sons, A and B, each own one-third of the stock of a corporation, under section 318(a)(1), A is treated as owning constructively the stock owned by his father but is not treated as owning the stock owned by B. Section 318(a)(4)(B) prevents the attribution of the stock of one brother through the father to the other brother, an attribution beyond the scope of section 318(a)(1) directly.

CORPORATE LIQUIDATIONS

EFFECTS ON RECIPIENTS

§ 1.331. STATUTORY PROVISIONS; GAIN OR LOSS TO SHAREHOLDERS IN CORPORATE LIQUIDATIONS.

SEC. 331. GAIN OR LOSS TO SHAREHOLDERS IN CORPORATE LIQUIDATIONS.

(a) GENERAL RULE.—

(1) COMPLETE LIQUIDATIONS.—Amounts distributed in complete liquidation of a corporation shall be treated as in full payment in exchange for the stock.

(2) PARTIAL LIQUIDATIONS.—Amounts distributed in partial liquidation of a corporation (as defined in section 346) shall be treated as in part or full payment in exchange for the stock.

(b) NONAPPLICATION OF SECTION 301.—Section 301 (relating to effects on shareholder of distributions of property) shall not apply to any distribution of property in partial or complete liquidation.

(c) CROSS REFERENCES.—

(1) For general rule for determination of the amount of gain or loss to the distributee, see section 1001.

(2) For general rule for determination of the amount of gain or loss recognized, see section 1002.

§ 1.331–1. CORPORATE LIQUIDATIONS.—(a) Section 331 contains rules governing the extent to which gain or loss is recognized to a shareholder receiving a distribution in complete or partial liquidation of a corporation. Under section 331(a)(1), it is provided that amounts distributed in complete liquidation of a corporation shall be treated as in full payment in exchange for the stock. Under section 331(a)-(2), it is provided that amounts distributed in partial liquidation of a corporation shall be treated as in full or part payment in exchange for the stock. For this purpose, the term "partial liquidation" shall have the meaning ascribed in section 346. If section 331 is applicable to the distribution of property by a corporation, section 301 (relating to the effects on a shareholder of distributions of property) has no application.

(b) The gain or loss to a shareholder from a distribution in partial or complete liquidation is to be determined under section 1001 by comparing the amount of the distribution with the cost or other basis of the stock. The gain or loss will be recognized to the extent provided in section 1002 and will be subject to the provisions of sections 1201–1223.

(c) A liquidation which is followed by a transfer to another corporation of all or part of the assets of the liquidating corporation or which is preceded by such a transfer may, however, have the effect of the distribution of a dividend or of a transaction in which no loss is recognized and gain is recognized only to the extent of "other property." See sections 301 and 356.

(d) In every case in which a shareholder transfers stock in exchange for property to the corporation which issued such stock, the facts and circumstances shall be reported on his return unless the property is part of a distribution made pursuant to a corporate resolution reciting that the distribution is made in liquidation of the corporation and the corporation is completely liquidated and dissolved within one year

after the distribution. See section 6043 for requirements relating to returns by corporations.

(e) The provisions of this section may be illustrated by the following example:

Example. A, an individual who makes his income tax returns on the calendar year basis, owns 20 shares of stock of the P Corporation, a domestic corporation, 10 shares of which were acquired in 1951 at a cost of $1,500 and the remainder of 10 shares in December 1954 at a cost of $2,900. He receives in April 1955 a distribution of $250 per share in complete liquidation, or $2,500 on the 10 shares acquired in 1951, and $2,500 on the 10 shares acquired in December 1954. The gain of $1,000 on the shares acquired in 1951 is a long-term capital gain to be treated as provided in sections 1201 through 1223. The loss of $400 on the shares acquired in 1954 is a short-term capital loss to be treated as provided in sections 1201 through 1223.

§ 1.332. STATUTORY PROVISIONS; COMPLETE LIQUIDATIONS OF SUBSIDIARIES.

SEC. 332. COMPLETE LIQUIDATIONS OF SUBSIDIARIES.

(a) GENERAL RULE.—No gain or loss shall be recognized on the receipt by a corporation of property distributed in complete liquidation of another corporation.

(b) LIQUIDATIONS TO WHICH SECTION APPLIES.—For the purposes of subsection (a), a distribution shall be considered to be in complete liquidation only if—

(1) The corporation receiving such property was, on the date of the adoption of the plan of liquidation, and has continued to be at all times until the receipt of the property, the owner of stock (in such other corporation) possessing at least 80 percent of the total combined voting power of all classes of stock entitled to vote and the owner of at least 80 percent of the total number of shares of all other classes of stock (except nonvoting stock which is limited and preferred as to dividends); and either

(2) The distribution is by such other corporation in complete cancellation or redemption of all its stock, and the transfer of all the property occurs within the taxable year; in such case the adoption by the shareholders of the resolution under which is authorized the distribution of all the assets of such corporation in complete cancellation or redemption of all its stock shall be considered an adoption of a plan of liquidation, even though no time for the completion of the transfer of the property is specified in such resolution; or

(3) Such distribution is one of a series of distributions by such other corporation in complete cancellation or redemption of all its stock in accordance with a plan of liquidation under which the transfer of all the property under the liquidation is to be completed within 3 years from the close of the taxable year during which is made the first of the series of distributions under the plan, except that if such transfer is not completed within such period, or if the taxpayer does not continue qualified under paragraph (1) until the completion of such transfer, no distribution under the plan shall be considered a distribution in complete liquidation.

If such transfer of all the property does not occur within the taxable year, the Secretary or his delegate may require of the taxpayer such bond, or waiver of the statute of limitations on assessment and collection, or both, as he may deem necessary to insure, if the transfer of the property is not completed within such 3-year period, or if the taxpayer does not continue qualified under paragraph (1) until the com-

pletion of such transfer, the assessment and collection of all income taxes then imposed by law for such taxable year or subsequent taxable years, to the extent attributable to property so received. A distribution otherwise constituting a distribution in complete liquidation within the meaning of this subsection shall not be considered as not constituting such a distribution merely because it does not constitute a distribution or liquidation within the meaning of the corporate law under which the distribution is made; and for purposes of this subsection a transfer of property of such other corporation to the taxpayer shall not be considered as not constituting a distribution (or one of a series of distributions) in complete cancellation or redemption of all the stock of such other corporation, merely because the carrying out of the plan involves (A) the transfer under the plan to the taxpayer by such other corporation of property, not attributable to shares owned by the taxpayer, on an exchange described in section 361, and (B) the complete cancellation or redemption under the plan, as a result of exchanges described in section 354, of the shares not owned by the taxpayer.

(c) SPECIAL RULE FOR INDEBTEDNESS OF SUBSIDIARY TO PARENT.—If—

(1) A corporation is liquidated and subsection (a) applies to such liquidation, and

(2) On the date of the adoption of the plan of liquidation, such corporation was indebted to the corporation which meets the 80 percent stock ownership requirements specified in subsection (b), then no gain or loss shall be recognized to the corporation so indebted because of the transfer of property in satisfaction of such indebtedness.

§ 1.332–1. DISTRIBUTIONS IN LIQUIDATION OF SUBSIDIARY CORPORATION—GENERAL.—Under the general rule prescribed by section 331 for the treatment of distributions in liquidation of a corporation, amounts received by one corporation in complete liquidation of another corporation are treated as in full payment in exchange for stock in such other corporation, and gain or loss from the receipt of such amounts is to be determined as provided in section 1001. Section 332 excepts from the general rule property received, under certain specifically described circumstances, by one corporation as a distribution in complete liquidation of the stock of another corporation and provides for the nonrecognition of gain or loss in those cases which meet the statutory requirements. Section 367 places a limitation on the application of section 332 in the case of foreign corporations. See section 334(b) for the basis for determining gain or loss from the subsequent sale of property received upon complete liquidations such as described in this section. See section 453(d)(4)(A) relative to distribution of installment obligations by subsidiary.

§ 1.332–2. REQUIREMENTS FOR NONRECOGNITION OF GAIN OR LOSS.—(a) The nonrecognition of gain or loss is limited to the receipt of such property by a corporation which is the actual owner of stock (in the liquidating corporation) possessing at least 80 percent of the total combined voting power of all classes of stock entitled to vote and the owner of at least 80 percent of the total number of shares of all other classes of stock (except nonvoting stock which is limited and preferred as to dividends). The recipient corporation must have been the owner of the specified amount of such stock on the date of the adoption of the plan of liquidation and have continued so to be at all times until the receipt of the property. If the recipient corporation does not continue qualified with respect to the ownership of stock of the liquidating corporation and if the failure to continue qualified occurs at any time prior to the completion of the transfer

of all the property, the provisions for the nonrecognition of gain or loss do not apply to any distribution received under the plan.

(b) Section 332 applies only to those cases in which the recipient corporation receives at least partial payment for the stock which it owns in the liquidating corporation. If section 332 is not applicable, see section 165(g) relative to allowance of losses on worthless securities.

(c) To constitute a distribution in complete liquidation within the meaning of section 332, the distribution must be (1) made by the liquidating corporation in complete cancellation or redemption of all of its stock in accordance with a plan of liquidation, or (2) one of a series of distributions in complete cancellation or redemption of all its stock in accordance with a plan of liquidation. Where there is more than one distribution, it is essential that a status of liquidation exist at the time the first distribution is made under the plan and that such status continue until the liquidation is completed. Liquidation is completed when the liquidating corporation and the receiver or trustees in liquidation are finally divested of all the property (both tangible and intangible). A status of liquidation exists when the corporation ceases to be a going concern and its activities are merely for the purpose of winding up its affairs, paying its debts, and distributing any remaining balance to its shareholders. A liquidation may be completed prior to the actual dissolution of the liquidating corporation. However, legal dissolution of the corporation is not required. Nor will the mere retention of a nominal amount of assets for the sole purpose of preserving the corporation's legal existence disqualify the transaction. (See § 39.22(a)-20 of Regulations 118, (26 CFR (1939), 1953 revision, § 39.22(a)-20).)

(d) If a transaction constitutes a distribution in complete liquidation within the meaning of the Internal Revenue Code of 1954 and satisfies the requirements of section 332, it is not material that it is otherwise described under the local law. If a liquidating corporation distributes all of its property in complete liquidation and if pursuant to the plan for such complete liquidation a corporation owning the specified amount of stock in the liquidating corporation receives property constituting amounts distributed in complete liquidation within the meaning of the Code and also receives other property attributable to shares not owned by it, the transfer of the property to the recipient corporation shall not be treated, by reason of the receipt of such other property, as not being a distribution (or one of a series of distributions) in complete cancellation or redemption of all of the stock of the liquidating corporation within the meaning of section 332, even though for purposes of those provisions relating to corporate reorganizations the amount received by the recipient corporation in excess of its ratable share is regarded as acquired upon the issuance of its stock or securities in a tax-free exchange as described in section 361 and the cancellation or redemption of the stock not owned by the recipient corporation is treated as occurring as a result of a tax-free exchange described in section 354.

(e) The application of these rules may be illustrated by the following example:

Example. On September 1, 1954, the M Corporation had outstanding capital stock consisting of 3,000 shares of common stock, par value $100 a share, and 1,000 shares of preferred stock, par value $100 a share, which preferred stock was limited and preferred as to dividends and had no voting rights. On that date, and thereafter until the date of dissolution of the M Corporation, the O Corporation owned 2,500 shares of common stock of the M Corporation. By statutory merger consummated on October 1, 1954, pursuant to a plan of liquidation adopted on September 1, 1954, the M Corporation was merged into the O Corporation, the O Corporation under the plan issuing stock which was received by the other holders of the stock of the M Corporation. The receipt by the O Corporation of the properties of the M Corporation is a distribution received by the O Corporation in complete liquidation of the M Corporation within the meaning of section 332, and no gain or loss is recognized as the result of the receipt of such properties.

§ 1.332-3. LIQUIDATIONS COMPLETED WITHIN ONE TAXABLE YEAR.—If in a liquidation completed within one taxable year pursuant to a plan of complete liquidation, distributions in complete liquidation are received by a corporation which owns the specified amount of stock in the liquidating corporation and which continues qualified with respect to the ownership of such stock until the transfer of all the property within such year is completed (see § 1.332-2(a)), then no gain or loss shall be recognized with respect to the distributions received by the recipient corporation. In such case no waiver or bond is required of the recipient corporation under section 332.

§ 1.332-4. LIQUIDATIONS COVERING MORE THAN ONE TAXABLE YEAR.—(a) If the plan of liquidation is consummated by a series of distributions extending over a period of more than one taxable year, the nonrecognition of gain or loss with respect to the distributions in liquidation shall, in addition to the requirements of § 1.332-2, be subject to the following requirements:

(1) In order for the distribution in liquidation to be brought within the exception provided in section 332 to the general rule for computing gain or loss with respect to amounts received in liquidation of a corporation, the entire property of the corporation shall be transferred in accordance with a plan of liquidation, which plan shall include a statement showing the period within which the transfer of the property of the liquidating corporation to the recipient corporation is to be completed. The transfer of all the property under the liquidation must be completed within three years from the close of the taxable year during which is made the first of the series of distributions under the plan.

(2) For each of the taxable years which falls wholly or partly within the period of liquidation, the recipient corporation shall, at the time of filing its return, file with the district director of internal revenue a waiver of the statute of limitations on assessment. The waiver shall be executed on such form as may be prescribed by the Commissioner and shall extend the period of assessment of all income and profits taxes for each such year to a

date not earlier than one year after the last date of the period for assessment of such taxes for the last taxable year in which the transfer of the property of such liquidating corporation to the controlling corporation may be completed in accordance with section 332. Such waiver shall also contain such other terms with respect to assessment as may be considered by the Commissioner to be necessary to insure the assessment and collection of the correct tax liability for each year within the period of liquidation.

(3) For each of the taxable years which falls wholly or partly within the period of liquidation, the recipient corporation may be required to file a bond, the amount of which shall be fixed by the district director of internal revenue. The bond shall contain all terms specified by the Commissioner, including provisions unequivocally assuring prompt payment of the excess of income and profits taxes (plus penalty, if any, and interest) as computed by the district director without regard to the provisions of sections 332 and 334(b) over such taxes computed with regard to such provisions, regardless of whether such excess may or may not be made the subject of a notice of deficiency under section 6212 and regardless of whether it may or may not be assessed. Any bond required under section 332 shall have such surety or sureties as the Commissioner may require. However, see 6 U. S. C. 15, providing that where a bond is required by law or regulations, in lieu of surety or sureties there may be deposited bonds or notes of the United States. Only surety companies holding certificates of authority from the Secretary as acceptable sureties on Federal bonds will be approved as sureties. The bonds shall be executed in triplicate so that the Commissioner, the taxpayer, and the surety or the depositary may each have a copy. On and after September 1, 1953, the functions of the Commissioner with respect to such bonds shall be performed by the district director of internal revenue for the internal revenue district in which the return was filed and any bond filed on or after such date shall be filed with such district director.

(b) Pending the completion of the liquidation, if there is a compliance with subparagraphs (1), (2), and (3) of paragraph (a) of this section and § 1.332–2 with respect to the nonrecognition of gain or loss, the income and profits tax liability of the recipient corporation for each of the years covered in whole or in part by the liquidation shall be determined without the recognition of any gain or loss on account of the receipt of the distributions in liquidation. In such determination, the basis of the property or properties received by the recipient corporation shall be determined in accordance with section 334 (b). However, if the transfer of the property is not completed within the three-year period allowed by section 332 or if the recipient corporation does not continue qualified with respect to the ownership of stock of the liquidating corporation as required by that section, gain or loss shall be recognized with respect to each distribution and the tax liability for each of the years covered in whole or in part by the liquidation shall be recomputed without regard to the provisions of section 332 or section 334(b) and the amount of any additional tax due upon such recomputation shall be promptly paid.

§ 1.332-5. Distributions in Liquidation as Affecting Minority Interests.—Upon the liquidation of a corporation in pursuance of a plan of complete liquidation, the gain or loss of minority shareholders shall be determined without regard to section 332, since it does not apply to that part of distributions in liquidation received by minority shareholders.

§ 1.332-6. Records To Be Kept and Information To Be Filed With Return.—(a) Permanent records in substantial form shall be kept by every corporation receiving distributions in complete liquidation within the exception provided in section 332 showing the information required by this section to be submitted with its return. The plan of liquidation must be adopted by each of the corporations parties thereto; and the adoption must be shown by the acts of its duly constituted responsible officers, and appear upon the official records of each such corporation.

(b) For the taxable year in which the liquidation occurs, or, if the plan of liquidation provides for a series of distributions over a period of more than one year, for each taxable year in which a distribution is received under the plan the recipient must file with its return a complete statement of all facts pertinent to the nonrecognition of gain or loss, including—

(1) A certified copy of the plan for complete liquidation, and of the resolutions under which the plan was adopted and the liquidation was authorized, together with a statement under oath showing in detail all transactions incident to, or pursuant to, the plan.

(2) A list of all the properties received upon the distribution, showing the cost or other basis of such properties to the liquidating corporation at the date of distribution and the fair market value of such properties on the date distributed.

(3) A statement of any indebtedness of the liquidating corporation to the recipient corporation on the date the plan of liquidation was adopted and on the date of the first liquidating distribution. If any such indebtedness was acquired at less than face value, the cost thereof to the recipient corporation must also be shown.

(4) A statement as to its ownership of all classes of stock of the liquidating corporation (showing as to each class the number of shares and percentage owned and the voting power of each share) as of the date of the adoption of the plan of liquidation, and at all times since, to and including the date of the distribution in liquidation. The cost or other basis of such stock and the date or dates on which purchased must also be shown.

§ 1.332-7 Indebtedness of Subsidiary to Parent.—If section 332(a) is applicable to the receipt of the subsidiary's property in complete liquidation, then no gain or loss shall be recognized to the subsidiary upon the transfer of such properties even though some of the properties are transferred in satisfaction of the subsidiary's indebtedness to its parent. However, any gain or loss realized by the parent corporation on such satisfaction of indebtedness, shall be recognized to the parent corporation at the time of the liquidation. For example, if the parent corporation purchased its subsidiary's bonds at a dis-

count and upon liquidation of the subsdiary the parent corporation receives payment for the face amount of such bonds, gain shall be recognized to the parent corporation. Such gain shall be measured by the difference between the cost or other basis of the bonds to the parent and the amount received in payment of the bonds.

§ 1.333. STATUTORY PROVISIONS; ELECTION AS TO RECOGNITION OF GAIN IN CERTAIN LIQUIDATIONS.

SEC. 333. ELECTION AS TO RECOGNITION OF GAIN IN CERTAIN LIQUIDATIONS.

(a) GENERAL RULE.—In the case of property distributed in complete liquidation of a domestic corporation (other than a collapsible corporation to which section 341 (a) applies), if—

(1) The liquidation is made in pursuance of a plan of liquidation adopted on or after June 22, 1954, and

(2) The distribution is in complete cancellation or redemption of all the stock, and the transfer of all the property under the liquidation occurs within some one calendar month,

then in the case of each qualified electing shareholder (as defined in subsection (c)) gain on the shares owned by him at the time of the adoption of the plan of liquidation shall be recognized only to the extent provided in subsections (e) and (f).

(b) EXCLUDED CORPORATION.—For purposes of this section, the term "excluded corporation" means a corporation which at any time between January 1, 1954, and the date of the adoption of the plan of liquidation, both dates inclusive, was the owner of stock possessing 50 percent or more of the total combined voting power of all classes of stock entitled to vote on the adoption of such plan.

(c) QUALIFIED ELECTING SHAREHOLDERS.—For purposes of this section, the term "qualified electing shareholder" means a shareholder (other than an excluded corporation) of any class of stock (whether or not entitled to vote on the adoption of the plan of liquidation) who is a shareholder at the time of the adoption of such plan, and whose written election to have the benefits of subsection (a) has been made and filed in accordance with subsection (d), but—

(1) In the case of a shareholder other than a corporation, only if written elections have been so filed by shareholders (other than corporations) who at the time of the adoption of the plan of liquidation are owners of stock possessing at least 80 percent of the total combined voting power (exclusive of voting power possessed by stock owned by corporations) of all classes of stock entitled to vote on the adoption of such plan of liquidation; or

(2) In the case of a shareholder which is a corporation, only if written elections have been so filed by corporate shareholders (other than an excluded corporation) which at the time of the adoption of such plan of liquidation are owners of stock possessing at least 80 percent of the total combined voting power (exclusive of voting power possessed by stock owned by an excluded corporation and by shareholders who are not corporations) of all classes of stock entitled to vote on the adoption of such plan of liquidation.

(d) MAKING AND FILING OF ELECTIONS.—The written elections referred to in subsection (c) must be made and filed in such manner as to be not in contravention of regulations prescribed by the Secretary or his delegate. The filing must be within 30 days after the date of the adoption of the plan of liquidation.

(e) NONCORPORATE SHAREHOLDERS.—In the case of a qualified electing shareholder other than a corporation—

(1) There shall be recognized, and treated as a dividend, so much of the gain as is not in excess of his ratable share of the earnings and profits of the corporation accumulated after February 28, 1913, such earnings and profits to be determined as of the close of the month in which the transfer in liquidation occurred under subsection (a) (2), but without diminution by reason of dis-

tributions made during such month; but by including in the computation thereof all amounts accrued up to the date on which the transfer of all the property under the liquidation is completed; and

(2) There shall be recognized, and treated as short-term or long-term capital gain, as the case may be, so much of the remainder of the gain as is not in excess of the amount by which the value of that portion of the assets received by him which consists of money, or of stock or securities acquired by the corporation after December 31, 1953, exceeds his ratable share of such earnings and profits.

(f) CORPORATE SHAREHOLDERS.—In the case of a qualified electing shareholder which is a corporation, the gain shall be recognized only to the extent of the greater of the two following—

(1) The portion of the assets received by it which consists of money, or of stock or securities acquired by the liquidating corporation after December 31, 1953; or

(2) Its ratable share of the earnings and profits of the liquidating corporation accumulated after February 28, 1913, such earnings and profits to be determined as of the close of the month in which the transfer in liquidation occurred under subsection (a)(2), but without diminution by reason of distributions made during such month; but by including in the computation thereof all amounts accrued up to the date on which the transfer of all the property under the liquidation is completed.

§ 1.333–1. CORPORATE LIQUIDATION IN SOME ONE CALENDAR MONTH—(a) *In general.* Section 333 provides a special rule, in the case of certain specifically described complete liquidations of domestic corporations (other than collapsible corporations to which section 341(a) applies) occurring within some one calendar month, for the treatment of gain on the shares of stock owned by qualified electing shareholders at the time of the adoption of the plan of liquidation. The effect of such section is in general to postpone the recognition of that portion of a qualified electing shareholder's gain on the liquidation which would otherwise be recognized and which is attributable to appreciation in the value of certain corporate assets unrealized by the corporation at the time such assets are distributed in complete liquidation. Only qualified electing shareholders are entitled to the benefits of section 333. The determination of who is a qualified electing shareholder is to be made under section 333(c). For the basis of property received on such liquidations, see section 334(c). Section 333 has no application to collapsible corporations. See section 341(b) for definition of collapsible corporations.

(b) *Type of Liquidation.* (1) The liquidation must be in pursuance of a plan of liquidation adopted on or after June 22, 1954. The plan must be adopted before the first distribution under the liquidation occurs. The 1954 Code requires that the transfer of all the property, both tangible and intangible, of the corporation to its shareholders shall occur entirely within some one calendar month. This requirement will be considered to have been complied with if cash is set aside under arrangements for the payment, after the close of such month, of unascertained or contingent liabilities and expenses, and such arrangements are made in good faith and the amount set aside is reasonable. It is not necessary that the month in which the transfer occurs must fall within the taxable or calendar year in which the plan of liquidation is adopted. Though it is not necessary that the corporation dissolve in the month of liquidation, it is essential that a status of liquidation exist at the time the first distribution is made

under the plan and that such status continue to the date of dissolution of the corporation. A status of liquidation exists when the corporation ceases to be a going concern and its activities are merely for the purpose of winding up its affairs, paying its debts, and distributing any remaining balance to its shareholders.

(2) If a transaction constitutes a distribution in complete liquidation within the meaning of the 1954 Code and satisfies the requirements of section 333, it is immaterial that it is otherwise described under the local law.

§ 1.333-2. QUALIFIED ELECTING SHAREHOLDER.—(a) No corporate shareholder may be a qualified electing shareholder if at any time between January 1, 1954 and the date of the adoption of the plan of liquidation, both dates inclusive, it is the owner of stock of the liquidating corporation possessing 50 percent or more of the total combined voting power of all classes of stock entitled to vote upon the adoption of the plan of liquidation. All other shareholders are divided into two groups for the purpose of determining whether they are qualified electing shareholders: (1) shareholders other than corporation, and (2) corporate shareholders.

(b) Any shareholder of either of such two groups, whether or not the stock he owns is entitled to vote on the adoption of the plan of liquidation, is a qualified electing shareholder if—

(1) His written election to be governed by the provisions of section 333, which cannot be withdrawn or revoked, has been made and filed as prescribed in § 1.333-3; and

(2) Like elections have been made and filed by owners of stock possessing at least 80 percent of the total combined voting power of all classes of stock owned by shareholders of the same group at the time of, and entitled to vote upon, the adoption of the plan of liquidation, whether or not the shareholders making such elections actually realize gain upon the cancellation or redemption of such stock upon the liquidation.

(c) The application of this section may be illustrated by the following example:

Example. The R Corporation has outstanding 20 shares of common stock on July 1, 1954, at the time of the adoption of a plan of liquidation within the provisions of section 333, each entitled to one vote upon the adoption of such plan of liquidation. At that time ten of such shares are owned by the S Corporation, two each by the X Corporation and the Y Corporation, one by the Z Corporation, and one each by A, B, C, D, and E, individuals. There are also outstanding at such time two shares of preferred stock, not entitled to vote on liquidation, one share being owned by F, an individual, and one share by the P Corporation. The S Corporation, being a corporate shareholder and the owner of 50 percent of the voting stock, may not be a qualified electing shareholder under any circumstances. In order for any other corporate shareholder to be a qualified electing shareholder, it is necessary that the X Corporation and the Y Corporation file their written elections to be governed by section 333. If this is done, the P Corporation will also be a qualified electing share-

holder if it has filed a like election. Similarly, in the case of the individual shareholders, some combination of four of the individual holders of the common stock must have filed their written elections, before any individual shareholder may be considered a qualified electing shareholder, but if this is done, F will also be a qualified electing shareholder if he has filed a like election.

(d) An election to be governed by the provisions of section 333 relates to the treatment of gain realized upon the cancellation or redemption of stock upon liquidation. Such election, therefore, can be made only by or on behalf of the person by whom gains, if any, will be realized. Thus, the shareholder who may make such election must be the actual owner of stock and not a mere record holder, such as a nominee.

(e) A shareholder is entitled to make an election relative to the gain only on stock owned by him at the time of the adoption of the plan of liquidation. The election is personal to the shareholder making it and does not follow such stock into the hands of a transferee.

§ 1.333-3. MAKING AND FILING OF WRITTEN ELECTIONS.—An election to be governed by section 333 shall be made on Form 964 (revised) in accordance with the instructions printed thereon and with this section. The original and one copy shall be filed by the shareholder with the district director of internal revenue with whom the final income tax return of the corporation will be filed. The elections must be filed within 30 days after the adoption of the plan of liquidation. Under no circumstances shall section 333 be applicable to any shareholders who fail to file their elections within the 30-day period prescribed. An election shall be considered as timely filed if it is placed in the mail on or before midnight of the 30th day after the adoption of the plan of liquidation, as shown by the postmark on the envelope containing the written election or as shown by other available evidence of the mailing date. Another copy of the election shall be attached to and made a part of the shareholder's income tax return for his taxable year in which the transfer of all the property under the liquidation occurs.

§ 1.333-4. TREATMENT OF GAIN—(a) *Computation of gain.* As in the case of shareholders generally, amounts received by qualified electing shareholders are treated as in full payment in exchange for their stock, as provided in section 331 and gain from the receipt of such amounts is determined as provided in section 1001. Gain or loss must be computed separately on each share of stock owned by a qualified electing shareholder at the time of the adoption of the plan of liquidation. The limited recognition and special treatment accorded by section 333 applies only to the gain on such shares of stock upon which gain was realized and not to net gain computed by setting off losses realized on some shares against gain on others. Since section 333 applies only to gain recognized, losses realized on the liquidation will be allowed only in the year of liquidation even though Forms 964 (revised) have been filed by those shareholders who realize only losses. Such filings may be necessary to fulfill the 80 percent requirement (under section 332(b)) so that those shareholders who realize gain may qualify under this section.

(b) *Recognition of gain.* Pursuant to section 333 only so much of the gain on each share of stock owned by a qualified electing shareholder at the time of the adoption of the plan of liquidation is recognized as does not exceed the greater of the following:

(1) Such share's ratable share of the earnings and profits of the corporation accumulated after February 28, 1913, computed as of the last day of the month of liquidation, without diminution by reason of distributions made during such month, and including in such computation all items of income and expense accrued up to the date on which the transfer of all the property under the liquidation is completed; or

(2) Such share's ratable share of the sum of the amount of money received by such shareholder on shares of the same class and the fair market value of all the stock or securities so received which were acquired by the liquidating corporation after December 31, 1953. The mere replacement after December 31, 1953 of lost or destroyed certificates or instruments acquired on or before December 31, 1953, or the mere conversion of certificates or instruments into certificates or instruments of larger or smaller denominations will not constitute an acquisition within the meaning of the phrase "acquired after December 31, 1953." Nor will such an acquisition result from the issuance after December 31, 1953 of certificates of stock in connection with a subscription made and accepted on or before December 31, 1953.

(c) *Treatment of recognized gain.* (1) In the case of a qualified electing shareholder other than a corporation, that part of the recognized gain on a share of stock owned at the time of the adoption of the plan of liquidation which is not in excess of his ratable share of the earnings and profits of the liquidating corporation accumulated after February 28, 1913, determined as provided in section 333(e)(1), is treated as a dividend. It retains its character as a dividend for all tax purposes. The remainder of the gain which is recognized is treated as a short-term or long-term capital gain, as the case may be. In the case of a qualified electing shareholder which is a corporation, the entire amount of the gain which is recognized is treated as a short-term or long-term capital gain, as the case may be.

(2) The application of subparagraph (1) of this paragraph may be illustrated by the following example:

Example. (i) X Corporation has only one class of stock outstanding, owned in equal amounts by three shareholders. The basis of the stock owned by each shareholder is $50, each having bought his stock in a single block prior to the date of the adoption of a plan of liquidation conforming to the requirements of section 333. One of the shareholders is an individual; two are corporations. All are "qualified electing shareholders".

(ii) X Corporation has earnings and profits accumulated after February 28, 1913 of $60 (computed as provided in section 333). Its assets consist of (*a*) cash of $75, (*b*) stock and securities acquired after December 31, 1953, having a fair market value of $90, and (*c*) other property having a fair market value of $240. In October 1954, all of these assets are distributed to the

shareholders pro rata in complete liquidation of the corporation, as provided in section 333. Each shareholder thus receives $135 in cash and property, and has $85 gain.

(iii) $55 of each shareholder's gain is recognized since such amount represents the sum of (*a*) the cash received by him and (*b*) the fair market value of the stock and securities received by him which were acquired by the X Corporation after December 31, 1953, and is greater than his ratable share of the earnings and profits ($20). The remainder of each shareholder's gain ($30) is not recognized.

(iv) In the case of the corporate shareholders the entire amount of the recognized gain ($55) is treated as capital gain. In the case of the individual shareholder, $20, being the amount of the shareholder's ratable share of the earnings and profits, is recognized and treated as a dividend, and $35, being the difference between the shareholder's ratable share of the earnings and profits and the sum of the cash and stock and securities received by him, is treated as a short-term or long-term capital gain as the case may be.

(v) If the basis of each shareholder's stock had been $100, instead of $50, each of the corporate shareholders would be taxed on only $35 as capital gain and the individual shareholder would be taxed on $20 as a dividend and on only $15 as capital gain, since the total amount taxed is limited to the amount of gain realized by the shareholder upon the cancellation or redemption of his stock.

§ 1.333-5. Records To Be Kept and Information To Be Filed With Return.—(a) Permanent records in substantial form shall be kept by every qualified electing shareholder receiving distributions in complete liquidation of a domestic corporation. Such shareholder must file with his income tax return for his taxable year in which the liquidation occurs a statement of all facts pertinent to the recognition and treatment of the gain realized by him upon the shares of stock owned by him at the time of the adoption of the plan of liquidation, including:

(1) A statement of his stock ownership in the liquidating corporation as of the date of the distribution, showing the number of shares of each class owned on such date and the cost or other basis of each such share;

(2) A list of all the property including money, received upon the distribution, showing the fair market value of each item of such property other than money on the date distributed and stating what items, if any, consist of stock or securities acquired by the liquidating corporation after December 31, 1953.

(3) A statement of his ratable share of the earnings and profits of the liquidating corporation accumulated after February 28, 1913, computed without diminution by reasons of distributions made during the month of liquidation; and

(4) A copy of such shareholder's written election to be governed by the provisions of section 333. (See § 1.333-3.)

(b) For information to be filed by the liquidating corporation, see section 6043.

§ 1.334. STATUTORY PROVISIONS; CORPORATE LIQUIDATIONS; BASIS OF PROPERTY RECEIVED IN LIQUIDATIONS.

SEC. 334. BASIS OF PROPERTY RECEIVED IN LIQUIDATIONS.

(a) GENERAL RULE.—If property is received in a distribution in partial or complete liquidation (other than a distribution to which section 333 applies), and if gain or loss is recognized in receipt of such property, then the basis of the property in the hands of the distributee shall be the fair market value of such property at the time of the distribution.

(b) LIQUIDATION OF SUBSIDIARY.—

(1) IN GENERAL.—If property is received by a corporation in a distribution in complete liquidation of another corporation (within the meaning of section 332(b)), then, except as provided in paragraph (2), the basis of the property in the hands of the distributee shall be the same as it would be in the hands of the transferor. If property is received by a corporation in a transfer to which section 332(c) applies, and if paragraph (2) of this subsection does not apply, then the basis of the property in the hands of the transferee shall be the same as it would be in the hands of the transferor.

(2) EXCEPTION.—If property is received by a corporation in a distribution in complete liquidation of another corporation (within the meaning of section 332(b)), and if—

(A) The distribution is pursuant to a plan of liquidation adopted—

(i) On or after June 22, 1954, and

(ii) Not more than 2 years after the date of the transaction described in subparagraph (B) (or, in the case of a series of transactions, the date of the last such transaction); and

(B) Stock of the distributing corporation possessing at least 80 percent of the total combined voting power of all classes of stock entitled to vote, and at least 80 percent of the total number of shares of all other classes of stock (except nonvoting stock which is limited and preferred as to dividends), was acquired by the distributee by purchase (as defined in paragraph (3)) during a period of not more than 12 months.

then the basis of the property in the hands of the distributee shall be the adjusted basis of the stock with respect to which the distribution was made. For purposes of the preceding sentence, under regulations prescribed by the Secretary or his delegate, proper adjustment in the adjusted basis of any stock shall be made for any distribution made to the distributee with respect to such stock before the adoption of the plan of liquidation, for any money received, for any liabilities assumed or subject to which the property was received, and for other items.

(3) PURCHASE DEFINED.—For purposes of paragraph (2)(B), the term "purchase" means any acquisition of stock, but only if—

(A) The basis of the stock in the hands of the distributee is not determined (i) in whole or in part by reference to the adjusted basis of such stock in the hands of the person from whom acquired, or (ii) under section 1014(a) (relating to property acquired from a decedent),

(B) The stock is not acquired in an exchange to which section 351 applies, and

(C) The stock is not acquired from a person the ownership of whose stock would, under section 318(a), be attributed to the person acquiring such stock.

(4) DISTRIBUTEE DEFINED.—For purposes of this subsection, the term "distributee" means only the corporation which meets the 80 percent stock ownership requirements specified in section 332(b).

(c) PROPERTY RECEIVED IN LIQUIDATION UNDER SECTION 333.—If—

(1) Property was acquired by a shareholder in the liquidation of a corporation in cancellation or redemption of stock, and

(2) With respect to such acquisition—

(A) Gain was realized, but

(B) As the result of an election made by the shareholder under section 333, the extent to which gain was recognized was determined under section 333,

then the basis shall be the same as the basis of such stock cancelled or redeemed in the liquidation, decreased in the amount of any money received by the shareholder, and increased in the amount of gain recognized to him.

§ 1.334–1. Basis of Property Received in Liquidations—(a) *In general.* Section 334 sets forth rules prescribing the basis of property received in a distribution in partial or complete liquidation of a corporation. The general rule of section 334 is set forth in section 334(a) to the effect that if property is received in a distribution in partial or complete liquidation and if gain or loss is recognized on the receipt of such property, then the basis of the property in the hands of the distributees shall be the fair market value of such property at the time of the distribution. Such general rule has no application to a liquidation to which section 332 or section 333 applies. See section 334(b) and (c).

(b) *Transferor's basis.* Unless section 334(b)(2) and subsection (c) of this section apply, property received by a parent corporation in a complete liquidation to which section 332 is applicable shall, under section 334(b)(1), have the same basis in the hands of the parent as its adjusted basis in the hands of the subsidiary. The rule stated above is applicable even though the subsidiary was indebted to the parent on the date the plan of liquidation was adopted and part of such property was received in satisfaction of such indebtedness in a transfer to which section 332(c) is applicable.

(c) *Application of stock basis to property.* If section 334(b)(2) applies to a complete liquidation to which section 332 is applicable, then property received by a parent corporation in such complete liquidation shall have a basis determined by reference to the basis of the stock of the subsidiary corporation with respect to which it is received. In general, section 334(b)(2) will be applicable to a distribution in complete liquidation of a subsidiary corporation if the parent corporation purchased, within the meaning of section 334(b)(3)(3) and during a period of not more than twelve months, 80 percent or more of the stock (other than nonvoting stock which is limited and preferred as to dividends) of the subsidiary corporation and then adopted a plan of liquidation (on or after June 22, 1954) not more than two years after the date on which the stock ownership requirement was met. The application of section 334(b)(2) is subject to the following rules:

(1) Property received with reference to stock owned immediately before the liquidation by the parent corporation is the only property to which section 334(b)(2) is applicable. The section is not applicable to property received with respect to debt or other claims. The basis of the stock used in determining the basis of the assets is the total basis of all stock held by the parent corporation whether or not such stock was acquired by purchase and whether or not such stock is the stock acquired during the period to which reference is made in section 334(b)(2)(A).

(2) The date of adoption of a plan of liquidation is determined under section 332(b)(2).

(3) (i) In the case of a series of purchases of stock, the two-year period specified in section 334(b) (2) (A) shall begin on the day following the date of the last such purchase if the amount of stock specified in section 334(b) (2) (B) is purchased during the preceding 12 months.

(ii) Application of the rule prescribed in subparagraph (3) (i) may be illustrated by the following examples:

Example (1). Twenty percent of the stock of Corporation A is purchased on each of the following dates: April 1, 1954, June 30, 1954, September 30, 1954, December 31, 1954, and April 1, 1955. Although 80 percent of the stock of Corporation A had been purchased as of December 31, 1954, the date of the last transaction of the series of transactions described in section 334(b) (2) (B) is April 1, 1955, and therefore the two-year period shall begin on April 2, 1955.

Example (2). The facts are the same as in example (1) except that the last purchase is made on July 1, 1955. Since the date of the last transaction of the series of transactions described in section 334(b) (2) (B) is December 31, 1954, the two-year period shall begin on January 1, 1955.

(4) For the purpose of section 334(b) (2) only, the following adjustments shall be made to the adjusted basis of the subsidiary's stock in the hands of the parent:

(i) Such adjusted basis shall be reduced by the amount of all distributions received by the parent from the subsidiary during the period beginning on the day on which the stock used in determining the applicability of section 334(b) (2) was purchased (or if such stock was purchased on more than one day, on the day of the earliest purchase of the stock so used) and ending when the plan of liquidation is adopted.

(ii) In order to apply the rule of (i) the amount of a distribution in kind shall be whichever of the following is the greater:

(*a*) The amount described in section 301(b) (1) (B) (ii) (regardless of the amount of the distribution under section 301(b)), or

(*b*) The portion of the adjusted basis of the stock allocable to the property so distributed.

(iii) The reduction provided in (i) shall be made whether or not such distributions were taxable to the parent as ordinary dividends.

(iv) The reduction provided in (i) shall not be made—

(*a*) To the extent that a reduction in the adjusted basis of the stock is required by section 301(c) (2); or

(*b*) To the extent that such distributions of the subsidiary are out of earnings and profits of the period beginning on the date of purchase and ending upon the date of the last distribution in liquidation.

(v) The adjusted basis of the subsidiary's stock held by the parent with respect to which the distributions in liquidation are made (reduced as in (i))—

(*a*) Shall be increased—

(*1*) By the amount of any unsecured liabilities assumed by the parent, and

(*2*) By the portion of the subsidiary's earnings and profits (less the amount of any distributions therefrom) of the period beginning on the date of purchase and ending upon the date of the last distribution in liquidation attributable to the stock of the subsidiary held by the parent.

(*b*) Shall be decreased—

(*1*) By the amount of any cash and its equivalent received, and

(*2*) By the portion of the subsidiary's deficit in earnings and profits of the period beginning on the date of purchase and ending upon the date of the last distribution in liquidation attributable to the stock of the subsidiary held by the parent.

(vi) For the purpose of (v) (*a*) (*2*) and (*b*) (*2*)—

(*a*) With respect to property held on the date of purchase and property held on the date additional stock, if any, is acquired any gain or loss from sales or exchanges of such property (whether tangible or intangible) and any other items determined by reference to basis of such property shall be computed by substituting for such basis a new basis determined by reference to the part of the adjusted basis of the stock allocable to such property,

(*b*) The part of the adjusted basis of stock allocable to such property for the purpose of (*a*) shall be the basis of the stock held on the date of purchase or on the date of a later acquisition of stock allocated among the assets held on such date on the basis of their net fair market values on such date,

(*c*) In order to prevent distortion in the adjusted basis of the stock—

(*1*) Transactions (including distributions, liquidations, and reorganizations) involving a corporation the affairs of which the subsidiary controls at any time after the date of purchase through ownership of stock (whether or not the subsidiary owns a majority of the stock of such corporation) may be disregarded in whole or in part, and

(*2*) Tax-free reorganizations involving the subsidiary may be disregarded in whole or in part, and

(*d*) In the case of a subsidiary using the cash receipts and disbursements method of accounting, the earnings and profits of such subsidiary shall be computed for the period specified in (v) (*a*) (*2*) and (*b*) (*2*) as if such subsidiary had used an accrual method of accounting prior to such period.

(vii) For the purposes of subdivisions (iv), (v), and (vi) the expression "the date of purchase" means the date of the transaction described in section 334(b)(2)(B) (or, in the case of a series of transactions, the date of the last such trans-

action), determined without regard to subparagraph (6) (iii).

(viii) In the case of a distribution by the subsidiary of property directly or indirectly acquired by the subsidiary through a direct or indirect contribution to capital by the parent, the basis of such property to the parent shall be the same as if such contribution had not been made and the adjusted basis of the stock shall not be increased or decreased because of such contribution and distribution. Except as provided in the preceding sentence, the amount of the adjusted basis of the stock adjusted as provided in this paragraph shall be allocated as basis among the various assets received (except cash and its equivalent) both tangible and intangible (whether or not depreciable or amortizable). Ordinarily, such allocation shall be made in proportion to the net fair market values of such assets on the date received (the net fair market value of an asset being its fair market value less any specific mortgage or pledge to which it is subject). To that portion of the basis thus determined, for each property against which there is a lien, should be added the amount of such lien. Where more than one property is covered by the same lien, the amount of the lien should be divided among the properties, allocating to each that portion of the lien which the fair market value of such property bears to the total fair market value of the properties covered by the same lien. Whether the mortgage indebtedness is assumed by the parent or the property is taken subject to the mortgage is immaterial. The basis of the property received shall be zero if the cash and its equivalent received is equal to or in excess of the adjusted basis of the stock.

(5) The application of the rules prescribed in (4) may be illustrated by the following examples:

Example (1). Corporation A bought all of the stock of Corporation B for $1,000 on January 1, 1955. The only asset of Corporation B was a building having a basis of $100. On July 1, 1955, such building was sold for $1,050. The amount received was invested in another building immediately thereafter. On December 30, 1955, Corporation B was liquidated under section 332 in a transaction in which the basis of the assets in the hands of the recipient corporation was determined under section 334(b)(2). The basis of the stock of Corporation B in the hands of Corporation A is increased by $50 pursuant to § 1.334–1(c)(4)(v) and (vi). The basis of the building received by Corporation A upon the liquidation of Corporation B is $1,050.

Example (2). The facts are the same as in example (1) except that the sale price of the building sold was $750. The basis of the building in the hands of Corporation A upon liquidation is $750.

(6) For the purposes of section 334(b)(2) the term "purchase" means any acquisition of stock, but only if—

(i) The basis of stock in the hands of the distributee is not determined either in whole or in part by reference to the

adjusted basis of stock in the hands of the person from whom acquired, or under section 1014(a) (relating to property acquired from the decedent);

(ii) The stock is not acquired in an exchange to which section 351 applies; and

(iii) The stock is not acquired from a person the ownership of whose stock would, under section 318(a), be attributed to the person acquiring such stock. However, if a corporation acquires stock pursuant to an option to buy such stock from a person who, without regard to such option, is not a person the ownership of whose stock would, under section 318(a), be attributed to such corporation, such stock shall be considered to have been purchased on the date of the acquisition of such option, if such option is exercised on or before the last day of a period of 12 months beginning on the day of the earliest purchase of stock (including the stock subject to such option) used in determining the applicability of section 334(b)(2) and for this purpose the stock with respect to which the option was exercised shall be deemed to have been purchased on the date such option was acquired.

(7) Section 334(b) does not apply to minority shareholders. The basis of property, other than cash, received by such shareholders shall be determined under section 334(a), 334(c) or 358.

§ 1.334-2. Property Received in Liquidation Under Section 333.—The basis of assets (other than money) acquired by stockholders in a liquidation upon which the amount of gain recognized was limited under section 333 shall be the same as the basis of the shares of stock redeemed or cancelled, decreased in the amount of any money received and increased in the amount of gain recognized and the amount of the unsecured liabilities assumed by the stockholders. The amount thus arrived at should be allocated to the various assets received on the basis of their net fair market values (the net fair market value of an asset is its fair market value less any specific mortgage or pledge to which it is subject). To that portion of the basis thus determined, for each property against which there is a lien, should be added the amount of such lien. Where more than one property is covered by the same lien, the amount of the lien should be divided among the properties, allocating to each that portion of the lien that the fair market value of such property bears to the total market value of the properties covered by the same lien. Whether the mortgage indebtedness is assumed by the shareholders or the property is taken subject to the mortgage is immaterial. The application of this section may be illustrated by the following example:

Example. The X Corporation distributed all its property in complete liquidation during the month of October 1954 pursuant to the provisions of section 333. A, an individual, and a qualifying electing shareholder, received, in cancellation or redemption of 100 shares of stock owned by him at the time of the adoption of the plan of liquidation, $1,000 in cash, property (other than stock or securities acquired by the corporation after December 31, 1953) with a fair market value of $22,000 subject to a lien of $1,000, and stock acquired by the liquidating corporation

after December 31, 1953 with a fair market value of $4,000. A, also assumed a $2,000 liability of the liquidating corporation. The basis of the shares owned by A was $120 per share or $12,000. A's ratable share of the earnings and profits of the X Corporation accumulated after February 28, 1913 (computed as provided in section 333) was $2,500. His gain is $12,000, but under section 333 only $5,000 of this gain is recognized, $2,500 thereof being taxed as a dividend. The basis of all the property other than money received by A is $19,000, computed as follows:

Adjusted basis of stock cancelled or redeemed	$12,000
Less: money received	1,000
Remainder	$11,000
Liability assumed	2,000
Specific lien against property (other than stock)	1,000
Gain recognized	5,000
Basis of property acquired	$19,000

The basis, excluding the specific lien attached to the property, ($19,000 less $1,000, $18,000) will be apportioned among the classes of property other than money received as follows: $21,000/$25,000 of $18,000 or $15,120 to the property other than stock; $4,000/$25,000 of $18,000 or $2,880 to the stock. The basis of the property other than stock, $15,120, must be increased by the amount of the specific lien attached thereto, $1,000, making a total basis for such property of $16,120.

EFFECTS ON CORPORATION

§ 1.336. STATUTORY PROVISIONS; GENERAL RULE.

SEC. 336. GENERAL RULE.

Except as provided in section 453(d) (relating to disposition of installment obligations), no gain or loss shall be recognized to a corporation on the distribution of property in partial or complete liquidation.

§ 1.336–1. GENERAL RULE ON LIQUIDATION OF CORPORATION.—Except as provided in section 453(d), no gain or loss is recognized to a corporation on the distribution by it of property in kind in partial or complete liquidation (regardless of the fact that such property may have appreciated or depreciated in value since its acquisition by the corporation). However, gain or loss is recognized to a corporation on all sales by it, whether directly or indirectly (as through trustees or a receiver), except as provided in section 337 (relating to sales or exchanges in connection with certain liquidations). See sections 61, 6036, 6155(a), 6161(c), 6503(b), 6601, 6871, 6872 and 6873.

§ 1.337. STATUTORY PROVISIONS; GAIN OR LOSS ON SALES OR EXCHANGES IN CONNECTION WITH CERTAIN LIQUIDATIONS.

SEC. 337. GAIN OR LOSS ON SALES OR EXCHANGES IN CONNECTION WITH CERTAIN LIQUIDATIONS

(a) GENERAL RULE.—If—

(1) A corporation adopts a plan of complete liquidation on or after June 22, 1954, and

(2) Within the 12-month period beginning on the date of the adoption of such plan, all of the assets of the corporation are distributed in complete liquidation, less assets retained to meet claims,

then no gain or loss shall be recognized to such corporation from the sale or exchange by it of property within such 12-month period.

(b) PROPERTY DEFINED.—

(1) IN GENERAL.—For purposes of subsection (a), the term "property" does not include—

(A) Stock in trade of the corporation, or other property of a kind which would properly be included in the inventory of the corporation if on hand at the close of the taxable year, and property held by the corporation primarily for sale to customers in the ordinary course of its trade or business,

(B) Installment obligations acquired in respect of the sale or exchange (without regard to whether such sale or exchange occurred before, on, or after the date of the adoption of the plan referred to in subsection (a)) of stock in trade or other property described in subparagraph (a) of this paragraph, and

(C) Installment obligations acquired in respect of property (other than property described in subparagraph (A)) sold or exchanged before the date of the adoption of such plan of liquidation.

(2) NONRECOGNITION WITH RESPECT TO INVENTORY IN CERTAIN CASES.—Notwithstanding paragraph (1) of this subsection, if substantially all of the property described in subparagraph (A) of such paragraph (1) which is attributable to a trade or business of the corporation is, in accordance with this section, sold or exchanged to one person in one transaction, then for purposes of subsection (a) the term "property" includes—

(A) Such property so sold or exchanged, and

(B) Installment obligations acquired in respect of such sale or exchange.

(c) LIMITATIONS.—

(1) COLLAPSIBLE CORPORATIONS AND LIQUIDATIONS TO WHICH SECTION 333 APPLIES.—This section shall not apply to any sale or exchange—

(A) Made by a collapsible corporation (as defined in section 341 (b)), or

(B) Following the adoption of a plan of complete liquidation, if section 333 applies with respect to such liquidation.

(2) LIQUIDATIONS TO WHICH SECTION 332 APPLIES.—In the case of a sale or exchange following the adoption of a plan of complete liquidation, if section 332 applies with respect to such liquidation, then—

(A) If the basis of the property of the liquidating corporation in the hands of the distributee is determined under section 334(b)(1), this section shall not apply; or

(B) If the basis of the property of the liquidating corporation in the hands of the distributee is determined under section 334(b)(2), this section shall apply only to that portion (if any) of the gain which is not greater than the excess of (i) that portion of the adjusted basis (adjusted for any adjustment required under the second sentence of section 334(b)(2)) of the stock of the liquidating corporation which is allocable, under regulations prescribed by the Secretary or his delegate, to the property sold or exchanged, over (ii) the adjusted basis, in the hands of the liquidating corporation, of the property sold or exchanged.

§ 1.337–1. GENERAL.—Except as provided in sections 337(c) and 392(b), if a corporation distributes all of its assets in complete liquidation within 12 months after the adoption of a plan of liquidation, which plan must be adopted on or after June 22, 1954, no gain or loss shall be recognized from the sale of property (as defined in section 337(b)) during such 12-month period. For this purpose such sales may be made before the adoption of the plan of liquidation if made on the same day such plan is adopted. All assets (less assets retained to meet claims), both tangible and intangible, must be distributed

within the 12-month period. Any assets retained after the expiration of the 12-month period for the payment of claims (including unascertained or contingent liabilities or expenses) must be specifically set apart for that purpose and must be reasonable in amount in relation to the items involved. The 12-month period shall begin on the date of adoption of the plan determined as provided in § 1.337–2(b) and no extension of such period can be granted. See section 453(d)(4)(B) relative to nonrecognition of gain on the distribution of certain installment obligations. Sales or exchanges made by a collapsible corporation (as defined in section 341(b)) are excluded from the operation of section 337 by section 337(c). Accordingly, section 337 does not apply to any sale or exchange of property whenever the distribution of such property in partial or complete liquidation to the shareholders in lieu of such sale or exchange would have resulted in the taxation of the gain from such distribution in the manner provided in section 341(a) as to any shareholder or would have resulted in the taxation of the gain in such manner, but for the application of section 341(d). Likewise, section 337 does not apply to sales or exchanges made by a corporation if such corporation is liquidated in a transaction to which section 333 is applicable, or in a transaction to which section 332 applies (except to the extent provided in section 337(c)(2)(B)). Section 392(b) provides special rules with respect to the recognition of gain or loss upon certain sales made by a liquidating corporation during 1954 and 1955.

§ 1.337–2. Sales or Exchanges Within the Scope of Section 337.—(a) Provided the other conditions of section 337 are met, sales or exchanges which occur on or after the date on which the plan of complete liquidation is adopted and within the 12-month period thereafter are subject to the provisions of such section. The date on which a sale occurs depends primarily upon the intent of the parties to be gathered from the terms of the contract and the surrounding circumstances. In ascertaining whether a sale or exchange occurs on or after the date on which the plan of complete liquidation is adopted, the fact that negotiations for sale may have been commenced, either by the corporation or its shareholders, or both shall be disregarded. Moreover, an executory contract to sell is to be distinguished from a contract of sale. Ordinarily, a sale has not occurred when a contract to sell has been entered into but title and possession of the property have not been transferred and the obligation of the seller to sell or the buyer to buy is conditional.

(b) Ordinarily the date of the adoption of a plan of complete liquidation by a corporation is the date of adoption by the shareholders of the resolution authorizing the distribution of all the assets of the corporation (other than those retained to meet claims) in redemption of all of its stock. Where the corporation sells substantially all of its property of the type defined in section 337(b) prior to the date of adoption by the shareholders of such resolution, then the date of the adoption of the plan of complete liquidation by such corporation is the date of the adoption by the shareholders of such resolution and gain or loss will be recognized with respect to such sales. Where no substantial part of the property of the type defined in section 337(b) has been sold by the corporation prior to the date of adoption by the shareholders of such resolution, the date of the adoption of the plan

of complete liquidation by such corporation is the date of adoption by the shareholders of such resolution and no gain or loss will be recognized on sales of such property on or after such date, if all the corporate assets (other than those retained to meet claims) are distributed in liquidation to the shareholders within 12 months after the date of the adoption of such resolution. In all other cases the date of the adoption of the plan of liquidation shall be determined from all the facts and circumstances. Section 337 shall not apply in any case in which all of the corporate assets (other than those retained to meet claims) are not distributed to the shareholders within 12 months after the date of the adoption of a resolution by the shareholders authorizing the distribution of all the corporate assets in redemption of all the corporate stock. A corporation will be considered to have distributed all of its property other than assets retained to meet claims even though it has retained an amount of cash equal to its known liabilities and liquidating expenses plus an amount of cash set aside under arrangements for the payment after the close of the 12-month period of unascertained or contingent liabilities and contingent expenses. Such arrangements for payment must be made in good faith, the amount set aside must be reasonable, and no amount may be set aside to meet claims of shareholders with respect to their stock. If it is established to the satisfaction of the Commissioner that there are shareholders who cannot be located, a distribution in liquidation includes a transfer to a State official, trustee, or other person authorized by law to receive distributions for the benefit of such shareholders. For the purposes of this paragraph "property of the type defined in section 337(b)" means property upon the sale of which section 337(a) may provide for the nonrecognition of gain or loss upon sale or exchange during a 12-month period, including property described in subparagraph (A) of section 337(b)(1) if sold or exchanged at any time under the conditions set forth in section 337(b)(2) and including installment obligations acquired in respect of such sale or exchange.

§ 1.337-3. PROPERTY DEFINED.—(a) Except as provided in section 337(b)(2) and this section, the term "property" as used in section 337(a) and § 1.337-1 does not include, (1) stock in trade of the corporation, or other property of a kind which would properly be included in the inventory of the corporation if on hand at the close of the taxable year and property held by the corporation primarily for sale to customers in the ordinary course of its trade or business (hereinafter for purposes of section 337 referred to as "inventory"), (2) installment obligations acquired at any time from the sale or exchange of inventory, or (3) installment obligations acquired from the sale or exchange of property (other than inventory) prior to the adoption of the plan of liquidation. With the exceptions listed above, the term "property" includes all assets owned by a corporation.

(b) Except as provided in paragraph (c) of this section, if substantially all of the inventory is sold or exchanged to one person in one transaction, then for the purpose of section 337(a) the term "property" shall include:

(1) The inventory so sold or exchanged, and
(2) Installment obligations acquired in such sale or exchange.

For this purpose, the term "substantially all" means substantially all of the inventory at the time of the sale and includes inventory subject to liabilities, specific or otherwise. Section 337(b)(2) shall be inapplicable if the inventory so sold is replaced by like inventory, or by a new kind of inventory.

(c) The term "property" in the case of a corporation which is engaged in two or more distinct businesses shall include the inventory of any one of such trades or businesses if substantially all of the inventory attributable to such trade or business is sold or exchanged to one person in one transaction. If installment obligations are received upon such a sale, such obligations are also included within the meaning of the term "property."

(d) This section may be illustrated by the following examples:

Example (1). Corporation A operates a grocery store at one location and a hardware store at another. Neither store handles items similar to those handled by the other. Both stores are served by a common warehouse. Pursuant to a plan of liquidation adopted by the corporation, the grocery store and all of its inventory, including that part of its inventory held in the warehouse, are sold to one person in one transaction. Thereafter, and within 12 months after the adoption of the plan of liquidation, all of the assets of the corporation are distributed to the shareholders. No gain or loss will be recognized upon the sale of all of the assets attributable to the grocery business, including the inventory items.

Example (2). Corporation B operates two department stores, one in the downtown business district and the other in a suburban shopping center. Both handle the same items and are served by a common warehouse which contains an amount of inventory items equal to the total of that in both stores. The part of the inventory in the warehouse which is attributable to each store cannot be clearly determined. Pursuant to a plan of liquidation adopted by the corporation, the assets of the suburban store, including the inventory held in such store, but not including any portion of the inventory held in the warehouse, are sold to one person in one transaction. Thereafter, and within 12 months after the adoption of the plan of liquidation, all of the assets of the corporation are distributed to the shareholders. No gain or loss will be recognized with respect to the sale of the property other than the inventory, but gain or loss will be recognized upon the sale of the inventory.

Example (3). The facts are the same as in example (2) except that the part of the inventory in the warehouse which is attributable to the suburban store can be clearly determined and both the inventory held in the store and that part of the inventory in the warehouse attributable to such store are sold. No gain or loss will be recognized upon the sale of the inventory.

§ 1.337-4. LIMITATION OF GAIN.—(a) Section 337(c)(2)(B) provides a limitation upon the amount of gain not recognized where a corporation sells or exchanges property pursuant to a plan of complete liquidation (and such property, if distributed, would take the basis of the stock held by the distributee pursuant to the provisions

of section 334(b)(2) (relating to plans of liquidation adopted within 2 years after purchase of the stock)). The amount of gain not recognized shall not be greater than the excess of (1) that portion of the adjusted basis (further adjusted as provided in the second sentence of section 334(b)(2) and in § 1.334–1(c)) of the stock of the liquidating corporation in the hands of its parent corporation allocable to the property sold or exchanged over (2) the adjusted basis of such property in the hands of the liquidating corporation.

(b) Paragraph (a) of this section may be illustrated by the following example:

Example.—Corporation A owns more than 80 percent of the stock of Corporation B, which it purchased for $10,000. All of the assets of Corporation B, having a total basis of $4,000 are sold for $12,000. The portion of the realized gain of $8,000 which is not recognized is $6,000, computed as follows:

Basis of stock allocable to property sold	$10,000
Basis of property sold	4,000
Excess (not recognized)	$6,000

In general, where section 337(c)(2)(B) is applicable and where the gain realized from the sale of property is greater than the excess of the selling price of the property over the basis of the stock allocable to the property sold, the amount of gain to be recognized from such sale is equal to such excess. In the above example, the $2,000 gain representing the excess of the selling price of $12,000 over the basis of the stock allocable to the property sold ($10,000) would be recognized to the liquidating corporation.

(c) For the purpose of this section only, the basis (adjusted as described in (a) above) of the liquidating corporation's stock in the hands of its parent corporation on the date of the first sale of property, shall be allocated to the assets of the liquidating corporation (unreduced by any amount applicable to minority interests) on the basis of the fair market value of such assets (see § 1.334–1(c)), both tangible and intangible, on the date the first property is sold by the liquidating corporation. The allocation then made shall remain unchanged for the purpose of determining recognized gain upon subsequent sales of property by the liquidating corporation unless the stock ownership of the parent corporation changes. In the event of such a change, a new allocation shall be made at the time of the next sale of property thereafter. The new allocation shall be made on the basis of the fair market value of the liquidating corporation's assets on the date of such sale.

§ 1.337–5. Information To Be Filed With Return.—There must be attached to the return of the liquidating corporation, the following information:

(a) A copy of the minutes of the stockholders' meeting at which the plan of liquidation was formally adopted, including a copy of the plan of liquidation.

(b) A statement of the assets sold after the adoption of the plan of liquidation including the dates of such sales. If section

337(c)(2)(B), relating to limited nonrecognition of gain on sales by subsidiaries, is applicable, this statement must include a computation of the total gain and of the gain not recognized under this section.

(c) Information as to the date of the final liquidating distribution.

(d) A statement of the assets, if any, retained to pay liabilities and the nature of the liabilities.

§ 1.338. STATUTORY PROVISIONS; EFFECT ON EARNINGS AND PROFITS.—

SEC. 338. EFFECT ON EARNINGS AND PROFITS.

For special rules relating to the effect on earnings and profits of certain distributions in partial liquidation, see section 312(e).

COLLAPSIBLE CORPORATIONS; FOREIGN PERSONAL HOLDING COMPANIES

§ 1.341. STATUTORY PROVISIONS; COLLAPSIBLE CORPORATIONS.

SEC. 341. COLLAPSIBLE CORPORATIONS.

(a) TREATMENT OF GAIN TO SHAREHOLDERS.—Gain from—

(1) The sale or exchange of stock of a collapsible corporation,

(2) A distribution in partial or complete liquidation of a collapsible corporation, which distribution is treated under this part as in part or full payment in exchange for stock, and

(3) A distribution made by a collapsible corporation which, under section 301(c)(3)(A), is treated, to the extent it exceeds the basis of the stock, in the same manner as a gain from the sale or exchange of property,

to the extent that it would be considered (but for the provisions of this section) as gain from the sale or exchange of a capital asset held for more than 6 months shall, except as provided in subsection (d), be considered as gain from the sale or exchange of property which is not a capital asset.

(b) DEFINITIONS.—

(1) COLLAPSIBLE CORPORATION.—For purposes of this section, the term "collapsible corporation" means a corporation formed or availed of principally for the manufacture, construction, or production of property, for the purchase of property which (in the hands of the corporation) is property described in paragraph (3), or for the holding of stock in a corporation so formed or availed of, with a view to—

(A) The sale or exchange of stock by its shareholders (whether in liquidation or otherwise), or a distribution to its shareholders, before the realization by the corporation manufacturing, constructing, producing, or purchasing the property of a substantial part of the taxable income to be derived from such property, and

(B) The realization by such shareholders of gain attributable to such property.

(2) PRODUCTION OR PURCHASE OF PROPERTY.—For purposes of paragraph (1), a corporation shall be deemed to have manufactured, constructed, produced, or purchased property, if—

(A) It engaged in the manufacture, construction, or production of such property to any extent,

(B) It holds property having a basis determined, in whole or in part, by reference to the cost of such property in the hands of a person who manufactured, constructed, produced, or purchased the property, or

(C) It holds property having a basis determined, in whole or in part, by reference to the cost of property manufactured, constructed, produced, or purchased by the corporation.

(3) SECTION 341 ASSETS.—For purposes of this section, the term "section 341 assets" means property held for a period of less than 3 years which is—

(A) Stock in trade of the corporation, or other property of a kind which would properly be included in the inventory of the corporation if on hand at the close of the taxable year;

(B) Property held by the corporation primarily for sale to customers in the ordinary course of its trade or business;

(C) Unrealized receivables or fees, except receivables from sales of property other than property described in this paragraph, or

(D) Property described in section 1231(b) (without regard to any holding period therein provided), except such property which is or has been used in connection with the manufacture, construction, production, or sale of property described in subparagraph (A) or (B).

In determining whether the 3-year holding period specified in this paragraph has been satisfied, section 1223 shall apply, but no such period shall be deemed to begin before the completion of the manufacture, construction, production, or purchase.

(4) UNREALIZED RECEIVABLES.—For purposes of paragraph (3)(C), the term "unrealized receivables or fees" means, to the extent not previously includible in income under the method of accounting used by the corporation, any rights (contractual or otherwise) to payment for—

(A) Goods delivered, or to be delivered, to the extent the proceeds therefrom would be treated as amounts received from the sale or exchange of property other than a capital asset, or

(B) Services rendered or to be rendered.

(c) PRESUMPTION IN CERTAIN CASES.—

(1) *In* GENERAL.—For purposes of this section, a corporation shall, unless shown to the contrary, be deemed to be a collapsible corporation if (at the time of the sale or exchange, or the distribution, described in subsection (a)) the fair market value of its section 341 assets (as defined in subsection (b)(3)) is—

(A) 50 percent or more of the fair market value of its total assets, and

(B) 120 percent or more of the adjusted basis of such section 341 assets.

Absence of the conditions described in subparagraphs (A) and (B) shall not give rise to a presumption that the corporation was not a collapsible corporation.

(2) DETERMINATION OF TOTAL ASSETS.—In determining the fair market value of the total assets of a corporation for purposes of paragraph (1)(A), there shall not be taken into account—

(A) Cash,

(B) Obligations which are capital assets in the hands of the corporation (and governmental obligations described in section 1221(5)), and

(C) Stock in any other corporation.

(d) LIMITATIONS ON APPLICATION OF SECTION.—In the case of gain realized by a shareholder with respect to his stock in a collapsible corporation, this section shall not apply—

(1) Unless, at any time after the commencement of the manufacture, construction, or production of the property, or at the time of the purchase of the property described in subsection (b)(3) or at any time thereafter, such shareholder (A) owned (or was considered as owning) more than 5 percent in value of the outstanding stock of the corporation, or (B) owned stock which was considered as owned at such time by another shareholder who then owned (or was considered as owning) more than 5 percent in value of the outstanding stock of the corporation;

(2) To the gain recognized during a taxable year, unless more than 70 percent of such gain is attributable to the property so manufactured, constructed, produced, or purchased; and

(3) To gain realized after the expiration of 3 years following the completion of such manufacture, construction, production, or purchase.

For purposes of paragraph (1), the ownership of stock shall be determined in accordance with the rules prescribed in paragraphs (1), (2),

(3), (5), and (6) of section 544(a) (relating to personal holding companies); except that, in addition to the persons prescribed by paragraph (2) of that section, the family of an individual shall include the spouses of that individual's brothers and sisters (whether by the whole or half blood) and the spouses of that individual's lineal descendants.

§ 1.341-1. COLLAPSIBLE CORPORATIONS—IN GENERAL.—Subject to the limitations contained in § 1.341-4, the entire gain from (a) the actual sale or exchange of stock of a collapsible corporation, (b) amounts distributed in complete or partial liquidation of a collapsible corporation which are treated, under section 331, as payment in exchange for stock, and (c) a distribution made by a collapsible corporation which, under section 301 (c) (3), is treated, to the extent it exceeds the basis of the stock, in the same manner as a gain from the sale or exchange of property, shall be considered as gain from the sale or exchange of property which is not a capital asset.

§ 1.341-2. DEFINITIONS—(a) *Determination of collapsible corporation.* (1) A collapsible corporation is defined by section 341(b)(1) to be a corporation formed or availed of principally (i) for the manufacture, construction, or production of property, (ii) for the purchase of property which (in the hands of the corporation) is property described in section 341(b)(3), or (iii) for the holding of stock in a corporation so formed or availed of, with a view to (*a*) the sale or exchange of stock by its shareholders (whether in liquidation or otherwise), or a distribution to its shareholders, prior to the realization by the corporation manufacturing, constructing, producing, or purchasing the property of a substantial part of the taxable income to be derived from such property, and (*b*) the realization by such shareholders of gain attributable to such property. See § 1.341-5 for a description of the facts which will ordinarily be considered sufficient to establish whether or not a corporation is a collapsible corporation under the rules of this section. See § 341-5(d) for examples of the application of section 341.

(2) Under section 341(b)(1) the corporation must be formed or availed of with a view to the action therein described, that is, the sale or exchange of its stock by its shareholders, or a distribution to them prior to the realization by the corporation manufacturing, constructing, producing, or purchasing the property of a substantial part of the taxable income to be derived from such property, and the realization by the shareholders of gain attributable to such property. This requirement is satisfied in any case in which such action was contemplated by those persons in a position to determine the policies of the corporation, whether by reason of their owning a majority of the voting stock of the corporation or otherwise. The requirement is satisfied whether such action was contemplated, unconditionally, conditionally, or as a recognized possibility. If the corporation was so formed or availed of, it is immaterial that a particular shareholder was not a shareholder at the time of the manufacture, construction, production, or purchase of the property, or if a shareholder at such time, did not share in such view. Any gain of such a shareholder on his stock in the corporation shall be treated in the same manner as gain of a shareholder who did share in such view. The existence of a bona fide business reason for doing business in the corporate form does not, by itself, negate the fact that the corpora-

tion may also have been formed or availed of with a view to the action described in section 341(b).

(3) A corporation is formed or availed of with a view to the action described in section 341(b) if the requisite view existed at any time during the manufacture, production, construction, or purchase referred to in that section. Thus, if the sale, exchange, or distribution is attributable solely to circumstances which arose after the manufacture, construction, production, or purchase (other than circumstances which reasonably could be anticipated at the time of such manufacture, construction, production, or purchase), the corporation shall, in the absence of compelling facts to the contrary, be considered not to have been so formed or availed of. However, if the sale, exchange or distribution is attributable to circumstances present at the time of the manufacture, construction, production, or purchase, the corporation shall, in the absence of compelling facts to the contrary, be considered to have been so formed or availed of.

(4) The property referred to in section 341(b) is that property or the aggregate of those properties with respect to which the requisite view existed. In order to ascertain the property or properties as to which the requisite view existed, reference shall be made to each property as to which, at the time of the sale, exchange, or distribution referred to in section 341(b) there has not been a realization by the corporation manufacturing, constructing, producing, or purchasing the property of a substantial part of the taxable income to be derived from such property. However, where any such property is a unit of an integrated project involving several properties similar in kind, the determination whether the requisite view existed shall be made only if a substantial part of the taxable income to be derived from the project has not been realized at the time of the sale, exchange, or distribution, and in such cases the determination shall be made by reference to the aggregate of the properties constituting the single project.

(5) A corporation shall be deemed to have manufactured, constructed, produced, or purchased property if it (i) engaged in the manufacture, construction, or production of property to any extent, or (ii) holds property having a basis determined, in whole or in part, by reference to the cost of such property in the hands of a person who manufactured, constructed, produced, or purchased the property, or (iii) holds property having a basis determined, in whole or in part, by reference to the cost of property manufactured, constructed, produced, or purchased by the corporation. Thus, under subdivision (i) of this subparagraph, for example, a corporation need not have originated nor have completed the manufacture, construction, or production of the property. Under subdivision (ii) of this subparagraph, for example, if an individual were to transfer property constructed by him to a corporation in exchange for all the capital stock of such corporation, and such transfer qualifies under section 351, then the corporation would be deemed to have constructed the property, since the basis of the property in the hands of the corporation would, under section 362 be determined by reference to the basis of the property in the hands of the individual. Under subdivision (iii) of this subparagraph, for example, if a corporation were to exchange property constructed by it for property of like kind constructed by another person, and such

exchange qualifies under section 1031(a), then the corporation would be deemed to have constructed the property received by it in the exchange, since the basis of the property received by it in the exchange would, under section 1031(d), be determined by reference to the basis of the property constructed by the corporation.

(6) In determining whether a corporation is a collapsible corporation by reason of the purchase of property, it is immaterial whether the property is purchased from the shareholders of the corporation or from persons other than such shareholders. The property, however, must be property which, in the hands of the corporation, is property of a kind described in section 341(b)(3). The determination whether property is of a kind described in section 341(b)(3) shall be made without regard to the fact that the corporation is formed or availed of with a view to the action described in section 341(b)(1).

(7) Section 341 is applicable whether the shareholder is an individual, a trust, an estate, a partnership, a company, or a corporation.

(b) *Section 341 assets.* For the purposes of this section, the term "section 341 assets" means the following listed property if held for less than 3 years:

(1) Stock in trade of the corporation, or other property of a kind which would properly be included in the inventory of the corporation if on hand at the close of the taxable year.

(2) Property held primarily for sale to customers in the ordinary course of a trade or business.

(3) Property used in trade or business as defined in section 1231(b) and held for less than 3 years, except property that is or has been used in connection with the manufacture, construction, production or sale of property described above in (1) and (2).

(4) Unrealized receivables or fees pertaining to property listed in this paragraph. The term "unrealized receivables or fees" means any rights (contractual or otherwise) to payment for property listed in (1), (2), and (3) above which has been delivered or is to be delivered and rights to payments for services rendered or to be rendered, to the extent such rights have not been included in the income of the corporation under the method of accounting used by it. In determining whether the assets referred to in this paragraph have been held for 3 years, the time such assets were held by a transferor shall be taken into consideration (section 1223). However, no such period shall begin before the date the manufacture, construction, production, or purchase of such assets is completed.

§ 1.341-3. PRESUMPTIONS.—(a) Unless shown to the contrary, a corporation shall be considered to be a collapsible corporation if at the time of the transactions described in § 1.341-1 the fair market value of the section 341 assets held by it constitutes 50 percent or more of the fair market value of its total assets and the fair market value of the section 341 assets is 120 percent or more of the adjusted basis of such assets. In determining the fair market value of the total assets, cash, obligations which are capital assets in the hands of the corporation, governmental obligations, and stock in any other corporation shall not be taken into consideration. The failure of a corporation to meet the requirements of this paragraph, shall not give

rise to the presumption that the corporation was not a collapsible corporation.

(b) The following example will illustrate the application of this section:

Example. A corporation, filing its income tax returns on the accrual basis, on July 31, 1955, owned assets with the following fair market values: Cash, $175,000; note receivable held for investment, $130,000; stocks of other corporations, $545,000; rents receivable, $15,000; and a building constructed by the corporation in 1953 and held thereafter as rental property, $750,000. The adjusted basis of the building on that date was $600,000. The only debt outstanding was a $500,000 mortgage on the building. On July 31, 1955, the corporation liquidated and distributed all of its assets to its shareholders. In computing whether the fair market value of the section 341 assets (only the building) is 50 percent or more of the fair market value of the total assets, the cash, note receivable, and stocks of other corporations are not taken into account in determining the value of the total assets, with the result that the fair market value of the total assets was $765,000 ($750,000 (building) plus $15,000 (rents receivable)). Therefore, the value of the building is 98 percent of the total assets ($750,000÷$765,000). The value of the building is also 125 percent of the adjusted basis of the building ($750,000÷$600,000). In view of the above facts, there arises a presumption that the corporation is a collapsible corporation.

§ 1.341-4. Limitations on Application of Section—(a) *General.* This section shall apply only to the extent that the recognized gain of a shareholder upon his stock in a collapsible corporation would be considered, but for the provisions of this section, as gain from the sale or exchange of a capital asset held for more than six months. Thus, if a taxpayer sells at a gain stock of a collapsible corporation which he had held for six months or less, this section would not, in any event, apply to such gain. Also, if it is determined, under provisions of law other than section 341, that a sale or exchange at a gain of stock of a collapsible corporation which has been held for more than six months results in ordinary income rather than long-term capital gain, then this section (including the limitations contained herein) has no application whatsoever to such gain.

(b) *Stock ownership rules.* (1) This section shall apply in the case of gain realized by a shareholder upon his stock in a collapsible corporation only if the shareholder, at any time after the actual commencement of the manufacture, construction, or production of the property, or at the time of the purchase of the property described in section 341(b)(3) or at any time thereafter, (i) owned, or was considered as owning, more than 5 percent in value of the outstanding stock of the corporation, or (ii) owned stock which was considered as owned at such time by another shareholder who then owned, or was considered as owning, more than 5 percent in value of the outstanding stock of the corporation.

(2) The ownership of stock shall be determined in accordance with the rules prescribed by section 544(a)(1), (2), (3), (5), and (6), except that, in addition to the persons prescribed by section 544(a)(2), the family of an individual shall include the spouses of that indi-

vidual's brothers and sisters, whether such brothers and sisters are by the whole or the half blood, and the spouses of that individual's lineal descendants.

(3) For the purpose of this limitation, treasury stock shall not be considered as outstanding stock.

(4) It is possible, under this limitation, that a shareholder in a collapsible corporation may have gain upon his stock in that corporation treated differently from the gain of another shareholder in the same collapsible corporation.

(c) *Seventy-percent rule.* (1) This section shall apply to the gain recognized during a taxable year upon the stock in a collapsible corporation only if more than 70 percent of such gain is attributable to the property referred to in section 341(b)(1). If more than 70 percent of such gain is so attributable, then all of such gain is subject to this section, and, if 70 percent or less of such gain is so attributable, then none of such gain is subject to this subsection.

(2) For the purpose of this limitation, the gain attributable to the property referred to in section 341(b)(1) is the excess of the recognized gain of the shareholder during the taxable year upon his stock in the collapsible corporation over the recognized gain which the shareholder would have if the property had not been manufactured, constructed, produced, or purchased. In the case of gain on a distribution in partial liquidation or a distribution described in section 301(c)(3)(A), the gain attributable to the property shall not be less than an amount which bears the same ratio to the gain on such distribution as the gain which would be attributable to the property if there had been a complete liquidation at the time of such distribution bears to the total gain which would have resulted from such complete liquidation.

(3) Gain may be attributable to the property referred to in section 341(b)(1) even though such gain is represented by an appreciation in the value of property other than that manufactured, constructed, produced, or purchased. Where, for example, a corporation owns a tract of land and the development of one-half of the tract increases the value of the other half, the gain attributable to the developed half of the tract includes the increase in the value of the other half.

(4) The following example will illustrate the application of the 70 percent rule:

Example: On January 2, 1954, A formed the Z Corporation and contributed $1,000,000 cash in exchange for all of the stock thereof. The Z Corporation invested $400,000 in one project for the purpose of building and selling residential houses. As of December 31, 1954, the residential houses in this project were all sold, resulting in a profit of $100,000 (after taxes). Simultaneously with the development of the first project and in connection with a second and separate project the Z Corporation invested $600,000 in land for the purpose of subdividing such land into lots suitable for sale as home sites and distributing such lots in liquidation before the realization by the corporation of a substantial part of the taxable income to be realized from this second project. As of December 31, 1954, Corporation Z had derived $60,000 in profits (after taxes) from the sale of

some of the lots. On January 2, 1955, the Z Corporation made a distribution in complete liquidation to shareholder A who received:

(i) $560,000 in cash and notes, and

(ii) Lots having a fair market value of $940,000. The gain recognized to shareholder A upon the liquidation is $500,000 ($1,500,000 minus $1,000,000). The gain which would have been recognized to A if the second project had not been undertaken is $100,000 ($1,100,000 minus $1,000,000). Therefore, the gain attributable to the second project which is property referred to in section 341(b)(1), is $400,000 $500,000 minus $100,000). Since this gain ($400,000) is more than 70 percent of the entire gain ($500,000) recognized to A on the liquidation, the entire gain so recognized is gain subject to section 341(a).

(d) *Three-year rule.* This section shall not apply to that portion of the gain of a shareholder that is realized more than three years after the actual completion of the manufacture, construction, production, or purchase of the property to which such portion is attributable.

§ 1.341–5. *Application of section.*—(a) Whether or not a corporation is a collapsible corporation shall be determined under the rules of § 1.341–2 and § 341–3 on the basis of all the facts and circumstances in each particular case. The following paragraphs of this section set forth those facts which will ordinarily be considered sufficient to establish that a corporation is or is not a collapsible corporation. The facts set forth in the following paragraphs of this section are not exclusive of other facts which may be controlling in any particular case. For example, if the facts in paragraph (b) of this section, but not the facts in paragraph (c) of this section, are present, the corporation may nevertheless not be a collapsible corporation if there are other facts which clearly establish that the rules of § 1.341–2 and § 1.341–3 are not satisfied. Similarly, if the facts in paragraph (c) of this section are present, the corporation may nevertheless be a collapsible corporation if there are other facts which clearly establish that the corporation was formed or availed of in the manner described in § 1.341–2 and § 1.341–3 or if the facts in paragraph (c) of this section are not significant by reason of other facts, such as the fact that the corporation is subject to the control of persons other than those who were in control immediately prior to the manufacture, construction, production, or purchase of the property. See § 1.341–4 for provisions which make section 341 inapplicable to certain shareholders of collapsible corporations.

(b) The following facts will ordinarily be considered sufficient (except as otherwise provided in paragraph (a) of this section and paragraph (c) of this section) to establish that a corporation is a collapsible corporation:

(1) A shareholder of the corporation sells or exchanges his stock, or receives a liquidating distribution, or a distribution described in section 301(c)(3)(A),

(2) Upon such sale, exchange, or distribution, such shareholder realizes gain attributable to the property described in subparagraphs (4) and (5) of this paragraph, and

(3) At the time of the manufacture, construction, production, or purchase of the property described in subparagraphs (4) and (5) of this paragraph, such activity was substantial in relation to the other activities of the corporation which manufactured, constructed, produced, or purchased such property.

The property referred to in subparagraphs (2) and (3) of this paragraph is that property or the aggregate of those properties which meet the following two requirements:

(4) The property is manufactured, constructed, or produced by the corporation or by another corporation stock of which is held by the corporation, or is property purchased by the corporation or by such other corporation which (in the hands of the corporation holding such property) is property described in section 341(b)(3), and

(5) At the time of the sale, exchange, or distribution described in subparagraph (1) of this paragraph, the corporation which manufactured, constructed, produced, or purchased such property has not realized a substantial part of the taxable income to be derived from such property.

In the case of property which is a unit of an integrated project involving several properties similar in kind, the rules of this subparagraph shall be applied to the aggregate of the properties constituting the single project rather than separately to such unit. Under the rules of this subparagraph, a corporation shall be considered a collapsible corporation by reason of holding stock in other corporations which manufactured, constructed, produced, or purchased the property only if the activity of the corporation in holding stock in such other corporations is substantial in relation to the other activities of the corporation.

(c) The absence of any of the facts set forth in paragraph (b) of this section or the presence of the following facts will ordinarily be considered sufficient (except as otherwise provided in paragraph (a) of this section) to establish that a corporation is not a collapsible corporation:

(1) In the case of a corporation subject to the rules of paragraph (b) of this section only by reason of the manufacture, construction, production, or purchase (either by the corporation or by another corporation the stock of which is held by the corporation) of property which is property described in section 341 (b)(3)(A) and (B), the amount (both in quantity and value) of such property is not in excess of the amount which is normal—

(i) For the purpose of the business activities of the corporation which manufactured, constructed, produced, or purchased the property if such corporation has a substantial prior business history involving the use of such property and continues in business, or

(ii) For the purpose of an orderly liquidation of the business if the corporation which manufactured, constructed, produced, or purchased such property has a substantial prior business history involving the use of such property and is in the process of liquidation.

(2) In the case of a corporation subject to the rules of paragraph (b) of this section with respect to the manufacture, construction, or production (either by the corporation or by another corporation the stock of which is held by the corporation) of property, the amount of the unrealized taxable income from such property is not substantial in relation to the amount of the taxable income realized (after the completion of a material part of such manufacture, construction, or production, and prior to the sale, exchange, or distribution referred to in paragraph (b)(1) of this section) from such property and from other property manufactured, constructed, or produced by the corporation.

(d) The following examples will illustrate the application of this section:

Example (1). (i) On January 2, 1954, A formed the W Corporation and contributed $50,000 cash in exchange for all of the stock thereof. The W Corporation borrowed $900,000 from a bank and used $800,000 of such sum in the construction of an apartment house on land which it purchased for $50,000. The apartment house was completed on December 31, 1954. On December 31, 1954, the corporation, having determine l that the fair market value of the apartment house, separate and apart from the land, was $900,000, made a distribution (permitted under the applicable State law) to A of $100,000. At this time, the fair market value of the land was $50,000. As of December 31, 1954, the corporation has not realized any earnings and profits. In 1955, the corporation began the operation of the apartment house and received rentals therefrom. The corporation has since continued to own and operate the building. The corporation reported on the basis of the calendar year and cash receipts and disbursements.

(ii) Since A received a distribution and realized a gain attributable to the building constructed by the corporation, since, at the time of such distribution, the corporation has not realized a substantial part of the taxable income to be derived from such building, and since the construction of the building was a substantial activity of the corporation, the W Corporation is considered a collapsible corporation under § 1.341-5(b). The provisions of section 341(d) do not prohibit the application of section 341(a). Therefore, the distribution, if and to the extent that it may be considered long-term capital gain rather than ordinary income without regard to section 341, will be considered ordinary income under section 341(a).

(iii) In the event of the existence of additional facts and circumstances in the above case, the corporation, notwithstanding the above facts, might not be considered a collapsible corporation. See §§ 1.341-2 and 1.341-5(a).

Example (2). (i) On January 2, 1954, B formed X Corporation and became its sole shareholder. In August 1954, the corporation completed construction of an office building. It immediately sold this building at a gain of $50,000, included this entire gain in its return for 1954, and distributed this entire gain (less taxes) to B. In June 1955, the corporation completed con-

struction of a second office building. In August 1955, B sold the entire stock of X Corporation at a gain of $12,000, which gain is attributable to the second building.

(ii) X Corporation is a collapsible corporation under section 341(b) for the following reasons: The gain realized through the sale of the stock of X Corporation was attributable to the second office building; the construction of that building was a substantial activity of X Corporation during the time of construction and, at the time of sale, the corporation had not realized a substantial part of the taxable income to be derived from such building. Since the provisions of section 341(d) do not prohibit the application of section 341(a) to B, the gain of $12,000 to B is, accordingly, considered ordinary income.

Example (3). The facts are the same in example (2), except that the following facts are shown: B was the president of the X Corporation and active in the conduct of its business. The second building was constructed as the first step in a project of the X Corporation for the development for rental purposes of a large suburban center involving the construction of several buildings by the corporation. The sale of the stock by B was caused by his retiring from all business activity as a result of illness arising after the second building was constructed. Under these additional facts, the corporation is not considered a collapsible corporation. See §§ 1.341–2 and 1.341–5(a).

Example (4). (i) On January 2, 1948, C formed the Y Corporation and became the sole shareholder thereof. The Y Corporation has been engaged solely in the business of producing motion pictures and licensing their exhibition. On January 2, 1955, C sold all of the stock of the Y Corporation at a gain. The Y Corporation has produced one motion picture each year since its organization and before January 2, 1955, it has realized a substantial part of the taxable income to be derived from each of its motion pictures except the last one made in 1954. This last motion picture was completed September 1, 1954. As of January 2, 1955, no license had been made for its exhibition. The fair market value on January 2, 1955, of this last motion picture exceeds the cost of its production by $50,000. A material part of the production of this last picture was completed on January 1, 1954, and between that date and January 2, 1955, the corporation had realized taxable income of $500,000 from other motion pictures produced by it. The corporation has consistently distributed to its shareholder its taxable income when received (after adjustment for taxes).

(ii) Although the corporation is within paragraph (b) of this section with respect to the production of property, the amount of the unrealized income from such property ($50,000) is not substantial in relation to the amount of the income realized, after the completion of a material part of the production of such property and prior to sale of the stock, from such property and other property produced by the corporation ($500,000). Accordingly, the Y Corporation is within paragraph (c)(2) of this section, and is not considered a collapsible corporation.

Example (5). The facts are the same as in example (4) except that C sold all of his stock to D on February 1, 1954. On January

2, 1955, D sold all of the Y Corporation stock at a gain, the gain being attributable to the picture completed September 1, 1954, and not released by the corporation for exhibition. In view of the change of control of the corporation, the provisions of paragraph (c) (2) of this section are not significant at the time of the sale by D, and the Y Corporation would be considered a collapsible corporation on January 2, 1955. See §§ 1.341-2 and 1.341-5(a).

§ 1.342. STATUTORY PROVISIONS; LIQUIDATION OF CERTAIN FOREIGN PERSONAL HOLDING COMPANIES.

SEC. 342. LIQUIDATION OF CERTAIN FOREIGN PERSONAL HOLDING COMPANIES.

(a) IN GENERAL.—If any distribution—

(1) Is, within the meaning of the Internal Revenue Code of 1939, a distribution in partial liquidation or in complete liquidation (including any one of a series of distributions made by the corporation in complete cancellation or redemption of all its stock) and

(2) Is made by a foreign corporation which, with respect to any taxable year beginning on or before, and ending after, August 26, 1937, was af oreign personal holding company, and with respect to which a United States group (as defined in section 552(a)(2)) existed after August 26, 1937, and before January 1, 1938,

then the distribution shall be treated as a distribution in full or part payment in exchange for the stock, and the amount of the gain recognized (determined under section 1002 without regard to this part) resulting from such distribution shall be considered as a gain from the sale or exchange of a capital asset held for not more than 6 months.

(b) SPECIAL RULE FOR CERTAIN LIQUIDATIONS BEFORE 1956.—Subsection (a) shall not apply in the case of a series of distributions in complete liquidation described in subsection (a) if—

(1) The first distribution is made on or after June 22, 1954, and

(2) The final distribution is made before January 1, 1956;

and the amount of the gain recognized (determined under section 1002 without regard to this part) resulting from such distributions shall be considered as a gain from the sale or exchange of a capital asset, or of property which is not a capital asset, as the case may be.

§ 1.342-1. GENERAL.—The determination of whether a foreign corporation was a foreign personal holding company with respect to a taxable year beginning on or before, and ending after August 26, 1937, shall be made under section 331 of the Revenue Act of 1936 and the regulations thereunder. For the purpose of section 342(a), a liquidation may be completed before the actual dissolution of the liquidating corporation. However, no liquidation shall be considered as completed until the liquidating corporation and the receiver (or trustees in liquidation) are finally divested of all the property, whether tangible or intangible.

DEFINITION

§ 1.346. STATUTORY PROVISIONS; PARTIAL LIQUIDATION DEFINED.

SEC. 346. PARTIAL LIQUIDATION DEFINED.

(a) IN GENERAL.—For purposes of this subchapter, a distribution shall be treated as in partial liquidation of a corporation if—

(1) The distribution is one of a series of distributions in redemption of all of the stock of the corporation pursuant to a plan; or

(2) The distribution is not essentially equivalent to a dividend, is in redemption of a part of the stock of the corporation pursuant to a plan, and occurs within the taxable year in which the plan is

adopted or within the succeeding taxable year, including (but not limited to) a distribution which meets the requirements of subsection (b).

For purposes of section 562(b) (relating to the dividends paid deduction)) and section 6043 (relating to information returns), a partial liquidation includes a redemption of stock to which section 302 applies.

(b) TERMINATION OF A BUSINESS.—A distribution shall be treated as a distribution described in subsection (a)(2) if the requirements of paragraphs (1) and (2) of this subsection are met.

(1) The distribution is attributable to the corporation's ceasing to conduct, or consists of the assets of, a trade or business which has been actively conducted throughout the 5-year period immediately before the distribution, which trade or business was not acquired by the corporation within such period in a transaction in which gain or loss was recognized in whole or in part.

(2) Immediately after the distribution the liquidating corporation is actively engaged in the conduct of a trade or business, which trade or business was actively conducted throughout the 5-year period ending on the date of the distribution and was not acquired by the corporation within such period in a transaction in which gain or loss was recognized in whole or in part.

Whether or not a distribution meets the requirements of paragraphs (1) and (2) of this subsection shall be determined without regard to whether or not the distribution is pro rata with respect to all of the shareholders of the corporation.

(c) TREATMENT OF CERTAIN REDEMPTIONS.—The fact that, with respect to a shareholder, a distribution qualifies under section 302(a) (relating to redemptions treated as distributions in part or full payment in exchange for stock) by reason of section 302(b) shall not be taken into account in dtermining whether the distribution, with respect to such shareholder, is also a distribution in partial liquidation of the corporation.

§ 1.346-1. PARTIAL LIQUIDATION—(a) *General.* This section defines a partial liquidation. If amounts are distributed in partial liquidation such amounts are treated under section 331(a)(2) as received in part or full payment in exchange for the stock. A distribution is treated as in partial liquidation of a corporation if—

(1) The distribution is one of a series of distributions in redemption of all of the stock of the corporation pursuant to a plan of complete liquidation, or

(2) The distribution—

(i) Is not essentially equivalent to a dividend,

(ii) Is in redemption of a part of the stock of the corporation pursuant to a plan, and

(iii) Occurs within the taxable year in which the plan is adopted or within the succeeding taxable year.

An example of a distribution which will qualify as a partial liquidation under paragraph (2) and section 346(a) is a distribution resulting from a genuine contraction of the corporate business such as the distribution of unused insurance proceeds recovered as a result of a fire which destroyed part of the business causing a cessation of a part of its activities. On the other hand, the distribution of funds attributable to a reserve for an expansion program which has been abandoned does not qualify as a partial liquidation within the meaning of section 346(a). A distribution to which section 355 applies (or so much of section 356 as relates to section 355) is not a distribution in partial liquidation within the meaning of section 346(a).

(b) *Special requirements on termination of business.* A distribution which occurs within the taxable year in which the plan is adopted or within the succeeding taxable year and which meets the requirements of subsection (b) of section 346 falls within subparagraph (2) of paragraph (a) of this section and within section 346(a)(2). The requirements which a distribution must meet to fall within subsection (b) of section 346 are:

(1) Such distribution is attributable to the corporation's ceasing to conduct, or consists of assets of, a trade or business which has been actively conducted throughout the five-year period immediately before the distribution, which trade or business was not acquired by the corporation within such period in a transaction in which gain or loss was recognized in whole or in part, and

(2) Immediately after such distribution by the corporation it is actively engaged in the conduct of a trade or business, which trade or business was actively conducted throughout the five-year period ending on the date of such distribution and was not acquired by the corporation within such period in a transaction in which gain or loss was recognized in whole or in part.

A distribution shall be treated as having been made in partial liquidation pursuant to section 346(b) if it consists of the proceeds of the sale of the assets of a trade or business which has been actively conducted for the five-year period and has been terminated, or if it is a distribution in kind of the assets of such a business, or if it is a distribution in kind of some of the assets of such a business and of the proceeds of the sale of the remainder of the assets of such a business. In general, a distribution which will qualify under section 346(b) may consist of, but is not limited to—

(i) Assets (other than inventory or property described in (ii)) used in the trade or business throughout the five-year period immediately before the distribution (for this purpose an asset shall be considered used in the trade or business during the period of time the asset which it replaced was so used), or

(ii) Proceeds from the sale of assets described in (i), and, in addition,

(iii) The inventory of such trade or business or property held primarily for sale to customers in the ordinary course of business, if—

(*a*) The items constituting such inventory or such property were substantially similar to the items constituting such inventory or property during the five-year period immediately before the distribution, and

(*b*) The quantity of such items on the date of distribution was not substantially in excess of the quantity of similar items regularly on hand in the conduct of such business during such five-year period,

or

(iv) Proceeds from the sale of inventory or property described in (iii), if such inventory or property is sold in bulk in the course of termination of such trade or business and if with respect to such inventory the conditions of (*a*) and (*b*)

of (iii) would have been met had such inventory or property been distributed on the date of such sale.

(c) *Active conduct of a trade or business.* For the purpose of section 346(b)(1), a corporation shall be deemed to have actively conducted a trade or business immediately before the distribution, if—

(1) In the case of a business the assets of which have been distributed in kind, the business was operated by such corporation until the date of distribution, or

(2) In the case of a business the proceeds of the sale of the assets of which are distributed, such business was actively conducted until the date of sale and the proceeds of such sale were distributed as soon thereafter as reasonably possible.

The term "active conduct of a trade or business" shall have the same meaning in this section as in § 1.355–1(c).

§ 1.346–2. TREATMENT OF CERTAIN REDEMPTIONS.—If a distribution in a redemption of stock qualifies as a distribution in part or full payment in exchange for the stock under both section 302(a) and this section, then only this section shall be applicable. None of the limitations of section 302 shall be applicable to such redemption.

§ 1.346–3. EFFECT OF CERTAIN SALES.—The determination of whether assets sold in connection with a partial liquidation are sold by the distributing corporation or by the shareholder is a question of fact to be determined under the facts and circumstances of each case.

CORPORATE ORGANIZATIONS AND REORGANIZATIONS

§ 1.351. STATUTORY PROVISIONS; TRANSFER TO CORPORATION CONTROLLED BY TRANSFEROR.

SEC. 351. TRANSFER TO CORPORATION CONTROLLED BY TRANSFEROR.

(a) GENERAL RULE.—No gain or loss shall be recognized if property is transferred to a corporation by one or more persons solely in exchange for stock or securities in such corporation and immediately after the exchange such person or persons are in control (as defined in section 368 (c)) of the corporation. For purposes of this section, stock or securities issued for services shall not be considered as issued in return for property.

(b) RECEIPT OF PROPERTY.—If subsection (a) would apply to an exchange but for the fact that there is received, in addition to the stock or securities permitted to be received under subsection (a), other property or money then—

(1) Gain (if any) to such recipient shall be recognized, but not in excess of—

(A) The amount of money received, plus

(B) The fair market value of such other property received; and

(c) SPECIAL RULE.—In determining control, for purposes of this section, the fact that any corporate transferor distributes part or all of the stock which it receives in the exchange to its shareholders shall not be taken into account.

(d) CROSS REFERENCES.—

(1) For special rule where another party to the exchange assumes a liability, or acquires property subject to a liability, see section 357.

(2) For the basis of stock, securities, or property received in an exchange to which this section applies, see sections 358 and 362.

(3) For special rule in the case of an exchange described in this section but which results in a gift, see section 2501 and following.

(4) For special rule in the case of an exchange described in this section but which has the effect of the payment of compensation by the corporation or by a transferor, see section 61(a)(1).

§ 1.351–1. TRANSFER TO CORPORATION CONTROLLED BY TRANSFEROR.—(a)(1) Section 351(a) provides, in general, for the nonrecognition of gain or loss upon the transfer by one or more persons of property to a corporation solely in exchange for stock or securities in such corporation if, immediately after the exchange, such person or persons are in control of the corporation to which the property was transferred. As used in section 351, the phrase "one or more persons" includes individuals, trusts, estates, partnerships, associations, companies, or corporations (see section 7701(a)(1)). To be in control of the transferee corporation, such person or persons must own immediately after the transfer stock possessing at least 80 percent of the total combined voting power of all classes of stock entitled to vote and at least 80 percent of the total number of shares of all other classes of stock of such corporation (see section 368(c)). In determining control under this section, the fact that any corporate transferor distributes part or all of the stock which it receives in the exchange to its shareholders shall not be taken into account. The phrase "immediately after the exchange" does not necessarily require simultaneous exchanges by two or more persons, but comprehends a situation where the rights of the parties have been previously defined and the execution of the agreement proceeds with an expedition consistent with orderly procedure. For purposes of this section—

(i) stock or securities issued for services rendered or to be rendered to or for the benefit of the issuing corporation will not be treated as having been issued in return for property, and

(ii) stock or securities issued for property which is of relatively small value in comparison to the value of the stock and securities already owned (or to be received for services) by the person who transferred such property, shall not be treated as having been issued in return for property if the primary purpose of the transfer is to qualify under this section the exchanges of property by other persons transferring property.

For the purpose of section 351, stock rights or stock warrants are not included in the term "stock or securities."

(2) The application of section 351(a) is illustrated by the following examples:

Example (1). C owns a patent right worth $25,000 and D owns a manufacturing plant worth $75,000. C and D organize the R Corporation with an authorized capital stock of $100,000. C transfers his patent right to the R Corporation for $25,000 of its stock and D transfers his plant to the new corporation for $75,000 of its stock. No gain or loss to C or D is recognized.

Example (2). B owns certain real estate which cost him $50,000 in 1930, but which has a fair market value of $200,000 in 1955. He transfers the property to the N Corporation in 1955 for 78 percent of each class of stock of the corporation having a fair market value of $200,000, the remaining 22 percent of the stock of the corporation having been issued by the corporation

in 1940 to other persons for cash. B realized a taxable gain of $150,000 on this transaction.

Example (3). E, an individual, owns property with a basis of $10,000 but which has a fair market value of $18,000. E also had rendered services valued at $2,000 to Corporation F. Corporation F has outstanding 100 shares of common stock all of which are held by G. Corporation F issues 400 shares of its common stock (having a fair market value of $20,000) to E in exchange for his property worth $18,000 and in compensation for the services he has rendered worth $2,000. Since immediately after the transaction, E owns 80 percent of the outstanding stock of Corporation F, no gain is recognized upon the exchange of the property for the stock. However, E realized $2,000 of ordinary income as compensation for services rendered to Corporation F.

(b) (1) Where property is transferred to a corporation by two or more persons in exchange for stock or securities, as described in paragraph (a) of this section, it is not required that the stock and securities received by each be substantially in proportion to his interest in the property immediately prior to the transfer. However, where the stock and securities received are received in disproportion to such interest, the entire transaction will be given tax effect in accordance with its true nature, and in appropriate cases the transaction may be treated as if the stock and securities had first been received in proportion and then some of such stock and securities had been used to make gifts (section 2501 and following), to pay compensation (section 61(a)(1)), or to satisfy obligations of the transferor of any kind.

(2) The application of paragraph (b)(1) of this section may be illustrated as follows:

Example (1). Individuals A and B, father and son, organize a corporation with 100 shares of common stock to which A transfers property worth $8,000 in exchange for 20 shares of stock, and B transfers property worth $2,000 in exchange for 80 shares of stock. No gain or loss will be recognized under section 351. However, if it is determined that A in fact made a gift to B, such gift will be subject to tax under section 2501 and following. Similarly, if B had rendered services to A (such services having no relation to the assets transferred or to the business of the corporation) and the disproportion in the amount of stock received constituted the payment of compensation by A to B, B will be taxable upon the fair market value of the 60 shares of stock received as compensation for services rendered, and A will realize gain or loss upon the difference between the basis to him of the 60 shares and their fair market value at the time of the exchange.

Example (2). Individuals C and D each transferred, to a newly organized corporation, property having a fair market value of $4,500 in exchange for the issuance by the corporation of 45 shares of its capital stock to each transferor. At the same time, the corporation issued to E, an individual, 10 shares of its capital stock in payment for organizational and promotional services

rendered by E for the benefit of the corporation. E transferred no property to the corporation. C and D were under no obligations to pay for E's services. No gain or loss is recognized to C or D. E received compensation taxable as ordinary income to the extent of the fair market value of the 10 shares of stock received by him.

§ 1.351-2. RECEIPT OF PROPERTY.—(a) If an exchange would be within the provisions of section 351(a) if it were not for the fact that the property received in exchange consists not only of property permitted by such subsection to be received without the recognition of gain, but also of other property or money, then the gain, if any, to the recipient shall be recognized, but in an amount not in excess of the sum of such money and the fair market value of such other property. No loss to the recipient shall be recognized.

(b) See section 357 and the regulations pertaining to that section for applicable rules as to the treatment of liabilities as "other property" in cases subject to section 351, where another party to the exchange assumes a liability, or acquires property subject to a liability.

(c) See sections 358 and 362 and the regulations pertaining to those sections for applicable rules with respect to the determination of the basis of stock, securities, or other property received in exchanges subject to section 351.

(d) See Part I of this subchapter and regulations pertaining to that Part for applicable rules with respect to the taxation of dividends where a distribution by a corporation of its stock or securities in connection with an exchange subject to section 351(a) has the effect of the distribution of a taxable dividend.

§ 1.351-3. RECORDS TO BE KEPT AND INFORMATION TO BE FILED.—(a) Every person who received the stock or securities of a controlled corporation, or other property as part of the consideration, in exchange for property under section 351, shall file with his income tax return for the taxable year in which the exchange is consummated a complete statement of all facts pertinent to such exchange, including—

(1) A description of the property transferred, or of his interest in such property, together with a statement of the cost or other basis thereof, adjusted to the date of transfer.

(2) With respect to stock of the controlled corporation received in the exchange, a statement of—

(i) The kind of stock and preferences, if any;

(ii) The number of shares of each class received; and

(iii) The fair market value per share of each class at the date of the exchange.

(3) With respect to securities of the controlled corporation received in the exchange, a statement of—

(i) The principal amount and terms; and

(ii) The fair market value at the date of exchange.

(4) The amount of money received, if any.

(5) With respect to other property received—

(i) A complete description of each separate item;

(ii) The fair market value of each separate item at the date of exchange; and

(iii) In the case of a corporate shareholder, the adjusted basis of the other property in the hands of the controlled corporation immediately before the distribution of such other property to the corporate shareholder in connection with the exchange.

(6) With respect to liabilities of the transferors assumed by the controlled corporation, a statement of—

(i) The nature of the liabilities;

(ii) When and under what circumstances created;

(iii) The corporate business reason for assumption by the controlled corporation; and

(iv) Whether such assumption eliminates the transferor's primary liability.

(b) Every such controlled corporation shall file with its income tax return for the taxable year in which the exchange is consummated—

(1) A complete description of all the property received from the transferors.

(2) A statement of the cost or other basis thereof in the hands of the transferors adjusted to the date of transfer.

(3) The following information with respect to the capital stock of the controlled corporation—

(i) The total issued and outstanding capital stock immediately prior to and immediately after the exchange, with a complete description of each class of stock.

(ii) The classes of stock and number of shares issued to each transferor in the exchange, and the number of shares of each class of stock owned by each tranferor immediately prior to and immediately after the exchange, and

(iii) The fair market value of the capital stock as of the date of exchange which was issued to each transferor.

(4) The following information with respect to securities of the controlled corporation—

(i) The principal amount and terms of all securities outstanding immediately prior to and immediately after the exchange,

(ii) The principal amoun and terms of securities issued to each transferor in the exchange, with a statement showing each transferor's holdings of securities of the controlled corporation immediately prior to and immediately after the exhange,

(iii) The fair market value of the securities issued to the transferors on the date of the exchange, and

(iv) A statement as to whether the securities issued in the exchange are subordinated in any way to other claims against the controlled corporation.

(5) The amount of money, if any, which passed to each of the transferors in connection with the transaction.

(6) With respect to other property which passed to each transferor—

(i) A compliete description of each separate item;

(ii) The fair market value of each separate item at the date of exchange, and

(iii) In the case of a corporate transferor, the adjusted basis of each separate item in the hands of the controlled corporation immediately before the distribution of such other property to the corporate transferor in connection with the exchange.

(7) The following information as to the transferor's liabilities assumed by the controlled corporation in the exchange—

(i) The amount and a description thereof,

(ii) When and under what circumstances created, and

(iii) The corporate business reason or reasons for assumption by the controlled corporation.

(c) Permanent records in substantial form shall be kept by every taxpayer who participates in the type of exchange described in section 351, showing the information listed above, in order to facilitate the determination of gain or loss from a subsequent disposition of stock or securities and other property, if any, received in the exchange.

EFFECTS ON SHAREHOLDERS AND SECURITY HOLDERS

§ 1.354. Statutory Provisions; Exchanges of Stock and Securities in Certain Reorganizations.

SEC. 354. EXCHANGES OF STOCK AND SECURITIES IN CERTAIN REORGANIZATIONS.

(a) General Rule.—

(1) In general.—No gain or loss shall be recognized if stock or securities in a corporation a party to a reorganization are, in pursuance of the plan of reorganization, exchanged solely for stock or securities in such corporation or in another corporation a party to the reorganization.

(2) Limitation.—Paragraph (1) shall not apply if—

(A) The principal amount of any such securities received exceeds the principal amount of any such securities surrendered, or

(B) Any such securities are received and no such securities are surrendered.

(3) Cross reference.—For treatment of the exchange if any property is received which is not permitted to be received under this subsection (including an excess principal amount of securities received over securities surrendered), see section 356.

(b) Exception.—

(1) In general.—Subsection (a) shall not apply to an exchange in pursuance of a plan of reorganization within the meaning of section 368(a)(1)(D), unless—

(A) The corporation to which the assets are transferred acquires substantially all of the assets of the transferor of such assets; and

(B) The stock, securities, and other properties received by such transferor, as well as the other properties of such transferor, are distributed in pursuance of the plan of reorganization.

(2) Cross reference.—For special rules for certain exchanges in pursuance of plans of reorganization within the meaning of section 368(a)(1)(D), see section 355.

(c) Certain Railroad Reorganizations.—Notwithstanding any other provision of this subchapter, subsection (a)(1) (and so much of section 356 as relates to this section) shall apply with respect to a plan of reorganization (whether or not a reorganization within the meaning of section 368(a)) for a railroad approved by the Interstate Commerce Commission under section 77 of the Bankruptcy Act, or under section 20b of the Interstate Commerce Act, as being in the public interest.

§ 1.354–1. EXCHANGES OF STOCK AND SECURITIES IN CERTAIN REORGANIZATIONS.—(a) Section 354 provides that under certain circumstances no gain or loss is recognized to a shareholder who surrenders his stock in exchange for other stock or to a security holder who surrenders his securities in exchange for stock. Section 354 also provides that under certain circumstances a security holder may surrender securities and receive securities in the same principal amount or in a lesser principal amount without the recognition of gain or loss to him. The exchanges to which section 354 applies must be pursuant to a plan of reorganization as provided in section 368(a) and the stock and securities surrendered as well as the stock and securities received must be those of a corporation which is a party to the reorganization. Section 354 does not apply to exchanges pursuant to a reorganization described in section 368(a)(1)(D) unless the transferor corporation—

(1) Transfers all or substantially all of its assets to a single corporation, and

(2) Distributes all of its remaining properties (if any) and the stock, securities and other properties received in the exchange to its shareholders or security holders in pursuance of the plan of reorganization. The fact that properties retained by the transferor corporation, or received in exchange for the properties transferred in the reorganization, are used to satisfy existing liabilities not represented by securities and which were incurred in the ordinary course of business before the reorganization does not prevent the application of section 354 to an exchange pursuant to a plan of reorganization defined in section 368(a)(1)(D).

(b) Except in the case described in subsection (c), section 354 is not applicable to an exchange of stock or securities if a greater principal amount of securities is received than the principal amount of securities the recipient surrenders, or if securities are received and the recipient surrenders no securities. See, however, section 356 and regulations pertaining to such section. See also section 306 with respect to the receipt of preferred stock in a transaction to which section 354 is applicable.

(c) An exchange of stock or securities shall be subject to section 354(a)(1) even though—

(1) Such exchange is not pursuant to a plan of reorganization described in section 368(a), and

(2) The principal amount of the securities received exceeds the principal amount of the securities surrendered or if securities are received and no securities are surrendered—

if such exchange is pursuant to a plan of reorganization for a railroad corporation as defined in section 77 (m) of the Bankruptcy Act and is approved by the Interstate Commerce Commission under section 77 of such Act or under section 20b of the Interstate Commerce Act as being in the public interest. Section 354 is not applicable to such exchanges if there is received property other than stock or securities. See, however, section 356 and regulations pertaining to such section.

(d) The rules of section 354 may be illustrated by the following examples:

Example (1). Pursuant to a reorganization under section 368(a) to which Corporations T and W are parties, A, a shareholder in Corporation T, surrenders all his common stock in Corporation T in exchange for common stock of Corporation W. No gain or loss is recognized to A.

Example (2). Pursuant to a reorganization under section 368(a) to which Corporations X and Y (which are not railroad corporations) are parties, B, a shareholder in Corporation X, surrenders all his stock in X for stock and securities in Y. Section 354 does not apply to this exchange. See, however, section 356.

Example (3). C, a shareholder in Corporation Z (which is not a railroad corporation), surrenders all his stock in Corporation Z in exchange for securities in Corporation Z. Whether or not this exchange is in connection with a recapitalization under section 368(a)(1)(E), section 354 does not apply. See, however, section 302.

(e) For the purpose of section 354, stock rights or stock warrants are not included in the term "stock or securities".

§ 1.355. STATUTORY PROVISIONS; DISTRIBUTION OF STOCK AND SECURITIES OF A CONTROLLED CORPORATION.

SEC. 355. DISTRIBUTION OF STOCK AND SECURITIES OF A CONTROLLED CORPORATION.

(a) EFFECT ON DISTRIBUTEES.—

(1) GENERAL RULE.—If—

(A) A corporation (referred to in this section as the "distributing corporation")—

(i) Distributes to a shareholder, with respect to its stock, or

(ii) Distributes to a security holder, in exchange for its securities,

solely stock or securities of a corporation (referred to in this section as "controlled corporation") which it controls immediately before the distribution,

(B) The transaction was not used principally as a device for the distribution of the earnings and profits of the distributing corporation or the controlled corporation or both (but the mere fact that subsequent to the distribution stock or securities in one or more of such corporations are sold or exchanged by all or some of the distributees (other than pursuant to an arrangement negotiated or agreed upon prior to such distribution) shall not be construed to mean that the transaction was used principally as such a device),

(C) The requirements of subsection (b) (relating to active businesses) are satisfied, and

(D) As part of the distribution, the distributing corporation distributes—

(i) All of the stock and securities in the controlled corporation held by it immediately before the distribution, or

(ii) An amount of stock in the controlled corporation constituting control within the meaning of section 368(c), and it is established to the satisfaction of the Secretary or his delegate that the retention by the distributing corporation of stock (or stock and securities) in the controlled corporation was not in pursuance of a plan having as one of its principal purposes the avoidance of Federal income tax,

then no gain or loss shall be recognized to (and no amount shall be includible in the income of) such shareholder or security holder on the receipt of such stock or securities.

(2) NON PRO RATA DISTRIBUTIONS, ETC.—Paragraph (1) shall be applied without regard to the following:

(A) Whether or not the distribution is pro rata with respect to all of the shareholders of the distributing corporation,

(B) Whether or not the shareholder surrenders stock in the distributing corporation, and

(C) Whether or not the distribution is in pursuance of a plan of reorganization (within the meaning of section 368(a)(1)(D)).

(3) LIMITATION.—Paragraph (1) shall not apply if—

(A) The principal amount of the securities in the controlled corporation which are received exceeds the principal amount of the securities which are surrendered in connection with such distribution, or

(B) Securities in the controlled corporation are received and no securities are surrendered in connection with such distribution.

For purposes of this section (other than paragraph (1)(D) of this subsection) and so much of section 356 as relates to this section, stock of a controlled corporation acquired by the distributing corporation by reason of any transaction which occurs within 5 years of the distribution of such stock and in which gain or loss was recognized in whole or in part, shall not be treated as stock of such controlled corporation, but as other property.

(4) CROSS REFERENCE.—For treatment of the distribution if any property is received which is not permitted to be received under this subsection (including an excess principal amount of securities received over securities surrendered), see section 356.

(b) REQUIREMENTS AS TO ACTIVE BUSINESS.—

(1) IN GENERAL.—Subsection (a) shall apply only if either—

(A) The distributing corporation, and the controlled corporation (or, if stock of more than one controlled corporation is distributed, each of such corporations), is engaged immediately after the distribution in the active conduct of a trade or business, or

(B) Immediately before the distribution, the distributing corporation had no assets other than stock or securities in the controlled corporations and each of the controlled corporations is engaged immediately after the distribution in the active conduct of a trade or business.

(2) DEFINITION.—For purposes of paragraph (1), a corporation shall be treated as engaged in the active conduct of a trade or business if and only if—

(A) It is engaged in the active conduct of a trade or business, or substantially all of its assets consist of stock and securities of a corporation controlled by it (immediately after the distribution) which is so engaged,

(B) Such trade or business has been actively conducted throughout the 5-year period ending on the date of the distribution,

(C) Such trade or business was not acquired within the period described in subparagraph (B) in a transaction in which gain or loss was recognized in whole or in part, and

(D) Control of a corporation which (at the time of acquisition of control) was conducting such trade or business—

(i) Was not acquired directly (or through one or more corporations) by another corporation within the period described in subparagraph (B), or

(ii) Was so acquired by another corporation within such period, but such control was so acquired only by reason of transactions in which gain or loss was not recognized in whole or in part, or only by reason of such transactions combined with acquisitions before the beginning of such period.

§ 1.355-1. DISTRIBUTION OF STOCK AND SECURITIES OF CONTROLLED CORPORATIONS—(a) *Application of section.* Section 355 provides for the separation, without recognition of gain or loss to the shareholders and security holders, of two or more existing businesses formerly operated, directly or indirectly, by a single corporation. It applies only to the separation of existing businesses which have been in active operation for at least five years, and which, in general, have been owned for at least five years by the corporation making the distribution of stock or of stock and securities. Section 355 does not apply to the division of a single business. For the purpose of section 355, stock rights or stock warrants are not included in the term "stock and securities".

(b) *Types of separations.* Section 355 is concerned with two general types of separations of businesses. The first is the distribution of the stock of an existing corporation. The second is the distribution of the stock of a new corporation which stock was received in exchange for the assets of a business previously operated by the distributing corporation. In both cases, this section contemplates the continued operation of the businesses existing prior to the separation.

(c) *Active business.* Section 355 is not applicable unless the controlled corporation and the distributing corporation are each engaged in the active conduct of a trade or business. For specific rules in this connection see section 355(b)(1) and (2). Without regard to such rules, for purposes of section 355, a trade or business consists of a specific existing group of activities being carried on for the purpose of earning income or profit from only such group of activities, and the activities included in such group must include every operation which forms a part of, or a step in, the process of earning income or profit from such group. Such group of activities ordinarily must include the collection of income and the payment of expenses. It does not include—

(1) The holding for investment purposes of stock, securities, land or other property, including casual sales thereof (whether or not the proceeds of such sales are reinvested),

(2) The ownership and operation of land or buildings all or substantially all of which are used and occupied by the owner in the operation of a trade or business, or

(3) A group of activities which, while a part of a business operated for profit, are not themselves independently producing income even though such activities would produce income with the addition of other activities or with large increases in activities previously incidental or insubstantial.

(d) The following examples illustrate the application of the rules described in paragraph (c) of this section:

Example (1). Corporation A is engaged in the manufacture and sale of soap and detergents and owns investment securities. It proposes to place the investment securities in a new corporation and distribute the stock of such new corporation to its shareholders. The holding of investment securities does not constitute a trade or business.

Example (2). Corporation B is engaged in the business of manufacturing and selling hats in its own factory building. It

proposes to transfer the factory building to a new corporation and distribute the stock of such new corporation to its shareholders. The activities in connection with the manufacturing of hats constitute a trade or business; but the operation of the factory building does not.

Example (3). Corporation C, a bank, owns an eleven-story downtown office building, the ground floor of which is occupied by it in the conduct of its banking business and the remaining ten floors of which it rents to various tenants. The ten floors are rented, managed and maintained by the real estate department of the bank. It is proposed to transfer the building to a new corporation and distribute the stock of such new corporation to the bank's shareholders. The activities in connection with banking constitute a trade or business as do also the activities in connection with the rental of the building.

Example (4). Corporation D, a bank, owns a two-story building in a suburban area, the ground floor and approximately one-half of the second floor of which is occupied by it in the conduct of its banking business. The remainder of the second floor is rented as storage space to a neighboring retail merchant. It is proposed to transfer the building to a new corporation and distribute the stock of such new corporation to the bank's shareholders. With respect to the rental of part of the second floor of its building, the bank is not engaged in the active conduct of a trade or business, such activity being only incidental to its banking business.

Example (5). Corporation E is engaged in the manufacture and sale of wood products. In connection with such manufacturing, it maintains a research department for its own use. It proposes to transfer the research department to a new corporation after which it will engage the services of the new corporation on a contract basis. The activities of the research department do not constitute a trade or business.

Example (6). Corporation F owns and rents an office building and owns vacant land. It proposes to transfer the vacant land to a new corporation and distribute the stock of such new corporation to its shareholders. The holding of the vacant land does not constitute a trade or business.

Example (7). Corporation G owns land on which it engages in the ranching business. Oil has been discovered in the area and it is apparent that oil may be found under the land on which the ranching activities are maintained. Corporation G has engaged in no activities in connection with the mineral rights. It proposes to transfer the mineral rights to a new corporation and distribute the stock of such new corporation to shareholders. Corporation G is not engaged in an active trade or business with respect to the mineral rights.

Example (8). Corporation H manufactures and sells ice cream at a plant in State X and at a plant in State Y. Corporation H proposes to transfer the plant and related activities in State Y to a new corporation and distribute the stock of such new corporation to its shareholders. The activities in each State constitute a trade or business.

Example (9). Corporation I manufactures and sells ice cream in State X. It purchases land and constructs a new plant in State Y. After manufacturing and selling operations have commenced at the new plant, it proposes to transfer it to a new corporation and distribute the stock of such new corporation to its shareholders. The activities at the new plant constitute a trade or business which, however, has been in existence only since such activities began.

Example (10). Corporation J has owned and operated a men's retail clothing store in the downtown area of the City of R for seven years and has also owned and operated a men's retail clothing store in the suburban area of the City of R for nine years. The manager of each store directs its operations and makes the necessary purchases. No common warehouse is maintained. Corporation J proposes to transfer the store building, fixtures, and inventory of the suburban store to a new corporation and distribute the stock of such new corporation to the shareholders of Corporation J. The activities of each store constitute a trade or business which has been in existence for more than five years.

Example (11). Corporation K processes and sells meat products. It is proposed to separate the selling from the manufacturing activities by forming a separate corporation, L, to handle sales. Corporation K will transfer to Corporation L certain physical assets pertaining to the sales function plus cash for working capital in exchange for the capital stock of Corporation L which will be distributed to the shareholders of Corporation K. Since the manufacturing and selling operations constitute only one integrated business, neither Corporation K nor Corporation L will be continuing the active conduct of a trade or business formerly conducted by Corporation K.

Example (12). Corporation M is engaged in the manufacture and sale of steel and steel products. In addition, Corporation M owns and operates a coal mine for the sole purpose of supplying its coal requirements in the manufacture of steel. It is proposed to transfer the coal mine to a new corporation and distribute the stock of such new corporation to the shareholders of Corporation M. The activities of Corporation M in connection with the operation of the coal mine do not constitute a trade or business, since such activities are not themselves independently producing income although a part of the business operated for profit.

Example (13). Corporation N manufactures steel containers for oil and oil products at a plant in State X and at a plant in State Y. Pursuant to a sales contract with Corporation O, Corporation N sells its entire product to Corporation O. Corporation N proposes to transfer the plant and related activities in State Y, together with that portion of the sales contract with Corporation O applicable to the sales of that plant to a new corporation and distribute the stock of such new corporation to its shareholders. The activities in each state constitute a trade or business before and after the transfer to the new corporation.

Example (14). Corporation P manufactures and sells steel containers for oil and oil products at a plant in State X and at a plant in State Y. Corporation P makes all of its sales through

its wholly-owned subsidiary pursuant to a sales contract, by virtue of which the subsidiary acts either as principal or sales agent for Corporation P. Corporation P proposes to transfer the plant and related activities in State Y, together with that portion of the sales contract applicable to the sales of that plant to a new corporation and distribute the stock of such new corporation to its shareholders. The activities in each state constitute a trade or business before and after the transfer to the new corporation.

Example (15). Corporation Q manufactures electrical products at a plant in State X and at a plant in State Y. The sales of the electrical products produced by each plant are made by the corporation's sales office located at the plant in State X. Corporation Q proposes to transfer the plant and related activities in State Y, together with that portion of the facilities and personnel of the sales office allocable to the sales of the plant in State Y to a new corporation and distribute the stock of such new corporation to its shareholders. The activities in each State constitute a trade or business before and after the transfer to the new corporation.

Example (16). Corporation R manufactures and sells automobiles and operates an executive dining room primarily for the convenience of its executives. The dining room is managed and operated as a separate unit and the executives are charged for their meals. Corporation R derives a profit from the operation of the dining room. The activities connected with the executive dining room do not constitute a trade or business.

(e) For further examples of businesses operated by one corporation, see § 1.337-3(d).

§ 1.355-2. LIMITATIONS—(a) *Property distributed.* The property distributed must consist solely of stock or stock and securities of a controlled corporation. If additional property (including an excess principal amount of securities received over securities surrendered) is received, see section 356.

(b) *Distribution of earnings and profits.* (1) The transaction must not have been used principally as a device for the distribution of the earnings and profits of the distributing corporation or of the controlled corporation or of both. If, pursuant to an arrangement negotiated or agreed upon prior to the distribution of stock or securities of the controlled corporation, part or all of the stock or securities of either corporation are sold or exchanged after the distribution, such sale or exchange will be evidence that the transaction was used principally as a device for the distribution of the earnings and profits of the distributing corporation or of the controlled corporation, or both. However, if the rules respecting continuity of interest contained in paragraph (c) of this section are not met, section 355 will not apply. If a sale of such stock or securities is made after the distribution and is not pursuant to an arrangement negotiated or agreed upon prior to the distribution, the mere fact of such sale is not determinative that the transaction was used principally as a device for the distribution of earnings and profits, but such fact will be evidence that the transaction was used principally as such a device.

(2) A sale is pursuant to an arrangement agreed upon prior to the distribution when enforcible rights to buy or to sell exist before such

distribution. In any case in which a sale or exchange was discussed by the buyer and the seller before the distribution, but enforcible rights to buy or to sell did not exist before such distribution, the question whether an arrangement was negotiated within the meaning of section 355(a)(1)(B) shall be determined from all the facts and circumstances.

(3) In determining whether a transaction was used principally as a device for the distribution of the earnings and profits of the distributing corporation or of the controlled corporation or both, consideration will be given to all of the facts and circumstances of the transaction. In particular, consideration will be given to the nature, kind and amount of the assets of both corporations (and corporations controlled by them) immediately after the transaction. The fact that at the time of the transaction substantially all of the assets of each of the corporations involved are and have been used in the active conduct of trades or businesses which meet the requirements of section 355(b) will be considered evidence that the transaction was not used principally as such a device.

(c) *Business purpose.* The distribution by a corporation of stock or securities of a controlled corporation to its shareholders with respect to its own stock or to its security holders in exchange for its own securities will not qualify under section 355 where carried out for purposes not germane to the business of the corporations. The principal reason for this requirement is to limit the application of section 355 to certain specified distributions or exchanges with respect to the stock or securities of controlled corporations incident to such readjustment of corporate structures as is required by business exigencies and which, in general, effect only a readjustment of continuing interests in property under modified corporate forms. Section 355 contemplates a continuity of the entire business enterprise under modified corporate forms and a continuity of interest in all or part of such business enterprise on the part of those persons who, directly or indirectly, were the owners of the enterprise prior to the distribution or exchange. All the requisites of business and corporate purposes described under § 1.368 must be met to exempt a transaction from the recognition of gain or loss under this section.

(d) *Stock and securities distributed.* The distributing corporation must distribute—

(1) All of the stock and securities of the controlled corporation which it owns, or

(2) At least an amount of the stock which constitutes control as defined in section 368(c). In such case all, or any part, of the securities of the controlled corporation may be distributed.

Where a part of either the stock or securities is retained under (2), it must be established to the satisfaction of the Commissioner that such retention was not in pursuance of a plan having as one of its principal purposes the avoidance of Federal income tax. Ordinarily, the business reasons (as distinguished from the desire to make a distribution of the earnings and profits) which support a distribution of stock and securities of a controlled corporation under paragraph (c) of this section will require the distribution of all of the stock and securities. If the distribution of all of the stock and securities of a controlled

corporation would be treated to any extent as a distribution of "other property" under section 356, this fact does not tend to establish that the retention of any of such stock and securities is not in pursuance of a plan having as one of its principal purposes the avoidance of Federal income tax.

(e) *Principal amount of securities.* (1) Section 355(a)(1) is not applicable if the principal amount of securities received exceeds the principal amount of securities surrendered or if securities are received and no securities are surrendered. In such cases, see section 356.

(2) If only stock is received in a transaction to which section 355 is applicable, the principal amount of securities surrendered, if any, and the par or stated value of stock is not relevant to the application of such section. For example: All of the stock of Corporation A is owned by X, an individual, and securities in the principal amount of $100,000 which were issued by Corporation A are owned by Y, an individual. Corporation A distributes all of the stock of a controlled corporation to Y in exchange for his securities. The par or stated value of the stock of the controlled corporation is $150,000. No gain or loss is recognized to Y upon the receipt of the stock of the controlled corporation.

(f) *Period of ownership.* (1) For the purposes of determining whether gain or loss will be recognized upon a distribution, stock of a controlled corporation acquired (in a transaction in which gain or loss is recognized, in whole or in part) within five years of the date of the distribution of such stock is treated as "other property." Section 355 does not apply to a transaction which includes a distribution of such stock. See section 356. The stock so acquired is "stock", however, for the purpose of the requirements respecting the distribution of stock of such controlled corporation provided in section 355(a)(1)(D).

(2) Paragraph (f)(1) of this section may be illustrated by the following example:

Example. Corporation A has held 85 of the 100 outstanding shares of the stock of Corporation B for more than five years on the date of distribution. Six months before such date, it purchased 10 shares of such stock. If all of the stock of the controlled corporation owned by Corporation A is distributed, section 355 is not applicable to such distribution since the 10 shares would represent "other property." See, however, section 356. If, however, for proper business reasons it is decided to retain some of the stock of Corporation B, then the determination of the amount of such stock which must be distributed under section 355(a)(1)(D) in order to constitute a distribution to which section 355 is applicable must be made by reference to all of the stock of the controlled corporation including the 10 shares acquired six months before such date and the 5 shares owned by others. Similarly, if, by the use of any agency, the distributing corporation acquires stock of the controlled corporation within five years of the date of distribution, for example, where another subsidiary purchases such stock, such stock will be treated as "other property." If Corporation A had held only 75 of the 100 outstanding shares of stock of Corporation B for more than five years on the date of distribution and had purchased the remaining 25 shares six months before such date, neither section 355 nor section 356 would be applicable.

(g) *Active businesses.* The rules of section 355(b) and § 1.355–4, relating to active businesses, must be satisfied.

§ 1.355–3. NON PRO RATA DISTRIBUTIONS, ETC.—(a) The rule of section 355(a)(1) prescribing that gain or loss will not be recognized applies whether or not the distribution is pro rata with respect to the interests of all the shareholders in the distributing corporation provided all other requirements of section 355 are satisfied. For example, if two individuals, A and B, own all of the stock of Corporation X which operates two active businesses, one business may be transferred to a new corporation in exchange for all of its stock and such stock distributed to either A or B in exchange for all of his stock of Corporation X. Similarly, if, in the above example, only a part of the stock of the new corporation is transferred to one of the shareholders in exchange for all of his stock of Corporation X and the balance of such stock is distributed to the other shareholder (whether or not such other shareholder surrenders stock in Corporation X), no gain or loss will be recognized. The same rule will be applicable if the stock of an existing controlled corporation is distributed to the shareholders even though such distribution is not pursuant to a plan of reorganization. Section 355 does not apply, however, if the substance of the transaction is merely an exchange between shareholders or security holders of stock or securities in one corporation for stock or securities in another corporation. For example, if two individuals, C and D, each own directly fifty percent of the stock of Corporation M and fifty percent of the stock of Corporation N, section 355 would not apply to a transaction in which C and D transfer all of their stock in Corporation M and Corporation N to a new corporation, P, for all of the stock of Corporation P, and Corporation P then distributes the stock of Corporation M to C and the stock of Corporation N to D.

(b) The stock of the controlled corporation which is distributed may consist of either common or preferred stock. See, however, section 306 with respect to the receipt of preferred stock in a transaction to which section 355 is applicable.

(c) The rule of section 355(a)(1) prescribing that gain or loss will not be recognized applies whether or not the shareholder surrenders stock in the distributing corporation and whether or not the distribution is in pursuance of a plan of reorganization (within the meaning of section 368(a)(1)(D)).

§ 1.355–4. ACTIVE CONDUCT OF A TRADE OR BUSINESS.—(a) A distribution of stock or securities of a controlled corporation is subject to section 355(a) only if:

(1) The distributing corporation and the controlled corporation are each engaged in the active conduct of a trade or business immediately after the distribution of stock or securities of the controlled corporation; or

(2) Immediately before the distribution the distributing corporation had no assets other than stock or securities in the controlled corporations and each of the controlled corporations is engaged in the active conduct of a trade or business immediately after the distribution. In connection with the requirement of "no assets" a de minimis rule is applicable.

(3) These rules are illustrated by the following examples:

Example (1). Corporation A, prior to the distribution, operates an active business and owns all of the stock of Corporation B which also is engaged in the active conduct of a business. Corporation A distributes all of the stock of Corporation B to its shareholders, and both continue the operations of their separate businesses. The active business requirement of section 355(b)(1)(A) is satisfied.

Example (2). The facts are the same as in example 1, except that Corporation A transfers all of its assets except the stock of Corporation B to a new corporation in exchange for all of its stock and transfers the stock of both controlled corporations to its shareholders. The active business requirement of section 355(b)(1)(B) is satisfied.

(b) (1) Section 355(b)(2) provides rules for determining whether any corporation is treated as engaged in the active conduct of a trade or business for purposes of ascertaining whether the distributing corporation and the controlled corporation meet the requirements of section 355(b)(1). Under section 355(b)(2)(A), a corporation is treated as engaged in the active conduct of a trade or business if it is itself engaged in such a trade or business or if substantially all of its assets consist of the stock and securities of a corporation or corporations controlled by it (immediately after the distribution) each of which is engaged in the active conduct of a trade or business. Regardless of whether the determination is based upon a corporation's own conduct of a trade or business or on the basis of its ownership of the stock of a corporation or corporations which conduct a trade or business, such trade or business must have been actively conducted for the five-year period ending on the date of distribution of the stock and securities of the controlled corporation the stock of which was distributed as provided in section 355(b)(2)(B). Furthermore, such trade or business must not have been acquired by either corporation during such five-year period unless it was acquired in a transaction in which gain or loss was not recognized (section 355(b)(2)(C)). In addition, under section 355(b)(2)(D), such business must not have been indirectly acquired during such five-year period by means of the acquisition of control of another corporation in a transaction in which gain or loss was recognized. Thus, section 355(b)(2)(D) requires that during the five-year period during which the trade or business must be actively conducted, such business cannot have been acquired, directly or indirectly, through another corporation by such other corporation or any of its predecessors in interest in a transaction in which gain or loss was recognized in whole or in part.

(2) Paragraph (b)(1) of this section may be illustrated by the following example:

Example. In 1956, Corporation B, having cash and other liquid assets and engaged in only one active business purchases all of the stock of Corporation A, also engaged in a single active business. Later in the same year, Corporation B in a "downstairs" statutory merger merges into Corporation A. In 1958, Corporation A places the assets of the active business formerly operated by Corporation B in a new subsidiary X. A distribution of the stock of Corporation X to the stockholders of Corporation A is

not within the terms of section 355, since one of the active businesses had, in effect, been purchased less than five years prior to the distribution.

(3) For the purpose of determining whether such trade or business has been actively conducted throughout the five-year period described in section 355(b)(2), the fact that during such five-year period such trade or business underwent change (for example, by the addition of new or the dropping of old products, changes in production capacity, and the like) shall be disregarded provided the changes are not of such a character as to constitute the acquisition of a new or different business.

§ 1.355-5. RECORDS TO BE KEPT AND INFORMATION TO BE FILED.—(a) Every corporation that makes a distribution of stock or securities of a controlled corporation, as described in section 355, shall attach to its return for the year of the distribution a detailed statement setting forth such data as may be appropriate in order to show compliance with the provisions of such section.

(b) Every taxpayer who receives a distribution of stock or securities of a corporation that was controlled by a corporation in which he holds stock or securities shall attach to his return for the year in which such distribution is received a detailed statement setting forth such data as may be appropriate in order to show the applicability of section 355. Such statement shall include, but shall not be limited to, a description of the stock and securities surrendered (if any) and received, and the names and addresses of all of the corporations involved in the transaction:

§ 1.356. STATUTORY PROVISIONS; RECEIPT OF ADDITIONAL CONSIDERATION.

SEC. 356. RECEIPT OF ADDITIONAL CONSIDERATION.

(a) GAIN ON EXCHANGES.—

(1) RECOGNITION OF GAIN.—If—

(A) Section 354 or 355 would apply to an exchange but for the fact that

(B) The property received in the exchange consists not only of property permitted by section 354 or 355 to be received without the recognition of gain but also of other property or money,

then the gain, if any, to the recipient shall be recognized, but in an amount not in excess of the sum of such money and the fair market value of such other property.

(2) TREATMENT AS DIVIDEND.—If an exchange is described in paragraph (1) but has the effect of the distribution of a dividend, then there shall be treated as a dividend to each distributee such an amount of the gain recognized under paragraph (1) as is not in excess of his ratable share of the undistributed earnings and profits of the corporation accumulated after February 28, 1913. The remainder, if any, of the gain recognized under paragraph (1) shall be treated as gain from the exchange of property.

(b) ADDITIONAL CONSIDERATION RECEIVED IN CERTAIN DISTRIBUTIONS.—If—

(1) Section 355 would apply to a distribution but for the fact that

(2) The property received in the distribution consists not only of property permitted by section 355 to be received without the recognition of gain, but also of other property or money,

then an amount equal to the sum of such money and the fair market value of such other property shall be treated as a distribution of property to which section 301 applies.

(c) Loss.—If—

(1) Section 354 would apply to an exchange, or section 355 would apply to an exchange or distribution, but for the fact that

(2) The property received in the exchange or distribution consists not only of property permitted by section 354 or 355 to be received without the recognition of gain or loss, but also of other property or money,

then no loss from the exchange or distribution shall be recognized.

(d) SECURITIES AS OTHER PROPERTY.—For purposes of this section—

(1) IN GENERAL.—Except as provided in paragraph (2), the term "other property" includes securities.

(2) EXCEPTIONS.—

(A) Securities With Respect to Which Nonrecognition of Gain Would Be Permitted.—The term "other property" does not include securities to the extent that, under section 354 or 355, such securities would be permitted to be received without the recognition of gain.

(B) Greater Principal Amount in Section 354 Exchange.—If—

(i) In an exchange described in section 354 (other than subsection (c) thereof), securities of a corporation a party to the reorganization are surrendered and securities of any corporation a party to the reorganization are received, and

(ii) The principal amount of such securities received exceeds the principal amount of such securities surrendered,

then, with respect to such securities received, the term "other property" means only the fair market value of such excess. For purposes of this subparagraph and subparagraph (C), if no securities are surrendered, the excess shall be the entire principal amount of the securities received.

(C) Greater Principal Amount in Section 355 Transaction.—If, in an exchange or distribution described in section 355, the principal amount of the securities in the controlled corporation which are received exceeds the principal amount of the securities in the distributing corporation which are surrendered, then, with respect to such securities received, the term "other property" means only the fair market value of such excess.

(e) EXCHANGES FOR SECTION 306 STOCK.—Notwithstanding any other provision of this section, to the extent that any of the other property (or money) is received in exchange for section 306 stock, an amount equal to the fair market value of such other property (or the amount of such money) shall be treated as a distribution of property to which section 301 applies.

(f) TRANSACTIONS INVOLVING GIFT OR COMPENSATION.—For special rules for a transaction described in section 354, 355, or this section, but which—

(1) Results in a gift, see section 2501 and following, or

(2) Has the effect of the payment of compensation, see section 61(a)(1).

§ 1.356–1. RECEIPT OF ADDITIONAL CONSIDERATION IN CONNECTION WITH AN EXCHANGE.—(a) If in any exchange to which the provisions of section 354 or section 355 would apply except for the fact that there is received by the shareholders or the security holders other property (in addition to property permitted to be received without recognition of gain by such sections, or money, then—

(1) The gain, if any, to the taxpayer shall be recognized in an amount not in excess of the sum of the money and the fair market value of the other property, but,

(2) The loss, if any, to the taxpayer from the exchange or distribution shall not be recognized to any extent.

(b) If the distribution of such other property or money by or on behalf of a corporation has the effect of the distribution of a dividend, then there shall be chargeable to each distributee (either an individual or a corporation)—

(1) As a dividend, such an amount of the gain recognized as is not in excess of the distributee's ratable share of the undistributed earnings and profits of the corporation accumulated after February 28, 1913, and

(2) As a gain from the exchange of property, the remainder of the gain so recognized.

(c) The rules of this section may be illustrated by the following examples:

Example (1). In an exchange to which the provisions of section 356 apply and to which section 354 would apply but for the receipt of property not permitted to be received without the recognition of gain or loss, A (either an individual or a corporation), received the following in exchange for a share of stock having an adjusted basis to him of $85:

One share of stock worth	$100
Cash	25
Other property (basis $25) fair market value	50
Total fair market value of consideration received	$175
Adjusted basis of stock surrendered in exchange	85
Total gain	$90
Gain to be recognized, limited to cash and other property received	$75
A's pro rata share of earnings and profits accumulated after February 28, 1913 (taxable dividend)	30
Remainder to be treated as a gain from the exchange of property	$45

Example (2). If, in example (1), A's stock had an adjusted basis to him of $200, he would have realized a loss of $25 on the exchange, which loss would not be recognized.

(d) Section 301(b)(1)(B) and section 301(d)(2) do not apply to a distribution of "other property" to a corporate shareholder if such distribution is within the provisions of section 356.

(e) See § 1.301-1(l) for certain transactions which are not within the scope of section 356.

§ 1.356-2. Receipt of Additional Consideration Not in Connection With an Exchange.—(a) If, in a transaction to which section 355 would apply except for the fact that a shareholder (individual or corporate) receives property permitted by section 355 to be received without the recognition of gain, together with other property or money, without the surrender of any stock or securities of the distributing corporation, then the sum of the money and the fair market value of the other property as of the date of the distribution shall be treated as a distribution of property to which the rules of section 301 (other than section 301(b) and section 301(d)) apply. See section 358 for determination of basis of such other property.

(b) The rule under paragraph (a) of this section may be illustrated by the following examples:

Example (1). Individuals A and B each own 50 of the 100 outstanding shares of common stock of Corporation X. Corporation X owns all of the stock of Corporation Y, 100 shares. Corporation X distributes to each shareholder 50 shares of the stock of Corporation Y plus $100 cash without requiring the surrender of any shares of its own stock. The $100 cash received by each is treated as a distribution of property to which the rules of section 301 apply.

Example (2). If, in the above example, Corporation X distributes 50 shares of stock of Corporation Y to A and 30 shares of such stock plus $100 cash to B without requiring the surrender of any of its own stock, the amount of cash received by B is treated as a distribution of property to which the rules of Section 301 apply.

§ 1.356-3. RULES FOR TREATMENT OF SECURITIES AS "OTHER PROPERTY."—(a) As a general rule, for purposes of section 356, the term "other property" includes securities. However, it does not include securities permitted under section 354 or section 355 to be received tax free. Thus, when securities are surrendered in a transaction to which section 354 or section 355 is applicable, the characterization of the securities received as "other property" does not include securities received where the principal amount of such securities does not exceed the principal amount of securities surrendered in the transaction. If a greater principal amount of securities is received in an exchange described in section 354 (other than subsection (c) thereof) or section 355 over the principal amount of securities surrendered, the term "other property" includes the fair market value of such excess principal amount as of the date of the exchange. If no securities are surrendered in exchange, the term "other property" includes the fair market value, as of the date of receipt, of the entire principal amount of the securities received.

(b) The following examples illustrate the application of the above rules:

Example (1). A, an individual, exchanged 100 shares of stock for 100 shares of stock and a security in the principal amount of $1,000 with a fair market value of $990. The amount of $990 is treated as "other property."

Example (2). B, an individual, exchanged 100 shares of stock and a security in the principal amount of $1,000 for 300 shares of stock and a security in the principal amount of $1,500. The security had a fair market value on the date of receipt of $1,575. The fair market value of the excess principal amount, or $525, is treated as "other property."

Example (3). C, an individual, exchanged a security in the principal amount of $1,000 for 100 shares of stock and a security in the principal amount of $900. No part of the security received is treated as "other property."

Example (4). D, an individual, exchanged a security in the principal amount of $1,000 for 100 shares of stock and a security in the principal amount of 1,200 with a fair market value of $1,100. The fair market value of the excess principal amount, or $183.33, is treated as "other property."

Example (5). E, an individual, exchanged a security in the principal amount of $1,000 for another security in the principal amount of $1,200 with a fair market value of $1,080. The fair market value of the excess principal amount, or $180, is treated as "other property."

Example (6). F, an individual, exchanged a security in the principal amount of $1,000 for two different securities each in the principal amount of $750. One of the securities had a fair market value of $750, the other had a fair market value of $600. One-third of the fair market value of each security ($250 and $200) is treated as "other property."

§ 1.356–4. EXCHANGES FOR SECTION 306 STOCK.—If, in a transaction to which section 356 is applicable, other property or money is received in exchange for section 306 stock, an amount equal to the fair market value of the property plus the money, if any, shall be treated as a distribution of property to which section 301 is applicable. The determination of whether section 306 stock is surrendered for other property (including money) is a question of fact to be decided under all of the circumstances of each case. Ordinarily, the other property (including money) received will first be treated as received in exchange for any section 306 stock owned by a shareholder prior to such transaction. For example, if a shareholder who owns a share of common stock (having a basis to him of $100) and a share of preferred stock which is section 306 stock(having a basis to him of $100) surrenders both shares in a transaction to which section 356 is applicable for one share of common stock having a fair market value of $80 and one $100 bond having a fair market value of $100, the bond will be deemed received in exchange for the section 306 stock and it will be treated as a distribution to which section 301 is applicable to the extent of its entire fair market value ($100).

§ 1.356–5. TRANSACTIONS INVOLVING GIFT OR COMPENSATION.—With respect to transactions described in sections 354, 355, or 356, but which—

(a) Result in a gift, see section 2501 and following, and the regulations pertaining thereto, or

(b) Have the effect of the payment of compensation, see section 61(a)(1), and the regulations pertaining thereto.

§ 1.357. STATUTORY PROVISIONS; ASSUMPTION OF LIABILITY.—

SEC. 357. ASSUMPTION OF LIABILITY.

(a) GENERAL RULE.—Except as provided in subsections (b) and (c), if—

(1) The taxpayer receives property which would be permitted to be received under section 351, 361, or 371 without the recognition of gain if it were the sole consideration, and

(2) As part of the consideration, another party to the exchange assumes a liability of the taxpayer, or acquires from the taxpayer property subject to a liability, then such assumption or acquisition shall not be treated as money or other property, and shall not prevent the exchange from being within the provisions of section 351, 361, or 371, as the case may be.

(b) TAX AVOIDANCE PURPOSE—

(1) IN GENERAL.—If, taking into consideration the nature of the liability and the circumstances in the light of which the arrange-

ment for the assumption or acquisition was made, it appears that the principal purpose of the taxpayer with respect to the assumption or acquisition described in subsection (a)—

(A) Was a purpose to avoid Federal income tax on the exchange, or

(B) If not such purpose, was not a bona fide business purpose,

then such assumption or acquisition (in the total amount of the liability assumed or acquired pursuant to such exchange) shall, for purposes of section 351, 361, or 371 (as the case may be), be considered as money received by the taxpayer on the exchange.

(2) BURDEN OF PROOF.—In any suit or proceeding where the burden is on the taxpayer to prove such assumption or acquisition is not to be treated as money received by the taxpayer, such burden shall not be considered as sustained unless the taxpayer sustains such burden by the clear preponderance of the evidence.

(c) LIABILITIES IN EXCESS OF BASIS.—

(1) IN GENERAL.—In the case of an exchange—

(A) To which section 351 applies, or

(B) To which section 361 applies by reason of a plan of reorganization within the meaning of section 368(a)(1)(D),

if the sum of the amount of the liabilities assumed, plus the amount of the liabilities to which the property is subject, exceeds the total of the adjusted basis of the property transferred pursuant to such exchange, then such excess shall be considered as a gain from the sale or exchange of a capital asset or of property which is not a capital asset, as the case may be.

(2) EXCEPTIONS.—Paragraph (1) shall not apply to any exchange to which—

(A) Subsection (b)(1) of this section applies, or

(B) Section 371 applies.

§ 1.357-1. ASSUMPTION OF LIABILITY.—(a) *General rule.*—Section 357(a) does not affect the rule that liabilities assumed are to be taken into account for the purpose of computing the amount of gain or loss realized under section 1001 upon an exchange. Section 357(a) provides, subject to the exceptions and limitations specified in section 357(b) and (c), that—

(1) Liabilities assumed are not to be treated as "other property or money" for the purpose of determining the amount of realized gain which is to be recognized under section 351, 361, or 371, if the transactions would, but for the receipt of "other property or money" have been exchanges of the type described in any one of such sections; and

(2) If the only type of consideration received by the transferor in addition to that permitted to be received by section 351, 361, or 371, consists of an assumption of liabilities, the transaction, if otherwise qualified, will be deemed to be within the provisions of section 351, 361, or 371.

(b) *Application of general rule.*—The application of paragraph (a) of this section may be illustrated by the following example:

Example. A, an individual, transfers to a controlled corporation property with an adjusted basis of $10,000 in exchange for stock of the corporation with a fair market value of $8,000, $3,000 cash, and the assumption by the corporation of indebtedness of A amounting to $4,000. A's gain is $5,000, computed as follows:

Stock received, fair market value	$8,000
Cash received	3,000
Liability assumed by transferee	4,000
Total consideration received	$15,000
Less: Adjusted basis of property transferred	10,000
Gain realized	$5,000

Assuming that the exchange falls within section 351 as a transaction in which the gain to be recognized is limited to "other property or money" received, the gain recognized to A will be limited to the $3,000 cash received, since, under the general rule of section 357(a), the assumption of the $4,000 liability does not constitute "other property."

(c) *Tax avoidance purpose.*—The benefits of section 357(a) do not extend to any exchange involving an assumption of liabilities where it appears that the principal purpose of the taxpayer with respect to such assumption was to avoid Federal income tax on the exchange, or, if not such purpose, was not a bona fide business purpose. In such cases, the total amount of liabilities assumed or acquired pursuant to such exchange (and not merely a particular liability with respect to which the tax avoidance purpose existed) shall, for the purpose of determining the amount of gain to be recognized upon the exchange in which the liabilities are assumed or acquired, be treated as money received by the taxpayer upon the exchange. Thus, if in the example set forth in paragraph (b) of this section, the principal purpose of the assumption of the $4,000 liability was to avoid tax on the exchange, or was not a bona fide business purpose, then the amount of gain recognized would be $5,000. In any suit or proceeding where the burden is on the taxpayer to prove that an assumption of liabilities is not to be treated as "other property or money" under section 357, which is the case if the Commissioner determines that the taxpayer's purpose with respect thereto was a purpose to avoid Federal income tax on the exchange or was not a bona fide business purpose, and the taxpayer contests such determination by litigation, the taxpayer must sustain such burden by the clear preponderance of the evidence. Thus, the taxpayer must prove his case by such a clear preponderance of all the evidence that the absence of a purpose to avoid Federal income tax on the exchange, or the presence of a bona fide business purpose, is unmistakable.

§ 1.357-2. Liabilities in Excess of Basis.—(a) Section 357(c) provides in general that in an exchange to which section 351 (relating to a transfer to a corporation controlled by the transferor) is applicable, or to which section 361 (relating to the nonrecognition of gain or loss to corporations) is applicable by reason of a section 368(a)(1)(D) reorganization, if the sum of the amount of liabilities assumed plus the amount of liabilities to which the property is subject, exceeds the total of the adjusted basis of the property transferred pursuant to such exchange, then such excess shall be considered as a gain from the sale or exchange of a capital asset or of property which is not a capital asset as the case may be. Thus, if an individual transfers, under section 351, properties having a total basis in his hands of $20,000, one of which has a basis of $10,000 but is subject to a mortgage of $30,000, to a corporation controlled by him, such individual will be subject to tax with respect to $10,000, the excess of the amount of the liability

over the total adjusted basis of all the properties in his hands. The same result will follow whether or not the liability is assumed by the transferee. The determination of whether a gain resulting from the transfer of capital assets is long- or short-term capital gain shall be made by reference to the holding period to the transferor of the assets transferred. An exception to the general rule of section 357(c) is made (1) for any exchange as to which under section 357(b) (relating to assumption of liabilities for tax avoidance purposes) the entire amount of the liabilities is treated as money received, and (2) for an exchange to which section 371 (relating to reorganizations in certain receivership and bankruptcy proceedings) is applicable.

(b) The application of paragraph (a) of this section may be illustrated by the following examples:

Example (1). If all such assets transferred are capital assets and if half the assets (ascertained by reference to their fair market value at the time of the transfer) have been held for less than 6 months and the remaining half for more than 6 months, half the excess of the amount of the liability over the total of the adjusted basis of the property transferred pursuant to the exchange shall be treated as short-term capital gain, and the remaining half shall be treated as long-term capital gain.

Example (2). If half of the assets (ascertained by reference to their fair market value at the time of the transfer) transferred are capital assets and half are assets other than capital assets, then half of the excess of the amount of the liability over the total of the adjusted basis of the property transferred pursuant to the exchange shall be treated as capital gain, and the remaining half shall be treated as gain from the sale or exchange of assets other than capital assets.

§ 1.358. Statutory Provisions; Basis to Distributees.

SEC. 358. BASIS TO DISTRIBUTEES.

(a) General Rule.—In the case of an exchange to which section 351, 354, 355, 356, 361 or 371(b) applies—

(1) Nonrecognition property.—The basis of the property permitted to be received under such section without the recognition of gain or loss shall be the same as that of the property exchanged—

(A) Decreased by—

(i) The fair market value of any other property (except money) received by the taxpayer, and

(ii) The amount of money received by the taxpayer, and

(B) Increased by—

(i) The amount which was treated as a dividend, and

(ii) The amount of gain to the taxpayer which was recognized on such exchange (not including any portion of such gain which was treated as a dividend).

(2) Other property.—The basis of any other property (except money) received by the taxpayer shall be its fair market value.

(b) Allocation of basis.—

(1) In general.—Under regulations prescribed by the Secretary or his delegate, the basis determined under subsection (a)(1) shall be allocated among the properties permitted to be received without the recognition of gain or loss.

(2) Special rule for section 355.—In the case of an exchange to which section 355 (or so much of section 356 as relates to section 355) applies, then in making the allocation under paragraph (1) of

this subsection, there shall be taken into account not only the property so permitted to be received without the recognition of gain or loss, but also the stock or securities (if any) of the distributing corporation which are retained, and the allocation of basis shall be made among all such properties.

(c) SECTION 355 TRANSACTIONS WHICH ARE NOT EXCHANGES.—For purposes of this section, a distribution to which section 355 (or so much of section 356 as relates to section 355) applies shall be treated as an exchange, and for such purposes the stock and securities of the distributing corporation which are retained shall be treated as surrendered, and received back, in the exchange.

(d) ASSUMPTION OF LIABILITY.—Where, as part of the consideration to the taxpayer, another party to the exchange assumed a liability of the taxpayer or acquired from the taxpayer property subject to a liability, such assumption or acquisition (in the amount of the liability) shall, for purposes of this section, be treated as money received by the taxpayer on the exchange.

(e) EXCEPTION.—This section shall not apply to property acquired by a corporation by the issuance of its stock or securities as consideration in whole or in part for the transfer of the property to it.

§ 1.358–1. BASIS TO DISTRIBUTEES.—(a) In the case of an exchange or distribution to which section 354, 355, or 371(b) applies in which, under the law applicable to the year in which the exchange is made, only nonrecognition property is received, the sum of the basis of all the stock and securities in the corporation whose stock and securities are exchanged or with respect to which the distribution is made, held immediately after the transaction, plus the basis of all the stock and securities received in the transaction shall be the same as the basis of all the stock and securities in such corporation held immediately before the transaction allocated in the manner described in § 1.358–2. In the case of an exchange to which section 351 or 361 applies in which, under the law applicable to the year in which the exchange was made, only nonrecognition property is received, the basis of all the stock and securities received in the exchange shall be the same as the basis of all property exchanged therefor. If in an exchange or distribution to which section 351, 356, 361, or 371(b) applies both nonrecognition property and "other property" are received, the basis of all the property except "other property" held after the transaction shall be determined as described in the preceding two sentences decreased by the sum of the money and the fair market value of the "other property" (as of the date of the transaction) and increased by the sum of the amount treated as a dividend (if any) and the amount of the gain recognized on the exchange, but the term "gain" as here used does not include any portion of the recognized gain that was treated as a dividend. The basis of the "other property" is its fair market value as of the date of the transaction.

(b) The application of paragraph (a) of this section may be illustrated by the following example:

Example. A purchased a share of stock in Corporation X in 1935 for $150. Since that date he has received distributions out of other than earnings and profits (as defined in section 316) totalling $60, so that his adjusted basis for the stock is $90. In a transaction qualifying under section 356, A exchanged this share for one share in Corporation Y, worth $100, cash in the amount of $10, and other property with a fair market value of $30. The exchange had the effect of the distribution of a divi-

dend. A's ratable share of the earnings and profits of Corporation X accumulated after February 28, 1913, was $5. A realized a gain of $50 on the exchange, but the amount recognized is limited to $40, the sum of the cash received and the fair market value of the other property. Of the gain recognized, $5 is taxable as a dividend, and $35 as a gain from the exchange of property. The basis to A of the one share of stock of Corporation Y is $90, that is, the adjusted basis of the one share of stock of Corporation X ($90), decreased by the sum of the cash received ($10) and the fair market value of the other property received ($30) and increased by the sum of the amount treated as a dividend ($5) and the amount treated as a gain from the exchange of property ($35). The basis of the other property received is $30.

§ 1.358-2. ALLOCATION OF BASIS AMONG NONRECOGNITION PROPERTY.—(a)(1) As used in this paragraph the term "stock" means stock which is not "other property" under section 356 or 371(b), stock with respect to which a distribution is made, and, in the case of a surrender of part of the stock of a particular class, the retained part of such stock. The term "securities" means securities (including, where appropriate, fractional parts of securities) which are not "other property" under section 356 or 371(b) and in the case of a surrender of part of the securities of a particular class, the retained part of such securities. Stock, or securities, as the case may be, which differ either because they are in different corporations or because the rights attributable to them differ (although they are in the same corporation) are considered different classes of stock or securities, as the case may be, for purposes of this section.

(2) If as the result of an exchange or distribution under the terms of section 354, 355, 356 or 371(b) a shareholder who owned stock of only one class before the transaction owns stock of two or more classes after the transaction, then the basis of all the stock held before the transaction (as adjusted under § 1.358-1 above) shall be allocated among the stock of all classes (whether or not such stock was received in the transaction) held immediately after the transaction in proportion to the fair market values of the stock of each class.

(3) If as the result of an exchange under the terms of section 354, 355, 356 or 371(b) a security holder who owned only securities, all of one class, before the transaction, owns securities or stock of more than one class, or owns both stock and securities, then the basis of all the securities held before the transaction (as adjusted under § 1.358-1 above) shall be allocated among all the stock and securities (whether or not received in the transaction) held immediately after the transaction in proportion to the fair market values of the stock of each class and the securities of each class.

(4) In every case in which, before the transactions, a person owned stock of more than one class or securities of more than one class or owned both stock and securities, a determination must be made, upon the basis of all the facts, of the stock or securities received with respect to stock and securities of each class held (whether or not surrendered). The allocation described in subparagraph (2) above shall be separately made as to the stock of each class with respect to which there is an exchange or distribution and the allocation described in

subparagraph (3) above shall be separately made with respect to the securities of each class, part or all of which are surrendered in the exchange.

(5) Notwithstanding the provisions of subparagraphs (2), (3) and (4) above, in any case in which a plan of recapitalization under section 368(a)(1)(E) provides that each holder of stock or securities of a particular class shall have an option to surrender some or none of such stock or securities in exchange for stock or securities, and a shareholder or security holder exchanges an identifiable part of his stock or securities, the basis of the part of the stock or securities retained shall remain unchanged and shall not be taken into account in determining the basis of the stock or securities received.

(b)(1) As used in this paragraph the term "stock" refers only to stock which is not "other property" under section 351 or 361 and the term "securities" refers only to securities which are not "other property" under section 351 or 361.

(2) If in an exchange to which section 351 or 361 applies property is transferred to a corporation and the transferor receives stock or securities of more than one class or receives both stock and securities, then the basis of the property transferred (as adjusted under § 1.358-1 above) shall be allocated among all of the stock and securities received in proportion to the fair market values of the stock of each class and the securities of each class.

(c) The application of paragraphs (a) and (b) of this section may be illustrated by the following examples:

Example (1). A, an individual, owns stock in Corporation X with an adjusted basis of $1,000. In a transaction qualifying under section 356 (so far as such section relates to section 354), he exchanged this stock for 20 shares of stock of Corporation Y worth $1,200 and securities of Corporation Y worth $400. A realizes a gain of $600 of which $400 is recognized. The adjusted basis in A's hands of each share of the stock of Corporation Y is $50 determined by allocating the basis of the stock of Corporation X ratably to the stock of Corporation Y received in the exchange. The securities of Corporation Y have a basis in the hands of A of $400.

Example (2). B, an individual, owns a security in the principal amount of $10,000 with a basis of $5,000. In a transaction to which section 354 is applicable, he exchanges this security for four securities in the principal amount of $750 each, worth $800 each, four securities in the principal amount of $750 each, worth $600 each, class A common stock worth $1,000, and class B common stock worth $400. B realizes a gain of $2,000, none of which is recognized. The basis of his original security, $5,000, will be allocated 32/70ths to the four securities worth $800, 24/70ths to the four securities worth $600, 10/70ths to the class A common stock, and 4/70ths to the class B common stock.

Example (3). C, an individual, owns stock of Corporation Y with a basis of $5,000 and owns a security issued by Corporation Y in the principal amount of $5,000 with a basis of $5,000. In a transaction to which section 354 is applicable, he exchanges the stock of Corporation Y for stock of Corporation Z with a value of $6,000, and he exchanges the security of Corporation Y for

stock of Corporation Z worth $1,500 and a security of Corporation Z in the principal amount of $4,500 worth $4,500. No gain is recognized to C on either exchange. The basis of the stock of Corporation Z received for the stock of Corporation Y is $5,000. The bases of the stock and security of Corporation Z received in exchange for the security of Corporation Y are $1,250 and $3,750, respectively.

Example (4). D, an individual, owns stock in Corporation M with a basis of $15,000, worth $40,000, and owns a security issued by Corporation M in the principal amount of $5,000 with a basis of $4,000. In a transaction qualifying under section 356 (so far as such section relates to section 355), he exchanges the security of Corporation M for a security of Corporation O (a controlled corporation) in the principal amount of $5,000, worth $5,000, and exchanges one-half of his stock of Corporation M for stock of Corporation O worth $15,000 and a security of Corporation O in the principal amount of $5,000, worth $5,000. All of the stock and securities of Corporation O are distributed pursuant to the transaction. D realizes a gain of $12,500 on the exchange of the stock of Corporation M for the stock and security of Corporation O of which $5,000 is recognized. D also realizes a gain of $1,000 on the exchange of a security of Corporation M for a security of Corporation O, none of which is recognized. The basis of his stock of Corporation M held before the transaction is allocated 20/35ths to the stock of Corporation M held after the transaction and 15/35ths to the stock of Corporation O. The basis of the security of Corporation O received in exchange for his security of Corporation M is $4,000, the basis of the security of Corporation M exchanged. The basis of the security of Corporation O received with respect to D's stock of Corporation M is $5,000, its fair market value.

§ 1.358-3. Treatment of Assumption of Liabilities.—(a) For purposes of section 358, where a party to the exchange assumes a liability of a distributee or acquires from him property subject to a liability, the amount of such liability is to be treated as money received by the distributee upon the exchange, whether or not the assumption of liabilities resulted in a recognition of gain or loss to the taxpayer under the law applicable to the year in which the exchange was made.

(b) The application of paragraph (a) of this section may be illustrated by the following examples:

Example (1). A, an individual, owns property with an adjusted basis of $100,000 on which there is a purchase money mortgage of $25,000. On December 1, 1954, A organizes Corporation X to which he transfers the property in exchange for all the stock of Corporation X and the assumption by Corporation X of the mortgage. The capital stock of the Corporation X has a fair market value of $150,000. Under sections 351 and 357, no gain or loss is recognized to A. The basis in A's hands of the stock of Corporation X is $75,000, computed as follows:

Adjusted basis of property transferred	$100,000
Less: Amount of money received (amount of liabilities assumed)	25,000
Basis of Corporation X stock to A	$75,000

Example (2). A, an individual, owns property with an adjusted basis of $25,000 on which there is a mortgage of $50,000. On December 1, 1954, A organizes Corporation X to which he transfers the property in exchange for all the stock of Corporation X and the assumption by Corporation X of the mortgage. The stock of Corporation X has a fair market value of $50,000. Under sections 351 and 357, gain is recognized to A in the amount of $25,000. The basis in A's hands of the stock of Corporation X is zero, computed as follows:

Adjusted basis of property transferred	$25,000
Less: Amount of money received (amount of liabilities)	−50,000
Plus: Amount of gain recognized to taxpayer	25,000
Basis of Corporation X stock to A	0

§ 1.358–4. EXCEPTION.—Section 358 does not apply in determining the basis of property acquired by a corporation by the issuance of its stock or securities (or by the issuance of stock or securities of another corporation which is in control of such corporation) as the consideration in whole or in part for the transfer of the property to it. See section 362 and the regulations pertaining to that section for rules relating to basis to corporations of property acquired in such cases.

EFFECTS ON CORPORATION

§ 1.361. STATUTORY PROVISIONS; NONRECOGNITION OF GAIN OR LOSS TO CORPORATIONS.

SEC. 361. NONRECOGNITION OF GAIN OR LOSS TO CORPORATIONS.

(a) GENERAL RULE.—No gain or loss shall be recognized if a corporation a party to a reorganization exchanges property, in pursuance of the plan of reorganization, solely for stock or securities in another corporation a party to the reorganization.

(b) Exchanges not solely in kind.—

(1) GAIN.—If subsection (a) would apply to an exchange but for the fact that the property received in exchange consists not only of stock or securities permitted by subsection (a) to be received without the recognition of gain, but also of other property or money, then—

(A) If the corporation receiving such other property or money distributes it in pursuance of the plan of reorganization, no gain to the corporation shall be recognized from the exchange, but

(B) If the corporation receiving such other property or money does not distribute it in pursuance of the plan of reorganization, the gain, if any, to the corporation shall be recognized, but in an amount not in excess of the sum of such money and the fair market value of such other property so received, which is not so distributed.

(2) Loss.—If subsection (a) would apply to an exchange but for the fact that the property received in exchange consists not only of property permitted by subsection (a) to be received without the recognition of gain or loss, but also of other property or money, then no loss from the exchange shall be recognized.

§ 1.361–1. NONRECOGNITION OF GAIN OR LOSS TO CORPORATIONS.—Section 361 provides the general rule that no gain or loss shall be recognized if a corporation, a party to a reorganization, exchanges property in pursuance of the plan of reorganization solely for stock or securities in another corporation, a party to the reorganization. This provision includes only stock and securities received in connec-

tion with a reorganization defined in section 368(a). It also includes nonvoting stock and securities in a corporation, a party to a reorganization, received in a transaction to which section 368(a)(1)(C) is applicable only by reason of section 368(a)(2)(B).

§ 1.362. STATUTORY PROVISIONS; BASIS TO CORPORATIONS.

SEC. 362. BASIS TO CORPORATIONS.

(a) PROPERTY ACQUIRED BY ISSUANCE OF STOCK OR AS PAID-IN SURPLUS.—If property was acquired on or after June 22, 1954, by a corporation—

(1) In connection with a transaction to which section 351 (relating to transfer of property to corporation controlled by transferor) applies, or

(2) As paid-in surplus or as a contribution to capital, then the basis shall be the same as it would be in the hands of the transferor, increased in the amount of gain recognized to the transferor on such transfer.

(b) TRANSFERS TO CORPORATIONS.—If property was acquired by a corporation in connection with a reorganization to which this part applies, then the basis shall be the same as it would be in the hands of the transferor, increased in the amount of gain recognized to the transferor on such transfer. This subsection 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.

(c) SPECIAL RULE FOR CERTAIN CONTRIBUTIONS TO CAPITAL.—

(1) PROPERTY OTHER THAN MONEY.—Notwithstanding subsection (a)(2), if property other than money—

(A) Is acquired by a corporation, on or after June 22, 1954, as a contribution to capital, and

(B) Is not contributed by a shareholder as such, then the basis of such property shall be zero.

(2) MONEY.—Notwithstanding subsection (a)(2), if money—

(A) Is received by a corporation, on or after June 22, 1954, as a contribution to capital, and

(B) Is not contributed by a shareholder as such, then the basis of any property acquired with such money during the 12-month period beginning on the day the contribution is received shall be reduced by the amount of such contribution. The excess, (if any) of the amount of such contributions over the amount of the reduction under the preceding sentence shall be applied to the reduction (as of the last day of the period specified in the preceding sentence) of the basis of any other property held by the taxpayer. The particular properties to which the reductions required by this paragraph shall be allocated shall be determined under regulations prescribed by the Secretary or his delegate.

§ 1.362-1. BASIS TO CORPORATIONS.—Section 362 provides, as a general rule, that if property was acquired on or after June 22, 1954, by a corporation in connection with (a) a transaction to which section 351 (relating to transfer of property to corporation controlled by transferror) applies, (b) as paid-in surplus or as a contribution to capital, or (c) in connection with a reorganization to which Part III of subchapter C applies, then the basis shall be the same as it would be in the hands of the transferor, increased in the amount of gain recognized to the transferor on such transfer. Section 362 does 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. (See also § 1.362-2 below.)

§ 1.362-2. CERTAIN CONTRIBUTIONS TO CAPITAL.—The following rules shall be used in the application of section 362(c):

(a) Property deemed to be acquired with contributed money shall be that property, if any, the acquisition of which was the purpose motivating the contribution;

(b) In the case of an excess of the amount of money contributed over the cost of the property deemed to be acquired with such money (as defined in (a) above) such excess shall be applied to the reduction of the basis (but not below zero) of other properties held by the corporation, on the last day of the 12-month period beginning on the day the contribution is received, in the following order—

(1) All property of a character subject to an allowance for depreciation (not including any properties as to which a deduction for amortization is allowable),

(2) Property with respect to which a deduction for amortization is allowable,

(3) Property with respect to which a deduction for depletion is allowable under section 611 but not under section 613, and

(4) All other remaining properties.

The reduction of the basis of each of the properties within each of the above categories shall be made in proportion to the relative bases of such properties.

(c) With the consent of the Commissioner, the taxpayer may, however, have the basis of the various units of property within a particular category adjusted in a manner different from the general rule set forth in paragraph (b) of this section. Variations from such rule may, for example, involve adjusting the basis of only certain units of the taxpayer's property within a given category. A request for variations from the general rule should be filed by the taxpayer with its return for the taxable year for which the transfer of the property has occurred.

§ 1.363. STATUTORY PROVISIONS; EFFECT ON EARNINGS AND PROFITS.

SEC. 363. EFFECT ON EARNINGS AND PROFITS.

For rules relating to the effect on earnings and profits of transactions to which this part applies, see sections 312 and 381.

SPECIAL RULE; DEFINITIONS

§ 1.367. STATUTORY PROVISIONS; FOREIGN CORPORATIONS.

SEC. 367. FOREIGN CORPORATIONS.

In determining the extent to which gain shall be recognized in the case of any of the exchanges described in section 332, 351, 354, 355, 356, or 361, a foreign corporation shall not be considered as a corporation unless, before such exchange, it has been established to the satisfaction of the Secretary or his delegate that such exchange is not in pursuance of a plan having as one of its principal purposes the avoidance of Federal income taxes. For purposes of this section, any distribution described in section 355 (or so much of section 356 as relates to section 355) shall be treated as an exchange whether or not it is an exchange.

§ 1.367-1. FOREIGN CORPORATIONS.—Whether any one of the exchanges or distributions described in section 332, 351, 354, 355, 356,

or 361, involving a foreign corporation, is in pursuance of a plan having as one of its principal purposes the avoidance of Federal income tax, is a question of fact. In any such case if a taxpayer desires to establish that an exchange or distribution is not in pursuance of such a plan, a statement under oath of the facts and circumstances relating to the plan under which the exchange or distribution is to be made, together with a copy of the plan, shall be forwarded to the Commissioner of Internal Revenue, Washington 25, D. C., for a ruling. A letter setting forth the Comissioner's determination will be mailed to the taxpayer. If the Commissioner determines that the exchange or distribution is not in pursuance of a plan having as one of its principal purposes the avoidance of Federal income tax, the taxpayer should retain a copy of the Commissioner's letter as authority for treating the foreign corporation as a corporation in determining the extent to which gain is recognized from the exchange or distribution. If the transaction is not carried out in accordance with the plan submitted, the Commissioner's approval will not render the transaction tax-free.

§ 1.368. STATUTORY PROVISIONS; DEFINITIONS RELATING TO CORPORATE REORGANIZATIONS.

SEC. 368. DEFINITIONS RELATING TO CORPORATE REORGANIZATIONS.

(a) REORGANIZATION.—

(1) IN GENERAL.—For purposes of parts I and II and this part, the term "reorganization" means—

(A) A statutory merger or consolidation;

(B) The acquisition by one corporation, in exchange solely for all or a part of its voting stock, of stock of another corporation if, immediately after the acquisition, the acquiring corporation has control of such other corporation (whether or not such acquiring corporation had control immediately before the acquisition);

(C) The acquisition by one corporation, in exchange solely for all or a part of its voting stock (or in exchange solely for all or a part of the voting stock of a corporation which is in control of the acquiring corporation), of substantially all of the properties of another corporation, but in determining whether the exchange is solely for stock the assumption by the acquiring corporation of a liability of the other, or the fact that property acquired is subject to a liability, shall be disregarded;

(D) A transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor, or one or more of its shareholders (including persons who were shareholders immediately before the transfer), or any combination thereof, is in control of the corporation to which the assets are transferred; but only if, in pursuance of the plan, stock or securities of the corporation to which the assets are transferred are distributed in a transaction which qualifies under section 354, 355, or 356;

(E) A recapitalization; or

(F) A mere change in identity, form, or place of organization, however affected.

(2) Special rules relating to paragraph (1).—

(A) Reorganizations described in both paragraph (1)(C) and Paragraph (1)(D). If a transaction is described in both paragraph (1)(C) and paragraph (1)(D), then, for purposes of this subchapter, such transaction shall be treated as described only in paragraph (1)(D).

(B) Additional Consideration in Certain Paragraph (1) (C) Cases. If—

(i) One corporation acquires substantially all of the properties of another corporation,

(ii) The acquisition would qualify under paragraph (1) (C) but for the fact that the acquiring corporation exchanges money or other property in addition to voting stock, and

(iii) The acquiring corporation acquires, solely for voting stock described in paragraph (1) (C), property of the other corporation having a fair market value which is at least 80 percent of the fair market value of all of the property of the other corporation,

then such acquisition shall (subject to subparagraph (A) of this paragraph) be treated as qualifying under paragraph (1) (C). Solely for the purpose of determining whether clause (iii) of the preceding sentence applies, the amount of any liability assumed by the acquiring corporation, and the amount of any liability to which any property acquired by the acquiring corporation is subject, shall be treated as money paid for the property.

(C) Transfers of Assets to Subsidiaries in Certain Paragraph (1) (A) and (1) (C) Cases.—A transaction otherwise qualifying under paragraph (1) (A) or paragraph (1) (C) shall not be disqualified by reason of the fact that part or all of the assets which were acquired in the transaction are transferred to a corporation controlled by the corporation acquiring such assets.

(b) PARTY TO A REORGANIZATION.—For purposes of this part, the term "a party to a reorganization" includes—

(1) A corporation resulting from a reorganization, and

(2) Both corporations, in the case of a reorganization resulting from the acquisition by one corporation of stock or properties of another.

In the case of a reorganization qualifying under paragraph (1) (C) of subsection (a), if the stock exchanged for the properties is stock of a corporation which is in control of the acquiring corporation, the term "a party to a reorganization" includes the corporation so controlling the acquiring corporation. In the case of a reorganization qualifying under paragraph (1) (A) or (1) (C) of subsection (a) by reason of paragraph (2) (C) of subsection (a), the term "a party to a reorganization" includes the corporation controlling the corporation to which the acquired assets are transferred.

(c) CONTROL.—For purposes of part I (other than section 304), part II, and this part, the term "control" means the ownership of stock possessing at least 80 percent of the total combined voting power of all classes of stock entitled to vote and at least 80 percent of the total number of shares of all other classes of stock of the corporation.

§ 1.368–1. PURPOSE AND SCOPE OF EXCEPTION OF REORGANIZATION EXCHANGES.—(a) *Reorganizations.*—As used in the regulations under parts I, II, and III of subchapter C of the Internal Revenue Code of 1954, the terms "reorganization" and "party to a reorganization" mean only a reorganization or a party to a reorganization as defined in subsections (a) and (b) of section 368. With respect to insolvency reorganizations, see part IV of subchapter C of the Internal Revenue Code of 1954.

(b) *Purpose.*—Under the general rule, upon the exchange of property, gain or loss must be accounted for if the new property differs in a material particular, either in kind or in extent, from the old property. The purpose of the reorganization provisions of the Internal Revenue Code is to except from the general rule certain specifically described exchanges incident to such readjustments of corporate struc-

tures made in one of the particular ways specified in the Code, as are required by business exigencies and which effect only a readjustment of continuing interest in property under modified corporate forms. Requisite to a reorganization under the Code are a continuity of the business enterprise under the modified corporate form, and (except as provided in section 368(a)(1)(D)) a continuity of interest therein on the part of those persons who, directly or indirectly, were the owners of the enterprise prior to the reorganization. The Code recognizes as a reorganization the amalgamation (occurring in a specified way) of two corporate enterprises under a single corporate structure if there exists among the holders of the stock and securities of either of the old corporations the requisite continuity of interest in the new corporation, but there is not a reorganization if the holders of the stock and securities of the old corporation are merely the holders of short-term notes in the new corporation. In order to exclude transactions not intended to be included, the specifications of the reorganization provisions of the law are precise. Both the terms of the specifications and their underlying assumptions and purposes must be satisfied in order to entitle the taxpayer to the benefit of the exception from the general rule. Accordingly, under the Code, a short-term purchase money note is not a security of a party to a reorganization, an ordinary dividend is to be treated as an ordinary dividend, and a sale is nevertheless to be treated as a sale even though the mechanics of a reorganization have been set up.

(c) *Scope.*—The nonrecognition of gain or loss is prescribed for two specifically described types of exchanges, viz: The exchange that is provided for in section 354(a)(1) in which stock or securities in a corporation, a party to a reorganization, are, in pursuance of a plan of reorganization, exchanged for the stock or securities in a corporation, a party to the same reorganization; and the exchange that is provided for in section 361(a) in which a corporation, a party to a reorganization, exchanges property, in pursuance of a plan of reorganization, for stock or securities in another corporation, a party to the same reorganization. Section 368(a)(1) limits the definition of the term "reorganization" to six kinds of transactions and excludes all others. From its context, the term "a party to a reorganization" can only mean a party to a transaction specifically defined as a reorganization by section 368(a). Certain rules respecting boot received in either of the two types of exchanges provided for in section 354(a)(1) and section 361(a) are prescribed in sections 356, 357, and 361(b). A special rule respecting a transfer of property with a liability in excess of its basis is prescribed in section 357(c). Under section 367 a limitation is placed on all these provisions by providing that except under specified conditions foreign corporations shall not be deemed within their scope. The provisions of the Internal Revenue Code referred to in this paragraph are inapplicable unless there is a plan of reorganization. A plan of reorganization must contemplate the bona fide execution of one of the transactions specifically described as a reorganization in section 368(a) and for the bona fide consummation of each of the requisite acts under which nonrecognition of gain is claimed. Such transaction and such acts must be ordinary and necessary incident of the conduct of the enterprise and must provide

for a continuation of the enterprise. A scheme, which involves an abrupt departure from normal reorganization procedure in connection with a transaction on which the imposition of a tax is imminent, such as a mere device that puts on the form of a corporate reorganization as a disguise for concealing its real character, and the object and accomplishment of which is the consummation of a preconceived plan having no business or corporate purpose, is not a plan of reorganization.

§ 1.368-2. DEFINITION OF TERMS.—(a) The application of the term "reorganization" is to be strictly limited to the specific transaction set forth in section 368(a). The term does not embrace the mere purchase by one corporation of the properties of another corporation, for it imports a continuity of interest on the part of the transferor or its shareholders in the properties transferred. If the properties are transferred for cash and deferred payment obligations of the transferee evidenced by short-term notes, the transaction is a sale and not an exchange in which gain or loss is not recognized.

(b) The words "statutory merger or consolidation" refer to a merger or consolidation effected pursuant to the corporation laws of the United States or a State or Territory or the District of Columbia.

(c) In order to qualify as a "reorganization" under section 368(a)(1)(B), the acquisition by the acquiring corporation of stock of another corporation must be in exchange solely for all or a part of the voting stock of the acquiring corporation, and the acquiring corporation must be in control of the other corporation immediately after the transaction. If, for example, Corporation X, in one transaction exchanges nonvoting preferred stock or bonds in addition to all or a part of its voting stock in the acquisition of stock of Corporation Y, the transaction is not a reorganization under section 368(a)(1)(B). The acquisition of stock of another corporation by the acquiring corporation solely for its voting stock is permitted tax-free even though the acquiring corporation already owns some of the stock of the other corporation. Such an acquisition is permitted tax-free in a single transaction or in a series of transactions taking place over a relatively short period of time such as 12 months. For example, Corporation A purchased 30 percent of the common stock of Corporation W (the only class of stock outstanding) for cash in 1939. On March 1, 1955, Corporation A offers to exchange its own voting stock for all the stock of Corporation W tendered within 6 months from the date of the offer. Within the 6 months' period Corporation A acquires an additional 60 percent of the stock of Corporation W solely for its own voting stock, so that it owns 90 percent of the stock of Corporation W. No gain or loss is recognized with respect to the exchanges of stock of Corporation A for stock of Corporation W. For this purpose, it is immaterial whether such exchanges occurred before Corporation A acquired control (80 percent) of Corporation W or after such control was acquired. If Corporation A had acquired 80 percent of the stock of Corporation W for cash in 1939, it could likewise acquire some or all of the remainder of such stock solely in exchange for its own voting stock without recognition of gain or loss.

(d) In order to qualify as a reorganization under section 368(a)(1)(C), the transaction must be one described in subparagraph (1) or (2) below:

(1) One corporation must acquire substantially all the properties of another corporation solely in exchange for all or a part of its own voting stock, or solely in exchange for all or a part of the voting stock of a corporation which is in control of the acquiring corporation. For example, Corporation P owns all the stock of Corporation A. All the properties of Corporation W are transferred to Corporation A either solely in exchange for voting stock of Corporation P or solely in exchange for less than 80 percent of the voting stock of Corporation A. Either of such transactions constitutes a reorganization under section 368(a)(1)(C). However, if the properties of Corporation W are acquired in exchange for voting stock of both Corporation P and Corporation A, the transaction will not constitute a reorganization under section 368(a)(1)(C). In determining whether the exchange meets the requirement of "solely for voting stock", the assumption by the acquiring corporation of liabilities of the transferor corporation, or the fact that property acquired from the transferor corporation is subject to a liability, shall be disregarded. Though such an assumption does not prevent an exchange from being solely for voting stock for the purposes of the definition of a reorganization contained in section 368(a)(1)(C), it may in some cases, however, so alter the character of the transaction as to place the transaction outside the purposes and assumptions of the reorganization provisions. Section 368(a)(1)(C) does not prevent consideration of the effect of an assumption of liabilities on the general character of the transaction but merely provides that the requirement that the exchange be solely for voting stock is satisfied if the only additional consideration is an assumption of liabilities.

(2) One corporation—

(i) Must acquire substantially all of the properties of another corporation in such manner that the acquisition would qualify under (1) above, but for the fact that the acquiring corporation exchanges money, or other property in addition to such voting stock, and

(ii) Must acquire solely for voting stock (either of the acquiring corporation or of a corporation which is in control of the acquiring corporation) properties of the other corporation having a fair market value which is at least 80 percent of the fair market value of all the properties of the other corporation.

(3) For the purposes of subparagraph (2)(ii) only, a liability assumed or to which the properties are subject is considered money paid for the properties. For example, Corporation A has properties with a fair market value of $100,000 and liabilities of $10,000. In exchange for these properties, Corporation Y transfers its own voting stock, assumes the $10,000 liabilities, and pays $8,000 in cash. The transaction is a reorganization even though a part of the properties of Corporation A is acquired for cash. On the other hand, if the properties of Corporation A worth $100,000, were subject to $50,000 in liabilities, an acquisition of all the properties, subject to the liabilities, for any consideration other than solely voting stock would not qualify as a reorganiza-

tion under this section since the liabilities alone are in excess of 20 percent of the fair market value of the properties. If the transaction would qualify under either (1) or (2) above and also under section 368(a)(1)(D), such transaction shall not be treated as a reorganization under section 368(a)(1)(C).

(e) A "recapitalization", and therefore a reorganization, takes place if, for example:

(1) A corporation with $200,000 par value of bonds outstanding, instead of paying them off in cash, discharges them by issuing preferred shares to the bondholders;

(2) There is surrendered to a corporation for cancellation 25 percent of its preferred stock in exchange for no par value common stock;

(3) A corporation issues preferred stock, previously authorized but unissued, for outstanding common stock;

(4) An exchange is made of a corporation's outstanding preferred stock, having certain priorities with reference to the amount and time of payment of dividends and the distribution of the corporate assets upon liquidation, for a new issue of such corporation's common stock having no such rights;

(5) An exchange is made of an amount of a corporation's outstanding preferred stock with dividends in arrears for a similar amount of a corporation's preferred stock plus an amount of stock (preferred or common) with respect to the amount of dividends in arrears. However, if such an exchange is made solely for the purpose of effecting the payment of dividends for the current and immediately preceding taxable years upon the preferred stock exchanged, an amount equal to the value of the stock issued in lieu of such dividends shall be treated as a distribution to which section 305(b)(1) is applicable.

(f) The term "a party to a reorganization" includes a corporation resulting from a reorganization, and both corporations in a transaction qualifying as a reorganization where one corporation acquires stock or properties of another corporation. A corporation remains a party to the reorganization although it transfers all or part of the assets acquired to a controlled subsidiary. A corporation controlling an acquiring corporation is a party to the reorganization when the stock of such controlling corporation is used in the acquisition of properties. Both corporations are parties to the reorganization if, under statutory authority, Corporation A is merged into Corporation B. All three of the corporations are parties to the reorganization if, pursuant to statutory authority, Corporation C and Corporation D are consolidated into Corporation E. Both corporations are parties to the reorganization if Corporation F transfers substantially all its assets to Corporation G in exchange for all or a part of the voting stock of Corporation G. All three corporations are parties to the reorganization if Corporation H transfers substantially all its assets to Corporation K in exchange for all or part of the voting stock of Corporation L, which is in control of Corporation K. Both corporations are parties to the reorganization if Corporation M transfers all or a part of its assets to Corporation N in exchange for all or a part of the stock and securities of Corporation N, but only if (1) immediately

after such transfer, Corporation M, or one or more of its shareholders (including persons who were shareholders immediately before such transfer), or any combination thereof, is in control of Corporation N, and (2) in pursuance of the plan, the stock and securities of Corporation N are transferred or distributed by Corporation M in a transaction in which gain or loss is not recognized under section 354 or 355, or is recognized only to the extent provided in section 356. Both Corporation O and Corporation P, but not Corporation S, are parties to the reorganization if Corporation O acquires stock of Corporation P from Corporation S in exchange solely for a part of the voting stock of Corporation O, if (1) the stock of Corporation P does not constitute substantially all of the assets of Corporation S, (2) Corporation S is not in control of Corporation O immediately after the acquisition, and (3) Corporation O is in control of Corporation P immediately after the acquisition.

(g) The term "plan of reorganization" has a reference to a consummated transaction specifically defined as a reorganization under section 368(a). The term is not to be construed as broadening the definition of "reorganization" as set forth in section 368(a), but is to be taken as limiting the nonrecognition of gain or loss to such exchanges or distributions as are directly a part of the transaction specifically described as a reorganization in section 368(a). Moreover, the transaction, or series of transactions, embraced in a plan of reorganization must not only come within the specific language of section 368(a), but the readjustments involved in the exchanges or distributions effected in the consummation thereof must be undertaken for reasons germane to the continuance of the business of a corporation a party to the reorganization. Section 368(a) contemplates genuine corporate reorganizations which are designed to effect a readjustment of continuing interests under modified corporate forms.

(h) As used in section 368, as well as in other provisions of the Internal Revenue Code, if the context so requires, the conjunction "or" denotes both the conjunctive and the disjunctive, and the singular includes the plural. For example, the provisions of the statute are complied with if "stock and securities" are received in exchange as well as if "stock or securities" are received.

§ 1.368-3. Records To Be Kept and Information To Be Filed With Returns.—(a) The plan of reorganization must be adopted by each of the corporations parties thereto; and the adoption must be shown by the acts of its duly constituted responsible officers, and appear upon the official records of the corporation. Each corporation, a party to a reorganization, shall file as a part of its return for its taxable year within which the reorganization occurred a complete statement of all facts pertinent to the nonrecognition of gain or loss in connection with the reorganization, including:

(1) A certified copy of the plan of reorganization, together with a statement under oath or affirmation showing in full the purposes thereof and in detail all transactions incident to, or pursuant to, the plan.

(2) A complete statement of the cost or other basis of all property, including all stock or securities, transferred incident to the plan.

(3) A statement of the amount of stock or securities and other property or money received from the exchange, including a statement of all distributions or other disposition made thereof. The amount of each kind of stock or securities and other property received shall be stated on the basis of the fair market value thereof at the date of the exchange.

(4) A statement of the amount and nature of any liabilities assumed upon the exchange, and the amount and nature of any liabilities to which any of the property acquired in the exchange is subject.

(b) Every taxpayer, other than a corporation a party to the reorganization, who receives stock or securities and other property or money upon a tax-free exchange in connection with a corporate reorganization shall incorporate in his income tax return for the taxable year in which the exchange takes place a complete statement of all facts pertinent to the nonrecognition of gain or loss upon such exchange including:

(1) A statement of the cost or other basis of the stock or securities transferred in the exchange, and

(2) A statement in full of the amount of stock or securities and other property or money received from the exchange, including any liabilities assumed upon the exchange, and any liabilities to which property received is subject. The amount of each kind of stock or securities and other property (other than liabilities assumed upon the exchange) received shall be set forth upon the basis of the fair market value thereof at the date of the exchange.

(c) Permanent records in substantial form shall be kept by every taxpayer who participates in a tax-free exchange in connection with a corporate reorganization showing the cost or other basis of the transferred property and the amount of stock or securities and other property or money received (including any liabilities assumed on the exchange, or any liabilities to which any of the properties received were subject), in order to facilitate the determination of gain or loss from a subsequent disposition of such stock or securities and other property received from the exchange.

INSOLVENCY REORGANIZATIONS

§ 1.371. STATUTORY PROVISIONS; INSOLVENCY REORGANIZATIONS; REORGANIZATION IN CERTAIN RECEIVERSHIP AND BANKRUPTCY PROCEEDINGS.

SEC. 371. REORGANIZATION IN CERTAIN RECEIVERSHIP AND BANKRUPTCY PROCEEDINGS.

(a) EXCHANGES BY CORPORATIONS.—

(1) IN GENERAL.—No gain or loss shall be recognized if property of a corporation (other than a railroad corporation, as defined in section 77(m) of the Bankruptcy Act (49 Stat. 922; 11 U. S. C. 205)) is transferred in pursuance of an order of the court having jurisdiction of such corporation—

(A) In a receivership, foreclosure, or similar proceeding, or,

(B) In a proceeding under chapter X of the Bankruptcy Act (52 Stat. 883-905; 11 U. S. C., chapter 10) or the corresponding provisions of prior law,

to another corporation organized or made use of to effectuate a plan of reorganization approved by the court in such proceeding, in exchange solely for stock or securities in such other corporation.

(2) GAIN FROM EXCHANGES NOT SOLELY IN KIND.—If an exchange would be within the provisions of paragraph (1) if it were not for the fact that the property received in exchange consists not only of stock or securities permitted by paragraph (1) to be received without the recognition of gain, but also of other property or money, then—

(A) If the corporation receiving such other property or money distributes it in pursuance of the plan of reorganization, no gain to the corporation shall be recognized from the exchange, but

(B) If the corporation receiving such other property or money does not distribute it in pursuance of the plan of reorganization, the gain, if any, to the corporation shall be recognized, but in an amount not in excess of the sum of such money and the fair market value of such other property so received, which is not so distributed.

(b) EXCHANGES BY SECURITY HOLDERS.—

(1) IN GENERAL.—No gain or loss shall be recognized on an exchange consisting of the relinquishment or extinguishment of stock or securities in a corporation the plan of reorganization of which is approved by the court in a proceeding described in subsection (a), in consideration of the acquisition solely of stock or securities in a corporation organized or made use of to effectuate such plan of reorganization.

(2) GAIN FROM EXCHANGES NOT SOLELY IN KIND.—If an exchange would be within the provisions of paragraph (1) if it were not for the fact that the property received in exchange consists not only of property permitted by paragraph (1) to be received without the recognition of gain, but also of other property or money, then the gain, if any, to the recipient shall be recognized, but in an amount not in excess of the sum of such money and the fair market value of such other property.

(c) LOSS FROM EXCHANGES NOT SOLELY IN KIND.—If an exchange would be within the provisions of subsection (a)(1) or (b)(1) if it were not for the fact that the property received in exchange consists not only of property permitted by subsection (a)(1) or (b)(1) to be received without the recognition of gain or loss, but also of other property or money, then no loss from the exchange shall be recognized.

(d) ASSUMPTION OF LIABILITIES.—In the case of a transaction involving an assumption of a liability or the acquisition of property subject to a liability, the rules provided in section 357 shall apply.

§ 1.371–1. EXCHANGES BY CORPORATIONS.—(a) *Exchange solely for stock or securities.*—(1) Section 371(a)(1) provides for the nonrecognition of gain or loss by a corporation upon certain exchanges made in connection with the reorganization of an insolvent corporation. The section does not apply to a railroad corporation as defined in section 77(m) of the Bankruptcy Act (49 Stat. 922; 11 U. S. C. 205). In order to qualify as a section 371(a) reorganization, the transaction must satisfy the express statutory requirements as well as the underlying assumptions and purposes for which the exchange is excepted from the general rule requiring the recognition of gain or loss upon the exchange of property.

(2) Section 371(a)(1) applies only with respect to a reorganization effected in one of two specified types of court proceedings: (i) Receivership, foreclosure, or similar proceedings, or (ii) corporate reorganization proceeds under Chapter X of the Bankruptcy Act (52 Stat. 883–905; 11 U. S. C. C. 10). The specific statutory requirements are the transfer of property of a corporation, in pursuance of an

order of the court having jurisdiction of the corporation in such proceeding, to another corporation organized or made use of to effectuate a plan of reorganization approved by the court in such proceeding, in exchange solely for stock or securities in such other corporation. If the consideration for the transfer consists of other property or money as well as stock and securities, see sections 371(a)(2) and 371(c). As to the assumption of liabilities in an exchange described in section 371(a), see section 371(d).

(3) The application of section 371(a)(1) is to be strictly limited to a transaction of the character set forth in such section. Hence, the section is inapplicable unless there is a bona fide plan of reorganization approved by the court having jurisdiction of the proceeding and the transfer of the property of the insolvent corporation is made pursuant to such plan. It is unnecessary that the transfer be a direct transfer from the insolvent corporation; it is sufficient if the transfer is an integral step in the consummation of the reorganization plan approved by the court. By its terms, the section has no application to a reorganization consummated by adjustment of the capital or debt structure of the insolvent corporation without the transfer of its assets to another corporation.

(4) As used in section 371(a)(1), the term "reorganization" is not controlled by the definition of "reorganization" contained in section 368. However, certain basic requirements, implicit in the statute, which are essential to a reorganization under section 368, are likewise essential to qualify a transaction as a reorganization under section 371(a)(1). Among these requirements are a continuity of the business enterprise under the modified corporate form and a continuity of interest therein on the part of those persons who were the owners of the enterprise prior to the reorganization. Thus, the nonrecognition accorded by section 371(a)(1) applies only to a genuine reorganization as distinguished from a liquidation and sale of property to either new or old interests supplying new capital and discharging the obligations of the old corporaton. For the purpose of determining whether the requisite continuity of interest exists, the interest of creditors who have, by appropriate legal steps, obtained effective command of the property of an insolvent corporation is considered as the equivalent of a proprietary interest. But the mere possibility of a proprietary interest is not equivalent. In general, any transaction will be subject to nonrecognition of gain or loss as prescribed by section 371(a)(1) where the property is transferred to a corporation and the stock and securities of such corporation are transferred to persons who were shareholders or creditors of the transferor corporation as if such stock or securities had been transferred to such persons as shareholders pursuant to the nonrecognition provisions of Part III of subchapter C. The determinative and controlling factors are the corporation's insolvency and the effective command by the creditors over its property. The term "insolvent" as used herein refers to insolvency at any time during the course of the proceeding referred to in section 371(a)(1), either in the sense of excess of liabilities over assets or in the sense of inability to meet obligations as they mature.

(5) A short-term purchase money note is not a security within the meaning of this section, and the transfer of the properties of the in-

solvent corporation for cash and deferred payment obligations of the transferee evidenced by short-term notes is a sale and not an exchange.

(b) *Exchange for stock or securities and other property or money.*—If an exchange would be within the provisions of section 371(a)(1) if it were not for the fact that the consideration for the transfer of the property of the insolvent corporation consists not only of stock or securities but also of other property or money, then, as provided in section 371(a)(2), if the other property or money received by the corporation is distributed by it pursuant to the plan of reorganization, no gain to the corporation will be recognized. Property is distributed within the meaning of this section if it is paid over or distributed to shareholders or creditors who have by appropriate legal steps obtained effective command of the property of the corporation. If the other property or money received by the corporation is not distributed by it pursuant to the plan of reorganization, the gain, if any, to the corporation from the exchange will be recognized in an amount not in excess of the sum of money and the fair market value of the other property so received which is not distributed. In either case no loss from the exchange will be recognized (see section 371(c)).

(c) *Records to be kept and information to be filed.*—(1) Each corporation a party to a section 371(a) reorganization shall furnish a complete statement of all facts pertinent to the nonrecognition of gain or loss in connection with the exchange, including:

(i) A certified copy of the plan of reorganization approved by the court in the proceeding, together with a statement showing in full the purposes thereof and in detail all transactions incident, or pursuant, to the plan;

(ii) A complete statement of the cost or other basis of all property, including all stock or securities, transferred incident to the plan;

(iii) A statement of the amount of stock or securities and other property or money received in the exchange, including a statement of all distributions or other disposition made thereof. The amount of each kind of stock or securities or other property shall be stated on the basis of the fair market value thereof at the date of the exchange;

(iv) A statement of the amount and nature of any liabilities assumed upon the exchange.

The information required by this section shall be filed as a part of the corporation's return for its taxable year within which the reorganization occurred.

(2) Permanent records in substantial form must be kept by every taxpayer who participates in a tax-free exchange in connection with a corporate reorganization showing the cost or other basis of the transferred property and the amount of stock or securities and other property or money received (including any liabilities assumed upon the exchange), in order to facilitate the determination of gain or loss from a subsequent disposition of such stock or securities and other property received from the exchange.

§ 1.371–2. EXCHANGES BY SECURITY HOLDERS.—(a) *In general.*—(1) Section 371(b) prescribes the rules relative to the recognition of gain or loss upon certain exchanges made by the holders of stock or

securities of an insolvent corporation in connection with a reorganization described in section 371(a). Under section 371(b)(1), no gain or loss shall be recognized if, pursuant to the plan of reorganization, stock or securities in the insolvent corporation are exchanged solely for stock or securities in the corporation organized or made use of to effectuate such plan. If, in addition to such stock or securities, other property or money is received upon such exchange, gain is recognized to the extent of such other property or money (section 371(b)(2)), but no loss is recognized (section 371(c)). As to the basis of the stock or securities or other property acquired upon an exchange under section 371(b), see section 358.

(2) By thus characterizing as an exchange, and regarding as a single taxable event, the event or series of events resulting in the relinquishment or extinguishment of the stock or securities in the old corporation and the acquisition in consideration thereof, in whole or in part, of stock or securities in the new corporation, the Internal Revenue Code secures uniformity of treatment for the participating security holders, regardless of the particular steps or the procedural devices by which such exchange is effected. Thus, the transaction which qualified as a reorganization under section 371(a) may take one of several forms. In a typical creditors' reorganization there may be a transfer of the property of the old corporation to its bondholders, or the bondholders' committee, upon surrender of the bonds, followed by the transfer of such property to the new corporation in consideration of stock in the latter; or there may be a transfer of the bonds to the new corporation in exchange for its stock or securities, followed by the transfer of the property of the old corporation in consideration of the surrender of its bonds. In either event, section 371(b) treats the result to the participating security holders as an exchange of the securities of the old corporation for securities of the new corporation. In order, however, to qualify as an exchange under section 371(b) the various events resulting in the relinquishment or extinguishment of the old securities and the acquisition of the new securities must be embraced within the plan of reorganization and must be undertaken for reasons germane to the plan. If the event, or series of events, qualifies as an exchange under section 371(b), no antecedent event necessarily a component of the relinquishment or extinguishment of the securities of the old corporation in consideration of the acquisition of the securities of the new corporation shall be considered a transaction or event having consequences for income tax purposes.

(b) *Exchange solely for stock or securities.*—Section 371(b)(1) provides that no gain or loss shall be recognized upon an exchange consisting of the relinquishment or extinguishment of stock or securities in an insolvent corporation described in section 371(a), in consideration of the acquisition solely of stock or securities in a corporation organized or made use of to effectuate the plan of reorganization. As used in this section, the term security does not include a short-term note.

(c) *Exchanges for stock or securities and other property or money.*—If an exchange would be within section 371(b)(1) if it were not for the fact that the property received in the exchange consists not

only of stock or securities in the corporation organized or made use of to effectuate the plan of reorganization, but also of other property or money, then

(1) As provided in section 371(b)(2), the gain, if any, to the taxpayer will be recognized in an amount not in excess of the sum of money and the fair market value of the other property. The gain so recognized shall be treated as capital gain.

(2) The loss, if any, to the taxpayer from such an exchange is not to be recognized to any extent (see section 371(c)).

(*d*) *Records to be kept and information to be filed.*—(1) Every taxpayer who receives stock or securities and other property or money upon an exchange described in section 371(b) in connection with a corporate reorganization, must furnish a complete statement of all facts pertinent to the recognition or nonrecognition of gain or loss upon such exchange, including—

(i) A statement of the cost or other basis of the stock or securities transferred in the exchange, and

(ii) A statement in full of the amount of stock or securities and other property or money received from the exchange, including any liability assumed upon the exchange. The amount of each kind of stock or securities and other property (other than liabilities assumed upon the exchange) received shall be set forth upon the basis of the fair market value thereof at the date of the exchange.

The statement shall be incorporated in the taxpayer's income tax return for the taxable year in which the exchange occurs.

(2) Permanent records in substantial form shall be kept by every taxpayer who participates in an exchange described in section 371(b), showing the cost or other basis of the transferred property and the amount of stock or securities and other property or money received (including any liabilities assumed upon the exchange), in order to facilitate the determination of gain or loss from a subsequent disposition of such stock or securities and other property received from the exchange.

§ 1.372. STATUTORY PROVISIONS; INSOLVENCY REORGANIZATIONS; BASIS IN CONNECTION WITH CERTAIN RECEIVERSHIP AND BANKRUPTCY PROCEEDINGS.

SEC. 372. BASIS IN CONNECTION WITH CERTAIN RECEIVERSHIP AND BANKRUPTCY PROCEEDINGS.

(a) CORPORATION.—If property was acquired by a corporation in a transfer to which—

(1) Section 371(a) applies,

(2) So much of section 371(c) as relates to section 371(a)(1) applies, or

(3) The corresponding provisions of prior law apply,

then notwithstanding the provisions of section 270 of the Bankruptcy Act (54 Stat. 709; 11 U. S. C. 670), the basis in the hands of the acquiring corporation shall be the same as it would be in the hands of the corporation whose property was so acquired, increased in the amount of gain recognized to the corporation whose property was so acquired under the law applicable to the year in which the acquisition occurred, and such

basis shall not be adjusted under section 1017 by reason of a discharge of indebtedness in pursuance of the plan of reorganization under which such transfer was made.

(b) STOCK OR SECURITY HOLDER.—For basis of stock or securities acquired under section 371(b), see section 358.

§ 1.372–1.—CORPORATIONS.—(a), If, as the result of a transaction described in section 371, so much of section 371(c) as relates to section 371(a), or the corresponding provisions of prior law, the property of an insolvent corporation is transferred, in pursuance of a plan of reorganization, to a corporation organized or made use of to effectuate such plan, the basis of such property in the hands of the acquiring corporation is the same as it would be in the hands of the insolvent corporation, increased in the amount of gain recognized upon such transfer under the law applicable to the year in which the transfer was made. In any such case, the adjustments to basis provided by section 270 of the Bankruptcy Act (54 Stat. 709; 11 U. S. C. 670), or section 1017 of the Internal Revenue Code of 1954, shall not be made in respect of any indebtedness cancelled pursuant to the plan of reorganization under which the transfer was made. If the transaction falls within the provisions of section 372(a), the basis of the property involved shall be determined pursuant to such provisions, notwithstanding that the transaction might otherwise fall within another basis provision.

(b) The provisions of section 372(a) are applicable in the determination of basis for all taxable years beginning after December 31, 1933, except that the basis so determined shall not be given effect in the determination of the tax liability for any taxable year beginning prior to January 1, 1943. With the exception indicated, the basis so prescribed is applicable from the date of acquisition of such property. For example, the provisions of section 1016 relating to adjusted basis shall be applied as if section 372(a) were a part of the Internal Revenue Code of 1939 and prior Internal Revenue laws applicable to all taxable years beginning after December 31, 1933. Hence, in determining the amount of the adjustments for depreciation, depletion, etc., under the provisions of section 1016(a)(2), the "amount allowable" is the amount computed with reference to the basis provided in section 372(a).

(c) The effect of the application of section 372(a) may be illustrated by the following examples:

Example (1). On January 1, 1935, the Y Corporation, a taxpayer making its returns on the calendar year basis, acquired depreciable property from the X Corporation as the result of a transaction described in section 372(a). On January 1, 1935, the property had, in the hands of the X Corporation, a basis of $200,000, an adjusted basis of $150,000, a fair market value as of January 1, 1935, of $80,000, and an estimated remaining life of 20 years. The 1935 transaction was treated as a taxable exchange and, accordingly, the Y Corporation claimed and was allowed depreciation in the amount of $4,000 for each of the eight taxable years 1935 through 1942, inclusive. For each of the twelve taxable years 1943 through 1954, inclusive, the Y Corporation claimed and was allowed depreciation in the amount of $7,500. On December 31, 1954, the property was sold for $10,000 cash. The amount of the gain realized upon the sale is computed as follows:

Basis to X Corporation		$200,000
Adjustment for depreciation in the hands of X Corporation (sec. 1016)		50,000
Adjusted basis for depreciation in the hands of both X and Y Corporations (sec. 372 (b))		$150,000
Deduct:		
Depreciation allowable in amount of $7,500 per year (1/20 of $150,000) for 8 years, from Jan. 1, 1935, through Dec. 31, 1942	$60,000	
Depreciation allowable Jan. 1, 1943, to Dec. 31, 1954 (12 years at $7,500)	90,000	
		150,000
Adjusted basis for computing gain or loss		0
Sale price		$10,000
Gain realized		$10,000

For the taxable year 1943 and succeeding taxable years, the Y Corporation is entitled to deductions for depreciation in respect of such property in the amounts of $7,500 in the determination of its tax liabilities for such years. But no change in the tax liability is authorized for preceding taxable years by reason of the difference between the $7,500 depreciation allowable and the $4,000 deduction previously allowed.

Example (2). Assume the same facts as in example (1), except that the property acquired by the Y Corporation had a fair market value as of January 1, 1935, of $180,000, instead of $80,000, and the Y Corporation claimed and was allowed depreciation in the amount of $9,000 for each of the eight taxable years 1935 to 1942, inclusive, and in the amount of $6,500 for the taxable years 1943 to 1954, inclusive. In such case, the amount of the gain realized upon the sale of the property would be computed as follows:

Adjusted basis for depreciation in the hands of Y Corporation as computed in example (1)		$150,000
Deduct:		
Depreciation allowed in the amount of $9,000 per year for 8 years, Jan. 1, 1935, to Dec. 31, 1942	$72,000	
Depreciation allowable Jan. 1, 1943, to Dec. 31, 1954, inclusive (12 times $6,500)	78,000	
		150,000
Adjusted basis for computing gain or loss		-0-
Sale price		10,000
Gain realized		$10,000

No change in the tax liability is authorized for taxable years preceding 1943 by reason of the difference between the $7,500 depreciation allowable and the $9,000 deduction previously allowed.

§ 1.373. STATUTORY PROVISIONS; INSOLVENCY REORGANIZATIONS; LOSS NOT RECOGNIZED IN CERTAIN RAILROAD REORGANIZATIONS.

SEC. 373. LOSS NOT RECOGNIZED IN CERTAIN RAILROAD REORGANIZATIONS

(a) NONRECOGNITION OF LOSS.—No loss shall be recognized if property of a railroad corporation, as defined in section 77(m) of the Bank-

ruptcy Act (49 Stat. 922 11 U. S. C. 205), is transferred in pursuance of an order of the court having jurisdiction of such corporation—

(1) In a receivership proceeding, or

(2) In a proceeding under section 77 of the Bankruptcy Act, to a railroad corporation (as defined in section 77(m) of the Bankruptcy Act) organized or made use of to effectuate a plan or reorganization approved by the court in such proceeding.

(b) BASIS.—

(1) RAILROAD CORPORATIONS.—If the property of a railroad corporation (as defined in section 77(m) of the Bankruptcy Act) was acquired after December 31, 1938, in pursuance of an order of the court having jurisdiction of such corporation—

(A) In a receivership proceeding, or

(B) In a proceeding under section 77 of the Bankruptcy Act, and the acquiring corporation is a railroad corporation (as defined in section 77(m) of the Bankruptcy Act) organized or made use of to effectuate a plan of reorganization approved by the court in such proceeding, the basis shall be the same as it would be in the hands of the railroad corporation whose property was so acquired.

(2) PROPERTY ACQUIRED BY STREET, SUBURBAN, OR INTERURBAN ELECTRIC RAILWAY CORPORATION.—If the property of any street, suburban, or interurban electric railway corporation engaged as a common carrier in the transportation of persons or property in interstate commerce was acquired after December 31, 1934, in pursuance of an order of the court having jurisdiction of such corporation in a proceeding under section 77B of the Bankruptcy Act (48 Stat. 912), and the acquiring corporation is a street, suburban, or interurban electric railway engaged as a common carrier in the transportation of persons or property in interstate commerce, organized or made use of to effectuate a plan of reorganization approved by the court in such proceeding, then, notwithstanding the provisions of section 270 of the Bankruptcy Act (52 Stat. 904; 11 U. S. C. 670), the basis shall be the same as it would be in the hands of the corporation whose property was so acquired.

§ 1.373–1. NONRECOGNITION OF LOSS UPON TRANSFER OF PROPERTY OF RAILROAD CORPORATION.—(a) For the purpose of section 373(a), it is unnecessary that the transfer be a direct transfer by the corporation undergoing reorganization or that such reorganization constitute a reorganization within the meaning of section 368(a) since that section does not apply to Part IV of subchapter C. It is sufficient if the transfer is made in pursuance of an order of the court and is an integral step in the consummation of a plan of reorganization approved by the court having jurisdiction of the proceeding. If these conditions are satisfied, no loss is recognized to the transferor upon the ultimate transfer of the property, or to the transferor upon any intermediate transfer.

(b) Section 373(a) applies only to a transfer resulting in a loss and has no application if the transfer therein described results in a gain.

(c) See section 354(c) relative to exchanges by stock or security holders.

§ 1.373–2. PROPERTY ACQUIRED BY RAILROAD CORPORATION IN A RECEIVERSHIP OR RAILROAD REORGANIZATION PROCEEDING.—(a) Section 373(b)(1) sets forth certain conditions under which the basis of property acquired by a railroad corporation is the same as it would have been in the hands of the railroad corporation whose property was acquired. For the purpose of section 373(b)(1), it is unnecessary that the acquisition in question be a direct transfer from the corpora-

tion undergoing reorganization or that such reorganization constitute a reorganization within the meaning of section 368(a) since that section does not apply to Part IV of subchapter C. It is sufficient if the acquisition is in pursuance of an order of the court and is an integral step in the consummation of a reorganization plan approved by the court having jurisdiction of the proceeding.

(b) If the conditions of section 373(b)(1) are satisfied, then for the purpose of determining basis, the provisions of section 373(b)(1) only shall apply, notwithstanding that the transaction might also fall within another basis provision.

§ 1.373–3. PROPERTY ACQUIRED BY ELECTRIC RAILWAY CORPORATION IN CORPORATE REORGANIZATION PROCEEDING.—Subject to the limitations and conditions set forth in section 373(b)(2), if the reorganization under section 77B of the Bankruptcy Act, 48 Stat. 912, of an electric railway corporation results in the acquisition of the property of such corporation by another corporate entity, the basis of such property in the hands of the acquiring corporation is the same as it would be in the hands of the old corporation. It is requisite to the application of the section that both corporations be street, suburban, or interurban electric railway corporations engaged in the transportation of persons or property in interstate commerce, and that the acquisition is in pursuance of an order of the court and is an integral step in the consummation of a reorganization plan approved by the court having jurisdiction of the proceeding. If section 373(b)(2) applies, section 270 of the Bankruptcy Act (11 U. S. C. 670), relating to the adjustment of basis by reason of the cancellation or reduction of indebtedness in a corporate reorganization proceeding, is inapplicable. Moreover, if the transaction is within the provisions of section 373(b)(2) and may also be considered to be within any other basis provision, then the provisions of section 373(b)(2) only shall apply.

EFFECTIVE DATE OF SUBCHAPTER C

§ 1.391. STATUTORY PROVISIONS; EFFECTIVE DATE OF PART I.

SEC. 391. EFFECTIVE DATE OF PART I.

Except as otherwise provided in this subchapter, part I shall take effect on June 22, 1954. Section 306 shall apply only with respect to dispositions (or redemptions) occurring on or after June 22, 1954.

§ 1.391–1. EFFECTIVE DATE OF PART I OF SUBCHAPTER C.—Pursuant to section 395 and regulations thereunder, the provisions of Part I of subchapter C shall be effective with respect to the described transactions which occur on or after June 22, 1954, and with respect to section 306 (relating to the disposition or redemption of "section 306 stock"), such section shall apply only to stock which is received in a transaction subject to the Internal Revenue Code of 1954, and which is disposed of or redeemed after June 22, 1954. Generally, stock issued after June 22, 1954, will be section 306 stock if such stock comes within the definition set forth in section 306(c). However, stock which otherwise qualifies within the definition set forth in section 306 is not section 306 stock if it is issued pursuant to a reorganization which by reason of the application of section 393(b) and section 395 is governed by the provisions of the Internal Revenue Code of 1939 without amendment by the Internal Revenue Code of 1954. In addition, stock which

otherwise qualifies within the definition set forth in section 306(c) is not section 306 stock if it is issued pursuant to a reorganization which by reason of an election under section 393(b)(2) is governed by the provisions of the Internal Revenue Code of 1939 without amendment by the Internal Revenue Code of 1954.

§ 1.392. STATUTORY PROVISIONS; EFFECTIVE DATE OF PART II.

SEC. 392. EFFECTIVE DATE OF PART II.

(a) GENERAL RULE.—Except as otherwise provided in this subchapter, part II shall apply with respect to a plan of liquidation only if the first distribution in pursuance of such plan occurs on or after June 22, 1954. Section 341 shall apply only with respect to sales, exchanges, and distributions on or after June 22, 1954.

(b) SPECIAL RULE FOR CERTAIN SALES DURING 1954.—

(1) NONRECOGNITION OF GAIN OR LOSS.—IF—

(A) All of the assets of a corporation (less assets retained to meet claims) are distributed before January 1, 1955, in complete liquidation of such corporation; and

(B) The corporation elects (at such time and in such manner as the Secretary or his delegate may by regulations prescribe) to have this subsection apply,

then no gain or loss shall be recognized to such corporation from the sale or exchange by it of property during the calendar year 1954.

(2) CERTAIN PROVISIONS OF SECTION 337 MADE APPLICABLE.—For purposes of paragraph (1)—

(A) The term "property" has the meaning given to such term by section 337(b); except that any determination required by section 337(b) to be made by reference to the date of the adoption of the plan of liquidation shall be made by reference to January 1, 1954; and

(B) The limitations of section 337(c) shall apply.

For purposes of section 453(d)(4)(B) (relating to disposition of installment obligations), nonrecognition of gain or loss under paragraph (1) of this subsection shall be treated as nonrecognition of gain or loss under section 337.

(3) PLANS OF LIQUIDATION ADOPTED AFTER DECEMBER 31, 1953, AND BEFORE JUNE 22, 1954.—If the plan of complete liquidation was adopted after December 31, 1953, and before June 22, 1954, then, at the election of the corporation (made at such time and in such manner as the Secretary or his delegate may by regulations prescribe)—

(A) The 12-month period beginning on the date of the adoption of such plan shall be (i) the period for distribution (in lieu of the requirement in paragraph (1)(A) of this subsection that the assets be distributed before January 1, 1955), and (ii) the period during which, by reason of paragraph (1) of this subsection, gain or loss to the corporation is not recognized (in lieu of nonrecognition of gain or loss during the calendar year 1954); and

(B) Notwithstanding paragraph (2)(A) of this subsection, any determination required by section 337(b) to be made by reference to the date of the adoption of the plan of liquidation shall be made by reference to such date (and not by reference to January 1, 1954).

§ 1.392-1. EFFECTIVE DATE OF PART II OF SUBCHAPTER C.—(a) *General.*—Section 392 provides the general rule that Part II of Subchapter C, relating to liquidations shall be applicable only if the first distribution in pursuance of any plan of liquidation occurs on or after June 22, 1954. For this purpose, the date of adoption of the plan of liquidation is not material, except as provided in such part.

(b) *Certain sales in 1954.*—Section 392(b) provides special rules with respect to nonrecognition of gain or loss upon certain sales or exchanges of property in connection with liquidations completed during the calendar year 1954 and in connection with plans of liquidation adopted after December 31, 1953, and before June 22, 1954.

(c) *Election.*—Any election provided in section 392(b) shall be made by attaching to the return of the liquidating corporation for the year in which falls the date of the final liquidating distribution, a statement indicating its election with respect to section 392(b) or, in any case in which the final return of the corporation was filed on or before December 11, 1954, the date of publication of the notice of proposed rule making, within 90 days after the date of final promulgation of these regulations by filing such a statement with the proper district director of internal revenue for association with the final return. If such a statement is not attached to the return for such year or, in any case in which the final return of the corporation was filed on or before December 11, 1954, is not filed with the proper district director of internal revenue within the time prescribed herein, the provisions of section 392(b) shall not be applicable.

§ 1.393. STATUTORY PROVISIONS; EFFECTIVE DATES OF PARTS III AND IV.

SEC. 393. EFFECTIVE DATES OF PARTS III AND IV OF SUBCHAPTER C.

(a) GENERAL RULE.—Except as otherwise provided in this subchapter, parts III and IV shall take effect on June 22, 1954.

(b) SPECIAL RULES FOR PLANS OF REORGANIZATION.—

(1) IN GENERAL.—Except as provided in paragraphs (2) and (3), parts III and IV shall apply only in respect of plans of reorganization adopted on or after June 22, 1954. For purposes of this paragraph and paragraphs (2) and (3), a plan to make a transfer to a controlled corporation described in section 351, or a plan to make an exchange or distribution which is described in section 355 (or so much of section 356 as relates to section 355) shall be treated as a plan of reorganization.

(2) ELECTION TO HAVE 1939 CODE APPLY.—If—

(A) A plan of reorganization was submitted to the Secretary or his delegate before June 22, 1954, but such plan was not adopted before such date,

(B) The Secretary or his delegate issues (whether before, on, or after such date) a ruling with respect to such plan, and

(C) The corporations which are parties to the reorganization elect (at such time and in such manner as the Secretary or his delegate may by regulations prescribe) to have this paragraph apply,

then, if such reorganization is completed in accordance with the plan so submitted, the tax treatment of such reorganization (as to the corporations which are parties to the reorganization and as to their shareholders and security holders) shall be determined under the Internal Revenue Code of 1939 (in accordance with the contents of such ruling) and not under this Code.

(3) ELECTION TO HAVE 1954 CODE APPLY.—If—

(A) A plan of reorganization—

(i) Was adopted after March 1, 1954, and before June 22, 1954, or

(ii) Was adopted before June 22, 1954, in pursuance of a court order and all distributions under the plan occur after March 1, 1954, and before July 1, 1954, and

(B) The corporations which are parties to the reorganization elect (at such time and in such manner as the Secretary or his delegate may by regulations prescribe) to have this paragraph apply,

then the tax treatment of such reorganization (as to the corporations which are parties to the reorganization and as to their shareholders and security holders) shall be determined under this Code and not under the Internal Revenue Code of 1939.

§ 1.393–1. EFFECTIVE DATES OF PARTS III AND IV.—Section 393 provides the general rule that Part III of Subchapter C, relating to corporate reorganizations, and Part IV of Subchapter C, relating to certain insolvency reorganizations, shall take effect on June 22, 1954.

§ 1.393–2. SPECIAL RULE WITH RESPECT TO CERTAIN PLANS OF REORGANIZATION ARISING IN 1954.—(a) For the purpose of section 393 (b) (1)—

(1) If a corporation has adopted a plan of reorganization as there described before June 22, 1954, it may, if no action has been taken with respect to such plan which would constitute a realization of income or loss (whether or not recognized), and if no conveyance, exchange or distribution has been made by the corporation, rescind by proper corporate action and adopt such plan or another plan of reorganization after June 22, 1954, if all other corporations, parties to such reorganization, likewise rescind and readopt after such date.

(2) A corporation shall be considered to have adopted a plan of reorganization on the date on which a resolution of the board of directors is passed, adopting such plan or recommending its adoption to the shareholders, or upon the date of adoption of the plan of reorganization by the shareholders of such corporation, whichever is earlier.

(b) For the purpose of section 393 (b) (2)—

(1) A plan of reorganization shall be deemed to have been submitted before June 22, 1954, if such plan was filed before such date, with any office of the Internal Revenue Service with a request for a ruling as to the tax treatment thereof,

(2) A ruling with respect to such plan shall be a ruling letter signed by an official authorized to issue rulings in the office of the Assistant Commissioner (Technical) in the National Office of the Internal Revenue Service,

(3) Any such ruling issued shall be conclusive as to the law applicable to the transaction under the Internal Revenue Code of 1939 and for this purpose such Code shall be deemed not to be amended by the provisions of Parts III and IV,

(4) A plan of reorganization shall be deemed to have been filed on the date it is placed in the mail as shown by the postmark on the envelope containing such request for ruling or as shown by other available evidence of the mailing date, if the envelope is properly addressed and the proper postage affixed.

(c) For the purpose of section 393 (b) (3), a plan of reorganization shall be considered to have been adopted by a corporation after March 1, 1954 and before June 22, 1954 if between such dates either the plan was adopted by the shareholders or a resolution of a board of directors

was passed adopting the plan or recommending its adoption to the shareholders.

§ 1.393–3. MAKING AND FILING OF ELECTIONS.—The elections provided for in subsection (b)(2) and (b)(3) of section 393 shall be executed in the same manner as is required in the case of the income tax returns of the taxpayers. When more than one corporation is involved in the transaction, all such corporations shall join in making the election, except that a corporation which was not in existence on June 22, 1954, shall not be required to make an election (unless it is the only corporation involved in the transaction). It will be sufficient if the corporations in existence on June 22, 1954, make the election for themselves and for the corporation to be organized after that date pursuant to the plan of reorganization, but such election shall be binding on the new corporation when it is formed and on the holders of its stock and securities. The elections are to be filed with the district director of internal revenue in the district in which the returns of the corporations are filed. The filing is to be accomplished by attaching the election (or certified copy thereof if more than one corporation is involved) to the tax return for the year in which the transaction took place. Furthermore, a copy of such election is to be attached to the income tax return of each shareholder or security holder who made exchanges, or received distributions, pursuant to the plan, for the year in which the transaction took place or, in any case in which the copy of the election is not received by such shareholder or security holder until after the due date for filing the return for the year in which the transaction took place, the copy of the election shall be filed with the proper district director of internal revenue for association with the return of such shareholder or security holder. The elections filed with the corporation returns must be accompanied by all relevant data pertaining to the transaction and by certified copies of the resolution of the directors authorizing the election. An election once made and filed by the corporations that are parties to the reorganization shall be irrevocable both as to the corporations involved and as to the holders of their stock and securities. Permanent records of all relevant data shall be kept by every taxpayer for whom an election was filed under section 393(b), in order to facilitate the determination of gain or loss from a subsequent disposition of stock or securities or other property acquired in the transaction in respect of which the election was filed.

§ 1.395. STATUTORY PROVISIONS; SPECIAL RULES FOR APPLICATION OF SUBCHAPTER C.

SEC. 395. SPECIAL RULES FOR APPLICATION OF THIS SUBCHAPTER.

(a) TAXABLE YEARS AFFECTED.—Any provision of this subchapter the applicability of which is stated in terms of a specific date shall apply with respect to taxable years ending after such date. Each provision shall, in the case of a taxable year subject to the Internal Revenue Code of 1939, be deemed to be included in the Internal Revenue Code of 1939, but shall apply only to taxable years ending after such specific date.

(b) REPEAL AND CONTINUANCE OF INTERNAL REVENUE CODE OF 1939.—To the extent that the provisions of this subchapter supersede the provisions of the Internal Revenue Code of 1939, such provisions of the In-

ternal Revenue Code of 1939 are hereby repealed. The provisions of the Internal Revenue Code of 1939 shall continue to apply with respect to transactions for which rules are provided in this subchapter until such rules take effect.

§ 1.395–1. Special Rules for Application of Subchapter C.—(a) In general, under section 7851, the provisions of subchapter C are applicable to any taxable year beginning after December 31, 1953, which ends after August 16, 1954, the date of the enactment of the Internal Revenue Code of 1954. The applicable date of each provision with respect to such year is stated either in connection therewith or in sections 391 through 394. The years to which this subchapter is applicable will include the calendar year 1954, and all fiscal years beginning in 1954 and ending after August 16, 1954. All years beginning before January 1, 1954, and ending either before, on or after August 16, 1954, are subject to the Internal Revenue Code of 1939. All taxable years beginning after December 31, 1953, and ending before August 16, 1954, are also subject to the Internal Revenue Code of 1939.

(b) If there is included in the return for a taxable year subject to the Internal Revenue Code of 1939 items to which the provisions of this subchapter would be applicable if such years were subject to the Internal Revenue Code of 1954, such items shall be reported pursuant to the requirements of this subchapter if the transactions giving rise to such items occurred after the applicable dates specified. The determination in this case of the proper tax treatment shall be made by substituting the applicable provisions of subchapter C for the provisions of the Internal Revenue Code of 1939 which would otherwise be applicable thereto. For example, if a complete liquidation of a corporation occurs and if such liquidation would have been subject to the provisions of section 332 had the Internal Revenue Code of 1954 been applicable then section 332 of this Code shall be deemed to have superseded section 112(b)(6) of the Internal Revenue Code of 1939. If such transaction occurred prior to the applicable date, then the provisions of the Internal Revenue Code of 1939 alone are applicable. If there is included in the return for a taxable year subject to the Internal Revenue Code of 1954 items to which the provisions of this subchapter would be applicable, except for the applicable dates specified, such items shall be reported pursuant to the requirements of the Internal Revenue Code of 1939 applicable to such transactions. For example, the tax treatment of a complete liquidation of a corporation described in section 332 will be determined not by section 332 but pursuant to the rules of section 112(b)(6) of the Internal Revenue Code of 1939. If such liquidation occurred after June 21, 1954, only section 332 shall be applicable.

O. Gordon Delk,
Acting Commissioner of Internal Revenue.

Approved November 25, 1955.

H. Chapman Rose,
Acting Secretary of the Treasury.

(Filed by the Division of the Federal Register December 2, 1955, 8:45 a. m.)

The treatment of a distribution as a result of a corporation redeeming its stock. See Rev. Rul. 55–515, page 222.

SECTION 302.—DISTRIBUTIONS IN REDEMPTION OF STOCK

(Also Section 311.) Rev. Rul. 55–462

A proposed redemption by a corporation purchasing certain shares of its preferred stock in order to equalize the preferred stockholdings of two shareholders pursuant to a prior agreement will constitute a distribution in full payment in exchange for the stock within the purview of section 302(a) and (b)(1) of the Internal Revenue Code of 1954.

Advice has been requested as to the Federal income tax consequences of a proposed redemption by a corporation of a part of its preferred stock.

The capital stock of *M* corporation outstanding consists of preferred and common stock. Two individuals are the sole officers and stockholders of the corporation. They are not related by blood or marriage. Each owns 50 percent of the common stock.

The preferred stock was issued in a previous year for 1,600*x* dollars. One shareholder purchased 1 share for 100*x* dollars and the other shareholder purchased 15 shares for 1,500*x* dollars. The first stockholder agreed to purchase 14 additional preferred shares for 1,400*x* dollars to match the investment of the latter. However, the first shareholder has not been able to do so due to personal finances.

In order to equalize the preferred stockholdings of both shareholders inasmuch as they originally agreed to purchase the same amount, it is proposed that the *M* corporation redeem from the other shareholder 14 shares of its preferred stock at 1,400*x* dollars, the payment of 1,400*x* dollars for the shares being made in cash.

During the past 4 taxable years the net income of *M* corporation has ranged from 4,500*x* dollars to 3,400*x* dollars. Cash dividends have been paid in each of these years from 4,400*x* dollars to 1,000*x* dollars. Earned surplus of the corporation is about 7,200*x* dollars.

Section 302 of the Internal Revenue Code of 1954 relating to distributions in redemption of stock provides in part as follows:

(a) GENERAL RULE.—If a corporation redeems its stock (within the meaning of section 317(b)), and if paragraph (1), (2), (3), or (4) of subsection (b) applies, such redemption shall be treated as a distribution in part or full payment in exchange for the stock.

(b) REDEMPTIONS TREATED AS EXCHANGES.—

(1) REDEMPTIONS NOT EQUIVALENT TO DIVIDENDS.—Subsection (a) shall apply if the redemption is not essentially equivalent to a dividend.

A redemption is not taxable as a dividend under section 301 of the Code if any one of the four subsections specified in section 302(b) applies. If one of those subsections applies the redemption is to be treated as a distribution in payment in exchange for the stock, and since stock is generally a capital asset, the gain on the redemption would be treated as a capital gain.

The question whether the redemption is not equivalent to a dividend under section 302(b)(1) of the Code depends upon the circumstances of each case. In the instant case, the transaction set forth above by its nature can be characterized as a sale of stock by the shareholder. The two shareholders are unrelated and there is no pro rata distribution in whole or part effected by the transaction.

Accordingly, the redemption of 14 shares of its preferred stock by the *M* corporation will be treated as a distribution in full payment in

exchange for the stock by the shareholder under section 302(a) of the Code. Under section 1002 of the Code, gain or loss, if any, will be recognized to the shareholder only to the extent of the difference between the consideration received and the adjusted basis of the stock redeemed. As provided by section 311(a) of such Code, no gain or loss will be recognized to *M* corporation on the distribution of cash in redemption of a part of its preferred stock.

(Also Section 301.) Rev. Rul. 55-515

A redemption by a corporation of a part of its common stock held by shareholders who actually or constructively own all of the common stock of such corporation will generally constitute a distribution essentially equivalent to a dividend.

Advice has been requested as to whether a proposed redemption of a part of the stock of a corporation would be essentially equivalent to a taxable dividend.

M corporation is engaged in the real estate business. It has total assets of $250x$ dollars including $50x$ dollars of stocks and bonds, and a net worth of $140x$ dollars consisting of $25x$ dollars in preferred stock, $15x$ dollars in common stock, and earned surplus of $100x$ dollars.

The corporation was founded by an individual who up to the date of his death owned all the common stock and most of the preferred stock of the corporation. Upon his death, this stock was acquired by the wife of the deceased, his two daughters, a son, and a trust created for the benefit of his wife and children. Under the constructive ownership of stock rules, the wife of the late stockholder or the trust created by him is considered as owning all of the common stock of the corporation within the meaning of section 318 of the Internal Revenue Code of 1954.

Pursuant to a resolution adopted by the stockholders, *M* corporation proposes to redeem part of the common stock held by the wife of the decedent and by the trust for the benefit of the decedent's wife and children. The corporation will pay for the stock redeemed by transferring to the shareholders stocks and bonds owned by the corporation as investments. The fair market value of the investments and of the common stock of the corporation will be computed and the number of shares to be redeemed will be determined accordingly. No contraction of the business will occur as a result of the proposed redemption.

Section 302 of the Code relating to distributions in redemption of stock provides in part as follows:

(a) GENERAL RULE.—If a corporation redeems its stock (within the meaning of section 317 (b), and if paragraph (1), (2), (3), or (4) of subsection (b) applies, such redemption shall be treated as a distribution in part or full payment in exchange for the stock.

(b) REDEMPTION TREATED AS EXCHANGES.—

(1) REDEMPTION NOT EQUIVALENT TO DIVIDENDS.—Subsection (a) shall apply if the redemption is not essentially equivalent to a dividend.

* * * * * * *

(d) REDEMPTIONS TREATED AS DISTRIBUTIONS OF PROPERTY.—Except as otherwise provided in this subchapter, if a corporation redeems its stock (within the meaning of section 317(b)), and if subsection (a) of this section does not apply, such redemption shall be treated as a distribution of property to which section 301 applies.

A redemption is not taxable as a dividend under section 301 of the Code if it qualifies under any of the specific exceptions contained in section 302(b). If it qualifies under one of these exceptions, the redemption is to be treated as a distribution in payment in exchange for the stock, and since stock is generally a capital asset, the gain on the redemption would be treated as a capital gain. The only possible exception in the instant case as set forth above is section 302(b)(1) of the Code.

The question of whether a redemption of stock is essentially equivalent to a taxable dividend depends primarily upon the net effect of the distribution rather than the motive or plan of the stockholders or the corporation. A redemption of stock which does not as a practical matter change the essential relationship between the stockholders and the corporation is generally considered equivalent to a dividend. See *M. A. Flanagan, Executor, Estate of J. J. McCaffrey* v. *Helvering*, 116 Fed. (2d) 937; *Commissioner* v. *John T. Roberts et al.*, 203 Fed. (2d) 304.

In the instant case for tax purposes the decedent's wife is considered to be the sole owner of the common stock of *M* corporation. The redemption of a part of her stock will not in any way change her relationship to the corporation. After the redemption, the stockholder will still own (actually and constructively) all of the common stock. Without special circumstances, a distribution in redemption of part of the common stock of a sole stockholder is considered to be essentially equivalent to a dividend.

The same applies with respect to the trust for the benefit of the decedent's wife and children.

Accordingly, it is held that the proposed redemption by *M* corporation of a part of its common stock will constitute a distribution essentially equivalent to a dividend. Such redemption will be treated as a distribution of property to which section 301 of the Code applies. The portion of the distribution constituting a dividend will be determined under the provisions of section 316 of such Code.

Rev. Rul. 55–745

Revenue Ruling 54–458, C. B. 1954–2, 167, relating to the sale and redemption of stock of the sole stockholder of a corporation, is applicable under the provisions of section 302(a) and (b)(3) of the 1954 Code with respect to similar situations involving a sale and redemption of stock of a sole stockholder.

Advice has been requested whether Revenue Ruling 54–458, C. B. 1954–2, 167, which was issued under the provisions of section 115(g) of the Internal Revenue Code of 1939, is equally applicable under the provisions of section 302(a) of the Internal Revenue Code of 1954.

In Revenue Ruling 54–458, *supra*, the Service stated that under the 1939 Code it will follow the decision in *Fern R. Zenz* v. *Quinlivan*, 213 Fed. (2d) 914, in cases where similar facts and circumstances are presented. At issue in the Zenz case was a situation involving a sole stockholder of a corporation selling part of her stock to a competitor and shortly thereafter selling the remainder of her stock to the corporation for an amount of cash and property approximately equal to its earned surplus. The court held that the purchase of the stock

by the corporation was not a dividend to the selling stockholder under the terms of section 115(g)(1) of the 1939 Code and that the amount received was treated as in payment for the stock surrendered under the provisions of section 115(c) of the Code of 1939, since the taxpayer was separated from all interest in the corporation.

It is held that Revenue Ruling 54-458, *supra*, is equally applicable under the 1954 Code. Thus, in a transaction such as the one described, the money received by the stockholder from the corporation will be treated as received in payment for the stock surrendered under section 302(a) because of section 302(b)(3). It should be noted however that there has been a change in nomenclature. Section 302(b)(3) is entitled "Termination of shareholder's interest." A transaction within that section is not a "partial liquidation," as specifically defined in section 346.

SECTION 305.—DISTRIBUTIONS OF STOCK AND STOCK RIGHTS

A distribution by a corporation to its shareholders in treasury stock. See Rev. Rul. 55-746, below.

SECTION 306.—DISPOSITIONS OF CERTAIN STOCK

(Also Section 305.) Rev. Rul. 55-746

> A dividend of common stock payable in treasury common stock by a corporation to the holders of its common stock will not constitute "section 306 stock" as defined in section 306(c)(1)(A) of the Internal Revenue Code of 1954.

Advice has been requested whether or not a proposed distribution by a corporation of a common stock dividend payable in treasury stock to the holders of its common stock will constitute "section 306 stock."

M is a corporation having capital stock consisting of 100 shares of preferred stock and 300 shares of common stock. All of the common stock is of one class. However, only 50 shares of preferred stock and only 75 shares of common stock are outstanding. The balance of the authorized common stock is held in the treasury.

For bona fide business reasons, the *M* corporation proposes to authorize a distribution of common stock held in the treasury to the common shareholders on the basis of three additional shares for each share outstanding.

Section 306(c) of the Internal Revenue Code of 1954 provides in part as follows:

> (c) SECTION 306 STOCK DEFINED.—
> (1) IN GENERAL.—* * * the term "section 306 stock" means stock which meets the requirements of subparagraph (A), * * * of this paragraph.
> (A) Distributed to Seller.—Stock (other than common stock issued with respect to common stock) which was distributed to the shareholder selling or otherwise disposing of such stock if, by reason of section 305(a), any part of such distribution was not includible in the gross income of the shareholder.

In order to come within the exception stated in the parenthetical clause of subsection (c)(1)(A), it makes no difference whether the

common stock distributed is treasury common stock or newly issued common stock, if the stock is to be distributed is the same in all respects as the common stock outstanding.

Accordingly, it is held that the common stock received will not constitute "section 306 stock" within the meaning of section 306(c) of the Code.

SUBPART B.—EFFECTS ON CORPORATION

SECTION 311.—TAXABILITY OF CORPORATION ON DISTRIBUTION

Tax treatment to a corporation upon the distribution by it of cash in redemption of part of its preferred stock. See Rev. Rul. 55-462, page 221.

PART II.—CORPORATE LIQUIDATIONS

SUBPART A.—EFFECTS ON RECIPIENTS

SECTION 331.—GAIN OR LOSS TO SHAREHOLDER IN CORPORATE LIQUIDATIONS

Treatment of amounts received from a corporate redemption of stock. See Rev. Rul. 55-517, page 297.

SUBPART B.—EFFECTS ON CORPORATION

SECTION 337.—GAIN OR LOSS ON SALES OR EXCHANGES IN CONNECTION WITH CERTAIN LIQUIDATIONS

Treatment of a corporation in liquidation from the sale or exchange by it of property. See Rev. Rul. 55-517, page 297.

PART III.—CORPORATE ORGANIZATIONS AND REORGANIZATIONS

SUBPART B.—EFFECTS ON SHAREHOLDERS AND SECURITY HOLDERS

SECTION 354.—EXCHANGES OF STOCK AND SECURITIES IN CERTAIN REORGANIZATIONS

The effects on shareholders as a result of exchanges between two corporations in pursuance of a plan of reorganization. See Rev. Rul. 55-440, page 226.

SECTION 358.—BASIS TO DISTRIBUTEES

The treatment of the basis to stockholders of their stock in exchange pursuant to a reorganization. See Rev. Rul. 55-440, page 226.

SUBPART D.—SPECIAL RULE; DEFINITIONS

SECTION 368.—DEFINITIONS RELATING TO CORPORATE REORGANIZATIONS

(Also Sections 354, 358.) Rev. Rul. 55-440

X corporation acquired 80 percent of the common stock of *Y* corporation in exchange solely for shares of *X* voting common stock. Prior to the exchange, *Y* corporation, having outstanding preferred stock in addition to common stock, called the preferred stock for retirement. However, some preferred shareholders had not surrendered their certificates prior to the effective date of the exchange of common stocks. *Held*, the transaction constitutes a nontaxable reorganization within the purview of section 368(a)(1)(B) of the Internal Revenue Code of 1954, regardless of the number of shares of preferred stock of *Y* corporation which, at the time of the consummation of the exchange, had not been presented for redemption.

Advice has been requested with respect to the tax consequences of a reorganization under the following circumstances.

Pursuant to a plan of reorganization, the *X* corporation acquired not less than 80 percent of the outstanding common stock of the *Y* corporation in exchange solely for voting common stock of *X*. The offer of exchange by *X* corporation was contingent upon its acceptance by the holders of at least 80 percent of the outstanding common stock of *Y* corporation.

Y corporation also has voting preferred stock outstanding. The certificate of incorporation provides, in part, that the preferred stock may be called at a specified price per share, plus accrued dividends, on any dividend date upon 30 days' notice to the stockholders of *Y's* intention to redeem the stock. Prior to the effective date of the exchange, the board of directors of *Y* resolved to call the preferred stock and the 30 days' notices of the call were mailed to the holders of the preferred stock. The redemption price of all the outstanding preferred stock was deposited with a bank as escrow agent.

After the exchange of common stock was consummated upon the tender of at least 80 percent of the common stock of *Y* corporation, all of the preferred stock of *Y* had been previously called, but there were certain shares of the preferred stock which had not been presented for redemption prior to the effective date of the exchange.

Section 368 of the Internal Revenue Code of 1954 provides, in part, as follows:

> (a) REORGANIZATION.—
> (1) IN GENERAL.—* * * the term "reorganization" means—
> * * * * * * *
> (B) the acquisition by one corporation, in exchange solely for all or a part of its voting stock, of stock of another corporation if, immediately after the acquisition, the acquiring corporation has control of such other corporation (whether or not such acquiring corporation had control immediately before the acquisition);
> * * * * * * * *
> (c) CONTROL.—* * * the term "control" means the ownership of stock possessing at least 80 percent of the total combined voting power of all classes of stock entitled to vote and at least 80 percent of the total number of shares of all other classes of stock of the corporation.

The question at issue is whether preferred shares previously called for redemption but not yet surrendered at the effective date of the exchange would be considered to be "stock" within the meaning of sec-

tion 368(c) of the Code for the purpose of determining whether the *X* corporation was in control of *Y* corporation after the exchange of common stock within the meaning of section 368(a)(1)(B) of the Code.

Under the terms of the preferred stock indenture pursuant to the certificate of incorporation, the *Y* corporation may call for redemption on any dividend date upon 30 days' notice to its stockholders to redeem such stock. Therefore, the rights as preferred stockholders terminated upon the call of the preferred shares. Thereafter, the holders of such shares had only the right to receive the call price upon the surrender of the shares for redemption, there being no issue regarding the rights of creditors. For the purpose of determining control under section 368(c), preferred shares which have been called but not yet presented for redemption will be disregarded.

In view of the foregoing, the acquisition by *X* corporation in exchange solely for shares of its voting common stock of at least 80 percent of the outstanding common stock of *Y* corporation constitutes a reorganization within the meaning of section 368(a)(1)(B) of the Code, regardless of the number of shares of preferred stock of *Y* corporation which, at the time of the consummation of the exchange, had not been presented for redemption. Accordingly, no gain or loss is recognizable to the common stockholders of *Y* as a result of the exchange of their common stock of *Y* for common stock of *X*. The basis in their hands of the common stock of *X* received upon the exchange is the same as the basis of the common stock of *Y* exchanged therefor.

SUBCHAPTER D.—DEFERRED COMPENSATION, ETC.

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

SECTION 401.—QUALIFIED PENSION, PROFIT-SHARING, AND STOCK BONUS PLANS

(Also Section 404.) Rev. Rul. 55-480

The qualification of an employees' pension plan and trust, under section 401(a) of the Internal Revenue Code of 1954, will not be affected when the employer's contribution to an "auxiliary fund," which is used to convert the contract purchased by the trustees to one providing the pensions specified in the plan, is postponed to a subsequent year if the benefits provided under the plan are not affected at any time by the postponement and if the unfunded past service cost at any time does not exceed the unfunded past service cost as of the date of establishment of the plan. The payment of the postponed contribution, in a subsequent year, will be allowed as a deduction within the limits of section 404(a)(1) of the 1954 Code.

Advice has been requested regarding the effect on the qualification, under section 401(a) of the Internal Revenue Code of 1954, of a pension plan and trust when the current year contribution to an "auxiliary fund" is postponed to a subsequent year and also as to the deductibility of such postponed payments when actually paid.

The *M* company established an employees' pension plan which has been held to meet the requirements for qualification under section 165(a) of the 1939 Code (section 401(a) of the 1954 Code). All contributions by the company are paid to the trustee of the trust forming a part of the plan. Contracts purchased by the trustee to fund benefits

under the plan call for level annual premiums providing a minimum basic pension with additional payments sufficient to convert the basic contract purchased to one providing the full pensions called for under the plan. The "additional payments" are paid over by the trustee to and are held by the insurer as an "auxiliary fund" to be applied as needed on the retirement of an employee. The current year premiums on the contracts have been paid but the company postponed the contribution to the trustee of the amount of the "additional payment" to the "auxiliary fund" with the intention of making such contributions in a subsequent year.

P. S. No. 57, dated August 5, 1946, holds that the applicability of a prior ruling as to qualification of a plan under section 165(a) of the 1939 Code, will not be affected by suspension of employer contributions if the benefits to be made under the plan are not affected at any time by the suspension and if the unfunded past service cost at any time does not exceed the unfunded past service cost as of the date of establishment of the plan.

Accordingly, it is held that the qualified status of the plan and trust, under section 401(a) of the 1954 Code, will not be affected by the postponement or suspension of the current year contribution to the "auxiliary fund" if the benefits provided under the plan are not affected at any time by the suspension and if the unfunded past service cost at any time (including any unfunded prior normal cost and unfunded interest on any unfunded cost) does not exceed the unfunded past service cost as of the date of establishment of the plan.

When the postponed contribution is paid in a subsequent year or years, deductions will be allowable within the limits of section 404(a)(1) of the 1954 Code provided the trust otherwise remains qualified. For the purposes of any such subsequent year, the entire unfunded cost of the plan for the year of the suspended contribution, including the then current costs which were not funded because of the suspension, will represent an unfunded cost of past service credits.

SECTION 402.—TAXABILITY OF BENEFICIARY OF EMPLOYEES' TRUST

(Also Part II, Section 165; Regulations 118, Section 39.165–6.) Rev. Rul.55–747[1]

> Bases upon which one-year term premiums may be computed for use in determining the amount required to be included in the income of an employee on account of current life insurance protection provided for such employee under a life or an endowment insurance contract held by an employees' trust qualified under section 401(a) of the Internal Revenue Code of 1954.

Advice has been requested regarding the bases which may be used in computing one-year term premiums for the purpose of determining the costs required to be included in the income of an employee, in accordance with section 39.165–6 of Regulations 118 (see T. D. 6091, C. B. 1954–2, 47), on account of current life insurance protection provided for him under a life or endowment insurance contract held by an employees' trust qualified under section 401(a) of the Internal Revenue Code of 1954 (section 165(a) of the 1939 Code).

[1] This Revenue Ruling reads substantially as P. S. No. 58, Revised, issued on March 7, 1947.

In principle the cost of $1,000 of such protection may be considered as the one-year term premium for $1,000 insurance, computed on the following basis:

(a) The mortality rate upon which the gross contract premium is based, adjusted to conform to the basis of any element of the current dividend under the contract properly attributable to a different current actual mortality experience.

(b) The interest rate upon which the gross contract premium is based, adjusted to conform to the basis of any element of the current dividend under the contract properly attributable to a different current actual interest earnings rate.

(c) A loading rate consistent with the loading rate upon which the gross contract premium is based, adjusted to conform to the basis of any element of the current dividend under the contract properly attributable to different current actual expenses.

In practice the basis outlined above cannot be accurately determined or applied.

One year term premiums may, however, be computed upon a basis which recognizes that the actual costs under a contract may be considerably smaller than costs consistent with the basis of the gross premiums thereunder but which produce uniform one-year term premiums per $1,000 of current life insurance protection for every employee of the same age without regard to the bases of the premiums, dividends, or risk classification under a particular contract. Such uniform one-year term premiums may be used for the purpose referred to in the first paragraph hereof provided the premiums are not less than those given in the table shown below.

Uniform One Year Term Premiums for $1,000 Life Insurance Protection

(Based on Table 38, U. S. Life Tables and Actuarial Tables (U. S. Government Printing Office, Washington, D. C.—1946), and 2½% interest.)

Age	Premium	Age	Premium	Age	Premium
15	$1. 27	35	$3. 21	55	$13. 74
16	1. 38	36	3. 41	56	14. 91
17	1. 48	37	3. 63	57	16. 18
18	1. 52	38	3. 87	58	17. 56
19	1. 56	39	4. 14	59	19. 08
20	1. 61	40	4. 42	60	20. 73
21	1. 67	41	4. 73	61	22. 53
22	1. 73	42	5. 07	62	24. 50
23	1. 79	43	5. 44	63	26. 63
24	1. 86	44	5. 85	64	28. 98
25	1. 93	45	6. 30	65	31. 51
26	2. 02	46	6. 78	66	34. 28
27	2. 11	47	7. 32	67	37. 31
28	2. 20	48	7. 89	68	40. 59
29	2. 31	49	8. 53	69	44. 17
30	2. 43	50	9. 22	70	48. 06
31	2. 57	51	9. 97	71	52. 29
32	2. 70	52	10. 79	72	56. 89
33	2. 86	53	11. 69	73	61. 89
34	3. 02	54	12. 67	74	67. 33
				75	73. 23

SECTION 403.—TAXATION OF EMPLOYEE ANNUITIES

Rev. Rul. 55-639

An annuity contract within the meaning of section 402 or 403 of the Internal Revenue Code of 1954 is a contract which provides primarily for periodic installment payments to the annuitant named therein, and under which the death benefits at any time cannot exceed the larger of the reserve or the total premiums paid for the annuity benefits. Thus, in any annuity contract, there is no pure insurance protection at any time. The fact that the contract may provide for return of total premiums paid for the annuity benefits in case of death, and such total premiums may exceed the reserve in the early years, will not be considered as providing insurance protection.

This ruling should not be interpreted as holding that every nontrusteed plan which uses such contracts as a medium of funding and providing benefits is a qualified annuity plan within the meaning of section 403(a) of the Code, nor should it be construed as constituting an approval by the Internal Revenue Service of such a contract. A determination as to whether a particular pension or annuity plan which uses this type of contract constitutes a qualified plan within the meaning of section 401(a) or section 403(a) of the Code can only be made after consideration of all the pertinent facts of the particular case. Request for such a determination should be made in each case by the taxpayer who establishes the plan, or by his authorized representative, to the appropriate office of the District Director of Internal Revenue, in accordance with the procedure outlined in Revenue Ruling 32, C. B. 1953-1, 265.

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

(Also Part II, Section 23(p); Regulations 118, Section 39.23(p)-4.) Rev. Rul. 55-428

An employer will be allowed a deduction for a prorata part of the annual contribution necessary to meet the current cost of an employees' pension plan, qualified under section 401(a) of the Internal Revenue Code of 1954 (section 165(a) of the 1939 Code), for the short taxable year resulting from a change in his accounting period.

Advice has been requested whether the allowable deduction for contributions of an employer to the trust of an employees' pension plan may be prorated for the short taxable year resulting from a change in the employer's accounting period.

The *M* corporation has been filing its Federal income tax returns on a fiscal year basis ending September 30. Permission has been granted by the Commissioner to change its taxable year from the accounting period heretofore used to one ending June 30. Thus, for the first period of change the taxable year represents a short period consisting of 9 months beginning with October 1 and ending June 30.

The employees' pension plan was established by the corporation with an anniversary date of September 30. The plan and trust forming a part of such plan were held to be qualified under section 401(a) of the Internal Revenue Code of 1954 (section 165(a) of the 1939 Code). The plan is self-insured.

Within 60 days after the close of the short taxable year the corporation made a contribution to the pension trust in an amount sufficient to cover three-fourths of the contribution required to meet the current cost of the employees' pension plan for the 12-month taxable year in which the change in accounting period took place. The actuarially determined current cost of the plan for the full 12-month period will not exceed the limitations under section 404(a)(1) of the 1954 Code (section 23(p)(1)(A) of the 1939 Code).

If the anniversary of the plan is the beginning of the taxable year the costs applicable to the taxable year are those for the concurrent plan year. In other cases, the costs applicable to the taxable year may be considered to be either (1) those for the year beginning on the anniversary of the plan which falls in the taxable year, or (2) those for the year ending the day before such anniversary, or (3) those for the period concurrent with the taxable year which may be computed directly or may be obtained by interpolation between (1) and (2), provided the same rule is used consistently every year so that there is no overlapping or gap for any period.

Accordingly, it is held that the employer is entitled to a deduction under section 404(a)(1) of the 1954 Code (section 23(p)(1)(A) of the 1939 Code), for the taxable year representing the 9-month period, for a contribution equal to three-fourths of the actuarially determined current cost for the 12-month period in which the change in the accounting period is made, provided that such current cost does not exceed the appropriate limitation under such section for a full 12-month taxable year. For each 12-month taxable year thereafter deductions will be allowable for contributions in an amount not to exceed the limitation under section 404(a)(1) of the 1954 Code for each such year.

Rev. Rul. 55-640

> Where under local law a promise under seal is binding without other consideration, such a promise of an employer to make contributions to the trustees of a profit-sharing trust may constitute the corpus of a valid trust; therefore, the first contribution of an employer on an accrual method to such a trust, forming part of an employees' profit-sharing plan which has been held to meet the requirements of section 401(a) of the Internal Revenue Code of 1954, which is made after the close of its taxable year to which the payment applies but within the time prescribed by law for filing the return for such taxable year (including extensions thereof), may be considered as a payment to a valid trust in existence on the last day of such taxable year.

Advice has been requested whether a contribution to a trust may, under the circumstances set forth below, be considered a payment to a valid existing trust under local law within the meaning of section 404 of the Internal Revenue Code of 1954.

The company in the instant case, a taxpayer on the accrual method, executed a trust agreement under seal as a part of its profit-sharing

plan for employees which has been held to meet the requirements of section 401(a) for tax exemption under section 501(a) of the Code. The trust agreement provides that the company shall make a contribution to the trustees during each fiscal year of the company according to a prescribed formula based on a graduated percentage of profits, subject to a limitation of 15 percent of the total compensation otherwise paid to all the participants in the trust.

For the first fiscal year of the plan, the profits of the company were such that no contribution was required under the profit-sharing formula and none was made. For the second fiscal year, the profits were such that a contribution of $60x$ dollars was required which was made after the close of the year but within the time prescribed for the filing of the company's return for that year. This was the first contribution of any kind received by the trustees. Previous to this contribution, the trust had no corpus unless the company's promise, executed under seal, to pay as prescribed by the profit-sharing formula may itself be treated as the corpus. Under the local law in the instant case, however, a seal imports consideration so that a trust executed under seal would be binding without other consideration.

The question presented is whether, for the taxable year to which the contribution applies, the trust had a corpus and was a valid existing trust so that the payment made after the close of the taxable year may be deducted from gross income under section 404 of the Code.

Section 404(a)(3) of the 1954 Code provides for deductions of contributions paid to a profit-sharing trust which is exempt under section 501(a) of the Code. In Mim. 5985, C. B. 1946–1, 72, it is stated that a plan must be in effect before the trust is entitled to exemption under Section 165(a) of the 1939 Code (corresponding to section 501(a) of the 1954 Code); that there must be a valid and existing trust to which the contribution is made; that if an essential element of a trust is lacking, there is, in effect, no trust; and that, thus, if the trust corpus is lacking, it cannot be said that a trust is in existence. The corollary, therefore, is that exemption under section 501(a) applies to an existing trust, complete in all respects, inclusive of possession of corpus.

Section 404(a)(6) of the Code provides that a taxpayer on the accrual method shall be deemed to have made a payment, for the purpose of paragraph (3), on the last day of the year of accrual if the payment is on account of such taxable year and is made within the time prescribed by law for filing the return for such taxable year (including extensions thereof). However, paragraph (6) does not create a trust or relate a trust back to a period when in fact it had no existence. Thus, contributions to an employees' trust, to constitute allowable deductions, must be made pursuant to a plan in effect and to a valid existing trust which is recognized as such under the law prevailing in the jurisdiction to which the trust is subject.

Under the local law in the instant case, a seal imports consideration so that a promise under seal is binding without other consideration. Also, under the local law, a trust established by an instrument executed under seal, under the terms of which the settler promises unqualifiedly to pay to the trustees a certain percentage of its profits for each taxable year, is not without a corpus at the end of the first year for which the employer has sufficient profits to require a contribution to the trust because the trustees are then in possession of an enforceable promise which may be the subject matter of a trust.

Accordingly, it is held that where, under local law, a promise executed under seal is binding without other consideration, such a promise of an employer to make contributions to the trustees of a profit-sharing trust may constitute the corpus of a valid trust; therefore, the first contribution of an employer on an accrual method to such a trust, forming a part of a qualified employees' profit-sharing plan, which is made after the close of its taxable year to which the payment applies but within the time prescribed by law for filing the return for such taxable year (including extensions thereof), may be considered as a payment to a valid trust in existence on the last day of the taxable year to which the payment applies, so as to be deductible under section 404 of the Code, notwithstanding the fact that the trust, prior to the payment of the contribution, had no corpus other than the employer's enforceable promise to pay.

Rev. Rul. 55–670

A timely contribution will be deemed to have been made, under section 404 of the Internal Revenue Code of 1954, where an employer using the accrual method of accounting makes a contribution to a deferred compensation plan or trust, which has been held to meet the requirements of section 401(a) of the 1954 Code (section 165(a) of the 1939 Code), after the 60-day period following the close of the taxable year as stipulated in the plan but before the time required by law for filing the return for such taxable year, including extensions thereof.

Advice has been requested as to whether an employer using the accrual method of accounting will be considered as having made a timely contribution to an employees' deferred compensation plan or trust, which meets the requirements of section 401(a) of the Internal Revenue Code of 1954 (section 165(a) of the 1939 Code), when payment is made after the 60-day period stated in the plan but before the time prescribed by law for filing the return for such taxable year.

An employer's deferred compensation plan created for the exclusive benefit of his employees, which has been held to meet the qualifications under section 401(a) of the 1954 Code (section 165(a) of the 1939 Code), provided that the employer's contributions be made within 60 days following the close of the taxable year of accrual.

Section 404(a)(6) of the 1954 Code provides that for the purpose of payments into pension, stock bonus, and profit-sharing trusts and toward the purchase of employees' annuities, an employer shall be deemed to have made a payment on the last day of the year of accrual if the payment is on account of such taxable year and is made not later than the time prescribed by law for filing the return for such taxable year, including extensions thereof. The employer in the instant case did not make the required payment within the 60 days specified in the plan but did make it within the time required by law for filing his return.

Section 39.165–1(a)(1) of Regulations 118 provides that in order for a trust to be exempt under section 165(a) of the Code it must be formed and availed of solely to aid in the proper execution of a plan which is a definite written program and arrangement. These regulations have been continued in effect by the stopgap regulations, Treasury Decision 6091, C. B. 1954–2, 47.

As a general rule, the plan which is in effect is to be followed. However, where the provisions of the plan were in conformance with the prior law but became inconsistent with the new law because of a more liberal treatment under the latter, no adverse consequences will ensue if action is taken in accordance with such new law.

Accordingly, it is held that a timely contribution is deemed to have been made, under section 404 of the 1954 Code, where an employer makes a contribution to a qualified plan or trust after the 60-day period following the close of the taxable year, as stipulated in the plan, but before the time required by law for filing the return for such taxable year, including extensions thereof. However, it would be advisable in the interest of consistency to amend the plan to conform to the more liberal provisions of the 1954 Code.

(Also Part II, Section 23 (p); Regulations 118, Section 39.23 (p)-4.) Rev. Rul. 55-748

Where an employees' pension trust purchases for employees retirement income contracts which provide that upon the death of an employee, the life insurance benefits under such contracts shall be paid to the trustee who, under the terms of the pension plan, shall apply such proceeds to the payment of subsequent premiums on behalf of the other employees, the contributions of the employer attributable to such insurance are not costs of the pension plan for the purpose of determining the limitations on contributions under section 404 (a) (1) of the Internal Revenue Code of 1954 and may not be currently deductible as such. Such nondeductible contributions may, however, be considered as contributions to the trust which may be deducted in later years in accordance with the provisions of section 404 (a) (1) (D) of the Code.

P. S. No. 6, dated July 29, 1944, revoked.

Advice has been requested relative to the treatment for Federal income tax purposes of contributions paid by an employer to an employees' pension trust qualified under section 401 (a) of the Internal Revenue Code of 1954 which are attributable to the life insurance part of retirement income contracts purchased for employees by the trust, the proceeds of which, upon the death of an employee, are payable to the trustee and are held by him for application to payment of subsequent premiums on similar contracts on behalf of other employees.

Under the terms of the plan, the trustee purchases retirement income contracts which provide insurance on the lives of employees covered by the plan. On the death of a covered employee, so much of the proceeds of the contract as is in excess of the cash surrender value of the contract is not paid to the employee's beneficiary, but remains in the trust to pay premiums next becoming due on contracts purchased on behalf of other employees. It is stated that under no circumstances may any of the proceeds of the contract payable on death ever be diverted from the trust to the employer.

Section 404 (a) of the Code provides in part as follows:

(a) GENERAL RULE.—If contributions are paid by an employer to or under a stock-bonus, pension, profit-sharing, or annuity plan, or if compensation is paid or accrued on account of any employee under a plan deferring the receipt of such compensation, such contributions or compensation shall not be deductible under section 162 (relating to trade or business expenses) or section 212 (relating to expenses for the production of income) but if they satisfy

the condition of either of such sections, they shall be deductible under this section, subject, however, to the following limitations as to the amounts deductible in any year:

(1) PENSION TRUSTS.—In the taxable year when paid, if the contributions are paid into a pension trust, and if such taxable year ends within or with a taxable year of the trust for which the trust is exempt under section 501 (a), in an amount determined as follows:

(A) an amount not in excess of 5 per cent of the compensation otherwise paid or accrued during the taxable year to all the employees under the trust, but such amount may be reduced for future years if found by the Secretary or his delegate upon periodical examinations at not less than 5-year intervals to be more than the amount reasonably necessary to provide the remaining unfunded cost of past and current service credits of all employees under the plan, plus

(B) any excess over the amount allowable under subparagraph (A) necessary to provide with respect to all of the employees under the trust the remaining unfunded cost of their past and current service credits distributed as a level amount, or a level percentage of compensation, over the remaining future service of each such employee, as determined under regulations prescribed by the Secretary or his delegate, but if such remaining unfunded cost with respect to any 3 individuals is more than 50 per cent of such remaining unfunded cost, the amount of such unfunded cost attributable to such individuals shall be distributed over a period of at least 5 taxable years, or

(C) in lieu of the amounts allowable under subparagraphs (A) and (B) above, an amount equal to the normal cost of the plan, as determined under regulations prescribed by the Secretary or his delegate, plus, if past service or other supplementary pension or annuity credits are provided by the plan, an amount not in excess of 10 per cent of the cost which would be required to completely fund or purchase such pension or annuity credits as of the date when they are included in the plan, as determined under regulations prescribed by the Secretary or his delegate, except that in no case shall a deduction be allowed for any amount (other than the normal cost) paid in after such pension or annuity credits are completely funded or purchased.

(D) Any amount paid in a taxable year in excess of the amount deductible in such year under the foregoing limitations shall be deductible in the succeeding taxable years in order of time to the extent of the difference between the amount paid and deductible in each such succeeding year and the maximum amount deductible for such year in accordance with the foregoing limitations.

That part of the employer's contributions attributable to the purchasing of life insurance benefits under retirement income contracts which, when they become payable, are applicable to the reduction of subsequent employer contributions to the plan may not be considered as a cost of the pension plan for the purpose of determining the limitation on deductions under section 404(a)(1)(A), (B), and (C) of the Code, for the year in which such contributions are paid, and may not be deducted as such. Contributions attributable to such insurance benefits, not otherwise determined, may be determined by applying the rates provided in Revenue Ruling 55-747, page 228, this Bulletin, to the amounts of insurance which would revert to the trust in the event of death of the insured employee in the year for which the premiums are paid.

Contributions paid to cover the cost of such insurance benefits are, however, contributions to the pension trust which may be deductible in a later year to the extent provided by section 404(a)(1)(D) of the Code, subject to the conditions and limitations applicable to such later year.

In later years, if an employer for any reason, such as the receipt by the trustee of life insurance proceeds under a retirement income contract because of the death of an employee, which proceeds were applied to the payment of premiums on similar contracts for the benefit of other employees, contributes to the trust a sum less than the maximum deduction permitted for that year under section 404(a)(1)(A), (B), or (C), he may deduct in that year, in addition to his current contribution, the contributions made in prior years and not then deductible because they were attributable to that part of the income contracts which would provide life insurance payable to the trustee, to the extent of the difference beween his current contribution and his maximum deduction permitted under section 404(a)(1)(A), (B), or (C).

In the case of a contributory pension plan, a separation between employer and employee contributions will be necessary before the previously described carry-over may be computed.

P. S. No. 6, dated July 29, 1944, which reached a contrary conclusion in a similar situation, is hereby revoked. However, under the authority of section 7805(b) of the Code, this ruling shall not be applied retroactively with respect to any tax advantage granted under any method of computing the amount attributable to life insurance heretofore approved by the Internal Revenue Service.

Deductibility of contributions of an employer to an employees' trust when paid in a year subsequent to the regular year of payment. See Rev. Rul. 55–480, page 227.

SUBCHAPTER E.—ACCOUNTING PERIODS AND METHODS OF ACCOUNTING

PART II.—METHODS OF ACCOUNTING

SUBPART A.—METHODS OF ACCOUNTING IN GENERAL

SECTION 446.—GENERAL RULE FOR METHODS OF ACCOUNTING

Change in method of accounting by a member of an affiliated group solely by reason of section 1.1502–44 of the Income Tax Regulations relating to consolidated returns. See Rev. Rul. 55–732, page 379.

SUBPART B.—TAXABLE YEAR FOR WHICH ITEMS OF GROSS INCOME INCLUDED

SECTION 451.—GENERAL RULE FOR TAXABLE YEAR OF INCLUSION

Guarantor's personal obligation to pay employee's corporate salary satisfied by purchase of an annuity or through formation of irrevocable trust for the benefit of such employee. See Rev. Rul. 55–691, page 21.

SECTION 452.—PREPAID INCOME

(Also section 462.) T. D. 6154[1]

TITLE 26—INTERNAL REVENUE, 1954.—CHAPTER I, SUBCHAPTER A, PART I.—INCOME TAX: TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1953

Regulations under Public Law 74, Eighty-fourth Congress, approved June 15, 1955.

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

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

On October 28, 1955, notice of proposed rulemaking regarding the regulations under Public Law 74 [page 748 of this Bulletin] Eighty-fourth Congress, approved June 15, 1955, was published in the Federal Register (20 F. R. 8120). After consideration of such relevant suggestions as were presented by interested persons regarding the proposals, the following regulations are hereby adopted:

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1.9000–1 Provisions of Public Law 74.
1.9000–2 Effect of repeal in general.
1.9000–3 Requirement of statement showing increase in tax liability.
1.9000–4 Form and content of statement.
1.9000–5 Effect of filing statement.
1.9000–6 Provisions for the waiver of interest.
1.9000–7 Provisions for estimated tax.
1.9000–8 Extension of time for making certain payments.

AUTHORITY: Sections 1.9000–1 to 1.9000–8 issued under Section 7805, 68A Stat. 917, Public Law 74, 84th Cong.; 26 U. S. C. 7805.

§ 1.9000–1 STATUTORY PROVISIONS.—Public Law 74, 84th Congress, approved June 15, 1955, provides as follows:

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. REPEAL OF SECTIONS 452 AND 462.

(a) PREPAID INCOME.—Section 452 of the Internal Revenue Code of 1954 is hereby repealed.

(b) RESERVES FOR ESTIMATED EXPENSES, ETC.—Section 462 of the Internal Revenue Code of 1954 is hereby repealed.

SEC. 2. TECHNICAL AMENDMENTS.

The following provisions of the Internal Revenue Code of 1954 are hereby amended as follows:

(1) Subsection (c) of section 381 is amended by striking out paragraph (7) (relating to carryover of prepaid income in certain corporate acquisitions).

(2) The table of sections for subpart B of part II of subchapter E of chapter 1 (relating to taxable year for which items of gross income included) is amended by striking out

"SEC. 452. PREPAID INCOME."

(3) The table of sections for subpart C of such part II (relating to taxable year for which deductions are taken) is amended by striking out—

"SEC. 462. RESERVES FOR ESTIMATED EXPENSES, ETC."

[1] 20 F. R. 9175.

SEC. 3. EFFECTIVE DATE.

The amendments made by this Act shall apply with respect to taxable years beginning after December 31, 1953, and ending after August 16, 1954.

SEC. 4. SAVING PROVISIONS.

(a) FILING OF STATEMENT.—If—

(1) The amount of any tax required to be paid for any taxable year ending on or before the date of the enactment of this Act is increased by reason of the enactment of this Act, and

(2) the last date prescribed for payment of such tax (or any installment thereof) is before December 15, 1955,

then the taxpayer shall, on or before December 15, 1955, file a statement which shows the increase in the amount of such tax required to be paid by reason of the enactment of this Act.

(b) FORM AND EFFECT OF STATEMENT.—

(1) Form of statement, etc.—The statement required by subsection (a) shall be filed at the place fixed for filing the return. Such statement shall be in such form, and shall include such information necessary or appropriate to show the increase in the amount of the tax required to be paid for the taxable year by reason of the enactment of this Act, as the Secretary of the Treasury or his delegates shall by regulations prescribe.

(2) TREATMENT AS AMOUNT SHOWN ON RETURN.—The amount shown on a statement filed under subsection (a) as the increase in the amount of the tax required to be paid for the taxable year by reason of the enactment of this Act shall, for all purposes of the internal revenue laws, be treated as tax shown on the return. Notwithstanding the preceding sentence, that portion of the amount of increase in tax for any taxable year which is attributable to a decrease (by reason of the enactment of this Act) in the net operating loss for a succeeding taxable year shall not be treated as tax shown on the return.

(3) WAIVER OF INTEREST IN CASE OF PAYMENT ON OR BEFORE DECEMBER 15, 1955.—If the taxpayer, on or before December 15, 1955, files the statement referred to in subsection (a) and pays in full that portion of the amount shown thereon for which the last date prescribed for payment is before December 15, 1955, then for purposes of computing interest (other than interest on overpayments) such portion shall be treated as having been paid on the last date prescribed for payment. This paragraph shall not apply if the amount shown on the statement as the increase in the amount of the tax required to be paid for the taxable year by reason of the enactment of this Act is greater than the actual increase unless the taxpayer establishes, to the satisfaction of the Secretary of the Treasury or his delegate, that his computation of the greater amount was based upon a reasonable interpretation and application of sections 452 and 462 of the Internal Revenue Code of 1954, as those sections existed before the enactment of this Act.

(c) SPECIAL RULES.—

(1) INTEREST FOR PERIOD BEFORE ENACTMENT.—Interest shall not be imposed on the amount of any increase in tax resulting from the enactment of this Act for any period before the day after the date of the enactment of this Act.

(2) ESTIMATED TAX.—Any addition to the tax under section 294 (d) of the Internal Revenue Code of 1939 shall be computed as if this Act had not been enacted. In the case of any installment for which the last date prescribed for payment is before December 15, 1955, any addition to the tax under section 6654 of the Internal Revenue Code of 1954 shall be computed as if this Act had not been enacted.

(3) TREATMENT OF CERTAIN PAYMENTS WHICH TAXPAYER IS REQUIRED TO MAKE.—If—

(A) the taxpayer is required to make a payment (or an additional payment) to another person by reason of the enactment of this Act, and

(B) the Internal Revenue Code of 1954 prescribes a period, which expires after the close of the taxable year, within which the taxpayer must make such payment (or additional payment) if the amount thereof is to be taken into account (as a deduction or otherwise) in computing taxable income for such taxable year,

then, subject to such regulations as the Secretary of the Treasury or his delegate may prescribe, if such payment (or additional payment) is made on or before December 15, 1955, it shall be treated as having been made within the period prescribed by such Code.

(4) TREATMENT OF CERTAIN DIVIDENDS.—Subject to such regulations as the Secretary of the Treasury or his delegate may prescribe, for purposes of section 561(a)(1) of the Internal Revenue Code of 1954, dividends paid after the 15th day of the third month following the close of the taxable year and on or before December 15, 1955, may be treated as having been paid on the last day of the taxable year, but only to the extent (A) that such dividends are attributable to an increase in taxable income for the taxable year resulting from the enactment of this Act, and (B) elected by the taxpayer.

(5) DETERMINATION OF DATE PRESCRIBED.—For purposes of this section, the determination of the last date prescribed for payment or for filing a return shall be made without regard to any extension of time therefor and without regard to any provision of this section.

(6) REGULATIONS.—For requirement that the Secretary of the Treasury or his delegate shall prescribe all rules and regulations as may be necessary by reason of the enactment of this Act, see section 7805(a) of the Internal Revenue Code of 1954.

§ 1.9000–2 EFFECT OF REPEAL IN GENERAL.—(a) Section 452 (relating to prepaid income) and section 462 (relating to reserves for estimated expenses) of the Internal Revenue Code of 1954 were repealed by Public Law 74, 84th Congress, with respect to all years subject to such Code. The effect of the repeal will generally be to increase the tax liability of taxpayers who elected to adopt the methods of accounting provided by sections 452 and 462. References to sections of law in § 1.9000–2 to § 1.9000–8, inclusive, are references to the Internal Revenue Code of 1954 unless otherwise specified.

(b) Public Law 74 provides that if the amount of any tax is increased by the repeal of sections 452 and 462, and if the last date prescribed for the payment of such tax (or any installment thereof) is before December 15, 1955, then the taxpayer shall on or before such date file a statement as prescribed in § 1.9000–3. The last date prescribed for payment for this purpose shall be determined without regard to any extensions of time and without regard to the provisions of Public Law 74.

§1.9000–3 REQUIREMENT OF STATEMENT SHOWING INCREASE IN TAX LIABILITY.—(a) *Returns filed before June 15, 1955.*—Where a return reflecting an election under section 452 or 462 was filed before June 15, 1955, the taxpayer must file on or before December 15, 1955, a statement on Form 2175 showing the increase in tax liability resulting from the repeal of sections 452 and 462. The provisions of this paragraph may be illustrated by the following example:

Example. Corporation X filed its income tax return for the calendar year 1954 on March 15, 1955, and elected under section 6152 to pay the unpaid amount of the tax shown thereon in two equal installments. Such installment payments are due on March 15, 1955, and June 15, 1955, respectively. The corporation elected to compute its tax for such taxable year under the

methods of accounting provided by sections 452 and 462. Corporation X's tax liability is increased by reason of the enactment of Public Law 74, and since the last date prescribed for paying its tax expires before December 15, 1955, it is required to submit the prescribed statement on or before December 15, 1955, showing its increase in tax liability.

(b) *Returns filed on or after June 15, 1955.*—A taxpayer filing a return on or after June 15, 1955, for a taxable year ending on or before such date, may elect to apply the accounting methods provided in sections 452 and 462. The election may be exercised by either of the following methods:

(1) By computing the tax liability shown on such return as though the provisions of sections 452 and 462 had not been repealed. In such a case, the taxpayer must file on or before December 15, 1955, a statement on Form 2175 showing the increase in tax liability resulting from the repeal of sections 452 and 462.

(2) By computing his tax liability without regard to sections 452 and 462. In this case, Form 2175 must be filed with the return. However, taxable income and the tax liability computed with the application of sections 452 and 462 shall be shown on lines 8 and 14, respectively, of the form in lieu of the amounts otherwise called for on those lines.

If a taxpayer does not make an election to have the provisions of sections 452 and 462 apply, the savings provisions of section 4 of Public Law 74 are not applicable.

(c) *Taxable years ending after June 15, 1955.*—A taxpayer having a taxable year ending after June 15, 1955, may not elect to apply the methods of accounting prescribed in sections 452 and 462 in computing taxable income for such taxable year. Such a taxpayer must file his return and pay the tax as if such sections had not been enacted.

(d) *Other situations requiring statements.*—(1) A person who made an election under section 452 or 462 but whose tax liability was not increased by reason of the enactment of Public Law 74, is nevertheless required to file a statement on Form 2175 if his gross income is increased or his deductions are decreased as the result of the repeal of sections 452 and 462. A partnership which makes an election under such sections must file such a statement. In addition, a partner, stockholder, distributee, etc. (whether on not such person made an election under section 452 or 462), shall file a statement showing any increase in his tax liability resulting from the effects of the repeal on the gross income or deductions of any person mentioned in the previous sentences of this subparagraph.

(2) A statement shall also be filed for a taxable year, other than a year to which an election under section 452 or 462 is applicable, if the repeal of such sections increases the tax liability of such year. Thus, a statement must be filed for any taxable year to which a net operating loss is carried from a year to which an election under section 452 or 462 is applicable, provided that the repeal of such sections affects the amount of the tax liability for the year to which such loss is carried. A separate statement must also be filed for a year in which there is a net operating loss which is changed by reason of the repeal of sections 452 and 462. Where there is a short taxable year

involved, a taxpayer may have two taxable years to which elections under sections 452 and 462 are applicable and, in such a case, a statement, on Form 2175, must be filed for each such year.

§ 1.9000–4 FORM AND CONTENT OF STATEMENT.—(a) *Information to be shown.*—The statement shall be filed on Form 2175 which may be obtained from district directors of internal revenue. It shall be filed with the district director for the district in which the return was filed. The statement shall be prepared in accordance with the instructions contained thereon and shall show the following information:

(1) The name and address of the taxpayer,

(2) The amounts of each type of income deferred under section 452,

(3) The amount of the addition to each reserve deducted under section 462,

(4) The taxable income and the tax liability of the taxpayer computed with the application of sections 452 and 462,

(5) The taxable income and the tax liability of the taxpayer computed without the application of sections 452 and 462,

(6) The details of the recomputation of taxable income and tax liability, including any changes in other items of income, deductions, and credits resulting from the repeal of sections 452 and 462, and

(7) If self-employment tax is increased, the computations and information required on page 3 of Schedule C, Form 1040.

(b) *Procedure for recomputing tax liability.*—In determining the taxable income and the tax liability computed without the application of sections 452 and 462, such items as vacation pay and prepaid subscription income shall be reported under the law and regulations applicable to the taxable year as if such sections had not been enacted. The tax liability for the year shall be recomputed by restoring to taxable income the amount of income deferred under section 452 and the amount of the deduction taken under section 462. Other deductions or credits affected by such changes in taxable income shall be adjusted. For example, if the deduction for contributions allowed for the taxable year was limited under section 170(b), the amount of such deduction shall be recomputed, giving effect to the increase in adjusted gross income or taxable income, as the case may be, by reason of the adjustments required by the repeal of sections 452 and 462.

§ 1.9000–5 EFFECT OF FILING STATEMENT.—(a) *Years other than years affected by a net operating loss carryback.*—If the taxpayer files a timely statement in accordance with the provisions of § 1.9000–3, the amount of the increase in tax shown on such statement for a taxable year shall, except as provided in paragraph (b), be considered for all purposes of the Internal Revenue Code, as tax shown on the return for such year. In general, such increase shall be assessed and collected in the same manner as if it had been tax shown on the return as originally filed. The provisions of this paragraph may be illustrated by the following example:

Example.—A taxpayer filed his return showing a tax liability computed under the methods of accounting provided by sections 452 and 462 as $1,000 and filed the statement in accordance with

§ 1.9000–3 showing an increase in tax liability of $200. The tax computed as though sections 452 and 462 had not been enacted is $1,200, and the difference of $200 is the increase in the tax attributable to the repeal of sections 452 and 462. This increase is considered to be tax shown on the return for such taxable year. Additions to the tax for fraud or negligence under section 6653 will be determined by reference to $1,200 (that is, $1,000 plus $200) as the tax shown on the return.

(b) *Years affected by a net operating loss carryback.*—In the case of a year which is affected by a net operating loss carryback from a year to which an election under section 452 or 462 applies, that portion of the amount of increase in tax shown on the statement for the year to which the loss is carried back which is attributable to a decrease in such net operating loss shall not be treated as tax shown on the return.

§ 1.9000–6 PROVISIONS FOR THE WAIVER OF INTEREST.—(a) *In general.*—If the statement is filed in accordance with § 1.9000–3 and if that portion of the increase in tax which is due before December 15, 1955, (without regard to any extension of time for payment and without regard to the provisions of § 1.9000–2 to § 1.9000–8, inclusive) is paid in full on or before such date, then no interest shall be due with respect to that amount. The provisions of this paragraph may be illustrated by the following example:

Example. Corporation M's return for the calendar year 1954 was filed on March 15, 1955, and the tax liability shown thereon was paid in equal installments on March 15, 1955, and June 15, 1955. M filed a statement on December 15, 1955, showing the increase in its tax liability resulting from the repeal of sections 452 and 462 and paid at that time the increase in tax shown thereon. No interest will be imposed with respect to the amount of such payment.

Interest shall be computed under the applicable provisions of the internal revenue laws on any portion of the increase in tax shown on the statement which is due after December 15, 1955, and which is not paid when due.

(b) *Limitation on application of waiver.*—The provisions of paragraph (a) shall not apply to any portion of the increase in tax shown on the statement if such increase reflects an amount in excess of that attributable solely to the repeal of sections 452 and 462, i. e., is attributable in whole or in part to excessive or unwarranted deferrals or accruals under section 452 or 462, as the case may be, in computing the tax liability with the application of such sections. Notwithstanding the preceding sentence, paragraph (a) shall be applicable if the taxpayer can show that the tax liability as computed with the application of sections 452 and 462 is based upon a reasonable interpretation and application of such sections as they existed prior to repeal. If the taxpayers complied with the provisions of the regulations under sections 452 and 462 in computing the tax liability with the application of such sections, he will be regarded as having reasonably interpreted and applied sections 452 and 462. In this regard, it is not essential that the taxpayer submit with his return the detailed information required by such regulations in support of the deduction claimed under section

462, but such information shall be supplied at the request of the Commissioner.

(c) *Interest for periods prior to June 16, 1955.*—No interest shall be imposed with respect to any increase in tax resulting solely from the repeal of sections 452 and 462 for any period prior to June 16, 1955, (the day after the date of the enactment of Public Law 74). The preceding sentence does not apply to that part of any increase in tax which is due to the improper application of sections 452 and 462. The provisions of this paragraph shall not apply to interest imposed under section 3779 of the 1939 Code. (See paragraph (d) of this section.)

(d) *Amounts deferred by corporations expecting carrybacks.*—Interest shall be imposed at the rate of 6 percent on so much of the amount of tax deferred under section 3779 of the Internal Revenue Code of 1939 as is not satisfied within the meaning of section 3779(i)(1), notwithstanding the fact that a greater amount would have been satisfied, had sections 452 and 462 not been repealed. Interest will be imposed at such rate until the amount so satisfied is paid.

§ 1.9000–7 *Provisions for estimated tax.*—(a) *Additions to tax under section 294(d) of the 1939 Code.*—Any addition to the tax under section 294(d) (relating to estimated tax) of the Internal Revenue Code of 1939 shall be computed as if the tax for the year for which the estimate was made were computed with sections 452 and 462 still applicable to such taxable year. For the purpose of the preceding sentence, it is not necessary for the taxpayer actually to have made an election under section 452 or 462; it is only necessary for the taxpayer to have taken such sections into account in estimating its tax liability for the year. Thus, if in determining the amount of estimated tax, the taxpayer computed his estimated tax liability by applying those sections, that portion of any additions to tax under section 294(d) resulting from the repeal of sections 452 and 462 shall be disregarded.

(b) *Additions to tax under section 6654.*—In the case of an underpayment of estimated tax, any additions to the tax under section 6654, with respect to installments due before December 15, 1955, shall be computed without regard to any increase in tax resulting from the repeal of sections 452 and 462. Any additions to the tax with respect to installments due on or after December 15, 1955, shall be imposed in accordance with the applicable provisions of the Internal Revenue Code, and as though sections 452 and 462 had not been enacted. Thus, a taxpayer whose declaration of estimated tax was based upon an estimate of his taxable income for the year of the estimate which was determined by taking sections 452 and 462 into account, must file an amended declaration on or before the due date of the next installment of estimated tax due on or after December 15, 1955. Such amended declaration shall reflect an estimate of the tax without the application of such sections. If the taxpayer bases his estimate on the tax for the preceding taxable year under section 6654(d)(1)(A), an amended declaration must be filed on or before the due date of the next installment due on or after December 15, 1955, if the tax for the preceding taxable year is increased as the result of the repeal of sections 452 and 462. Similarly, if the taxpayer bases his estimate on the tax computed under section 6654(d)(1)(B), he must file an amended declaration on or before the due date of the next

installment due on or after December 15, 1955, taking into account the repeal of sections 452 and 462 with respect to the preceding taxable year. Any increase in estimated tax shown on an amended declaration filed in accordance with this paragraph must be paid in accordance with section 6153(c).

(c) *Estimate of tax of corporations.*—Corporations required to file a declaration of estimated tax under section 6016 for taxable years ending on and after December 31, 1955, shall estimate their tax liability for such year as if sections 452 and 462 had not been enacted. Thus, if the corporation bases its estimated tax liability under section 6655(d)(1) or (2) on its operations for the preceding taxable year, the effect of the repeal of sections 452 and 462 with respect to such year must be taken into account.

§ 1.9000–8 EXTENSION OF TIME FOR MAKING CERTAIN PAYMENTS.—(a) *Time for payment specified in Code.*—(1) If the treatment of any payment (including its allowance as a deduction or otherwise) is dependent upon the making of a payment within a period of time specified in the Internal Revenue Code, the period within which the payment is to be made is extended where the amount to be paid is increased by reason of the repeal of sections 452 and 462, provided that:

(i) The taxpayer, because of a pre-existing obligation, is required to make a payment or an additional payment to another person by reason of such repeal;

(ii) The deductibility of the payment or additional payment is contingent upon its being made within a period prescribed by the Code, which period expires after the close of the taxable year; and

(iii) The payment or additional payment is made on or before December 15, 1955.

If the foregoing conditions are met, the payment or additional payment will be treated as having been made within the time specified in the Internal Revenue Code, and, subject to any other conditions in the Code, it shall be deductible for the year to which it relates. The provisions of this paragraph may be illustrated by the following examples:

Example 1.—Section 267 (relating to losses, expenses and interest between related taxpayers) applies to amounts accrued by taxpayer A for salary payable to B. For the calendar year 1954, A is obligated to pay B a salary equal to 5 percent of A's taxable income for the taxable year. The amount accrued as salary payable to B for 1954 is $5,000 with the taxable income reflecting the application of section 462. As a result of the repeal of section 462 the salary payable to B for 1954 is increased to $6,000. The additional $1,000 is paid to B on December 15, 1955. In recomputing A's tax liability for 1954 the additional deduction of $1,000 for salary payable to B will be treated as having been made within two and one-half months after the close of the taxable year and will be deductible in that year.

Example 2. On March 1, 1955, Corporation X, a calendar year taxpayer using the accrual method of accounting, makes a payment described in section 404(a)(6) (relating to contribu-

tions to an employees' trust) of $10,000 which is accrued for 1954 and is determined on the basis of the amount of taxable income for that year. The taxpayer filed its return on March 15, 1955. By reason of the repeal of section 462, X's taxable income is increased so that it is required to make an additional contribution of $2,000 to the employees' trust. The additional payment is made on December 15, 1955. For purposes of recomputing X's tax liability for 1954, this additional payment is deemed to have been made on the last day of 1954.

(2) The time for inclusion in the taxable income of the payee of any additional payment of the type described in subparagraph (1) above, shall be determined without regard to section 4(c) (3) of Public Law 74 and § 1.9000–2 to § 1 9000–8, inclusive.

(b) *Dividends paid under section 561.*—Under section 4(c) (4) of Public Law 74 the period during which distributions may be recognized as dividends paid under section 561 for a taxable year to which section 452 or 462 apply may be extended under the conditions set forth below.

(1) *Accumulated earnings tax or personal holding company tax.*—In the case of the accumulated earnings tax or the personal holding company tax, if—

(i) The income of a corporation is increased for a taxable year by reason of the repeal of sections 452 and 462 so that it would become liable for the tax (or an increase in the tax) imposed on accumulated earnings or personal holding companies unless additional dividends are distributed;

(ii) The corporation distributes dividends to its stockholders after the 15th day of the 3rd month following the close of its taxable year and on or before December 15, 1955, which dividends are attributable to an increase in its accumulated taxable income or undistributed personal holding company income, as the case may be, resulting from the repeal of sections 452 and 462, and

(iii) The corporation elects in its statement, submitted under § 1.9000–3, to have the provisions of section 4(c) (4) of Public Law 74 apply—

then such dividends shall be treated as having been paid on the last day of the taxable year to which the statement applies.

(2) *Regulated investment companies.*—In the case of a regulated investment company taxable under section 852, if—

(i) The taxable income of the regulated investment company is increased by reason of the repeal of sections 452 and 462 (without regard to any deduction for dividends paid as provided for in this subparagraph);

(ii) The company distributes dividends to its stockholders after the 15th day of the 3rd month following the close of its taxable year and on or before December 15, 1955, which dividends are attributable to an increase in its investment company income resulting from the repeal of sections 452 and 462; and

(iii) The company elects in its statement, submitted under § 1.9000–3, to have the provisions of section 4(c) (4) of Public Law 74 apply—

then such dividents are to be treated as having been paid on the last day of the taxable year to which the statement applies. The dividends paid are to be determined under this subparagraph without regard to the provisions of section 855.

(3) *Related provisions.*—An election made under subparagraph (b) (1) or (2) is irrevocable. The time for inclusion in the taxable income of the distributees of any distributions of the type described in subparagraph (b) (1) or (2) shall be determined without regard to section 4(c) (4) of Public Law 74 and § 1.9000–2 to § 1.9000–8, inclusive.

RUSSELL C. HARRINGTON,
Commissioner of Internal Revenue.

Approved December 8, 1955.
H. CHAPMAN ROSE,
Acting Secretary of the Treasury.

(Filed by the Division of the Federal Register December 8, 1955, 12 : 30 p. m.)

(Also Section 462.) Rev. Rul. 55–539 [1]

Increase in tax liability resulting from the repeal of sections 452 and 462 of the Internal Revenue Code of 1954.

SECTION 1. PURPOSE.

The purpose of this Revenue Ruling is to set forth the procedure for the reporting and payment of the increase in tax liability resulting from the enactment of Public Law 74, 69 Stat. 134, page 748 of this Bulletin, repealing sections 452 and 462 of the Internal Revenue Code of 1954.

SEC. 2. BACKGROUND.

Section 452 (relating to prepaid income) and section 462 (relating to reserves for estimated expenses), enacted as part of the Internal Revenue Code of 1954, have been repealed by Public Law 74, *supra*, as to all years subject to such Code. The effect of the repeal will generally be to increase the tax liability of taxpayers who elected the methods of accounting provided by sections 452 and 462 of the Code. References in this Revenue Ruling are to sections of the Internal Revenue Code of 1954 unless otherwise specified.

SEC. 3. REQUIREMENT FOR FILING STATEMENT.

.01 Where a return reflecting an election under section 452 or 462 of the Code was filed prior to the enactment of Public Law 74, *supra*, the taxpayer must file on or before December 15, 1955, a statement on the prescribed form showing the increase in tax liability resulting from the repeal of sections 452 and 462 of the Code. For example, corporation *X* filed its income tax return for the calendar year 1954 on March 15, 1955, and elected under section 6152 of the Code to pay the unpaid amount of the tax shown thereon in two equal installments. Such installment payments were due on March 15, 1955, and June 15, 1955, respectively. The corporation elected to compute its tax for such taxable year under the methods of accounting provided by sec-

[1] Based on IR-Circular No. 55–83, dated July 12, 1955; Revenue Ruling amplified by Revenue Procedure 55–8, page 908.

tions 452 and 462 of the Code. Corporation *X*'s tax liability is increased by reason of the enactment of Public Law 74, *supra*, and since the last date prescribed for paying its tax expires before December 15, 1955, it is required to submit the prescribed statement on or before December 15, 1955, showing its increase in tax liability.

.02 A taxpayer who has a taxable year ending on or before the date of enactment of Public Law 74, *supra*, but who has not filed his return before such time may file his return using the methods of accounting provided by sections 452 and 462 of the Code. In such case, he must file a statement at the time and in the manner provided under subsection .01 of this section.

.03 A taxpayer having a taxable year ending after the date of enactment of Public Law 74, *supra*, may not elect to compute his tax under sections 452 and 462 of the Code for such taxable year. Such a taxpayer must file his return and pay the tax as if such sections had never been enacted.

.04 A taxpayer who made an election under section 452 or 462 of the Code, but whose tax liability is not increased by reason of the enactment of Public Law 74, *supra*, is nevertheless required to file a statement in accordance with the procedure outlined in subsection .01 or .02 of this section if his gross income is increased or his deductions are decreased as the result of the repeal of sections 452 and 462 of the Code. For the purpose of the preceding sentence, the term "taxpayer" includes a partnership. In addition, a partner, stockholder, distributee, etc., shall file a statement in accordance with the procedure outlined in subsection .01 or .02 showing any increase in his tax liability resulting from the effects of the repeal on the gross income or deductions of the taxpayer mentioned in the preceding sentences.

.05 A statement shall also be filed for a taxable year other than the year to which an election under section 452 or 462 of the Code is applicable if the repeal of such sections increases the tax liability of the other year. Thus, a statement must be filed, on or before December 15, 1955, in accordance with the procedure outlined in subsection .01 or .02 of this section, for any taxable year to which a net operating loss is carried from the year to which an election under section 452 or 462 of the Code is applicable, provided that the repeal of such sections affects the amount of the tax liability for such year. A separate statement must also be filed for a year in which there is a net operating loss which is changed by reason of the repeal of section 452 and 462 of the Code. Where there is a short taxable year involved, a taxpayer may have 2 taxable years to which elections under sections 452 and 462 of the Code are applicable. In such a case, a statement must be filed for each year in accordance with the procedure outlined in subsection .01 or .02.

SEC. 4. FORM AND CONTENT OF STATEMENT.

.01 The statement shall be filed on Form 2175, Statement to be Filed Pursuant to Repeal of Sections 452 and 462 of the Internal Revenue Code of 1954, which may be obtained from District Directors of Internal Revenue. It shall be filed with the office of the District Director in which the return was filed. The statement shall be prepared in accordance with the instructions contained thereon and shall show the following information:

1. The name and address of the taxpayer;
2. The amounts of each type of income deferred under section 452 of the Code as of the close of the taxable year;
3. The balance in each reserve under section 462 of the Code at the end of the taxable year;
4. The taxable income of the taxpayer as reported on the income tax return and the taxable income as computed without the application of sections 452 and 462 of the Code;
5. The tax liability of the taxpayer as reported on the income tax return and the tax liability as computed without the application of sections 452 and 462 of the Code; and
6. The details of the recomputation of taxable income and tax liability including any changes in other items of income, deductions, and credits resulting from the repeal of sections 452 and 462 of the Code.

.02 The taxable income and the change in tax liability shown on the statement shall be recomputed as if the taxpayer had not made an election under sections 452 and 462 of the Code. Such items as the treatment of vacation pay and advance receipts of subscription income shall be reported under the law and regulations applicable to the taxable year as if sections 452 and 462 of the Code had not been enacted. The tax liability for the year shall be recomputed by restoring to taxable income the amount of income deferred under section 452 of the Code and the amount of the deduction under section 462 of the Code. Other deductions or credits affected by such changes in taxable income shall be adjusted. For example, if the deduction for contributions allowed for the taxable year had been limited under section 170(b) of the Code, the amount of such deduction shall be recomputed giving effect to the increase in adjusted gross income or taxable income, as the case may be, by reason of the adjustments required by the repeal of sections 452 and 462 of the Code.

SEC. 5. EFFECT OF FILING STATEMENT.

.01 If the taxpayer files a timely statement in accordance with the provisions of section 3 of this Revenue Ruling, the amount of the increase in tax shown on such statement for a year to which an election under section 452 or 462 of the Code is applicable shall, for all purposes of the Internal Revenue Code, be considered as tax shown on the return for such year. (See, however, subsection .02 below.) In general, such increase shall be assessed and collected in the same manner as if it had been tax shown on the return as originally filed. For example, taxpayer *A* filed his return showing the tax liability computed under the methods of accounting provided by sections 452 and 462 of the Code as $1,000 and filed the statement in accordance with section 3 of this Revenue Ruling. The tax computed as though sections 452 and 462 of the Code had not been enacted is $1,200, and the difference of $200 is the increase in the tax attributable to the repeal of sections 452 and 462 of the Code. This increase is considered for all purposes of the Internal Revenue Code to be a part of the tax shown on the return for such taxable year. Additions to the tax for fraud or negligence under section 6653 of the Code will be determined by reference to $1,200 (that is, $1,000 plus $200) as tax shown on the return.

.02 In the case of a year which is affected by a net operating loss carryback from a year to which an election under section 452 or 462 of the Code applies, that portion of the amount of increase in tax shown on the statement for the year to which the loss is carried back and which is attributable to a decrease in such net operating loss shall not be treated as tax shown on the return.

SEC. 6. INTEREST PROVISIONS.

.01 If the statement is filed in accordance with section 3 of this Revenue Ruling and that portion of the increase in tax which is due before December 15, 1955 (determined without regard to any extension of time for payment and without regard to the provisions of section 4 of Public Law 74, *supra*), is paid in full on or before December 15, 1955, no interest shall be due with respect to such portion. For example, corporation *M*'s return for the calendar year 1954 was filed on March 15, 1955, and the tax liability shown thereon was paid in equal installments on March 15, 1955, and June 15, 1955. It filed a statement on December 15, 1955, showing the increase in its tax liability resulting from the repeal of sections 452 and 462 of the Code and paid at that time the increase in tax shown thereon. No interest will be imposed with respect to the amount of such payment. Interest shall be computed under the applicable provisions of the Internal Revenue Code on any portion of the increase in tax shown on the statement which is due on or after December 15, 1955, but which is not paid when due.

.02 Subsection .01 of this section shall apply only if the tax liability shown on the return as filed for the year was based upon a reasonable interpretation and application of sections 452 and 462 of the Code as those sections existed prior to repeal.

.03 No interest shall be imposed with respect to any increase in tax resulting from the repeal of sections 452 and 462 of the Code for any period prior to June 16, 1955, the day after the date of the enactment of Public Law 74, *supra*.

SEC. 7. PROVISIONS FOR ESTIMATED TAX.

.01 Any addition to the tax under section 294(d) of the Internal Revenue Code of 1939 (relating to estimated tax) shall be computed as if the tax for the year for which the estimate was made were computed with sections 452 and 462 of the Code still applicable to such taxable year. For the purpose of the preceding sentence, it is not necessary for the taxpayer actually to have made an election under section 452 or 462 of the Code; it is only necessary for the taxpayer to have taken such sections into account in estimating his tax liability for the year.

.02 In the case of an underpayment of estimated tax under section 6654 of the Code, any additions to the tax for installments due before December 15, 1955, shall be computed without regard to any increase in tax resulting from the repeal of sections 452 and 462 of the Code. Any additions to the tax with respect to installments due on or after December 15, 1955, shall be imposed in accordance with the applicable provisions of the Internal Revenue Code and as though sections 452 and 462 of the Code had not been enacted. Thus, a taxpayer whose declaration of estimated tax was based upon an estimate of his taxable

income for the year of the estimate, which was determined as though sections 452 and 462 of the Code were applicable, must file an amended declaration on or before the due date of the next installment of estimated tax, due on or after December 15, 1955. Such amended declaration shall reflect an estimate of the tax without the application of these sections. If the taxpayer bases his estimate on the tax for the preceding taxable year under section 6654(d)(1)(A) of the Code, an amended declaration must be filed on or before the due date of the next installment, due on or after December 15, 1955, if the tax for the preceding taxable year is increased as the result of the repeal of sections 452 and 462 of the Code. If the taxpayer bases his estimate on the tax computed under section 6654(d)(1)(B) of the Code, he must file an amended declaration on or before the due date of the next installment, due on or after December 15, 1955, taking into account the repeal of sections 452 and 462 of the Code with respect to the preceding taxable year. Any increase in estimated tax shown on an amended declaration filed in accordance with this subsection must be paid in accordance with section 6153(c) of the Code.

.03 Corporations required to file a declaration of estimated tax under section 6016 of the Code for taxable years ending on or after December 31, 1955, shall estimate their tax liability for such year as if sections 452 and 462 of the Code had never been enacted. Thus, if the corporation bases its estimated tax liability on its operations for the preceding taxable year under section 6655(d)(1) or (2) of the Code, the effect of the repeal of sections 452 and 462 of the Code with respect to such year must be taken into account.

SEC. 8. EXTENSION OF TIME FOR MAKING CERTAIN PAYMENTS.

.01 If the allowance of any deduction is dependent upon the making of a payment within a period of time specified in the Internal Revenue Code, the period within which the payment is to be made is extended where the amount to be paid is increased by reason of the repeal of sections 452 and 462 of the Code, provided that:

1. The taxpayer, because of a pre-existing obligation, is required to make a payment or an additional payment to another person by reason of the enactment of Public Law 74, *supra;*
2. The deductibility of the payment is contingent upon its being made within a period prescribed by the Code, which period expires after the close of the taxable year; and
3. The payment or additional payment is made on or before December 15, 1955.

If the foregoing conditions are met, the payment shall be treated as having been made within the time specified in the Code and it shall be deductible for the year to which the payment relates, subject to the other conditions provided by the Code. The provisions of this paragraph may be illustrated by the following:

Example 1. Section 267 of the Code (relating to losses, expenses and interest between related taxpayers) applies to amounts accrued by taxpayer *A* for salary payable to *B*. For the calendar year 1954, *A* is obligated to pay *B* a salary equal to five percent of *A*'s taxable income for the taxable year. The amount accrued as salary payable to *B* for 1954 is $5,000 with the taxable income

reflecting the application of section 462 of the Code. As a result of the repeal of section 462 of the Code, the salary payable to *B* for 1954 is increased to $6,000. The additional $1,000 is paid to *B* on December 15, 1955. In recomputing *A*'s tax liability for 1954, the additional deduction of $1,000 for salary payable to *B* will be treated as having been made within two and one-half months after the close of the taxable year and will be deductible in that year.

Example 2. On March 1, 1955, corporation *X*, a calendar year taxpayer using an accrual method of accounting, makes a payment described in section 404(a)(6) of the Code (relating to contributions to an employees' trust) of $10,000 which is accrued for 1954 and is determined on the basis of the amount of taxable income for that year. The taxpayer filed its return on March 15, 1955. By reason of the repeal of section 462 of the Code, *X*'s taxable income is increased so that it is required to make an additional contribution of $2,000 to the employees' trust. The additional payment is made on December 15, 1955. For purposes of recomputing *X*'s tax liability for 1954, this additional payment is deemed to have been made on the last day of 1954.

The time for inclusion in the taxable income of the payee of any additional payment of the type described in this subsection shall be determined without regard to section 4(c)(3) of Public Law 74, *supra*, and the provisions of this subsection.

.02 Under section 4(c)(4) of Public Law 74, *supra*, the period during which distributions may be recognized as dividends paid under section 561 of the Code for a taxable year to which section 452 or 462 of the Code applies may be extended under conditions set forth below.

1. In the case of the accumulated earnings tax or the personal holding company tax, if

a. The income of a corporation is increased for a taxable year by reason of the repeal of sections 452 and 462 of the Code so that it would become liable for the tax (or an increase in the tax) imposed on accumulated earnings or personal holding companies unless additional dividends are distributed;

b. It distributes dividends to its stockholders after the 15th day of the 3rd month following the close of its taxable year and on or before December 15, 1955, which dividends are attributable to an increase in its accumulated taxable income or undistributed personal holding company income, as the case may be, resulting from the repeal of sections 452 and 462 of the Code; and

c. It elects in its statement, submitted under section 3 of this Revenue Ruling, to have the provisions of section 4(c)(4) of Public Law 74, *supra*, apply—

then such dividends are to be treated as having been paid on the last day of the taxable year to which the statement applies.

2. In the case of a regulated investment company taxable under section 852 of the Code, if

a. Its investment company taxable income is increased by reason of the repeal of sections 452 and 462 of the Code (without regard to any deduction for dividends paid as provided for in this subdivision);

b. It distributes dividends to its stockholders after the 15th day of the 3rd month following the close of its taxable year and on or before December 15, 1955, which dividends are attributable to an increase in its investment company income resulting from the repeal of sections 452 and 462 of the Code; and

c. It elects in its statement, submitted under section 3 of this Revenue Ruling to have the provisions of section 4(c)(4) of Public Law 74, *supra*, apply—

then such dividends are to be treated as having been paid on the last day of the taxable year to which the statement applies. The dividends paid are to be determined under this subdivision without regard to the provisions of section 855 of the Code.

3. An election made under this subsection is irrevocable. The time for inclusion in the taxable income of the distributee of any distributions of the type described in this subsection shall be determined without regard to section 4(c)(4) of Public Law 74, *supra*, and the provisions of this subsection.

Procedure with respect to taxpayer whose tax liability is affected by the repeal of sections 452 and 462 of the Internal Revenue Code of 1954. See Rev. Proc. 55–8, page 908.

SECTION 453.—INSTALLMENT METHOD

Rev. Rul. 55–429

Where payments from the sale of a patent are reported, for Federal income tax purposes, under the installment method of accounting, a modification of the contract of sale to reduce the selling price and installment payments to meet the potential sales and profits established by experience in the manufacture of the product covered by the patent, does not constitute a disposition or satisfaction of an installment obligation within the meaning of section 453(d) of the Internal Revenue Code of 1954. The execution of the modification will not, in and of itself, result in taxable income to the seller.

Advice has been requested whether the modification of an agreement to sell a patent under the circumstances set forth below will result in a disposition of an installment obligation giving rise to gain or loss under section 453(d) of the Internal Revenue Code of 1954.

An individual who owned a patent made a bona fide installment sale thereof to a corporation. Under the sales contract the taxpayer relinquished all his right to and interest in the patent to the corporation for a stipulated amount to be paid in equal installments over a period of 20 years. The agreement was binding and inured to the benefit of the parties thereto, their respective heirs, executors, successors, and assigns, except that if the corporation assigned the agreement, payment

immediately of the entire sales price must be made to the taxpayer minus such amounts as had been previously paid. The corporation had the right to terminate the agreement but such termination did not relieve it of paying amounts accruing and becoming due to the seller prior to the time such termination was effective.

The taxpayer who files his Federal income tax returns on the cash receipts and disbursement basis reported the only payment received under the installment method.

The sales and profits from the article manufactured under the patent were not as great as was expected; accordingly the taxpayer and corporation modified the terms of the original agreement. Under the agreement as modified the sales price was reduced to one-third of the original amount and the amount due after application of the only payment under the original agreement was to be paid in equal yearly installments over a period of 10 years. The corporation relinquished its right to terminate the agreement and relieve itself of future payments.

Section 453 of the Code provides in part as follows:

> (d) GAIN OR LOSS ON DISPOSITION OF INSTALLMENT OBLIGATIONS.—
> (1) GENERAL RULE.—If an installment obligation is satisfied at other than its face value or distributed, transmitted, sold, or otherwise disposed of, gain or loss shall result to the extent of the difference between the basis of the obligation and—
> (A) the amount realized, in the case of satisfaction at other than face value or a sale or exchange, or
> (B) the fair market value of the obligation at the time of distribution, transmission, or disposition, in the case of the distribution, transmission, or disposition otherwise than by sale or exchange.
> Any gain or loss so resulting shall be considered as resulting from the sale or exchange of the property in respect of which the installment obligation was received.

It is held that where payments from the sale of a patent are reported under the installment method, a modification of the contract to reduce the selling price and installment payments to meet the potential sales and profits established by experience in the manufacture of the product covered by the patent, does not constitute a disposition or satisfaction of an installment obligation within the meaning of section 453(d) of the Internal Revenue Code of 1954. The execution of the modification will not, in, and of itself, result in taxable income to the seller.

Sale of a capital asset under a contract providing that the seller will receive one-fourth of the sales price immediately and has the unqualified right to receive total price during taxable period of sale. See Rev. Rul. 55-694, page 299.

SECTION 454.—OBLIGATIONS ISSUED AT DISCOUNT

(Also Part II, Section 42; Regulations 118, Section 39.42-6.) Rev. Rul. 55-655

The election provided by section 454 of the Internal Revenue Code of 1954 for a taxpayer to treat as income in a taxable year the increases

at stated intervals in the redemption price of non-interest-bearing obligations, such as Series E bonds, where such income does not otherwise constitute income to him in such year, may not be exercised by such taxpayer in an amended return filed after the expiration of the statutory period for filing the original return; and such election may not be exercised by a taxpayer in a return which is not timely filed. The election provided by section 454 is a matter of legislative grace and must be exercised *in the manner and in the time* prescribed by Congress. See *Alexander Howe* v. *Commissioner*, 44 B. T. A. 894; I. T. 3775, C. B. 1946–1, 76; and *J. E. Riley Investment Co.* v. *Commissioner*, 311 U. S. 55, Ct. D. 1469, C. B. 1940–2, 225.

SUBPART C.—TAXABLE YEAR FOR WHICH DEDUCTIONS TAKEN

SECTION 461.—GENERAL RULE FOR TAXABLE YEAR OF DEDUCTION

Rev. Rul. 55–731

The additional Ohio State francise taxes for the years 1952 and 1953, arising from the decision of the Supreme Court of Ohio on March 10, 1954, in the case of the *Fifth Third Union Trust Co. et al.* v. *Peck, Tax Commissioner*, 161 Ohio St. 169, 118 N. E. (2d) 398, which held that obligations of the United States Government must be included in the Ohio State francise tax base of an Ohio corporation, are accruable and deductible as taxes by a corporation, on the acerual method, in the year 1954.

Advice has been requested relative to the proper year for accruing or claiming a deduction for additional franchise taxes imposed by the State of Ohio under the following circumstances:

Prior to the year 1952, obligations of the United States Government were required to be included in the tax base on which the Ohio State franchise tax was imposed upon an Ohio corporation. On February 13, 1952, the Supreme Court of Ohio in *Wrenn Paper Co. et al.* v. *Glander, Tax Commissioner*, 156 Ohio St. 583, 103 N. E. (2d) 756, which on June 4, 1952, was adhered to on rehearing in *Wrenn Paper Co. et al.* v. *Glander, Tax Commissioner*, 158 Ohio St. 15, 106 N. E. (2d) 625, held that such obligations should be excluded from the franchise tax base. Following this decision, many corporations filed claims for refund for years prior to 1952 with the Ohio Department of Taxation; but these claims were held in abeyance pending the outcome of the appeal, involving the same issue, in the case of the *Fifth Third Union Trust Co. et al.* v. *Peck, Tax Commissioner*, 161 Ohio St. 169, 118 N. E. (2d) 398. In the latter case, the Supreme Court of Ohio on March 10, 1954, overruled its decision in the Wrenn case, and held that obligations of the United States Government must be included in the Ohio State franchise tax base of an Ohio corporation.

The Ohio Department of Taxation subsequent to the Fifth Third Union Trust case rejected all claims for refund based on the Wrenn decision, and assessed in the year 1954 additional Ohio State franchise taxes for the years 1952 and 1953. Under these circumstances, the question arises as to the proper year that a corporation, on the accrual

method of accounting, should deduct such additional franchise taxes for purposes of Federal income tax.

The general rule applicable to taxpayers which keep their accounts and file their returns on the accrual method is that expenses should be accrued and deducted only in the year in which the liability therefor is incurred, even though such expenses may not be paid until a subsequent year. *H. H. Brown Co.*, 8 B. T. A. 112, acquiescence, C. B. VII–1, 5 (1928). Where all the events which determine the liability of the taxpayer have occurred within the taxable year, the liability may be said to have accrued even though the amount thereof has not been definitely ascertained during the taxable year. *United States* v. *P. Chauncey Anderson et al.*, 269 U. S. 422, T. D. 3839, C. B. V–1, 179 (1926); *Lucas* v. *American Code Co., Inc.*, 280 U. S. 445, Ct. D. 168, C. B. IX–1, 314 (1930). But, if it is uncertain whether any liability exists, there can be no accrual for tax purposes until the contingency disappears and liability becomes fixed and certain. *Arthur M. Brown* v. *Helvering*, 291 U. S. 193, Ct. D. 786, C. B. XIII–1, 223 (1934); *Highland Milk Condensing Co.* v. *Phillips*, 34 Fed. (2d) 777, Ct. D. 117, C. B. VIII–2, 301 (1929).

Applying the rationale adopted by the courts in the cases cited in the preceding paragraph, the Tax Court of the United States in *Baltimore Transfer Company of Baltimore City* v. *Commissioner*, 8 T. C. 1, at 7, acquiescence, C. B. 1947–2, 1, said "* * * The propriety of the accruals must be judged by the facts which petitioner knew or could reasonably be expected to know at the closing of its books for the taxable year * * *." Continuing on page 7 the Court observed, "* * * It seems obvious to us that a proper accrual of such an obligation so asserted and which the taxpayer sees no reason to challenge is not conditioned upon his testing it judicially or by professional legal opinion." And on page 9 the Court stated, "* * * Changes in law and in official interpretation of law, particularly if not reasonably expectable, must * * * be regarded as independent operative facts for accounting purposes. * * *." The Court, also on page 9, cited the decision in *Security Flour Mills* v. *Commissioner*, 321 U. S. 281, Ct. D. 1603, C. B. 1944, 526, as holding that events occurring in a subsequent year may not "be seized upon as a basis for determining the allowable deductions of an earlier period."

The Security Flour Mills case, *supra*, was cited by the Tax Court in *Taylor Instrument Companies* v. *Commissioner*, 14 T. C. 338, acquiescence, C. B. 1950–2, 4, as supporting the rule, "* * * But the theory that accrual basis accounting permits of adjustments for developments subsequent to the close of the tax year, even though relating to the income of that year, has now been repudiated with a certainty that seems to forbid reexamination. * * *"

Based upon the foregoing cited authorities, it is evident that the change in interpretation of the Ohio State franchise tax law, requiring obligations of the United States to be included in the franchise tax base of an Ohio corporation, could not be reasonably expected until March 10, 1954, when the Supreme Court of Ohio handed down its decision in the Fifth Third Union Trust case. Hence, this decision does not afford a proper basis for the accrual in the years 1952 and 1953

of the additional Ohio franchise taxes for years 1952 and 1953 which were assessed in the year 1954.

Accordingly, it is held that the additional Ohio State franchise taxes for the years 1952 and 1953, arising from the decision of the Supreme Court of Ohio on March 10, 1954, in the Fifth Third Union Trust case, are accruable and deductible as taxes by a corporation, on the accrual method, in the year 1954.

SECTION 462.—RESERVES FOR ESTIMATED EXPENSES, ETC.

Rules for computing and reporting the increase in tax liability resulting from the repeal of sections 452 and 462 of the 1954 Code by Public Law 74. See T. D. 6154, page 237.

Increase in tax liability resulting from the repeal of sections 452 and 462 of the Internal Revenue Code of 1954 by Public Law 74, 69 Stat. 134, page 748 of this Bulletin. See Rev. Rul. 55–539, page 246.

Procedure with respect to taxpayers whose tax liability is affected by the repeal of sections 452 and 462 of the Internal Revenue Code of 1954. See Rev. Proc. 55–8, page 908.

SUBPART D.—INVENTORIES

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

Rev. Rul. 55–692

Price indexes for July 1955, published by the Bureau of Labor Statistics on August 31, 1955, for use by department stores employing the retail inventory and last-in, first-out inventory methods.

The following price indexes for July 1955, published by the Bureau of Labor Statistics on August 31, 1955, for use by department stores employing the retail inventory and last-in, first-out inventory methods, are accepted by the Internal Revenue Service pursuant to Treasury Decision 5605, C. B. 1948–1, 16, and Mimeograph 6244, C. B. 1948–1, 21, for appropriate application to inventories for taxable years of 12 months ended June 30, 1955 and July 31, 1955.

Indexes are given on a national basis for the store total, for 20 major groups of departments, and for two special group combinations. The store total includes all departments in the store, both those listed in the groups and those not specifically listed, except for candy, foods, liquor, tobacco, and paints and wall paper. Contract departments are also excluded.

Bureau of Labor Statistics, department store inventory price indexes, by department groups

[January 1941=100]

Department groups	July 1954	July 1955	Percent change from July 1954 to July 1955
I. Piece goods	203.1	200.5	−1.3
II. Domestics and draperies	196.0	194.3	−0.9
III. Women's and children's shoes	215.5	215.1	−0.2
IV. Men's and boys' shoes	212.7	213.0	+0.1
V. Infants' wear	170.9	170.1	−0.5
VI. Women's underwear	171.9	169.6	−1.3
VII. Women's and girls' hosiery	171.3	166.0	−3.1
VIII. Women's and girls' accessories	170.5	170.8	+0.2
IX. Women's outerwear and girls' wear	180.4	176.9	−1.9
X. Men's clothing	205.3	206.0	+0.3
XI. Men's furnishings	198.7	197.2	−0.8
XII. Boys' clothing and furnishings	201.9	199.2	−1.3
XIII. Jewelry	164.4	165.1	+0.4
XIV. Notions	160.2	159.2	−0.6
XV. Toilet articles and drugs	165.8	168.5	+1.6
XVI. Furniture and bedding	210.5	206.5	−1.9
XVII. Floor covering	190.1	188.5	−0.8
XVIII. Housewares	197.9	198.2	+0.2
XIX. Major appliances	151.0	142.7	−5.5
XX. Radios and television sets	152.1	139.3	−8.6
Total Groups I–XV	188.7	187.2	−0.8
Total Groups XVI–XX	189.0	185.1	−2.1
Store total	188.7	186.6	−1.1

SUBCHAPTER F.—EXEMPT ORGANIZATIONS

PART I.—GENERAL RULE

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

Rev. Rul. 55-439

The *M* organization was incorporated for benevolent, charitable and educational purposes. Specifically, it is engaged in giving aid, counsel and advice in connection with the location and construction of homes to be purchased by individuals in the low to moderate income groups in an area where no adequate housing exists for such groups. Its activities consist of purchasing acreage in a stated locality, making arrangements for water and sewer facilities and entering into arrangements for the erection and sale of dwellings thereon. No part of the net income inures to the benefit of any private individual. *Held*, the *M* organization qualifies for exemption from Federal income tax under the provisions of section 501(c)(4) of the Internal Revenue Code of 1954 as a civic league not organized for profit but operated exclusively for the promotion of social welfare. See *Garden Homes Company* v. *Commissioner*, 64 Fed. (2d) 593.

(Also Part II, Section 101(7); Regulations 118, Section 39.101(7)-1.) Rev. Rul. 55-444

An organization formed to promote the business of a particular industry and which carries out its purposes primarily by conducting a general advertising campaign to encourage the use of products and services of the industry as a whole is entitled to exemption from Federal income tax as a business league under section 501(c)(6) of the Internal Revenue Code of 1954, notwithstanding the fact that such advertising to a minor extent constitutes the performance of particular services for its members.

Advice has been requested whether an organization composed of retail dealers which conducts an advertising campaign for the benefit of an industry as a whole, under the circumstances set forth below, qualifies for exemption from Federal income tax as a business league under section 501(c)(6) of the Internal Revenue Code of 1954.

The instant organization was incorporated under state law to improve the relationship between certain dealers and the public by the improvement of delivery, the maintenance of quality, and the development and maintenance of high standards of service. Membership is open to any person or association engaged in the retailing of products or equipment related to a particular industry. No part of the net earnings inures to any private shareholder or individual. The receipts are derived from assessments on members and from contributions from the national industry association. Its disbursements are for advertising, pilot surveys, an educational program and for general operating expenses. The advertising expenditures constitute approximately 60 percent of the organization's expenses.

The organization has endeavored to increase public acceptance of the industry's product for home use by advertising in newspapers, on radio and television, in the classified telephone directory, by means of pamphlets, etc. The advertisements have stressed the economical and other desirable features of the product. None of the advertising, with the exception of one newspaper advertisement and a listing in the classified telephone directory, contained the names of individual members. In these two instances the space for the members' names was paid for by the individual members and not by the organization. A substantial part of the advertising related to a 24-hour service which was supplied by contractors who were not members of the organization and which was available to all consumers regardless of whether or not they bought from a member. Most of the advertising contained the central phone number of the organization and some of the newspaper and radio advertisements urged consumers to buy from an organization member.

Section 501(c)(6) of the Code excepts from Federal income tax "Business leagues, chambers of commerce, real-estate boards, or boards of trade, not organized for profit and no part of the net earnings of which inures to the benefit of any private shareholder or individual."

Section 39.101(7)-1 of Regulations 118, made applicable herein by Treasury Decision 6091, C. B. 1954-2, 47, holds that a business league is an association of persons having some common business interest, the purpose of which is to promote such common interest and not to engage in a regular business of a kind ordinarily carried on for profit and that the activities of such an association should be directed to the improvement of business conditions of one or more lines of busi-

ness as distinguished from the performance of particular services for individual persons.

In *Washington State Apples, Inc.* v. *Commissioner*, 46 B. T. A. 64, acquiescence, C. B. 1942–1, 17, the apple growers of Washington organized a corporation to engage in the business of advertising and promoting the sale of apples grown and produced in the State of Washington. The United States Board of Tax Appeals, now The Tax Court of the United States, held that since the purpose of the organization was to promote the industry as a whole, and not to serve individual members, such organization was a "business league" exempt from tax under section 101(7) of the Revenue Act of 1936, the provisions of which are identical with the provisions of the statute here involved.

The purpose of the advertising compaign conducted by the instant organization was not to make a profit or to render particular services to individual members. The advertising was designed primarily for the improvement of conditions in the particular industry. Most of the benefits to members of the organization were indirect and accrued alike to members and other persons in the industry. With respect to that part of the advertising which carried the names of members or urged consumers to buy from an organization member, it may be said generally that such advertising constitutes the furnishing of particular services to members. However, in this case the advertising which carried the names of individual members or otherwise directly aided members represented only a minor portion of the total advertising expenditures and may be regarded as only incidental or subordinate to the main or principal purpose. Under these circumstances, the advertising campaign conducted by the instant organization was primarily for the benefit of the industry as a whole.

Accordingly, it is held that the organization, in conducting its advertising campaign, is engaged in activities directed to the improvement of business conditions of the particular industry as a whole as distinguished from the performance of particular services for individual persons and that it qualifies for exemption as a business league under section 501(c)(6) of the Code.

Rev. Rul. 55–495

The *M* association which provides for the payment of life, sick, accident or other benefits to members or their dependents, but does not operate under the lodge system, or for the exclusive benefit of the members of an organization so operating, is not entitled to exemption from Federal income tax as an organization described in section 501(c)(8) of the Internal Revenue Code of 1954.

The *M* association falls within a class ordinarily associated with organizations not organized for profit, but operated exclusively for the promotion of social welfare, and is exempt from Federal income tax as an organization described in section 501(c)(4) of the Internal Revenue Code of 1954.

Advice has been requested whether the *M* association described below qualifies for exemption from Federal income tax under section 501(c)(8) of the Internal Revenue Code of 1954.

The *M* association was organized as a local association for the purpose of assisting its members in time of sickness, distress, and in case of death. It has no parent organization or subordinate branches. The

membership is restricted to individuals who subscribe to a designated religious creed, are of good character and health, and have the ability to earn a livelihood. The association holds periodic meetings, operates a loan fund for members and administers a plan providing for the payment of sick, accident and death benefits to members. Its income is derived mainly from membership dues and is used principally for the payment of operating expenses, benefits to members and for donations to charitable organizations.

Section 501(c)(8) of the Code describes certain fraternal beneficiary societies, orders, or associations which are exempt from taxation under section 501(a) of the Code. The exemption applies to fraternal organizations which operate under the lodge system, or for the exclusive benefit of the members of a fraternity itself operating under the lodge system, and which provide for the payment of life, sick, accident or other benefits to members of the organizations or their dependents.

Section 39.101(3)-1 of Regulations 118, made applicable under the 1954 Code by virtue of Treasury Decision 6091, C. B. 1954-2, 47, provides that "operating under the lodge system" means carrying on activities under a form of organization that comprises local branches, chartered by a parent organization and largely self-governing, called lodges, chapters, or the like. On the basis of the facts in the instant case, it is held that the association is not operating under the lodge system or for the exclusive benefit of the members of an organization so operating. Accordingly, such association is not entitled to exemption from Federal income tax as an organization described in section 501(c)(8) of the Internal Revenue Code of 1954.

It is apparent, however, that the purposes and activities of the association are of a class ordinarily associated with organizations not organized for profit but operated exclusively for the promotion of social welfare as described in section 501(c)(4) of the Code. Accordingly, it is further held that the *M* association is entitled to exemption from Federal income tax under the provisions of section 501(a) of the Code as an organization described in section 501(c)(4) of the Internal Revenue Code of 1954.

Rev. Rul. 55-516

A nonprofit corporation which operates a semiprofessional baseball club as its principal activity is not entitled to exemption from Federal income tax under the provisions of section 501 (c) (4) of the Internal Revenue Code of 1954.

Advice has been requested whether a nonprofit corporation, which is operated for the primary purpose of conducting a semiprofessional baseball club, is entitled to exemption from Federal income tax under section 501(c)(4) of the Internal Revenue Code of 1954.

The instant corporation was organized as a nonprofit corporation to engage in and promote athletic contests, particularly the game of baseball, for the social entertainment and physical development of its members, to provide training for athletes and to provide exhibitions of the game of baseball. Its sole activity consists of the operation of a semiprofessional baseball club. The income is derived from gate receipts, concessions and score cards. Appropriately 95 percent of the net gate receipts is divided among the players as players' splits or

shares pursuant to individual contracts entered into between the corporation and the players.

Section 501(c)(4) of the Code provides in part for the exemption of:

> Civic leagues or organizations not organized for profit but operated exclusively for the promotion of social welfare, * * *.

Section 39.101(8)–1 of Regulations 118, made applicable under the 1954 Code by T. D. 6091, C. B. 1954–2, 47, provides in part that civic leagues entitled to exemption comprise those not organized for profit but operated exclusively for purposes beneficial to the community as a whole, and, in general, include organizations engaged in promoting the welfare of mankind, other than organizations comprehended within section 101(6) of the Internal Revenue Code of 1939 (section 501(c)(3) of the 1954 Code).

In the instant case, the corporation expended almost all of its funds for the purpose of conducting a semiprofessional baseball club, which is ordinarily considered a commercial activity. There is no showing that it engaged in any other activity or that it expended any part of its funds for any other purpose. Although it is shown that the corporation is not organized for profit and that some of its purposes may be considered as beneficial to the community as a whole, it cannot be said that the corporation is operated exclusively for the promotion of social welfare.

Accordingly, it is held that the corporation herein involved, which operates a semiprofessional baseball club as its principal activity, is not entitled to exemption from Federal income tax under the provisions of section 501(c)(4) of the Internal Revenue Code of 1954 or any other section thereof.

Rev. Rul. 55–587

An interscholastic athletic association was formed as an unincorporated, nonprofit association for the purposes of promoting and protecting the health of high school athletes through uniform interscholastic competition under the direction and control of school officials, and of cultivating the ideals of good sportsmanship, loyalty and fair play. The membership consists of approved and accredited public high schools of a State. The association directs and controls interscholastic high school athletic competition; prescribes eligibility rules for contestants and penalties for the violation of such rules, as well as the rules of play in the various sports; conducts sectional, district and state meets or tournaments; arranges schedules for contests; trains and assigns game officials; and makes suitable awards in State meets. The association is directed by a board of control, the members of which must be either school superintendents, principals or officials. They are elected by the representatives of the schools who must also be either a superintendent, principal or faculty member of a high school. All contest officials must be trained and/or approved by the association after rigid examinations as to their character and capabilities. Officials of the association receive no compensation for their services, with the exception perhaps of an executive secretary or treasurer, or corresponding officer. Income is derived from school

dues, registration, membership fees, and a percentage of gate receipts from the contests to which admission charges are made. Funds are expended to defray operating expenses of the association in promoting its purposes. No part of the net income inures to the benefit of any private individual. *Held*, the instant interscholastic athletic association is organized and operated primarily for educational purposes and is exempt from Federal income tax under section 501(c)(3) of the Internal Revenue Code of 1954.

Rev. Rul. 55-610

An organization is formed to operate the activities which its principal founder conducted as his personal undertaking or hobby in prior years. The organization plans to reimburse its founder for the expenses incurred by him in prior years in the conduct of these activities. *Held*, since a portion of the net earnings of the organization will inure to the benefit of the founder, the organization is not entitled to exemption from income tax under section 501(c)(3) of the Internal Revenue Code of 1954.

Rev. Rul. 55-656

A community nursing bureau operated as a community project, which maintains a nonprofit register of qualified nursing personnel, including graduate nurses, unregistered nursing school graduates, licensed attendants and practical nurses, for the benefit of hospitals, health agencies, doctors and individuals, which receives its primary financial support from various community organizations and public contributions, qualifies for exemption under the provisions of section 501(c)(3) of the Internal Revenue Code of 1954.

Advice has been requested whether a community nursing bureau, which maintains a nonprofit register of qualified nursing personnel and receives substantial financial support from various community organizations and public contributions, qualifies for exemption under section 501(c)(3) of the Internal Revenue Code of 1954.

The instant organization was formed as a result of a study by the nursing council of a metropolitan area, a constituent agency of the health and welfare council of that area, in cooperation with civic and professional groups, to broaden the scope of service rendered by existing nurses' registers which was inadequate as a general community activity. The organization was established to operate a central directory of qualified nursing personnel, both professional and nonprofessional, in addition to the official nurses directory which continues to operate in the area. It is controlled by a board of directors drawn principally from public health and welfare organizations and the public at large.

The activities of the organization consist of operating a nonprofit registry for qualified nursing personnel including graduate nurses, unregistered nursing school graduates, licensed attendants and practical nurses. The activities include receiving applicants for registration, determining whether the applicants meet qualification standards, classifying and registering qualified applicants, and operating the registry so as to assure a prompt supply of qualified responsible nurs-

ing personnel in response to calls from hospitals, health agencies, doctors and individuals.

The organization is supported primarily by contributions from individuals and community organizations such as the community chest and local hospitals. Such contributions are supplemented by registration fees. Expenditures are for salaries and office expenses. No part of the net income inures to the benefit of any private individual.

In view of the foregoing, it is apparent that the purposes and activities of the organization are directed to the relief of conditions relating to the health of the community, which is a matter of public concern, rather than those of a professional society. Accordingly, it is held that a community nursing bureau operated as a community project, which maintains a nonprofit register of qualified nursing personnel, including graduate nurses, unregistered nursing school graduates, licensed attendants and practical nurses, for the benefit of hospitals, health agencies, doctors and individuals and which receives its primary financial support from various community organizations and public contributions, qualifies for exemption under the provisions of section 501(c)(3) of the 1954 Code.

Rev. Rul. 55–715

The *M* organization was incorporated as a nonprofit organization for the purpose of regulating the sale at auction of a specified agricultural commodity in a certain area in order to protect alike the interest of producers, warehousemen and purchasers. To evenly distribute sales among all warehousemen where auctions are held, regulations have been adopted limiting the quantity of products sold and arranging schedules of dates, hours and location of auctions. A trading floor is not maintained. Schedules are so arranged that processing plants will not be overloaded, and so that all crops can be disposed of and yet assure maximum competition at each sale. The organization polices the auctions and enforces its regulations through a supervisor of sales. High standards of the market are maintained by the supervisor, resulting in benefits to the buyers as well as the growers. The organization furnishes by radio for the benefit of growers technical information on farming of the specified product and during the selling season furnishes market quotations for the previous day. A committee on roads and traffic calls the attention of state officials to growers' needs in bringing their crops to market. *Held*, the organization qualifies for exemption from Federal income tax under the provisions of section 501(c)(6) of the Internal Revenue Code of 1954 as a board of trade.

Rev. Rul. 55–716

An organization formed for the purpose of furnishing television antenna service to its members is not entitled to exemption from Federal income tax under section 501(c)(7) of the Internal Revenue Code of 1954 as a club organized exclusively for pleasure, recreation, and other nonprofitable purposes. Furthermore, there are no other provisions of law under which such an organization may be held to be exempt from Federal income tax.

Advice has been requested whether an organization formed for the purpose of furnishing television antenna service to its members is entitled to exemption from Federal income tax under section 501(c)(7) of the Internal Revenue Code of 1954 as a club organized exclusively for pleasure, recreation, and other nonprofitable purposes.

The instant organization was formed for the purpose of furnishing and providing television antenna service to members upon payment of a stipulated membership fee and a monthly charge for maintenance of the antenna. Income is derived from membership fees and service charges. Funds are expended for equipment, maintenance and miscellaneous expense.

Section 501(c) of the Code describes certain organizations exempt from Federal income tax under section 501(a) and reads, in part, as follows:

> (7) Clubs organized and operated exclusively for pleasure, recreation, and other nonprofitable purposes, no part of the net earnings of which inures to the benefit of any private shareholder.

The term "club" as used in the above section of law contemplates the commingling of members, one with the other, in fellowship. Personal contacts and fellowship must also play a material part in the life of an organization in order for it to come within the meaning of the term "club". G. C. M. 23688, C. B. 1943, 283, at page 286.

The only activity of the instant organization is the operation and maintenance of a television antenna system providing television services to its members in their homes. Furthermore, fellowship does not constitute a material part of the life of the organization, since the services do not afford an opportunity for personal contacts and fellowship among members receiving such services.

Accordingly, it is held that an organization formed for the purpose of furnishing television antenna service to its members is not entitled to exemption from Federal income tax under section 501(c)(7) of the Code as a club organized exclusively for pleasure, recreation, and other nonprofitable purposes. Furthermore, there are no other provisions of law under which such an organization may be held to be exempt from Federal income tax. Compare Rev. Rul. 54-394, C. B. 1954-2, 131, which holds that an organization whose sole activity is to provide television reception in an area not adaptable to ordinary reception, for which service it charges installation and service fees, is not exempt from Federal income tax under section 101(8) of the Internal Revenue Code of 1939 as a civic league.

Radio station, cinder block plant and laundry operated by a tax-exempt organization. See Rev. Rul. 55-676, page 266.

SECTION 504.—DENIAL OF EXEMPTION

Rev. Rul. 55-674

Discussion of various questions relating to (1) accumulation of income by organizations held to be exempt from tax under section 501(c)(3) of the Internal Revenue Code of 1954 and (2) filing by such organizations of Form 990-A, U. S. Return of Organization Exempt From Tax.

The Internal Revenue Service has been requested to express its position on several questions in connection with the accumulation of income by an organization held to be exempt from tax under section 501(c)(3) of the Internal Revenue Code of 1954. These questions were prompted by the publication of Revenue Ruling 54–137, C. B. 1954–1, 289, and were presented to enable organizations such as those there involved to properly reflect income and disbursements on return Form 990–A, U. S. Return of Organization Exempt From Tax.

In Revenue Ruling 54–137, *supra*, it is held that a charitable foundation whose primary purposes and functions consist of making distributions to tax-exempt hospitals and medical research organizations, but which is not operated primarily for the purpose of actually performing the activities generally carried on by such organizations, is not engaged in providing medical or hospital care within the meaning of section 3813(a)(5) of the Internal Revenue Code of 1939 (section 503(b)(5) of the 1954 Code) and is, therefore, subject to the provisions of section 3814 of the 1939 Code (section 504 of the 1954 Code) relating to the accumulation of income. In Revenue Ruling 54–137 it is also held that the accumulation of income for a 3-year period from bequests or gifts from the creator who was the sole contributor to the organization is not considered unreasonable in amount or duration within the contemplation of section 3814 of the Code, in the case of a charitable foundation which has for a period of years distributed substantially all contributions received and has accumulated no income, provided that only an amount equal to the charitable grants made from capital in prior years, which under the facts in the case is not more than approximately 1 year's income, is permanently retained as capital and the balance of the accumulated income is distributed in its entirety at the end of the specific period.

The specific questions with respect to which advice has been requested are set forth below. The answers thereto are confined to the factual situation as outlined in Revenue Ruling 54–137, *supra*.

A. In the case of a specific and unconditional grant of a certain sum made in the current year to defray the cost and expense of a bona fide scientific or educational project for a term of three years, to be expended by the donee on a pro-rata basis over the three-year period, must the entire amount be paid over to the donee in the current year in order that a deduction may be claimed for contributions, grants, etc., on the Form 990–A to be filed for the current year, or may such a deduction be claimed without violation of section 504 of the Code if advances are made from time to time as requested or needed by the donee, notwithstanding a substantial portion is not paid out until after the expiration of the current year? (In this case and under (B) below, a reserve would be set up on the books of the foundation for the full amount and until paid or rescinded the funds would not be invested or otherwise used so as to jeopardize their availability for payment of the grant. If for any reason the total amount of the grant were not paid, any balance remaining would be considered as distributable income for the year in which the commitment was otherwise satisfied or released.)

A specific and unconditional grant for a bona fide scientific or educational purpose, for which a reserve is created (in the manner set forth above), may be reported as a contribution, gift, grant, etc., on Form 990–A in its entirety for the year in which the commitment is made, notwithstanding that it is advanced over a fixed period which extends beyond the year of the commitment and a substantial portion

thereof is not paid out until after the calendar year of the grant. In each such case an explanatory statement should be attached to the Form 990–A for the year in which the grant is reported and for all subsequent years in which the reserve is unexpended.

B. A specific grant is made for a hospital for use in renovating and improving a wing for indigent patients, the work to be completed in a year or a year and a half. Must the entire amount of the grant be transferred to the donee in the year of the grant in order that a deduction therefor may be taken currently on the Form 990–A, or may the money be paid in installments as the work progresses, and a deduction claimed for the entire amount of the grant for the current year even though a substantial portion of the grant is not paid until after the expiration of the calendar year?

A specific and unconditional grant for which a reserve is created, as indicated, may be paid in installments over the period necessary to accomplish the purposes for which made, and may be reported in its entirety on Form 990–A for the year in which the commitment is made. An explanatory statement similar to that referred to in the answer to question A should be attached to the form.

C. The foundation obligates itself to provide and pay for all maintenance and repairs to certain premises leased rent-free to an educational organization during the period of the lease in an amount not to exceed a stated sum. How should the amount so expended each year be reported on Form 990–A?

Such payments may be reflected on Form 990–A as administrative and operating expenses of the foundation or as contributions, gifts, grants, etc., provided they are properly identified and treated consistently each year.

With respect to any reserves established for grants or commitments made and the investment of amounts so set aside, the earnings on such investments must be distributed as well as any unexpended portion of the corpus.

The question whether reserves for expected future costs or expenses are currently deductible or may represent, in whole or in part, the unreasonable accumulation of income, depends upon the particular facts in the case involved.

PART II.—TAXATION OF BUSINESS INCOME OF CERTAIN EXEMPT ORGANIZATIONS

SECTION 511.—IMPOSITION OF TAX ON UNRELATED BUSINESS INCOME OF CHARITABLE, ETC., ORGANIZATIONS

Radio station, cinder block plant and laundry operated by a tax-exempt organization. See Rev. Rul. 55–676, below.

SECTION 512.—UNRELATED BUSINESS TAXABLE INCOME

(Also Sections 501, 511 and 513.) Rev. Rul. 55–676

A radio station and cinder block plant conducted in a manner similar to commercial undertakings by a university exempt from Federal income taxes under section 501(c)(3) of the Internal Revenue Code of 1954 constitute unrelated businesses as defined

in section 513, and the income derived therefrom is taxable under the provisions of section 511, which impose a tax on unrelated business taxable income.

However, a laundry operated by a tax-exempt university primarily for the convenience of its students, officers or employees, comes within the exception of section 513(a)(2); therefore, the income derived from the laundry would not be taxable under the provisions of section 511.

Advice has been requested whether a university exempt from Federal income taxes under section 501(c)(3) of the Internal Revenue Code of 1954 will be taxable under section 511 on income received from certain auxiliary enterprises including, among others, a radio station, a cinder block plant and a laundry.

The radio station was acquired by the university as a source of income to the school, to serve as a laboratory for training students in radio, as a medium for advertising the university and as a medium for adult education. It is affiliated with a network, is assigned a regular frequency and operates on a day and night basis. Although the station is used in part in carrying out the educational program of the university, the greatest portion of its time is devoted to activities conducted by regularly constituted commercial radio stations.

The cinder block plant was acquired by the university when it started construction of several buildings and needed concrete blocks. During the period that the buildings were under construction, the greatest portion of the plant's output was used by the university. It is the only cinder block plant in the community and presently is operated chiefly for the purpose of supplying cinder blocks to the general public, and not primarily for the college.

The university maintains a laundry and dry cleaning plant which is operated primarily to serve the student body and members of the faculty, although the general public may be served.

Section 511 of the Internal Revenue Code of 1954 imposes a tax on the unrelated business taxable income of certain organizations exempt from tax under section 501(c)(3) of the 1954 Code. The term "unrelated business taxable income" as defined in section 512 of the 1954 Code means, with certain exceptions, additions, and limitations, the gross income derived by any organization from any unrelated trade or business regularly carried on by it, less allowable deductions directly connected with the carrying on of such trade or business. Section 513 of the 1954 Code defines the term "unrelated trade or business," in the case of any organization subject to the tax imposed by section 511 of the Code, as any trade or business the conduct of which is not substantially related (aside from the need of such organization for income or funds or the use it makes of the profits derived) to the exercise or performance by such organization of its charitable, educational, or other purpose or function constituting the basis for its exemption under section 501 of the Code.

A trade or business not otherwise related does not become substantially related to an organization's exempt purpose merely because incidental use is made of the trade or business in order to further the exempt purpose. A trade or business is considered related if operated primarily as an integral part of the educational program of the university, but is considered unrelated if operated in substantially the same manner as a commercial operation.

In view of the foregoing, it is held that the radio station and the cinder block plant in the instant case, which are conducted in a manner similar to commercial undertakings by a university exempt from Federal income taxes under section 501(c)(3) of the Internal Revenue Code of 1954, constitute unrelated businesses as defined in section 513, and the income derived therefrom is taxable under the provisions of section 511, which impose a tax on unrelated business taxable income.

However, the laundry operated by a tax-exempt university primarily for the convenience of its students, officers or employees, comes within the exception of section 513(a)(2); therefore, the income derived from the laundry would not be taxable under the provisions of section 511.

SECTION 513.—UNRELATED TRADE OR BUSINESS

Radio station, cinder block plant and laundry operated by a tax-exempt organization. See Rev. Rul. 55-676, page 266.

PART III.—FARMERS' COOPERATIVES

SECTION 521.—EXEMPTION OF FARMERS' COOPERATIVES FROM TAX

(Also Part II, Section 101; Regulations 118, Section 39.101(12)-1.) Rev. Rul. 55-496

A cooperative marketing association which otherwise qualifies for exemption under section 521 of the Internal Revenue Code of 1954 will not be denied such exemption if it markets for members products furnished by nonmember producers, where the member is legally bound to turn back to such producers the proceeds of the sale of their products, less necessary marketing expenses, and to furnish the association with evidence that such obligation has been met, provided however, the value of the products marketed for such nonmembers does not exceed the value of the products marketed for the members.

Advice has been requested whether a cooperative marketing association which markets products of nonmembers under the circumstances set forth below may qualify for exemption under section 521 of the Internal Revenue Code of 1954.

An association was organized to engage in cooperative marketing of citrus fruit for its members. Its entire voting stock is held by cooperative associations, individuals, partnerships and corporations all of which qualify as producers. It markets citrus fruit for members only and operates on a strictly cooperative basis, turning back to the patrons the proceeds of sales, less necessary marketing expenses. Several of the members, however, market fruit of nonmember producers as well as their own through the association. Such fruit is handled by the agent member for the actual producers under a written agency agreement which provides that all proceeds of the fruit mar-

keted, less only actual expenses incurred in connection therewith, shall be returned, credited and paid to the actual producers of such fruit. Products amounting in value to approximately 20 percent of the value of all products marketed by the association during the taxable year were produced by nonmembers.

Prior to the acceptance of an agent member and prior to the marketing of any fruit by such agent member, the association requires such member to execute and deliver to it an agreement providing, among other things, that all fruit delivered to the association on account of other producers will be the actual property of such producers and that the agent member will return to such producers the proceeds of sales of their fruit, less necessary expenses. The agreement further provides that the agent member shall furnish the association with a written authorization from each such producer showing his right to represent such producer.

Section 39.101(12)–1 of Regulations 118, made applicable herein by Treasury Decision 6091, C. B. 1954–2, 47, provides that a cooperative association engaged in the marketing of farm products for farmers, fruit growers, livestock growers, dairymen, etc., and turning back to the producers the proceeds of the sales of their products, less the necessary operating expenses, on the basis of the products furnished by them, are exempt from income tax.

I. T. 3853, C. B. 1947–1, 42, holds that in marketing and otherwise handling the products of nonmembers as those of its members, an association does not meet the statutory requirement that the proceeds of the sale of products, less necessary operating expenses, be returned to producers on the basis of the quantity or value of products furnished by them, since a substantial amount of the products being marketed by the members in that instance were products they had *purchased* from the nonmembers rather than products they had produced themselves.

In this case, however, the nonmember producers retain ownership of the products marketed for them through the association. The agent member operates under an agency agreement with the nonmember producers which requires the agent member to turn back to such producers the proceeds received from the sale of their products, less the necessary marketing expenses. Moreover, the agent member is under a legal obligation to furnish the association with evidence that his agreements with nonmember producers are being carried out. Accordingly, it is held that a cooperative marketing association which otherwise qualifies for exemption under section 521 of the Internal Revenue Code of 1954 will not be denied such exemption if it markets for members products furnished by nonmember producers, where the member is legally bound to turn back to such producers the proceeds of the sale of their products, less necessary marketing expenses, and to furnish the association with evidence that such obligation has been met, provided, however, the value of the products marketed for such nonmembers does not exceed the value of the products marketed for the members.

(Also Sections 162, 264.) Rev. Rul. 55-558
(Also Part II, Sections 23(a), 24(a), 101;
Regulations 118, Sections 39.23(a)-1,
39.24(a)-3, 39.101(12)-1.)

A farmers' cooperative marketing association which purchases life insurance policies on the lives of its members does not meet the requirements for exemption under section 521 of the Internal Revenue Code of 1954, corresponding to section 101(12) of the Internal Revenue Code of 1939, since it would not be turning back to its members and other producers the proceeds of the sales of their products less the necessary marketing expenses.

Advice has been requested by a cooperative association whether the purchase of life insurance policies on the lives of its five members will affect its exempt status established under the provisions of section 101(12)(A) of the Internal Revenue Code of 1939.

The instant association is engaged in grading, packing, precooling, and marketing of vegetables for its members and other producers. Its membership is composed of five producers who contribute over 95 percent of the volume of business done by the association, the remainder being supplied by nonmember producers. In view of the large volume of products marketed for members and the effect the loss of a member's volume might have on its operation, the association has purchased a life insurance policy on the life of each of its five members, named itself beneficiary, and has undertaken to pay the annual premiums on the policies.

A farmers' cooperative marketing association in order to meet the requirements for exemption under section 521 of the Internal Revenue Code of 1954, corresponding to section 101(12) of the 1939 Code, must, among other things, turn back to its members or other producers the proceeds of sales less the necessary marketing expenses, on the basis of either the quantity or the value of the products furnished by them.

An association which uses any of its income in the payment of annual premiums on the life insurance policies purchased on the lives of its members is not turning back to its members and other producers the proceeds of the sales of their products less the necessary marketing expenses. Such an expense may not be properly considered as a "marketing" expense. Accordingly, the association does not meet the requirements for exemption from Federal income tax under section 521 of the 1954 Code, which provision of law corresponds to section 101(12) of the 1939 Code.

Rev. Rul. 55-611

An association which purchases supplies and equipment for its members who are fishermen is not a farmers' purchasing association within the meaning of section 521(b)(1) of the Internal Revenue Code of 1954 and, therefore, is not exempt from Federal income tax under such section.

Advice has been requested whether an association which purchases supplies and equipment for its members who are fishermen is a farmers' purchasing association within the intendment of section 521(b)(1) of the Internal Revenue Code of 1954.

The instant organization was incorporated for the purpose of engaging in any activity involving or relating to collecting, catching, taking, planting, producing, buying, receiving, grading, processing, packing, storing, financing, preparing for market, handling, marketing, selling, and/or distributing of aquatic products, or conducive to buying, selling or otherwise handling fishery and marine supplies and equipment; and for the conduct of any activity deemed to be necessary, convenient, proper or expedient for the accomplishment of such purposes on a cooperative basis for the mutual benefit of its members.

It is contended on behalf of the instant organization that it operates in a manner similar to a farmers' or fruit growers' association or other group of persons, and should be considered a "like association" as that term is used in section 521 of the Code. In this connection, it is pointed out that under the State laws the term "agricultural products" includes fish and salt water sea food and that the State law has recognized the instant association as an agricultural association.

Section 521(b)(1) of the Code relating to exempt farmers' cooperatives reads in part as follows:

> * * * The farmers' cooperatives exempt from taxation to the extent provided in subsection (a) are farmers', fruit growers', or like associations organized and operated on a cooperative basis (A) for the purpose of marketing the products of members or other producers, and turning back to them the proceeds of sales, less the necessary marketing expenses, on the basis of either the quantity or the value of the products furnished by them, or (B) for the purpose of purchasing supplies and equipment for the use of members or other persons, and turning over such supplies and equipment to them at actual cost, plus necessary expenses.

An association which is not composed of farmers, fruit growers, or persons engaged in similar pursuits is not exempt under section 521 of the Code unless it could be considered a "like association" within the intendment of that section. The provisions of any State laws are not controlling in determining status for Federal income tax purposes. See *Munro L. Lyeth* v. *Hoey*, 305 U. S. 188, Ct. D. 1370, C. B. 1938–2, 208.

An issue similar to that here presented was before the court in *Sunset Scavenger Company, Incorporated* v. *Commissioner*, 84 Fed (2d) 453, Ct. D. 1190, C. B. 1937–1, 202 at 204. In that case the court stated:

> We believe, as the Commissioner contends, that under the principle of *ejusdam generis*, the words "like associations" are limited by the words "farmers" and "fruit growers" and as thus limited mean only such associations as market agricultural products, or purchase supplies and equipment for those who are engaged in producing agricultural products. * * *

It is therefore held that an association which purchases supplies and equipment for its members who are fishermen is not an association of farmers or fruit growers, or a like association within the meaning of section 521(b)(1) of the Internal Revenue Code of 1954 and is not exempt from Federal income tax under such section.

The principles stated herein relative to the application of section 521 of the 1954 Code to an association which purchases supplies and equipment for its members, who are fishermen, applies equally in case of membership in an association composed of oyster growers.

SUBCHAPTER G.—CORPORATIONS USED TO AVOID INCOME TAX ON SHAREHOLDERS

PART I.—CORPORATIONS IMPROPERLY ACCUMULATING SURPLUS

SECTION 541.—IMPOSITION OF PERSONAL HOLDING COMPANY TAX

Amount of net long-term capital gain derived from sale of securities by a personal holding company which may be retained in the corporation. See Rev. Rul. 55–702, below.

SECTION 545.—UNDISTRIBUTED PERSONAL HOLDING COMPANY INCOME

(Also Sections 541, 1201.) Rev. Rul. 55–702

A domestic personal holding company, as defined in section 542 of the Internal Revenue Code of 1954, may retain in the corporation the net long-term capital gain derived from the sale of securities during a taxable year governed by the 1954 Code, less the amount of Federal income tax applicable to such capital gain.

Advice has been requested as to the extent to which capital gains derived from the sale of securities by a domestic personal holding company may be retained in the corporation pursuant to the personal holding company provisions of the Internal Revenue Code of 1954.

A domestic corporation, qualifying as a personal holding company within the meaning of section 542 of the Internal Revenue Code of 1954, had for the taxable year 1954 dividend income from domestic corporations of $35,000, net long-term capital gain of $50,000, and expenses of $9,000. The corporation employs the accrual method of accounting and reports its income on the calendar year basis. The corporation desires to retain in the corporation the net capital gain for the year, less the income tax applicable thereto, and distribute all other net income.

Section 545 of the Code, relating to undistributed personal holding company income, provides in part as follows:

(a) DEFINITION.—For purposes of this part, the term "undistributed personal holding company income" means the taxable income of a personal holding company adjusted in the manner provided in subsection (b), * * *.

(b) ADJUSTMENTS TO TAXABLE INCOME.—For the purposes of subsection (a), the taxable income shall be adjusted as follows:

* * * * * * *

(5) LONG-TERM CAPITAL GAINS.—There shall be allowed as a deduction the excess of the net long-term capital gain for the taxable year over the net short-term capital loss for such year, minus the taxes imposed by this subtitle attributable to such excess. The taxes attributable to such excess shall be an amount equal to the difference between—

(A) the taxes imposed by this subtitle (except the tax imposed by this part) for such year, and

(B) such taxes computed for such year without including such excess in taxable income.

* * * * * * *

Section 541 of the Code provides that, in addition to the other taxes imposed by chapter 1 of the Code, there is imposed on the undis-

tributed personal holding company income as defined in section 545 a personal holding company tax equal to the sum of 75 percent of the undistributed personal holding company income not in excess of $2,000, plus 85 percent of the undistributed personal holding company income in excess of $2,000.

Section 1201 of the Code provides that if the net long-term capital gain of any corporation exceeds the net short-term capital loss, then, in lieu of the income tax imposed by section 11 of the Code (normal tax and surtax), an alternative tax shall be imposed, if such tax is less than the tax imposed by section 11, which shall consist of a partial tax computed on the taxable income reduced by the excess net long-term capital gain, plus 26 percent of the excess for taxable years beginning before April 1, 1954 (25 percent of the excess for taxable years beginning on or after April 1, 1954).

The application of the foregoing sections of the 1954 Code to the amounts shown in the example above results in a net capital gain which may be retained by the corporation of $37,000 ($50,000 net capital gain less income tax of $13,000 applicable thereto) in 1954 as shown in the following computations:

Computation of alternative tax

Total gross income			$85,000
Less: Expenses			9,000
Taxable income			$76,000
Less: Net long-term capital gain			50,000
Net income			$26,000
Less: Dividends received deduction (85 percent of net income)			22,100
Balance			$3,900
Partial tax (30 percent of $3,900)			$1,170
26 percent of net long-term gain (25 percent for taxable years beginning on or after April 1, 1954			13,000
Alternative tax			$14,170

Computation of personal holding company tax

Taxable income			$76,000
Less: Income tax		$14,170	
Net long-term capital gain	$50,000		
Less: Income tax attributable to net long-term capital gain	13,000	37,000	51,170
Undistributed personal holding company income			$24,830

Computation of tax

75 percent of $2,000	$1,500.00
85 percent of $22,830 (excess over $2,000)	19,405.50
Personal holding company tax	$20,905.50

Accordingly, a domestic personal holding company, as defined in section 542 of the Internal Revenue Code of 1954, may retain in the corporation the net long-term capital gain derived from the sale of securities during a taxable year governed by the provisions of the 1954 Code less the amount of Federal income tax for the taxable year applicable to such capital gain.

SUBCHAPTER H.—BANKING INSTITUTIONS

PART II.—MUTUAL SAVINGS BANKS, ETC.

SECTION 591.—DEDUCTION FOR DIVIDENDS PAID ON DEPOSITS

Rev. Rul. 55-703

A savings and loan association claimed a deduction under section 591 of the Internal Revenue Code of 1954 for the taxable year 1954 for amounts credited to the accounts of and withdrawable by its depositors in 1954 as dividends on their deposits. These dividends covered a period of one and one-half years. The dividend due on December 31, 1953, for the six-month period ended on that date was declared payable and withdrawable on January 2, 1954. The dividend payable for the last half of 1954 was declared payable and withdrawable on December 30, 1954. *Held*, the deduction for both amounts for the taxable year 1954 is allowable since the amounts so credited were withdrawable by its depositors on demand in 1954, in accordance with the provisions of section 591 of the Code.

SECTION 593.—ADDITIONS TO RESERVE FOR BAD DEBTS

(Also Part II, Section 23(k); Regulations 118, Section 39.23(k)-5.) Rev. Rul. 55-704

> Where a mutual savings bank, pursuant to certain compromise agreements, canceled a portion of its mortgages receivable in years in which it was not subject to Federal income tax, such cancellations have the effect of reducing the basis of such mortgages, for Federal income tax purposes, by the total of the amounts canceled. Furthermore, the amounts so canceled shall not be included in the surplus, undivided profits and reserves of the bank for the purpose of determining the ratio of the bank's addition to its reserve for bad debts as provided in section 593 of the Internal Revenue Code of 1954.

Advice has been requested whether the adjusted basis of certain mortgages held by a mutual savings bank should be decreased by the amount of the partial cancellation thereof during years when it was not subject to Federal income tax, in the computation of the addition to the bad debt reserve for 1954 and subsequent years.

During the years 1940 to 1950, inclusive, the taxpayer, a mutual savings bank not subject to Federal income tax during such years, entered into a number of compromise agreements with certain of its mortgagors whereunder a portion of the principal due on the mortgages was forgiven and compromised by the taxpayer. The agreements, which had the effect of partially reducing the principal amount of the mortgages, were entered into in situations where the value of the mortgaged properties had declined in value to such an extent that the bank would be in no better position if it were to foreclose than it would be if it agreed to reduce the outstanding principal to an

amount more nearly equivalent to the value of the property. The agreements were accompanied by an extension of the mortgage term and, in some cases, also provided for an immediate cash payment to the bank by the mortgagor. The agreements resulted solely from negotiations between the mortgagors and the mortgagee, and were not directed by the state banking department or any other supervisory authority. Immediately upon the execution of an extension agreement, the taxpayer reflected on its books of account the partial write-down of the particular mortgage indebtedness and carried the mortgage thereafter at the reduced amount. The original mortgage was not canceled, but remained on record in unsatisfied form. The extension agreement was also recorded. No partial bad debt deduction was claimed for Federal income tax purposes since for those years mutual savings banks were not subject to Federal income tax.

Section 593 of the Internal Revenue Code of 1954, relative to additions to reserve for bad debts in the case of mutual savings banks, provides in part as follows:

SEC. 593. ADDITIONS TO RESERVE FOR BAD DEBTS.

* * * * * * *

* * * the reasonable addition to a reserve for bad debts for any taxable year shall in no case be less than the amount determined by the taxpayer as the reasonable addition for such year; except that the amount determined by the taxpayer under this sentence shall not be greater than the lesser of—

(1) the amount of its taxable income for the taxable year, computed without regard to this section, or

(2) the amount by which 12 percent of the total deposits or withdrawal accounts of its depositors at the close of such year exceeds the sum of its surplus, undivided profits, and reserves at the beginning of the taxable year.

Section 39.23(k)–5(b) of Regulations 118, applicable under the Code of 1954 by virtue of Treasury Decision 6091, C. B. 1954–2, 47, defines "surplus, undivided profits and reserves" of a mutual savings bank as meaning the amount by which the total assets exceed the total liabilities. The term "total assets" is defined therein as meaning the sum of money, plus the aggregate of the adjusted basis of the property other than money, held by an institution. In arriving at the deposits-surplus ratio under section 593, *supra*, the taxpayer must decrease the previously determined basis of the mortgages held by the total of the amounts canceled pursuant to the compromise agreements, since at the time of the execution of the agreement it relinquished its claim to that portion of the amount canceled and the mortgagor is no longer liable for such amount.

Accordingly, it is held that under the foregoing circumstances the partial cancellation of a mortgage held by a mutual savings bank has the effect of reducing the adjusted tax basis of the mortgage by the extent of the amount canceled. The portion of the mortgage canceled shall not be included in the surplus, undivided profits and reserves of the mortgagee-bank for the purpose of determining the ratio of additions to the bank's reserve for bad debts as provided in section 593 of the Internal Revenue Code of 1954.

SUBCHAPTER I.—NATURAL RESOURCES

PART I.—DEDUCTIONS

SECTION 611.—ALLOWANCE OF DEDUCTION FOR DEPLETION

Treatment of farm land composed of peat soils. See Rev. Rul. 55-730, page 53.

SECTION 613.—PERCENTAGE DEPLETION

Rev. Rul. 55-657

Gypsum rock used or sold to be used as a retarder in the manufacture of cement is not considered used as "concrete aggregates or for similar purposes" under the provisions of section 613(b)(6) of the Internal Revenue Code of 1954 and consequently the 15 percent rate for percentage depletion is allowable.

Advice has been requested whether gypsum rock used or sold for use in the manufacture of cement is considered as being used as "concrete aggregates or for similar purposes" with an allowable percentage depletion rate of five percent.

Gypsum sold to cement manufacturers to be added to the clinker produced by the cement kilns and ground to a powder with the clinker becomes an integral part of the finished cement. The purpose of adding the gypsum is to regulate the "setting" of the cement.

It is held that gypsum rock falls within the classification of "all other minerals" specified in section 613(b)(6) of the Internal Revenue Code of 1954 and, if not used as a stone in making concrete but sold for use as a retarder in the manufacturing of cement, the allowable percentage depletion rate is 15 percent. See Rev. Rul. 55-67, C. B. 1955-1, 357.

SECTION 615.—EXPLORATION EXPENDITURES

Rev. Rul. 55-430

During 1954 the *M* mining company, while operating a mine which was in the exploration stage, discovered small quantities of ore which it extracted and sold to a smelter. In such year the company incurred exploration expenditures of $105,000 and received income of $5,000 from the sale of the ore. *Held*, the *M* company in computing taxable income for 1954 is entitled to deduct, or to treat as deferred expenses, subject to the provisions and limitations of section 615 of the Internal Revenue Code of 1954, the excess of such exploration expenditures over the net receipts derived from the sale of the ore in an amount not to exceed the statutory limitation of $100,000. *Held further*, the taxable income from the property under the circumstances stated would be zero and since percentage depletion is limited to 50 percent of taxable income from the property (computed without allowance for depletion), no percentage depletion is allowable to the company in 1954.

PART III.—SALES AND EXCHANGES

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

(Also Part II, Section 117(k); Regulations 118, Section 39.117(k)-1.) Rev. Rul. 55-621

Section 117(k)(2) of the Internal Revenue Code of 1939, relating to gain or loss upon the disposal of timber or coal (including lignite), is not applicable to a sublessor (or lessee-assignor) of coal properties. However, effective with respect to taxable years beginning after December 31, 1953, and ending after August 16, 1954, the provisions of section 631(c) of the Internal Revenue Code of 1954, corresponding, in the case of coal, to the provisions of section 117(k)(2) of the 1939 Code, may apply to any person who owns an economic interest in coal in place, including a sublessor. Under section 117(k)(2) of the 1939 Code and section 631(c) of the 1954 Code, an assignee or other successor in interest to the original lessor of coal properties may be entitled to the benefits of the statute to the same extent as such original lessor.

SUBCHAPTER J.—ESTATES, TRUSTS, BENEFICIARIES, AND DECEDENTS

PART II.—INCOME IN RESPECT OF DECEDENTS

SECTION 691.—RECIPIENTS OF INCOME IN RESPECT OF DECEDENTS

Rev. Rul. 55-463

Income realized by the estate of a deceased person resulting from a claim which was in process of litigation at the date of his death constitutes income acquired by reason of the death of the decedent and, under the provisions of section 691 of the Internal Revenue Code of 1954, is includible in its gross income in the taxable year when received.

Advice has been requested whether the estate of a deceased person acquired a right to receive income realized under the following circumstances.

At the date of decedent's death there was in litigation an action which he had commenced praying for a permanent injunction against future infringements of certain patent rights, a preliminary injunction pending trial, and an assessment of damages arising out of the alleged infringements. The question presented for consideration is whether any amount realized by the estate upon such a claim is income in respect of the decedent includible in its gross income under section 691 of the Internal Revenue Code of 1954.

Section 691(a)(1) of the Code taxes to a decedent's estate any income received by it, if the right to receive it is acquired by the estate from the decedent.

Section 691(a)(3) of the Code provides that the right, described in paragraph (1), to receive an amount shall be treated, in the hands of

the estate of the decedent, as if it had been acquired by the estate in the transaction in which the right to receive the income was originally derived and the amount includible in gross income under paragraph (1) shall be considered in the hands of the estate to have the character which it would have had in the hands of the decedent if the decedent had lived and received such amount.

In the case of *Estate of Edgar V. O'Daniel* v. *Commissioner*, 173 Fed. (2d) 966, the court held that a bonus paid to the estate of a decedent-employee was includible in the gross income of the estate under section 126(a) of the Internal Revenue Code of 1939 (section 691(a) of the Internal Revenue Code of 1954) because the right to receive it was "acquired by the decedent's estate from the decedent" within the meaning of that section, even though the decedent had no enforceable right to receive it. The court stated:

> The amount of $28,143.65 was plainly gross income in respect of the decedent which had to be included in the taxable year when received for the reason that the right to receive it was "acquired by the decedent's estate from the decedent" within the meaning of section 126(a)(1)(A), *supra*. It is true that the decedent would not have had a legally enforceable right to receive the foregoing amount until it was allocated by the American Cyanamid Company, but the payment clearly represented compensation for his services and any right to receive it that was realized by his estate was acquired through him and never arose in any other way or through any other source. This is made all the more clear by subdivision (3) of section 126(a) by the statement that "the amount includible in gross income * * * shall be considered in the hands of the estate * * * to have the character which it would have had in the hands of the decedent if the decedent had lived and received such amount." We believe it is not disputed that if the decedent had lived and received the bonus in 1944, it would have been reportable and taxable in that year as income for services.

In *Estate of Edward Bausch et al.* v. *Commissioner*, 186 Fed. (2d) 313, in affirming 14 T. C. 1433, the court held that monthly payments made by a corporation to the executors of a deceased founder of the corporation for the year following death constituted a reward for services performed for the employer which alone should be enough to render the payments taxable. In any event they were made to the executors of the deceased employee who in contemplation of law continued the legal personality of the employee and were specifically taxable under section 126(a) of the Internal Revenue Code of 1939 upon receipts for services by their testator.

In *Commissioner* v. *Rose J. Linde*, 213 Fed. (2d) 1, the court held that liquidating proceeds of cooperative marketing associations' wine pools paid to the decedent's widow in the year after that in which the estate was closed constituted "items of gross income in respect of a decedent" within the statutory provision requiring the inclusion of such items in gross income of the person acquiring from the decedent the right to receive them by bequest, devise or inheritance. The court said:

> We find no merit in the suggestion that the gross income here referred to is limited to income from personal services. The language of section 126(a)(3), previously mentioned, discloses that it cannot be confined to any particular type or kind of income. For by that subsection "the amount includible in gross income under paragraph (1) or (2) shall be considered in the hands of the estate or such person to have the same character which it would have had in the hands of the decedent if the decedent had lived and received such amounts." (Emphasis

added.) This clearly discloses that income from all sources was contemplated, including capital gains, business income, interest, dividends, and the like; in short, income of the various types mentioned in section 29.22(a)-1 of Regulations 111. * * *

In the instant case any award received by the estate will be for income lost by the decedent during his lifetime from the exploitation of his patent rights. He commenced the action to recover his loss which at the date of his death was in process of litigation. It cannot be said that he did not have a "right to receive" an award of compensation for his lost income merely because his claim was still in dispute at the time of his death. Any judgment entered in favor of his estate will be in recognition of his claim that he had a "right to receive" such an award. If the decedent had lived and received the judgment it would have been taxable to him. See *United States* v. *Safety Car Heating and Lighting Co.*, 297 U. S. 88, Ct. D. 1073, C. B. XV-1, 294 (1936).

In view of the foregoing, it is held that income realized by the estate of a deceased person resulting from a claim which was in process of litigation at the date of his death constitutes income acquired by reason of the death of the decedent and, under the provisions of section 691 of the Internal Revenue Code of 1954, is includible in its gross income in the taxable year when received.

(Also Part II, Section 126(c); Regulations 118, Section 39.126(c)-1.) Rev. Rul. 55-481

Since 100 percent of a long-term capital gain is included in the gross estate of a decedent for Federal estate tax purposes, and 100 percent of a long-term capital gain is taken into account in computing gross income for Federal income tax purposes, the same percentage is taken into consideration in computing the deduction authorized to recipients of income in respect of decedents by section 691(c) of the Internal Revenue Code of 1954.

Effect of elimination of the requirement to file a bond for the purpose of deferring gain to the recipient from installment obligations transmitted at death on a bond which was executed under the provisions of section 44(d) of the Internal Revenue Code of 1939. See Rev. Rul. 55-627, page 550.

SUBCHAPTER L.—INSURANCE COMPANIES

PART I.—LIFE INSURANCE COMPANIES

SECTION 802.—IMPOSITION OF TAX

Extension of time granted life insurance companies to file declarations of estimated tax and to pay the tax due thereon. See Rev. Proc. 55-3, page 899.

SECTION 804.—RESERVE AND OTHER POLICY LIABILITY DEDUCTION

T. D. 6146[1]

TITLE 26—INTERNAL REVENUE, 1954.—CHAPTER I, SUBCHAPTER A, PART 1.—INCOME TAX; TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1954

Figure to be used in determining reserve and other policy liability deduction for life insurance companies.

DEPARTMENT OF THE TREASURY,
Washington 25, D. C.

To Officers and Employees of the Treasury Department and Others Concerned:

PARAGRAPH 1. By virtue of the authority vested in me by section 804(a) of the Internal Revenue Code of 1954 (68A Stat. 258; 26 U. S. C. 804(a)), it is hereby determined that the figure to be used in computing the "reserve and other policy liability deduction" of life insurance companies for the taxable year 1955 shall be .8238.

PAR. 2. It is found that notice and public procedure are unnecessary, since the figure announced in this Treasury Decision is computed from information contained in the income tax returns of life insurance companies for the year 1954 which are not open to public inspection. The public accordingly cannot effectively participate in the determination of such figure.

H. CHAPMAN ROSE,
Acting Secretary of the Treasury.

(Filed by the Division of the Federal Register September 9, 1955, 4:55 p. m.)

SECTION 806.—ADJUSTMENT FOR CERTAIN RESERVES

Rev. Rul. 55-705

The "adjustment for certain reserves," as provided for by section 806 of the Internal Revenue Code of 1954, contemplates an adjustment of all "unearned premiums" and all "unpaid losses" and not "unearned premium reserves" and "unpaid loss reserves." Accordingly, a life insurance company in computing its "adjustment for certain reserves" should include all "unearned premiums" and all "unpaid losses" and "unpaid losses" should include the amounts set aside by it to meet its liability for such losses as well as the reserves for the present value of amounts not yet due on future claims.

In computing such adjustment, "unearned premiums" with respect to cancellable health and accident insurance for maternity benefits written by a life insurance company should include premiums paid for deferred maternity benefits during the period for which such premiums have been paid but for which the company is not liable or "on the risk" under the terms of the policy.

The inconsistent manner in which life insurance companies in general have computed their nonlife insurance reserves under section 806 of the Internal Revenue Code of 1954 reflects the need of clarification by the Internal Revenue Service of the method to be used in the computation of the adjustment for certain reserves as provided by that section.

[1] 20 F. R. 6703.

Briefly stated, the issues are (1) whether in computing the amount of adjustment for certain nonlife insurance reserves only reserves held against future unaccrued contingent payments should be included or whether there should also be included policy claims and losses outstanding which represent accrued liabilities, and (2) whether reserves for deferred maternity benefits should be included in "unearned premiums" or in "unpaid losses" in computing the amount of adjustment for certain nonlife insurance reserves.

Section 806 of the Internal Revenue Code of 1954 is substantially the same as section 202(c) of the Internal Revenue Code of 1939 and provides in part as follows:

> In the case of a life insurance company writing contracts other than life insurance or annuity contracts (either separately or combined with noncancellable health and accident insurance), the term "adjustment for certain reserves" means an amount equal to 3¼ percent of the unearned premiums and unpaid losses on such other contracts which are not included in life insurance reserves * * *.

Prior to the enactment of the above section (section 202(c)), a life insurance company writing health, accident or other insurance contracts was taxable only on investment income. Since there is very little investment income derived from the investment of premiums on such contracts, the real income from the accident, health and other business derived from premiums was not taxable. As a result, section 202(c) of the 1939 Code was enacted in order to provide a more easily determinable tax base for the cancellable health and accident and other business of life insurance companies. See Senate Report No. 1631, 77th Cong., C. B. 1942–2, 504, at 614.

While the insurance industry often refer to "unearned premiums" as a "reserve," it is not such a reserve as involves future contingencies nor is it based upon recognized mortality or morbidity tables as is the case in the reserve for the present value of amounts not yet due on future claims.

Section 806 of the Code and section 39.202–2 of Regulations 118, which, under the provisions of Treasury Decision 6091, C. B. 1954–2, 47, continue in effect pending the issuance of new regulations pertinent to the corresponding sections of the 1954 Code, provide for a base consisting of "unearned premiums" and "unpaid losses" and not for "unpaid premium reserves" and "unpaid loss reserves." Thus, in the computation of the "adjustment for certain reserves" as provided by section 806 of the Internal Revenue Code of 1954, all "unearned premiums" and all "unpaid losses" should be included.

The second issue for consideration is whether, in computing the amount of the adjustment for certain reserves, reserves for deferred maternity benefits are includible in "unearned premiums," or whether they represent "unpaid losses." The description of this type of policy shows that the insurer incurs no liability from the date of issue until a period of nine months thereafter. Then for the period of the last three months of the year of issue and for an extension of nine months beyond the year of issue (making a full twelve-month period of actual liability) the insurer is liable for maternity benefits to the policyholder. It is apparent that the insurer is not on the risk until nine months after the contract is issued or the policyholder's insurance begins. Premiums in these circumstances cannot be earned except

during the period in which the insurer is on the risk, which includes the three-month period of the year of issue and the nine-month period of insured's rights under the policy. When the insured event occurs, claim liabilities or claim reserves are set up for benefits which may be due and unpaid at the time or which may become due in the future.

The term "unearned premiums," as applied to insurance companies other than life and to noncancellable policies in general, has been held to mean not only advance premiums collected which the company had not yet had time to earn, but also to include the net value of policies, defined as the liability of the company upon insurance contracts other than accrued claims. It has been further held that an insurance company other than life or mutual is entitled, in computing the "premiums earned," to exclude therefrom the net addition made during that year to the additional reserve for noncancellable health and accident policies required by law, or, in other words, that this addition to the reserve fund was a part of "unearned premiums." See *Massachusetts Protective Association, Inc.* v. *U. S.*, 114 Fed. (2d) 304, Ct. D. 1483, C. B. 1941–1, 383; *Travelers Equitable Insurance Co.* v. *Commissioner*, 22 B. T. A. 784, acquiescence, C. B. X–2, 71 (1931); *United Life Insurance Co.* v. *Commissioner*, 47 B. T. A. 960, acquiescence, C. B. 1943–23; and G. C. M. 22503, C. B. 1941–1, 265. The limitation to cases involving noncancellable health and accident insurance was subsequently withdrawn by G. C. M. 25256, C. B. 1947–1, 68, as a result of the decision in the case of the *C. P. A. Co.* v. *Commissioner*, 7 T. C. 912, acquiescence, C. B. 1947–1, 1, in which it was held, in the case of an insurance company other than life or mutual writing noncancellable retirement, discharge, sick, accident and life insurance on a level premium basis, that reserves with respect to retirement and death benefit features of its policies, as required by the State, constitute "unearned premiums," and therefore the increase in reserves during a taxable year should not be included in gross income.

The reasoning employed in these decisions is equally applicable to cancellable policies where premiums paid for maternity benefits represent a present payment for future coverage when no premiums will be paid. As such, they constitute "unearned premiums" during the period for which such premiums have been paid but upon which the company is not liable or "on the risk" under the terms of the policy.

PART III.—OTHER INSURANCE COMPANIES

SECTION 831.—TAX ON INSURANCE COMPANIES (OTHER THAN LIFE OR MUTUAL), MUTUAL MARINE INSURANCE COMPANIES, AND MUTUAL FIRE INSURANCE COMPANIES ISSUING PERPETUAL POLICIES

(Also Section 832.) Rev. Rul. 55–580
(Also Part II, Section 204; Regulations 118, Section 39.204–2.)

An insurance company taxable under the provisions of section 831 of the Internal Revenue Code of 1954 is entitled, under the provisions of section 832(b)(6) of the Code, to a deduction for "expenses incurred" involving estimates of future costs of adjusting claims and similar types of expenses, according to the accounting

method adopted by the National Convention of Insurance Commissioners used in filing the company's annual statement. As in the case of determining the "losses incurred" deductible, no corresponding change should be made at the beginning of the year where the taxpayer has obtained substantial tax benefits through the method of determining "loss adjustment expenses" deductible in its returns for prior years, which returns have been finally closed, and upon which the statute of limitation has expired.

Methods required for the computation of "loss adjustment expenses" are not prescribed by the Internal Revenue Service and any reasonable method may be employed, subject to acceptance, upon examination, by the Service.

Advice has been requested as to whether an insurance company, other than a life or mutual company, as defined in section 831 of the Internal Revenue Code of 1954, is entitled to compute its "loss adjustment expenses" on an estimated or reserve basis, and if so what method of computation should be used in determining such expenses.

Some insurance companies taxable under section 831 of the 1954 Code, in addition to claiming deductions for actual allocated "loss adjustment expenses," also claim deductions for the entire amount of unallocated expenses relating to losses which have occured but have not been examined and settled.

Section 832 of the Code provides, in part, as follows:

(b) DEFINITIONS. * * *.

(5) LOSSES INCURRED.—The term "losses incurred" means losses incurred during the taxable year on insurance contracts, computed as follows:

(A) To losses paid during the taxable year, add salvage and reinsurance recoverable outstanding at the end of the preceding taxable year and deduct salvage and reinsurance recoverable outstanding at the end of the taxable year.

(B) To the result so obtained, add all unpaid losses outstanding at the end of the taxable year and deduct unpaid losses outstanding at the end of the preceding taxable year.

(6) EXPENSES INCURRED.—* * * means all expenses shown on the annual statement approved by the National Convention of Insurance Commissioners, and shall be computed as follows: To all expenses paid during the taxable year, add expenses unpaid at the end of the taxable year and deduct expenses unpaid at the end of the preceding taxable year. For the purpose of computing the taxable income * * * there shall be deducted from expenses incurred (as defined in this paragraph) all expenses incurred which are not allowed as deductions by subsection (c).

(c) DEDUCTIONS ALLOWED.—In computing the taxable income of an insurance company subject to the tax imposed by section 831, there shall be allowed as deductions:

(1) All ordinary and necessary expenses incurred, as provided in section 162 (relating to trade or business expenses); * * *

The reference in section 832 of the Code to the annual statement approved by the National Convention of Insurance Commissioners contemplates that the method of accounting used in preparing that statement should be followed in computing gross income and that the provision in section 832(b)(6) above, which prohibits the deduction of expenses not allowed under subsection (c) of such section, should be construed as meaning that deductions of a type not enumerated in subsection (c) will not be allowed. Therefore, if an expense is of the type which would be allowable as a deduction under section 162(a) of the Code, it should be allowed as a deduction in the year determined on the basis of the accounting method adopted by the National Convention of Insurance Commissioners as reflected in the annual statement. The question here relates to "expenses incurred"

involving estimates of future costs of adjusting claims and similar types of expenses but does not include administrative or clerical expenses of a nature that can be actually determined.

Section 832 of the Code does not provide for the deduction of any reserve as such, but it does provide for the deduction of "unpaid losses." Section 39.204–2(b) of Regulations 118, applicable under the 1954 Code by virtue of T. D. 6091, C. B. 1954–2, 47, provides that every insurance company of the type with which this Revenue Ruling is concerned must establish to the satisfaction of the Commissioner of Internal Revenue that the part of the deduction for "losses incurred" which represents "unpaid losses" at the close of the taxable year comprises only actual unpaid losses stated in amounts which, based upon the facts in each case and the company's experience with similar cases, can be said to represent a fair and reasonable estimate of the amount the company will be required to pay.

Accordingly, it is held, in view of the fact that the determination of "loss adjustment expenses" bears a relation to the determination of "unpaid losses," that an insurance company taxable under the provisions of section 831 of the Code is in like manner entitled, under the provisions of section 832(b)(6) of the Code, to a deduction for "expenses incurred" involving estimates of future costs of adjusting claims and similar types of expenses, according to the accounting method adopted by the National Convention of Insurance Commissioners used in filing the company's annual statement. As in the case of determining the "losses incurred" deductible, no corresponding change should be made at the beginning of the year where the taxpayer has obtained substantial tax benefits through the method of determining "loss adjustment expenses" deductible in its returns for prior years, which returns have been finally closed, and upon which the statute of limitation has expired.

Methods required for the computation of "loss adjustment expenses" are not prescribed by the Internal Revenue Service and any reasonable method may be employed, subject to acceptance, upon examination, by the Revenue Service.

Since sections 831 and 832 of the 1954 Code cited and referred to in this Revenue Ruling, in substance, embody the same provisions relating to the taxing of insurance companies (other than life or mutual), mutual marine insurance companies, and mutual fire insurance companies issuing perpetual policies as were contained in section 204 of the Internal Revenue Code of 1939, the discussion and conclusions reached herein would be equally applicable if this same question were considered under the provisions of the 1939 Code.

SECTION 832.—INSURANCE COMPANY TAXABLE INCOME

Rev. Rul. 55–693

An amount transferred under a reinsurance agreement to *X* casualty company from *Y* mutual insurance company for reinsurance of *Y*'s insured liability risks represents a premium for the reinsurance undertaken by *X*, and that portion of the premium

which remains unearned at the end of the taxable year is deductible as an "unearned premium" under section 832(b)(4) of the Internal Revenue Code of 1954.

Advice has been requested as to the taxability of an amount transferred from a mutual insurance company to a casualty insurance company for the purpose of reinsuring liability risks for catastrophe losses.

X casualty company, a stock fire insurance company taxable under section 831 of the Internal Revenue Code of 1954, entered into a reinsurance agreement with *Y* mutual insurance company, a mutual insurance company having no reinsurance protection or protection against catastrophe losses, whereby *Y* transferred the sum of 500*x* dollars, representing a portion of its reserve for unearned premiums, to *X* as a "catastrophe loss reserve." This "reserve" is to be kept intact by *X* for catastrophe insurance losses of *Y* except for the portion which *X* may earn into its underwriting income each year. Under the terms of the agreement, 80 percent of the premiums received thereafter by *Y* will be paid in consideration for such reinsurance and *X* will reinsure 100 percent of *Y*'s liability on insurance risks either issued or to be issued.

Section 832(b) of the 1954 Code, defining taxable income in the case of insurance companies other than life or mutual insurance companies, provides, in part, as follows:

(3) UNDERWRITING INCOME.—The term "underwriting income" means the premiums earned on insurance contracts during the taxable year less losses incurred and expenses incurred.

(4) PREMIUMS EARNED.—The term "premiums earned on insurance contracts during the taxable year" means an amount computed as follows:

(A) From the amount of gross premiums written on insurance contracts during the taxable year, deduct return premiums and premiums paid for reinsurance.

(B) To the result so obtained, add unearned premiums on outstanding business at the end of the preceding taxable year and deduct unearned premiums on outstanding business at the end of the taxable year.

The word "premium," which has been defined as the consideration paid for a contract of insurance, is the proper term to use in designating the sum which one insurance company pays to another on its reinsurance contract. *Hoosier Casualty Co.* v. *Commissioner*, 32 Fed. (2d) 940, certiorari denied, 280 U. S. 581. Accordingly, the "catastrophe loss reserve" also represents in the instant case the "premium" paid by *Y* to *X* for reinsurance. The words "unearned premiums" as used above must be given their commonly accepted meaning. Compare *Helvering* v. *Edythe LeGierse et al.*, 312 U. S. 531, Ct. D. 1491, C. B. 1941–1, 430. "Unearned premiums" may be defined as that portion which the company has not yet had time to earn or, more precisely, that portion paid by the policyholder which must be returned on cancellation of the policy, and which is in direct proportion to the unexpired time which the policy is to run. Huebner, Property Insurance, (1929 edition), Chapter XVI, 217; *Early, Jr.* v. *Lawyers Title Insurance Corporation*, 132 Fed. (2d) 42; *Massachusetts Protective Association, Inc.*, v. *United States*, 114 Fed. (2d) 304, Ct. D. 1483, C. B. 1941–1, 383; *Aetna Insurance Co. et al.* v. *Hyde*,

decided by the Supreme Court of Missouri, May 21, 1926, 285 S. W. 65. Therefore, in the instant case, until the transferred reserve composed of unearned premiums has been earned by *X* through the lapse of time, it may be considered as "unearned" within the meaning of section 832(b)(4) of the 1954 Code.

Accordingly, it is held that the amount transferred under a reinsurance agreement to *X* casualty company from *Y* mutual insurance company for reinsurance of *Y*'s insured liability risks represents a premium for the reinsurance undertaken by *X*, and that portion of the premium which remains unearned at the end of the taxable year is deductible as an "unearned premium" under section 832(b)(4) of the 1954 Code.

Deduction of unallocated "loss adjustment expenses" relating to losses which have occurred but have not been examined and settled. See Rev. Rul. 55–580, page 282.

SUBCHAPTER N.—TAX BASED ON INCOME FROM SOURCES WITHIN OR WITHOUT THE UNITED STATES

PART I.—DETERMINATION OF SOURCES OF INCOME

SECTION 861.—INCOME FROM SOURCES WITHIN THE UNITED STATES

Determination of amount paid for personal services where payment is in currency of Japan. See Rev. Rul. 55–472, page 776.

PART II.—NONRESIDENT ALIENS AND FOREIGN CORPORATIONS

SUBPART A.—NONRESIDENT ALIEN INDIVIDUALS

SECTION 871.—TAX ON NONRESIDENT ALIEN INDIVIDUALS

Taxability of compensation for professional services received by a French citizen who is in the United States on an exchange visitor's visa. See Rev. Rul. 55–508, page 775.

SUBPART C.—MISCELLANEOUS PROVISIONS

SECTION 894.—INCOME EXEMPT UNDER TREATY

Exemption from United States tax of a Belgian corporation which markets goods in the United States through a United States commission agent. See Rev. Rul. 55–617, page 774.

PART III.—INCOME FROM SOURCES WITHOUT THE UNITED STATES

SUBPART A.—FOREIGN TAX CREDIT

SECTION 901.—TAXES OF FOREIGN COUNTRIES AND OF POSSESSIONS OF UNITED STATES

(Also Part II, Section 131(a); Regulations 118, Section 39.131(a)-1.) Rev. Rul. 55-454

Taxes on net profits paid to Costa Rica by a United States corporation pursuant to law but limited as to maximum rate by a contract with the Costa Rican Government, duly approved by their Legislative Assembly, will be allowed as a credit against United States income tax under provisions of section 901 of the Internal Revenue Code of 1954 as limited by section 904 of the Code.

Advice has been requested whether taxes on net profits paid to Costa Rica by a United States corporation at a maximum rate established by contract with the Costa Rican Government but otherwise in conformity to rates imposed by the Costa Rican Income Tax Law will be allowed as a credit against United States income tax under the provisions of section 901 of the Internal Revenue Code of 1954.

Costa Rica has an Income Tax Law which imposes a taxe on net profits of foreign corporations doing business in that country. A United States corporation entered into a contract with the Costa Rican Government, which was duly approved by the Legislative Assembly, providing that in lieu of the general income tax on foreign corporations the corporation would pay a tax based on a fixed percentage of its net profits as determined under Federal income tax laws. When an increase in general income tax rates was under consideration, the contract was amended to provide that the corporation will pay to Costa Rica a tax on its net profits derived in that country at the rates established by law, provided that the maximum rate does not exceed a stated percentage. Any increase in the existing rate of tax shall be applicable to the corporation from the legal date of such increase. The contract is subject to ratification by the Legislative Assembly. It is anticipated that any increase in existing income tax rates will be made retroactive but that the effective date of increase will not be the same for all classes of taxpayers.

While the Costa Rican tax system differs from our Federal tax system in permitting the rate of tax with respect to a particular taxpayer to be determined by contract approved by the Legislative Assembly, if the tax generally imposed is an income tax within the meaning of section 901 of the Code, limitation of the maximum rate of tax by contract with respect to a particular taxpayer does not change its character. See *New York & Honduras Rosario Mining Co.* v. *Commissioner*, 168 Fed. (2d) 745. Furthermore, the possibility that the retroactive date on which the tax becomes effective may not be the same for all taxpayers does not change the nature of the tax.

Accordingly, it is held that taxes on net profits paid to Costa Rica by a United States corporation pursuant to law but limited as to maximum rate by a contract with the Costa Rican Government, duly approved by their Legislative Assembly, will be allowed as a credit against United States income tax under the provisions of section 901 of the Code as limited by section 904 of the Code.

(Also Part II, Section 131(a); Regulations 118, Section 39.131(a)-1.) Rev. Rul. 55-455

The tax imposed under Tariff Third of Article III, Chapter Sixth, of the Cuban Emergency Tax Law of January 29, 1931, as amended, constitutes an income tax for which a credit is allowable against United States income tax to the extent provided under section 901 of the Internal Revenue Code of 1954, as limited by section 904 of the Code.

Advice has been requested whether the tax imposed by Tariff Third of Article III, Chapter Sixth, of the Cuban Emergency Tax Law of January 29, 1931, as amended by Act of June 23, 1938, Decree No. 2597 of September 17, 1941, pursuant to Law No. 28 of September 8, 1941, Law No. 7 of April 5, 1943, and Decree No. 833 of March 15, 1944, falls within the United States concept of an income tax for which credit against the United States income tax is allowable under section 901 of the Internal Revenue Code of 1954.

Chapter Sixth of the Cuban Emergency Tax Law of January 29, 1931, as amended, provides for a general tax on profits. Articles I and II provide as follows:

Article I. From the time this law becomes effective a contribution or tax is established on net profits or benefits according to the tariffs hereinafter copied.

Article II. The payment of this contribution or tax shall be made by: Every person, natural or juridic, Cuban or foreign, by reason of net profits or benefits obtained in Cuban territory, or which are paid, within or without the Republic, by natural or juridic persons domiciled or residing therein, or which are paid in Cuban territory even though the debtor is located outside thereof.

Article III, Tariff Third, provides in part as follows:

Individual merchants and manufacturers and all commercial and industrial companies or organizations, excepting those comprised in Tariff Fourth, shall pay in accordance with the following scale: * * *.

Section 901 of the Internal Revenue Code provides in part as follows:

(a) ALLOWANCE OF CREDIT.—If the taxpayer chooses to have the benefits of this subpart, the tax imposed by this chapter [chapter 1 of the Code] shall, subject to the limitation of section 904, be credited with * * *

(b) AMOUNT ALLOWED.—Subject to the limitation of section 904, the following amounts shall be allowed as the credit under subsection (a):

(1) CITIZENS AND DOMESTIC CORPORATIONS.—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 * * *.

Section 903 of the Internal Revenue Code provides:

For purposes of this subpart and of section 164(b), the term "income, war profits, and excess profits taxes" shall include a tax paid in lieu of a tax on income, war profits, or excess profits otherwise generally imposed by any foreign country or by any possession of the United States.

The basis of the imposition of the tax under the Cuban Emergency Tax Law of January 29, 1931, in the case of individual merchants and manufacturers and commercial and industrial companies or organizations is the amount of net profit or benefit arising from the business in the period of imposition. For the determination of the net profit or benefit, there is allowable as a deduction from the sum of the gross revenue obtained in such period, whether proceeding from direct operation or from lease of the business, the amount of ordinary and necessary expenses paid or incurred during the period and those of management, conservation and a reasonable depreciation (Article VII).

In order for a tax paid to a foreign country to be allowable as a credit against United States income tax under section 901 as enlarged by section 903 of the Code it must be shown that the tax imposed by the foreign country is an income tax as that term is used and understood for United States income tax purposes, or is a tax in lieu of an income tax. See I. T. 4065, C. B. 1951-2, 74, and Rev. Rul. 31, C. B. 1953-1, 225.

The tax imposed by Tariff Third of Article III, Chapter Sixth, of the Cuban Emergency Tax Law of January 29, 1931 is a levy upon net income within the meaning of section 901 of the Code. Accordingly, the tax imposed under Tariff Third of the above-mentioned law, as amended by Act of June 23, 1938, Decree No. 2597 of September 17, 1941 pursuant to Law No. 28 of September 8, 1941, Law No. 7 of April 5, 1943, and Decree No. 833 of March 15, 1944, constitutes an income tax for which a credit is allowable against United States income tax to the extent provided under section 901 of the Code as limited by Code section 904.

(Also Sections 904 and 905.) Rev. Rul 55-612

Article 2 of the Spanish income tax law, "General Tax on Income," dated December 20, 1932, provides that there shall be subject to the tax, in addition to specified Spanish subjects and employees of the Spanish State, "Those who have their domicile or habitual residence within Spanish territory." Article 19 of such law, as modified by article 6 of the Law of February 6, 1943, provides that from the amount of tax assessable there shall be deducted the amount paid or payable abroad for taxes in respect of the income originating abroad or the tax on the value of the property from which such foreign income is derived. *Held*, Spain satisfies the similar credit requirements of section 901(b)(3) of the Internal Revenue Code of 1954. Accordingly, under the provisions and subject to the limitations of the applicable sections of the 1954 Code (sections 901, 904 and 905), a United States resident who is a citizen of Spain is entitled to a credit against his United States income tax for income tax paid or accrued during the taxable year to any foreign country or countries including income tax withheld at the source on dividend payments.

Rev. Rul. 55-677

The West German Income Tax Law of 1951, as amended, and the Corporation Tax Law of 1951, as amended, are laws imposing income taxes within the United States concept of an income tax. The tax imposed by the Corporation Tax Law on the profit derived by a domestic corporation on the sale of all of the stock of a German corporation to two other German corporations is allowable as a credit under section 901 of the Internal Revenue Code of 1954, subject to the limitation of section 904.

Acceptance by the West German tax authorities of the assignment by the seller of a portion of its claim for the purchase price in an amount equal to such tax due and the issuance of a receipt to that effect by such authorities constitutes payment of such tax within the intendment of section 901 of the 1954 Code. Gain from the sale of the stock is considered income from sources within West Germany in calculating the limitation on this credit under section 904 of the 1954 Code.

Advice has been requested whether a domestic corporation is allowed credit against its United States income tax liability, pursuant to section 901 of the Internal Revenue Code of 1954, as limited by section 904, for an assignment made by the domestic corporation to the German tax authorities of a portion of its interest in the sales price of its stock in a German corporation as full payment of its German income tax liability on such sale; and whether the gain from the sale of the stock in the German corporation by the domestic corporation is considered income from sources within Germany for purposes of calculating the limitation on credit against the seller's United States income tax under section 904 of the 1954 Code.

The domestic corporation agreed to sell all the issued and outstanding shares of the stock of a German corporation, which it held, to two corporations organized under the laws of Germany. Under the agreement, the stock was delivered to a bank in West Germany and title to the shares passed there. Payment was made to the seller in part by credit to its account in a bank in Switzerland. The West German tax authorities agreed to accept as full payment of the seller's West German income tax liability an assignment of a part of the seller's claim against the two German corporations for the purchase price in an amount equal to the German income tax on the profits from such transaction. Upon such assignment the German tax authorities issued to the seller a receipt for payment of the tax in full.

The West German Income Tax Law of 1951, as amended, provides for a tax on revenues from various sources. Taxable income is computed by deducting losses, certain taxes, business expenses, and an allowance for depreciation on certain assets. The tax is imposed on all income of physical persons having their domicile or their customary residence in the national territory and on income obtained within the national territory by nonresident individuals. The Corporation Tax Law of 1951, as amended, imposes a tax on income of certain types of juridical persons. Those having neither their administrative board nor their main office in the national territory are taxed only on income obtained in the country, whereas others are subject to tax on income from all sources. Reference is made to the Income Tax Law for the concept of taxable income and allowable deductions, and the law contains other provisions applicable only to juridical persons. Both an individual and a juridical person who sell stock are subject, under certain conditions, to a tax on the gain derived from the sale of stock measured by the difference between the sales price and the basis of the stock in the hands of the seller.

The income tax is progressive and varies according to the family status of an individual taxpayer and his source of income. The tax on corporations also is not uniform for all taxpayers. In the case of a taxpayer who is subject to liability for tax on income derived only from sources within the national territory, local agents of the land finance ministry in whose district a business activity has its office or an individual his residence may abate totally or partially, or assess in a lump-sum, the tax payable by persons or corporations subject to such limited liability if such special assessment appears to be in the interest of the German economy. In important cases the proposed settlement has to be approved by the president of the regional office of the land; if the amount involved is exceptionally high, he has to obtain the approval of the finance minister of the land for such settlement.

In order for a tax paid to a foreign country to be allowable as a credit against United States income tax under section 901 of the Internal Revenue Code of 1954, it must be shown that the tax imposed by the foreign law is a tax on income within the United States concept of an income tax.

In view of the foregoing, it is held that both the West German Income Tax Law and the Corporation Tax Law of 1951, as amended, are laws imposing income taxes within the United States concept of an income tax. Accordingly, the tax imposed on the profit derived by a domestic corporation on the sale of all of the stock of a German corporation to two other German corporations is allowable as a credit under section 901 of the Internal Revenue Code of 1954, subject to the limitation of section 904. Acceptance by the German authorities of the assignment by the seller of a portion of its claim for the purchase price in an amount equal to such tax due and issuance of a receipt to that effect by such authorities constitutes payment of such tax within the intendment of section 901 of the 1954 Code.

It is held further that for the purpose of calculating the limitation, if any, on the amount of the German tax allowable as a credit under section 904 of the Internal Revenue Code of 1954, the gain from the sale of the shares of stock is considered income from sources within West Germany. See G. C. M. 25131, C. B. 1947-2, 85

SECTION 904.—LIMITATION ON CREDIT

Foreign tax credit to Spanish citizens for taxes paid to any foreign country. See Rev. Rul. 55-612, page 289.

SECTION 905.—APPLICABLE RULES

Foreign tax credit to Spanish citizens for taxes paid to any foreign country. See Rev. Rul. 55-612, page 289.

SUBPART B.—EARNED INCOME OF CITIZENS OF UNITED STATES

SECTION 911.—EARNED INCOME FROM SOURCES WITHOUT THE UNITED STATES

(Also Part II, Section 116; Regulations 118, Section 39.116-1.) Rev. Rul. 55-464

A United States citizen, who has been a bona fide resident in a foreign country as a missionary throughout an entire taxable year is entitled to exclude from his gross income for a taxable year beginning after December 31, 1950, the entire amount of a furlough allowance attributable to the services performed abroad during his period of foreign residence regardless of when it is received, whether or not he intends to return to the foreign country upon completion of his furlough, and whether or not he remains in the United States beyond his regular furlough period.

Advice has been requested as to whether a missionary who has established a bona fide residence in a foreign country, may exclude from

his gross income the amount of a furlough allowance for a furlough of one year spent in the United States, if at the end of the furlough period he resigned and did not return abroad.

The taxpayer, a United States citizen who had established a bona fide residence abroad, returned to the United States for his regular furlough following an absence of over four years, during which he was a missionary in a foreign country. At the end of his furlough he was prevented from returning to his foreign post because of the poor health of a member of his family and resigned.

Prior to the amendment of section 116(a)(1) of the Internal Revenue Code of 1939 by the Revenue Act of 1951, it was the position of the Internal Revenue Service that missionaries who had established a bona fide residence in a foreign country did not lose such status when they returned to the United States periodically for their regular furlough (usually one year) if it was their intention to return to their foreign post upon the completion of the furlough period. If, however, they remained in the United States beyond the regular furlough, regardless of the reason therefor, they would lose their status as bona fide foreign residents at the expiration of their regular furlough. In either event, the allowance received during the regular furlough spent in this country was held to be exempt from taxation.

After its amendment by the Revenue Act of 1951, section 116(a)(1) of the Internal Revenue Code of 1939 (section 911(a)(1) of the 1954 Code is substantially the same as the corresponding section of the 1939 Code) provided that in the case of a citizen of the United States who establishes a bona fide residence in a foreign country for an uninterrupted period which includes an entire taxable year, amounts of earned income from sources outside the United States (except amounts paid by the United States or any agency thereof) which are attributable to his period of foreign residence shall be excluded from gross income.

Accordingly, it is held that a missionary who has been a bona fide resident of a foreign country throughout an entire taxable year is entitled to exclude from his gross income for a taxable year beginning after December 31, 1950, the entire amount of his furlough allowance attributable to his services performed abroad, regardless of when received, whether or not he intends to return to the foreign country upon completion of his furlough, and whether or not he remains in the United States beyond his regular furlough period. If, however, his foreign residence status is terminated, either when he returns to this country or upon the expiration of his regular furlough, he must again meet the foreign residence or presence requirements of section 911(a)(1) or (2) of the Internal Revenue Code of 1954 before he will be entitled to the benefits of that section in respect to compensation for services performed abroad thereafter.

Rev. Rul. 55–497

"First year" and "renewal" commission income received by an individual citizen of the United States for life insurance policies written during a period of bona fide foreign residence for an uninterrupted period which includes an entire taxable year, may be excluded from gross income whenever and wherever received. All "earned income," including "first year" and "renewal" commission income, received by an individual citizen of the United States which

is attributable to a period of "physical presence" in a foreign country or countries for at least 510 full days during any period of 18 consecutive months may be excluded from gross income in the amount which bears the same ratio to $20,000 as the number of days in the part of the taxable year within the 18 month period bears to the total number of days in such year. Commission income, attributable to a period of "physical presence" in a foreign country received in a subsequent year, no part of which falls within the 18-month period, may not be excluded from gross income.

Advice has been requested whether "first year" commission income for life insurance policies written in a foreign country by an individual citizen of the United States, but paid subsequent to resuming residence in the United States, and "renewal" commission income on such life insurance policies which will be received over a period of 8 or 9 years are includible in gross income for Federal income tax purposes.

A United States citizen was a resident of a foreign country from 1951 through March 1955, when he returned to the United States. As a life insurance salesman he was entitled to receive "first year" commission income on policies written during the period of foreign residence, as well as "renewal" commission income over a period of 8 or 9 years on those policies which were renewed by the policyholders.

Contracts between life insurance companies and their agents generally provide that the contracting company will pay to its agents a first year commission on life insurance policies procured by them and accepted by the company, and that subsequently, for a period of time specified in the contract, renewal commissions will be paid to the agents as premiums are received on such policies.

Section 911(a) of the Internal Revenue Code of 1954 provides for a special tax treatment of citizens of the United States who (1) establish to the satisfaction of the Secretary of the Treasury or his delegate that they have been bona fide residents of a foreign country or countries for an uninterrupted period which includes an entire taxable year, or (2) during any period of 18 consecutive months are physically present in a foreign country or countries during at least 510 full days in such period. Such citizens are entitled to exclude from gross income compensation attributable to such period which is received for personal services performed without the United States, provided that such compensation is not paid by the United States or any agency thereof.

There is no limitation upon the amount which may be excluded from gross income under the provisions of section 911(a)(1) of the Code. The amount which may be excluded from gross income under section 911(a)(2) of the Code, for those physically present in a foreign country, is limited to $20,000 for an entire taxable year which falls within the 18-month period and to a proportionate part of $20,000 for a lesser part of a taxable year which falls within the period. The exemption allowed under section 911(a) of the Code, however, does not apply to the entire income of an individual who qualifies for its benefits, but only to that portion of the income which constitutes compensation for the performance of personal services outside the United States.

"Renewal" commissions represent additional compensation for personal services previously rendered. Although an insurance salesman

may have no contractual right to such commissions until the policy holders remit renewal premiums, such rights as he does have exist by reason of the fact that he originally procured the insurance contract. It is therefore held that "renewal" commissions on insurance policies written by a taxpayer during a period when he was a "bona fide resident" of or "physically present" in a foreign country or countries are attributable to such period.

Thus, "first year" and "renewal" commissions received by a United States citizen for life insurance policies written during a period of bona fide foreign residence would, under section 911(a)(1) of the Code, be excludable from gross income whether received before or after returning to the United States.

Where a United States citizen qualifies under section 911(a)(2) of the Code, earned income derived from the performance of personal services, including "first year" and "renewal" commission income, which is received during a taxable year falling entirely within an 18-month period of presence in a foreign country or countries, may be excluded from gross income to the extent of the limitation indicated above. Where only a portion of the taxable year is included in the 18-month period described above, earned income may be excluded only to the extent that such income bears the same ratio to $20,000 as the number of days in the taxable year falling within the 18-month period bears to the total number of days in such year. Earned income, including commission income, attributable to such period of "physical presence" in a foreign country, which is received in a subsequent year or years, in which no part of the taxable year falls within the 18-month period, would be fully taxable. See Rev. Rul. 54–72, C. B. 1954–1, 117.

SUBCHAPTER O.—GAIN OR LOSS ON DISPOSITION OF PROPERTY

PART I.—DETERMINATION OF AMOUNT OF AND RECOGNITION OF GAIN OR LOSS

SECTION 1001.—DETERMINATION OF AMOUNT OF AND RECOGNITION OF GAIN OR LOSS

The amount realized from the sale or other disposition of property pursuant to a corporate liquidation. See Rev. Rul. 55–517, page 297.

SECTION 1002.—RECOGNITION OF GAIN OR LOSS

(Also Part II, Section 112 (a); Regulations 118, Section 39.112(a)–1.) Rev. Rul. 55–641

When United States Treasury Certificates of Indebtedness, issued in unregistered form and without interest coupons, are surrendered at maturity in 1954 in exchange for a like face amount of such certificates with a later maturity date, such exchange constitutes a transaction in which gain or loss is recognized for Federal income tax purposes. Compare I. T. 2734, C. B. XII–2, 73 (1933), and I. T. 2359,

C. B. VI–I, 51 (1927); and see section 39.112(b)(1)–1(d) of Regulations 118. Since any premiums paid upon the purchase of the old certificates of indebtedness were not amortizable (see Rev. Rul. 54–66, C. B. 1954–1, 128), any gain or loss is measured by the difference between the cost (including any premiums paid upon the acquisition thereof) or other basis of the old certificates and the fair market value of the new certificates at the date of the exchange. Interest accrued on the old certificates to the date of the exchange should be treated as ordinary income. Compare Sol. Op. 46, C. B. 3, 90 (1920). If the old certificates are capital assets in the hands of a taxpayer, any gain or loss thus determined constitutes a capital gain or loss. The market value thus established for the new certificates received represents the basis of such certificates for the purpose of computing gain or loss upon subsequent disposition.

That portion of Revenue Ruling 54–66, C. B. 1954–1, 128, which holds that any losses realized upon redemption of such types of obligations are deductible as ordinary losses is not applicable in the instant case since that ruling is concerned with loss upon redemption and not with gain or loss upon the exchange of such obligations, at maturity, under the circumstances described above.

PART III.—COMMON NONTAXABLE EXCHANGES

SECTION 1031.—EXCHANGE OF PROPERTY HELD FOR PRODUCTIVE USE OR INVESTMENT

(Also part II, Section 112(b); Regulations 118, Section 39.112(b)(1)–1.) Rev. Rul. 55–749

> Where under applicable state law, water rights are considered real property rights, the exchange of perpetual water rights for a fee interest in land constitutes a nontaxable exchange of property of like kind within the meaning of section 1031(a) of the Internal Revenue Code of 1954, provided the requirements of that section as to holding for productive use in the trade or business or for investment are met.

Advice has been requested whether the exchange of perpetual water rights for a fee interest in land under the circumstances set forth below constitutes a nontaxable exchange of property of like kind within the purview of section 1031(a) of the Internal Revenue Code of 1954.

A is the owner in fee of 20 acres of arid land, all of which is in an irrigation district, but he is not entitled to receive water from such district facilities. *B* has a contract with the irrigation district whereby he has the right to "petition into" such district a specified number of acres of arid land for perpetual irrigation purposes. *B* has agreed to petition the 20 acres of arid land owned by *A* into the irrigation district for water facilities in perpetuity in exchange for one half of such land. Under the applicable laws of the state in which the property is located, water rights are considered real property rights.

Section 1031(a) of the Code, regarding the nonrecognition of gain or loss from exchanges solely in kind, states, in part, as follows:

"* * * 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.

Section 39.112(b)(1)-1 of Regulations 118, applicable to section 1031(a) by virtue of Treasury Decision 6091, C. B. 1954-2, 47, provides, in part, that the words "like kind," as used in section 1031(a) of the Code, have reference to the nature or character of the property and not to its grade or quality. One kind or class of property may not, under such section, be exchanged for property of a different kind or class.

In the instant case, the fact that the two varieties of property, namely water rights and land, may be legally classified as real property does not of itself signify that the two are property of like nature or character within the meaning of section 1031(a) of the Code. If there be substantial difference in the rights created in and to the respective properties, then the properties are not of like kind. See *Wm. Fleming and Bessie M. Fleming et al.*, v. *Commissioner*, 24 T. C. No. 93.

In the Wm. Fleming and Bessie M. Fleming case, *supra*, the Internal Revenue Service was sustained in the view that an exchange of the fee simple title to a ranch for an in-oil payment right was not an exchange solely in kind under section 112(b)(1) of the 1939 Code. In arriving at its decision, the court stated that in comparing properties to determine their likeness within the meaning of section 112(b)(1) there must be considered not alone the nature and character of the physical properties but also the nature and character of the title conveyed or the rights of the parties therein; that from the applicable regulations the implication is clear that the rights vested in the respective grantees in and to the properties exchanged must be of the same general character or of substantial equality and, if they are not, then the properties exchanged are not of like kind within the meaning of the Code. Under the circumstances in the instant case, where the water right, whatever its size, is in perpetuity, as distinguished from a right to a specific total amount of water or to a specific amount of water for a limited period, the water rights and the land involved are regarded as sufficiently similar to constitute property of like kind within the meaning of section 1031(a) of the Code. See I. T. 4093, C. B. 1952-2, 130.

Accordingly, it is held that where, under applicable state law, water rights are considered real property rights, the exchange of perpetual water rights for a fee interest in land constitutes a nontaxable exchange of property of like kind within the meaning of section 1031(a) of the Internal Revenue Code of 1954, provided the requirements of that section as to holding for productive use in the trade or business or for investment are met.

SECTION 1033.—INVOLUNTARY CONVERSIONS

(Also Sections 331, 337, 1001.) Rev. Rul. 55–517

Where a corporation elects to replace property involuntarily converted within a period prescribed by section 1033(a)(3)(B) of the Internal Revenue Code of 1954 and subsequently adopts a plan of liquidation under sections 331(a)(1) and 337(a) of such Code before replacement of the property, the nontaxable provisions of section 337(a) and the application of section 331(a)(1) do not preclude the nonrecognition of gain under section 1033(a)(3)(A) provided the replacement is completed prior to the expiration of the replacement period and before completion of the corporate liquidation.

The amounts distributed to the stockholders in redemption of their stock shall be treated as a distribution in full payment in exchange for such stock in accordance with the provisions of sections 331(a)(1) and 1001 of the 1954 Code.

Advice has been requested as to the Federal income tax consequences to a corporation and its shareholders where property is being replaced in accordance with section 1033(a)(3)(B) and a plan is adopted to liquidate the corporation.

The *M* corporation is engaged in the real estate business. It has only one class of stock outstanding, all of which is owned by a husband and his wife. The corporation suffered extensive damage to its property as a result of the hurricane and flood of 1954, and the amount of insurance payments which will be collected for damages will exceed the basis of the property damaged. Therefore, the corporation has elected on its income tax return for the fiscal year in which the damage occurred to use the insurance proceeds to replace the damaged property.

Pursuant to such election, the corporation has acquired a parcel of land and entered into a contract with a contractor to build a structure similar in service and use to the property destroyed. The cost of the new construction will exceed the insurance proceeds received from the involuntary conversion. However, the corporation is considering adopting a plan of liquidation before the new structure is completed and to complete its liquidation within the 12-month period during which time the replacement building is expected to be completed.

The nonrecognition of gain provisions of section 1033 of the Internal Revenue Code of 1954, as they relate to involuntary conversions of property which occur after December 31, 1950, provide, in effect, that where property is compulsorily or involuntarily converted and the taxpayer, during the period specified, purchases other property similar or related in service or use to the property so converted, at the election of the taxpayer, the gain shall be recognized only to the extent that the money realized from such conversion exceeds the cost of the replacement property.

As provided in the same section of the Code, the period within which such property must be replaced is the period beginning with the date of the disposition of the converted property, or the earliest date of the threat or imminence of requisition or condemnation of the converted property, and ending one year after the close of the first taxable year in which any part of the gain upon the conversion is realized.

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Section 337(a) of the Code relating to gain or loss on sales or exchanges in connection with certain liquidations provides, in part, that under the general rule if a corporation adopts a plan of complete liquidation on or after June 22, 1954, and within the 12-month period beginning on the date of the adoption of such plan, all of the assets of the corporation are distributed in complete liquidation, less assets retained to meet claims, then no gain or loss shall be recognized to such corporation from the sale or exchange by it of property within the 12-month period.

In the instant case and upon the basis of the facts presented, it is held that where property is involuntarily converted and the corporation elects to replace such property within the period prescribed by section 1033(a)(3) (A) and (B) of the Code, the fact that the corporation subsequently adopts a plan of liquidation under sections 337(a) and/or 331(a)(1) of such Code, before replacement of the property, will not preclude the application of section 1033 of the Code, provided the replacement is completed prior to the expiration of the replacement period and before completion of the corporate liquidation.

Gain or loss will be recognized to the stockholders measured by the difference between the cost or other basis of the stock surrendered and the fair market value of the assets distributed in liquidation under sections 331(a)(1) and 1001 of the Internal Revenue Code of 1954.

Rev. Rul. 55–717

The sale of shares of stock made necessary by a state legislative act is not a transaction consummated under a threat of condemnation within the meaning of section 1033 of the Internal Revenue Code of 1954. Further, if the proceeds from the sale are reinvested in similar shares of stock in another company, there has not been a nontaxable exchange within the provisions of such section or within any provision of the income tax statute.

Advice has been requested whether the transaction described below constitutes a transaction under a threat of condemnation for Federal income tax purposes, resulting under the given circumstances in a nontaxable exchange.

A state statute provides that any stock life insurance company of that state may adopt a plan of mutualization and to that end may acquire all of its outstanding capital stock. The statute further provides that, after the plan has been in effect for more than 5 years and the company has acquired at least 90 percent of its outstanding stock, if the company is unable to obtain the remaining shares, the courts of that state have jurisdiction to compel the sale of the outstanding stock to the company at a price determined by the court. After such a sale, the stock is retired and cancelled and the former holders possess no further rights with respect thereto.

In the instant case, an insurance company has, within the terms of the statute, acquired more than 90 percent of its outstanding stock but has been unable to purchase the remaining shares. The taxpayer owns a portion of the remaining outstanding stock. Pursuant to the prescribed court order, the taxpayer sells his shares to the company and reinvests the proceeds in similar stock of another life insurance company.

Section 1033 of the Internal Revenue Code of 1954 provides in part that if property (as a result of its destruction in whole or in part, theft, seizure, or requisition or condemnation or threat or imminence thereof) is compulsorily or involuntarily converted into money, and the taxpayer within the period prescribed purchases other property similar or related in service or use to the property involuntarily converted or purchases stock in the acquisition of control of a corporation owning such other property, at the election of the taxpayer the gain shall be recognized only to the extent that the amount realized upon such conversion exceeds the cost of such other property or such stock.

In order to receive the benefits of section 1033 of the Code, it is necessary that a taxpayer show that the property in question was converted in one of the ways described in such section. Here the sale of stock to the insurance company, in accordance with the state law or as a result of court action in connection with the carrying out of such law, does not constitute a transaction consummated under a threat of condemnation or under condemnation proceedings within the meaning of section 1033 of the Code.

Accordingly, it is held that the sale of shares of stock made necessary by a state legislative act is not a transaction consummated under a threat of condemnation within the meaning of section 1033 of the Internal Revenue Code of 1954. Further, if the proceeds from the sale are reinvested in similar shares of stock in another company, there has not been a nontaxable exchange within the provisions of such section or within any provision of the income tax statute.

Procedure in regard to requests for rulings on prospective or actual replacement of involuntary converted property. See Rev. Proc. 55–14, page 918.

SUBCHAPTER P.—CAPITAL GAINS AND LOSSES

PART I.—TREATMENT OF CAPITAL GAINS

SECTION 1201.—ALTERNATIVE TAX

Amount of net long-term capital gain derived from the sale of securities by a personal holding company which may be retained in the corporation. See Rev. Rul. 55–702, page 272.

PART III.—GENERAL RULES FOR DETERMINING CAPITAL GAINS AND LOSSES

SECTION 1221.—CAPITAL ASSET DEFINED

(Also Section 453.) Rev. Rul. 55–694

A corporation desiring to qualify a corporate name in California, which it had adopted and qualified in all other States of the United States, paid a California corporation, which had filed its articles of incorporation and previously adopted the same name in California, a

stipulated amount for the right to use the name, one-fourth of such amount payable immediately and the balance on demand of the seller. *Held*, the right to the use of a corporate name under the corporation laws of the State of California is deemed to constitute an intangible capital asset of indefinite life. Accordingly, the gain from the sale thereof represents capital gain within the meaning of section 1221 of the Internal Revenue Code of 1954. Since the selling corporation has under the contract of sale the unqualified right to receive the total price during the taxable period in which the sale was made, the requirement of section 453(b) of the Code, with respect to the limitation on the maximum amount of the initial payment, has not been met and the transaction does not qualify for treatment as an installment sale.

Fully depreciated motion picture films sold in a single transaction by a motion picture company exclusively engaged in the production and rental of motion picture films. See Rev. Rul. 55–706, below.

PART IV.—SPECIAL RULES FOR DETERMINING CAPITAL GAINS AND LOSSES

SECTION 1231.—PROPERTY USED IN THE TRADE OR BUSINESS AND INVOLUNTARY CONVERSIONS

(Also Section 1221.) Rev. Rul. 55-706

Where a motion picture producer which distributes motion picture films on a rental or lease basis, but does not sell such films in the ordinary course of its business, sells a quantity of its own fully depreciated films in one unusual and isolated transaction, the gain realized from the sale is taxable as a long-term capital gain under the provisions of section 1231 of the Internal Revenue Code of 1954, provided the conditions of that section are otherwise met.

Advice has been requested as to the proper treatment for Federal income tax purposes of proceeds from the sale of fully depreciated motion picture films in a transaction as described below.

X pictures corporation, a corporation whose stock is widely held, is engaged in the business of producing motion picture films and distributing films owned by others as well as its own films. The corporation sold 200 of its old films to another corporation. *X* corporation has never before sold films to exhibitors, but has rented them either for a fixed daily or weekly fee, or upon a percentage of box office receipts. Ownership of the films has not been relinquished by *X* during this rental process. *X* has, on occasion, leased or licensed rights for television exhibition of certain films for a limited period. However, *X* has retained ownership of the leased films, and at the end of the license or lease period, all television rights have reverted to *X*.

Neither the purchasing corporation nor any of its officers or stockholders own any shares of stock in *X* corporation; nor are any of such officers or stockholders related to the principal stockholders, officers, or members of the board of directors of *X* corporation. The films sold in this transaction were all old films, originally produced and released during the period from 1931 to 1946. The films were

fully depreciated on the corporation's books and were carried at a zero basis. Although the films have a residual value as re-issues or re-releases for exhibition purposes in foreign countries or for long-range television purposes, they were producing negligible rental income to X corporation. The motive for the sale was to convert dormant assets into working capital, increase the net worth of the corporation, improve its balance sheet, and provide an additional base for bank borrowing. A substantial payment was made to X at the time of sale, the balance payable in four installments, secured by a mortgage, pledge, and assignment with respect to the films. The mortgage and pledge will remain in force until the full purchase price is paid. The purchasing corporation may possibly engage X corporation to act as a distributing agent for some of the purchased films on the usual distribution fee basis charged for such a service.

No participating interests in the films sold were held by any individuals as joint venturers in a particular production. The films sold were produced by the efforts of individuals who were paid by X the then full market value of their efforts and services. None of such individuals owned stock in the corporation at the time the films were made, or owned any stock or stock options in the corporation at the time of the sale of the films. None of the individuals contributed efforts and services to the production of these films with a view toward subsequently realizing additional money returns, directly or indirectly, through the medium of the sale of the films upon a capital gain basis.

Section 1221 of the Internal Revenue Code of 1954 excludes from the definition of a capital asset the following items, among others:

> (1) stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business;
>
> (2) property, used in his trade or business, of a character which is subject to the allowance for depreciation provided in section 167, * * *;
>
> (3) a copyright, a literary, musical, or artistic composition, or similar property, held by—
>
> (A) a taxpayer whose personal efforts created such property, or
>
> (B) a taxpayer in whose hands the basis of such property is determined, for the purpose of determining gain from a sale or exchange, in whole or in part by reference to the basis of such property in the hands of the person whose personal efforts created such property;

From the facts presented, it is evident that the 200 films were not stock in trade, or property of a kind which would properly be included in inventory if on hand at the close of the taxable year, or property held primarily for sale to customers in the ordinary course of trade or business. Rather, they were the subject of leases by the taxpayer to exhibitors on a rental basis. Although fully depreciated, they were assets of a character subject to the allowance for depreciation, used in the trade or business.

There is excluded from the definition of property used in the trade or business, as provided in section 1231(b) of the 1954 Code, a copyright, a literary, musical, or artistic composition, or similar property held by a taxpayer described in paragraph (3) of section 1221. Many corporations, including some whose stock is widely held and traded on established stock exchanges, create copyrights as well as other property described in paragraph (3) of section 1221. The property

created by these corporations is not considered to be created by the personal efforts of a taxpayer where all of the costs and expenses are paid for by the corporation at the current going rate for the services rendered. The production of each of the films in the instant case involved a multiplicity of skills and abilities, the combined efforts of numerous individuals of various backgrounds and trades, and the use of substantial amounts of capital. Thus, no single individual may be said to have created by his personal efforts the films in question or a property in the films.

Based on the foregoing circumstances, it is held that since the sale of the 200 films was an isolated and unusual sale the films were not property held primarily for sale to customers in the ordinary course of trade or business. It is further held that the gain realized from the sale of the films is taxable as long-term capital gain under the provisions of section 1231 of the 1954 Code, provided the conditions of that section are otherwise met.

Treatment of gain or loss upon the sale of lock boxes and fixtures owned by a postmaster and purchased by another postmaster, the Post Office Department or outsiders. See Rev. Rul. 55-579, page 47.

SUBCHAPTER Q.—READJUSTMENT OF TAX BETWEEN YEARS AND SPECIAL LIMITATIONS

PART I.—INCOME ATTRIBUTABLE TO SEVERAL TAXABLE YEARS

SECTION 1301.—COMPENSATION FROM AN EMPLOYMENT

(Also Sections 74 and 1302.) Rev. Rul. 55-642

Where the taxpayer won an award in a contest conducted to promote the sales of a company's product, he is not entitled to the benefits of either section 1301 or section 1302 (providing for limitation on tax on certain income attributable to several taxable years).

Advice has been requested with respect to the treatment for Federal income tax purposes of an award won in a contest which was established for the purpose of selling a company's product. Specifically, the taxpayer inquires whether, under section 1301 or section 1302 of the Internal Revenue Code of 1954, he may compute the tax attributable to the award as if it had been received ratably over a period of several years.

The contest in question, which involved some original and creative work based on research, mathematical ability, art, and skill in obtaining material and creating and constructing original answer word solutions, began in November 1951 and ended in September 1954. The award was made in 1955.

Section 1301(a)(1) of the 1954 Code provides that section 1301 applies to an individual or partnership that "engages in an employment as defined in subsection (b)."

Section 1301(b) provides:

DEFINITION OF AN EMPLOYMENT.—For purposes of this section, the term "an employment" means an arrangement or series of arrangements for the performance of personal services by an individual or partnership to effect a particular result, regardless of the number of sources from which compensation therefor is obtained.

Section 1301(a)(2) further restricts the applicability of section 1301 to such employment as covers a period of 36 months or more from the beginning to the completion thereof.

Section 1302(b)(2) provides that for the purposes of the benefits allowed under section 1302 the term "artistic work" means a literary, musical, or artistic composition or a copyright covering a composition of such type.

In the instant case, the efforts of the taxpayer that resulted in his winning the award were not "an employment" as defined in section 1301(b), as they neither were pursuant to an arrangement or series of arrangements to effect a particular result nor constituted personal services. See *E. Phillips Oppenheim v. Commissioner*, 31 B. T. A. 563. In addition, the work did not cover a period of 36 months or more. Therefore, the award may not be treated for Federal income taxes in the manner provided by section 1301 of the 1954 Code.

The taxpayer also is not entitled to the benefits of section 1302 of the 1954 Code since his efforts have not resulted in an invention or a literary, musical or artistic composition within the usually accepted meaning of those terms.

Accordingly, it is held that the taxpayer is not entitled to the benefits of either section 1301 or section 1302 in respect to the award.

SECTION 1302.—INCOME FROM AN INVENTION OR ARTISTIC WORK

Award received in a word-solution contest may not be treated as income from artistic work. See Rev. Rul. 55–642, page 302.

SECTION 1303.—INCOME FROM BACK PAY

(Also Section 61.) Rev. Rul. 55–498

Capital gains must be included in full in gross income in determining whether the amount of back pay, as defined in section 1303(b) of the Internal Revenue Code of 1954, received or accrued by an individual during the taxable year exceeds 15 percent of the gross income of the individual for such year. For such purpose the deduction with respect to net long-term capital gains as well as the deduction for capital losses allowed under the provisions of sections 1202 and 165(f) of the Code, respectively, are not factors in the determination of gross income.

Advice has been requested whether capital gains and losses are to be taken into account in the determination of gross income of an individual for a taxable year in determining whether back pay, as defined in section 1303(b) of the Internal Revenue Code of 1954, received by an individual exceeds 15 percent of his gross income for the year.

Section 1303 of the 1954 Code, in providing for a limitation on income tax for the amount of back pay received by an individual for the taxable year, provides in part as follows:

(a) LIMITATION ON TAX.—If the amount of the back pay received or accrued by an individual during the taxable year exceeds 15 percent of the gross income of the individual for such year * * *.

Gross income is defined by section 61 of the 1954 Code, which reads in part as follows:

(a) GENERAL DEFINITION.—Except as otherwise provided in this subtitle [Subtitle A], gross income means all income from whatever source derived, including (but not limited to) the following items:

* * * * * * *

(3) Gains derived from dealings in property;

The basic definition of gross income contained in section 61 of the 1954 Code is a broad one which does not provide for a complete detailed itemization of all items includible in gross income although some items of income are listed therein and certain other such items are specifically set forth in part II of subchapter B (sections 71 through 77 of the 1954 Code) as includible in gross income. Under the broad concept of income, all such items are included in gross income unless specifically excluded therefrom. The specific exclusions from gross income are set forth in part III of subchapter B (sections 101 through 121) of the 1954 Code.

From the above it is evident that capital gains are included in full under the broad concept of gross income. The 50 percent reduction for net long-term capital gains is allowed as a deduction from gross income under section 1202 of the Code. Likewise, capital losses along with certain other types of losses are deductions from gross income under the provisions of section 165 of the Code. Since the 50 percent reduction for long-term capital gains as well as the reduction for capital losses constitutes deductions and not exclusions from gross income such items are not factors in the determination of gross income.

In the case of *Leslie H. Green* v. *Commissioner*, 7 T. C. 263, acquiescence, C. B. 1946–2, 2, affirmed on other grounds, 168 Fed. (2d) 994, one of the issues involved was the computation of gross income where the taxpayer had reported a capital loss in his return filed. The court stated:

Under section 22(a) [section 61 of the 1954 Code] "gross income" is defined generally to include gains, profits and income from various specified sources, including sales or dealings in property, whether real or personal, or derived "from any source whatever". Nothing is contained in any of the provisions of section 22 requiring an adjustment to be made in the computation of gross income on account of capital losses. Provision for deduction of such losses is found in subsection (g) of section 23 entitled "Deductions from Gross Income." [Section 165(f) of the 1954 code].

It seems clear from these provisions that capital losses form no part of the gross income, * * *.

In view of the foregoing it is held that capital gains must be included in full in gross income in determining whether the amount of back pay, as defined in section 1303(b) of the Internal Revenue Code of 1954, received or accrued by an individual during the taxable year exceeds 15 percent of the gross income of the individual for such year. For such purpose the deduction with respect to net long-term capital gains as well as the deduction for capital losses allowed under the provisions of sections 1202 and 165 (f) of the Code, respectively, are not factors in the determination of gross income.

PART III.—INVOLUNTARY LIQUIDATION AND REPLACEMENT OF LIFO INVENTORIES

SECTION 1321.—INVOLUNTARY LIQUIDATION OF LIFO INVENTORIES

26 CFR 1.1321–1: Involuntary liquidation of lifo inventories. T. D. 6118[1]

TITLE 26—INTERNAL REVENUE, 1954.—CHAPTER I, SUBCHAPTER A, PART I.—INCOME TAX; TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1953

Regulations prescribed under section 1321 of the Internal Revenue Code of 1954.

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

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

AUTHORITY: §§ 1.1321 through 1.1321–2, incl., issued under secs. 1321, 7805, I. R. C. 1954; 68A Stat. 342, 917; 26 U. S. C. 1321, 7805.

On July 12, 1955, notice of proposed rule making regarding the regulations for taxable years ending after June 30, 1950, and before January 1, 1955, under section 1321 (relating to involuntary liquidation of lifo inventories) of the Internal Revenue Code of 1954, was published in the Federal Register (20 F. R. 4956). All comments regarding the proposed regulations having been considered and no change having been found necessary, the following regulations as so published are hereby adopted.

§ 1.1321 STATUTORY PROVISIONS; INVOLUNTARY LIQUIDATION OF LIFO INVENTORIES.

SEC. 1321. INVOLUNTARY LIQUIDATION OF LIFO INVENTORIES.

(a) ADJUSTMENT OF TAXABLE INCOME AND RESULTING TAX.—If, for any taxable year ending after June 30, 1950, and before January 1, 1955, the closing inventory of a taxpayer inventorying goods under the method provided in section 22(d) of the Internal Revenue Code of 1939, reflects a decrease from the opening inventory of such goods for such year, and if the taxpayer elects, at such time and in such manner and subject to such regulations as the Secretary or his delegate may prescribe, to have this section apply, and if it is established to the satisfaction of the Secretary or his delegate, in accordance with such regulations, that such decrease is attributable to the involuntary liquidation of such inventory as defined in section 22(d)(6)(B) of the Internal Revenue Code of 1939 (as modified by subsection (b) of this section), and if the closing inventory of a subsequent taxable year, ending before January 1, 1956, reflects a replacement, in whole or in part, of the goods so previously liquidated, then the taxable income of the taxpayer otherwise determined for the year of such involuntary liquidation shall be increased by an amount equal to the excess, if any, of the aggregate cost of such goods reflected in the opening inventory of the year of involuntary liquidation over the aggregate replacement cost, or decreased by an amount equal to the excess, if any, of the aggregate replacement cost of such goods over the aggregate cost thereof reflected in the opening inventory of the year of the involuntary liquidation. The taxes imposed by this chapter (and by chapters 1 and 2 of the Internal Revenue Code of 1939) for the year of such liquidation, for preceding taxable years, and for all taxable years intervening between

[1] 20 F. R. 7540.

the year of liquidation and the year of replacement shall be redetermined, giving effect to such adjustments. Any increase in such taxes resulting from such adjustments shall be assessed and collected as a deficiency but without interest, and any overpayment so resulting shall be credited or refunded to the taxpayer without interest.

(b) DEFINITIONS.—For purposes of this section, the term "involuntary liquidation" shall have the meaning given to it in section 22(d)(6)(B) of the Internal Revenue Code of 1939 and, in addition, it shall mean a failure, as referred to in that section, on the part of the taxpayer due, directly and exclusively, to disruption of normal trade relations between countries. For purposes of this section, the words "enemy" and "war", as used in such section 22(d)(6)(B), shall be interpreted, pursuant to regulations prescribed by the Secretary or his delegate, in such a way as to apply to circumstances, occurrences and conditions, lacking a state of war, which are similar, by reason of a state of national preparedness, to those which would exist under a state of war.

(c) SPECIAL RULES.—Subparagraphs (C) and (E) of section 22(d)(6) of the Internal Revenue Code of 1939, to the extent that they refer to any taxpayer subject to subparagraph (A) of such section or to the adjustments specified in or resulting from the effect of subparagraph (A) of such section, shall apply to a taxpayer subject to this section or to adjustments specified in or resulting from the effect of this section as though they specifically referred to this section. If, for any taxable year ending after June 30, 1950, and before January 1, 1953, subparagraph (C) of such section 22(d)(6) applies with respect to involuntary liquidations of goods of the same class subject to both subparagraph (A) of such section and to this section, the involuntary liquidations of such goods subject to this section shall be considered for the purpose of such subparagraph (C) as having occurred before the involuntary liquidations of such goods subject to subparagraph (A) of such section 22(d)(6). For the purpose of this subsection, and with respect to the taxable years covered by this section, the reference in subparagraph (E) of such section 22(d)(6) to section 734(d) shall be taken as a reference to section 452(d) of the Internal Revenue Code of 1939, and, with respect to any taxable year to which any provision of the Internal Revenue Code of 1939 may not be applicable, references in such subparagraph to such provision shall, where applicable, be deemed a reference to the corresponding provision of the Internal Revenue Code of 1954.

SEC. 1.1321–1 INVOLUNTARY LIQUIDATION OF LIFO INVENTORIES.—(a) Section 22(d)(6)(B) of the Internal Revenue Code of 1939 provides as follows:

> (B) Definition of Involuntary Liquidation.—The term "involuntary liquidation", as used in this paragraph, means the sale or other disposition of goods inventoried under the method described in this subsection, either voluntary or involuntary, coupled with a failure on the part of the taxpayer to purchase, manufacture, or otherwise produce and have on hand at the close of the taxable year in which such sale or other disposition occurred such goods as would, if on hand at the close of such taxable year, be subject to the application of the provisions of this subsection, if such failure on the part of the taxpayer is due, directly and exclusively, (i) to enemy capture or control of sources of limited foreign supply; (ii) to shipping or other transportation shortages; (iii) to material shortages resulting from priorities or allocations; (iv) to labor shortages; or (v) to other prevailing war conditions beyond the control of the taxpayer.

(b)(1) If, during any taxable year ending after June 30, 1950, and before January 1, 1955, the disruption of normal trade relations between countries, or one or more of the conditions attributable to a state of national preparedness and beyond the control of the taxpayer, as prescribed by section 22(d)(6)(B) of the Internal Revenue Code of 1939, as modified by section 1321(b) of the Internal Revenue Code

of 1954, should render it impossible during such period for a taxpayer using the last-in first-out inventory method to have on hand at the close of the taxable year a stock of merchandise in kind and description like that included in the opening inventory for the year, or in a quantity equal to that of the opening inventory, the resulting inventory decrease for the year will be regarded, at the election of the taxpayer, as reflecting an involuntary liquidation subject to replacement. If the taxpayer notifies the Commissioner within the period prescribed below that he intends to effect a replacement of the liquidated stock, in whole or in part, and that he desires to have applied in his case the involuntary liquidation and replacement provisions of section 1321, and if he establishes to the satisfaction of the Commissioner the involuntary character of the liquidation to which his stock has been subjected, effect shall be given, when replacement has been made, in whole or in part, but only to the extent made in taxable years ending before January 1, 1956, to an adjustment of taxable income for the year of liquidation in the amount of the difference between the replacement costs incurred and the original inventory cost of the liquidated base stock inventory that is replaced. The notification is to be given within 6 months after the filing by the taxpayer of his income tax return for the year of the liquidation. However, if the liquidation occurs in a taxable year ending after December 31, 1953, the notification may be given at any time within 3 months after the promulgation of regulations under section 1321, or prior to the expiration of the 6-month period following the filing of the return, whichever expiration date later occurs.

(2) If the replacement costs exceed such inventory costs, the taxable income of the taxpayer otherwise computed for the year of liquidation shall be reduced by an amount equal to such excess. If the replacement costs are less than the inventory costs, taxable income otherwise computed for the year of liquidation shall be increased to the extent of such difference. Any deficiency in the income or excess profits tax of the taxpayer, or any overpayment of such taxes, attributable to such adjustment shall be assessed and collected or credited or refunded to the taxpayer without interest.

(c) (1) A failure on the part of the taxpayer to have on hand in his closing inventory for the taxable year merchandise of the kind, description, and quantity of that reflected in his opening inventory will be considered as an involuntary liquidation only if it is established to the satisfaction of the Commissioner that such failure is due wholly to his inability to purchase, manufacture, or otherwise produce and procure delivery of such merchandise during the taxable year of liquidation by reason of the disruption of normal trade relations between countries or by reason of certain war conditions, described in section 22(d)(6)(B) of the Internal Revenue Code of 1939, as modified by section 1321(b). Such war conditions are (i) shortages in the source of foreign supply by reason of capture or control by an enemy; (ii) shipping or other transportation shortages; (iii) material shortages resulting from priorities or allocations; (iv) labor shortages; and (v) similar war conditions beyond the control of the taxpayer. For the purpose of the preceding sentence the words "enemy" and "war" shall be interpreted to apply to circumstances, occurrences, and conditions lacking a state of war, which are similar, by reason of a state of

national preparedness, to those which would exist under a state of war.

(2) The various directives, orders, regulations, and allotments issued by the Federal Government in connection with national preparedness are among such circumstances and conditions which might be recognized as effecting an involuntary liquidation under this section. Likewise, a voluntary compliance with a request of an authorized representative of the Federal Government made upon an industry or an important segment thereof, or a voluntary allocation of materials by an industry or important segment thereof sanctioned by the Federal Government, if made in connection with the national preparedness program, might be considered as such a circumstance or condition. Similarly, so much of an inventory decrease as is directly and exclusively attributable to the Federal Government's stockpiling program for periods during which an item is not subject to allotment shall also be considered as subject to the provisions of section 1321. Thus, so much of an inventory decrease as is due wholly to the effect of directives, orders, regulations, or allotments issued pursuant to the Defense Production Act of 1950, as amended (50 U. S. C. App. 2061), or to any other circumstance or condition which is solely dependent upon other action taken by the Federal Government in furtherance of the national preparedness program, ordinarily shall be considered as an involuntary liquidation under section 1321 and this section; however, to the extent that such a decrease is due to the disposition of goods acquired in violation of such directives, orders, regulations, or allotments, such decrease shall not be considered as such an involuntary liquidation. An inventory decrease due directly and exclusively to a disruption of normal trade relations between countries shall be considered as an involuntary liquidation subject to the rules and requirements prescribed in this section, including the requirement that the taxpayer establish to the satisfaction of the Commissioner the cause of the involuntary liquidation. A disruption of normal trade relations between countries may be reflected by unusual export limitations imposed by a foreign government, by unusual exchange restrictions, or by other unusual circumstances or conditions beyond the control of the taxpayer.

(3) A voluntary shift by the taxpayer, in the exercise of business judgment, to merchandise of a different character, description, or use, or to merchandise processed out of a substantially different kind of raw materials while raw materials of the type originally used are still available will not be considered as an involuntary liquidation notwithstanding the fact that such a shift in merchandise stocked was prompted by a shifting market demand attributable to the above conditions. The term "involuntary liquidation" presupposes a physical inability to maintain a normal inventory as distinguished from a financial or business disinclination on the part of the taxpayer to do so.

(d) If the taxpayer would have the involuntary liquidation and replacement provisions applicable with respect to any inventory decrease, he must so elect within the time prescribed by this section. In making such election, the taxpayer shall attach to his return and make a part thereof, or he shall furnish separately to the Commissioner, a statement setting forth the following matters: (1) The desire of the taxpayer to invoke the involuntary liquidation and

replacement provisions; (2) a detailed list or other identifying description of the items of merchandise claimed to have been subjected to involuntary liquidation and the extent to which replacement is intended; (3) the circumstances relied upon as rendering the taxpayer unable to maintain throughout the taxable year a normal inventory of the items involved, including evidence of the applicable inventory control figures for the beginning and the close of the taxable year submitted to the appropriate Federal agency in control of defense production (or if none, a statement to that effect), allotments applied for, allotments received, and reason for failure to place allotments received; (4) detailed proof of such circumstances to the extent that they may not be the subject-matter of common knowledge; (5) a full description of what efforts were made on the part of the taxpayer to effect replacement during the taxable year and the result of such efforts; and (6) in the case of an election made pursuant to an extension of time granted by the Commissioner, the circumstances relied upon as justifying the election at such time, together with a disclosure of the extent, if any, to which replacements have already been made.

(e) The election of the taxpayer to treat an involuntary decrease of inventory as subject to the replacement adjustments is to be exercised separately for each taxable year reflecting such a decrease and the election once exercised with respect to a given year, shall be irrevocable with respect to the particular decrease involved and its replacement, and shall be binding for the year of liquidation, the year of replacement, and all prior, intervening, and subsequent years to the extent that such prior, intervening, and subsequent years are affected by the adjustments authorized. The ultimate replacement and the resulting adjustment for the year of liquidation may have consequences, among others, in the earnings and profits of intervening years and the inventory accounts of subsequent years. They may have consequences in the prior years by reason of adjustments in net operating loss or unused excess profits credit carry-backs, and in intervening and subsequent taxable years by reason of adjustments in carry-overs. Adjustments are to be made for the several years affected consistent with the adjustments made for the year of liquidation. Detailed records shall be maintained such as will enable the Commissioner, in his examination of the taxpayer's returns for the year of replacement, readily to verify the extent of the inventory decrease claimed to be involuntary in character and the facts upon which such claim is based, all subsequent inventory increases and decreases, and all other facts material to the replacement adjustment authorized. For taxable years subject to the Internal Revenue Code of 1939, an election under § 39.22(d)-7(e) of Regulations 118 or § 29.22(d)-7 of Regulations 111 to have the involuntary liquidation and replacement provisions of section 22(d)(6) of the Internal Revenue Code of 1939 apply with respect to any inventory decrease for taxable years to which such section applies, shall be given the same effect as if such election had been made under this section. (See section 7807(b)(2).)

(f) Notwithstanding the ultimate purchase price or the cost of production ultimately incurred by the taxpayer in effecting replacement of a stock involuntarily liquidated, the merchandise reflecting the replacement shall be taken into purchases and included in the

closing inventory for the year of replacement, and shall be included in the inventories of subsequent taxable years, at the inventory cost figure of the merchandise replaced.

(g) The goods reflected in any inventory increase in a year subsequent to a year of involuntary liquidation, to the extent that they constitute items of the kind and description liquidated in prior years, whether or not in a year of involuntary liquidation, shall be deemed, in the order of their acquisition, as having been acquired by the taxpayer in replacement of like goods most recently liquidated and not previously replaced. In a case involving involuntary liquidations of goods of the same class subject to the provisions of both section 22(d)(6)(A) of the Internal Revenue Code of 1939 and section 1321 of the Internal Revenue Code of 1954, the involuntary liquidations of such goods subject to the provisions of section 1321 shall, for the purpose of replacements made in taxable years ending before January 1, 1953, be considered as having occurred prior to the involuntary liquidations of such goods subject to the provisions of section 22(d)-(6)(A) of the Internal Revenue Code of 1939. To the extent that the items of increase are allocated to items liquidated voluntarily, no adjustment will be required or permitted. Such replacement merchandise will be carried in the inventory at its actual cost of acquisition. To the extent that replacements are allocated to items involuntarily liquidated, however, the provisions of this section shall apply, both with respect to adjustments for the year of liquidation and other taxable years affected and with respect to inventory computations for the year of replacement and all subsequent taxable years.

(h) In some cases it may appear that, at the time of the filing of the income tax return for the year of replacement, or within three years thereafter, an adjustment with respect to the income or excess profits taxes for the year of the involuntary liquidation, or for some prior, intervening, or subsequent taxable year, is prevented by the running of the statute of limitatians, by the execution of a closing agreement, by virtue of a court decision which has become final, or by reason of some other provision or rule of law other than section 7122 (relating to compromises) and other than the inventory replacement provisions. The adjustments provided for in connection with the involuntary liquidation and replacement of inventory shall nevertheless be made, but only if, within a period of three years after the date of the filing of the income tax return for the year of replacement, a notice of deficiency is mailed or a claim for refund is filed. No credit or refund will be allowed under such circumstances, whether within or without such three-year period, in the absence of a claim for refund duly filed; nor will a resulting deficiency be assessed or collected under section 6213(d) relating to waivers of restrictions. The issuance of the statutory notice of deficiency or the filing of a claim for refund are statutory conditions upon which depend the provisions of section 22(d)(6)(E) of the Internal Revenue Code of 1939, referred to in section 1321(c) of the Internal Revenue Code of 1954. The adjustment authorized by section 22(d)(6)(E) of the Internal Revenue Code of 1939 is limited further to the tax attributable solely to the replacement adjustments. The amount of the adjustment shall be computed by reference to the amount of the tax

previously determined, and without regard to factors affecting the taxable year involved to which no effect was given in such prior determination. The tax previously determined shall be ascertained in accordance with the principles stated in section 452(d) of the Internal Revenue Code of 1939. Any deficiency paid or any overpayment credited or refunded under these circumstances shall not be subject to recovery on a claim for refund or a suit for the recovery of an erroneous refund in any case in which such claim or suit is based upon factors other than those giving rise to the adjustments made.

§ 1.1321-2 LIQUIDATION AND REPLACEMENT OF LIFO INVENTORIES BY ACQUIRING CORPORATIONS.—For additional rules in the case of certain corporate acquisitions referred to in section 381(a), see section 381(c)(5) and the regulations thereunder.

JUSTIN F. WINKLE,
Acting Commissioner of Internal Revenue.

Approved October 4, 1955.

H. CHAPMAN ROSE,
Acting Secretary of the Treasury.

(Filed by the Division of the Federal Register October 7, 1955, 8:49 a. m.)

SUBCHAPTER R.—ELECTION OF CERTAIN PARTNERSHIPS AND PROPRIETORSHIPS AS TO TAXABLE STATUS

SECTION 1361.—UNINCORPORATED BUSINESS ENTERPRISES ELECTING TO BE TAXED AS DOMESTIC CORPORATIONS

Rev. Rul. 55-465

Treasury Decision 6124, C. B. 1955-1, 719, provides that statements of election under the provisions of section 1361 of the Internal Revenue Code of 1954, whereby certain unincorporated business enterprises may elect to be taxed as domestic corporations, must contain certain specified information and commitments. However, with respect to the calendar year 1954, Treasury Decision 6124 was promulgated at such a late date (February 24, 1955) that there was apparently insufficient time for meeting its requirements within the 60 day period which section 1361(a) of the Code allows for the making of an election after the close of any taxable year. Accordingly, where taxpayers, for the calendar year 1954, have filed a timely statement of election under section 1361 of the Code which statement does not wholly conform to the requirements set forth in Treasury Decision 6124, such taxpayers will be afforded an opportunity to bring such statement into conformity with such requirements within a reasonable period of time, in no event to be later than the time allowed by paragraph 23(b)(3), as added to T. D. 6118, C. B. 1955-1, 698, by T. D. 6124, *supra*, for the perfecting of the election by the filing of a return or amended return, as the case may be, on Form 1120.

CHAPTER 2.—TAX ON SELF-EMPLOYMENT INCOME

SECTION 1402.—DEFINITIONS

(Also Part II, Section 481(a); Regulations 118, Section 39.481–1.) Rev. Rul. 55–431

Generally, when an individual accepts an occasional invitation to make a speech for which he receives an honorarium, he is not engaged in a trade or business for self-employment tax purposes. If, however, he seeks or otherwise indicates his availability for speaking engagements for which he receives lecture fees or other compensation and fills such engagements with reasonable regularity during the year, such activity would constitute a trade or business, the income from which is includible in computing net earnings from self-employment for purposes of the Self-Employment Contributions Act of 1954.

An inquiry has been received by the Internal Revenue Service relative to the status, for purposes of the Self-Employment Contributions Act of 1954 (chapter 2, subtitle A, Internal Revenue Code of 1954) of individuals, who make speeches for which they receive honorariums or lecture fees.

Section 1402 of the Act provides in part:

(a) NET EARNINGS FROM SELF-EMPLOYMENT.—The term "net earnings from self-employment" means the gross income derived by an individual from any trade or business carried on by such individual, less the deductions allowed by this subtitle [Subtitle A] which are attributable to such trade or business, * * *

* * * * * * *

(c) TRADE OR BUSINESS.—The term "trade or business", when used with reference to self-employment income or net earnings from self-employment, shall have the same meaning as when used in section 162, * * *.

Whether a certain activity constitutes engaging in a "trade or business" is dependent upon all the facts and circumstances in the particular case. As a general rule, when a person is regularly engaged in an occupation or profession for profit and as to such occupation or profession, is not regarded as an employee for purposes of the taxes imposed by the Federal Insurance Contributions Act or otherwise excluded from the self-employment provisions, he is engaged in a "trade or business." Thus, lecturing or speech making may or may not be a trade or business depending upon whether such engagements are carried on with a degree of regularity, whether the individual seeks or otherwise indicates his availability for speaking engagements, and whether he receives compensation for his services.

Accordingly, as a general rule, an individual who accepts an occasional invitation to make a speech for which he receives an honorarium is not engaged in a "trade or business." However, if he seeks or otherwise indicates his availability for speaking engagements for which he receives lecture fees or other compensation and fills such engagements with reasonable regularity during the year, such activity would constitute a "trade or business," the income from which is includible in computing net earnings from self-employment for purposes of the Self-Employment Contributions Act.

Regardless of whether such person is considered to be engaged in a trade or business as to such activity, the remuneration he receives constitutes taxable income to him even though designated as an honorarium.

[(Also Section 3121.) Rev. Rul. 55–538

X, an individual owner and lessee of farm lands, enters into agreements with other individuals, hereinafter referred to as share-farmers, pursuant to which the share-farmers undertake to produce a crop on *X*'s land. The crop produced by each share-farmer or the proceeds from the sale thereof, are to be divided between him and *X*. The amount of the share to be received by the share-farmer, depends on the amount of the crop which he produces. *Held*, (1) the share-farmers are not employees of *X* with respect to such undertakings but rather are independent contractors and self-employed individuals; (2) the shares received by the share-farmers pursuant to such agreements are includible in determining "net earnings from self-employment" and are subject to the provisions of the Self-Employment Contributions Act of 1954, as amended; and (3) the shares received by *X* pursuant to such agreements constitute rentals from real estate and, as such, are excluded from "net earnings from self-employment" for purposes of the Self-Employment Contributions Act of 1954, as amended.

Certain of these individuals work for *X* for a daily or hourly wage, and are subject to his direction and control, when there is little or no work to be done under their share agreements. *Held*, the individuals are, with respect to such services, employees of *X* for purposes of the Federal Insurance Contributions Act.

The Internal Revenue Service has been requested to determine the status, for purposes of the Federal Insurance Contributions Act and the Self-Employment Contributions Act of 1954 (chapter 21, subtitle C, and chapter 2, subtitle A, Internal Revenue Code of 1954), as respectively amended by the Social Security Amendments of 1954, of *X*, an individual owner and lessee of farm lands, and of other individuals, commonly known as share-farmers, who enter into agreements with him to produce crops on land owned or leased by *X* in return for a share of the crops produced or of the proceeds from their sale. *X* raises crops on tracts of land other than those assigned to the share-farmers and hires regular employees whose status is not in question to carry on such operations for him.

The share-farmers are engaged under oral contracts for a crop year and each is allowed to select his tract from those available, with due consideration being given to such factors as the number of workers in his family, the size of the house available for use as a residence, etc. Each share-farmer is offered the use of a garden plot and is allowed to keep livestock and poultry on his premises.

Under the terms of each contract, *X* agrees to furnish and plant the seed and to furnish the equipment and livestock needed for the planting and cultivating operations. Each share-farmer agrees to pay a proportionate share of the costs of the fertilizer and insecticides used on his tract, and to perform, or pay for, the labor necessary for cultivating, raising, and harvesting the crops. *X* and the share-farmers also agree as to the type of crops to be grown; the location of areas to be planted; the duties of, or services to be rendered by, each party; and the amount to be advanced to the share-farmer during the planting, growing, and harvesting seasons, and the interest to be paid thereon.

X determines the time for planting. A foreman or other representative of *X* periodically inspects the area assigned to each share-farmer for the purpose of determining whether he is properly caring for the area and discharging his duties. Upon mutual agreement,

cultivating or harvesting, or both, may be done by *X*'s regular employees, in which case appropriate charges are made against the share-farmer's account. The crops grown by the share-farmer are sold by *X*, the advances and other charges are deducted from the share-farmer's share of the proceeds, and the remainder is paid to him in cash.

In addition, some of the share-farmers work for *X* for a daily or hourly wage when there is little or no work to be done under their share agreements.

The Internal Revenue Code of 1954, as amended by the Social Security Amendments of 1954, extended the application of the tax on self-employment income to farm operators effective with respect to taxable years ending after December 31, 1954. Section 1402(a)(1) was also amended to provide specifically that there shall be excluded from net earnings from self-employment "rentals paid in crop shares" unless such rentals are received in the course of a trade or business as a real estate dealer.

It is the position of the Service that an individual who enters into a crop-sharing agreement with another person is an independent contractor and not an employee if (1) he undertakes to produce a crop or livestock on land owned or leased by such other person; (2) the crop or livestock produced, or the proceeds thereof, are to be divided between the individual and such other person; and (3) the amount of such individual's share depends on the amount of the crop or livestock produced. In connection with the treatment of the respective shares of the landowner and the share-farmer under such an agreement, it is the position of the Service (1) that the share received by the share-farmer is includible in determining his "net earnings from self-employment"; and (2) that the share received by the landowner constitutes rentals from real estate and, as such, is excluded from net earnings from self-employment under section 1402(a)(1) of the Self-Employment Contributions Act of 1954, as amended.

In accordance with the above-stated interpretation, it is held that the individuals engaged in producing crops pursuant to the agreements between them and *X* considered herein are, with respect to such undertakings, not employees of *X* but independent contractors and self-employed individuals. The amount received by the share-farmer for producing the crops under his share agreement with *X* is includible in determining his "net earnings from self-employment" and is subject to the provisions of the Self-Employment Contributions Act of 1954, as amended.

It is further held that, with respect to the services performed by the individuals for *X* for a daily or hourly wage, *X* exercises or has the right to exercise over such individuals the control necessary to establish the relationship of employer and employee for Federal employment tax purposes.

Insofar as *X*'s self-employment tax liability is concerned, the amounts received by him under his share arrangements with his share-farmers are considered to be rentals from real estate and consequently are to be excluded by him in computing his "net earnings from self-employment." However, the proceeds of the crops produced by *X* on the land farmed for him by his regular employees are includible in

determining his "net earnings from self-employment" and are subject to the provisions of the Self-Employment Contributions Act of 1954, as amended.

The rules stated above as to the status of share-farmers under the Federal Insurance Contributions Act, as amended by the Social Security Amendments of 1954, also are applicable for determining the status of such individuals under the Federal Insurance Contributions Act, as amended by the Social Security Act Amendments of 1950.

(Also Part II, Section 481(a); Regulations 118, Section 39.481–1.) Rev. Rul. 55-559

Income received by an individual, who is not a real estate dealer, from the rental of space in an office building constitutes rentals from real estate and is excluded in computing net earnings from self-employment for purposes of the Self-Employment Contributions Act of 1954, where no services are rendered to the occupants of the property.

An inquiry has been received relative to the treatment for purposes of the Self-Employment Contributions Act of 1954 (chapter 2, subtitle A, Internal Revenue Code of 1954) of income received by an individual from the rental of space in an office building.

In the instant case, an individual owns an office building from which he derives income from the rental of space. The building is not held for sale in the course of a trade or business as a real estate dealer, but is held solely for investment purposes. He provides heat, water and electricity to the occupants of the building, as well as a trash and garbage collection service, and he employs a full-time janitor.

Section 1402(a)(1) of the Code provides that in computing net earnings from self-employment, rentals from real estate and from personal property leased with the real estate, together with deductions attributable thereto, shall be excluded unless such rentals are received in the course of a trade or business as a real estate dealer.

Since the individual in the instant case is not in a trade or business as a real estate dealer, any income which he receives from the operation of the office building which constitutes "rentals from real estate" is not to be included in computing net earnings from self-employment.

In defining rentals from real estate, section 39.481(c)(1) of Regulations 118, applicable to the provisions of the Internal Revenue Code of 1954 by virtue of T. D. 6091, C. B. 1954–2, 47, provides that payments for the use or occupancy of rooms or other space where services are also rendered to the occupant, such as for the use or occupancy of rooms or other quarters in hotels, boarding houses, etc., do not constitute rentals from real estate and, consequently, such payments are included in determining net earnings from self-employment. Generally, services are considered rendered to the occupant if they are primarily for his convenience and are other than those usually or customarily rendered in connection with the rental of rooms or other space for occupancy only, such as maid service. However, the furnishing of heat and light, the cleaning of public entrances, exits, stairways and lobbies, the collection of trash, and so forth, are not considered as services rendered to the occupant.

In the instant case, the furnishing of such items at heat, water and electricity, as well as a trash and garbage collection service, to the occupants of offices in the building does not constitute services rendered to the occupants as contemplated by the regulations referred to above, notwithstanding the fact that a janitor is employed by the building owner on a full-time basis.

Accordingly, it is held that income received by an individual, who is not a real estate dealer, from the rental of space in an office building constitutes rentals from real estate and is excluded in computing net earnings from self-employment for purposes of the Self-Employment Contributions Act of 1954, where no services are rendered to the occupants thereof.

Income from carpentry and masonry services. See Rev. Rul. 55-582, page 403.

CHAPTER 3.—WITHHOLDING OF TAX ON NONRESIDENT ALIENS AND FOREIGN CORPORATIONS AND TAX-FREE COVENANT BONDS

SUBCHAPTER A.—NONRESIDENT ALIENS AND FOREIGN CORPORATIONS

SECTION 1441.—WITHHOLDING OF TAX ON NONRESIDENT ALIENS

(Also Section 1442.) Rev. Rul. 55-482
(Also Part II, Sections 143, 144; Regulations 118, Sections 39.143-1, 39.144-1.)

Revenue Ruling 54-475, C. B. 1954-2, 11, insofar as it relates to the treatment of copyright royalties under the United States-Canada income tax convention, is modified.

Reconsideration has been given Rev. Rul. 54-475, C. B. 1954-2, 11. The chart contained therein indicates that under the United States-Canada income tax convention, Treasury Decision 6047, C. B. 1953-2, 59, copyright royalties are subject to withholding at the rate of 15 percent. Article XIII C of the convention reads as follows:

Royalties for the right to use copyrights or in respect of the right to produce or reproduce any literary, dramatic, musical, or artistic work (but not inclusive of rents or royalties in respect of motion picture films) derived from sources within one of the contracting States by a resident or corporation or other entity of the other contracting State not engaged in trade or business in the former State through a permanent establishment shall be exempt from tax imposed by such former State.

Accordingly, the royalties column opposite Canada in Rev. Rul. 54-475, *supra*, is hereby modified to eliminate in that column reference to footnote 2 and substitute therefor a reference to footnote 13. There is added a new footnote 13 which reads as follows:

[13] Copyright royalties are exempt from tax and withholding provided the taxpayer has no permanent establishment in the United States.

Release of excess tax withheld, and exemption from, or reduction in rate of, withholding tax at source in the case of residents of the Netherlands Antilles, as affected by the income tax convention between the United States and the Netherlands. See T. D. 6153, page 777.

SECTION 1442.—WITHHOLDING OF TAX ON FOREIGN CORPORATIONS

Release of excess tax withheld, and exemption from, or reduction in rate of, withholding of tax at source in the case of Netherlands Antilles corporations, as affected by the income tax convention between the United States and the Netherlands. See T. D. 6153, page 777.

Treatment of copyright royalties under the United States-Canada income tax convention, Treasury Decision 6047, C. B. 1953–2, 59. See Rev. Rul. 55–482, page 316.

CHAPTER 6.—CONSOLIDATED RETURNS

SUBCHAPTER A.—RETURNS AND PAYMENT OF TAX

SECTION 1501.—PRIVILEGE TO FILE CONSOLIDATED RETURNS

26 CFR 1.1501–1: Privilege to file consolidated returns. T. D. 6140[1]

(Also Sections 1502, 1503, 1504, 1551, 1552; 26 CFR 1.1502–1 through 1.1502–3, 1.1502–10 through 1.1502–19, 1.1502–30 through 1.1502–50, 1.1503–1, 1.1504–1, 1.1551–1, 1.1552–1.)

TITLE 26—INTERNAL REVENUE, 1954.—CHAPTER I, SUBCHAPTER A, PART 1.—INCOME TAX; TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1953

Regulations under subchapter A of chapter 6 relating to returns and payment of tax (consolidated returns), and subchapter B, related rules, of the Internal Revenue Code of 1954.

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

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

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[1] 20 F. R. 6319.

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Authority: Secs. 1.1501 to 1.1505, incl., issued under secs. 1502, 7805, I. R. C. 1954; secs. 1.1551 to 1.1551–1, incl., issued under sec. 7805, I. R. C. 1954; secs. 1.1552 to 1.1552–1, incl., issued under secs. 1552, 7805, I. R. C. 1954; 68A Stat. 367, 371, 917; 26 U. S. C. 1502, 1552, 7805.

On July 2, 1955, notice of proposed rulemaking regarding the regulations for taxable years beginning after December 31, 1953, and ending after August 16, 1954, except where otherwise provided, under chapter 6 (relating to consolidated returns) of the Internal Revenue Code of 1954 was published in the Federal Register (20 F. R. 4719).

After consideration of all such relevant matter as was presented by interested persons regarding the rules proposed, the following regulations are hereby adopted:

SEC. 1.1501. STATUTORY PROVISIONS; PRIVILEGE TO FILE CONSOLIDATED RETURNS.

SEC. 1501. PRIVILEGE TO FILE CONSOLIDATED RETURNS.

An affiliated group of corporations shall, subject to the provisions of this chapter, have the privilege of making a consolidated return with respect to the income tax imposed by chapter 1 for the taxable year in lieu of separate returns. The making of a consolidated return shall be upon the condition that all corporations which at any time during the taxable year have been members of the affiliated group consent to all the consolidated return regulations prescribed under section 1502 prior to the last day prescribed by law for the filing of such return. The making of a consolidated return shall be considered as such consent. In the case of a corporation which is a member of the affiliated group for a fractional part of the year, the consolidated return shall include the income of such corporation for such part of the year as it is a member of the affiliated group.

SEC. 1.1501-1. PRIVILEGE TO FILE CONSOLIDATED RETURNS.—For regulations relating to the privilege of filing consolidated returns, see section 1.1502-0 and following. For convenience, the several sections of the regulations under section 1502 have to the extent practicable, been given numbers corresponding, respectively, to the section numbers of prior consolidated returns regulations but preceded by the code number 1.1502.

SEC. 1.1502. STATUTORY PROVISIONS; REGULATIONS.

SEC. 1502. REGULATIONS.

The Secretary or his delegate shall prescribe such regulations as he may deem necessary in order that the tax liability of any affiliated group of corporations making a consolidated return and of each corporation in the group, both during and after the period of affiliation, may be returned, determined, computed, assessed, collected, and adjusted, in such manner as clearly to reflect the income-tax liability and the various factors necessary for the determination of such liability, and in order to prevent avoidance of such tax liability.

SEC. 1.1502-0 INTRODUCTORY.—The regulations prescribed under section 1502 of the Internal Revenue Code of 1954 are applicable in the case of all corporations (with certain statutory exceptions) to taxable years beginning after December 31, 1953 and ending after August 16, 1954, and with respect to such taxable years, the regulations under section 1502 supersede Regulations 129. Any provision of the regulations under such section, the applicability of which is stated in terms of a specific date (occurring after December 31, 1953) or in terms of taxable years ending after a specific date (occurring after December 31, 1953), shall apply to taxable years ending after such specific date. Each such provision shall in the case of a taxable year subject to Regulations 129, be deemed included in Regulations 129 but shall be applicable only to taxable years ending after such specific date. The provisions of Regulations 129, superseded by provisions of the regulations under section 1502, the applicability of which is stated in terms of a specific date (occurring after December 31, 1953) shall be deemed to be included in the regulations under such section but shall be applicable only to the period prior to the taking effect of the corresponding provision of the regulations under such section.

SEC. 1.1502-1. PRIVILEGE OF MAKING CONSOLIDATED RETURNS.—(a) Section 1501 gives to the corporations of an affiliated group the privilege of making a consolidated income tax return for the taxable year in lieu of separate returns. This privilege is given, however, upon the condition that all corporations which have been members of the affiliated group at any time during the taxable year for which the return is made consent to the regulations under section 1502 applicable to such taxable year and any amendments thereof duly prescribed prior to the last day prescribed by law for the filing of the return; and the making of the consolidated return is considered as such consent.

(b) With respect to a taxable year to which Regulations 129, as amended by the regulations under section 1502 is applicable, the regulations to which consent is made are those in Regulations 129, as amended, and as further amended by the regulations under such section. With respect to a taxable year to which the regulations under section 1502 are applicable, the regulations to which consent is made are the regulations under such section as changed to the extent that portions of Regulations 129 are applicable. For example, in the case of a fiscal year ending October 31, 1954, the Internal Revenue Code of 1939 and Regulations 129 are applicable to a consolidated return filed for such year. In such case, if the first distribution in pursuance of a plan of complete liquidation of a member of the affiliated group occurs on or after June 22, 1954, section 1.1502-38 is applicable in lieu of section 24.38 of Regulations 129. On the other hand, if such a distribution occurs before June 22, 1954, section 24.38 of Regulations 129 is applicable. Similarly in the case of a return filed for the calendar year 1954, the Internal Revenue Code of 1954 and the regulations under section 1502 are applicable. In such case, if the first distribution in pursuance of a plan of complete liquidation of a member of the affiliated group occurs prior to June 22, 1954, section 24.38 of Regulations 129 is applicable in lieu of section 1.1502-38. If such distribution occurs on or after June 22, 1954, section 1.1502-38 is applicable.

(c) The last day prescribed by law for the filing of the return includes the last day of the period of any extension of time granted by the Commissioner.

(d) The tax liability of the members of the affiliated group for the taxable year involved will be determined in accordance with the provisions of the regulations to which consent is given and without regard to any changes of the rules therein prescribed made subsequent to the last day prescribed by law for the filing of the return for such year.

SEC. 1.1502-2. DEFINITIONS—(a) *Code.*—The term "Code" means the Internal Revenue Code of 1954 and the sections of statutory law referred to in the regulations under section 1502 unless otherwise stated, are sections of that Code.

(b) *Affiliated group.*—(1) the term "affiliated group" is defined in section 1504 and includes the common parent corporation and every other corporation for the period during which such corporation is a member of the affiliated group within the meaning of such section. It does not include any corporation which is not an "includible cor-

poration" as defined by section 1504(b). An includible corporation is defined by such section to mean any corporation, except—

(i) A corporation exempt under section 501 from the taxes imposed by subtitle A;

(ii) An insurance company subject to taxation under section 802 or 821 (except as provided in section 1504 (c));

(iii) A foreign corporation (except as provided in section 1504 (d));

(iv) A corporation entitled to the benefits of section 931 by reason of receiving a large percentage of its income from sources within possessions of the United States;

(v) A corporation organized under the China Trade Act, 1922;

(vi) A regulated investment company subject to tax under subchapter M of chapter 1; and

(vii) An unincorporated business enterprise subject to tax as a corporation under section 1361.

The consolidated income tax return must include every includible corporation which, under the provisions of section 1504, is a member of the affiliated group. No corporation which is connected by stock ownership with an affiliated group of includible corporations through a nonincludible corporation may be included in the consolidated return of such group. In no case may a consolidated return be filed by subsidiary corporations as an affiliated group unless the common parent corporation through which the subsidiaries are connected is a member of the group. For instance, there will not be recognized as an affiliated group two domestic industrial corporations, the common parent corporation of which is a regulated investment company subject to tax under subchapter M of chapter 1.

(2) An insurance company subject to tax under section 831 is an includible corporation and may be included in an affiliated group, together with corporations other than insurance companies taxable under section 802 or 821. Insurance companies subject to tax under section 802 or 821 are not includible corporations under section 1504(b). Under section 1504(c), however, a domestic insurance company taxable under section 802 may be included in an affiliated group comprised solely of other domestic insurance companies taxable under section 802; it may not be included in an affiliated group with other corporations. An affiliated group of domestic insurance companies taxable under section 802 may not include a domestic insurance company taxable under section 821 or 831.

(3) In the case of a domestic corporation owning or controlling, directly or indirectly, 100 percent of the capital stock (exclusive of directors' qualifying shares) of a corporation organized under the laws of Canada or of Mexico and maintained solely for the purpose of complying with the laws of such country as to title and operation of property, such foreign corporation may, at the option of the domestic corporation, be treated for income tax purposes as a domestic corporation. The option to treat such foreign corporation as a domestic corporation so that it may be included in a consolidated return must be exercised at the time of making the consolidated return, and cannot be exercised at any time thereafter. If the election is exercised

to treat such foreign corporation as a domestic corporation, it must be included in the consolidated return of the affiliated group of which it is a member for each consecutive year thereafter for which such group makes or is required to make a consolidated return.

(4) An affiliated group of corporations, within the meaning of section 1504 of the Code, is formed at the time that the common parent corporation, which is an includible corporation, becomes the owner directly of stock possessing at least 80 percent of the voting power of all classes of stock and at least 80 percent of each class of nonvoting stock (not including nonvoting stock which is limited and preferred as to dividends) of another includible corporation; a corporation becomes a member of such an affiliated group at the time that one or more members of such group become the owners directly of stock possessing at least 80 percent of the voting power of all classes of its stock and at least 80 percent of each class of its nonvoting stock (not including nonvoting stock which is limited and preferred as to dividends); and a corporation ceases to be a member of such an affiliated group at the time that the members of such group cease to own directly stock possessing at least 80 percent of the voting power of all classes of its stock, or at least 80 percent of each class of its nonvoting stock (not including nonvoting stock which is limited and preferred as to dividends).

(c) *Consolidated return period.*—The term "consolidated return period" means the taxable year 1929, or any subsequent taxable year, for which a consolidated return is made or is required, income tax return, excess profits tax return, or both, including the period during which a subsidiary corporation is engaged in distributing its assets in liquidation.

(d) *Subsidiary.*—The term "subsidiary" means a corporation (other than the common parent corporation) which is a member of the affiliated group during any part of the consolidated return period.

(e) *Tax.*—The term "tax" means any tax imposed by chapter 1 of subtitle A, and includes any interest, penalty, additional amount, or addition to the tax, payable in respect thereof.

(f) *Terms defined in Internal Revenue Code.*—Terms which are defined in the Code shall, when used in the regulations under section 1502 have the meaning assigned to them by the Code, unless specifically otherwise defined.

(g) *Regulated public utility.*—(1) The term "regulated public utility" means a corporation described in section 1503(c). It includes a corporation (i) whose operations are an integral part of the furnishing or sale of a product or service described in such section by an interconnected and coordinated public utility system or systems and (ii) whose rates for furnishing products or services to the system or systems are established or approved by a regulatory body described in section 1503(c)(1). For the purpose of determining whether or not 80 percent of the gross income of the corporation is from the furnishing or sale of such product or service, income received in consideration for the product or service described shall include only income received directly therefrom and income from the furnishing or sale of byproducts and residual products which are directly necessary and incidental to the furnishing of such product or service. In determining under (i) whether the operations of a particular corporation

constitute an integral part of the "furnishing or sale" of a product or service described in section 1503(c), the income of a corporation shall be deemed to be from such source only to the extent that it is in consideration for necessary processing of either the product described in section 1503(c) or the essential facilities used in making available to customers such product or service.

SEC. 1.1502–3. APPLICABILITY OF OTHER PROVISIONS OF LAW.—Any matter in the determination of which the provisions of the regulations under section 1502 are not applicable shall be determined in accordance with the provisions of the Code or other law applicable thereto.

ADMINISTRATIVE PROVISIONS

SEC. 1.1502–10. EXERCISE OF PRIVILEGE—(a) *When privilege must be exercised.*—The privilege of making a consolidated return under section 1502 for any taxable year of an affiliated group must be exercised at the time of making the return of the common parent corporation for such year. For this purpose, the return is considered as made on the due date of such return (including any extensions of time granted by the Commissioner), regardless of the actual previous date of filing. Under no circumstances can such privilege be exercised at any time thereafter. The filing of separate returns for a taxable year does not constitute an election binding upon the corporation in subsequent years. If the privilege is exercised at the time of making the return, separate returns cannot thereafter be made for such year. (See, however, section 1.1502–18, relating to failure to comply with the regulations under section 1502.)

(b) *Effect of tentative returns.*—In no case will the privilege under paragraph (a) be considered as exercised at the time of making a so-called "tentative return" (made, for example, in order to obtain an extension of time for making the return required by law). However, if any such tentative return is made upon the basis of a consolidated return or a separate return, the return required by law must be made upon the same basis, unless upon the making of the return required by law (either a separate return or a consolidated return, as the case may be) the payments theretofore made and to be made are adjusted in a manner satisfactory to the Commissioner.

(c) *Estimated tax.*—(1) Except as provided in (2), the provisions of section 6016 (relating to declarations of estimated tax by corporations) and section 6154 (relating to payments of estimated tax by corporations) shall be applicable to the several members of an affiliated group in the same manner and to the same extent as in the case of corporations filing separate returns, whether or not such affiliated group files a consolidated return. The declaration of estimated tax shall be filed and payments shall be made to the director for the district prescribed for the filing of a separate income tax return in the case of each member of the group required to file a declaration of estimated tax. If a consolidated return is filed, the amounts of any payments made with respect to the consolidated return period shall be credited against the tax liability of the affiliated group with respect to the consolidated return period.

(2) If the affiliated group intends to file a consolidated return for the taxable year, the common parent corporation may file a declaration

of estimated tax for the group. In such case, all of the several members of the affiliated group shall be treated for the purpose of applying the provisions of sections 6016 and 6154 as a single corporation. Where such a declaration is filed, each subsidiary shall notify the director for the district prescribed for the filing of a separate income tax return by such subsidiary that its estimate is included in the declaration made by the common parent corporation. If the affiliated group does not file a consolidated return for the year for which such a declaration is filed, the payments made with respect to such declaration shall be apportioned among the several members of the group in the manner designated by the common parent corporation for the purpose of determining any addition to the tax provided by section 6655.

(3) In any case in which an affiliated group has made payments with respect to a declaration made on a group basis and such group does not file a consolidated return for the taxable year, the payments made thereon shall be applied against the tax liability of the members of the group in a manner satisfactory to the Commissioner.

(4) See section 1.1502–15 (relating to liability for tax) and section 1.1502–49 (relating to additions to tax for failure to pay estimated tax).

SEC. 1.1502–11. CONSOLIDATED RETURNS FOR SUBSEQUENT YEARS—(a) *Consolidated returns required for subsequent years.*—If a consolidated return is made under section 1502 for any taxable year, 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 group) has become a member of the group during such subsequent taxable year, or (2) subsequent to the exercise of the election to make consolidated returns, subtitle A of the Code to the extent applicable to corporations, or the regulations under section 1502 which have been consented to, have been amended and any such amendment is of a character which makes substantially less advantageous to affiliated groups as a class the continued filing of consolidated returns, regardless of the effective date of such amendment, 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. For the purpose of (2), above, the expiration of a provision shall be considered as an amendment to the Code made on the date of such expiration.

(b) *Effect of separate returns when consolidated return is required.*—If the making of a consolidated return is required for any taxable year, the tax liability of the members of the affiliated group shall be computed in the same manner as if a consolidated return had been made, even though separate returns are made; amounts assessed upon the basis of separate returns shall be considered as having been assessed upon the basis of a consolidated return; and amounts paid upon the basis of separate returns shall be considered as having been paid by the common parent corporation. In such cases the making of separate returns shall not be considered as the making of a return for the purpose of computing any period of limitation or any deficiency. If a consolidated return for such taxable year is thereafter made, such return shall, for the purpose of computing periods of limitation and any deficiency, be considered as the return for such year.

(c) *When affiliated group remains in existence.*—For the purpose of the regulations under section 1502, an affiliated group shall be considered as remaining in existence if the common parent corporation remains as a common parent and at least one subsidiary remains affiliated with it, whether or not such subsidiary was a member of the group at the time the group was formed and whether or not one or more corporations have become subsidiaries or have ceased to be subsidiaries at any time after the group was formed.

(d) *When affiliated group terminates.*—For the purpose of the regulations under section 1502, an affiliated group shall be considered as terminated if the common parent corporation ceases to be the common parent or if there is no subsidiary affiliated with it.

SEC. 1.1502–12. MAKING CONSOLIDATED RETURN AND FILING OTHER FORMS—(a) *Consolidated return made by common parent corporation.*—A consolidated return shall be made on Form 1120 by the common parent corporation for the affiliated group. Such return shall be filed at the time, and in the office of the Director of Internal Revenue for the district prescribed for the filing of a separate return by such common parent corporation.

(b) *Authorizations and consents.*—Each subsidiary must prepare duplicate originals of Form 1122, consenting to the regulations under section 1502 and authorizing the common parent corporation to make a consolidated return on its behalf for the taxable year and authorizing the common parent (or, in the event of its failure, the Commissioner or the district director) to make a consolidated return on its behalf (as long as it remains a member of the affiliated group), for each year thereafter for which, under section 1.1502–11(a), the making of a consolidated return is required. One of such forms, as prepared by each subsidiary shall be attached to the consolidated return, as a part thereof; and the other shall be filed, at or before the time the consolidated return is filed, in the office of the director for the district prescribed for the filing of a separate return by such subsidiary. No such consent can be withdrawn or revoked at any time after the consolidated return is filed.

(c) *Affiliations schedule filed by common parent corporation.*—The common parent corporation shall prepare Form 851 (Affiliations Schedule), which shall be attached to and made a part of the consolidated return.

(d) *Persons qualified to execute returns and forms.*—Each return or form required to be made or prepared by a corporation must be executed by the person authorized under section 6062 to execute returns of separate corporations. In cases where receivers or trustees in bankruptcy are operating the property or business of corporations, each return or form required to be made or prepared by such corporation must be executed by the receiver or trustee, as the case may be, pursuant to an order or instructions of the court, and be accompanied by a copy of such order or instructions.

(e) *Signatures in case subsidiary has left affiliated group.*—Since Form 1122 is required even though, during the taxable year of the common parent corporation, the subsidiary (because of a dissolution or sale of stock, or otherwise) has ceased to be a member of the affiliated group, it may be advisable for the common parent to obtain the proper signatures to the form prior to the time the subsidiary ceases to be a member of the group.

SEC. 1.1502-13. CHANGE IN AFFILIATED GROUP DURING TAXABLE YEAR.[1]—(a) *General rule.*—Except as hereinafter provided, a consolidated return must include the income of the common parent corporation and of each subsidiary for the entire taxable year of the affiliated group.

(b) *Formation of affiliated group after beginning of year.*—If an affiliated group is formed after the beginning of the taxable year of the corporation which becomes the common parent corporation, the consolidated return must include the income of the common parent for its entire taxable year (excluding any portion of such year during which its income is included in the consolidated return of another affiliated group) and the income of each subsidiary from the time it became a member of the affiliated group.

(c) *Complete termination of affiliated group prior to close of taxable year.*—If an affiliated group is terminated prior to the close of the taxable year of the group, the consolidated return must include the income of the common parent corporation for its entire taxable year (excluding any portion of such year during which its income is included in the consolidated return of another affiliated group) and of each subsidiary for the period prior to the termination. (See paragraphs (c) and (d) of section 1.1502-11 in determining whether the group has terminated.)

(d) *Addition to affiliated group of a subsidiary during year.*—If a corporation becomes a member of the affiliated group during the taxable year of the group, the consolidated return must include its income from the time when it became a member of the group.

(e) *Elimination from affiliated group of a subsidiary during year.*—If a subsidiary ceases to be a member of the affiliated group during the taxable year of the group, the consolidated return must include its income for the period during which it was a member of the group.

(f) *Period of 30 days or less may be disregarded.*—A subsidiary may at its option be considered as having been a member of the affiliated group during the entire taxable year of the group (or during the entire period of the existence of the subsidiary, whichever is shorter) if the period during which it was not a member of such group does not exceed 30 days. If a corporation has been a member of the affiliated group for a period of less than 31 days during the taxable year of the group, it may at its option be considered as not having been a member of the group during the taxable year. An option under this paragraph must be exercised at the time the consolidated return is made.

(g) *Separate returns for periods not included in consolidated return.*—If a corporation, during its taxable year (determined without regard to the affiliation), becomes a member of an affiliated group, its income for the portion of such taxable year not included in the consolidated return of such group must be included in a separate return (or, if a member of another affiliated group which makes a consolidated return for such period, then in such consolidated return). If a corporation ceases to be a member of the affiliated group during the taxable year of the group, its income for the period after

[1] This section has no bearing upon the question whether a consolidated return may or must be made, but relates only to the effect of changes in the affiliated group during the taxable year.

the time when it ceased to be a member of the group must be included in a separate return (or, if it becomes a member of another affiliated group which makes a consolidated return for such period, then in such consolidated return).

(h) *Time for making separate returns for periods not included in consolidated return.*—If a corporation, during its taxable year (determined without regard to the affiliation, becomes a member of an affiliated group, the separate return required for the portion of such taxable year during which it was not a member of the group must be made on or before the 15th day of the third month following the close of its taxable year (determined without regard to the affiliation). For example, Corporation P, reporting its income on a calendar year basis, acquires on January 1, 1954, all the stock of Corporation S, which reports its income on a fiscal year basis ending March 31. P and S elect to make a consolidated return for the calendar year 1954. The separate return of S for the taxable period April 1, 1953, to December 31, 1953, should be made on or before June 15, 1954.

SEC. 1.1502–14. ACCOUNTING PERIOD OF AN AFFILIATED GROUP.—(a) The taxable year of an affiliated group which makes a consolidated return shall be the same as the taxable year of the common parent corporation; and, upon having elected to file a consolidated return, each subsidiary corporation shall, not later than the close of the first consolidated taxable year ending thereafter, adopt an annual accounting period, fiscal year or calendar year as the case may be, in conformity with that of the common parent.

(b) If a change of accounting period is necessary in order to conform the accounting periods of the common parent and of its subsidiaries, Form 1128 shall be submitted at or before the time of filing the consolidated return for the taxable year in which the subsidiary has first adopted the parent corporation's annual accounting period.

(c) With respect to computations for years involved in the change to the consolidated basis, see section 1.1502–32.

SEC. 1.1502–15. LIABILITY FOR TAX—(a) *Several liability of members of affiliated group.*—Except as provided in paragraphs (b) and (c) of this section, the common parent corporation and each subsidiary, a member of the affiliated group during any part of a consolidated return period, shall be severally liable for the tax (including any deficiency in respect thereof) computed as provided in section 1.1502–30, and for any addition to the tax computed as provided in section 1.1502–49 for underpayment of estimated tax for the consolidated return period.

(b) *Liability of a corporation in bankruptcy or receivership.*—If, at the time of filing a consolidated return, one or more, but not all, of the members of the affiliated group are in bankruptcy under the laws of the United States or in receivership in any court of the United States or of any State, Territory, or the District of Columbia, then the liability under paragraph (a) of each such member of the group with respect to the period covered by such return shall not exceed such portion of the consolidated tax liability for such period as the several corporations included in the consolidated return may, subject to the approval of the Commissioner, agree upon, or, in the absence of such an agreement, an amount equal to its liability for such year computed as if a separate return had been filed.

(c) *Liability of subsidiary after withdrawal.*—If a subsidiary has ceased to be a member of the affiliated group, its liability under paragraph (a) shall remain unchanged, except that if such cessation occurred prior to the date upon which any deficiency is assessed and resulted from a bona fide sale of stock for fair value, the Commissioner may, if he believes that the assessment or collection of the balance of the deficiency will not be jeopardized, make assessment and collection of such deficiency from such former subsidiary in an amount not exceeding the portion thereof allocable to it upon the basis of income used in the computations, respectively, of the normal tax, the surtax, and any other tax imposed by chapter 1 of subtitle A included in such deficiency.

(d) *Effect of intercompany agreements.*—Any agreement entered into by one or more members of the affiliated group with any other members of such group or with any other person shall in no case have the effect of reducing the liability prescribed under this section.

(e) *Liability of transferee not affected.*—This section shall not be considered as extinguishing or diminishing any liability, at law or in equity, of a transferee of property of a taxpayer, including any liability under any provision of law, State or Federal, relating to liabilities pursuant to corporate dissolution or transfer or distribution of assets, whether or not in connection with a merger or consolidation.

SEC. 1.1502–16. COMMON PARENT CORPORATION AGENT FOR SUBSIDIARIES.—(a) *Scope of agency of common parent corporation.*—Except as provided in paragraphs (b) and (c) of this section—

> The common parent corporation shall be for all purposes (other than the making of the subsidiary consent required by section 1.1502–12(b)) in respect of the tax for the taxable year for which a consolidated return is made or is required, the sole agent, duly authorized to act in its own name in all matters relating to such tax, for each corporation which during any part of such year was a member of the affiliated group. The corporations, other than the common parent, shall not have authority to act for or to represent themselves in any such matter. For example, all correspondence will be carried on directly with the common parent; notices of deficiencies will be mailed only to the common parent, and the mailing to the common parent shall be considered as a mailing to each such corporation; notice and demand for payment of taxes will be given only to the common parent, and such notice and demand shall be considered as a notice and demand to each such corporation; the common parent will file petitions and conduct proceedings before The Tax Court of the United States, and any such petition shall be considered as having also been filed by each such corporation; the common parent will file claims for refund or credit; refunds will be made directly to and in the name of the common parent and will discharge any liability of the Government in respect thereof to any such corporation; and the common parent in its name will give waivers, give bonds, and execute closing agreements, offers in compromise, and all other documents, and any waiver or bond so given, or agreement, offer in compromise, or any other document so executed, shall be considered as having also been given or executed

by each such corporation. Notwithstanding the provisions of this paragraph, however, any notice of deficiency, in respect of the tax for a consolidated return period, will name each corporation which was a member of the affiliated group during any part of such period, and any assessment (whether of the original tax or of a deficiency) will be made in the name of each such corporation (but a failure to include the name of any such corporation will not affect the validity of the notice of deficiency or the assessment as to the other corporations); any notice and demand for payment will name each corporation which was a member of the affiliated group during any part of such period (but a failure to include the name of any such corporation will not affect the validity of the notice and demand as to the other corporations); and any levy (or warrant or notice in respect thereof), any notice of a lien, or any other proceedings to collect the amount of any assessment, after the assessment has been made, will name the corporation from which such collection is to be made. The provisions of this paragraph shall apply whether or not a consolidated return is made for any subsequent year, and whether or not one or more subsidiaries have become or have ceased to be members of the group at any time. Notwithstanding the provisions of this paragraph, the Commissioner may, if he deems it advisable, deal directly with any member of the group in respect of its liability, in which event such member shall have full authority to act for itself.

(b) *Effect of withdrawal of subsidiary.*—For the purpose of the assertion, assessment, and collection of any deficiency, and of a credit or refund of any amount paid by a former subsidiary as a deficiency determined under section 1.1502-15(c), but for no other purpose, the agency of the common parent corporation in respect of any subsidiary which has ceased to be a member of the affiliated group shall be terminated upon the expiration of 30 days (or prior thereto if the Commissioner consents) from the date upon which such subsidiary files written notice with the Commissioner that it has ceased to be a member of the affiliated group and that it is terminating such agency. For example, if a subsidiary has ceased to be a member of the group (and if the 30-day period has expired) prior to the mailing of a notice of deficiency to the common parent, a separate notice of deficiency will be mailed in due course to the subsidiary in respect of its deficiency if it becomes necessary to enforce its liability.

(c) *Effect of dissolution of common parent corporation.*—If the common parent corporation contemplates dissolution, or is about to be dissolved, or if for any other reason its existence is about to terminate, it shall forthwith notify the Commissioner of such fact and designate, subject to the approval of the Commissioner, another member of the affiliated group to act as agent in its place to the same extent and subject to the same conditions and limitations as are applicable to the common parent. If the notice thus required is not given by the common parent, the remaining members of the group may, subject to the approval of the Commissioner, designate another member of the group to act as such agent, and notice of such designation shall be given to the Commissioner. Until a notice in writing designating a new agent

has been received by the Commissioner, any notice of deficiency or other communication mailed to the common parent shall be considered as having been properly mailed to the agent of the group; or, if the Commissioner has reason to believe that the existence of the common parent has terminated, he may, if he deems it advisable, deal directly with any member of the group in respect of its liability.

SEC. 1.1502–17. WAIVERS.—(a) *Effect of waiver given by common parent corporation.*—Any consent given by the common parent corporation (or by an agent in accordance with paragraph (c) of section 1.1502–16) extending the time within which an assessment may be made or levy or proceeding in court begun, in respect of the tax for a consolidated return period, shall be applicable (1) to each corporation which was a member of the affiliated group during any part of such period (whether or not any such corporation has ceased to be a member of the group), and (2) to each corporation the income of which was included in the consolidated return, or which filed Form 1122, for such period, even though it is subsequently determined that such corporation was not a member of the group.

(b) *Acceptance of waivers from common parent corporation and alleged subsidiary.*—In no case will a separate waiver be accepted from a corporation the income of which was included in the consolidated return (for example, a corporation which the Commissioner determines was not a member of the affiliated group), or which filed Form 1122, unless a waiver is also obtained from the common parent, or unless the Commissioner is dealing directly with such corporation to enforce its liability.

SEC. 1.1502–18. FAILURE TO COMPLY WITH REGULATIONS.—(a) *Exclusion of a subsidiary from consolidated return.*—If there has been a failure to include in the consolidated return the income of any subsidiary, or a failure to file any of the forms required by these regulations, notice thereof shall be given the common parent corporation by the Commissioner, and the tax liability of each member of the affiliated group shall be determined on the basis of separate returns unless such income is included or such forms are filed within the period prescribed in such notice, or any extension thereof, or unless under section 1.1502–11 a consolidated return is required for such year.

(b) *Common parent corporation incorrectly designated in consolidated return.*—If a consolidated return includes a corporation as the common parent and such corporation was not (under the provisions of section 1502), the common parent, the tax liability of each corporation included in the return will be computed in the same manner as if separate returns had been made, unless, upon application, the Commissioner approves the making of a consolidated return, or unless under section 1.1502–11 a consolidated return is required for such year.

(c) *Inclusion of one or more subsidiaries not members of affiliated group.*—If a consolidated return includes a corporation as a subsidiary and such corporation was not a member of the affiliated group during the consolidated return period, the tax liability of such corporation will be determined upon the basis of a separate return (but see paragraph (a)), and the consolidated return shall be considered as including only the corporations which were members of the group during such period. If the consolidated return includes two or more

corporations which are not members of the group but which constitute a separate affiliated group, the tax liability of the corporations constituting the separate group will be computed in the same manner as if separate returns had been made by such corporations, unless the Commissioner, upon application, approves the making of a consolidated return for the separate group, or unless under section 1.1502–11 a consolidated return is required for the separate group.

(d) *Effect of authorization and consent filed pursuant to notice.*—If Form 1122 is filed by any corporation, pursuant to a notice under paragraph (a) of this section, such corporation shall be considered for all purposes as having joined in the making of the consolidated return.

(e) *Allocation of payments in the event of change by one or more corporations to separate returns.*—In any case in which amounts have been assessed and paid upon the basis of a consolidated return and the tax liability of one or more of the corporations included in the consolidated return is to be computed in the same manner as if separate returns had been made, the amounts so paid shall be allocated between the affiliated group composed of the corporations properly included in the consolidated return and each of the corporations the tax liability of which is to be computed on a separate basis, in such manner as the corporations included in the consolidated return may, subject to the approval of the Commissioner agree upon, or, in the absence of an agreement, upon the bases used in the respective computations of the normal tax, the surtax and any other tax imposed by chapter 1 of the subtitle A, as shown upon the consolidated return.

SEC. 1.1502–19. TENTATIVE CARRYBACK ADJUSTMENTS.—(a) *Groups with constant membership; consolidated returns only.*—In the case of an affiliated group the membership of which remains unchanged and for which consolidated returns are made or are required for the taxable years involved, any statement filed under section 6164 of the Code with respect to an expected carryback and any application for a tentative carryback adjustment filed under section 6411 shall be filed by the common parent corporation and shall disclose all material facts and circumstances relating to the group as a whole. Such statement or application shall be filed on the appropriate form prescribed for such purpose, Form 1138 or Form 1139, as the case may be. Any refunds allowable under any such application will be made directly to and in the name of the common parent. The making of any such refund will discharge any liability of the Government in respect thereof to the several affiliated corporations. The common parent corporation and its several subsidiaries shall be severally liable for any amounts assessed pursuant to section 6213(b)(2), together with any interest or penalty assessed in connection therewith.

(b) *Groups with changing membership; cases involving a separate return period.*—(1) The membership of an affiliated group may change during a taxable year for which a net operating loss arises, or in the preceding taxable year affected by such net loss. Or an affiliated group making a consolidated return for the year of such net loss may have made separate returns for the preceding year; or a group making separate returns for the year of the net loss may have made a consolidated return for the preceding year. In any such case, the statement provided for in section 6164 of the Code and the application

for the tentative carryback adjustment provided for in section 6411 shall be a joint statement or application concurred in and executed by each corporation which was a member of the group at any time during either of the taxable years involved in the deferment or adjustment sought. The time for the payment of taxes shall be extended under section 6164 and the adjustment provided for in section 6411 shall be made only in accordance with an agreement of the several corporations involved to be made a part of such statement or application. Any refund allowable under any such application with respect to a consolidated return period will be made directly to and in the name of the common parent corporation, and the making of any such refund will discharge any liability of the Government in respect thereof to the several affiliated corporations. The common parent corporation and its several subsidiaries shall be severally liable for any amounts assessed pursuant to section 6213(b)(2), together with any interest or penalty assessed in conenction therewith.

(2) In the absence of an agreement between the several corporations, or in the event of their failure to set forth the provisions of such an agreement as a part of their statement or application, no extension of time for the payment of any tax under the provisions of section 6164 shall be granted, and no tentative adjustment shall be made under section 6411.

(3) Notwithstanding any agreement between the several affiliated corporations, no tentative adjustment shall be made with respect to either a consolidated or a separate return period in disregard of the several liability of the several corporations with respect to any taxable year for which a consolidated return was made or was required.

COMPUTATION OF TAX, RECOGNITION OF GAIN OR LOSS, AND BASIS

SEC. 1.1502–30. COMPUTATION OF TAX.—(a) *General rule.*—In the case of an affiliated group which makes, or is required to make, a consolidated return for any taxable year, the tax liability of each corporation for the period during such year that it was a member of such group shall be computed, subject to the provisions of paragraph (b), upon the consolidated taxable income and the consolidated taxable income plus the aggregate of the deductions of the several affiliated corporations allowable under section 242, or, in the case of the taxes imposed by section 531, section 541 (except as provided in paragraph (b) (4)), and section 802, upon the consolidated accumulated taxable income, the consolidated undistributed personal holding company income, the consolidated life insurance company taxable income, the consolidated life insurance company taxable income plus the aggregate of the deductions of the several affiliated corporations allowable under section 242, or the consolidated 1954 life insurance company taxable income, as the case may be, determined in each case in accordance with the regulations under section 1502. In the case of an affiliated group realizing long-term capital gains and computing its tax under the alternative tax provisions of section 1201, the tax shall be computed with reference to the consolidated taxable income, and the excess of the consolidated net long-term capital gain over the consolidated net short-term capital loss. The tax imposed under section 11(c) or section 831 shall be increased for any taxable year for which an affiliated group makes or is required to make a consolidated

return by 2 percent of the consolidated taxable income (computed without regard to the deduction, if any, provided in section 242 for partially tax-exempt interest).

(b) *Special rules.*—The general rule prescribed in paragraph (a) of this section is subject to the following special rules:

(1) *In the case of Western Hemisphere trade corporations and regulated public utilities.*—If the affiliated group filing a consolidated return includes a Western Hemisphere trade corporation, as defined in section 921, or a regulated public utility, as defined in section 1503 and section 1.1502–2(g), the increase of 2 percent provided in section 1503(a) in the corporation surtax rate shall be applied only on that portion of the consolidated taxable income attributable to the members of the group other than the Western Hemisphere trade corporation or the regulated public utility without any increase with respect to any partially tax-exempt interest of such Western Hemisphere trade corporation or such regulated public utility.

(2) *In case of mutual savings banks conducting life insurance business.*—If the parent corporation of an affiliated group is a mutual savings bank which, if a separate return were filed, would be subject to the alternative tax of section 594(a) (relating to a mutual savings bank conducting a life insurance business), the provisions of section 594(a) shall apply to such group and the alternative tax of such group under section 594(a) shall be computed with reference to the consolidated taxable income of the group attributable to such parent corporation determined without regard to any items of gross income or deductions properly allocable to the business of the life insurance department, and with reference to the income of such life insurance department determined under the provisions of section 594(a)(2) and section 1.1502–31(b).

(3) *Changes in methods of accounting.*—In any case in which a member of the affiliated group changes its method of accounting, if the year of the change is a year for which a consolidated return is filed (or is required to be filed), and if the requirements of section 481(b) are met, then the tax under chapter 1 attributable to the increase in consolidated taxable income required by section 1.1502–44(c) shall not be greater than the tax under chapter 1 (or the corresponding provisions of prior law) which would result if the provisions of section 481(b) were applied to the corporation required to make the change in accounting method, but with the taxes for any year determined on the basis of the regulations under section 1502 (or prior consolidated returns regulations) if the income of such corporation was included in a consolidated return for such year, or on the basis of a separate return, if the income of such corporation was reported in a separate return for such year.

(4) *Personal holding companies.* In the case of an affiliated group which makes or is required to make a consolidated return for any taxable year, the tax liability of each corporation for the period during such year that it was a member of such group shall not be computed in the case of the tax imposed by section 541 upon the consolidated undistributed personal holding company income if—

(i) The affiliated group is an ineligible affiliated group as defined in section 542(b)(2),

(ii) The affiliated group includes as a member (including the common parent corporation) an excluded corporation within the meaning of section 542(c),

(iii) The consolidated personal holding company income is less than 80 percent of the consolidated section 542 gross income, or

(iv) At no time during the last half of the taxable year more than 50 percent in value of the outstanding stock of the parent corporation was owned directly or indirectly by or for not more than 5 individuals within the meaning of section 542(a)(2).

If the tax liability of each corporation under section 541 is not computed upon the consolidated undistributed personal holding company income solely by reason of the application of (iii) or (iv) above (or both), no member of the affiliated group shall be subject to the tax under section 541 for such year or part thereof that it was a member of the affiliated group. If the tax liability of each corporation under section 541 is not computed upon the consolidated undistributed personal holding company income by reason of the application of (i) or (ii) above (whether or not (iii) or (iv) above, or both, are applicable), then such liability shall be computed by reference to the tax liability of the several members of the affiliated group which are personal holding companies within the meaning of section 542(a) in the same manner as if such corporations had filed separate returns except that section 1.1502-31(b)(1)(i) shall be applicable (except with respect to dividends received from other members of the group) in the computation of gross income, personal holding company income, and undistributed personal holding company income, and section 562(d) shall be applicable in the computation of dividends paid.

SEC. 1.1502-31. BASES OF TAX COMPUTATION.—In the case of an affiliated group of corporations which makes, or is required to make a consolidated return for any taxable year, and except as otherwise provided in the regulations under section 1502, the tax liability determined under section 1.1502-30 shall be determined subject to the definitions and rules of computation set forth in paragraphs (a) and (b) of this section.

(a) *Definitions*—(1) *Consolidated taxable income.*—The consolidated taxable income shall be the combined taxable income of the several affiliated corporations—

(i) Minus the sum of—

(*a*) Any consolidated net operating loss deduction,

(*b*) Any consolidated section 1231 net loss, relating to net losses from involuntary conversions and from sales or exchanges of property subject to the provisions of section 1231,

(*c*) Any consolidated charitable contribution deduction, but not in excess of 5 percent of the consolidated taxable income computed without regard to such consolidated charitable contribution deduction, any deductions under Part VIII (except section 248) of subchapter B, any consolidated net

operating loss carry-backs, and any deduction under section 922 (special deduction for Western Hemisphere trade corporations),

(*d*) Any consolidated dividends received deduction,

(*e*) Any consolidated section 922 deduction,

(*f*) Any consolidated section 175 deduction, but not in excess of 25 percent of the consolidated section 175 gross income, and

(*g*) Any consolidated section 247 deduction,

(ii) Plus consolidated net capital gain, or

(iii) Minus, in the case of an affiliated group including as members one or more corporations subject to the tax imposed by section 831, the combined additional capital loss deductions of such corporations authorized by section 832(c)(5) (but in an amount not in excess of the consolidated net capital loss).

(2) *Consolidated net operating loss deduction.*—The consolidated net operating loss deduction shall be an amount equal to the aggregate of the consolidated net operating loss carryovers and of the consolidated net operating loss carrybacks to the taxable year.

(3) *Consolidated net operating loss carry-overs.*—The consolidated net operating loss carryovers to the taxable year shall consist of

(i) The consolidated net operating losses, if any, for the five preceding taxable years (not including as a fifth preceding taxable year any taxable year beginning prior to 1950, unless such preceding taxable year began in 1949 and ended in 1950, and unless all members of the group for such preceding taxable year commenced business in 1949; and in such case the amount of the consolidated net operating loss for such fifth year shall not be treated as a carryover except to the extent that such consolidated net operating loss is allocable to 1950) to the extent that the consolidated net operating loss for any such preceding taxable year was not attributable to a corporation making a separate return or joining in a consolidated return filed by another affiliated group for the taxable year and was not absorbed as a carryover or carryback for preceding or intervening taxable years.

and, with respect to a net operating loss sustained by a corporation in a taxable year for which a separate return was filed, or for which such corporation joined in a consolidated return filed by another affiliated group, but subject to the limitations prescribed in section 1.1502-31(b)(3)—

(ii) The amount of the net operating losses, if any, of such corporation for the five preceding taxable years (not including as a fifth preceding taxable year any taxable year beginning prior to 1950 unless such preceding taxable year began in 1949 and ended in 1950, and unless such corporation commenced business in 1949) to the extent that the net operating loss for any such preceding taxable year was not absorbed as a carryover or carryback for preceding or intervening taxable years

See, however, section 1.1502-31(b)(21) in any case in which a member of the group is an acquiring corporation in a transaction described in section 381(a) or any member of the group is subject to the limitations provided in section 382.

(4) *Consolidated net operating loss carrybacks.*—The consolidated net operating loss carrybacks to the taxable year shall consist of—

(i) The amount of the consolidated net operating loss, if any, for the first succeeding taxable year (to the extent not attributable to a corporation making a separate return or joining in a consolidated return filed by another affiliated group for the taxable year) reduced to the extent absorbed as a carryback, consolidated or separate, as the case may be, for the first preceding taxable year;

(ii) The amount of the consolidated net operating loss, if any, for the second succeeding taxable year to the extent not attributable to those corporations making separate returns in the taxable year;

and, with respect to a net operating loss sustained by a corporation which, for either of the two succeeding taxable years, files a separate return or joins in a consolidated return filed by another affiliated group, but subject to the limitations prescribed in section 1.1502-31(b)(3),

(iii) The amount of the net operating loss, if any, sustained by such corporation for the first succeeding taxable year reduced to the extent absorbed by such corporation for the first preceding taxable year or, if the income of such corporation is included in the consolidated return for the first preceding taxable year, reduced to the extent absorbed by such consolidated return; and

(iv) The amount of the net operating loss, if any, sustained by such corporation for the second succeeding taxable year.

See, however, section 1.1502-31(b)(21) in any case in which a member of the group is an acquiring corporation in a transaction described in section 381(a) or any member of the group is subject to the limitations provided in section 382.

(5) *Consolidated net operating loss.*—The consolidated net operating loss shall be an amount equal to the excess of the sum of—

(i) The combined net operating losses of the several affiliated corporations having net operating losses,

(ii) The consolidated section 175 deduction,

(iii) The consolidated section 1231 net loss, and

(iv) The aggregate of the deductions of the several affiliated corporations under sections 243, 244, and 245 (computed without regard to the limitation contained in section 246(b)) and under section 247 (computed without regard to the limitation of (a)(1)(B) of such section),

over the sum of—

(v) The combined taxable income of the several affiliated corporations having taxable income, computed without regard to any deductions under section 242 (relating to partially tax-exempt interest), and

(vi) The consolidated net capital gain.

(6) *Consolidated section 1231 net loss.*—The consolidated section 1231 net loss shall be the excess of the aggregate of the recognized losses of the character described in section 1231 sustained by the several affiliated corporations over the aggregate of the recognized gains of the character described in section 1231 realized by the several affiliated corporations.

(7) *Consolidated charitable contribution deduction.*—The consolidated charitable contribution deduction shall be the aggregate amount of the deductions of the several affiliated corporations allowable under section 170 for the taxable year (determined without regard to the 5 percent limitation of section 170(b)(2)) and an amount equal to the aggregate of the consolidated charitable contribution carryovers to the taxable year.

(8) *Consolidated charitable contribution carryovers.*—The consolidated charitable contribution carryovers to the taxable year shall consist of—

(i) The excess, if any, of the amount of the consolidated charitable contribution deduction (computed without regard to any charitable contribution carryovers) for the two preceding taxable years over the limitation of paragraph (1)(i)(*c*) for such years to the extent that the consolidated charitable contribution deduction for any such preceding taxable year was not attributable to a corporation making a separate return, or joining in a consolidated return filed by another affiliated group, for the taxable year and was not absorbed as a carryover by the consolidated or separate net income or taxable income for the separate net income or taxable income for the intervening taxable year

and, with respect to any excess of charitable contributions over the applicable 5 percent limitation of a corporation in a taxable year for which a separate return was filed or for which such corporation joined in a consolidated return filed by another affiliated group—

(ii) The amount of such excesses of such corporation for the two preceding taxable years to the extent that such excess for the second preceding taxable year was not absorbed as a carryover by consolidated or separate net income or taxable income for the first preceding taxable year.

(9) *Consolidated net capital gain.*—The consolidated net capital gain shall be the excess of the sum of—

(i) The aggregate of the capital gains of the several affiliated corporations, and

(ii) The consolidated section 1231 net gain, over the sum of—

(iii) The aggregate of the capital losses of such corporations, and

(iv) The aggregate of the consolidated net capital loss carryovers to the taxable year.

(10) *Consolidated section 1231 net gain.*—The consolidated section 1231 net gain shall be the excess of the aggregate of the recognized gains of the character described in section 1231 realized by the several affiliated corporations over the aggregate of the recognized losses of the character described in section 1231 sustained by the several affiliated corporations.

(11) *Consolidated net capital loss carryover.*—The consolidated net capital loss carryovers to the taxable year shall consist of—

(i) The consolidated net capital losses, if any, for the 5 preceding taxable years to the extent that such losses were not attributable to a corporation making a separate return, or joining in a consolidated return filed by another affiliated group, for the taxable year, and were not absorbed by net capital gains for intervening taxable years pursuant to the provisions of section 1212

or corresponding provisions of prior law, consolidated or separate, as the case may be,

and, with respect to net capital losses sustained by a corporation for taxable years for which separate returns were filed, or for which such corporation joined in a consolidated return filed by another affiliated group—

(ii) The net capital losses, if any, sustained by such corporation for its 5 preceding taxable years to the extent that such losses were not absorbed by the net capital gains of such corporation (or, if the income of such corporation was included in a consolidated return, by the consolidated net capital gain) for intervening taxable years pursuant to the provisions of section 1212 or corresponding provisions of prior law.

(12) *Consolidated net capital loss.*—The consolidated net capital loss shall be the excess of the aggregate of the capital losses of the several affiliated corporations over the sum of—

(i) The aggregate of the capital gains of such corporations, and

(ii) The consolidated section 1231 net gain,

reduced, in the case of an affiliated group including as members one or more corporations subject to the tax imposed by section 831, but only for the purpose of net capital loss carryover computations, by whichever of the following amounts is the lesser,

(iii) The combined additional capital loss deductions of such corporations authorized by section 832(c)(5), or

(iv) The consolidated taxable income computed without regard to capital gains and losses and without regard to any deduction for partially tax exempt interest provided by section 242.

(13) *Consolidated dividends received deduction.*—The consolidated dividends received deduction shall be the aggregate of the deductions of the several affiliated corporations allowable under sections 243, 244, and 245 (computed without regard to the limitation of section 246(b)), but in an amount not greater than 85 percent of the consolidated taxable income computed without regard to the consolidated net operating loss deduction, the consolidated section 247 deduction, and without regard to any consolidated dividends received deduction. The limitation of the previous sentence shall not apply for any taxable year for which there is a consolidated net operating loss.

(14) *Consolidated section 247 deduction.*—The consolidated section 247 deduction, relating to dividends paid by public utilities on preferred stock, shall be an amount computed as follows:

(i) First, determine the amount which is the lesser of—

(*a*) The aggregate of the dividends paid by members of the affiliated group which are public utilities within the meaning of section 247(b)(1) on preferred stock within the meaning of section 247(b)(2), or

(*b*) The portion of the consolidated taxable income for the taxable year attributable to such members computed without regard to the consolidated section 247 deduction.

(ii) Then multiply the amount determined under paragraph (i) by the fraction specified in section 247(a)(2).

(15) *Consolidated section 922 deduction.*—The consolidated section 922 deduction, relating to Western Hemisphere trade corporations, shall be that portion of the consolidated taxable income attributable

to those members of the affiliated group which are Western Hemisphere trade corporations (computed without regard to the consolidated section 922 deduction) multiplied by the fraction specified in section 922(2).

(16) *Consolidated net long-term capital gain.*—The consolidated net long-term capital gain shall be the excess of the sum of—

(i) The aggregate of the long-term capital gains of the several affiliated corporations, and

(ii) The consolidated section 1231 net gain,

over

(iii) The aggregate of the long-term capital losses of such corporations.

(17) *Consolidated net short-term capital loss.*—The consolidated net short-term capital loss shall be the sum of—

(i) The aggregate of the short-term capital losses of the several affiliated corporations, and

(ii) The consolidated net capital loss carryovers,

minus

(iii) The aggregate of the short-term capital gains of such corporations.

(18) *Consolidated accumulated taxable income.*—The consolidated accumulated taxable income shall be the consolidated taxable income computed without regard to any capital loss carryover, without regard to any charitable contribution deduction under section 170, without regard to any net operating loss deduction, and without regard to any deduction under part VIII (except section 248) of subchapter B of chapter 1, minus the sum of—

(i) The combined Federal income and excess profits taxes (other than the excess profits tax imposed by subchapter E of chapter 2 of the Internal Revenue Code of 1939, for taxable years beginning after December 31, 1940) and income, war-profits and excess-profits taxes of foreign countries and possessions of the United States (to the extent not allowable as a deduction under section 164(b)(6)), accrued during the taxable year by the several affiliated corporations, but not including the accumulated earnings tax imposed by section 531, the personal holding company tax imposed by section 541, or the taxes imposed by corresponding sections of a prior income tax law,

(ii) The consolidated charitable contribution deduction computed without regard to the limitation in section 170(b)(2) except that there shall not be included in the consolidated charitable contribution carryover any amount which has previously been used in the determination of consolidated accumulated taxable income or separate accumulated taxable income,

(iii) The excess of the sum of the capital losses of the several affiliated corporations (computed without regard to any capital loss carryover) over the sum of the capital gains of such corporations,

(iv) The excess of the consolidated net long-term capital gain over the consolidated net short-term capital loss (computed without regard to any capital loss carryover) minus the taxes imposed by subtitle A attributable to such excess,

(v) In the case of an affiliated group including one or more holding company affiliates of a bank, as defined in section 2 of the Banking Act of 1933, the consolidated section 601 deduction, relating to earnings or profits devoted to the acquisition of readily marketable assets, other than bank stock,

(vi) The consolidated accumulated earnings, credit, and

(vii) The consolidated section 561 dividends paid deduction.

(19) *Consolidated accumulated earnings credit.*—The consolidated accumulated earnings credit shall be—

(i) In the case of an affiliated group which is not a mere holding or investment group, an amount equal to such part of the aggregate of the earnings and profits for the taxable year of the several members of the group as are retained for the reasonable needs of the business of the group, minus the deduction allowed by subparagraph (18)(iv), but not less than the amount (if any) by which $60,000 exceeds the aggregate of the accumulated earnings and profits of the several members of the group at the close of the preceding taxable year, or

(ii) In the case of an affiliated group which is a mere holding or investment group, the amount (if any) by which $60,000 exceeds the aggregate of the accumulated earnings and profits of the several members of the group at the close of the preceding taxable year.

For the purpose of (i) above, the amount of the earnings and profits for the taxable year of the several members of the group which are retained is the amount by which the aggregate of the earnings and profits of the several members of the group for the taxable year exceed the consolidated section 561 dividends paid deduction for such year. For the purpose of the preceding sentence and (ii) above, the accumulated earnings and profits of the several members of the group at the close of the preceding taxable year shall be reduced by the dividends paid to other than members of the group under section 563(a) (relating to dividends paid after the close of the taxable year) which are considered as paid during such taxable year.

(20) *Consolidated section 561 dividend paid deduction.*—The consolidated section 561 dividends paid deduction shall be the sum of—

(i) The aggregate of the deductions allowable to the several members of the group with respect to dividends under section 561(a) (1) and (2) determined without regard to any deductions attributable to payments made or considered to be made of dividends to other members of the group, and

(ii) In case the affiliated group is subject to tax on its consolidated undistributed personal holding company income, the consolidated dividend carryover.

(21) *Consolidated section 542 gross income.*—The consolidated section 542 gross income shall be the combined gross income of the several members of the affiliated group computed without regard to any gross income from other members of the group and by including only the excess of the gains of the several members of the group over the losses of the several members of the group from transactions in stocks or securities as described in section 543(a)(2) and by including only the excess of the gains of the several members of the group over the losses of the several members of the group with respect to commodity transactions as described in section 543(a)(3).

(22) *Consolidated personal holding company income.*—The consolidated personal holding company income shall be that part of the consolidated section 542 gross income from the sources described in section 543.

(23) *Consolidated undistributed personal holding company income.*—The consolidated undistributed personal holding company income shall be the consolidated taxable income computed without regard to any deductions under part VIII (except section 248) of subchapter B of chapter 1, without regard to any charitable contribution deduction under section 170, without regard to any net operating loss deduction, and without regard to deductions disallowed by section 545 (b) (8), minus the sum of—

(i) The combined Federal income and excess profits taxes (other than the excess-profits tax imposed by subchapter E of chapter 2 of the Internal Revenue Code of 1939 for taxable years beginning after December 31, 1940) and income, war-profits and excess-profits taxes of foreign countries and possessions of the United States (to the extent not allowable as a deduction under section 164(b)(6)) accrued during the taxable year by the several affiliated corporations but not including the accumulated earnings tax imposed by section 531, the personal holding company tax imposed by section 541, or the taxes imposed by corresponding sections of a prior income tax law;

(ii) In lieu of the deduction provided by section 1.1502-31 (a)(1)(i)(*c*), the consolidated charitable contribution deduction limited as provided in section 170(b)(1) (A) and (B) except that the 10 and 20 percent limitations therein shall be applied with respect to the consolidated adjusted gross income; and except that there shall not be included in the consolidated charitable contribution carry-over any amount which has been previously used in the determination of consolidated undistributed personal holding company income or separate undistributed personal holding company income.

(iii) The amount of the consolidated net operating loss for the preceding taxable year to the extent not attributable to corporations making a separate return, or joining in a consolidated return filed by another affiliated group for the taxable year, and, with respect to a corporation which filed a separate return or joined in a consolidated return filed by another affiliated group for the preceding taxable year, the net operating loss of such corporation for such preceding taxable year, but not in excess of the portion of the consolidated personal holding company income attributable to such corporation for the taxable year.

(iv) The excess of the consolidated net long-term capital gain for the taxable year over the consolidated net short-term capital loss for such year minus the taxes imposed by subtitle A attributable to such excess;

(v) The aggregate amount subject to the provisions of section 545(b)(7) used or irrevocably set aside by the several affiliated corporations to pay or retire indebtedness incurred prior to January 1, 1934, not including such portion of any such indebtedness as was owned on January 1, 1934, or at any time thereafter, directly or indirectly, by another member of the group;

(vi) The sum of the amounts deductible by the several members of the affiliated group allowable under section 545(b)(9), but there shall be added to the consolidated taxable income any amount required to be included in taxable income under such section;

(vii) The consolidated section 561 dividends paid deduction; and

(viii) In the case of an affiliated group including one or more holding company affiliates of a bank, as defined in section 2 of the Banking Act of 1933, the consolidated section 601 deduction, relating to earnings or profits devoted to the acquisition of readily marketable assets, other than bank stock.

(24) *Consolidated adjusted gross income.*—The consolidated adjusted gross income shall be the consolidated taxable income computed without regard to any charitable contributions deductions, any deductions under part VIII (except section 248), any net operating loss carryback to the taxable year, any deductions under section 922, and without deduction of the amount disallowed by section 545(b)(8).

(25) *Consolidated deficiency dividends deduction.*—The consolidated deficiency dividends deduction shall be the aggregate of the amounts determined as provided in section 547 with respect to dividends distributed by the several members of the affiliated group pursuant to a determination of liability for personal holding company tax described in section 547, with respect to the consolidated undistributed personal holding company income of the affiliated group for the taxable year of the group computed without regard to any dividends distributed to members of the affiliated group.

(26) *Consolidated dividend carryover.*—The consolidated dividend carryover to the taxable year shall be the sum of—

(i) The excess of—

(*a*) The consolidated section 561 dividends paid deduction for the first preceding taxable year, determined without regard to any consolidated dividend carryover, over

(*b*) The consolidated undistributed personal holding company income for such year, determined without regard to any dividends paid deduction and dividend carryover,

to the extent that such deduction and such income are not attributable to a corporation making a separate return, or joining in a consolidated return filed by another affiliated group for the taxable year,

(ii) The amount of the consolidated section 561 dividends paid deduction (determined as provided in paragraph (i) (*a*)) for the second preceding taxable year reduced by the consolidated undistributed personal holding company income for such year (determined as provided in paragraph (i)(*b*)) and further reduced by the amount of the consolidated undistributed personal holding company income for the first preceding taxable year determined without regard to any dividend carryover from the second preceding taxable year to the extent that any such consolidated section 561 dividends paid deduction and any such consolidated undistributed personnel holding company income are not attributable to a corporation making a separate return, or joining in a consolidated return filed by another affiliated group for the taxable year,

and, with respect to taxable years for which a member of the affiliated group filed a separate return or for which such member joined in a consolidated return filed by another affiliated group—

(iii) The excess of the deduction allowable to such corporation under section 561 for dividends paid for the first preceding taxable year (determined without regard to any dividend carryover) over the taxable income of such corporation for such year computed with the adjustments provided in section 545 (or if its income was included in the consolidated return of another affiliated group, that portion of the excess of the consolidated section 561 dividends paid deductions (determined as provided in paragraph (1) (*a*)) for the first preceding taxable year, over the consolidated undistributed personal holding company income (determined as provided in paragraph (i) (*b*)) for such year attributable to such corporation), and

(iv) The excess of the deduction allowable to such corporation under section 561 (determined without regard to any dividend carryover) for the second preceding taxable year over the taxable income of such corporation for such year computed with the adjustments provided in section 545 (or if its income was included in the consolidated return of another affiliated group, that portion of the excess of the consolidated section 561 dividends paid deduction (determined as provided in paragraph (i) (*a*)) for the second preceding taxable year, over the consolidated undistributed personal holding company income (determined as provided in paragraph (i) (*b*)) for such year, attributable to such corporation) and reduced by—

(*a*) The excess of the amount of its taxable income so computed for the first preceding taxable year over its dividends paid deduction under section 561, determined without regard to any dividend carryover from the second preceding taxable year (or, if its income was included in the consolidated return of another affiliated group, that portion of the amount of such deduction absorbed in such consolidated return of another affiliated group), or

(*b*) If the income of such corporation is included in the consolidated return for the first preceding taxable year, the excess, if any, of the consolidated undistributed personal holding company income (determined without regard to any dividends paid deduction and dividend carryover) for the first preceding taxable year over the consolidated section 561 dividends paid deduction for such year, determined without regard to any dividend carryover.

(27) *Consolidated section 601 deduction.*—The consolidated section 601 deduction relating to bank affiliates, shall be an amount equal to the aggregate of the earnings or profits of members of the group which are holding company affiliates of a bank as defined in section 2 of the Banking Act of 1933 devoted to the acquisition of readily marketable assets other than bank stock (not including any asset acquired, directly or indirectly, from another member of the group), subject, in the case of each such affiliate, to the limitations imposed by section 601 determined without regard to the qualifications expressed in (b) (1) (ii) and (iii) of this section.

(28) *Consolidated life insurance company taxable income.*—The consolidated life insurance company taxable income in the case of an affiliated group consisting of corporations subject to the tax imposed by section 802 shall be the consolidated taxable income minus the consolidated section 804 deduction and plus the consolidated section 806 adjustment.

(29) *Consolidated section 804 deduction.*—The consolidated section 804 deduction relating to the reserve and other policy liabilities shall be the consolidated taxable income multiplied by a figure to be determined and proclaimed by the Secretary for each taxable year pursuant to section 804.

(30) *Consolidated section 806 adjustment.*—The consolidated section 806 adjustment relating to certain reserves provided in section 806 shall be an amount equal to 3¼ percent of the combined unearned premiums and unpaid losses of the several affiliated corporations on contracts other than life insurance or annuity contracts computed in the case of each corporation pursuant to the provisions of section 806 but the combined unearned premiums shall not be considered to be less than 25 percent of the combined net premiums on such other contracts written during the taxable year.

(31) *Consolidated 1954 life insurance company taxable income.*—The consolidated 1954 life insurance company taxable income in the case of an affiliated group consisting of corporations subject to the tax imposed by section 802(b) for taxable years beginning in 1954 shall be the consolidated taxable income plus eight times the consolidated section 806 adjustment and minus the consolidated reserve interest credit, if any.

(32) *Consolidated reserve interest credit.*—The consolidated reserve interest credit shall be the aggregate of the reserve interest credits of the several members of the affiliated group.

(33) *Consolidated section 175 deduction.*—The consolidated section 175 deduction shall be the aggregate of the amount of the deductions of the several affiliated corporations allowable under section 175 for the taxable year (determined without regard to the 25 percent limitation of section 175(b)) and an amount equal to the aggregate of the consolidated section 175 carryovers to the taxable year.

(34) *Consolidated section 175 gross income.*—The consolidated section 175 gross income shall be the combined gross income derived from farming of the several affiliated corporations engaged in the business of farming and having expenditures of the type described in section 175(a). For this purpose, there shall be eliminated profits and losses on intercompany transactions; and proper adjustment shall be made to eliminate any distortion in the amount of gross income attributable to transactions between members of the affiliated group at markedly fictitious values.

(35) *Consolidated section 175 carryovers.*—The consolidated section 175 carryovers to the taxable year shall consist of—

(i) The excess, if any, of the amount of the consolidated section 175 deductions over 25 percent of the consolidated section 175 gross income of preceding taxable years to the extent that such consolidated section 175 deduction for any preceding taxable year was not attributable to a corporation making a separate return or joining in a consolidated return filed by another affili-

ated group for the taxable year and was not absorbed as a carryover by the consolidated section 175 gross income for preceding taxable years

and, with respect to any excess of deductions under section 175 over the 25 percent limitation of section 175(b) of a corporation in a taxable year for which a separate return was filed or for which such corporation joined in a consolidated return filed by another affiliated group, but subject to the limitation prescribed in section 1.1502–31(b)(16).

(ii) The amount of such excesses of such corporation for preceding taxable years to the extent that such excesses were not absorbed as carryovers for preceding taxable years.

(b) *Computations.*—In the case of affiliated corporations which make, or are required to make, a consolidated return, and except as otherwise provided in the regulations under section 1502—

(1) *Taxable income.*—The taxable income of each corporation shall be computed in accordance with the provisions covering the determination of taxable income of separate corporations, except—

(i) There shall be eliminated unrealized profits and losses in transactions between members of the affiliated group and dividend distributions from one member of the group to another member of the group (referred to in the regulations under section 1502 as intercompany transactions);

(ii) No net operating loss deduction shall be taken into account;

(iii) No capital gains or losses shall be taken into account;

(iv) There shall be disregarded all gains and losses from involuntary conversions and from sales and exchanges of property subject to the provisions of section 1231;

(v) In the computation of the deduction under section 171, relating to amortizable bond premium, there shall be disregarded the bonds of one member of the group owned by another member of the group during the taxable year;

(vi) In the computation of the taxable income of a corporation for the taxable year in which it became the common parent corporation of the affiliated group filing a consolidated return, the aggregate deductions of such corporation for such year otherwise allowable in excess of the gross income of such corporation for such year shall be excluded to the extent that such excess is attributable to that portion of such year preceding the date upon which such corporation became the common parent corporation of the group. Any amount excluded under this paragraph shall, to the extent that it constitutes a net operating loss within the provisions of section 172 or a net capital loss within the provisions of section 1222, be considered as a net operating loss or a net capital loss, as the case may be, separately sustained by such corporation and subject to the provisions of section 1.1502–31(a)(3)(ii) or (a)(11)(ii);

(vii) In the case of a corporation which became a member of the affiliated group after January 1, 1954, common parent corporation or subsidiary, as the case may be, allowable deductions shall be determined subject to the qualifications prescribed in section 1.1502–31(b)(9);

(viii) No deduction under section 170 with respect to charitable or other contributions shall be taken into account;

(ix) In the case of the deduction provided in section 615 (relating to mine exploration expenditures), the allowable deduction shall be determined subject to the qualifications prescribed in section 1.1502–31(b)(12);

(x) In the case of a distribution of inventory to which section 311(b) is applicable, or in the case of a distribution of property to which section 311(c) is applicable by one member of the group to another member of the group, the gain recognized under such sections shall be eliminated;

(xi) No deductions under section 243, 244, 245, or 247 (relating to deductions with respect to dividends received and dividends paid) or under section 922 (relating to the special deduction for Western Hemisphere trade corporations), shall be taken into account; and

(xii) No deductions under section 175 (relating to soil and water conservation expenditures) shall be taken into account by a member of an affiliated group to which the consolidated section 175 deduction is applicable.

Intercompany profits and losses which have been realized by the group through final transactions with persons other than members of the group, and intercompany transactions which do not affect the consolidated taxable income shall not be eliminated. For the purpose of this subparagraph gain includible in income pursuant to section 357(c) with respect to transfers of assets other than the capital assets and other than assets to which section 1231 is applicable, shall not be eliminated. For the purpose of the regulations under section 1502, a transaction not involving a sale or exchange of a capital asset or of property subject to the provisions of section 1231 shall not be considered an intercompany transaction if such transaction occurs in the regular course of the trade or business of the members of the group and if such members adopt, with the consent of the Commissioner and subject to such conditions as he deems proper, a consistent accounting practice of taking into account in the computation of consolidated taxable income the gains and losses reflected in such transactions. As used in this paragraph, the term "taxable income" includes the case in which the allowable deductions of a member (not including any net operating loss deduction) exceed its gross income.

(2) *Other computations on separate basis.*—The various other computations required by the regulations under section 1502 to be made by the several affiliated corporations shall be made in the case of each such corporation in the same manner and under the same conditions as if a separate return were to be filed, but with the following exceptions:

(i) *Taxable income.*—The taxable income used in any such computation shall be the taxable income of the corporation determined in accordance with the provisions of this section.

(ii) *Dividends received.*—In the computation of the dividends received, there shall be excluded all dividends received from other members of the affiliated group.

(iii) *Capital gains and losses.*—Capital gains and losses, short-term capital gains and losses, long-term capital gains and losses,

and the additional capital loss deduction authorized by section 832(c)(5) shall be determined without regard to—

(*a*) Gains or losses arising in intercompany transactions (other than gains described in section 357(c)) and gains recognized to the distributing corporation pursuant to section 311(c) by reason of distributions by one member of the group to another member of the group,

(*b*) Gains or losses from involuntary conversions and from sales or exchanges of property subject to the provisions of section 1231,

(*c*) The net capital loss carryovers provided in section 1212, and

(*d*) In the case of a corporation which became a member of the affiliated group subsequent to January 1, 1954, common parent corporation or subsidiary, as the case may be, capital losses to the extent disallowed pursuant to the provisions of section 1.1502–31(b)(9).

(iv) *Net operating loss.*—In the computation of the net operating loss, as defined in section 172, the provisions of this section pertaining to the determination of taxable income shall apply.

(v) *Dividends paid.*—In the computation of dividends paid, there shall be excluded all dividends paid by one member of the group to another, except as provided in section 1.1502–30(b)(4).

(vi) *Federal income tax.*—In the computation of the Federal income tax, there shall be used the consolidated tax, or a proportionate part thereof, if the tax payable is properly computed on the basis of the consolidated return.

(vii) *Dividends paid by public utility.*—In the computation of dividends paid on the preferred stock of a public utility, there shall be excluded all dividends paid by such public utility to another member of the group.

(viii) *Gains or losses under section 1231.*—Gains and losses from involuntary conversions and from sales or exchanges of property subject to the provisions of section 1231 shall be determined without regard to—

(*a*) Gains or losses from intercompany transactions (other than gains described in section 357(c)) and gains recognized pursuant to section 311(c) upon the distribution of property subject to the provisions of section 1231 by one member of the group to another member of the group, and

(*b*) In the case of a corporation which became a member of the affiliated group subsequent to January 1, 1954, common parent corporation or subsidiary, as the case may be, such portion of any such loss as is disallowed pursuant to the provisions of section 1.1502–31(b)(9).

(ix) *Mutual savings banks, domestic building and loan associations, and cooperative banks.*—In the case of a mutual savings bank, a domestic building and loan association, and a cooperative bank—

(*a*) In the computation of total deposits or withdrawable accounts at the close of the taxable year for the purpose of section 593(2) (relating to the deduction for bad debts), there shall be excluded the total deposits or withdrawable accounts of other members of the group, and

'(b) In the computation of the deduction provided in section 591 (relating to dividends paid by banking corporations), there shall be excluded amounts paid to, or credited to the accounts of, other members of the group.

'(3) *Limitations on net operating loss carryovers and carrybacks from separate return years.*—In no case shall there be included in the consolidated net operating loss deduction for the taxable year as consolidated net operating loss carryovers under (a) (3) (ii) of this section (relating to the net operating losses sustained by a corporation in years for which separate returns were filed, or for which such corporation joined in a consolidated return filed by another affiliated group), and as consolidated net operating loss carrybacks under (a) (4) (iii) and (iv) of this section (relating to a net operating loss sustained by a corporation which for either of the two succeeding taxable years files a separate return or joins in a consolidated return filed by another affiliated group), an amount exceeding in the aggregate the taxable income of such corporation included in the computation of the consolidated taxable income for the taxable year decreased by its deductions under sections 243, 244, 245, 247, and 922, (and in the case of a member of an affiliated group to which the consolidated section 175 deduction is applicable, the section 175 deduction) increased by its separate net capital gain, and increased or decreased, as the case may be, with respect to its separate gains or losses from involuntary conversions and from sales or exchanges of property subject to the provisions of section 1231. This subparagraph shall not be applicable to a carryover under (a) (3) (ii) of this section of a net operating loss of a corporation attributable to a period for which it was included in a consolidated return filed by another affiliated group for a taxable year beginning prior to January 1, 1954, all of whose members are included in the consolidated return filed for the taxable year if all of the members of such other affiliated group would have been members of the affiliated group if the law applicable to the taxable year had been applicable to such prior taxable year.

(4) *Law applicable to computations of net operating loss carryovers and carrybacks.*

(i) In determining the amount of any net operating loss carryback or carryover, consolidated or separate, to any taxable year, the necessary computations involving any other taxable year shall be made under the law and regulations applicable to such other taxable year. The preceding sentence shall apply with respect to all taxable years whether they begin before, on, or after January 1, 1954.

(ii) In the case of a consolidated net operating loss for a taxable year beginning in 1953 and ending in 1954, the amount of such consolidated net operating loss which shall be carried to the second preceding taxable year shall be the amount which bears the same ratio to such consolidated net operating loss as the number of days in the loss year after December 31, 1953, bears to the total number of days in such year. In determining the amount carried to any other taxable year, the amount absorbed for the second taxable year preceding the loss year shall not exceed the portion of the consolidated net operating loss which is carried to the second preceding taxable year.

(iii) For purposes of section 141 of the Internal Revenue Code of 1939 and that part of the regulations promulgated thereunder which relate to subchapter D of chapter 1 of such Code, excess profits net income and consolidated section 433(a) excess profits net income shall be computed as if the regulations under section 1502 did not apply and as if such section and such regulations continued to apply to taxable years beginning after December 31, 1953.

(iv) Except as provided in (i), (ii) and (iii) the computation of net operating loss deductions for the transitional years described in section 172(g) shall be determined under regulations 129 in any case in which, under such section, the rules of the Internal Revenue Code of 1939 are applicable, and under the regulations under section 1502 in any case in which, under such section, the rules of the Internal Revenue Code of 1954 are applicable.

(5) *Limitation on absorption of unused dividend carryovers.*—If, in the computation of the consolidated dividend carryover for the second consolidated return period in respect of which the income of a corporation is included in the consolidated return of the group, there is involved a separate unused dividend carryover of such corporation for the second preceding taxable year together with a consolidated unused dividend carryover for the second preceding taxable year, or if, for the second consolidated return period in respect of which the income of two or more members of the group is included in the consolidated return of the group, there are involved the separate unused dividend carryovers of such corporations for the second preceding taxable year, no portion of the excess of the consolidated undistributed personal holding company income (determined without regard to any dividends paid deduction and dividend carryover) over the consolidated section 561 dividends paid deduction (determined without regard to any dividend carryover) for the first preceding taxable year shall be taken into account more than once in giving effect to the provisions of (a)(26) (ii) and (iv) of this section (relating to the computation of that part of the consolidated dividend carryover attributable to the unused dividend carryovers of the second preceding taxable year).

(6) *Apportionment of consolidated net operating loss.*—If an affiliated group filing a consolidated return sustains a consolidated net operating loss within the provisions of section 172, relating to the net operating loss deduction, and if there are included as members of such group one or more corporations which made separate returns, or joined in a consolidated return filed by another affiliated group, either in a preceding taxable year or in a succeeding taxable year, the portion of such consolidated net operating loss attributable to such corporations severally shall be determined, such portion in the case of any such corporation being determined in an amount proportionate to the net losses (capital net losses and ordinary net losses alike) of the several affiliated corporations having net losses, to the extent that such losses were taken into account in the computation of the consolidated net operating loss.

(7) *Apportionment of consolidated net capital loss.*—If an affiliated group filing a consolidated return sustains a consolidated net capital loss, and if there are included as members of such group one or more corporations which make separate returns, or join in a con-

solidated return filed by another affiliated group, in a succeeding taxable year, the portion of such consolidated net capital loss attributable to such corporations severally shall be determined, such portion in the case of any such corporation being an amount which bears the same ratio to the consolidated net capital loss which the net capital loss of such corporation bears to the aggregate of the net capital losses for the taxable year sustained by the several affiliated corporations having net capital losses.

(8) *Limitation on net capital loss carryover from separate return year.*—In no case shall there be included in the computation of the consolidated net capital gain for the taxable year as a consolidated net capital loss carryover under (a) (11) (ii) (relating to net capital losses separately sustained) an amount exceeding in the aggregate the net capital gains of such corporation (determined without regard to any net capital loss carryover) included in the computation of the consolidated net capital gain for the taxable year increased with respect to its separate net gains from involuntary conversions and from sales or exchanges of property subject to the provisions of section 1231.

(9) *Qualifications on deductions where group membership changed after January 1, 1954.*—In the case of an affiliated group formed at any time after January 1, 1954, or having among its members in the taxable year one or more subsidiaries which became members of the group subsequent to January 1, 1954, the consolidated taxable income for the taxable year, and for prior and subsequent taxable years to the extent affected by carrybacks and carryovers from the taxable year, shall be determined subject to the following qualifications:

(i) There shall be excluded in the case of the common parent corporation and in the case of any subsidiaries which were members of the group on January 1, 1954, those deductions from gross income otherwise allowable with respect to—

(*a*) Sales or exchanges of capital assets,

(*b*) Involuntary conversions and sales or exchanges of property subject to the provisions of section 1231,

(*c*) Securities subject to the provisions of section 165(g)(3), or

(*d*) Debts subject to the provisions of section 166,

to the extent that such deductions otherwise allowable exceed in the aggregate—

(*e*) In the case of capital losses, the excess of the aggregate capital gains over the aggregate capital losses of such corporations for the taxable year, or

(*f*) In the case of ordinary losses, the aggregate of the ordinary taxable income of such corporations for the taxable year, increased in an amount equal to any excess of aggregate capital gains over aggregate capital losses of such corporations,

such capital gains and losses and such ordinary taxable income being determined pursuant to the provisions of the regulations under section 1502 but without regard to the provisions of (b) (1) (iv) and (b) (2) (iii) (*b*) of this section and without regard to the losses in question:

(ii) There shall be excluded in the case of a subsidiary corporation which became a member of the affiliated group subsequent to January 1, 1954, those deductions from gross income otherwise allowable with respect to—

(*a*) Sales or exchanges of capital assets,

(*b*) Involuntary conversions and sales or exchanges of property subject to the provisions of section 1231,

(*c*) Securities subject to the provisions of section 165(g)(3), or

(*d*) Debts subject to the provisions of section 166,

to the extent that such deductions otherwise allowable are attributable to events preceding the date upon which such corporation became a member of the group, and

(*e*) Being capital losses, exceed (*1*) the capital gains reduced by all other capital losses of such corporation for the taxable year, in the case in which such corporation was not, on January 1, 1954, a member of an affiliated group within the meaning of section 1504, or (*2*) in case such corporation was a member of an affiliated group on January 1, 1954, an amount which together with like losses computed subject to the provisions of the regulations under section 1502 in the case of other members of the group during the taxable year which were affiliated with such corporation on January 1, 1954, within the meaning of section 1504 is equal to the aggregate capital gains reduced by the aggregate of all other capital losses of such corporation and of such other members of the group, or

(*f*) Being ordinary losses exceed (*1*) the ordinary taxable income of such corporation for the taxable year increased in an amount equal to any excess of capital gains over capital losses for the taxable year, in the case in which such corporation was not, on January 1, 1954, a member of an affiliated group within the meaning of section 1504, or (*2*) in case such corporation was a member of an affiliated group on January 1, 1954, an amount which, together with like losses computed subject to the provisions of the regulations under section 1502 in the case of other members of the group during the taxable year which were affiliated with such corporation on January 1, 1954, within the meaning of section 1504, is equal to the ordinary taxable income of such corporation for the taxable year increased by the aggregate of the ordinary taxable income and decreased by the aggregate of the ordinary net losses of other members of the affiliated group during the taxable year which were affiliated with such corporation on January 1, 1954, within the meaning of section 1504, and increased further in an amount equal to any excess of aggregate capital gains over aggregate capital losses of such corporations,

such capital gains and losses, and ordinary taxable income and net losses, as the case may be, being determined pursuant to the provisions of the regulations under section 1502 but without regard to the provisions of (b)(1)(iv) and (b)(2)(iii)(*b*) of this section, and without regard to the losses in question.

(iii) The portion of any loss otherwise allowable as a deduction for the taxable year which is disallowed pursuant to the provisions of (i) and (ii) of this subparagraph shall, to the extent that it constitutes a net capital loss or a net operating loss, be considered as a net capital loss or a net operating loss, as the case may be in respect to those members of the group by reference to which the amount of the deduction disallowed under (i) and (ii) of this subparagraph was determined, and, for the purpose of the carryback provisions, the year of the loss shall be considered as a taxable year occuring subsequent to the last taxable year in respect of which the income of such members of the group was included in a consolidated return, and, for the purpose of the carryover provisions, as a taxable year occurring prior to the first taxable year in respect of which their income was included in a consolidated return;

(iv) The provisions of (i) and (ii) shall not apply with respect to the common parent corporation of an affiliated group formed subsequent to January 1, 1954, or to the common parent corporation or subsidiaries of a group in existence on January 1, 1954, acquiring new members subsequent to January 1, 1954, or with respect to subsidiaries becoming members of the group subsequent to January 1, 1954—

(*a*) If the group consists solely of the common parent corporation and one or more subsidiaries created, directly or indirectly, by the common parent corporation or by other members of the group;

(*b*) If, immediately after the corporation involved became a member of the group, common parent corporation or subsidiary, as the case may be, stock possessing at least 80 percent of the voting power of all classes of its stock then outstanding and at least 80 percent of each class of its nonvoting stock then outstanding is owned, directly or indirectly, by substantially the same interests by which such stock was owned on January 1, 1954;

(*c*) If the affiliated group involved was formed, or the new subsidiary became a member of the group, as an incident to an involuntary conversion or to a transfer made pursuant to an order of the Securities and Exchange Commission, the Federal Communications Commission, the Interstate Commerce Commission, or a similar regulatory body of State or Federal Government; or

(*d*) To the extent to which, upon consideration of the facts or circumstances presented by the particular case, the Commissioner determines that a consolidated taxable income computed with respect to the affiliated group but without regard to those paragraphs will not serve to distort the income tax liability of the group or of any of its members.

(10) *Loss to group of investment in an affiliate.*—In the case of a loss to one or more members of an affiliated group sustained during the taxable year as the result of the worthlessness of the investment of such members in another affiliate, whether such investment was reflected in the stock, bonds, or open account advances to such other affiliate—

(i) Such losses shall be taken into account in the computation of consolidated taxable income for the year of the loss in an amount not greater in the aggregate than the excess of the consolidated taxable income for such year computed without regard to any such loss over that portion of such consolidated taxable income so computed attributable to such other affiliate; and

(ii) The portion of any such loss otherwise allowable as a deduction for the taxable year which is disallowed pursuant to the provisions of (i) shall be considered as a consolidated net operating loss to be taken into account as a consolidated carryback to the two preceding taxable years and as consolidated carryovers to succeeding taxable years, but in an amount not greater for any such year than the excess of the consolidated taxable income for such year, computed without regard to such carryback or carryover, as the case may be, over that portion of such consolidated taxable income so computed for such year attributable to such other affiliate.

(11) *Disposal of timber or coal.*—(i) *Intercompany transactions.*—Section 631 (b) or (c) (relating to the disposal of timber or coal) shall apply to an amount received by a member of the group only to the extent such amount is received by the member of the group as a party to a transaction described in section 631 (b) or (c) with persons not members of the group.

(ii) *Application of sections 531 and 541 to coal royalties.*—For the purpose of determining the consolidated accumulated taxable income and the consolidated undistributed personal holding company income the provisions of 631(c) shall not apply to any amount received by a member of the group upon the disposal of coal.

(12) *Mine exploration expenditures.*—(i) *Limitation under section 615(a).*—If the aggregate of the deductions, computed without regard to this sentence, allowable under section 615(a) to the several members of the group exceeds $100,000,

(*a*) The deduction under that section allowable to any member of the group shall be an amount which bears the same ratio to $100,000 as its deduction computed without regard to this sentence bears to the aggregate of such deductions so computed for the members of the group, except that,

(*b*) If all the members of the group consent in writing, the deduction under that section allowable to such member shall be the deduction under that section computed without regard to this sentence, or such part thereof as the common parent corporation shall determine at the time the consent is filed, provided, however, that the aggregate of the deductions so allowable for all members of the group shall not exceed $100,000.

(ii) *Limitation under 615(c).*—If the limitation provided in section 615(c) is applicable to any member of the group, such limitation shall be deemed applicable to all members of the group.

(13) *Apportionment of unused dividend carryover and allowance of consolidated deficiency dividends deduction.*—(i) *Apportionment of unused dividend carryover.*—If an affiliated group filing a consolidated return has an unused consolidated dividend carryover and if there are included as members of such group one or more corporations which make separate returns, or join in a consolidated return filed by

another affiliated group or if any member of the group computes its tax liability under section 541 pursuant to the last sentence of section 1.502-30(b)(4), in a succeeding taxable year, the portion of such unused consolidated dividend carryover attributable to such corporations severally shall be determined for the purpose of the dividend carryover, such portion in the case of any such corporation shall be determined in an amount proportionate to the deduction for dividends paid and the taxable incomes of the several affiliated corporations (determined with the adjustments provided in section 545) to the extent that such deduction and such taxable income were taken into account in the computation of the consolidated dividend carryover and the consolidated and undistributed personal holding company income.

(ii) *Deficiency dividends deduction.*—For the purpose of applying section 547, relating to deficiency dividends, in case the affiliated group is subject to tax on its consolidated undistributed personal holding company income for the taxable year to which the deficiency in personal holding company tax relates, the consolidated deficiency dividends deduction described in section 1.502-31(a)(25) shall be allowed.

(14) *Apportionment of consolidated charitable contribution deduction.*—If an affiliated group filing a consolidated return has an excess of the consolidated charitable contribution deduction over the limitation of paragraph (a)(1)(i)(*c*) of this section for the taxable year, and if there are included as members of such group one or more corporations which make separate returns or join in a consolidated return filed by another affiliated group in a succeeding taxable year, the portion of such excess attributable to such corporations severally shall be determined, such portion in the case of any such corporation being determined in an amount proportionate to such excess as the contributions of each such corporation bear to the aggregate of such contributions.

(15) *Limitation on section 175 carryovers from separate return years.*—In no case shall there be included in the consolidated section 175 deductions for the taxable year as consolidated section 175 carryovers under (a)(36)(ii) of this section (relating to excess section 175 deductions of a corporation for years for which separate returns were filed or for which such corporation joined in a consolidated return filed by another affiliated group), an amount exceeding in the aggregate the amount by which 25 percent of the gross income of such corporation derived from farming included in the computation of the consolidated section 175 gross income for the taxable year exceeds the amount of the expenditures of such corporation of the taxable year deductible under section 175.

(16) *Apportionment of consolidated section 175 deduction.*—If an affiliated group filing a consolidated return has an excess of the consolidated section 175 deduction over the limitation of 25 percent of the consolidated section 175 gross income for the taxable year, and if there are included as members of such group one or more corporations which make separate returns, or are joined in a consolidated return filed by another affiliated group, in a succeeding taxable year, the portion of such excesses attributable to such corporations severally shall be determined; such portion in the case of any such corporation being determined in an amount proportionate to such excess as the deductions of each such corporation bears to the aggregate of such deductions.

(17) *Applicability of consolidated section 175 deduction.*—An affiliated group shall not be eligible to use the consolidated section 175 deduction unless all of the members of such group which are engaged in the business of farming during the taxable year have adopted, pursuant to section 175(d), the method described in section 175. In the case of a corporation which is a member of an affiliated group which is not eligible to use the consolidated section 175 deduction, the deduction provided by section 175 shall be used in the computation of the taxable income of such corporation in the same manner and under the same conditions as if a separate return were to be filed, except that the gross income from farming of such corporation shall be determined without regard to profits or losses on intercompany transactions; and proper adjustment shall be made to elminate any distortion in the amount of gross income attributable to transactions between members of the group at markedly fictitious values.

(18) *Computation of consolidated accumulated taxable income.*—In the computation of consolidated accumulated taxable income no amount shall be taken into account with respect to any income or deductions attributable to members of the affiliated group which are subject to tax under section 541 as described in the last sentence of section 1.1502-30(b)(4).

(19) *Law applicable to the computation of consolidated dividends carryover.*—In the computation of the consolidated section 561 dividends paid deduction, the amount of the consolidated dividends carryover from a year to which subtitle A is not applicable to a taxable year to which such subtitle applies shall be determined under Regulations 129 if a consolidated return was filed for the year in which the dividends were paid or under the provisions of the Internal Revenue Code of 1939 if a separate return was filed for such year.

(20) *Law applicable to computation of deficiency dividends deduction.*—If a deficiency is asserted with respect to a taxable year which began before January 1, 1954, the amount of any "deficiency dividend" shall include only amounts which would have been includible in the computation of the consolidated basic surtax credit, as defined in Regulations 129, or in the computation under the Internal Revenue Code of 1939 of the basic surtax credit for such taxable year, as the case may be.

(21) *Rules with respect to net operating losses under sections 381 and 382.*—(i) If, in the computation of the consolidated net operating loss carryover, there is included an amount with respect to a net operating loss of a corporation sustained in a taxable year for which it filed a separate return or for which such corporation joined in a consolidated return filed by another affiliated group, which is a transferor or distributor of assets to a member of the affiliated group within the meaning of section 381(a), the amount allowable as a carryover with respect to such transferor or distributor shall not exceed the amount of the taxable income of the acquiring corporation included in the computation of the consolidated taxable income for the taxable year. The computation shall be made as described in (b)(3) of this section as though the acquiring corporation had sustained a net operating loss in a year for which separate returns were filed or for which the acquiring corporation had joined in a consolidated return filed by another affiliated group.

(ii) If, in addition to the amount described in (i) above, there is included an amount with respect to a net operating loss sustained by the acquiring corporation in a year for which it filed separate returns or for which it joined in a consolidated return filed by another affiliated group, the losses sustained by both the acquiring corporation and the transferor or distributor corporation which may be taken into account as a net operating loss deduction in determining the consolidated taxable income may not exceed the taxable income of the acquiring corporation computed in a manner described in (b)(3) of this section.

(iii) For purposes of (i) and (ii), if the transferor or distributor corporation was a member of another affiliated group which filed a consolidated return, the amount of the consolidated net operating loss of such affiliated group, if any, attributable to such transferor or distributor, shall be treated as the net operating loss of such corporation separately sustained.

(iv) In any case in which a consolidated net operating loss was sustained by an affiliated group which includes a member whose net operating loss is subject to the limitations upon net operating losses provided by section 382, such section shall be applicable with respect to such member as if the portion of such consolidated net operating loss attributable to such corporation were a net operating loss of such corporation separately sustained.

(22) *Rules with respect to capital loss carryovers under section 381.*—(i) If in the computation of the consolidated net capital loss carryovers for a taxable year there is included an amount with respect to a net capital loss of a corporation sustained in a taxable year for which it filed a separate return or for which such corporation joined in a consolidated return filed by another affiliated group, which is a transferor or distributor of property to a member of the affiliated group within the meaning of section 381(a), the amount allowable with respect to such transferor or distributor shall not exceed the net capital gains of the acquiring corporation (determined without regard to any net capital loss carryover) included in the computation of the consolidated net capital gain for the taxable year increased with respect to its separate gains for involuntary conversions and from sales or exchanges of property subject to the provisions of section 1231.

(ii) If there is included under (a)(11)(ii) of this section an amount with respect to net capital losses separately sustained by such acquiring corporation in years for which separate returns were filed or for which such corporation joined in a consolidated return filed by another affiliated group, the limitation described in (i) above shall be applicable with respect to the aggregate of such losses and the losses of its transferor or distributor corporations.

(iii) For purposes of (i) and (ii) if the transferor or distributor corporation was a member of another affiliated group which filed a consolidated return, the amount of the consolidated net capital loss of such affiliated group, if any, attributable to such transferor or distributor, shall be treated as the net capital loss of such corporation separately sustained.

(c) *Statements and schedules for subsidiaries.*—The statement of gross income and deductions and the several schedules required by the instructions on the return must be prepared and filed by the common

parent corporation in columnar form so that the details of the items of gross income, deductions, and credits, for each member of the affiliated group, may be readily audited. Such statements and schedules shall include in columnar form a reconciliation of surplus for each such corporation, together with a reconciliation of the consolidated surplus. Consolidated balance sheets as of the beginning and close of the taxable year of the group, taken from the books of the members of the group, shall accompany the consolidated return prepared in a form similar to that required for reconciliation of surplus. If any member of the affiliated group computes its tax under section 541 in the manner provided in section 1.1502-30(b)(4), a personal holding company schedule for such corporation shall be filed with the consolidated return.

(d) *Net operating loss deduction, excess charitable contributions, excess section 175 deductions, and dividend carryover before or after consolidated return period.*—The consolidated net operating loss of an affiliated group, the excess of the consolidated charitable contributions over the 5 percent limitation of section 1.1502-31(a)(1)(i)(*c*), the excess of the deductions under section 175 over the limitation of 25 percent provided in section 1.1502-31(a)(1)(i)(*f*), or the unused consolidated dividend carryover shall be used in computing the consolidated net operating loss deduction, the consolidated charitable contribution carryover, the consolidated section 175 carryover, or the consolidated dividend carryover, as the case may be, notwithstanding that one or more corporations members of the group in the taxable year in which such loss or carryovers originate make separate returns (or join in a consolidated return made by another affiliated group) for a subsequent taxable year (or in the case of a carryback computation for a preceding taxable year), but only to the extent that such consolidated net operating loss, such excess charitable contribution, such excess section 175 deduction, or such unused consolidated dividend carryover is not attributable to such corporations; and such portion of such consolidated net operating loss, such excess charitable contributions, such unused section 175 deductions, or such unused consolidated dividend carryover as is attributable to the several corporations making separate returns or computing their tax liability under section 541 pursuant to the last sentence of section 1.1502-30(b)(4) (or joining in a consolidated return made by another affiliated group) for a subsequent taxable year (or in the case of a carryback computation for a preceding taxable year) shall be used by such corporations severally as carryovers or as carrybacks in such separate returns in such separate computations under section 541, or in such consolidated returns of the other affiliated group. Any unused dividend carryover of a corporation separately produced for a year prior to a taxable year in respect of which its tax liability under section 541 is computed upon the consolidated undistributed personal holding company income shall be used in computing the dividend carryover of such corporation (or the consolidated dividend carryover of another affiliated group of which it becomes a member) for a subsequent taxable year for which it makes a separate return or joins in a consolidated return of another group, but only to the extent that such unused dividend carryover was not absorbed in the computation of the consolidated section 561 dividends paid deduction for the intervening consolidated return

period. Any net operating loss separately sustained by a corporation prior to a first taxable year in respect of which its income is included in the consolidated return of the group (or in either of the two years immediately following a consolidated return year) shall be used in computing the net operating loss deduction of such corporation (or the consolidated net operating loss deduction of another affiliated group of which it becomes a member) for a subsequent taxable year for which it makes a separate return or joins in a consolidated return of another group, but only to the extent that such net operating loss was not absorbed (either as a carryover or as a carryback) in the computation of the consolidated net operating loss deduction for consolidated return periods. Any excess of charitable contributions of a corporation for the year prior to a first taxable year in respect of which its income is included in the consolidated return of the group shall be used in computing the charitable contribution deduction of such corporation (or the consolidated charitable contribution deduction of another affiliated group of which it becomes a member) for a subsequent taxable year for which it makes a separate return or joins in a consolidated return of another group, but only to the extent that such excess charitable contribution was not absorbed as a carryover in the consolidated charitable contribution deduction for consolidated return periods. Any excess of section 175 deductions of a corporation for a year prior to a first taxable year in respect of which its income is included in the consolidated return of the group shall be used in computing the section 175 deduction of such corporation (or the consolidated section 175 deduction of another affiliated group of which it becomes a member) for a subsequent taxable year for which it makes a separate return or joins in a consolidated return of another group, but only to the extent that such excess section 175 deduction was not absorbed as a carryover in the computation of a consolidated section 175 deduction for consolidated return periods.

(e) *Taxable year of less than 12 months.*—Any period of less than 12 months for which either a separate return or a consolidated return is filed under the provisions of section 1.1502–13 shall be considered as a taxable year.

SEC. 1.1502–32. METHOD OF COMPUTATION OF INCOME FOR PERIOD OF LESS THAN 12 MONTHS.—If a corporation, during the taxable year of the group, becomes a member or ceases to be a member of an affiliated group which makes or is required to make a consolidated return for such year, the income of such corporation to be included in the consolidated return shall be computed on the basis of its income as shown by its books if the accounts are so kept that the income for the period during which it is a member of the group can be clearly and accurately determined. If the accounts are not so kept, the income to be included in the consolidated return shall be computed on the basis of that proportion of its income (subject to the elimination of items exempt from taxation and the addition of items not allowable as deductions) for the full period covered by its books which the number of days for which its income is included in the consolidated return bears to the number of days in the full period covered by its books; but, in the discretion of the Commissioner, there may be eliminated before the proration is made items of income or deduction clearly and accurately determined to be attributable to particular periods,

and, after the proration is made, such eliminated items will be added to (if items of income) or deducted from (if deductible items) the income determined by proration for the period to which such items are applicable.

SEC. 1.1502–33. GAIN OR LOSS FROM SALE OF STOCK, OR BONDS OR OTHER OBLIGATIONS.—Gain or loss from the sale or other disposition (whether or not during a consolidated return period), by a corporation which during any period of time has been a member of an affiliated group which makes or is required to make a consolidated return, of any share of stock or any bond or other obligation issued or incurred by another corporation which during any part of such period was a member of the same group, shall be determined, and the extent to which such gain or loss shall be recognized and shall be taken into account shall also be determined, in the same manner, to the same extent, and upon the same conditions as though such corporations had never been affiliated except—

(a) In the case of a disposition (by sale, or in complete or partial liquidation not involving cash in an amount in excess of the adjusted basis of both the stock and the bonds and other indebtedness liquidated, or otherwise) during a consolidated return period to another member of the group (sections 1.1502–31 and 37);

(b) That the basis for determining the gain or loss, in the case of shares of stock, or in the case of bonds or other obligations, held during any part of a consolidated return period, shall be determined in accordance with sections 1.1502–34 and 35; and

(c) As provided in section 1.1502–36 (imposing certain limitations upon losses otherwise allowable upon sales of stock, or bonds or other obligations).

SEC. 1.1502–34. SALE OF STOCK; BASIS FOR DETERMINING GAIN OR LOSS.—(a) *Scope of section.*—This section prescribes the basis for determining the gain or loss upon any sale or other disposition (hereinafter referred to as "sale") by a corporation which is (or has been) a member of an affiliated group which makes (or has made) a consolidated return for any taxable year, of any share of stock issued by another member of such group (whether issued before or during the period that it was a member of the group and whether issued before, during, or after the taxable year 1929), and held by the selling corporation during any part of a period for which a consolidated return is made or required under the regulations under section 1502. For the basis in the case of a sale of bonds, see section 1.1502–35.

(b) *Sales made while selling corporation is member of affiliated group.*—If the sale is made within a period during which the selling corporation is a member of the affiliated group, whether or not during a consolidated return period, and whether or not, as a result of such sale, the issuing corporation ceases to be a member of the group, the basis shall be determined as follows:

(1) The aggregate bases of all shares of stock of the issuing corporation held by each member of the affiliated group (exclusive of the issuing corporation) immediately prior to the sale, shall be determined separately for each member of the group, and adjusted in accordance with the other provisions of subtitle A, but

without regard to any adjustment under the last sentence of section 1051 relating to losses of the issuing corporation sustained by such corporation after it became a member of the group.

(2) From the combined aggregate bases as determined in subparagraph (1), there shall be deducted the sum of—

(i) All losses of such issuing corporation sustained during taxable years for which consolidated income tax returns were made or were required (whether the taxable year 1929 or any prior or subsequent taxable year) after such corporation became a member of the affiliated group and prior to the sale of the stock to the extent that such losses could not have been availed of by such corporation as net loss or net operating loss in computing its net income or taxable income, as the case may be, for such taxable years if it had made a separate return for each of such years,

(ii) With respect to each of such taxable years for which consolidated returns were made or were required both for income and for excess profits tax purposes, the excess, if any, of all losses of such issuing corporation for such year, properly adjusted in the computation of consolidated excess profits net income over the amount of such losses for such year computed under (i) to the extent that such excess could not have been availed of by such corporation as a net operating loss in computing its excess profits net income for such taxable years if it had made a separate return for each of such years, and

(iii) With respect to each of such taxable years for which consolidated returns were made or were required for excess profits tax purposes only, all losses of such issuing corporation for such year, properly adjusted in the computation of consolidated excess profits net income, to the extent that such losses could not have been availed of by such corporation as a net operating loss in computing its excess profits net income for such taxable years if it had made a separate excess profits tax return for each of such years,

reduced by any losses of the issuing corporation apportioned under this section to its stock sold or otherwise disposed of in a prior transaction, disregarding any transaction between members of the affiliated group during a consolidated income or excess profits tax return period which did not constitute a partial liquidation of the issuing corporation. For any taxable year in which the group sustained a consolidated loss not availed of in prior or subsequent years as a deduction under net loss or net operating loss provisions, the amount deducted under this subparagraph shall be further reduced by an amount equal to that proportion of such consolidated loss which the loss of the issuing corporation for the year in which such loss was sustained bears to the aggregate losses of the members of the group for such year.

(3) The sum of the aggregate bases of all shares of stock, after making the deduction under subparagraph (2), shall then be apportioned among the members of the affiliated group which hold stock of the issuing corporation, by allocating to each such member that proportion of the sum of the aggregate bases so reduced

which the aggregate basis of the stock in the issuing corporation held by such member bears to the sum of the aggregate bases.

(4) The aggregate basis as determined under subparagraph (3) for each member of the affiliated group shall then be equitably apportioned among the several classes of stock of the issuing corporation held by such member according to the circumstances of the case—ordinarily by allocating to each class of such stock that proportion of the aggregate basis which the basis of each class of such stock held by it at the time of the sale is to the sum of the bases of the several classes of such stock held by it.

(5) The basis of each share of stock of each class held by a member of the affiliated group shall then be determined by dividing the basis apportioned to such class under subparagraph (4) by the total number of shares of such class held by it.

(c) *Sales after selling corporation has ceased to be member of affiliated group.*—If the sale is made after the selling corporation has ceased to be a member of the affiliated group, such basis shall be determined in accordance with paragraph (b), of this section except that—

(1) The aggregate basis (under paragraph (b)(1)) shall be determined for all shares of the issuing corporation held by each member of the group immediately prior to the time the selling corporation ceased to be a member of the group (rather than immediately prior to the sale);

(2) The reduction (under paragraph (b)(2)) with respect to losses apportioned to stock sold or otherwise disposed of in prior transactions shall be determined without regard to the transaction which terminated the affiliation and all subsequent transactions;

(3) The allocation (under paragraph (b)(3)) shall be made to each member of the group which held stock of the issuing corporation immediately prior to the time the selling corporation ceased to be a member of the group (rather than to the members holding such stock at the time of the sale); and

(4) The basis of each share of stock held by the selling corporation (determined, as above, as of the time the selling corporation ceased to be a member of the group) shall then be adjusted in accordance with the other provisions of subtitle A in order to determine the basis at the time of the sale.

(d) *Definition of "loss", "consolidated loss", "net loss", or "net operating loss", and "consolidated excess profits net income".*—As used in this section the term "loss" means either the excess over the gross income of the issuing corporation of the sum of its allowable deductions (not including any net loss or net operating loss deduction) allowable in computing consolidated taxable income or the excess over the gross income of the issuing corporation of the sum of its allowable deductions (not including any net loss or net operating loss deduction), plus the proportionate part properly attributable to such corporation of the credits relating to interest on certain Government obligations and dividends received allowable in computing consolidated normal tax net income, the consolidated special class net income or consolidated net income subject to tax determined in accordance with the Internal Revenue Code of 1939 and provisions of consolidated returns

regulations applicable to the period. The term "consolidated loss" means the excess of the sum of the losses, separately computed, over the sum of the normal tax net income, the special class net income, the net income subject to tax or the taxable income determined in accordance with the provisions of the Internal Revenue Code of 1939 or the Revenue Act or of subtitle A of the Internal Revenue Code of 1954 and pursuant to the provisions of consolidated returns regulations applicable to the period; the term "net loss" or "net operating loss" means the net loss or net operating loss, as the case may be, determined in accordance with the provisions of the Internal Revenue Code of 1939 or the Revenue Act or of subtitle A of the Internal Revenue Code of 1954 and pursuant to the provisions of consolidated returns regulations applicable to the period; and the term "consolidated excess profits net income" means the consolidated excess profits net income or consolidated section 433(a) excess profits net income determined in accordance with the provisions of the Internal Revenue Code of 1939 or the Revenue Act and pursuant to the provisions of consolidated returns regulations applicable to the period.

SEC. 1.1502–35. SALE OF BONDS OR OTHER OBLIGATIONS; BASIS FOR DETERMINING GAIN OR LOSS.—In the case of a sale or other disposition by a corporation, which is (or has been) a member of an affiliated group which makes (or has made) a consolidated income tax or excess profits tax return for any taxable year, of bonds or other obligations issued or incurred by another member of such group (whether or not issued or incurred while it was a member of the group and whether issued or incurred before, during, or after the taxable year 1929) and held by the selling corporation during any part of a period for which a consolidated return is made or required under the regulations under section 1502, the basis of each bond or obligation, for determining the gain or loss upon such sale or other disposition, determined in accordance with the other provisions of subtitle A, but without regard to any adjustment under the last sentence of section 1051, shall be decreased (except as otherwise provided in this section) by the excess, if any, of the aggregate of the deductions computed under section 1.1502–34 (b) (2) or (c) over the sum of the aggregate bases of the stock of the debtor corporation as computed under section 1.1502–34 (b) (1) or (c) as the case may be, held by the members of the group. The adjustment with respect to so much of such deductions as is based upon losses sustained during the taxable year 1929 and subsequent taxable years for which the last day prescribed by law for the filing of the return fell on or before March 1, 1945, (the date on which Treasury Decision 5441 was filed with the Division of the Federal Register) and availed of on consolidated returns filed for such years shall be made only in those cases in which the sales or other disposition of such bonds or other obligations resulted in a loss. See also section 1.1502–40 relating to disallowance of loss upon intercompany bad debts.

SEC. 1.1502–36. LIMITATION ON ALLOWABLE LOSSES ON SALE OF STOCK, OR BONDS, OR OTHER OBLIGATIONS.—(a) *General rule.*—No loss shall be allowed under sections 1.1502–33, 34, or 35 upon the sale or other disposition of stock or bonds or obligations to the extent that such loss is attributable to—

(1) Transfers of assets within the affiliated group (by sale, gift, or otherwise) without consideration or at markedly fictitious values, during the period in which the corporations were affiliated (whether or not a consolidated return was made), or

(2) A distribution during a period in which the corporations were affiliated of earnings or profits accumulated prior to the date upon which the distributing corporation became a member of the group.

(b) *Qualification of general rule.*—Paragraph (a) of this section shall not be considered as in any way limiting the operation of the provisions of subtitle A relating to the basis for determining gain or loss upon the sale or other disposition of property, but as being in amplification of and not in substitution for such provisions; subject, however, to this qualification; that to the extent that the transfers of assets referred to in paragraph (a) are taken into account under the terms of subtitle A in making adjustments in the basis, such transfers will not be taken into account in denying losses under paragraph (a).

SEC. 1.1502–37. LIQUIDATIONS; RECOGNITION OF GAIN OR LOSS—(a) *During consolidated return period.*—(1) Gain or loss shall not be recognized upon a distribution during a consolidated return period, by a member of an affiliated group to another member of such group, in cancellation or redemption of all or any portion of its stock, except—

(i) Where such distribution is in complete liquidation and redemption of all of its stock (whether in one distribution or a series) and of its bonds and other indebtedness, if any, and falls without the provisions of section 332, and is the result of a bona fide termination of the business and operations of such member of the group, in which case the adjustments specified in sections 1.1502–34 and 1.1502–35 shall be made, and section 1.1502–36 shall be applicable; or

(ii) Where such a distribution without the provisions of section 332 is one made in cash in an amount in excess of the adjusted basis of the stock, and bonds and other indebtedness, in which case gain shall be recognized to the extent of such excess.

(2) When the business and operations of the liquidated member of the affiliated group are continued by another member of the group, it shall not be considered a bona fide termination of the business and operations of the liquidated member. With respect to the acquisition of its bonds by the issuing company, see section 1.1502–41(b).

(3) For the purpose of determining whether an affiliated corporation receiving property in a liquidating distribution qualifies under the provisions of section 332(b)(1), the aggregate amount of the stock of the liquidated corporation owned by the several members of the affiliated group on the date of the adoption of the plan of liquidation and at all times, subsequent thereto and prior to the receipt of the property in liquidation shall be considered as owned by the distributee.

(b) *After consolidated return period.*—In case any such distribution is made after a consolidated return period, whether in complete or partial liquidation, except a complete liquidation within the provisions of section 332(b), with respect to stock and with respect to bonds, debentures, notes, certificates, and other indebtedness of the liquidated corporation acquired prior to or during any taxable year subsequent to 1928 for which a consolidated income or excess profits tax return was

filed, the adjustments specified in sections 1.1502–34 and 1.1502–35 shall be made, and section 1.1502–36 will be applicable.

SEC. 1.1502–38. BASIS OF PROPERTY—(a) *General rule.*—Subject to the provisions of paragraphs (b) and (c) and except as otherwise provided in sections 1.1502–34, 1.1502–35 and 1.1502–39 the basis during a consolidated return period for determining the gain or loss from the sale or other disposition of property, or upon which exhaustion, wear and tear, obsolescence, amortization, and depletion are to be allowed, shall be determined and adjusted in the same manner as if the corporations were not affiliated, whether such property was acquired before or during a consolidated return period. Except as otherwise provided in section 1.1502–39 such basis immediately after a consolidated return period (whether the affiliation has been broken or whether the privilege of making a consolidated return is not exercised) shall be the same as immediately prior to the close of such period.

(b) *Intercompany transactions.*—The basis prescribed in paragraph (a) shall not be affected by reason of a transfer during a consolidated return period, other than upon liquidation as provided in paragraph (c) (whether by sale, gift, dividend, or otherwise) from a member of the affiliated group to another member of such group.

(c) *Basis after liquidation.*—(1) Where property is acquired upon a distribution described in section 1.1502–37(a) in which gain or loss is recognized to the distributee, the basis of such property shall be its fair market value at date of acquisition.

(2) Where property is acquired upon a liquidation to which section 332 is applicable and if the first distribution in pursuance of the plan of liquidation occurs on or after June 22, 1954—

(i) Unless (ii) is applicable, the basis of such property shall be the same as it would be in the hands of the transferor;

(ii) If the basis of such property is determined under 334(b)(2), such section shall be applicable in determining the basis of property received on the liquidation (except property received by the liquidating corporation from other members of the affiliated group during a consolidated return period) and to any property transferred by the liquidating corporation to other members of the group during a consolidated return period as if such property had not been transferred and was received in such liquidation. In addition, proper adjustment shall be made with respect to the effect of any other transactions between members of the group during a consolidated return period which creates a distortion of income or a substantial variation in basis of property from the basis such property would have had if there had been no such transactions.

(3) Where property is acquired upon a distribution (not a complete liquidation within the provisions of section 332(b)) in which gain or loss to the distributee is not recognized as provided in section 1.1502–37(a) the basis of such property shall be the same as the basis of the stock and the bonds and other obligations exchanged therefor, adjusted for—

(i) The transfer of assets within the affiliated group by the distributing corporation (by sale, gift, or otherwise) without consideration or at markedly fictitious values, during the period for which the corporations were affiliated (whether or not a consolidated return was made);

(ii) Distributions during a period in which the corporations were affiliated of earnings or profits accumulated prior to the date upon which the distributing corporation became a member of the group; and

(iii) Cash received in the distribution.

(4) Where property was acquired upon a distribution in which gain or loss to the distributee was recognized pursuant to the provisions of section 333(a) or the corresponding provisions of the Internal Revenue Code of 1939 or the Revenue Act of 1938, the basis of such property shall be the same as the basis of the stock exchanged therefor, adjusted for—

(i) The transfer of assets within the affiliated group by the distributing corporation (by sale, gift, or otherwise) without consideration or at markedly fictitious values, during the period for which the corporations were affiliated (whether or not a consolidated return was made);

(ii) Distribution during a consolidated return period of earnings or profits accumulated prior to the date upon which the distributing corporation became a member of the group;

(iii) Cash received in the distribution; and

(iv) The amount of gain recognized to the distributee in the liquidation.

(d) *Basis not affected by acquisition or sale of stock.*—Neither the acquisition of stock of a corporation nor its sale or other disposition shall affect the basis of the property of such corporation for determining gain or loss or upon which exhaustion, wear and tear, obsolescence, amortization, and depletion are to be allowed.

SEC. 1.1502-39. INVENTORIES.—(a) *Consolidated return for first year of affiliation.*—If the income of an affiliated corporation is included in a consolidated return for the period immediately following the date upon which such corporation became a member of the affiliated group, the value of its opening inventory to be used in computing the consolidated taxable income shall be the proper value of the closing inventory used in computing its taxable income for the preceding taxable year.

(b) *Consolidated return after separate return by affiliates.* If—

(1) A corporation which is a member of the affiliated group for the first consolidated return period was a member of the group in the preceding taxable year, or

(2) A corporation which filed a separate return for its previous taxable year was not a member of the affiliated group within the meaning of section 141 of the Internal Revenue Code of 1939, at any time during the last taxable year of the group not subject to section 1502, but which would have been a member of the group during such period if section 1504 had been applicable and is a member of the affiliated group filing a consolidated return for the first taxable year to which section 1502 is applicable,

the value of its opening inventory to be used in computing the consolidated taxable income for the first consolidated return period shall be the proper value of the closing inventory used in computing its taxable income for the preceding taxable year, decreased in the amount of profits or increased in the amount of losses reflected in such inventories which arose in transactions between members of the affiliated group

and which have not been realized by the group through final transactions with persons other than members of the group.

(c) *Separate returns made after consolidated returns.*—If a corporation which was a member of an affiliated group in a consolidated return period makes or is required to make a separate return for the succeeding taxable year, the value of its opening inventory to be used in computing its taxable income for such succeeding taxable year shall be the proper value of its closing inventory used in computing consolidated taxable income for the last consolidated return period increased in the amount of profits or decreased in the amount of losses eliminated in the computation of such inventory as profits or losses arising in transactions between members of the affiliated group, but in an amount not exceeding, in the case of profits, either the amount of profits arising from such intercompany transactions reflected in the closing inventory of such corporation for such succeeding taxable year or the amount of such intercompany profits eliminated from its opening inventory for its first consolidated return period pursuant to the provisions of paragraph (b), and not exceeding, in the case of losses, either the amount of losses arising from intercompany transactions reflected in the closing inventory for such corporation for such succeeding taxable year or the amount of such intercompany losses eliminated from its opening inventory for its first consolidated return period pursuant to the provisions of paragraph (b) of this section.

SEC. 1.1502-40. BAD DEBTS.—(a) *Deduction during consolidated return period.*—No deduction shall be allowed during a consolidated return period to any member of the affiliated group on account of worthlessness in whole or in part of any obligation (including accounts receivable, bonds, notes, debts, and claims of whatsoever nature) of any other corporation which was a member of the group as of the last day of the taxable year or which was liquidated by the group during such year, except as a loss resulting from a bona fide termination of the business and operations of such other corporation, whether in liquidation or otherwise, in which case the loss shall be computed subject to the adjustments specified in section 1.1502-35 and the provisions of section 1.1502-36 shall be applicable.

(b) *Limitation of allowance after consolidated return period.* With respect to obligations (including accounts receivable) of a member of an affiliated group acquired in any way by another member of the group prior to or during any taxable year subsequent to 1928 for which a consolidated income or excess profits tax return was filed, the adjustments prescribed with respect to the allowance of losses upon the sale of bonds shall be applicable to the allowance of any bad debt deduction for any period subsequent to the consolidated return period. See section 1.1502-35.

SEC. 1.1502-41. SALE AND RETIREMENT BY CORPORATION OF ITS BONDS.—(a) *Issued at discount or premium.*—If a corporation which during any taxable year has been a member of an affiliated group which makes or is required to make a consolidated return, has issued its bonds at a discount or premium (whether or not during a consolidated return period), deduction will be allowed for the amortization of the discount, and income included for the amortization of the premium, in the same manner, to the same extent, and upon the same conditions as if the corporation had never been affiliated, except that no deduction for amortization of discount shall be allowed, and no income shall be

included for amortization of premium, during a period for which a consolidated return is made, on bonds of one member of the group owned by another member of the group.

(b) *Acquisition of bonds by issuing company.*—If a corporation which has been a member of an affiliated group which makes or is required to make a consolidated return, acquires its bonds (whether or not from another member of such group and whether or not during a consolidated return period), gain or loss shall be recognized in the same manner to the same extent and upon the same conditions as if the corporation had never been affiliated, except that, if such bonds are acquired from another member of the group during a consolidated return period, and in a transaction other than a distribution in a liquidation in which gain or loss to the distributee is recognized pursuant to section 1.1502–37(a) in determining the gain or loss to the issuing company from such acquisition, the basis thereof to such other member of the group shall be deemed the purchase price.

SEC. 1.1502–42. CAPITAL LOSS LIMITATIONS AND CARRYOVER.—(a) The provisions of sections 165, 832(c) (5), 1211, 1212, and 1231 with respect to gains and losses from sales or exchanges of capital assets shall be applied, in respect of such gains and losses sustained during a consolidated return period as if the affiliated group were the taxpayer.

(b) With respect to a net capital loss sustained by a corporation in a taxable year prior to the first consolidated return period in respect of which its income is included in a consolidated return, such loss (in an amount not in excess of the net capital gain of such corporation for succeeding consolidated return periods) shall, for the purposes of section 1212, relating to net capital loss carryovers, be treated is if such net capital loss had been sustained by the affiliated group.

(c) A consolidated net capital loss of an affiliated group for a consolidated return period shall be considered as a consolidated short-term capital loss in subsequent consolidated return periods notwithstanding that one or more corporations, members of the group in the taxable year in which such loss was sustained, make separate returns for subsequent taxable years (or join in a consolidated return made by another affiliated group), but only to the extent that such consolidated net capital loss is not attributable to such corporations; and such portion of such consolidated net capital loss as is attributable to the several corporations making separate returns (or joining in a consolidated return made by another affiliated group) for a subsequent taxable year shall be considered as a short-term capital loss in such separate returns, or in such consolidated return of the other affiliated group, but only to the extent that such portion of such consolidated net capital loss was not absorbed in intervening taxable years by net capital gains, consolidated or separate, as the case may be. Any net capital loss sustained by a corporation prior to the first taxable year in respect of which its income is included in the consolidated return shall be considered as a short-term capital loss in the separate return of such corporation (or the consolidated return of another affiliated group of which it becomes a member) for a subsequent taxable year for which it makes a separate return or joins in a consolidated return of another group, but only to the extent that such net capital loss was not absorbed in intervening taxable years by net capital gains, consolidated or separate, as the case may be.

SEC. 1.1502-43. CREDIT FOR FOREIGN TAXES.—The credit allowed to an affiliated group for taxes paid or accrued under section 901 and for taxes deemed to have been paid under section 902 during the consolidated return period to any foreign country or to any possession of the United States, shall be computed and allowed as if the affiliated group were the taxpayer and as if the aggregate taxes paid or deemed to have been paid by the several members of the group and the credits allowed with respect to such payments were payments made and deemed to have been made by, and credits allowed to, the group.

SEC. 1.1502-44. METHODS OF ACCOUNTING.—(a) *In general.*—All members of the affiliated group shall adopt that method of accounting which clearly reflects the consolidated taxable income. A method of accounting which does not treat with reasonable consistency all items of gross income and deductions of the various members of the group shall not be regarded as clearly reflecting the consolidated taxable income. For example, one member of the group will not be permitted to report items of income or deductions on the cash method of accounting while another member of the same group reports the same or similar items on the accrual method. The provisions of this paragraph are subject to the exceptions stated in (b).

(b) *Combination of methods.*—If the members of an affiliated group have established different methods of accounting, each member may retain such method with the consent of the Commissioner: Provided, That the consolidated taxable income is clearly reflected and, provided further that intercompany transactions affecting such consolidated taxable income shall be eliminated and adjustments on account of such transactions shall be made with reference to a uniform method of accounting to be selected by the members of the group with the consent of the Commissioner.

(c) *Adjustments required by changes in method of accounting.*—In any case in which a member of an affiliated group changes its method of accounting the provisions of section 481 (a) shall be applicable.

SEC. 1.1502-45. MINE EXPLORATION EXPENDITURES.—For the purpose of applying the limitation provided in section 615(c) (whether during a consolidated return period or during a period for which a separate return is made), if during a preceding taxable year for which a consolidated return was made or was required to be made any member of the affiliated group for such preceding taxable year was allowed the deduction provided in section 615(a) or made the election provided in section 615(b), each member of the affiliated group for such preceding taxable year shall be deemed to have been allowed such deduction or to have made such election, as the case may be.

SEC. 1.1502-46. DEPRECIATION.—In the computation of the deduction for depreciation under section 167, property received by one member of the group from another member of the group during a consolidated return period, shall be treated in the same manner as it could be treated if it were held by the transferor.

SEC. 1.1502-47. ELECTION TO DEDUCT ACCRUED TAXES.—If all members of the affiliated group were taxpayers which, for each taxable year in which they were subject to the tax imposed by section 500 of the Internal Revenue Code of 1939 deducted Federal income and excess

profits taxes when paid for the purpose of computing subchapter A net income under such Code, the affiliated group shall, if the tax liability under section 541 is computed upon the consolidated undistributed personal holding company income, deduct taxes under section 545 when paid unless a member of the common affiliated group elects in its return or the common parent elects in a consolidated return for the group of which it is the common parent for a taxable year ending after June 30, 1954, to deduct the taxes described in section 545, when accrued. In any case in which the common parent corporation or any member of the affiliated group has, prior to the taxable year, elected to deduct such taxes when accrued, each member of the group shall be deemed to have so elected in the first year thereafter in which its income is included in the consolidated personal holding company income. If an election is made by the common parent corporation with respect to a year for which the tax liability under section 541 is computed upon the consolidated undistributed personal holding company income, each member of the group shall be deemed to have made such election in such year. Any such election made or deemed to have been made shall be applicable to each member of the group for the taxable year for which the election is made and for all subsequent taxable years. Any election so made shall be irrevocable.

SEC. 1.1502–48. LIABILITY FOR TAX UNDER SECTION 531.—In any case in which an affiliated group computes the tax liability under section 541, upon the consolidated undistributed personal holding company income, the tax imposed by section 531 shall not be applicable.

SEC. 1.1502–49. ADDITIONS TO TAX FOR FAILURE TO PAY ESTIMATED TAX.—(a) Except in the case of an affiliated group described in (b), any addition to the tax under section 6655 for underpayment of estimated tax of a member of an affiliated group which files a consolidated return for the taxable year shall be determined by allocating the tax shown on the consolidated return to the several members of the group by any of the methods provided in section 1.1552–1(a) selected by the common parent corporation for the taxable year, without regard to the method elected under section 1552. If the group would use the method of allocation authorized by section 1.1552–1(a)(4), it must be the method elected by the group with the approval of the Commissioner for the purpose of determining earnings and profits. In the application of section 6655(d)(1) with respect to a member of the group which was included in a consolidated return for the preceding taxable year, whether or not such member is included in a consolidated return for the taxable year, the "tax shown on the return" for the preceding taxable year shall be the portion of the tax shown on such consolidated return determined by allocating such tax to the several members of the group by the procedure described above. In the application of section 6655(d)(2) if the corporation was included in a consolidated return for the preceding taxable year, the "facts shown on the return" shall be the facts shown on the consolidated return of the group (whether of this or another affiliated group) for the preceding taxable year attributable to such corporation.

(b) In the case of an affiliated group which has filed pursuant to the provisions of section 1.1502–10(c)(2) a declaration of estimated

tax for the taxable year for which a consolidated return is filed, any addition to the tax provided by section 6655 shall be determined by reference to the payments made on such declaration and to the tax shown on the consolidated return.

(c) In the application of section 6655(d)(1) with respect to the affiliated group described in (b), the "tax shown on the return" shall be—

(1) If the group filed a consolidated return for the preceding taxable year, the tax shown on such return, or

(2) If the group did not file a consolidated return for the preceding taxable year, the aggregate of the taxes of the several members of the group shown on any separate returns of such corporations for the preceding taxable year, plus the tax shown on a consolidated return for the preceding taxable year attributable to any member of the group which joined in a consolidated return with another affiliated group for such preceding taxable year. The tax attributable to any such corporation which joined in a consolidated return shall be determined by allocating the tax shown on such consolidated return in accordance with the procedure described in paragraph (a) of this section.

(d) In the application of section 6655(d)(2) with respect to the affiliated group described in (b), the "facts shown on the return" shall be—

(1) If the group filed a consolidated return for the preceding taxable year, the facts shown on such return, or

(2) If the group did not file a consolidated return for the ceding taxable year, the facts shown on the separate returns of the members of the affiliated group for the preceding taxable year together with the facts shown on a consolidated return for the preceding taxable year attributable to any member of the group which joined in a consolidated return with another affiliated group for such preceding taxable year.

SEC. 1.1502–50. GAIN ON SALE OF BONDS AND OTHER EVIDENCES OF INDEBTEDNESS.—In the application of section 1232(a), if one member of the affiliated group acquires a bond or other evidence of indebtedness from another member of the affiliated group during a consolidated return period, the determination of the amount which is treated as gain from the sale or exchange of property which is not a capital asset shall be made by including in the period of time during which such bond or other evidence of indebtedness was held, the period of time during which it was held by any other corporation which transferred it in a transaction to which section 1.1502–31(b)(1)(i) (or the corresponding provision of prior consolidated returns regulations) is applicable without regard to any period of time before the last sale or exchange of such instrument to which such section is not applicable. In the application of section 1232(c), if a bond or other evidence of indebtedness was acquired from another member of an affiliated group during a consolidated return period, then the bond or other evidence of indebtedness shall be deemed to have been purchased at the time of, and as having a market value with coupons attached, determined by reference to the earliest date of purchase by any other corporation which transferred it in a transaction to which section 1.1502–31(b)-

(1)(i) (or the corresponding provision of prior consolidated returns regulations) is applicable without regard to any purchase prior to the last purchase to which such section is not applicable.

SEC. 1.1503. STATUTORY PROVISIONS; COMPUTATION AND PAYMENT OF TAX.

SEC. 1503. COMPUTATION AND PAYMENT OF TAX.

(a) GENERAL RULE.—In any case in which a consolidated return is made or is required to be made, the tax shall be determined, computed, assessed, collected, and adjusted in accordance with the regulations under section 1502 prescribed prior to the last day prescribed by law for the filing of such return; except that the tax imposed under section 11(c) or section 831 shall be increased for any taxable year by 2 percent of the consolidated taxable income of the affiliated group of includible corporations. For purposes of this section, the term "consolidated taxable income" means the consolidated taxable income computed without regard to the deduction provided by section 242 for partially tax-exempt interest.

(b) LIMITATION.—If the affiliated group includes one or more Western Hemisphere trade corporations (as defined in section 921) or one or more regulated public utilities (as defined in subsection (c)), the increase of 2 percent provided in subsection (a) shall be applied only on the amount by which the consolidated taxable income of the affiliated group exceeds the portion (if any) of the consolidated taxable income attributable to the Western Hemisphere trade corporations and regulated public utilities included in such group.

(c) REGULATED PUBLIC UTILITY DEFINED.—

(1) IN GENERAL.—For purposes of subsection (b), the term "regulated public utility" means—

(A) A corporation engaged in the furnishing or sale of—

(i) Electric energy, gas, water, or sewerage disposal services, or

(ii) Transportation (not included in subparagraph (C)) on an intrastate, suburban, municipal, or interurban electric railroad, on an intrastate, municipal, or suburban trackless trolley system, or on a municipal or suburban bus system, or

(iii) Transportation (not included in clause (ii)) by motor vehicle—

if the rates for such furnishing or sale, as the case may be, have been established or approved by a State or political subdivision thereof, by an agency or instrumentality of the United States, by a public service or public utility commission or other similar body of the District of Columbia or of any State or political subdivision thereof, or by a foreign country or an agency or instrumentality or political subdivision thereof.

(B) A corporation engaged as a common carrier in the furnishing or sale of transportation of gas by pipeline, if subject to the jurisdiction of the Federal Power Commission.

(C) A corporation engaged as a common carrier (i) in the furnishing or sale of transportation by railroad, if subject to the jurisdiction of the Interstate Commerce Commission, or (ii) in the furnishing or sale of transportation of oil or other petroleum products (including shale oil) by pipe line, if subject to the jurisdiction of the Interstate Commerce Commission or if the rates for such furnishing or sale are subject to the jurisdiction of a public service or public utility commission or other similar body of the District of Columbia or of any State.

(D) A corporation engaged in the furnishing or sale of telephone or telegraph service, if the rates for such furnishing or sale meet the requirements of subparagraph (A).

(E) A corporation engaged in the furnishing or sale of transportation as a common carrier by air, subject to the jurisdiction of the Civil Aeronautics Board.

(F) A corporation engaged in the furnishing or sale of transportation by common carrier by water, subject to the jurisdiction of the Interstate Commerce Commission under part III of the Interstate Commerce Act, or subject to the jurisdiction of the Federal Maritime Board under the Intercoastal Shipping Act, 1933.

(2) LIMITATION.—For purposes of subsection (b), the term "regulated public utility" does not (except as provided in paragraph (3)) include a corporation described in paragraph (1) unless 80 percent or more of its gross income (computed without regard to dividends and capital gains and losses) for the taxable year is derived from sources described in paragraph (1). If the taxpayer establishes to the satisfaction of the Secretary or his delegate that—

(A) Its revenue from regulated rates described in paragraph (1) (A) or (D) and its revenue derived from unregulated rates are derived from its operation of a single interconnected and coordinated system or from the operation of more than one such system, and

(B) The unrelated rates have been and are substantially as favorable to users and consumers as are the regulated rates, such revenue from such unregulated rates shall be considered, for purposes of this paragraph, as income derived from sources described in paragraph (1) (A) or (D).

(3) CERTAIN RAILROAD CORPORATIONS.—

(A) Lessor Corporation.—For purposes of subsection (b), the term "regulated public utility" shall also include a railroad corporation subject to part I of the Interstate Commerce Act, if (i) substantially all of its railroad properties have been leased to another such railroad corporation or corporations by an agreement or agreements entered into prior to January 1, 1954, (ii) each lease is for a term of more than 20 years, and (iii) at least 80 percent or more of its gross income (computed without regard to dividends and capital gains and losses) for the taxable year is derived from such leases and from sources described in paragraph (1). For purposes of the preceding sentence, an agreement for lease of railroad properties entered into prior to January 1, 1954, shall be considered to be a lease including such term as the total number of years of such agreement may, unless sooner terminated, be renewed or continued under the terms of the agreement, and any such renewal or continuance under such agreement shall be considered part of the lease entered into prior to January 1, 1954.

(B) Common Parent Corporation.—For purposes of subsection (b), the term "regulated public utility" also includes a common parent corporation which is a common carrier by railroad subject to part I of the Interstate Commerce Act if at least 80 percent of its gross income (computed without regard to capital gains or losses) is derived directly or indirectly from sources described in paragraph (1). For purposes of the preceding sentence, dividends and interest, and income from leases described in subparagraph (A), received from a regulated public utility shall be considered as derived from sources described in paragraph (1) if the regulated public utility is a member of an affiliated group (as defined in section 1504) which includes the common parent corporation.

SEC. 1.1503-1. COMPUTATION AND PAYMENT OF TAX—(a) *General rule.*—In any case in which a consolidated return is filed or required to be filed, the tax shall be determined, computed, assessed, collected, and adjusted in accordance with the regulations prescribed under section 1502 promulgated prior to the last date prescribed by law for the filing of such return.

(b) *Limitation.*—If the affiliated group includes one or more Western Hemisphere trade corporations (as defined in section 921) or one or more regulated public utilities (as defined in section 1503(c)) the

increase in tax described in section 1503(a) shall be applied in a manner provided in the regulations under section 1502.

(c) *Regulated public utilities.*—For regulations relating to the definition of "regulated public utility", see section 1.1502–2(g).

SEC. 1.1504. STATUTORY PROVISIONS; DEFINITIONS.

SEC. 1504. DEFINITIONS.

(a) DEFINITION OF "AFFILIATED GROUP."—As used in this chapter, the term "affiliated group" means one or more chains of includible corporations connected through stock ownership with a common parent corporation which is an includible corporation if—

(1) Stock possessing at least 80 percent of the voting power of all classes of stock and at least 80 percent of each class of the nonvoting stock of each of the includible corporations (except the common parent corporation) is owned directly by one or more of the other includible corporations; and

(2) The common parent corporation owns directly stock possessing at least 80 percent of the voting power of all classes of stock and at least 80 percent of each class of the nonvoting stock of at least one of the other includible corporations.

As used in this subsection, the term "stock" does not include nonvoting stock which is limited and preferred as to dividends.

(b) DEFINITION OF "INCLUDIBLE CORPORATIONS."—As used in this chapter, the term "includible corporation" means any corporation except—

(1) Corporations exempt from taxation under section 501.

(2) Insurance companies subject to taxation under section 802 or 821.

(3) Foreign corporations.

(4) Corporations entitled to the benefits of section 931, by reason of receiving a large percentage of their income from sources within possessions of the United States.

(5) Corporations organized under the China Trade Act, 1922.

(6) Regulated investment companies subject to tax under subchapter M of chapter 1.

(7) Unincorporated business enterprises subject to tax as corporations under section 1361.

(c) INCLUDIBLE INSURANCE COMPANIES.—Despite the provisions of paragraph (2) of subsection (b), two or more domestic insurance companies each of which is subject to taxation under the same section of this subtitle shall be considered as includible corporations for the purpose of the application of subsection (a) to such insurance companies alone.

(d) SUBSIDIARY FORMED TO COMPLY WITH FOREIGN LAW.—In the case of a domestic corporation owning or controlling, directly or indirectly, 100 percent of the capital stock (exclusive of directors' qualifying shares) of a corporation organized under the laws of a contiguous foreign country and maintained solely for the purpose of complying with the laws of such country as to title and operation of property, such foreign corporation may, at the option of the domestic corporation, be treated for the purpose of this subtitle as a domestic corporation.

SEC. 1.1504–1. DEFINITIONS.—The privilege of filing consolidated returns is extended to all includible corporations constituting affiliated groups as defined in section 1504. See the regulations under section 1.1502 for a description of an affiliated group and the corporations which may be considered as includible corporations.

SEC. 1.1505. STATUTORY PROVISIONS; CROSS REFERENCES.

SEC. 1505. CROSS REFERENCES.

(1) For suspension of running of statute of limitations when notice in respect of a deficiency is mailed to one corporation, see section 6503(a)(1).

(2) For allocation of income and deductions of related trades or businesses, see section 482.

SEC. 1.1551. STATUTORY PROVISIONS; DISALLOWANCE OF SURTAX EXEMPTION AND ACCUMULATED EARNINGS CREDIT.

SEC. 1551. DISALLOWANCE OF SURTAX EXEMPTION AND ACCUMULATED EARNINGS CREDIT.

If any corporation transfers, on or after January 1, 1951, all or part of its property (other than money) to another corporation which was created for the purpose of acquiring such property or which was not actively engaged in business at the time of such acquisition, and if after such transfer the transferor corporation or its stockholders, or both, are in control of such transferee corporation during any part of the taxable year of such transferee corporation, then such transferee corporation shall not for such taxable year (except as may be otherwise determined under section 269(b)) be allowed either the $25,000 exemption from surtax provided in section 11(c) or the $60,000 accumulated earnings credit provided in paragraph (2) or (3) of section 535(c), unless such transferee corporation shall establish by the clear preponderance of the evidence that the securing of such exemption or credit was not a major purpose of such transfer. For purposes of this section, control means the ownership of stock possessing at least 80 percent of the total combined voting power of all classes of stock entitled to vote or at least 80 percent of the total value of shares of all classes of stock of the corporation. In determining the ownership of stock for the purpose of this section, the ownership of stock shall be determined in accordance with the provisions of section 544, except that constructive ownership under section 544(a)(2) shall be determined only with respect to the individual's spouse and minor children. The provisions of section 269(b), and the authority of the Secretary under such section, shall, to the extent not inconsistent with the provisions of this section, be applicable to this section.

SEC. 1.1551–1. DISALLOWANCE OF SURTAX EXEMPTION AND ACCUMULATED EARNINGS CREDIT.—(a) *In general.*—If one corporation transfers on or after January 1, 1951, all or part of its property (other than money) to another corporation, neither the $25,000 exemption from surtax provided in section 11(c) nor the $60,000 accumulated earnings credit provided in paragraph (2) or (3) of section 535(c) shall be allowed the transferee if:

(1) The transferee was created for the purpose of acquiring such property, or

(2) The transferee was not actively engaged in business at the time of the acquisition, and

(3) After such transfer, the transferor or its stockholders, or both, are in control of the transferee during any part of the taxable year of the transferee, unless—

(4) The transferee establishes by the clear preponderance of the evidence that the securing of either such exemption or credit or both was not a major purpose of such transfer, or

(5) The Commissioner allows such exemption or credit pursuant to the authority provided in section 1551 and section 269(b).

(b) *Purpose of section 1551.*—(1) The purpose of section 1551 is to prevent avoidance or evasion of the surtax imposed by section 11(c) or of the accumulated earnings tax imposed by section 531. It is not intended, however, that section 1551 be interpreted as delimiting or abrogating any principle of law established by judicial decision, or any existing provisions of the Internal Revenue Code, such as sections 269 and 482, which have the effect of preventing the avoidance or evasion of income taxes. Such principles of law and such provisions

of the Code, including section 1551 are not mutually exclusive, and in appropriate cases they may operate together or they may operate separately.

(2) The provisions of section 269(b) and the authority of the Commissioner thereunder, to the extent not inconsistent with the provisions of section 1551 are applicable to cases covered by section 1551. Pursuant to the authority provided in section 269(b) the Commissioner may allow to the transferee any part of a surtax exemption or accumulated earnings credit for a taxable year for which such exemption or credit would otherwise be disallowed under section 1551; or he may apportion such exemption or credit among the corporations involved. For example, Corporation A transfers on January 1, 1955, all its property to Corporations B and C in exchange for all the stock of such corporations. Immediately thereafter, Corporation A is dissolved and its stockholders become the sole stockholders of Corporations B and C. Assuming that Corporations B and C are unable to establish by the clear preponderance of the evidence that the securing of the surtax exemption provided in section 11(c) or the accumulated earnings credit provided in section 535 or both, was not a major purpose of the transfer, the Commissioner, nevertheless, has authority under sections 1551 and 269(b) to allow one such exemption and credit and to apportion such exemption and credit between Corporations B and C.

(3) For the purpose of section 1551 and this section, a corporation maintaining an office for the purpose of preserving its corporate existence is not considered to be "actively engaged in business" even though such corporation may be deemed to be "doing business" for other purposes. Similarly, for the purpose of section 1551 and this section, a corporation engaged in winding up its affairs, prior to an acquisition to which section 1551 is applicable, is not considered to be "actively engaged in business."

(c) *Meaning and application of the term "control."*—For the purpose of section 1551 and this section, the term "control" means the ownership of stock possessing either (1) at least 80 percent of the total combined voting power of all classes of stock entitled to vote, or (2) at least 80 percent of the total value of shares of all classes of stock of the corporation. In determining whether stock possessing at least 80 percent of the total combined voting power of all classes of stock entitled to vote is owned, all classes of such stock shall be considered together; it is not necessary that 80 percent of each class of voting stock be owned. Likewise, in determining whether stock possessing at least 80 percent of the total value of shares of all classes of stock is owned, all classes of stock of the corporation shall be considered together; it is not necessary that 80 percent of the value of shares of each class be owned. The fair market value of a share shall be considered as the value to be used for the purpose of this computation. The ownership of stock shall be determined in accordance with the provisions of section 544 and the regulations thereunder, except that constructive ownership under section 544(a)(2) shall be determined only with respect to the individual's spouse and minor children. For example, in addition to stock held directly or under an option to purchase, an individual is deemed to own stock held directly or indirectly by or for his spouse or minor children, and also to own a proportionate

part of the stock owned by a corporation, partnership, estate, or trust in which he holds an interest as a shareholder, partner, or beneficiary.

Disallowance of the exemption and credit under section 1551 is not limited to the taxable year of the transferee corporation in which the transfer of property occurs. Section 1551 provides for the disallowance of the exemption and credit for any taxable year whether the taxable year in which the transfer of property occurs or any subsequent taxable year of the transferee corporation, if, during any part of such year, the transferor corporation or its stockholders, or both, are in control of the transferee corporation. Thus, if Corporation D on January 1, 1955, transfers a part of its property to Corporation E, a corporation not actively engaged in business at the time of the acquisition of such property, in exchange for 60 percent of the voting stock of Corporation E, and, thereafter, during a later taxable year with respect to which section 1551 is applicable, acquires an additional 20 percent of the voting stock of Corporation E, Corporation D, by reason of such later acquisition, is considered to be in control of Corporation E as of the time of such acquisition for the purpose of section 1551. Accordingly, Corporation E will be disallowed the surtax exemption and accumulated earnings credit for the taxable year in which the later acquisition of stock occurred and for each taxable year thereafter in which the requisite control continues, unless Corporation E establishes by the clear preponderance of the evidence that the securing of such exemption or credit, or both, was not a major purpose of the transfer of the property in 1955.

In determining, for the purpose of section 1551 whether a corporation, its stockholders, or both, are in control of a transferee corporation, it is not necessary that the stock be acquired on or after January 1, 1951. Thus, if Corporation F on June 1, 1950, owns 70 percent of the voting stock of Corporation G, and, thereafter, on January 2, 1955, Corporation F acquires an additional 10 percent of such stock, control within the meaning of section 1551 is acquired by Corporation F on January 2, 1955.

(d) *Nature of transfer.*—A transfer made by any corporation of all or part of its assets, whether or not such transfer qualifies as a reorganization under section 368 is within the scope of section 1551 except that section 1551 does not apply to a transfer of money only. For example, the transfer of cash for the purpose of expanding the business of the transferor corporation through the formation of a new corporation is not a transfer within the scope of section 1551 irrespective of whether the new corporation uses the cash to purchase from the transferor corporation stock in trade or similar property.

(e) *Purpose of transfer.*—In determining, for the purpose of section 1551 whether the securing of the exemption from surtax or the accumulated earnings credit constituted "a major purpose" of the transfer, all circumstances relevant to the transfer shall be considered. For disallowance of the surtax exemption and accumulated earnings credit under section 1551, it is not necessary that the obtaining of either such credit or exemption or both have been the sole or principal purpose of the transfer of the property. It is sufficient if it appears, in the light of all the facts and circumstances, that the obtaining of such exemption or credit, or both, was one of the major considerations that prompted the transfer. Thus, the securing of the surtax exemption or the accumulated earnings credit may constitute "a major purpose" of the

transfer, notwithstanding that such transfer was effected for a valid business purpose and qualified as a reorganization within the meaning of section 368. The taxpayer's burden of establishing by the clear preponderance of the evidence that the securing of either such exemption or credit or both was not "a major purpose" of the transfer may be met, for example, by a showing that the obtaining of such exemption, or credit, or both, was not a major factor in relationship to the other consideration or considerations which prompted the transfer.

SEC. 1.1552. STATUTORY PROVISIONS; EARNINGS AND PROFITS.

SEC. 1552. EARNINGS AND PROFITS.

(a) GENERAL RULE.—Pursuant to regulations prescribed by the Secretary or his delegate the earnings and profits of each member of an affiliated group required to be included in a consolidated return for such group filed for a taxable year beginning after December 31, 1953, and ending after the date of enactment of this title, shall be determined by allocating the tax liability of the group for such year among the members of the group in accord with whichever of the following methods the group shall elect in its first consolidated return filed for such a taxable year:

(1) The tax liability shall be apportioned among the members of the group in accordance with the ratio which that portion of the consolidated taxable income attributable to each member of the group having taxable income bears to the consolidated taxable income.

(2) The tax liability of the group shall be allocated to the several members of the group on the basis of the percentage of the total tax which the tax of such member if computed on a separate return would bear to the total amount of the taxes for all members of the group so computed.

(3) The tax liability of the group (excluding the tax increases arising from the consolidation) shall be allocated on the basis of the contribution of each member of the group to the consolidated taxable income of the group. Any tax increases arising from the consolidation shall be distributed to the several members in direct proportion to the reduction in tax liability resulting to such members from the filing of the consolidated return as measured by the difference between their tax liabilities determined on a separate return basis and their tax liabilities (determined without regard to the 2 percent increase provided by section 1503 (a)) based on their contributions to the consolidated taxable income.

(4) The tax liability of the group shall be allocated in accord with any other method selected by the group with the approval of the Secretary or his delegate.

(b) FAILURE TO ELECT.—If no election is made in such first return, the tax liability shall be allocated among the several members of the group pursuant to the method prescribed in subsection (a)(1).

SEC. 1.1552-1. EARNINGS AND PROFITS.—(a) *General rule.*—For the purpose of determining the earnings and profits of each member of an affiliated group which is required to be included in a consolidated return for such group filed for a taxable year beginning after December 31, 1953, and ending after August 16, 1954, the tax liability of the group shall be allocated among the members of the group in accordance with whichever of the following methods the group shall elect in its first consolidated return for such a taxable year:

(1) The tax liability shall be apportioned among the members of the group in accordance with the ratio which that portion of the consolidated taxable income attributable to each member of the group having taxable income bears to the consolidated taxable income.

(2) The tax liability of the group shall be allocated to the several members of the group on the basis of the percentage of the total tax which the tax of such member if computed on a separate return would bear to the total amount of the taxes for all members of the group so computed.

(3) The tax liability of the group (excluding the tax increases arising from the consolidation) shall be allocated on the basis of the contribution of each member of the group to the consolidated taxable income of the group. Any tax increases arising from the consolidation shall be distributed to the several members in direct proportion to the reduction in tax liability resulting to such members from the filing of the consolidated return as measured by the difference between their tax liabilities determined on a separate return basis and their tax liabilities (determined without regard to the 2 percent increase provided by section 1503(a) and § 1.1502-30(a)) based on their contributions to the consolidated taxable income.

(4) The tax liability of the group shall be allocated in accord with any other method selected by the group with the approval of the Commissioner.

(b) *Method of election.*—The election under section 1552(a) (1), (2), or (3) shall be made not later than the time prescribed by law for filing the first consolidated return of the group for a taxable year beginning after December 31, 1953 and ending after August 16, 1954 (including extensions thereof). If the group elects to allocate its tax liability in accordance with the method prescribed in section 1552(a) (1), (2), or (3), a statement shall be attached to the return so stating. Such statement shall be made by the common parent corporation and shall be binding upon all members of the group. In the event that the group desires to allocate its tax liability in accordance with any other method pursuant to section 1552(a) (4), approval of such method by the Commissioner must be obtained within the time prescribed above. If such approval is not obtained in such time, the group shall allocate in accordance with the method prescribed in section 1552(a) (1). The request shall state fully the method which the group wishes to apply in apportioning the tax liability. An election once made shall be irrevocable and shall be binding upon the group with respect to the year for which made and for all future years for which a consolidated return is filed or required to be filed unless the Commissioner authorizes a change to another method prior to the time prescribed by law for filing the return for the year in which such change is to be effective.

(c) *Failure to elect.*—If a group fails to make an election in accordance with paragraph (b), the method prescribed under section 1552 (a)(1) shall be applicable and shall be binding upon the group in the same manner as if an election had been made to so allocate.

T. COLEMAN ANDREWS,
Commissioner of Internal Revenue.

Approved August 24, 1955.

A. N. OVERBY,
Acting Secretary of the Treasury.

(Filed by the Division of the Federal Register August 29, 1955, 8:49 a. m.)

SECTION 1502.—REGULATIONS

(Also Section 6081.) Rev. Rul. 55–560
(Also Part II, Section 141; Regulations 129, Section 24.10.)

Where an extension of time for filing a consolidated return is desired, a parent corporation may request extensions for each subsidiary by listing their names and addresses on and filing Form 7004, Application for Automatic Extension of Time to File U. S. Corporation Income Tax Return. See Revenue Ruling 54–86, C. B. 1954–1, 79, for proper procedure for filing Form 7004. Section 24.10(b) of Regulations 129, applicable to the 1954 Code by authority of Treasury Decision 6091, C. B. 1954–2, 47, provides that in no case will the privilege of filing a consolidated return be considered as exercised at the time of making a so-called "tentative return," made in order to obtain an extension of time for filing a return. Since Form 7004 is in lieu of a request for the granting of an extension of time and of the tentative return otherwise required, the filing of Form 7004 is not considered as an exercise of the privilege of making a consolidated return.

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26 CFR 1.1502–44: Methods of accounting. Rev. Rul. 55–732
(Also Section 446.)

Section 446(e) of the Internal Revenue Code of 1954, which requires that the consent of the Secretary or his delegate be secured by a taxpayer prior to a change in his method of accounting, does not apply where a corporation, a member of an affiliated group within the meaning of section 1504 of the Code, is required to change its method of accounting solely by reason of the provisions of section 1.1502–44 of the Income Tax Regulations, relating to consolidated returns, in order to clearly reflect consolidated net income of the affiliated group.

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26 CFR 1.1502–1: Privilege of making consolidated returns.

Regulations under the Internal Revenue Code of 1954. See T. D. 6140, page 317.

SECTION 1503.—COMPUTATION AND PAYMENT OF TAX

(Also Section 172.) Rev. Rul. 55–499
(Also Part II, Section 141; Regulations 129, Sections 24.11, 24.31.)

An affiliated group of which the common parent corporation during the taxable year 1952 is the common parent in 1954, even though one of the subsidiaries in 1952 is no longer affiliated in 1954, is considered as remaining in existence during 1954. Consequently, pursuant to section 172(e) of the Internal Revenue Code of 1954 and section 24.31(a)(2) of Regulations 129, consolidated net operating loss carryback from 1954 to 1952 must be adjusted for the excess of per-

centage depletion over cost depletion allowed to the former affiliate in a consolidated income and excess profits tax return filed for the taxable year 1952.

Advice has been requested as to whether, for the purpose of filing a consolidated income tax return for the taxable year 1954 and the adjustments to a consolidated net operating loss carryback to 1952, an affiliated group consisting of the common parent corporation and one subsidiary remaining after a change in the affiliated group has occurred is a different group from the group which filed a consolidated return for 1952.

Corporations *M*, *N*, and *O*, an affiliated group of which *M* was the common parent corporation, filed consolidated income and excess profits returns for the calendar year 1952. In the return for 1952, *O*, engaged in the discovery and development of oil, was allowed percentage depletion in excess of cost depletion in the amount of 400*x* dollars.

On October 1, 1953, *O* corporation ceased to be a member of the group by reason of the transfer of all of its capital stock to a nonaffiliated company. For the year 1954, during which both *M* and *N* had net operating losses, it is contemplated that a consolidated return will be filed which will result in a consolidated net operating loss carryback to the taxable year 1952.

Section 172(e) of the Internal Revenue Code of 1954 provides that in determining the amount of any net operating loss carryback or carryover to any taxable year, the necessary computations involving any other taxable year, whether it begins before, on, or after January 1, 1954, shall be made under the law applicable to such other taxable year. Section 24.31(a)(2) of Regulations 129, applicable pursuant to Treasury Decision 6091, C. B. 1954–2, 47, provides for the necessary computations involving the amount of the consolidated net operating loss carryback for the taxable year 1952.

Section 24.11(c) of Regulations 129 provides that an affiliated group shall be considered as remaining in existence if the common parent and at least one subsidiary remains affiliated with it, whether or not such subsidiary was a member of the group at the time the group was formed and whether or not one or more corporations have become subsidiaries or have ceased to be subsidiaries at any time after the group was formed.

Accordingly, in view of the foregoing and based upon the facts presented, it is held that the affiliated group of which *M* corporation was the common parent during 1952 is considered as remaining in existence during 1954. It is further held, pursuant to section 172(e) of the Code of 1954 and to section 24.31(a)(2) of Regulations 129, that the amount of the consolidated net operating loss carryback from the year 1954 to 1952 is required to be adjusted for the excess of percentage depletion over cost depletion allowed to corporation *O* for the taxable year 1952.

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26 CFR 1.1503–1: Computation and payment of tax.

Regulations under the Internal Revenue Code of 1954 relating to consolidated returns and payment of tax. See T. D. 6140, page 317.

SECTION 1504.—DEFINITIONS

26 CFR 1.1504–1: Definitions.

Corporations constituting affiliated groups for purposes of filing consolidated returns. Regulations under the Internal Revenue Code of 1954. See T. D. 6140, page 317.

SUBCHAPTER B.—RELATED RULES

SECTION 1551.—DISALLOWANCE OF SURTAX EXEMPTION AND ACCUMULATED EARNINGS CREDIT

26 CFR 1.1551–1: Disallowance of surtax exemption and accumulated earnings.

Regulations under the Internal Revenue Code of 1954. See T. D. 6140, page 317.

SECTION 1552.—EARNINGS AND PROFITS

26 CFR 1.1552–1: Earnings and profits.

Regulations under the Internal Revenue Code of 1954. See T. D. 6140, page 317.

SUBTITLE B.—ESTATE AND GIFT TAXES

CHAPTER 11.—ESTATE TAX

SUBCHAPTER A.—ESTATE OF CITIZENS OR RESIDENTS

PART III.—GROSS ESTATE

SECTION 2033.—PROPERTY IN WHICH THE DECEDENT HAD AN INTEREST

(Also Section 61.) Rev. Rul. 55–581

The allowance equal to 6 months' pay paid by the United States Government because of the death of an officer or enlisted member of the Armed Forces of the United States does not constitute property of the decedent within the meaning of section 2033 of the Internal Revenue Code of 1954. It is not includible in the decedent's gross estate for Federal estate purposes and is not taxable as income to the recipients for Federal income tax purposes.

Advice has been requested whether the allowance equal to 6 months' pay, commonly referred to as "the 6 months' gratuity pay," paid by the United States Government because of the death of an officer or enlisted member of the Armed Forces of the United States is includible in his gross estate for Federal estate tax purposse, or is taxable as income to the recipients.

Title 10 United States Code, section 903, relating to the United States Army and Air Force, provides in part as follows:

Immediately upon official notification of the death from wounds or disease, not the result of his own misconduct, of any officer or enlisted man on the active list of the Regular Army or on the retired list when on active duty, the branch, office, or officers of the Army the Secretary of the Army may from time to time designate shall cause to be paid to the widow, and if there be no widow to the child or children, and if there be no widow or child to any other dependent relative of such officer or enlisted man previously designated by him, an amount equal to six months' pay at the rate received by such officer or enlisted man at the date of his death. * * *

The provisions of section 903 of Title 10 are made applicable to officers and enlisted men of the Air Force by section 208(c) of the National Security Act of 1947, 61 Stat. 495, 5 U. S. C. 626 c(c).

Similar allowances are provided in the case of officers and enlisted personnel of the United States Navy, Marine Corps, and Coast Guard. See 14 U. S. C. 489; 34 U. S. C. 943.

The right to receive the gratuity is conferred by the statute upon the beneficiaries of the deceased serviceman and the amount of the payment is made directly to them. An examination of the nature of these payments discloses that the decedent has no control over the designation of the beneficiary or the amount of the payment.

The right to receive the statutory payment was not procured or acquired by the decedent as additional compensation; rather, the payment is a gift from the United States to the statutory beneficiaries. Rev. Rul. 55–330, C. B. 1955–1, 236. Therefore, the decedent did not have a property interest in such payments at his death or during his life which he could have transferred. Accordingly, it is held that the payments are not includible in the gross estate of the decedent under sections 2033 or 2037 of the Internal Revenue Code of 1954. Also, the power to appoint a dependent relative under the statute does not constitute a power of appointment under section 2041.

Rev. Rul. 55–605

The interest of the wife in community property constitutes a vested interest under the law of the State of Nevada. Accordingly, the value of one-half of the community property and one-half of the jointly owned property acquired with community funds is includible in her gross estate for Federal estate tax purposes.

Advice has been requested whether the wife's interest in community property acquired under the law of the State of Nevada is vested and includible in her gross estate or is in the nature of an interest in expectancy which vests in her only in the event that she survives her husband, since under Nevada law a wife does not have the right to dispose of her interest by will where she is survived by her husband.

Section 3395.01 of Nevada compiled laws provides as follows:

Disposition of Community Property upon Death of Wife. 1. Upon the death of the wife the entire community property shall vest without administration, in the surviving husband except that in case the husband shall have abandoned his wife and lived separate and apart from her without such cause as would have entitled him to a divorce, the half of the community property subject to

the payment of its equal share of the debts chargeable to the estate owned in community, by the husband and wife, is at her testamentary disposition in the same manner as her separate property, and in the absence of such disposition goes to her descendants equally, if such descendants are in the same degree of kindred to the decedent; otherwise, according to the right of representation; and in the absence of both such disposition and such descendants, shall vest in her other heirs at law, exclusive of her husband.

In the case of *In re Williams' Estate*, 161 Pac. 741, 40 Nev. 241, the State attempted to impose an inheritance tax on the surviving spouse's one-half interest in the community property which was freed from the control of her husband upon his death. The State contended that the wife's interest in the community property did not vest in her until her husband's death. In holding that the wife's one-half community interest was always vested in her and therefore was not subject to inheritance tax in the estate of her husband, the Supreme Court of Nevada stated in part:

Section 31, art. 4, of our Constitution reads:

"All property, both real and personal, of the wife owned or claimed by her before marriage, and that acquired afterward by gift, devise or descent, shall be her separate property; and laws shall be passed, more clearly defining the rights of the wife in relation, as well to her separate property, as to that *held in common* with her husband. Laws shall also be passed providing for the registration of the wife's separate property." [Italics supplied.]

* * * * * * *

* * * The property here going to the appellant was property which she at all times under our statutory provision held in common with her husband. Hence there was no privilege to be taxed, but rather a right in property recognized by statutory prescription held by her at all times in common with her husband. The death of the husband only dissolved the community, and released that which she held from the statutory dominance of her deceased spouse. * * * The fact that the Legislature may have seen fit to place the control of this community property in the husband in no wise detracts from the fact that the property as such was a thing in which the wife had at all times a vested interest.

* * * * * * *

It may, we think, be asserted, supported by the great weight of authority, that the interest of the wife in the community property and her title thereto is no less than that held by the husband, and this interest and title in the wife is not to be regarded as a mere expectancy. 5 R. C. L. 850.

In view of the decision of the Supreme Court of Nevada in the case of *In re Williams' Estate*, holding that the interest of the wife in the community property is not an interest in expectancy but is at all times a vested interest, it is held that the value of one-half of the community property and one-half of the jointly owned property acquired with community funds is includible in the deceased wife's gross estate for Federal estate tax purposes.

Death gratuity payment, specifically authorized by Congress, made to a surviving spouse of a Member of Congress. See Rev. Rul. 55–609, page 34.

SECTION 2041.—POWERS OF APPOINTMENT

(Also Section 2056.) Rev. Rul. 55-518

Where the lifetime income beneficiary of a testamentary trust created by her spouse has the unrestricted power to use, consume and dispose of the principal during her lifetime, the value of the principal of such trust at the date of her death is includible in her gross estate under the provisions of section 2041 of the Internal Revenue Code of 1954, even though she was incompetent at all times from the date of the creation of the trust to the date of her death. The value of the trust as of the date of its creation would qualify for the marital deduction authorized by section 2056 of the Code, notwithstanding such incompetence.

Advice has been requested whether the decedent, under the circumstances set forth below, died possessed of a power of appointment within the meaning of section 2041 of the Internal Revenue Code of 1954.

The decedent was the lifetime income beneficiary of a testamentary trust created by her husband. She had the unrestricted power to use, consume, and dispose of the trust principal during her lifetime. However, she was mentally incompetent at all times from the date of her husband's death in 1950 to the date of her death in 1954.

Section 2041(a)(2) of the Code provides that the value of the gross estate of the decedent shall be determined by including the value at the time of his death of all property "to the extent of any property with respect to which the decedent has at the time of his death a general power of appointment created after October 21, 1942 * * *."

The representatives of the instant estate contended that the power given the decedent under the will of her husband was not a general power of appointment for the reason that the decedent, at no time after the death of her husband, had the mental capacity either to renounce the bequest or to exercise the power. They further contended that, since the decedent was incompetent from the time of the death of her husband until her own death, her use and disposition of the principal of the trust were limited to the amount necessary for her comfortable maintenance and support and, therefore, her power was restricted by an ascertainable standard and, consequently, was a nongeneral power under section 2041(b)(1)(A) of the Code.

A similar problem and similar contentions were presented in *Estate of Edward Hurd et al.* v. *Commissioner*, 160 Fed. (2d) 610. There, in applying the provisions of section 811(d) of the Internal Revenue Code of 1939, relating to reserved powers to alter, amend, revoke, or terminate a trust, the question of mental capacity to exercise the power was raised. In holding that the capacity of a decedent to exercise such power is immaterial, the court said:

* * * The statute is not concerned with the *manner* in which the power is exercised, but rather with the existence of the power. The decedent may have been limited in his method by his incapacity, but it is not open to question that the power existed in his behalf, either by the trust instrument itself, or by the general law of Massachusetts; and he could have been removed. Although not directly in point, the case of *City Bank Co.* v. *McGowan*, 323 U. S. 594 [Ct. D. 1629, C. B. 1945, 403], furnishes a persuasive analogy, for in that case it was held that a woman, although incurably insane, might make a "gift in

contemplation of death" because the motive of the fiduciary, who made the transfers under court sanction, would be imputed to her and were the "motives and considerations as would have mover her." In other words, although insane, she could still make a gift in contemplation of death because of the power she possessed through a fiduciary.

Thus, while an incompetent person may, through appointment of legal guardianship, be restricted from wasting his own property, such person may dispose of his property with the approval of the local court. Likewise, a life tenant under a will with an unrestricted power of disposition of the principal may dispose of the principal with the approval of the local court. In such a case, the life tenant has the power of disposal and, although such power is not unfettered, it is exercisable with the approval of the court, a person having no substantial adverse interest in the property. If the incompetent does not have the power, the court cannot act for him. Therefore, a person may have a power without ever being able freely to exercise it. There is a distinction between the existence of a power and the capacity to exercise it. The taxable event is the possession at death of the power rather than an exercise of the power.

It is accordingly held that where the lifetime income beneficiary of a testamentary trust created by her spouse has the unrestricted power to use, consume, and dispose of the principal during her lifetime, the value of the principal of such trust at the date of her death is includible in her gross estate under the provisions of section 2041 of the Internal Revenue Code of 1954, even though she was incompetent at all times from the date of the creation of the trust to the date of her death.

It is held further that the value of the trust as of the date of its creation would qualify for the marital deduction authorized by section 2056 of the Code, notwithstanding such incompetence. Compare *Estate of Frank E. Tingley* v. *Commissioner*, 22 T. C. 402.

SECTION 2042.—PROCEEDS OF LIFE INSURANCE

Rev. Rul. 55–622

The proceeds of life insurance policies issued under the World War Veterans' Act of 1924, the National Service Life Insurance Act of 1940, and the Servicemen's Indemnity Act of 1951 are includible in the decedent's gross estate for Federal estate tax purposes under section 2042 of the Internal Revenue Code of 1954. *See United States Trust Company of New York* v. *Helvering*, 307 U. S. 57, C. B. 1939–1 (Part 1) 330, in which it is held that the proceeds of a war risk insurance policy payable to a deceased veteran's widow are includible in the veteran's gross estate for Federal estate tax purposes. The statutory exemption from taxation of the proceeds of life insurance policies issued by the Veterans' Administration does not apply to an excise imposed upon the transfer of property brought about by the death of an insured.

PART IV.—TAXABLE ESTATE

SECTION 2055.—TRANSFERS FOR PUBLIC, CHARITABLE, AND RELIGIOUS USES

Rev. Rul. 55–519

A bequest to trustees to use and apply the income and principal of the trust estate for the care of neglected or homeless domestic animals generally and to alleviate the sickness, suffering, hunger, and want of such animals constitutes a bequest to trustees for charitable purposes within the meaning of section 2055 of the Internal Revenue Code of 1954. Accordingly, the value of the trust estate is deductible from the decedent's gross estate for the purpose of determining the value of the decedent's taxable estate.

SECTION 2056.—BEQUESTS, ETC., TO SURVIVING SPOUSE

Rev. Rul. 55–643

Where the decedent has bequeathed to his wife an amount equal to 50 percent of the value of his adjusted gross estate as finally determined for Federal estate tax purposes, less the aggregate amount of other property passing to her which qualifies for the marital deduction, and the executors of the estate elect to claim certain expenses of administration as deductions from the gross income of the estate under sections 162 or 212 of the Internal Revenue Code of 1954, rather than as deductions from the decedent's gross estate under section 2053 of the 1954 Code, the value of the adjusted gross estate is determined by subtracting from the gross estate only the deductions authorized by section 2053 which are actually allowed as deductions for estate tax purposes, and the value of the interest which actually passes to the surviving spouse should not be reduced by the amounts of those items which are not allowed as deductions under section 2053.

Advice has been requested whether under the circumstances outlined below an election by the executors to claim certain expenses of administration, otherwise allowable as deductions from the decedent's gross estate, as deductions for Federal income tax purposes will have any effect upon the value of the adjusted gross estate and the amount allowable as a marital deduction.

In the instant case the decedent bequeathed an amount equal to 50 percent of the value of his adjusted gross estate as finally determined for Federal estate tax purposes, less the aggregate amount of other property passing to his wife which qualifies for the marital deduction, in trust, to pay the income to his wife during her lifetime and conferred upon her a general testamentary power of appointment over the entire corpus of such trust. The decedent directed that all inheritance and estate taxes imposed with respect to any property included in his gross estate shall be paid out of the residuary estate.

Under the general rule provided by section 2056(c) of the Internal Revenue Code of 1954, the value of a decedent's adjusted gross estate, for the purpose of arriving at the 50 percent limitation on the amount allowable as a marital deduction, is to be determined by subtracting

from the entire value of the gross estate the aggregate amount of the deductions allowed by sections 2053 and 2054 of the Code.

Section 2053(a) of the Internal Revenue Code of 1954 provides that the value of the taxable estate shall be determined by deducting from the value of the gross estate such amounts for administration expenses as are allowable by the laws of the jurisdiction under which the estate is being administered.

Where amounts allowable under section 2053 or section 2054 of the Code are claimed as deductions for Federal income tax purposes under sections 162 or 212 of the 1954 Code and the right to have such items allowed as deductions under sections 2053 or 2054 is waived under the provisions of section 642(g) of the 1954 Code, such items do not constitute deductions allowed by sections 2053 or 2054. Section 642(g) of the Code is a limitation upon sections 2053 and 2054.

Where a decedent merely bequeaths one-half of his estate to his surviving spouse, it is presumed that the net value of the interest passing to her is one-half after payment of all debts and expenses of administration whether or not deductions therefor are claimed and allowed for Federal estate tax purposes. However, where, as in this case, a decedent bequeaths to his surviving spouse one-half of the value of his adjusted gross estate as determined for Federal estate tax purposes and the executors elect to claim administration expenses for income tax purposes, the effect of such bequest is to give her more than one-half of his net distributable estate. In such case, the election of the executors to claim the administration expenses as deductions for income tax purposes, operates to increase (1) the value of the adjusted gross estate for the purpose of the 50 percent limitation contained in section 2056(c) and (2) the amount of the bequest to the surviving spouse.

Questions relating to the effect of the use of the marital deduction formula on the value of property passing to the surviving spouse are not within the jurisdiction of the Internal Revenue Service. However, the possibility that it may not have been the intention of the decedent by using the marital deduction formula clause to give his wife more than one-half of the net distributable estate after payment of debts and administration expenses, may give beneficiaries other than the wife a right to question any act of the executors which operates to decrease their interests under the will.

In view of the foregoing, it is held that where the decedent has bequeathed to his wife an amount equal to 50 percent of the value of his adjusted gross estate as finally determined for Federal estate tax purposes, less the aggregate amount of other property passing to her which qualifies for the marital deductions, and the executors of the estate elect to claim certain expenses of administration as deductions from the gross income of the estate under sections 162 or 212 of the Internal Revenue Code of 1954 rather than as deductions from the decedent's gross estate under section 2053 of the 1954 Code, the value of the adjusted gross estate is determined by subtracting from the gross estate only the deductions authorized by section 2053 which are actually allowed as deductions for estate tax purposes. See Rev. Rul. 55-225, C. B. 1955-1, 460. The value of the interest which actually passes to the surviving spouse should not be reduced by the amounts of those items which are not allowed as deductions under section 2053.

Rev. Rul. 55-733

Where insurance proceeds are to be paid to decedent's surviving spouse while living, with named secondary or contingent beneficiaries in the event she should die before having received the guaranteed monthly installments for 120 months, the marital deduction is disallowed by reason of the terminable interest rule of section 2056(b)(1) of the Internal Revenue Code of 1954, even though the widow has a life expectancy of more than ten years.

Advice has been requested whether the estate tax marital deduction authorized by section 2056 of the Internal Revenue Code of 1954 will be allowable with respect to the proceeds of life insurance under the circumstances set forth below.

In the instant case, a policy of insurance provides that the proceeds are to be paid in 120 monthly installments after the death of the insured to his wife while living, but if she died the same should be paid to named secondary or contingent beneficiaries. The specific question is whether the interest passing to the surviving wife will constitute a terminable interest within the meaning of section 2056(b) of the Internal Revenue Code of 1954 since she has a life expectancy of more than ten years according to the American Experience Table of Mortality and the Actuaries' or Combined Experience Table of Mortality.

Section 2056(b)(1) of the Internal Revenue Code of 1954 provides that no marital deduction shall be allowed with respect to certain property interests (referred to generally as "terminable interests") which pass from the decedent to his surviving spouse, if (1) an interest in the same property passed at any time for less than an adequate and full consideration in money or money's worth from the decedent to any person other than such spouse, or the estate of such spouse, and (2) by reason thereof, such person, or his heirs or assigns, may possess or enjoy any part of such property after the termination or failure of the interest therein which passed from the decedent to his surviving spouse.

Section 2056(b)(6) of the 1954 Code provides an exception to the above-mentioned "terminable interest" provision in the case of an interest in property consisting of proceeds under a life insurance contract where the surviving spouse has (1) the right to receive the proceeds in installments, payable annually or at more frequent intervals, commencing not later than 13 months after the decedent's death, and (2) the further right to appoint, at death, any amount remaining unpaid to whomever she may please, including her estate.

Under the terms of the instant policy, any installments certain remaining unpaid upon the death of the surviving spouse are payable to named secondary or contingent beneficiaries. Thus, an interest in the proceeds of the policy also passed from the decedent to persons other than his surviving wife. Since such persons may possess or enjoy the proceeds, or a part thereof, upon the termination or failure of her interest therein, the interest which passed to her is a terminable one within the meaning of section 2056(b) of the 1954 Code.

In view of the foregoing, it is held that where insurance proceeds are to be paid to the decedent's surviving wife while living, with

named secondary or contingent beneficiaries in the event she dies before receiving the guaranteed monthly installments for 120 months, the marital deduction is disallowed by reason of the terminable interest rule of Section 2056(b)(1) of the Internal Revenue Code of 1954, even though the widow has a life expectancy of more than ten years.

Marital deduction where surviving spouse has a general power of appointment over trust property but lacks the capacity to exercise the power. See Rev. Rul. 55–518, page 384.

CHAPTER 12.—GIFT TAX

SUBCHAPTER A.—DETERMINATION OF TAX LIABILITY

SECTION 2503.—TAXABLE GIFTS

Rev. Rul. 55–678

Taxpayer (donor) transferred property, by gift, to a trust the terms of which provide that the trustee shall pay the trust income to a class of beneficiaries consisting of his children and grandchildren during his lifetime, with the provision that after-born members of the class shall share in the trust income the same as if they were living at the time the trust was created. Upon the death of the grantor, the trust is to terminate and the corpus is to be distributed to the members of the class who are then entitled to share in the trust income. *Held*, the gifts of the right to share in the trust corpus upon the grantor's death are gifts of future interests in property and do not qualify for the annual gift tax exclusion authorized by section 2503(b) of the Internal Revenue Code of 1954. *Held further*, the gifts to the members of the class who were living at the time the trust was created of the right to share in the trust income during the grantor's lifetime were of present interests in property and qualify for the annual gift tax exclusion. However, as the donor taxpayer claiming the exclusion has the burden of showing that the value of what he claims is other than a future interest, the exclusion will be allowed in such cases only to the extent that it is shown that the amount or value of the present interest given is susceptible of determination and hence severable from the gift of the future interest. In other words, if after taking into consideration all possible future contingencies, it can be shown that the present interest given has some ascertainable value, based upon sound actuarial principles, then the exclusion is allowable to the extent of the minimum value of such interest, or $3,000, whichever is the lesser. In such cases it is not necessary that the exact value of the gift of the present interest in property be determinable on the basis of recognizable actuarial principles. See Rev. Rul. 55–679, page 390, this Bulletin. Also, see *Commissioner* v. *William D. Disston*, 325 U. S.

442, Ct. D. 1642, C. B. 1945, 426; *William H. Kniep* v. *Commissioner*, 172 Fed. (2d) 755; *Commissioner* v. *Frank O. Lowden*, 131 Fed. (2d) 127; *F. J. Sensenbrenner* v. *Commissioner*, 134 Fed. (2d) 883; *Elizabeth H. Fisher* v. *Commissioner*, 132 Fed. (2d) 383; *Andrew Geller* v. *Commissioner*, 9 T. C. 484.

Rev. Rul. 55-679

Where it can be demonstrated that the value of the present interest of each beneficiary in the income from a trust established for a term of years will equal $3,000, the gift tax exclusions authorized by section 2503(b) of the Internal Revenue Code of 1954 are allowable although the number of eventual donees is not ascertainable or the present interest of each beneficiary is not susceptible of valuation.

Advice has been requested whether the gift tax exclusions authorized by section 2503(b) of the Internal Revenue Code of 1954 are allowable under the circumstances set forth below.

The donor transferred property in trust having a value in excess of $2,000,000. The trust was to continue for a period of ten years. The trust instrument provides that during the ten-year period the trustees shall pay over the entire net income in such installments as shall be commensurate with the orderly administration of the trust, as nearly quarterly as possible, in equal shares to such of the settlor's grandchildren as shall be living at the time of such payment and to the then living issue of such of the settlor's grandchildren who shall then be dead, the then living issue of any grandchild not then living to receive in equal shares per stirpes that share of the net income which the said grandchild would have received if living at the time. At the time of the creation of the trust, the donor had four children, all of whom were married, and ten grandchildren.

Generally, the gift tax exclusion is not allowable unless the number of eventual donees is ascertainable or unless the interest of each beneficiary is susceptible of valuation. However, the allowance of the exclusion is determined by the facts in each particular case.

In the trust involved in the case of *United States* v. *Arthur Pelzer*, 312 U. S. 399, Ct. D. 1495, C. B. 1941-1, 441, the income was to be accumulated for ten years and then distributed to the living grandchildren. The gifts were clearly of future interests. After referring to the statement in the Congressional Committee Report that the denial of the exemption in the case of gifts of future interests is dictated by the apprehended difficulty, in many instances, of determining the number of eventual donees and the values of their respective gifts, the court said: "The gift thus involved the difficulty of determining the 'number of eventual donees and the value of the respective gifts' which it was the purpose of the statute to avoid." If the trustee is authorized to pay out or accumulate income, the right of a beneficiary to receive income has no ascertainable value.

In the trust involved in the case of *William H. Kniep* v. *Commissioner*, 172 Fed. (2d) 755, the actual values of the present interests of the beneficiaries could not be determined, but the minimum values of such interests were determined and exclusions were allowed for such values which were substantially less than $3,000.

In the instant case, the gifts of income to the ten grandchildren are of present interests and exclusions are allowable provided such interests may be valued by recognized methods of valuation. While the full value of the present interest of each of the ten beneficiaries is not determinable, it may be demonstrated that the value of the present interest of each exceeds $3,000.

Assume as a possibility, for example, that there could be 50 additional grandchildren, or a total of 60 income beneficiaries at the expiration of the ten-year period. If there had been 60 beneficiaries at the time of the creation of the trust and the oldest beneficiary was 21 years of age, the present interest of the oldest in the income for ten years would be computed as follows:

Based on U. S. Life Table 38 with interest at 3½ percent, the present worth of the right to receive $1.00 per annum for 10 years or until the prior death of a person aged 21 is $8.2423. The present interest of the oldest would then be (.035×$2,000,000÷60)×8.2423, or $9,616.04.

It is thus apparent that if the oldest living grandchild was aged 21 years at the date of the creation of the trust in the instant case the present interest of each of the ten beneficiaries has a value substantially in excess of $3,000.

In view of the foregoing, it is held that where it can be demonstrated that the value of the present interest of each beneficiary in the income from a trust established for a term of years will equal $3,000, the gift tax exclusions authorized by section 2503(b) of the Internal Revenue Code of 1954 are allowable although the number of eventual donees is not ascertainable or the present interest of each beneficiary is not susceptible of valuation. See Rev. Rul. 55–678, page 389, this Bulletin.

SUBCHAPTER C.—DEDUCTIONS

SECTION 2522.—CHARITABLE AND SIMILAR GIFTS

(Also Part II, Section 1004; Regulations 108, Section 86.13.) Rev. Rul. 55–483

Where the remainder interest which charity may receive under the terms of an irrevocable inter vivos trust is based upon the contingency that the life tenants, aged 40 and 50 years, respectively, on the date of gift, die without being survived by issue, no deduction may be allowed in respect of the charitable interest under section 2522 of the Internal Revenue Code of 1954.

Advice has been requested whether the value of the remainder interest of an irrevocable inter vivos trust qualifies for the charitable deduction authorized by section 2522 of the Internal Revenue Code of 1954 under the following circumstances.

Under the terms of an irrevocable inter vivos trust the trustee is directed to pay the net income from the principal of the trust estate to the son and daughter of the grantor, aged 40 and 50 years, respectively, on the date of gift, in equal shares during their joint lives. Upon the death of the first to die, the trust corpus will be divided into

two equal parts and one of such parts paid in equal shares per stirpes to the surviving issue, if any, of that deceased life tenant. The net income from the remaining portion of the trust corpus and, if the first life tenant to die is not survived by issue, the net income from both parts of the trust corpus shall be paid to the surviving income beneficiary for life. Upon the death of the last to die of the income beneficiaries, the trust corpus then held for his or her benefit shall be paid in equal shares per stirpes to his or her surviving issue and, if none, in equal shares per stirpes to the surviving issue of the first to die, if any. In the event that, at the death of the last to die, no issue of either life tenant is then living, the trust corpus is to be paid to a charitable institution.

Section 2522 of the Internal Revenue Code of 1954 provides that, in computing the net gifts for the calendar year, there shall be allowed as deductions the amount of all gifts made during such year to or for the use of:

> (a) (2) a corporation, or trust, or community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, including the encouragement of art and the prevention of cruelty to children or animals; no part of the net earnings of which inures to the benefit of any private shareholder or individual, and no substantial part of the activities of which is carrying on propaganda, or otherwise attempting to influence legislation. * * *

In the case of *Estate of Simon Guggenheim* v. *Commissioner*, 1 T. C. 845, the court, in a factual situation similar to the one presented herein, held that considering the contingencies provided for in the trust instrument, it was so wholly uncertain that anything would go to charity that deduction in respect of its interest should not be allowed for Federal gift tax purposes.

In the instant case the provisions contained in the trust instrument clearly indicate that if issue of either of the grantor's children should survive the death of the last of the income beneficiaries, nothing will pass to the charitable institution. Thus the gift to charity is contingent upon the death of the last to die of the son and daughter of the grantor without being survived by the issue of either of them.

In the case of *Commissioner* v. *Estate of Louis Sternberger*, 348 U. S. 187, Ct. D. 1777, C. B. 1955–1, 450, the Supreme Court of the United States held that, for Federal estate tax purposes, a deduction from the value of a decedent's gross estate may not be allowed under section 812(d) of the Internal Revenue Code of 1939 (now section 2055(a) of the Internal Revenue Code of 1954) where the charitable bequest is to take effect only if the decedent's childless 27-year-old daughter dies without descendants surviving her and her mother.

While the Sternberger case involved the estate tax, the rationale of that case is equally applicable to the instant case and is considered controlling on the question. The gift and estate tax statutes on this point are in pari materia and are to be considered with reference to each other.

In view of the foregoing, it is held that where the remainder interest which charity may receive under the terms of an irrevocable inter vivos trust is based upon the contingency that the life tenants, aged 40 and 50 years, respectively, on the date of gift, die without being survived by issue, no deduction may be allowed in respect of that charitable interest under section 2522 of the Internal Revenue Code of 1954.

SUBTITLE C.—EMPLOYMENT TAXES

CHAPTER 21.—FEDERAL INSURANCE CONTRIBUTIONS ACT

SUBCHAPTER A.—TAX ON EMPLOYEES

SECTION 3101.—RATE OF TAX

Credit against income tax liability of employee tax incurred and paid under both the Federal Insurance Contributions Act and the Railroad Retirement Tax Act for the same period. See Rev. Rul. 55-690, page 14.

SUBCHAPTER C.—GENERAL PROVISIONS

SECTION 3121.—DEFINITION

(Also Section 3401.) Rev. Rul. 55-520
(Also Part II, Sections 1426(a), 1621(a); Regulations 128, Section 408.226; Regulations 120, Section 406.207.)

An amount paid to an individual as a compromise settlement for the cancellation, before the normal expiration date, of an employment contract does not constitute "wages" for services performed by the employee for Federal employment and income tax withholding purposes. However, such amount is includible in gross income for Federal income tax purposes.

Advice has been requested whether an amount paid to an individual as a compromise settlement for the cancellation, before the normal expiration date, of an employment contract constitutes "wages" for purposes of the Federal Insurance Contributions Act and the Collection of Income Tax at Source on Wages, (chapters 21 and 24, respectively, Subtitle C, Internal Revenue Code of 1954).

In the instant case, an individual was employed as a general manager of a television company under a written agreement. Under the contract, the individual was to receive $12,000 per year, to be paid in monthly installments, for services rendered for a period of 2 years. In January of the second year, due to policy differences, the company demanded and received the individual's resignation, conditioned upon the payment of the amount due under the contract for the remaining period. The company offered a lump sum settlement of $5,000 in lieu of the monthly payments of $1,000. This was refused by the individual and he instituted court proceedings. Because the employment contract provided for the payment of wages by the month, it was considered technically necessary to sue initially for only one month's wages and, as ensuing months passed, to amend the complaint until it would cover the full balance of wages due under the employment contract. During the following June, the negotiations were reopened with the view toward a settlement of the pending litigation

between the parties. As a result, the individual accepted an offer of $4,760 made by the company and signed a general release of all claims upon the company, and the law suit was dismissed.

For purposes of the Federal Insurance Contributions Act and income tax withholding, "wages" consist of all remuneration for services performed by an employee for his employer, including the cash value of all remuneration paid in any medium other than cash, with certain exceptions not here material.

Under the circumstances stated, it is held that the amount of $4,760 paid in consideration of the cancellation of the employment contract does not constitute "wages" for Federal employment and income tax withholding purposes. Consequently, the company was not required to deduct such taxes from the settlement payment nor to prepare a Form W–2, Withholding Tax Statement, with respect to such payment. However, such amount is includible in gross income for Federal income tax purposes.

Rev. Rul. 55–584

An employer may not, in determining the first $4,200 of wages paid to one of his employees under the Federal Insurance Contributions Act, take into consideration wages paid to such employee by another employer (except a predecessor employer) in a calendar year. Similarly, an employer may not obtain a refund of employer tax paid on the first $4,200 of wages paid by him to an employee solely because the employee receives wages from another employer (other than a predecessor employer) in the same year.

Advice has been requested, for purposes of the Federal Insurance Contributions Act (chapter 21, subtitle C, Internal Revenue Code of 1954) as to (1) whether an employer may, in determining the first $4,200 of wages paid to his employee during the year, take into consideration wages paid to such employee by other employers during the year; and (2) whether an employer may obtain a refund of employer tax paid with respect to wages paid an employee where wages are also paid the same employee by other employers during the same year and the total of all such wages exceeds $4,200.

Although section 6413(c)(1) of the 1954 Code provides that an employee is entitled to a credit or refund of employee tax collected with respect to the excess of wages received from more than one employer within any calendar year after 1954 over the first $4,200 of such wages, no such provision is made with respect to the employer tax. See Rev. Rul. 54–221, C. B. 1954–1, 73, relating to an employee's wages in excess of $3,600 under the 1939 Code.

Section 3111 of the Act imposes on every employer an excise tax, with respect to having individuals in his employ, equal to a certain percentage of the wages up to $4,200 paid by him with respect to employment. Accordingly, an employer may not, in determining the first $4,200 of wages paid to an employee during a calendar year, take into consideration wages paid to the employee by another employer during that year except under circumstances contemplated in section 3121(a)(1) of the Act relative to predecessor-successor employers. See Rev. Rul. 55–585, page 395, this Bulletin.

In the Senate Report No. 734, Seventy-sixth Congress, First Session, on the Social Security Act Amendments of 1939, C. B. 1939–2, 565 at 574, the Committee on Finance stated:

> No ground for relief exists in the case of the employer's tax. Each employer will and should be liable for the tax with respect to the first $3,000 paid to each employee notwithstanding the employee may be receiving, or may later in the year receive, wages from another employer.

No change, other than the wage limitation ($4,200), has been made in the special refund provision of law in any of the subsequent amendments of the Internal Revenue Code. From the foregoing, it is evident that the Congress did not intend the special refund provisions to be applicable to the employer tax under the Federal Insurance Contributions Act. Accordingly, an employer may not obtain a refund of any portion of the employer tax paid on the first $4,200 of wages of an employee during a calendar year who has previously received, is receiving, or will receive wages from another employer during that year, the total of which exceeds or will exceed $4,200, unless such other employer is a predecessor employer as contemplated in section 3121(a)(1) of the Act. See Rev. Rul. 55–585, below.

(Also Part II, Section 1426(a); Regulations 128, Section 408.227.) Rev. Rul. 55–585

> Wages paid by a predecessor employer to its employees should be treated as having been paid to such employees by the successor employer for purposes of the $4,200 wage limitation provided by section 3121(a) of the Federal Insurance Contributions Act where the test prescribed by that section relative to successor employers is met. The fact that the predecessor employer, a corporation, does not dissolve but remains dormant, is immaterial.

A question has been received by the Internal Revenue Service as to the effect of section 3121(a) of the Federal Insurance Contributions Act (chapter 21, subtitle C, Internal Revenue Code of 1954), relative to wages paid employees by a predecessor employer being considered attributable to a successor employer for purposes of the $4,200 wage limitation, in a situation where the predecessor employer, a corporation, does not dissolve but remains dormant.

In the instant case, the *X* corporation acquired the merchandise inventory, equipment, and premises' lease of the *Y* corporation on August 1, 1954, and has, since that date, continued the operation of the latter's manufacturing business. Former employees of the *Y* corporation have been employed by the *X* corporation. The *Y* corporation did not dissolve upon the transfer of its property to its successor but remains dormant, having as its principal asset a 25 percent interest in the capital stock of *X* corporation, the purchase price of the predecessor corporation's property acquired by the successor corporation.

In defining wages subject to the taxes imposed by the Act, section 3121(a)(1) prescribes a limitation of $4,200 for such wages. It also provides that the wages paid by a predecessor employer to an employee should be treated as having been paid to such employee by a successor employer if (1) the successor during the calendar year acquired substantially all of the property used in a trade or business, or used in a separate unit of a trade or business, of the predecessor; (2) such

employee was employed in the trade or business of the predecessor immediately prior to the acquisition and is employed by the successor in his trade or business immediately after the acquisition; and (3) such wages were paid during the calendar year in which the acquisition occurred and prior to such acquisition.

Since these three conditions are met in the instant case, the wages paid by *Y*, the predecessor employer, to its employees are considered as having been paid to such employees by *X*, the successor employer, for purposes of the $4,200 wage limitation provided by section 3121(a) of the Act. The fact that the predecessor employer does not dissolve, but remains as a dormant corporation, is immaterial for purposes of the above section of the Act.

(Also Part II, Section 1426(d); Regulations 128, Section 408.204.) Rev. Rul. 55–445

An individual performs services as a gardener on a continuing basis on the premises of the person engaging him. He does not furnish any tools or equipment, advertise his services, or maintain an office, shop, or other place of business. His services may be terminated at any time. *Held*, the individual is an employee, for Federal employment tax purposes, of the person for whom the gardening services are performed.

A question has been presented to the Internal Revenue Service relative to the status, for purposes of the Federal Insurance Contributions Act (chapter 21, subtitle C, Internal Revenue Code of 1954) of an individual who performs gardening services on a continuing basis on the premises of the person engaging him.

Upon answering a newspaper advertisement the individual in question was engaged to do the garden work on an estate. The work consists of mowing the lawn, weeding the flower beds, and keeping the grounds of the estate in good condition. He works 5 days a week and receives regular weekly remuneration for his services. He does not furnish any of the gardening tools or equipment used in performing the services, advertise his services in the newspapers or the classified telephone directory, or maintain an office, shop, or other place of business. He does, however, perform similar services for others and his services may, in all instances, be terminated at any time.

Section 3121(d) of the Federal Insurance Contributions Act, provides among other things, that the term "employee" means any individual who, under the usual common law rules applicable in determining the employer-employee relationship, has the status of an employee.

Whether an individual is an employee under the usual common law rules depends upon the particular facts in each case. The guides for determining, under such rules, whether an employer-employee relationship exists, are found in section 408.204(c) of Regulations 128, applicable to the provisions of the Internal Revenue Code of 1954 by virtue of Treasury Decision 6091, C. B. 1954–2, 47.

An individual engaged by a person to do the type of work described above in or about the person's private premises is the employee of such person unless it is clearly established that the individual is an independent contractor. The fact that he performs similar services

for others is not, in and of itself, conclusive in determining that he is an independent contractor and not an employee with respect to such services. Nor does the fact that direction and control are not exercised preclude an employer-employee relationship since, in the performance of comparatively simple services as are involved in the instant case, adherence to specified hours of work and detailed supervision over the manner of the services performed may not be necessary or practicable. It is sufficient, in order to establish such a relationship, if the right to exercise direction and control over the individual's services is retained by the person for whom the services are performed.

Accordingly, it is held that an individual who performs services as a gardener on a continuing basis on the private premises of the person engaging him, furnishes none of his tools or equipment, does not advertise his services, does not maintain an office, shop, or other place of business, and whose services may be terminated at any time, is an employee, for Federal employment tax purposes, of the person for whom the gardening services are performed. Compare Revenue Ruling 55–328, C. B. 1955–1, 98, which holds that the relationship between the owner of a cemetery and a sexton is not that of employer-employee.

It may be pointed out that services performed by a gardener in or about a private nonfarm home of the person by whom he is employed constitutes domestic services. Under the provision of section 3121 (a) (7) (B) of the Act, the term "wages" does not include cash remuneration of less than $50 paid by an employer in any calendar quarter to an employee for domestic services in a private nonfarm home of the employer. Thus, unless a domestic worker is paid cash remuneration of $50 or more by his employer in a calendar quarter, liability for the taxes imposed under the Act is not incurred by the employer for such quarter.

(Also Part II, Section 1426(d); Regulations 128, Section 408.204.) Rev. Rul. 55–466

An individual is engaged on a part-time basis to assist a firm of consulting engineers in the solution of engineering problems. During the progress of his assignment he is under the supervision and guidance of the firm and upon completion of a project his work is checked by the firm for soundness of conclusions. Any necessary helpers are hired with consent of the firm and paid thereby. The individual does not maintain an office of his own, nor does he hold himself out to the public as an engineering consultant. *Held*, that the individual is an employee of the firm for Federal employment tax purposes.

A question has been presented to the Internal Revenue Service relative to the status, for purposes of the Federal Insurance Contributions Act (chapter 21, subtitle C, Internal Revenue Code of 1954), of an individual performing engineering services on a part-time basis for a firm of consulting engineers under the circumstances described below.

The engineering firm specializes in research and development and enters into contracts with various firms for the solution of their engineering problems by the study of machines or parts of machines. Upon being given an assignment by the firm, the individual, a regularly

employed college professor of engineering, is required to carry through to completion the project assigned to him, performing whatever engineering, designing, building and testing that may be necessary. The firm furnishes drawing paper, calculating paper, typing service, and use of its library for reference purposes. Any helpers that may be needed to assist the individual are engaged with the consent of the firm and their wages are paid by the firm.

The individual furnishes his own engineering tools such as drawing instruments and slide rule. Except when a project has a deadline on it, there are no requirements as to hours of work. All calculations and analyses are carried out in his own home or other place of his choosing. Being thoroughly competent, he receives only general guidance. Supervision of his services is exercised by discussions between him and the owner of the engineering firm. No formal, periodical reports are made to the firm. However, the firm is kept informed verbally of all phases of the work and checks the individual's work, when completed, for soundness of conclusion. The individual is paid on an hourly basis and is reimbursed by the firm for any expenditures for equipment. He does not maintain an office of his own, nor does he advertise or otherwise hold himself out to the public as being available to render services as an engineering consultant.

Section 3121(d) of the Federal Insurance Contributions Act provides among other things that the term "employee" means any individual who, under the usual common law rules applicable in determining the employer-employee relationship, has the status of an employee. Whether an individual is an employee under the usual common law rules depends upon the particular facts in each case. The guides for determining, under the common law rules, whether an employer-employee relationship exists are found in section 408.204 (c) of Regulations 128, applicable to the provisions of the Internal Revenue Code of 1954 by virtue of T. D. 6091, C. B. 1954–2, 47.

Although the individual here involved may be extremely well qualified to perform the work assigned to him without detailed supervision and does perform services with considerable freedom of action, it is apparent in this case that such freedom stems primarily from the individual's analytical ability and not from any contractual obligation which prevents the firm from imposing its will upon him. It is clear that the engineering firm retains a general over-all control with respect to the services necessary to establish the relationship of employer and employee. Accordingly, it is held that the individual is an employee of the firm for Federal employment tax purposes.

(Also Part II, Section 1426(d); Regulations 128, Section 408.204.) Rev. Rul. 55–500

A college leased one of its buildings to a manufacturing corporation and it was agreed that its students only are to be employed as production workers for the corporation. Selections and withdrawals of student workers are to be made by the college. Training for the jobs is given by the corporation, which controls the quality and manner of performance of the work. All equipment and materials used are furnished by the corporation. All remuneration due students for their services is paid by the corporation to the college, which credits it to the students' accounts with the college. *Held*, the students are the employees of the manufacturing corporation for Federal employment tax purposes.

A question has been presented to the Internal Revenue Service relative to the status, for purposes of the Federal Insurance Contributions Act (chapter 21, subtitle C, Internal Revenue Code of 1954), of college students performing services for a manufacturing corporation under the circumstances described below.

In order to afford its deserving and needy students a means for earning money for payment of their tuition, a college entered into an agreement with a manufacturing corporation whereby the college leased one of its campus buildings to the corporation, and the corporation agreed to conduct some of its business operations in that building using only college students as the production workers. All assignments and withdrawals of students to or from the jobs are to be made by the college and not by the corporation. In accordance with the agreement, the corporation notifies the college on the first day of each month as to the hours of student labor it will require during the ensuing month in its operations, and the college furnishes, so far as possible, all the labor necessary to comply with the corporation's request. The corporation pays to the college certain hourly rates set forth in the agreement for each student furnished to the corporation. The college has the complete right, power and authority to determine which students will be eligible and the number of hours any student is to work. The college also has absolute authority as to the hiring and releasing of any students.

The agreement further provides that the corporation has the right to submit a written report to the college about any student whose work is unsatisfactory, and that the college may or may not take such report into consideration in its control of the hiring or releasing of such student; that the corporation will reimburse the college for all monies spent by it for compensation insurance for the students who perform services for the corporation; and that the agreement may be cancelled by either party as of the close of any academic year, upon ninety days' written notice, or otherwise by mutual agreement of the parties.

The students are solicited, screened and assigned by the college to work for the corporation. The work involves inspection, assembly, packaging and machine-operation on a part-time basis in connection with the manufacture of the corporation's products. Training therefor is given by the corporation, and it controls the quality and manner in which the work is performed. All equipment and materials used are provided by the corporation and all work is performed on the premises leased to the corporation. If a student worker is dropped from classes because of an unsatisfactory academic record, the college replaces him with another student for work with the corporation. If a student's production record is unsatisfactory to the college or to the corporation and the college, he is relieved and his place is taken by another student assigned by the college. All remuneration due a student for his services is paid to the college, and it in turn credits the amounts received to the student's account with the college.

Section 3121(d) of the Federal Insurance Contributions Act provides, among other things, that the term "employee" means any individual who, under the usual common law rules applicable in determining the employer-employee relationship, has the status of an employee. Whether an individual is an employee under such rules depends upon the particular facts in each case. The guides for deter-

mining whether a common-law employer-employee relationship exists are found in section 408.204(c) of Regulations 128, applicable to the provisions of the Internal Revenue Code of 1954 by virtue of Treasury Decision 6091, C. B. 1954–2, 47.

It is concluded, in the instant case, that the manufacturing corporation exercises, or has the right to exercise over the students of the college in the performance of their services the direction and control necessary to constitute an employer-employee relationship. Accordingly, it is held that the students are employees, for Federal employment tax purposes, of the corporation with respect to the services performed therefor.

(Also Sections 3306, 3401.) Rev. Rul. 55–543
(Also Part II, Sections 1426(d), 1607(i), 1621(c); Regulations 128, Section 408.204; Regulations 107, Section 403.204; Regulations 120, Section 406.203.)

The *M* company operates a motor truck freight line. Its employee-drivers engage local union helpers to unload "drop" freight shipments at points which do not have terminal facilities. The employee-drivers pay such helpers and are subsequently repaid by the company. *Held*, the helpers are employees of the company for purposes of the Federal employment taxes and the withholding of income tax.

The Internal Revenue Service has been requested to determine the status for purposes of the Federal Insurance Contributions Act, the Federal Unemployment Tax Act and the Collection of Income Tax at Source on Wages (chapters 21, 23 and 24, respectively, subtitle C, Internal Revenue Code of 1954) of helpers engaged by employee-drivers of the *M* company to unload "drop" freight shipments.

The *M* company operates a motor truck freight line between its home office and various cities where it has terminal facilities. The company also accepts "drop" freight shipments for delivery at in-between points, at which it does not have terminal facilities. The employee-drivers of the company, due to local employment conditions relating to the trucking industry, are required to employ local union helpers to unload such "drop" shipments and to remunerate them at the prevailing hourly rate, subject to a minimum of eight-hours' pay for each helper employed. The drivers are subsequently repaid by the company. Information reaching the Service indicates the payments to the helpers are generally made in cash by the drivers.

It is the position of the Service that employees performing services under the direction of an employee of a company, in connection with that employee's employment by the company, are also employees of the company for Federal employment tax purposes, even though such subemployees do not appear on the company's payroll and are paid by the supervising employee out of the gross amount received by him from the company. See S. S. T 70, C. B. 1937–1, 387.

In the instant case, the truck drivers are admittedly employees of the *M* company for Federal employment tax purposes. In accordance with the position of the Service as stated above, it is held that the local union helpers engaged and paid by the employee-drivers under the circumstances stated are employees of the *M* company for purposes of

the Federal Insurance Contributions Act, the Federal Unemployment Tax Act, and for income tax withholding under section 3402 of the Code. Accordingly, the *M* company is liable for the reporting on its appropriate tax returns of the wages paid to the helpers and for the payment of the taxes with respect to such wages.

(Also Section 3401.) Rev. Rul. 55-544
(Also Part II, Sections 1426(d), 1621(d); Regulations 128, Section 408.204; Regulations 120, Section 406.205.)

Special peace officers appointed by the Governor of the State of Kentucky, pursuant to the provisions of section 61.360 of the Kentucky Revised Statutes 1953, to protect property, and who are subject to the property owner's direction and control in the performance of such services, are employees of such property owner for purposes of the Federal Insurance Contributions Act and the Federal Unemployment Tax Act. The State, having control of the payment of the officers' wages, is responsible for the withholding of income tax on such wages.

The Internal Revenue Service has been requested to state its position with respect to the status, for purposes of the Federal Insurance Contributions Act and the Federal Unemployment Tax Act (chapters 21 and 23, respectively, subtitle C, Internal Revenue Code of 1954), of special peace officers who are appointed by the Governor of the State of Kentucky pursuant to the provisions of section 61.360 of the Kentucky Revised Statutes 1953, to protect property, subject to the direction and control of the property owner. The question at hand is whether such peace officers are employees of the property owner.

Under the provisions of section 61.360 of the Kentucky Revised Statutes 1953, an owner of property may make application for the services of a special peace officer to protect and preserve his property from waste or destruction. The Governor may apoint an individual recommended by the owner if the individual's eligibility for the position is established to the satisfaction of the Governor. The duties of the peace officer are confined to the premises to be protected except that he may pursue a person fleeing from the property after committing an act of violence or destruction and make arrest anywhere within the State. Such peace officer may not wear any uniform of any public police officer, nor in any way impersonate or represent himself to be a public police officer. The owner of the property is required to pay into the State treasury an amount equal to the salary of the officer, and the salary of the officer is paid out of the State treasury by order of the Governor. The Governor may remove the peace officer at will or at the request of the owner of the property.

In a case which is representative of the question at hand, an individual was appointed special peace officer by the Governor of the State in accordance with the above provisions of the Statute, to protect the property of a company at the company's request. The control of the method of the officer's work and all working conditions under which his services were performed were under the supervision of the company's superintendent.

Under section 3121(d)(2) of the Federal Insurance Contributions Act the term "employee" means any individual who, under the usual

common law rules applicable in determining the employer-employee relationship, has the status of an employee. Whether an individual is an employee under the usual common law rules depends upon the particular facts in each case. The guides for determining, under such rules, whether an employer-employee relationship exists, are found in section 408.204(c) of Regulations 128, applicable to the provisions of the Internal Revenue Code of 1954 by virtue of T. D. 6091, C. B. 1954–2, 47.

It is the position of the Internal Revenue Service that the appointment of special peace officers by the Governor of the State of Kentucky pursuant to the Kentucky Revised Statutes 1953, *supra*, is only to vest them with certain authority and power in performing their services. Any control which the Governor may exercise over such officers is merely for the purpose of insuring compliance with the provisions of the statutes under which they are appointed.

Accordingly, it is held that special peace officers appointed by the Governor pursuant to the above Statutes to protect property, who are subject to the property owner's direction and control in the performance of such services, are employees of such property owner for purposes of the Federal Insurance Contributions Act and the Federal Unemployment Tax Act. The State, having control of the payment of the officers' wage, is responsible for the withholding of income tax on such wages. See Rev. Rul. 54–471, C. B. 1954–2, 348 at 350.

See S. S. T. 327, C. B. 1938–2, 317, holding a regular police officer, under entirely different facts, to be an employee of the city employing him and not of an amusement company which owns a theater to which he is assigned.

(Also Part II, Section 1426(d); Regulations 128, Section 408.204.) Rev. Rul. 55–561

An individual possessing an exclusive license to make, use, and sell a certain invention assigned his rights thereto to a company with which he entered into an agreement to manage and supervise the exploitation of the rights conferred by the license. He is required to devote his best efforts to the development of the business and his activities as manager are subject to the general direction and control of the company. The individual receives a minimum annual salary or a percentage of the net profits from the business, whichever is greater. All services are performed on the company's premises; assistants are engaged and paid by the company; and all commercial and financial commitments must have the prior approval of the company. *Held*, the individual is an employee of the company for Federal employment tax purposes.

The Internal Revenue Service has been requested to determine the status, for purposes of the Federal Insurance Contributions Act (chapter 21, subtitle C, Internal Revenue Code of 1954), of an individual performing services as manager of a company under the circumstances described below.

The individual, possessing an exclusive license to make, use, and sell a certain invention, assigned his rights under such license to a company and entered into an agreement with the company to act as its manager and supervise the exploitation of the rights conferred by the license. Under the terms of the agreement, he is required to de-

vote his best efforts to the development of the business, and his management activities are subject to the general control and direction of the company and its president. His services are performed on the company's premises, and his assistants are engaged and paid by the company. All commercial and financial commitments must have the prior approval of the president of the company and all correspondence is to be made available at the president's request. The individual receives a minimum annual salary or a percentage of the net profits from the business, whichever is greater. The agreement may be terminated by the company in the event the operation of the business results in a loss or the manufacture or sale of the product involves patent infringement. In either event, the license will be reassigned to the individual.

Under section 3121(d) of the Federal Insurance Contributions Act, the term "employee" means any individual who, under the usual common law rules applicable in determining the employer-employee relationship, has the status of an employee.

Whether an individual is an employee under the usual common law rules depends upon the particular facts in each case. The guides for determining, under such rules, whether an employer-employee relationship exists, are found in section 408.204(c) of Regulations 128, applicable to the provisions of the Internal Revenue Code of 1954 by virtue of T. D. 6091, C. B. 1954–2, 47.

It is concluded in the instant case that the company exercises or retains the right to exercise such direction and control over the individual in the performance of his services as is necessary to constitute an employer-employee relationship. Accordingly, it is held that the individual is an employee of the company for Federal employment tax purposes.

(Also Section 1402.) Rev. Rul. 55–582
(Also Part II, Sections 481(a), 1426(d);
Regulations 118, Section 39.481–3,
Regulations 128, Section 408.204.)

An individual performs carpentry and masonry services in a community, obtaining the work as a result of his reputation and ability to operate on a small scale. He furnishes most of the tools and equipment needed, determines his own hours of work, and is paid on the basis of a regular hourly rate. *Held*, the individual is not an employee of the persons for whom he performs the services, for Federal employment tax purposes. *Held further*, the individual is engaged in a "trade or business" for purposes of the Self-Employment Contributions Act and his earnings should be considered in computing net earnings from self-employment under such Act.

The Service has been requested to determine whether an individual performing carpentry and masonry services is an employee, for purposes of the Federal Insurance Contributions Act (chapter 21, subtitle C, Internal Revenue Code of 1954), and, if not, whether he is engaged in a "trade or business" with respect to such services, for purposes of the Self-Employment Contributions Act of 1954 (chapter 2, subtitle A of such Code).

An individual holds himself out to the public, in the community where he resides, as being available for carpentry and masonry work. He is well known in the community and the work is obtained by him because of his reputation for good work and his ability to operate on a small scale. He does not advertise his services in any manner. None of the people for whom the services are performed has a preferred call on his services or has the right to supervise him or to determine the hours during which such services are performed. All the tools used in the work are furnished by him except, on certain jobs, a tool or piece of equipment, such as a ladder, may be more rapidly available than his own and is used. He obligates himself to complete a specific job and is paid for his services at a regular hourly rate, based on records kept by him as to the number of hours worked.

Under section 3121(d) of the Code the term "employee" means—

* * * * * * *

(2) any individual who, under the usual common law rules applicable in determining the employer-employee relationship, has the status of an employee; * * *."

* * * * * * *

The guides for determining, under the usual common law rules, whether an employer-employee relationship exists, are found in section 408.204(c) of Regulations 128, applicable to the provisions of the Internal Revenue Code of 1954 by virtue of T. D. 6091, C. B. 1954–2, 47.

Whether an individual is an independent contractor or an employee is largely a question of fact to be determined upon consideration of the particular facts in each case. In this case, it is determined that the individual is not an employee, for Federal employment tax purposes, of the persons for whom the services are performed, but he is an independent contractor with respect to such services. This determination is based principally upon a conclusion that the facts presented show the persons for whom the services are performed have the right to control and direct the individual only as to the results to be accomplished by the work but not as to the details and means by which such results are accomplished. Also, the fact that the individual offers his services to the public and furnishes his own tools and equipment is material to the determination.

Section 1402(c) of the Self-Employment Contributions Act provides that the term "trade or business," when used with reference to self-employment income or net earnings from self-employment, shall have the same meaning as when used in section 162 of the Code (relating to trade or business expenses), with certain exceptions not here material.

Generally, a person who is not an employee, for Federal employment tax purposes, and who is regularly engaged in an occupation or profession for profit which constitutes all or a part of his livelihood, is engaged in a "trade or business."

It is held that the individual performing the services described herein under the circumstances stated is engaged in a "trade or business" with respect to such services and the income he derives therefrom is includible in computing net earnings from self-employment.

(Also Section 3401.)
(Also Part II, Sections 1426(d), 1621(c);
Regulations 128, Section 408.204;
Regulations 120, Section 406.203.)

Rev. Rul. 55-583

A professor employed to perform teaching services at a State college was designated by the college to carry out a research project under a grant-in-aid to the college by a foundation. The professor continued to draw his salary as a professor and, for time spent in research in excess of his regular teaching time, received additional remuneration from the college out of funds from the grant. A stenographer engaged by the professor to work on the research project performed services under his direct supervision and was remunerated by the college out of funds from the grant. *Held*, both the professor and the stenographer are employees of the college within the meaning of the Federal Insurance Contributions Act and for purposes of income tax withholding.

An inquiry has been received relative to the status, for purposes of the Federal Insurance Contributions Act, and Collection of Income Tax at Source on Wages (chapters 21 and 24 respectively, subtitle C, Internal Revenue Code of 1954) of individuals engaged to perform services in connection with a research project financed by a grant-in-aid to a State college by a foundation.

In the instant case, the State college, a wholly owned instrumentality of the state, was awarded a grant-in-aid by the foundation for the purpose of enabling the college to conduct a research project. A professor, as part of his duties for the college, was assigned to the project and made responsible for conducting the research and supervising the work of a stenographer engaged by him to assist in connection with the project. While conducting the research project the professor was released from a portion of his regular teaching duties, but continued to draw his entire salary as a professor and, in addition, received amounts for time devoted to the research project in excess of the released teaching time. These amounts were paid out of the funds from the grant. A substitute professor was engaged by the college to perform teaching services during the hours that the regular professor was engaged on the research project. The stenographer engaged to assist the regular professor in connection with the research project and the substitute professor were paid from the funds made available under the grant.

The actual work in connection with the project was done in the college, in libraries and in the home of the professor. The means and methods of carrying on the project, as well as the hours during which the research services were performed, were left to the judgment of the professor. However, the college had broad general supervision over the way the grant was expended, and had the right to exercise direction and control, through a special committee set up under the foundation project, over the individuals performing services in connection with the research project.

Section 3121(d) of the Federal Insurance Contributions Act provides, among other things, that the term "employee" means any individual who, under the usual common law rules applicable in determining the employer-employee relationship, has the status of an employee. Whether an individual is an employee depends upon the particular facts in each case. The guides for determining whether an employer-employee relationship exists are found in section 408.-

204(c) of Regulations 128, applicable to the provisions of the Internal Revenue Code of 1954 by virtue of T. D. 6091, C. B. 1954–2, 47.

Section 3401(c) of chapter 24 of the 1954 Code (Collection of Income Tax at Source on Wages) provides, among other things, that the term "employee" includes an officer, employee, or elected official of a State or any agency or instrumentality of a State. The guides for determining whether an employer-employee relationship exists for purposes of income tax withholding are found in section 406.203 of Regulations 120, applicable to the provisions of the Internal Revenue Code of 1954 by virtue of T. D. 6091, *supra.*

In the instant case, it is held that the college is the employer, for purposes of the Federal employment taxes and income tax withholding, of the professor with respect to his services in connection with the research project as well as his regular duties for the college. The substitute professor engaged by the college is also its employee for such purposes.

The Internal Revenue Service holds that where an employee, with either the express or implied consent of his employer, engages other individuals in connection with his employment by such employer, that such other individuals are also employees of his employer for Federal employment tax purposes. See S. S. T. 215, C. B. 1937–2, 443 and S. S. T. 336, C. B. 1938–2, 295. The fact that the stenographer, in this case, was paid from funds made available to the State college by a foundation is not determinative of whether she is an employee of the college. Accordingly, it is held that the stenographer engaged with the implied consent of the college to assist the professor in the research project is also an employee of the college for purposes of the Federal employment taxes and income tax withholding.

Since the college is a wholly owned State instrumentality, the services performed by its employees are excepted from "employment" by reason of section 3121(b)(7) of the Federal Insurance Contributions Act. It follows that the instrumentality is not required to report and pay the taxes imposed under that Act with respect to the remuneration paid for such services. However, the college, as employer, is required to withhold income tax under section 3402 of the Code from the wages of its employees.

Although the services here involved are excepted from employment for purposes of the Federal Insurance Contributions Act, section 218 of the Social Security Act, as amended, extends social security coverage to employees of a state instrumentality pursuant to agreement between the state and the Department of Health, Education and Welfare. Questions related to that matter should be addressed to that Department.

(Also Part II, Section 1426(d); Regulations 128, Section 408.204.) Rev. Rul. 55–613

An individual is engaged in the operation of a "remnant or mill ends" store as a factory outlet of a fabric corporation. He has no investment in the enterprise, may not handle goods competitive to those produced by the corporation, and is required to perform the services personally. The corporation may dispense with the services of such individual at any time. *Held,* the individual is an employee of the corporation for purposes of the Federal Insurance Contributions Act.

The question has been presented to the Internal Revenue Service whether an individual operating a "remnant or mill ends" store as a factory outlet of a fabric manufacturing corporation under the conditions hereinafter set forth is an employee of the corporation for purposes of the Federal Insurance Contributions Act (chapter 21, subtitle C, Internal Revenue Code of 1954).

Under an arrangement between the individual, hereinafter called the "operator," and the corporation, the corporation rents the store in which its remnants or mill ends are sold, pays all utilities and furnishes certain equipment. Under this arrangement, the operator receives as remuneration $5x$ percent of the retail price at which the goods are sold. The operator has no investment in the business and may not handle goods which are competitive to those produced by the corporation. He makes a determination at the factory regarding some of the types of merchandise to be sent to the store for sale, while the corporation sets the retail selling price thereof. The corporation bills the goods to "Sales Room" in care of the operator, retains title to such goods, and includes them in its inventory until sold by the operator. The operator is required to perform the services personally and to turn over the sales books and cash (retail price, less his percentage thereof) to the corporation at intervals of 1 or 2 weeks. While no specific agreement was made as to the particular hours during which the store is to be open for business, it is understood that it will be open during the same hours generally as other business houses in the vicinity. The corporation may dispense with the services of the operator at any time.

Section 3121(d) of the Act provides, among other things, that the term "employee" means any individual who, under the usual common law rules applicable in determining the employer-employee relationship, has the status of an employee. The guides for determining whether, under the usual common law rules, an employer-employee relationship exists are found in section 408.204(c) of Regulations 128, applicable to the Internal Revenue Code of 1954 by virtue of T. D. 6091, C. B. 1954–2, 47.

From the facts presented, it is the opinion of the Service that the corporation either exercises or has the right to exercise such control and direction over the operator as is necessary to establish the relationship of employer and employee under the usual common law rules. Accordingly, it is held that the operator is an employee of the corporation for purposes of the Federal Insurance Contributions Act.

(Also Part II, Section 1426(d); Regulations 128, Section 408.204.) Rev. Rul. 55–658

An individual who is engaged in the printing trade and is self-employed with respect to such activity, entered into an agreement with a company for an indefinite period to produce printed matter used in its business. The company furnishes its own printing presses and other equipment, all necessary materials, and guaranteed the printer a minimum monthly income. He is required to do the work personally, work a regular five-day week exclusively for the company, and is not permitted to engage helpers. The company has first call on his services and can discharge him at any time. *Held,*

the individual is an employee of the company for Federal employment tax purposes with respect to the services performed for the company.

Advice has been requested relative to the status, for purposes of the Federal Insurance Contributions Act (chapter 21, subtitle C, Internal Revenue Code of 1954), of a self-employed printer who is engaged for an indefinite period to perform printing services exclusively for a company on a full-time basis.

In the instant case, the printer has an established printing business which he operates from his home under a trade name. He maintains a small printing press in the basement of his home and he advertises his business in the local paper and telephone directory. Generally, he is self employed with respect to such operations. As a result of his advertising, a wholesale drug company entered into an oral contract with him to print labels, catalogues, and other materials for it, guaranteeing him a minimum monthly income during the existence of the contract. The company has a printing press on its premises and, together with certain equipment and materials, made it available to him for work under the contract. The parties agreed that the company has a first call on the printer's services and may require that he perform his services on company premises at any time. He is not permitted to hire any assistants with respect to the work performed for the company. For the duration of the contract, he agreed to work exclusively for the company during regular business hours. The facts show that he has worked a regular forty-hour, five-day week for the company, and any work undertaken for others was performed at other than those hours. The company has the right to discharge him at any time and he may terminate his services at any time without incurring any liability with respect to unfinished work. Although he is permitted to print some of the company's materials on his own press, very little of it has been so produced; even then, however, the company furnished the materials used in such production.

Section 3121(d) of the Act provides, among other things, that the term "employee" means any individual who, under the usual common law rules applicable in determining the employer-employee relationship, has the status of an employee. The guides for determining, under such rules, whether an employer-employee relationship exists are found in section 408.204(c) of Regulations 128, applicable to the provisions of the Internal Revenue Code of 1954 by virtue of Treasury Decision 6091, C. B. 1954–2, 47.

It is concluded, upon the basis of the above facts, that the company has retained the right to exercise the direction and control over the printer necessary to constitute an employer-employee relationship. Accordingly, it is held that such individual is an employee of the company for Federal employment tax purposes with respect to the services performed for the company. Thus, in computing the amount of self-employment income derived from his own printing business during the taxable year, the individual should take into consideration the amount of "wages" received by him from the company during such year, in accordance with the provisions of section 1402(b) of the Self-Employment Contributions Act of 1954 (chapter 2, subtitle A, Internal Revenue Code of 1954).

(Also Part II, Section 1426(d); Regulations 128, Section 408.205.) Rev. Rul. 55-669

A and *B* entered into an oral agreement for the rental of a large apartment in order to secure suitable living accommodations for *A* and his wife, and *B*. *A* and *B* each contributes to the payment of the monthly rental and in alternate weeks each pays the wages of *C*, who is engaged as a domestic servant to clean the entire apartment. *Held*, *A* and *B* constitute the employing unit and *C* is considered as having a single employer for purposes of the Federal Insurance Contributions Act taxes.

In the instant or similar cases, either member of the employing unit may file, on behalf of the unit, the Employer's Quarterly Tax Return for Household Employees, Form 942, reporting thereon the taxes due.

Advice has been requested concerning the status of *A* and *B* with respect to the employment of *C* as a domestic servant under the circumstances set forth below for purposes of the taxes imposed by the Federal Insurance Contributions Act (chapter 21, subtitle C, Internal Revenue Code of 1954).

A and *B* entered into an oral agreement for the rental of a large apartment in order to secure suitable living accommodations for *A* and his wife, and *B*. The apartment was rented in the name of *A* who signed the lease. *A* contributes two-thirds of the monthly rental and *B* contributes one-third. They share the bath and kitchen and each has the use of the entire apartment. *C* is engaged as a domestic servant to clean the entire apartment one day each week, for which service she is paid the amount of $6. *A* and *B* alternate in paying *C* her weekly wages.

The question to be determined is whether liability for the taxes imposed by the Act is incurred by either *A* or *B* with respect to *C*'s remuneration since *A* and *B* each pays one-half of her quarterly wages of $72 and since neither *A* nor *B* pays her $50 or more cash wages in a calendar quarter.

The taxes imposed under the Federal Insurance Contributions Act apply to cash wages paid for domestic service in a private home of the employer, if such wages meet the "$50 a quarter" test provided in section 3121(a)(7)(B) of the Act. Wages of a household employee are taxable if an employer pays an employee $50 or more cash wages in a calendar quarter for nonfarm household services regardless of when earned.

The services performed by *C* pertain to space occupied and/or used by both *A* and *B*. The apartment is operated as a single housekeeping unit. Therefore, *A* and *B* constitute the employing unit with respect to *C's* services.

Accordingly, it is held that *C* should be considered as having a single employer for purposes of the taxes imposed by the Federal Insurance Contributions Act. Since the combined wages paid to *C* by *A* and *B* during a quarter amount to $50 or more, the total amount of wages paid to *C* are taxable and both *A* and *B* are liable for filing proper returns on behalf of the employing unit and for the payment of the taxes shown to be due. However, in the instant or similar cases, either member of the employing unit may file, on behalf of the unit, the Employer's Quarterly Tax Return for Household Employees, Form 942, reporting thereon the taxes due.

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(Also Part II, Section 1426(d); Regulations 128, Section 408.204.) Rev. Rul. 55-695

An employee, upon reaching retirement age, was retained by her employer to train a replacement for her job. She was required, under an agreement, to devote all of her knowledge, skill and working time to the company. She worked exclusively for the company on its premises under the direction of a company manager; was furnished office space, equipment, telephone, stationery, etc., without charge; was reimbursed for all expenses incurred on the company's behalf; and received a retainer fee for her services. The agreement was terminable by the company at any time upon proper notice. *Held*, the individual was an employee of the company for Federal employment tax purposes with respect to services performed during the term of the agreement.

The Internal Revenue Service has been requested to determine the status, for purposes of the Federal Insurance Contributions Act (chapter 21, subtitle C, Internal Revenue Code of 1954), of an individual who, upon reaching retirement age, was retained by her "former" employer as a consultant on a retainer fee basis for the purpose of training a replacement for her job.

The individual had worked as an employee of the company for many years and was thoroughly familiar with all the details of her work. When she attained retirement age, the company desired, because of her knowledge of the work, to retain her services for an extended period of time for the purpose of training a replacement. An agreement entered into between the individual and the company provided that she was to be engaged as an independent contractor to serve in the capacity of a consultant; that she would devote all of her knowledge, skill and working time solely to the business and other interests of the company; and that she would be paid a retainer fee payable in equal monthly installments. The company agreed to reimburse her for amounts paid out for expenses incurred in its behalf. She agreed not to incur any extraordinary expenses without company approval. Deductions from her fee would be made for periods of absence on account of illness or other causes. The contract was terminable by the company upon 30 days written notice for performance not in keeping with the terms of the contract. The individual worked exclusively for the company on its premises and was furnished office space, office equipment, telephone, stationery, etc., without charge. She worked under the general direction of the company's office manager but did not require supervision in the details of her work in view of her past experience on the job. The services performed were the same as those performed by her prior to her attainment of retirement age, except that at the same time she was occupied in training a replacement for her job.

Section 3121(d) of the Act provides, among other things, that the term "employee" means any individual who, under the usual common law rules applicable in determining the employer-employee relationship, has the status of an employee.

Whether a person is an independent contractor or an employee is largely a question to be determined under the particular facts in each

case. The guides for determining, under the usual common law rules, whether an employer-employee relationship exists are found in section 408.204(c) of Regulations 128, applicable to the provisions of the Internal Revenue Code of 1954 by virtue of Treasury Decision 6091, C. B. 1954–2, 47.

Section 408.204(a) of Regulations 128, *supra*, provides that if the relationship of employer and employee exists, the designation or description of the relationship of the parties as anything other than that of employer and employee is immaterial. Thus, if such relationship exists, it is of no consequence that the employee is designated as a partner, coadventurer, agent, independent contractor, or the like. Hence, although the contract stipulated that the relationship of the parties would be that of principal and contractor, such designation of the parties in interest as to their relationship may be accepted only if warranted by the facts in the case.

Under the circumstances stated, it is apparent that the individual performed, on a continuing basis, personal services of the type normally performed by an employee for a business firm, and that the company either exercised, or retained the right to exercise, over her the direction and control necessary to establish the relationship of employer and employee. Accordingly, it is held that the individual was an employee of the company for Federal employment tax purposes for the period during which she served the company as a consultant subsequent to her attainment of retirement age.

(Also Section 3306.) Rev. Rul. 55–718
(Also Part II, Sections 1426(d), 1607(i); Regutions 128, Section 408.204; Regulations 107, Section 403.204.)

An individual performs services as a "disc jockey," announcer, and master of ceremonies for a radio station. The station determines the time and length of the programs and the time for rehearsals. It has the right to the exclusive services of the individual, to the use of his name for publicity purposes, and to reject advertisements and announcements secured by him which do not meet certain standards. *Held*, the individual is an employee of the radio station, for Federal employment tax purposes.

Advice has been requested as to the status, for purposes of the Federal Insurance Contributions Act (chapter 21, substitle C, Internal Revenue Code of 1954), of an individual performing services as a "disc jockey" for a radio station.

The individual entered into a contract with the radio station to perform services, for a 5-year period, as a "disc jockey," announcer, and master of ceremonies. The contract provides that the services shall be performed 7 days a week, on a program or programs having a title or titles selected by the radio station, but including the individual's professional name; that the program shall be a "disc jockey" type of program, with commercial announcements and appropriate comments about the records played; that the format and type of rec-

ords used on the program shall be similar to those on a recording of a prior program, copies of which each party has; that the individual's services shall be performed at such hour or hours of the day and at such locations as shall be designated by the radio station and shall include time necessary for rehearsals; that the individual shall abide by all rules, regulations and instructions issued by the station and shall not announce, act, perform, speak, or otherwise appear in any radio programs broadcast by another radio station without permission; that the station shall have the right to use or to authorize the use of the individual's name, endorsements, and photographs for its publicity purposes; that the individual shall be given a vacation each year, during which time tape recordings previously made shall be used and the individual paid therefor as if the programs had been broadcast live; that the individual shall exercise his best efforts in the sale of commercial announcements for the programs; that all advertisements and announcements shall be subject to the station's approval; that the individual shall be paid a stated amount each week, plus a percentage of the net revenue from the commercial announcements made on the programs; and that it is understood that the individual is an independent contractor.

Supplemental agreements entered into by the station and the individual allow him to perform services on another radio station until such time as his weekly income under the above-described contract reaches a certain level, whereupon his services shall be performed exclusively under the contract.

Under section 3121(d)(2) of the Act, the term "employee" means any individual who, under the usual common law rules applicable in determining the employer-employee relationship, has the status of an employee. The guides for determining whether, under such rules, an employer-employee relationship exists are found in section 408.204(c) of Regulations 128, applicable to the Internal Revenue Code of 1954 by virtue of Treasury Decision 6091, C. B. 1954–2, 47. Where the relationship of employer and employee exists, the designation or description of the relationship by the parties as anything other than that of employer and employee is immaterial. Thus, if such relationship exists, it is of no consequence that the employee is designated as an agent, independent contractor, or the like.

In the instant case, the radio station has the right to exercise such control over the individual in the performance of his services as is necessary under the usual common law rules to establish the relationship of employer and employee. The nature of the services makes close supervision unnecessary and impracticable. The individual, however, abides by all rules and instructions issued by the station. Under the terms of the contract, he is not pursuing an independent business. He is employed to perform personal services on a continuing basis and he is assured a regular minimum amount each week for his services. The station controls the time, format, length, and contents of the program.

Accordingly, it is held that the individual is an employee of the radio station for Federal employment tax purposes.

(Also Section 3401.) Rev. Rul. 55–734
(Also Part II, Sections 1426(d), 1621(c);
Regulations 128, Section 408.204;
Regulations 120, Section 406.203.)

Individuals engaged as "house-to-house" canvassers or solicitors of orders for a company's product, perform such services for the company under the direction and guidance of its crew manager. They also receive company training, are required to meet quotas and work regular hours in specified territories, and may not handle goods competitive to the company's products. *Held*, such individuals are employees of the company for Federal employment tax purposes.

Other "house-to-house" canvassers or solicitors perform services for the company under an agreement whereby they determine their own working methods, hours, and territories; are given no leads; have no quotas to meet; file no reports; furnish their own transportation and pay their own expenses; and are not under the guidance or direction of a company crew manager. *Held*, such individuals are not employees of the company for Federal employment tax purposes.

The Internal Revenue Service has been requested to determine the status, for purposes of the Federal Insurance Contributions Act and the Collection of Income Tax At Source On Wages (chapters 21 and 24, respectively, subtitle C, Internal Revenue Code of 1954), of individuals engaged to perform services as house-to-house canvassers or solicitors for a company in connection with the sale of its products to householders under the two situations described below.

Case 1.

In the first case, individuals are engaged by a retail sales company to canvass or solicit, from house-to-house, orders for its merchandise. Under an agreement entered into with the company, the individuals are required to operate in a crew under the direction and control of a company crew manager; are required to work regular hours weekly; are not allowed to operate as free lancers but must work specified territories as assigned by the crew manager; and may not handle goods competitive to the company's products while working for the company. The company trains the individuals, furnishes them with samples, cards and order books, and provides transportation to the assigned territories. On occasion, the individuals are required to meet certain quotas.

Section 3121(d) of the Federal Insurance Contributions Act provides, among other things, that the term "employee" means any individual who, under the usual common law rules applicable in determining the employer-employee relationship, has the status of an employee. The rules for determining whether, under the usual common law rules, an employer-employee relationship exists are found in section 408.204 (c) of Regulations 128, applicable to the provisions of the Internal Revenue Code of 1954 by virtue of Treasury Decision 6091, C. B. 1954–2, 47.

It is concluded that the company exercises such direction and control over the canvassers or solictors, in this first case, in the performances of their services as is necessary, under the usual common law rules, to constitute an employer-employee relationship. Accordingly,

it is held that such individuals are employees of the company for Federal employment tax purposes, including the withholding of income tax on wages.

Case 2.

Other individuals engaged by the company to perform services as "house-to-house" canvassers or solicitors operate under agreements with the company whereby they work during hours determined solely by them. They may work in any territory in which the company does business and are not under the guidance or direction of a crew manager, or other representative as to the means and methods of performing services. They receive no training for the work, are not furnished with leads; and are not required to meet quotas or to make any reports to the company as to the time devoted to the work or persons contacted. They furnish their own transportation, pay their own expenses and are free to sell other lines of merchandise not competitive to the company's merchandise while soliciting for the company.

Applying the provisions of section 3121(d) of the Code and the applicable regulations referred to above, it is held that the company does not exercise or have the right to exercise the control necessary under the common law rules to establish an employer-employee relationship. Moreover, since the individuals solicit or canvass orders exclusively from homeowners or householders rather than from the types of customers specified in section 3121(d)(3)(D) of the Federal Insurance Contributions Act, it is further held that such solicitors or canvassers do not meet all of the conditions set forth therein. Mimeograph 6583, C. B. 1951–1, 97. Accordingly, the individuals are not employees of the company for Federal employment tax purposes, including the withholding of income tax on wages.

(Also Section 3306.) Rev. Rul. 55–623
(Also Part III, Sections 1426(g), 1607(c); Regulations 128, Section 408.212; Regulations 107, Section 403.211.)

An American company owns vessels and aircraft of foreign registry. It employs, as officers and crew members on such vessels and aircraft, citizens of the United States, resident aliens, and nonresident aliens. When a vessel is placed on "idle status" in an American port, certain crew members continue to perform services on or in connection with the vessel. At times, while a vessel or aircraft is in "idle status," an officer is hired to replace a regular officer and the new officer proceeds with the vessel or aircraft when it returns to service. *Held*, services performed prior to 1955 on or in connection with a foreign vessel or aircraft by an individual employed on and in connection with the vessel or aircraft when outside the United States, are excepted from "employment" for purposes of the taxes imposed under the Federal Insurance Contributions Act; such services after 1954 are not excepted from "employment" for purposes of such taxes if performed by a United States citizen for an American employer. *Held further*, such services on or in connection with a foreign vessel, whenever performed, are excepted from "employment" for Federal Unemployment Tax Act purposes without regard to whether the employee is a citizen or the employer an American employer; such services on or in connec-

tion with a foreign aircraft, whenever and by whomever performed, are not excepted from "employment" for Federal Unemployment Tax Act purposes; however, the term "employment," as used in the Federal Unemployment Tax Act, does not include such services performed outside the United States.

The Service has been asked to determine whether certain services on non-American vessels and aircraft owned by an American company are excepted from employment under the Federal Insurance Contributions Act and the Federal Unemployment Tax Act (subchapters A and C, respectively, chapter 9, Internal Revenue Code of 1939, and chapters 21 and 23, respectively, subtitle C, Internal Revenue Code of 1954).

An American company owns and operates vessels registered under the flags of several foreign countries and aircraft of foreign registry. Citizens of the United States, resident aliens, and nonresident aliens are employed as officers and crew members. In certain cases when a vessel is placed in "idle status" in an American port, the shipping articles under which the seamen are hired are temporarily suspended, and most members of the crew are released subject to recall when the vessel is returned to service. However, officers of the deck and engine departments, the chief steward, and, at times, the chief cook continue to perform services on or in connection with the vessel while it is in "idle status." Occasionally, while a vessel is in "idle status," an officer, not originally connected with the vessel, is hired to replace a regular officer and to proceed with the vessel when it is returned to service. Similar replacements of personnel are also made on the company's aircraft when the need arises.

Section 1426(b) of the Federal Insurance Contributions Act, applicable to services performed prior to 1955, contains the following exception from "employment," as defined in such Act:

(5) Service performed by an individual on or in connection with a vessel not an American vessel, or on or in connection with an aircraft not an American aircraft, if the individual is employed on and in connection with such vessel or aircraft when outside the United States;

Effective January 1, 1955, section 3121(b) of the Federal Insurance Contributions Act extends coverage to United States citizens employed by American employers aboard vessels and aircraft of foreign registry by limiting the exception from "employment" as follows:

(4) service performed by an individual on or in connection with a vessel not an American vessel, or on or in connection with an aircraft not an American aircraft, if (A) the individual is employed on and in connection with such vessel or aircraft, when outside the United States and (B) (i) such individual is not a citizen of the United States or (ii) the employer is not an American employer;

Section 1607(c) of the Federal Unemployment Tax Act, applicable to services performed prior to 1955, contains the following exception from "employment," as defined in such Act:

(4) Service performed on or in connection with a vessel not an American vessel by an employee, if the employee is employed on and in connection with such vessel when outside the United States;

Effective January 1, 1955, section 3306(c)(4) of the Federal Unemployment Tax Act contains identical provisions.

Services on or in connection with a foreign vessel or aircraft performed prior to 1955 by officers or members of the crew who are employed on and in connection with the vessel or aircraft when outside the United States are excepted from "employment," for purposes of the taxes imposed by the Federal Insurance Contributions Act, by reason of the provisions of section 1426(b)(5) of such Act. This is true (1) whether the services are performed by an officer or crew member signed on at the beginning of a voyage or by another hired thereafter as a replacement, (2) whether the officer or crew member is or is not a citizen or resident of the United States, (3) whether the vessel is or is not in "idle status" in an American port when the particular services are performed, and (4) whether the employer is or is not an American employer.

Services on or in connection with a foreign vessel or aircraft performed in 1955 or subsequent years by officers or members of the crew who are employed on and in connection with the vessel or aircraft when outside the United States are excepted from "employment," for purposes of the taxes imposed by the Federal Insurance Contributions Act, by reason of the provisions of section 3121(b)(4) of such Act, *only* if the employer is not an American employer *or* the employee is not a citzen of the United States. Where the employer is an American employer and the employee is a citizen of the United States, the services are not excepted under section 3121(b)(4). However, in determining whether the exception applies, it is immaterial (1) whether the officer or crew member was signed on at the beginning of the voyage or thereafter as a replacement, (2) whether the employee is or is not a resident of the United States, and (3) whether the vessel or aircraft is or is not in "idle status" when particular services are performed.

Services on or in connection with a foreign vessel performed before 1955 or after 1954 by officers or members of the crew who are employed on and in connection with the vessel when outside the United States are excepted from "employment," for purposes of the tax imposed by the Federal Unemployment Tax Act, by reason of the provisions of section 1607(c)(4) of the Act as in effect before 1955, or section 3306(c)(4) of the Act as in effect after 1954. This is true (1) whether the services are performed by an officer or crew member signed on at the beginning of a voyage or by another hired thereafter as a replacement, (2) whether the employee or the employer is or is not a citizen or resident of the United States, and (3) whether the vessel is or is not in "idle status" when particular services are performed.

Services performed either before 1955 or after 1954 on or in connection with a foreign aircraft are not within the exception from "employment" provided in section 1607(c)(4) of the Federal Unemployment Tax Act as in effect before 1955, or section 3306(c)(4) of the Act as in effect after 1954. However, the term "employment," as used in that Act as in effect before 1955 and after 1954, does not include any services performed outside the United States, except certain services performed on or in connection with an American vessel.

(Also Part II, Section 1426(h); Regulations 128, Section 408.208.) Rev. Rul. 55-441

An individual operates a hatchery, which is located on a one-acre plot of ground. Less than 1 percent of the chicks hatched are kept and raised by him, for the purpose of controlling the quality of the hatching eggs. All other chicks are sold within 36 hours and delivered within 2 weeks of the time of hatching. *Held*, the services performed in connection with the operation of the hatchery do not constitute "agricultural labor" within the meaning of section 3121(g) of the Federal Insurance Contributions Act.

The Internal Revenue Service has been requested to determine whether services performed in the operation of a hatchery constitute "agricultural labor" within the meaning of section 3121(g) of the Federal Insurance Contributions Act (chapter 21, subtitle C, Internal Revenue Code of 1954).

An individual operates a hatchery which is located on a one-acre plot of land. He also keeps about 200 laying hens known as a primary flock on the premises. He sells chickens and eggs from the primary flock to chicken breeders who, in turn, supply him with hatching eggs. In this way the quality of the hatching eggs is controlled by him. About 90 percent of the chicks hatched are sold within 24 hours and the other 10 percent, except for those he keeps, are sold within 36 hours of the time of hatching. All chicks are delivered to the customers within 2 weeks. Less than one-fourth of 1 percent of the chicks are kept by him and eventually added to the primary flock. In addition to operating the hatchery, the individual sells feed, egg mash, special medicines, and special feed mixes for chickens.

Under section 3121(g) of the Act, the term "agricultural labor" includes all service performed—

(1) on a farm, in the employ of any person, * * * in connection with raising * * * poultry, * * *;

* * * * * * *

As used in this subsection the term "farm" includes, * * * poultry * * * farms, * * *

Section 408.208(d)(2), Regulations 128, applicable to the provisions of the Internal Revenue Code of 1954 by virtue of Treasury Decision 6091, C. B. 1954-2, 47, provides, in part, that services performed in connection with the hatching of poultry constitute "agricultural labor" only if such services are performed on a farm. Thus, services performed in connection with the operation of a hatchery, if not operated as a part of a poultry or other farm, do not constitute "agricultural labor."

Any plot of ground or other area used *primarily* for the conduct of a poultry *raising* enterprise is a "farm" within the meaning of section 3121(g), *supra*, irrespective of its size or location and without regard to the extent to which the soil is used in connection with poultry production operations. Rev. Rul. 54-310, C. B. 1954-2, 264.

On the other hand, where the plot of ground or other area on which a commercial hatchery is located would not be considered a farm in the ordinarily accepted sense, the primary purpose of the enterprise is controlling in determining whether the premises constitute a farm. Thus, in cases where it can be established that it is the intent of the operator of a commercial hatchery to limit his business primarily to the hatching and selling of baby chicks, the fact that he raises a very

small percentage of the chicks hatched (solely for the purpose of controlling the quality of the hatching eggs) is not in itself sufficient to change the primary purpose of the enterprise from the hatching and sale of chicks to the raising of poultry. However, where the operator of a commercial hatchery follows, from year to year, a set pattern of keeping a good portion of the chicks he hatches until they reach the broiler, fryer or other marketable stage attainable only by an appreciable weight increase, it may be found that the primary purpose of his enterprise is to raise poultry.

Since, in the instant case, the facts indicate the the primary purpose of the individual's operations is the hatching of poultry, and the raising of poultry is merely incidental, it is held that his hatchery is not operated as a part of a poultry or other farm. Accordingly, the services performed in connection with the operation of the hatchery do not constitute "agricultural labor" within the meaning of section 3121(g) of the Act.

(,Also Part II, Section 1426(h); Regulations 128, Section 408.208.) Rev. Rul. 55–456

An individual raises bees and extracts, packs, and sells honey. He produces all of the honey handled by him. All of his operations are conducted at one location and are limited to the beekeeping enterprise. *Held*, the location on which the enterprise is conducted is a "farm," within the meaning of section 3121(g) of the Federal Insurance Contributions Act, and all the services performed thereon in connection with the enterprise constitute "agricultural labor" under such section.

The Internal Revenue Service has been requested to determine whether services performed in connection with raising bees and producing, packing, and selling honey constitute "agricultural labor" within the meaning of section 3121(g) of the Federal Insurance Contributions Act (chapter 21, subtitle C, Internal Revenue Code of 1954).

An individual, known generally as a beekeeper, is engaged in raising bees and producing, extracting, packing, and selling honey. All of his operations are conducted at one location. He maintains several hundred colonies of bees, extracts all of the honey produced, and sells most of it at wholesale. He packs about one-half of the honey in glass jars for sale to retail stores. He does not raise or sell any other agricultural commodities or engage in any other farming activities.

Section 3121(g) of the Act defines the term "agricultural labor" as including all services performed—

(1) on a farm, in the employ of any person, * * * in connection with raising * * * bees, * * *;

(2) in the employ of the owner or tenant or other operator of a farm, in connection with the operation, management, conservation, improvement, or maintenance of such farm and its tools and equipment, * * * if the major part of such service is performed on a farm;

* * * * * * *

(4)(A) in the employ of the operator of a farm in handling, * * * packing, packaging, * * *, in its unmanufactured state, any agricultural or horticultural commodity; but only if such operator produced more than one-half of the commodity with respect to which such service is performed;

* * * * * * *

As used in this section, the term "farm" includes stock, dairy, poultry, fruit, fur-bearing animal, and truck farms, plantations, ranches, nurseries, ranges, greenhouses or other similar structures used primarily for the raising of agricultural or horticultural commodities, and orchards.

Any plot of ground or other place used primarily for conducting a bee-raising enterprise is a "farm," as contemplated by section 3121(g) of the Act, regardless of its size or location or the extent to which the soil is used in connection with the apiary operation. The fact that no crops or other farm products are raised on the premises does not, in and of itself, require a different conclusion. Accordingly, it is held that the location on which the bee-raising enterprise is conducted constitutes a "farm," within the meaning of section 3121(g) of the Act, and that services performed thereon by employees of the beekeeper in connection with raising bees constitute "agricultural labor." Compare Rev. Rul. 54–310, C. B. 1954–2, 264. Since in the instant case all the activities are conducted on the farm, all services performed in the employ of the beekeeper in connection with the operation, management, improvement, or maintenance of such farm and its tools and equipment, including clerical, bookkeeping, and sales services and the maintenance and repair of hives and other beekeeping equipment, are classified as "agricultural labor."

Services performed in preparing honey, in its unmanufactured state, for market and in delivering such commodity to the wholesale or retail market or to a carrier for transportation to market constitute "agricultural labor" if certain conditions are met. In order to constitute "agricultural labor" under section 3121(g)(4)(A) of the Act, such services must be performed in the employ of a person who is in possession and engaged in the operation of the farm or farms on which more than one-half of the honey handled in a pay period is produced. Accordingly, in the instant case, all services performed in the employ of the individual in handling, packing, and packaging the honey constitute "agricultural labor."

If the beekeeper pays an employee cash wages of $100 or more in a calendar year for agricultural labor, the taxes imposed by the Federal Insurance Contributions Act apply to all cash wages he pays such employee in that year, not in excess of $4,200.

(Also Part II, Section 1426(h); Regulations 128, Section 408.208.) Rev. Rul. 55–696

An individual engages in the business of slaughtering, dressing, and cutting up livestock for the general public. His slaughterhouse is located on a farm which he owns and operates but he does not produce any of the livestock handled at the slaughterhouse. *Held*, none of the services performed in connection with the custom butchering operations constitute "agricultural labor" within the meaning of section 3121 (g) of the Federal Insurance Contributions Act.

The Internal Revenue Service has been requested to determine whether services performed on a farm in connection with custom butchering operations constitute "agricultural labor" within the meaning of section 3121(g) of the Federal Insurance Contributions Act (chapter 21, subtitle C, Internal Revenue Code of 1954.)

An individual owns and operates a farm. He does not employ any individuals to assist him in his farming operations. Also, from the latter part of November through March of each succeeding year he does custom butchering for the general public. His slaughterhouse

is located on his farm and he engages individuals to perform services in connection with the operation thereof. He does not butcher any of the livestock he raises on his farm.

Section 3121(g) of the Act defines the term "agricultural labor" as including all services performed—

> (4) (A) in the employ of the operator of a farm in handling, * * * packing, packaging, processing, * * *, in its unmanufactured state, any agricultural or horticultural commodity; but only if such operator produced more than one-half of the commodity with respect to which such service is performed;

Services performed in slaughtering, dressing, and cutting up livestock constitute "agricultural labor" if certain conditions are met. In order to constitute "agricultural labor" under section 3121(g)(4)-(A) of the Act, such services must be performed in the employ of a person who is in possession and engaged in the operation of the farm or farms on which more than one-half of the livestock handled in a pay period is produced. It is immaterial whether the packing or handling establishment is located on a farm. See section 408.208(d)(5) of Regulations 128, applicable to the provisions of the Internal Revenue Code of 1954 by virtue of T. D. 6091, C. B. 1954–2, 47.

In the instant case, the individual is not in possession or engaged in the operation of any of the farms on which the livestock is produced. Accordingly, none of the services performed by his employees in slaughtering, dressing and cutting up livestock constitute "agricultural labor" for purposes of the taxes imposed by the Federal Insurance Contributions Act.

(Also Sections 3401, 3402.) Rev. Rul. 55–707

> The guides set forth in Revenue Ruling 54–587 for determining whether services performed prior to 1955 in the employ of commercial greenhouse operators constitute "agricultural labor" for purposes of the Federal Insurance Contributions Act apply with respect to services performed after 1954; however, because of certain changes in the law, new guides are provided for determining whether wages for agricultural labor are taxable.
>
> Guides are also established for determining whether such wages are subject to income tax withholding.

Advice has been requested whether the guides set forth in Revenue Ruling 54–587, C. B. 1954–2, 359, for use in determining whether services performed prior to 1955 in the employ of commercial greenhouse operators constitute "agricultural labor," as defined in the Federal Insurance Contributions Act, are also applicable for purposes of the Act, as amended by the Social Security Amendments of 1954, and the Collection of Income Tax at Source on Wages (chapters 21 and 24, respectively, subtitle C, Internal Revenue Code of 1954) with respect to services performed after 1954.

The definition of the term "agricultural labor" is the same in section 3121(g) of the Federal Insurance Contributions Act, as amended by the Social Security Amendments of 1954, as it was in section 1426(h) of the Act in force prior to 1955. Accordingly, by substituting "section 3121(g)" for "section 1426(h)," the guides contained in

paragraphs numbered (1) through (6) of Revenue Ruling 54–587, *supra*, may be used in determining whether services performed on and after January 1, 1955, in the employ of commercial greenhouse operators constitute "agricultural labor" within the meaning of section 3121(g) of the Act. However, with respect to such services (whether performed before 1955 or after 1954) for which the remuneration is paid after 1954, the provisions of law and the principles set forth in paragraphs numbered (7), (8), (9), and (10) below are to be used instead of those contained in paragraph numbered (7) and the last paragraph of Revenue Ruling 54–587, *supra*.

As so revised, the guides to be used in determining whether services performed after 1954 in the employ of commercial greenhouse operators constitute "agricultural labor" within the meaning of section 3121(g) of the Federal Insurance Contributions Act are as follows:

(1) Pursuant to paragraph (1) of section 3121(g) of the Act, services performed on a "farm" in the employ of any person in connection with growing, propagating and harvesting plants, flowers and other agricultural or horticultural commodities constitute "agricultural labor."

(2) Under paragraph (2) of section 3121(g) of the Act, services performed in connection with the operation, management, conservation, improvement, or maintenance of a farm and its tools and equipment, including clerical and sales services, are classified as "agricultural labor" if performed (a) in the employ of the owner or tenant or other operator of the farm to which the services relate and (b) in major part on a "farm."

(3) Pursuant to paragraph (4) of section 3121(g) of the Act, services performed in the handling, packing, and delivering to market, or to a carrier for transportation to market, of any agricultural or horticultural commodity in its unmanufactured state constitute "agricultural labor," if such services are performed (a) in the employ of a person who is in possession and engaged in the operation of a farm or farms on which more than one-half of the particular commodity handled in a pay period is produced or (b) in the employ of a group of operators of farms (other than a cooperative organization) provided such operators produced all of the commodity with respect to which such services are performed.

(4) Section 3121(g) of the Act defines the term "farm" as including, among other things, "greenhouses or other similar structures used primarily for the raising of agricultural or horticultural commodities." Therefore, the principal factor necessary for a finding that a greenhouse or other similar structure constitutes a farm is that it be used primarily for the *raising* of agricultural or horticultural commodities. Thus, the primary use of a greenhouse as a display or salesroom or for the fabrication of wreaths, corsages, or bouquets and with only incidental use for the raising of agricultural or horticultural commodities would preclude classification of such establishment as a "farm."

(5) In determining whether handling services, performed in a greenhouse, as contemplated by paragraph (4) of section

3121(g) of the Act, constitute "agricultural labor," no distinction is made between preparation for, and delivering to, the wholesale or retail markets. Further, it is immaterial whether the packing or handling establishment is located on a farm. Accordingly, the fabrication of wreaths, corsages, and bouquets and the delivery of such items to wholesale or retail purchasers are considered to be services of the type contemplated by paragraph (4) of section 3121(g) and are held to constitute "agricultural labor," provided such services are performed under the circumstances and conditions necessary to meet the requirements of that paragraph. (See item (3) above.)

(6) If the packing establishment is located on a "farm" and the handling services constitute "agricultural labor," then nonhandling services, such as services relating to the maintenance and repair of such establishment and its tools and equipment, as well as clerical services relating to the packing operation, may constitute "agricultural labor" if the requirements of paragraph (2) of section 3121(g) are met. (See item (2) above.)

(7) The term "employment" as defined in section 3121 (b) of the Act in force on and after January 1, 1955, contains no exception for services which constitute "agricultural labor" other than those provided in section 3121(b)(1) relating to services in connection with certain gum resin products and services performed by certain foreign agricultural workers. Accordingly, "agricultural labor" as defined in section 3121(g) of the Act constitutes "employment" except to the extent otherwise provided in section 3121(b)(1), *supra*. This applies to all "agricultural labor" for which the remuneration is paid after 1954 regardless of whether the services were performed before 1955 or after 1954.

(8) The rules relating to "included and excluded services" contained in section 3121(c) of the Act should not be applied in determining whether liability for the taxes imposed by that Act is incurred by the employer with respect to the remuneration of an employee for services performed during a pay period unless during such pay period the employee performs services which constitute "employment" (including "agricultural labor") and services which are excepted from "employment" under a specific provision of section 3121(b) of the Act. For this purpose, a pay period is construed as a period (of not more than 31 consecutive days) for which a payment of remuneration is ordinarily made to the employee by the employer.

(9) Under the provisions of section 3121(a)(8)(A) of the Act, the term "wages" does not include remuneration paid in any medium other than cash for "agricultural labor." Under the provisions of section 3121(a)(8)(B) of the Act, the term "wages" does not include cash remuneration paid by an employer in any calendar year after 1954 to an employee for "employment" in "agricultural labor," if the cash remuneration paid in such year by the employer to the employee for such labor is less than $100. This is usually referred to as the "$100-a-year" test. The following examples show how the test works:

1. *Less than $100 cash wages paid in year.*—An employer paid his agricultural worker several times during a year, but the payments added up to only $95. No taxes are due since the $100-a-year test has not been met.

2. *Different employers.*—An agricultural employee worked part time for employer *A* and part time for employer *B*. *A* paid him $125 during the year but *B* paid him only $75 during the year. *A* must pay the taxes on his payments since they were $100 or more. *B* owes no taxes on his payments since he paid the employee less than $100.

3. *Different employees.*—An employer engaged agricultural employees by the day but not always the same ones. During the year, he paid one of them cash wages totalling $80, another $150, and still another $50. The employer must pay taxes on the $150 since the $100-a-year test has been met. No taxes are due from the employer on the other payments.

4. *Year of payment.*—An agricultural employee worked for his employer during most of a calendar year, but quit his job near the end of that year. He earned $300 for his services and the employer paid him $90 during such calendar year and the balance of $210 in the following year. No taxes are due on the $90 paid the employee during the first calendar year, but the employer must pay taxes for the second calendar year on the $210 since the $100-a-year test is met in that year.

(10) If an employee receives cash remuneration from an employer both for services which constitute "employment" in "agricultural labor" and for services which do not constitute "employment" in "agricultural labor," only the amount of the remuneration which is attributable to "employment" in "agricultural labor" should be included in determining whether the "$100-a-year" test is met.

(11) *Income Tax Withholding.*—Remuneration paid for "agricultural labor," as defined in section 3121(g) of the Federal Insurance Contributions Act, is excluded from "wages," as defined in section 3401(a) of the Code of 1954, for purposes of the income tax withholding under section 3402 of the Code. In dealing with remuneration a part of which is included in "wages" and a part of which is excluded from "wages" for income tax withholding purposes, section 3402(e) provides that if the remuneration paid by an employer to an employee for services performed during one-half or more of any payroll period of not more than 31 consecutive days constitutes "wages," all the remuneration paid by the employer to the employee for such period shall be deemed to be wages;" but if the remuneration paid by an employer to an employee for services performed during more than one-half of any such payroll period does not constitute "wages," then none of the remuneration paid by such employer to the employee for that period shall be deemed to be "wages." For this purpose, the term "payroll period" is construed to mean the period of service for which a payment of wages is ordinarily made to an employee by his employer.

(Also Part II, Section 1426(h); Regulations 128, Section 408.208a.) Rev. Rul. 55-750

Services performed within the United States by an agricultural worker brought to this country from Canada are not excepted from "employment" under section 3121(b)(1)(B) of the Federal Insurance Contributions Act or any similar provision of law. The Federal Insurance Contributions Act taxes apply to all cash wages, not in excess of $4,200, paid to such Canadian in a calendar year for "agricultural labor" if the "$100-a-year" test is met.

Advice is requested whether services performed within the United States by a Candian farm worker are categorically excepted from "employment" by reason of the provisions of section 3121(b)(1)(B) of the Federal Insurance Contributions Act (chapter 21, subtitle C, Internal Revenue Code of 1954), as amended by the Social Security Amendments of 1954, or any similar provision of law.

In the instant case, an individual farm owner and operator employs a Canadian to perform services on his farm in connection with the production of a potato crop. The Canadian was lawfully admitted to this country, under a permit and bond, for a period of six months. The bond must be renewed at the end of the six months' period. If, at any time, there is a sufficient supply of domestic agricultural workers obtainable in the area, or if the Canadian's services are terminated, the Canadian must return to his home country. A bona fide employer-employee relationship exists between the farmer and the Canadian. The services performed by the employee constitute "agricultural labor" within the meaning of section 3121(g) of the Federal Insurance Contributions Act.

Section 3121(b) of the Federal Insurance Contributions Act provides, in part:

EMPLOYMENT.—For purposes of this chapter, the term "employment" means * * * any service, of whatever nature, performed after 1954 * * * by an employee for the person employing him, irrespective of the citizenship or residence of either, * * * within the United States, * * *; except that * * * such term shall not include—

* * * * * * *

(1)(B) service performed by foreign agricultural workers (i) under contracts entered into in accordance with title V of the Agricultural Act of 1949, as amended (65 Stat. 119; 7 U. S. C. 1461–1468), or (ii) lawfully admitted to the United States from the Bahamas, Jamaica, and the other British West Indies on a temporary basis to perform agricultural labor;

The provisions of section 3121(b), *supra*, are specific in that services performed "within the United States" by an employee for the person employing him, irrespective of the citizenship or residence of either, constitute "employment," unless specifically excepted. The exception from "employment" accorded by paragraph (1)(B) of that section to services performed by certain foreign agricultural workers does not apply to services performed by agricultural workers brought to this country from Canada. Moreover, the Act does not contain a similar exception from "employment" for services performed in this country by Canadian agricultural workers. Only Mexican agricultural workers come within the terms of the provisions of Title V of the Agricultural Act of 1949, as amended, referred to in section 3121(b)(1)(B) above.

The "agricultural labor" performed by the Canadian in the employ of the farmer in the instant case is not excepted from "employment"

for purposes of the taxes imposed by the Federal Insurance Contributions Act. Accordingly, if he pays the Canadian cash wages of $100 or more in a calendar year for "agricultural labor," the taxes imposed by such Act apply to all cash wages, not in excess of $4,200, which he pays such employee in that year. See section 3121(a)(8)(B) of the Act.

(Also Part II, Section 1426(i); Regulations 128, Section 408.203.) Rev. Rul. 55–644

A voluntary employees' beneficiary association organized without capital stock in the Canal Zone pursuant to the provisions of the Canal Zone Code does not constitute an "American employer" for purposes of the Federal Insurance Contributions Act (chapter 21, subtitle C, of the Internal Revenue Code of 1954) as that term is defined in section 3121(h) of the Act. Accordingly, services in the employ of the association performed outside the United States do not constitute "employment" within the meaning of the Act, and the remuneration therefor is not subject to the taxes imposed by the Act.

(Also Part II, Section 1426(l); Section 408.216, Regulations 128.) Rev. Rul. 55–473

Procedures to be followed, pending the issuance of regulations under the Federal Insurance Contributions Act, in applying the provisions of section 403(a) and (b) of the Social Security Amendments of 1954 and Section 3121(k) of the Federal Insurance Contributions Act, as amended by the Social Security Amendments of 1954, for the social security coverage of individuals employed by certain exempt organizations.

SECTION I. PURPOSE.

The purpose of this Revenue Ruling is to furnish an explanation of and procedures to be followed in applying the provisions of section 403(a) and (b) of the Social Security Amendments of 1954, approved September 1, 1954, and the provisions of section 3121(k) of the Internal Revenue Code of 1954 (Federal Insurance Contributions Act, chapter 21, subtitle C, of the Internal Revenue Code of 1954), as amended by the Social Security Amendments of 1954, which latter section supersedes section 1426(1) of the Internal Revenue Code of 1939 (chapter 9, subchapter A, of the 1939 Code).

SEC. 2. SCOPE.

The instructions in this Revenue Ruling are interim in nature and are subject to modification by regulations to follow. However, any such modification shall not render invalid any act performed pursuant to, and in accordance with, the provisions of this Revenue Ruling.

SEC. 3. STATUTORY PROVISIONS.

.01 Section 3121(k) of the 1954 Code, as amended by the Social Security Amendments of 1954 provides, in part, as follows:

(k) EXEMPTION OF RELIGIOUS, CHARITABLE, AND CERTAIN OTHER ORGANIZATIONS.—

(1) WAIVER OF EXEMPTION BY ORGANIZATION.—An organization described in section 501(c)(3) which is exempt from income tax under section 501(a)

may file a certificate (in such form and manner, and with such official, as may be prescribed by regulations made under this chapter) certifying that it desires to have the insurance system established by title II of the Social Security Act extended to service performed by its employees and that at least two-thirds of its employees concur in the filing of the certificate. Such certificate may be filed only if it is accompanied by a list containing the signature, address, and social security account number (if any) of each employee who concurs in the filing of the certificate. Such list may be amended at any time prior to the expiration of the twenty-fourth month following the first calendar quarter for which the certificate is in effect, by filing with the prescribed official a supplemental list or lists containing the signature, address, and social security account number (if any) of each additional employee who concurs in the filing of the certificate. The list and any supplemental list shall be filed in such form and manner as may be prescribed by regulations made under this chapter. The certificate shall be in effect (for purposes of subsection (b)(8)(B) and for purposes of section 210(a)(8)(B) of the Social Security Act) for the period beginning with the first day following the close of the calendar quarter in which such certificate is filed, except that, in the case of service performed by an individual whose name appears on a supplemental list filed after the first month following the first calendar quarter for which the certificate is in effect, the certificate shall be in effect, for purposes of such subsection (b)(8) and for purposes of section 210(a)(8) of the Social Security Act, only with respect to service performed by such individual after the calendar quarter in which such supplemental list is filed.

.02 Section 403 of the Social Security Amendments of 1954 provides as follows:

Sec. 403. (a) In any case in which—

(1) An individual has been employed, at any time subsequent to 1950 and prior to the enactment of this Act, by an organization which is exempt from income tax under section 101(6) of the Internal Revenue Code of 1939 but which has failed to file prior to the enactment of this Act a waiver certificate under section 1426(1)(1) of the Internal Revenue Code of 1939;

(2) The service performed by such individual as an employee of such organization during the period subsequent to 1950 and prior to 1955 would have constituted employment (as defined in section 210 of the Social Security Act and section 1426(b) of the Internal Revenue Code of 1939) if such organization had filed prior to the performance of such service such a certificate accompanied by a list of the signatures of employees who concurred in the filing of such certificate and such individual's signature had appeared on such list;

(3) The taxes imposed by sections 1400 and 1410 of the Internal Revenue Code of 1939 have been paid with respect to any part of the remuneration paid to such individual by such organization for such service;

(4) Part of such taxes have been paid prior to the enactment of this Act;

(5) So much of such taxes as have been paid prior to the enactment of this Act have been paid by such organization in good faith and upon the assumption that a waiver certificate had been filed by it under section 1426(1)(1) of the Internal Revenue Code of 1939; and

(6) No refund of such taxes has been obtained,

the amount of such remuneration with respect to which such taxes have been paid shall, upon the request of such individual (filed in such form and manner, and with such official, as may be prescribed by regulations made under subchapter A of chapter 9 of the Internal Revenue Code of 1939), be deemed to constitute remuneration for employment as defined in section 210 of the Social Security Act and section 1426(b) of the Internal Revenue Code of 1939.

(b) In any case in which—

(1) An individual has been employed, at any time subsequent to 1950 and prior to the enactment of this Act, by an organization which has filed a waiver certificate under section 1426(1)(1) of the Internal Revenue Code of 1939;

(2) The service performed by such individual during the time he was so employed would have constituted employment (as defined in section 210

of the Social Security Act and section 1426(b) of the Internal Revenue Code of 1939) if such individual's signature had appeared on the list of signatures of employees who concurred in the filing of such certificate;

(3) The taxes imposed by sections 1400 and 1410 of the Internal Revenue Code of 1939 have been paid prior to the enactment of this Act with respect to any part of the remuneration paid to such individual by such organization for such service; and

(4) No refund of such taxes has been obtained,

the amount of such remuneration with respect to which such taxes have been paid shall, upon the request of such individual (filed on or before January 1, 1957, and in such form and manner, and with such official, as may be prescribed by regulations made under subchapter A of chapter 9 of the Internal Revenue Code of 1939), be deemed to constitute remuneration for employment as defined in section 210 of the Social Security Act and section 1426(b) of the Internal Revenue Code of 1939, and such individual shall be deemed to have concurred in the filing of the waiver certificate filed by such organization under section 1426(1) (1) of the Internal Revenue Code of 1939.

SEC. 4. SUPPLEMENTAL LISTS FILED UNDER SECTION 3121(k) OF THE 1954 CODE, AS AMENDED

.01 In general.—Pursuant to section 3121(k) of the 1954 Code, as amended, a supplemental list on Form SS–15a Supplement, Amendment to List on Form SS–15a, properly filled out and signed, will be accepted as a valid amendment to the list on Form SS–15a, List to Accompany Certificate on Form SS–15 Waiving Exemption From Taxes Under the Federal Insurance Contributions Act, if it is filed before the end of the 24th month following the first calendar quarter for which the certificate on Form SS–15 Certificate Waiving Exemptions From Taxes Under the Federal Insurance Contributions Act, is in effect. Section 3121 (k) of the 1954 code, as amended, is effective with respect to services performed on and after January 1, 1955.

.02 Nonapplicability of section 3121 (k) of the 1954 code, as amended.—In view of the 24-month period, section 3121 (k), as amended, has no application to a supplemental list which purports to amend a list filed with a certificate which is effective for any calendar quarter beginning before July 1, 1952. Also, section 3121 (k) of the 1954 Code, as amended, has no application to a supplemental list filed prior to September 1, 1954 (the date of enactment of the Social Security Amendments of 1954).

.03 Supplemental list filed on or after September 1, 1954.—A supplemental list filed on or after September 1, 1954, will constitute a valid amendment provided such supplemental list is filed within the 24-month period prescribed by section 3121 (k) of the 1954 Code, as amended. If a supplemental list is filed prior to the end of the first month following the first calendar quarter for which the certificate is in effect, the certificate will be effective, in the case of any individual whose name appears on such supplemental list, with respect to services performed on and after the effective date of the certificate. If the supplemental list is filed after the first month following the first calendar quarter for which the certificate is in effect, the certificate will be effective, in the case of an individual whose name appears on such supplemental list, with respect to services performed after the calendar quarter in which the supplemental list is filed, except that the certificate shall not be effective with respect to services performed by any such individual prior to January 1, 1955.

Example 1. *XYZ* corporation, an organization exempt from income tax under section 101(6) of the 1939 Code, filed a certificate on Form SS–15 which was effective July 1, 1952. *B*, an employee of *XYZ* corporation, did not concur in the original filing of the certificate and the *XYZ* corporation did not report any of *B's* remuneration. In September 1954, *B* signed a Form SS–15a Supplement which was filed in the office of the District Director of Internal Revenue during September 1954. The Form SS–15a Supplement was filed within the 24-month period following the first calendar quarter for which the certificate was in effect. However, even though the Form SS–15a Supplement is valid, all services performed by *B* prior to January 1, 1955, are excepted from employment for the reason that the certificate is effective in the case of *B* only as to services performed by him after December 31, 1954.

Example 2. The same circumstances exist as in Example 1, except that the certificate filed by the *XYZ* corporation was effective April 1, 1952. The Form SS–15a Supplement filed in September 1954 is invalid since it was not filed before the end of the 24th month following the first calendar quarter for which the certificate was in effect. Likewise, any supplemental list filed in the fourth quarter of 1954 which purports to amend a list filed with a certificate which is effective for any calendar quarter beginning prior to October 1, 1952, will not be filed within the 24-month period prescribed by section 3121(k) of the 1954 Code, as amended and therefore is invalid.

Example 3. The same circumstances exist as in Example 1, except that the certificate filed by the *XYZ* corporation became effective July 1, 1954, and the Form SS–15a Supplement was filed in October 1954. Such supplemental list is effective with respect to all services performed by *B* on and after July 1, 1954, since such supplemental list was filed prior to the end of the first month following the first calendar quarter for which the certificate is in effect. (The provisions of section 3121(k) of the 1954 Code, as amended, are not applicable in this case, the certificate and the supplemental list having been filed pursuant to and in accordance with the provisions of section 1426 (l) of the 1939 Code. However, the same result would be reached in any case where the supplemental list is filed prior to the end of the first month following the first calendar quarter for which the certificate is in effect, irrespective of whether the supplemental list is filed pursuant to section 1426 (l) of the 1939 Code or section 3121 (k) of the 1954 Code as amended.)

.04 Reopening of cases involving prior invalid amendments.—District Directors of Internal Revenue are not required to initiate any action with respect to the reopening of cases involving supplemental lists on Form SS–15a Supplement which were invalid for the reason that they were not filed within the time limit specified in section 1426 (l) of the 1939 Code. However, the amendment of section 3121(k) makes it possible for such organizations to submit new supplemental lists provided the 24-month time limitation specified by section 3121(k) of the 1954 Code, as amended, is met.

SEC. 5. REQUESTS OF INDIVIDUALS UNDER SECTION 403(a) OF THE SOCIAL SECURITY AMENDMENTS OF 1954.

.01 In general.—Under certain circumstances an individual, who as an employee performed services after December 31, 1950, and prior to September 1, 1954, for an organization which had failed to file, prior to September 1, 1954, a valid certificate on Form SS–15, may request that the remuneration received by him for services performed after 1950 and before 1955 be deemed to constitute remuneration for employment for purposes of the taxes imposed under the Federal Insurance Contributions Act and for purposes of benefits under title II of the Social Security Act. However, the provisions of section 1426(a) of the 1939 Code are applicable in determining the extent to which such remuneration will constitute wages for purposes of such taxes. In order that the remuneration may be so deemed to be remuneration for employment, it is necessary that all of the following requirements be met:

1 The individual performed some services for the organization subsequent to December 31, 1950, and prior to September 1, 1954;

2 The organization was exempt under section 101(6) of the 1939 Code and failed to file prior to September 1, 1954, a valid certificate under section 1426(1) of the 1939 Code;

3 The individual's services subsequent to December 31, 1950, and prior to January 1, 1955, would have constituted employment, as defined in section 1426(b) of the 1939 Code, if a certificate filed by the organization had been in effect for the period during which the services were performed and the individual's signature had appeared on the accompanying list on Form SS–15a;

4 Employee and employer taxes under the Federal Insurance Contributions Act have been paid with respect to at least a part of the remuneration received by the individual from the organization for such services;

5 A part of such taxes was paid prior to September 1, 1954;

6 Such taxes as were paid before September 1, 1954, were paid by the organization in good faith and upon the assumption that it had filed a valid certificate; and

7 No refund (or credit) of such taxes has been obtained either by the employee or the employer, exclusive of any refund (or credit) which would be allowable if the services performed by the individual had constituted employment.

.02 Filing of certificate by organization.—The provisions of section 403(a) of the Social Security Amendments of 1954 are applicable even though a valid certificate on Form SS–15 is never filed by the organization. However, the organization may file a certificate which will have effect for future periods. See subsection .07 of this section.

.03 Requests under section 403(a) of the Social Security Amendments of 1954.—Except where the alternative procedure set forth in subsection .04 of this section is followed, a request of an individual under section 403(a) shall be made and filed as provided in this subsection. The request shall be in writing, shall be signed and dated by such individual, and shall include (1) the name and address of the organization, (2) the name, address, and social security account number of the individual, (3) a statement that the individual has not

obtained a refund (other than a refund or credit which would be allowable if the services had constituted employment) from the District Director of Internal Revenue of any part of the employee tax under the Federal Insurance Contributions Act paid with respect to remuneration received by him from the organization for services performed after 1950 and before 1955, and (4) a request that all remuneration received by him from the organization for such services with respect to which employee and employer taxes have been paid shall be deemed to constitute remuneration for employment to the extent authorized by section 403(a) of the Social Security Amendments of 1954. The request of an individual shall be accompanied by a statement of the organization incorporating the substance of each of the seven requirements enumerated in subsection .01 of this section. The statement of the organization should also disclose the District Director with whom returns on Form 941 are filed. Such statement must be signed by the president or a principal officer of the organization who shall certify that the statement is correct to the best of his knowledge and belief. If the statement of the organization is not submitted with the individual's request, the individual shall include in his request an explanation of his inability to submit such statement. Other information may be required, but should be submitted only upon receipt of a specific request therefor. No particular form is prescribed for making the request or the statement of the organization required to be submitted with the request. The individual's request should be filed with the District Director with whom the organization files returns on Form 941, Employer's Quarterly Federal Tax Return.

.04 Filing of requests by organization.—An organization having individuals in its employ, including former employees, with respect to whom section 403(a) of the Social Security Amendments of 1954 is applicable may, if it so desires, prepare a form or forms for use by an individual or by individuals in making requests under section 403(a). Any such form shall provide space for the signature of the individual or individuals and shall contain such information as is required by subsection .03 of this section to be included in a request. Any form used by more than one individual, and any form used by one individual which is signed and returned to the organization, shall be submitted by the organization, together with its statement, as required in subsection .03, to the District Director with whom the organization files returns on Form 941. An individual is not required to use a form prepared by the organization but may, at his election, file his request in accordance with the provisions of subsection .03.

.05 Optional tax payments by the organization.—An organization may report and pay taxes under the Federal Insurance Contributions Act with respect to any portion of the remuneration paid to an individual, who is eligible to file a request under section 403(a) of the Social Security Amendments of 1954; for services performed by him subsequent to 1950 and prior to 1955 which has not been reported and which would have constituted wages if a valid certificate had been in effect during the period the services were performed and the individual had concurred in the filing of the certificate. All such remuneration with respect to which the taxes have been paid will be deemed to be wages if a proper request is filed. Such taxes may be reported as an adjustment without interest in the manner prescribed

in sections 408.702 and 408.703 of Regulations 128. The statement in explanation of such adjustment shall include a reference to section 403(a) of the Social Security Amendments of 1954.

.06 Taxes paid after filing of request.—The request of an individual will be effective only as to remuneration with respect to which taxes under the Federal Insurance Contributions Act are paid on or before the date on which the request is filed with the District Director.

.07 Remuneration for services after 1954.—The provisions of section 403(a) of the Social Security Amendments of 1954 have no application to remuneration for services performed after 1954. If the organization is eligible to file a certificate under section 3121(k) of the 1954 Code, as amended, and desires to have the Federal old-age and survivors insurance system established by title II of the Social Security Act extended to services performed after 1954 by its employees, it must file a valid certificate on Form SS–15.

SEC. 6. REQUESTS OF INDIVIDUALS UNDER SECTION 403(b) OF THE SOCIAL SECURITY AMENDMENTS OF 1954.

.01 In general.—Under certain circumstances an individual, who as an employee performed services after December 31, 1950, and prior to September 1, 1954, for an organization which filed a valid certificate on Form SS–15 but who failed to sign the list of concurring employees, may request that the remuneration received by him for such services be deemed to constitute remuneration for employment for purposes of the taxes imposed under the Federal Insurance Contributions Act and for purposes of benefits under title II of the Social Security Act. However, the provisions of section 1426 (a) of the 1939 Code are applicable in determining the extent to which such remuneration will constitute wages for purposes of such taxes. In order that the remuneration may be so deemed to be remuneration for employment, it is necessary that all of the following requirements be met:

1 The individual performed some services for the organization subsequent to December 31, 1950, and prior to September 1, 1954;

2 The organization filed a valid certificate under section 1426 (1) of the 1939 Code;

3 The individual's services would have constituted employment if the individual's signature had appeared on the list of employees who concurred in the filing of the certificate;

4 Employee and employer taxes imposed under the Federal Insurance Contributions Act were paid prior to September 1, 1954, with respect to at least a part of the remuneration received by the individual from the organization for such services;

5 No refund (or credit) of such taxes has been obtained either by the employee or the employer, exclusive of any refund (or credit) which would be allowable if the services performed by the individual constituted employment without regard to the provisions of section 403(b); and

6 The request is filed on or before January 1, 1957.

.02 Requests under section 403(b) of the Social Security Amendments of 1954.—Except where the alternative procedure set forth in subsection .03 of this section is followed, a request of an individual under section 403(b) shall be made and filed as provided in this sub-

section. The request shall be in writing, shall be signed and dated by such individual, and shall include (1) the name and address of the organization, (2) the name, address, and social security account number of the individual, (3) a statement that the individual has not obtained a refund (other than a refund or credit which would be allowable if the services had constituted employment) from the District Director of any part of the employee tax under the Federal Insurance Contributions Act paid before September 1, 1954, with respect to remuneration received by him from the organization, (4) a request that all remuneration received by the individual from the organization for services performed after 1950 and before September 1, 1954, with respect to which employee and employer taxes were paid before September 1, 1954, shall be deemed to constitute remuneration for employment to the extent authorized by section 403(b) of the Social Security Amendments of 1954, and (5) a statement that the individual understands that, upon making such request (a) he will be deemed to have concurred in the certificate which was previously filed by the organization, and (b) the employee and employer taxes will be applicable to all wages received, and to be received, by him for services performed for the organization on or after the effective date of such certificate to the extent such taxes would have been applicable if he had signed the list on Form SS–15a submitted with the certificate. The request of an individual shall be accompanied by a statement of the organization incorporating the substance of each of the six requirements enumerated in subsection .01 of this section. The statement of the organization should also disclose the District Director with whom returns on Form 941 are filed. Such statement must be signed by the president or a principal officer of the organization who shall certify that the statement is correct to the best of his knowledge and belief. If the statement of the organization is not submitted with the individual's request, the individual shall include in his request an explanation of his inability to submit such statement. Other information may be required, but should be submitted only upon receipt of a specific request therefor. No particular form is prescribed for making the request or the statement of the organization required to be submitted with the request. The individual's request should be filed with the District Director with whom the organization files returns on Form 941.

.03 Filing of requests by organization.—An organization having individuals in its employ, including former employees, with respect to whom section 403(b) of the Social Security Amendments of 1954 is applicable may, if it so desires, prepare a form or forms for use by an individual or individuals in making requests under section 403(b). Any such form shall provide space for the signature of the individual or individuals and shall contain such information as is required by subsection .02 of this section to be included in a request. Any form used by more than one individual, and any form used by one individual which is signed and returned to the organization, shall be submitted by the organization, together with its statement, as required in subsection .02, to the District Director with whom the organization files returns on Form 941. An individual is not required to use a form prepared by the organization but may, at his election, file his request in accordance with the provisions of subsection .02.

.04 Remuneration not reported as wages.—Since an individual who files a request pursuant to section 403(b) of the Social Security Amendments of 1954 will be deemed to have signed the list filed with the certificate, all services performed by him on and after the effective date of the certificate will constitute employment under the Federal Insurance Contributions Act to the same extent as if he had, in fact, signed the list. Accordingly, liability will be incurred for the employee and employer taxes imposed by the Federal Insurance Contributions Act with respect to any remuneration which constitutes wages, except to the extent the taxes have been paid with respect to such wages. District Directors shall consider requests of individuals, if found to be in proper order, to be effective immediately. Liability incurred by an organization for employee and employer taxes with respect to the wages of an individual who files a request pursuant to section 403(b) may be reported as an adjustment without interest within the time specified in sections 408.702 and 408.703 of Regulations 128. The statement in explanation of such adjustment shall include a reference to section 403 (b) of the Social Security Amendments of 1954.

SEC. 7. REQUEST SIGNED BY LEGAL REPRESENTATIVE.

If the individual is deceased or mentally incompetent and the request filed pursuant to section 403 (a) or (b) of the Social Security Amendments of 1954 is made by the legal representative of the individual or other person authorized to act on his behalf, the request must be accompanied by evidence showing such person's authority to make the request.

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26 CFR 36.3121(l)(1)–1: Agreements entered into by domestic corporations with respect to foreign subsidiaries. (Also 36.3121(l)(1)–2 through 36.3121(l)(10)–4; Section 176, 26 CFR 1.176.)

T. D. 6145 [1]

TITLE 26—INTERNAL REVENUE, 1954.—CHAPTER I, SUBCHAPTER A, PART 1.—INCOME TAX; TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1953

TITLE 26—INTERNAL REVENUE, 1954.—CHAPTER I, SUBCHAPTER C, PART 36.—REGULATIONS RELATING TO CONTRACT COVERAGE OF EMPLOYEES OF FOREIGN SUBSIDIARIES

Regulations prescribed under section 176 and section 3121 (l) of the Internal Revenue Code of 1954, as amended.

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

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

AUTHORITY: § 1.176, §§ 36.3121(l)–0 to 36.3121(l)(10)–4, incl., issued under sections 3121(l), 7805, I. R. C. 1954; 68 Stat. 1094, 68A Stat. 917; 26 U. S. C. 3121(l), 7805.

On May 27, 1955, notice of proposed rulemaking regarding the regulations under section 176 and section 3121(l) of the Internal

[1] 20 F. R. 6577.

Revenue Code of 1954, as added by Public Law 761, Eighty-third Congress [C. B. 1954–2, 603], approved September 1, 1954, was published in the Federal Register (20 F. R. 3738). All comments regarding the proposed regulations having been considered and no change having been found necessary, the following regulations as so published are hereby adopted.

INCOME TAX REGULATIONS [26 CFR, PART 1]

§ 1.176. Statutory Provisions; Payments With Respect to Employees of Certain Foreign Corporations.

SEC. 176. PAYMENTS WITH RESPECT TO EMPLOYEES OF CERTAIN FOREIGN CORPORATIONS.

In the case of a domestic corporation, there shall be allowed as a deduction amounts (to the extent not compensated for) paid or incurred pursuant to an agreement entered into under section 3121 (l) with respect to services performed by United States citizens employed by foreign subsidiary corporations. Any reimbursement of any amount previously allowed as a deduction under this section shall be included in gross income for the taxable year in which received.

[Sec. 176 as added by sec. 210, Social Security Amendments 1954]

REGULATIONS RELATING TO CONTRACT COVERAGE OF EMPLOYEES OF FOREIGN SUBSIDIARIES [26 CFR, PART 36]

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PART 36.—CONTRACT COVERAGE OF EMPLOYEES OF FOREIGN SUBSIDIARIES

(SECTION 3121(l), INTERNAL REVENUE CODE OF 1954)

APPLICABLE ON AND AFTER JANUARY 1, 1955

§ 36.3121(l)-0. INTRODUCTION.—(a) The regulations in this part deal with the circumstances under which a domestic corporation may enter into an agreement with the district director for the purpose of extending the insurance system established by title II of the Social Security Act to certain services performed outside the United States by citizens of the United States as employees of a foreign subsidiary of the domestic corporation, and with the obligations of a domestic corporation which enters into such an agreement. The provisions of the Internal Revenue Code of 1954, as amended, to which the regulations in this part pertain are contained in section 3121(l). The liabilities assumed under an agreement entered into pursuant to such section are based on the remuneration for services covered by the agreement. Such agreement may not be effective prior to January 1, 1955.

(b) Although the obligations incurred under an agreement entered into pursuant to section 3121(l) of the Internal Revenue Code of 1954, as amended, must be distinguished from the obligations imposed on employers with respect to the taxes under the Federal Insurance Contributions Act, the two are similar in many respects. Accordingly, the regulations in this part are prescribed as a supplement to the regulations (Subpart B of Part 31 of Title 26 of the Code of Federal Regulations) relating to the employee tax and the employer tax imposed by the Federal Insurance Contributions Act. The terms used in these regulations have the same meaning, unless otherwise provided, as when used in the regulations relating to the taxes imposed by such Act.

(c) These regulations constitute Part 36 of Title 26 of the Code of Federal Regulations. As used in the regulations in this part, the word "Code" means the Internal Revenue Code of 1954, as amended, and the term "Federal Insurance Contributions Act" means chapter 21 of such Code. Each section of the regulations is preceded by the provision of the Code which it interprets. All references to sections of law are references to the Code unless otherwise indicated. The number of each section of the regulations begins with 36 followed by a decimal point (36.). Numbers which do not begin with 36 followed by a decimal point are numbers of sections of law unless otherwise indicated. In identifying sections of regulations, the symbol "§" is used.

§ 36.3121(l)(1). STATUTORY PROVISIONS: AGREEMENTS ENTERED INTO BY DOMESTIC CORPORATIONS WITH RESPECT TO FOREIGN SUBSIDIARIES.

SEC. 3121. DEFINITIONS. * * *

(l) AGREEMENTS ENTERED INTO BY DOMESTIC CORPORATIONS WITH RESPECT TO FOREIGN SUSIDIARIES.—

(1) AGREEMENT WITH RESPECT TO CERTAIN EMPLOYEES OF FOREIGN SUBSIDIARIES.—The Secretary or his delegate shall, at the request of any domestic corporation, enter into an agreement (in such form and manner as may be prescribed by the Secretary or his delegate) with any such corporation which desires to have the insurance system established by title II of the Social Security Act extended to service performed outside the United States in the employ of any one or more of its foreign subsidiaries (as defined in paragraph (8))

by all employees who are citizens of the United States, except that the agreement shall not be applicable to any service performed by, or remuneration paid to, an employee if such service or remuneration would be excluded from the term "employment" or "wages", as defined in this section, had the service been performed in the United States. Such agreement may be amended at any time so as to be made applicable, in the same manner and under the same conditions, with respect to any other foreign subsidiary of such domestic corporation. Such agreement shall be applicable with respect to citizens of the United States who, on or after the effective date of the agreement, are employees of and perform services outside the United States for any foreign subsidiary specified in the agreement. Such agreement shall provide—

(A) That the domestic corporation shall pay to the Secretary or his delegate, at such time or times as the Secretary or his delegate may by regulations prescribe, amounts equivalent to the sum of the taxes which would be imposed by sections 3101 and 3111 (including amounts equivalent to the interest, additions to the taxes, additional amounts, and penalties which would be applicable) with respect to the remuneration which would be wages if the services covered by the agreement constituted employment as defined in this section; and

(B) That the domestic corporation will comply with such regulations relating to payments and reports as the Secretary or his delegate may prescribe to carry out the purposes of this subsection.

[Sec. 3121 (l) (1) as added by sec. 209, Social Security Amendments 1954]

§ 36.3121(l)(1)–1. AGREEMENTS ENTERED INTO BY DOMESTIC CORPORATIONS WITH RESPECT TO FOREIGN SUBSIDIARIES.—(a) *In general.*—(1) Any domestic corporation having one or more foreign subsidiaries may request the district director to enter into an agreement for the purpose of extending the Federal old-age and survivors insurance system established by title II of the Social Security Act to certain services performed outside the United States by all citizens of the United States who are employees of any such foreign subsidiary. See § 36.3121(l)(8)–1, relating to the definition of foreign subsidiary. Except as provided in § 36.3121(l)(5)–1, relating to the effect of the termination of an agreement entered into pursuant to the provisions of section 3121(l), the district director shall, at the request of a domestic corporation, enter into such an agreement on Form 2032 in any case where a Form 2032 is executed, and submitted to the district director, by the domestic corporation in the manner prescribed in this section. A domestic corporation may not have in effect at the same moment of time more than one agreement on Form 2032.

(2) An agreement authorized in section 3121(l)(1) may not be made applicable to any services performed outside the United States which would not constitute employment, for purposes of the taxes imposed under the Federal Insurance Contributions Act, if the services were performed within the United States. Thus, such an agreement shall have no application with respect to any services performed outside the United States which, if performed within the United States, would be specifically excepted from employment under any of the numbered paragraphs of section 3121(b), or which, although not so excepted, would be deemed not to be employment by application of section 3121(c), relating to included and excluded services. Further, an agreement may not be made applicable with respect to any services performed outside the United States which constitute employment, as defined in section 3121(b). Thus, an agreement may not be made

applicable to services for any employer performed by any employee on or in connection with an American vessel or American aircraft when outside the United States, if (i) performed under a contract of service which is entered into within the United States or (ii) during the performance of which and while the employee is employed on the vessel or aircraft it touches at a port in the United States, because such services constitute employment as defined in section 3121(b). An agreement may not be made applicable to remuneration which would not constitute wages, as defined in section 3121(a), even if the services to which such remuneration is attributable had constituted employment.

(3) The terms "corporation", "domestic", and "foreign", as used in the regulations in this part, have the meaning assigned by paragraphs (3), (4), and (5), respectively, of section 7701(a). Section 7701(a) (3), (4), and (5) provides as follows:

SEC. 7701. DEFINITIONS.

(a) When used in this title [Internal Revenue Code of 1954], where not otherwise distinctly expressed or manifestly incompatible with the intent thereof—

* * * * * * *

(3) CORPORATION.—The term "corporation" includes associations, joint-stock companies, and insurance companies.

(4) DOMESTIC.—The term "domestic" when applied to a corporation * * * means created or organized in the United States or under the law of the United States or of any State or Territory.

(5) FOREIGN.—The term "foreign" when applied to a corporation * * * means a corporation * * * which is not domestic.

(b) *Form and contents of agreement.*—Form 2032 is the form prescribed for the agreement authorized in section 3121(l)(1). The agreement shall include provisions substantially as follows:

(1) That the agreement shall apply to all services performed outside the United States by all citizens of the United States who are in the employ of the foreign subsidiary or subsidiaries to which the agreement is made applicable, but only to the extent that the remuneration paid each employee for such services would constitute wages if paid by one employer for services performed in the United States;

(2) That the agreement shall not apply to any services which constitute employment within the meaning of section 3121;

(3) That the agreement shall become effective on the first day of the calendar quarter in which the Form 2032 is signed by the district director or on the first day of the next succeeding calendar quarter, whichever is specified in the agreement;

(4) That the domestic corporation will pay, as required by the regulations in this part, amounts equivalent to the sum of the taxes which would be imposed by sections 3101 and 3111, respectively, if the remuneration for the services covered by the agreement constituted wages;

(5) That the domestic corporation will pay, in accordance with written notification and demand therefor to the domestic corporation, amounts equivalent to the interest, additions to the taxes, additional amounts, and penalties which would be applicable if the remuneration for services covered by the agreement constituted wages; and

(6) That the domestic corporation will comply with all provisions of the regulations in this part.

(c) *Execution and filing of Form 2032.*—The request of any domestic corporation that the district director enter into an agreement with the corporation on Form 2032 shall be signified by the corporation by executing and filing Form 2032 in triplicate with the District Director for the district in which is located the principal place of business in the United States of the domestic corporation. Such form shall be executed in accordance with the regulations in this part and the instructions relating to the form. Each copy of the form shall be signed and dated by the officer of the corporation authorized to enter into the agreement, shall show the title of such officer, and shall have the corporate seal affixed thereto. A certified copy of the minutes of the meeting of the board of directors of the domestic corporation, or other evidence, showing the authority of such officer so to act shall accompany the form. Form 2032 executed and filed as provided in this paragraph shall be signed and dated by the district director and, upon such signing, the Form 2032 so executed and filed will constitute the agreement authorized in section 3121(l)(1). The District Director will return one copy of the agreement to the domestic corporation, will transmit one copy to the Department of Health, Education, and Welfare, and will retain one copy (together with all related papers).

§ 36.3121(l)(1)-2. AMENDMENT OF AGREEMENT.—(a) An agreement entered into by a domestic corporation as provided in § 36.3121 (l)(1)-1 may be amended so as to be made applicable, in the same manner and under the same conditions, with respect to any one or more of the foreign subsidiaries of the domestic corporation not previously named in the agreement. See paragraph (b) of § 36.3121 (l)(2)-1, relating to the effective period of an amendment of an agreement.

(b) Form 2032 Supplement is the form prescribed for use in amending an agreement entered into by a domestic corporation as provided in § 36.3121(l)(1)-1.

(c) A domestic corporation shall signify its desire to amend an agreement entered into by the corporation as provided in § 36.3121 (l)(1)-1 by executing and filing Form 2032 Supplement in triplicate with the District Director for the district in which is located the principal place of business in the United States of the domestic corporation.

(d) Form 2032 Supplement shall be executed and filed in the manner and in conformity with the requirements prescribed in paragraph (c) of § 36.3121(l)(1)-1 in respect of an agreement on Form 2032. Form 2032 Supplement executed and filed as provided in this paragraph shall be signed and dated by the District Director, and, upon such signing, the Form 2032 Supplement so executed and filed will constitute an amendment of the agreement entered into on Form 2032. The District Director will return one copy of the amendment to the domestic corporation, will transmit one copy to the Department of Health, Education, and Welfare, and will retain one copy (together with all related papers).

§ 36.3121(l)(1)-3. EFFECT OF AGREEMENT.—(a) *Liability for amounts equivalent to tax.*—(1) *In general.*—A domestic corporation which has entered into an agreement (as provided in § 36.3121(l)

(1)-1), or any amendment thereof (as provided in § 36.3121(l)(1)-2), incurs liability under the agreement in respect of certain remuneration paid by each foreign subsidiary named in the agreement, or any amendment thereof. Liability is incurred in respect of the remuneration paid to all those employees of the foreign subsidiaries who are citizens of the United States and who perform services outside the United States (other than services which constitute employment) for the foreign subsidiaries. However, liability is incurred only with respect to that portion of such remuneration paid by the foreign subsidiary which is attributable to services performed during the period for which the agreement is in effect with respect to such subsidiary, and then only to the extent that the remuneration would constitute wages if the services to which the remuneration is attributable were performed in the United States. Liability with respect to such remuneration is incurred in an amount equivalent to the sum of the employee and employer taxes which would be imposed by sections 3101 and 3111, respectively, if such remuneration constituted wages. If an individual performs services for more than one of the foreign subsidiaries named in an agreement, including any amendment thereof, such services are regarded as being performed in the employ of a single employer for purposes of determining the amount of the remuneration for such services which would constitute wages if the services were performed in the United States. See § 36.3121(l)(9)-1, relating to the treatment of a domestic corporation as a separate entity in its capacity as a party to an agreement.

(2) *Examples.* The application of subparagraph (1) may be illustrated by the following examples:

Example (1). P, a domestic corporation, has entered into an agreement as provided in § 36.3121(l)(1)-1, effective with respect to services performed on and after January 1, 1955. Three foreign subsidiaries, S-1, S-2, and S-3 are named in the agreement. A, a citizen of the United States, is employed during 1955 by S-1, S-2, and S-3, for the performance outside the United States of services covered by the agreement. In 1955 A is paid remuneration of $2,500 for such services by each of the foreign subsidiaries. The circumstances are such that the entire $7,500 would constitute wages if the services had been performed in the United States. However, only $4,200 of such remuneration would constitute wages if the services had been performed in the United States for a single employer, and it is with respect to this amount only that P incurs liability under its agreement.

Example (2). On August 1, 1955, P, the domestic corporation in the preceding example, amends its agreement to include therein its foreign subsidiary S-4. The amendment is in effect with respect to S-4 for the period beginning with October 1, 1955. B, a citizen of the United States, is employed by S-4 throughout 1955 for the performance of services outside the United States. B is paid remuneration of $500 in each month of 1955 for these services. The circumstances are such that the first $4,200 of such remuneration would constitute wages if the services had been performed in the United States, and, except for the $4,200 limitation, the remainder of such remuneration would constitute wages if the services had been so performed. P incurs no liability with

respect to remuneration paid B for services performed for S–4 prior to October 1, 1955. However, P incurs liability under its agreement with respect to the $1,500 paid B in October, November, and December 1955, for services performed in these months. Since the remuneration paid to B for services performed during the first nine months of 1955 is not covered by the agreement, such remuneration is not taken into account in computing the $4,200 limitation or the liability under the agreement.

Example (3). Assume the same facts as in example (2) except that B's services for S–4 during December 1955 are performed in connection with the production or harvesting of crude gum (oleoresin) and that such services if performed within the United States would be excepted from employment. See section 3121(b)(1)(A). Accordingly, P incurs no liability under the agreement with respect to the $500 paid in December 1955 for such services.

(3) *Determination of liability.*—The amount of the liability referred to in subparagraph (1) incurred by a domestic corporation for any period shall be determined in the same manner as liability for the employee tax and for the employer tax imposed by the Federal Insurance Contributions Act is determined, pursuant to regulations relating to the taxes under such Act as in effect for the same period, with respect to wages paid by an employer to an employee.

(b) *Liability for amounts equivalent to interest or penalties.*—A domestic corporation which has entered into an agreement as provided in § 36.3121(l)(1)–1 also incurs liability under the agreement for amounts equivalent to the amount of interest, additions to the taxes, additional amounts, and penalties which would be applicable if the remuneration for services covered by the agreement constituted wages.

(c) *Deductions from employees' remuneration.*—There is no obligation to deduct, or cause to be deducted, from the remuneration of any employee of a foreign subsidiary any part of the amount due from a domestic corporation under its agreement. Whether such deduction shall be made is a matter for settlement between the employee and the domestic corporation or such other person as may be concerned.

(d) *Cross reference.*—For other obligations of a domestic corporation under an agreement, see § 36.3121(l)(10)–1.

§ 36.3121(l)(2). STATUTORY PROVISIONS; EFFECTIVE PERIOD OF AGREEMENT.

SEC. 3121. DEFINITIONS. * * *

(l) AGREEMENTS ENTERED INTO BY DOMESTIC CORPORATIONS WITH RESPECT TO FOREIGN SUBSIDIARIES. * * *

(2) EFFECTIVE PERIOD OF AGREEMENT.—An agreement entered into pursuant to paragraph (1) shall be in effect for the period beginning with the first day of the calendar quarter in which such agreement is entered into or the first day of the succeeding calendar quarter, as may be specified in the agreement, but in no case prior to January 1, 1955; except that in case such agreement is amended to include the services performed for any other subsidiary and such amendment is executed after the first month following the first calendar quarter for which the agreement is in effect, the agreement shall be in effect with respect to service performed for such other subsidiary only after the calendar quarter in which such amendment is executed.

[Sec. 3121(l)(2) as added by sec. 209, Social Security Amendments 1954]

§ 36.3121(l)(2)-1. EFFECTIVE PERIOD OF AGREEMENT.—(a) *In general.*—An agreement entered into as provided in § 36.3121(l)(1)-1 shall be in effect for the period beginning with the first day of the calendar quarter in which the agreement is signed by the District Director, or the first day of the calendar quarter following the calendar quarter in which the agreement is signed by the District Director, whichever is specified in the agreement. In no case, however, shall the agreement be effective for any calendar quarter which begins prior to January 1, 1955.

(b) *Amendment of agreement.*—If an amendment on Form 2032 Supplement (filed by a domestic corporation to include in its agreement services performed for a foreign subsidiary not previously named therein) is signed by the District Director within the quarter for which the agreement is first effective or within the first calendar month following such quarter, the agreement shall be effective with respect to the subsidiary named in the amendment as of the date such agreement first became effective. However, if the amendment is signed by the District Director after the last day of the fourth month for which the agreement is in effect, such agreement shall be in effect with respect to the subsidiary named in the amendment for the period beginning with the first day of the calendar quarter following the calendar quarter in which the amendment is signed by the District Director.

§ 36.3121(l)(3). STATUTORY PROVISIONS; TERMINATION OF PERIOD BY A DOMESTIC CORPORATION.

SEC. 3121. DEFINITIONS. * * *

(l) AGREEMENTS ENTERED INTO BY DOMESTIC CORPORATIONS WITH RESPECT TO FOREIGN SUBSIDIARIES. * * *

(3) TERMINATION OF PERIOD BY A DOMESTIC CORPORATION.—The period for which an agreement entered into pursuant to paragraph (1) of this subsection is effective may be terminated with respect to any one or more of its foreign subsidiaries by the domestic corporation, effective at the end of a calendar quarter, upon giving two years' advance notice in writing, but only if, at the time of the receipt of such notice, the agreement has been in effect for a period of not less than eight years. The notice of termination may be revoked by the domestic corporation by giving, prior to the close of the calendar quarter specified in the notice of termination, a written notice of such revocation. Notice of termination or revocation thereof shall be filed in such form and manner as may be prescribed by regulations. Notwithstanding any other provision of this subsection, the period for which any such agreement is effective with respect to any foreign corporation shall terminate at the end of any calendar quarter in which the foreign corporation, at any time in such quarter, ceases to be a foreign subsidiary as defined in paragraph (8).

[Sec. 3121(l)(3) as added by sec. 209, Social Security Amendments 1954]

§ 36.3121(l)(3)-1. TERMINATION OF AGREEMENT BY DOMESTIC CORPORATION OR BY REASON OF CHANGE IN STOCK OWNERSHIP.—(a) *Termination by domestic corporation.*—(1) A domestic corporation which has entered into an agreement under section 3121(l)(1) with respect to one or more of its foreign subsidiaries may terminate such agreement in part or in its entirety by giving (to the District Director for the district in which is located the principal place of business in the United States of the domestic corporation) 2 years'

advance notice in writing of its desire so to terminate the agreement at the end of a specified calendar quarter, provided that, at the time of the receipt of such notice by the District Director, the agreement has been in effect with respect to the subsidiary or subsidiaries covered by the notice for at least 8 years. The notice of termination shall be signed and dated and shall show (i) the title of the officer authorized to sign the notice, (ii) the name, address, and identification number of the domestic corporation, (iii) the District Director with whom the agreement was entered into, (iv) the name and address of each foreign subsidiary with respect to which the agreement is to be terminated, (v) the date on which the agreement became effective with respect to each such foreign subsidiary, and (vi) the date on which the agreement is to be terminated with respect to each such foreign subsidiary. The notice shall be submitted in duplicate and shall be accompanied by a certified copy of the minutes of the meeting of the board of directors of the domestic corporation, or other evidence, showing authorization for the notice of termination. No particular form is prescribed for the notice of termination. The District Director will transmit one copy of the notice of termination to the Department of Health, Education, and Welfare.

(2) A notice of termination given by a domestic corporation in respect to any one or more of its foreign subsidiaries may be revoked by the corporation with respect to any such subsidiary or subsidiaries by giving, prior to the close of the calendar quarter specified in the notice of termination, written notice of revocation. The notice of revocation shall be filed with the District Director with whom the notice of termination was filed. Such notice of revocation shall be signed and dated and shall show (i) the title of the officer authorized to sign the notice of revocation, (ii) the name, address, and identification number of the domestic corporation, (iii) the name, and address of each foreign subsidiary with respect to which the notice of termination is revoked, and (iv) the date of the notice of termination to be revoked. The notice shall be submitted in duplicate and shall be accompanied by a certified copy of the minutes of the meeting of the board of directors of the domestic corporation, or other evidence, showing authorization for the notice of revocation. No particular form is prescribed for the notice of revocation. The District Director will transmit one copy of the notice of revocation to the Department of Health, Education, and Welfare.

(b) *Termination by reason of change in stock ownership.*—(1) The period for which an agreement entered into by a domestic corporation as provided in § 36.3121(l)(1)-1 is in effect with respect to a foreign corporation is automatically terminated at the end of the calendar quarter in which the foreign corporation ceases, at any time, in such quarter, to be a foreign subsidiary of the domestic corporation. See § 36.3121(l)(8)-1, relating to definition of foreign subsidiary.

(2) A domestic corporation which has entered into an agreement as provided in § 36.3121(l)(1)-1 shall furnish to the District Director for the district in which is located its principal place of business in the United States written notification in the event that a foreign corporation named in the agreement, including any amendment thereof, as a foreign subsidiary of the domestic corporation ceases

to be its foreign subsidiary. The written notification shall be furnished in duplicate on or before the last day of the first month following the close of the calendar quarter in which the foreign corporation ceases, at any time in such quarter, to be a foreign subsidiary of the domestic corporation. Such notification shall be signed and dated by the president or other principal officer of the domestic corporation. The written notification shall show (i) the title of the officer signing the notice, (ii) the name, address, and identification number of the domestic corporation, (iii) the District Director with whom the agreement was entered into, (iv) the date on which the agreement was entered into, (v) the name and address of the foreign corporation with respect to which the notification is furnished, and (vi) the date on which the foreign corporation ceased to be a foreign subsidiary of the domestic corporation. No particular form is prescribed for the written notification. The district director will transmit one copy of the written notification to the Department of Health, Education, and Welfare.

§ 36.3121(l)(4). STATUTORY PROVISIONS; TERMINATION OF PERIOD BY SECRETARY.

SEC. 3121. DEFINITIONS. * * *

(l) AGREEMENTS ENTERED INTO BY DOMESTIC CORPORATIONS WITH RESPECT TO FOREIGN SUBSIDIARIES. * * *

(4) TERMINATION OF PERIOD BY SECRETARY.—If the Secretary or his delegate finds that any domestic corporation which entered into an agreement pursuant to this subsection has failed to comply substantially with the terms of such agreement, the Secretary or his delegate shall give such domestic corporation not less than sixty days' advance notice in writing that the period covered by such agreement will terminate at the end of the calendar quarter specified in such notice. Such notice of termination may be revoked by the Secretary or his delegate by giving, prior to the close of the calendar quarter specified in the notice of termination, written notice of such revocation to the domestic corporation. No notice of termination or of revocation thereof shall be given under this paragraph to a domestic corporation without the prior concurrence of the Secretary of Health, Education, and Welfare.

[Sec. 3121(l)(4) as added by sec. 209, Social Security Amendments 1954]

§ 36.3121(l)(4)-1. TERMINATION OF AGREEMENT BY COMMISSIONER.—(a) *Notice of termination.*—The period for which an agreement entered into with a domestic corporation as provided in § 36.3121(l)(1)-1 is in effect may be terminated by the Commissioner, with the prior concurrence of the Secretary of Health, Education, and Welfare, upon a finding by the Commissioner that the domestic corporation has failed to comply substantially with the terms of the agreement. The Commissioner shall give the corporation not less than 60 days' advance notice in writing that the period for which the agreement is in effect will terminate at the end of the calendar quarter specified in the notice of termination.

(b) *Revocation of notice of termination.*—A notice of termination given to a domestic corporation by the Commissioner may be revoked by the Commissioner, with the prior concurrence of the Secretary of Health, Education, and Welfare, by giving written notice of revocation to the corporation prior to the close of the calendar quarter specified in the notice of termination.

§ 36.3121(l)(5). STATUTORY PROVISIONS; NO RENEWAL OF AGREEMENT.

SEC. 3121. DEFINITIONS. * * *

(l) AGREEMENTS ENTERED INTO BY DOMESTIC CORPORATIONS WITH RESPECT TO FOREIGN SUBSIDIARIES. * * *

(5) NO RENEWAL OF AGREEMENT.—If any agreement entered into pursuant to paragraph (1) of this subsection is terminated in its entirety (A) by a notice of termination filed by the domestic corporation pursuant to paragraph (3), or (B) by a notice of termination given by the Secretary or his delegate pursuant to paragraph (4), the domestic corporation may not again enter into an agreement pursuant to paragraph (1). If any such agreement is terminated with respect to any foreign subsidiary, such agreement may not thereafter be amended so as again to make it applicable with respect to such subsidiary.

[Sec. 3121(l)(5) as added by sec. 209, Social Security Amendments 1954]

§ 36.3121(l)(5)-1. EFFECT OF TERMINATION.—(a) *Termination of entire agreement.*—(1) If the effective period of an agreement entered into by a domestic corporation as provided in § 36.3121(l)(1)-1 is terminated by the domestic corporation, pursuant to paragraph (a) of § 36.3121(l)(3)-1, with respect to all foreign subsidiaries named in the agreement, including any amendment thereof, an agreement may not again be entered into by the domestic corporation under the provisions of section 3121(l)(1).

(2) If the effective period of an agreement entered into by a domestic corporation as provided in § 36.3121(l)(1)-1 is terminated by the Commissioner, pursuant to paragraph (a) of § 36.3121(l)(4)-1, an agreement may not again be entered into by the domestic corporation under the provisions of section 3121(l)(1).

(3) If the effective period of an agreement entered into by a domestic corporation as provided in § 36.3121(l)(1)-1 is terminated automatically by reason of a change in stock ownership (see paragraph (b) of § 36.3121(l)(3)-1) with respect to all foreign corporations named in the agreement, including any amendment thereof, a new agreement may be entered into by the domestic corporation, as provided in § 36.3121(l)(1)-1, with respect to any foreign corporation which is a foreign subsidiary of the domestic corporation.

(b) *Partial termination of agreement.*—(1) If the effective period of an agreement entered into by a domestic corporation as provided in § 36.3121(l)(1)-1, is terminated by the domestic corporation, pursuant to paragraph (a) of § 36.3121(l)(3)-1, with respect to one or more foreign subsidiaries named in the agreement, including any amendment thereof, the period for which the agreement is in effect will continue with respect to any other foreign subsidiary or subsidiaries named in the agreement (or amendment). However, the agreement may not thereafter be amended to include any foreign subsidiary with respect to which the effective period of the agreement has been terminated.

(2) If the effective period of an agreement entered into by a domestic corporation as provided in § 36.3121(l)(1)-1 is terminated automatically by reason of a change in stock ownership (see paragraph (b) of § 36.3121(l)(3)-1 with respect to a foreign corporation

which has ceased to be a foreign subsidiary of the domestic corporation, but the period for which the agreement is in effect continues with respect to one or more other foreign subsidiaries, the agreement may not thereafter be amended to include such foreign corporation even though the foreign corporation may again become a foreign subsidiary of the domestic corporation.

§ 36.3121(l)(6). STATUTORY PROVISIONS; DEPOSITS IN TRUST FUND.

SEC. 3121. DEFINITIONS. * * *

(l) AGREEMENTS ENTERED INTO BY DOMESTIC CORPORATIONS WITH RESPECT TO FOREIGN SUBSIDIARIES. * * *

(6) DEPOSITS IN TRUST FUND.—For purposes of section 201 of the Social Security Act, relating to appropriations to the Federal Old-Age and Survivors Insurance Trust Fund, such remuneration—

(A) Paid for services covered by an agreement entered into pursuant to paragraph (1) as would be wages if the services constituted employment, and

(B) As is reported to the Secretary or his delegate pursuant to the provisions of such agreement or of the regulations issued under this subsection,

shall be considered wages subject to the taxes imposed by this chapter [chapter 21, I. R. C. 1954].

[Sec. 3121(l)(6) as added by sec. 209, Social Security Amendments 1954]

§ 36.3121(l)(7). STATUTORY PROVISIONS; OVERPAYMENTS AND UNDERPAYMENTS.

SEC. 3121. DEFINITIONS. * * *

(l) AGREEMENTS ENTERED INTO BY DOMESTIC CORPORATIONS WITH RESPECT TO FOREIGN SUBSIDIARIES. * * *

(7) OVERPAYMENT AND UNDERPAYMENTS.

(A) If more or less than the correct amount due under an agreement entered into pursuant to this subsection is paid with respect to any payment of remuneration, proper adjustments with respect to the amounts due under such agreement shall be made, without interest, in such manner and at such times as may be required by regulations prescribed by the Secretary or his delegate.

(B) If an overpayment cannot be adjusted under subparagraph (A), the amount thereof shall be paid by the Secretary or his delegate, through the Fiscal Service of the Treasury Department, but only if a claim for such overpayment is filed with the Secretary or his delegate within two years from the time such overpayment was made.

[Sec. 3121(l)(7) as added by sec. 209, Social Security Amendments 1954]

§ 36.3121(l)(7)-1 OVERPAYMENTS AND UNDERPAYMENTS.—(a) *Adjustments.*—(1) *In general.*—Errors in the payment of amounts for which liability equivalent to the employee and employer taxes with respect to any payment of remuneration is incurred by a domestic corporation pursuant to its agreement are adjustable by the domestic corporation in certain cases without interest. However, not all corrections made under this section constitute adjustments within the meaning of the regulations in this part. The various situations in which such corrections constitute adjustments are set forth in subparagraphs (2) and (3). All corrections in respect of underpayments and all adjustments or credits in respect of overpayments made under this section must be reported on a return filed by the domestic corporation under the regulations in this part and not on a return

filed with respect to the employee and employer taxes imposed by sections 3101 and 3111, respectively. Every return on which such a correction (by adjustment, credit, or otherwise) is reported pursuant to this section must have securely attached as a part thereof a statement explaining the error in respect of which the correction is made, designating the calendar quarter in which the error was ascertained, and setting forth such other information as would be required if the correction were in respect of an overpayment or underpayment of taxes under the Federal Insurance Contributions Act. An error is ascertained when the domestic corporation has sufficient knowledge of the error to be able to correct it. An underpayment may not be corrected under this section after receipt from the district director of written notification of the amount due and demand for payment thereof, but the amount shall be paid in accordance with such notification.

(2) *Underpayments.*—If a domestic corporation fails to report, on a return filed under the regulations in this part, all or any part of the amount for which liability equivalent to the employee and employer taxes is incurred under its agreement with respect to any payment of remuneration, the domestic corporation shall adjust the underpayment by reporting the additional amount due as an adjustment on a return or supplemental return filed on or before the last day on which the return for the return period in which the error is ascertained is required to be filed. The amount of each underpayment adjusted in accordance with this subparagraph shall be paid to the district director, without interest, at the time fixed for reporting the adjustment. If an adjustment is reported pursuant to this subparagraph but the amount thereof is not paid when due, interest thereafter accrues.

(3) *Overpayments.*—If a domestic corporation pays more than the amount for which liability equivalent to the employee and employer taxes is incurred under its agreement with respect to any payment of remuneration, the domestic corporation may correct the error, subject to the requirements and under the conditions stated in this paragraph, by deducting the amount of the overpayment from the amount of liability reported on a return filed by the domestic corporation, except that—

(i) A correction may not be made in respect of any part of an overpayment which was collected from an individual by reason of the agreement unless the domestic corporation (*a*) has repaid the amount so collected to the individual, has secured the written receipt of the individual showing the date and amount of the repayment, and retains such receipt as a part of its records, or (*b*) has reimbursed the individual by reducing the amounts which otherwise would have been deducted from his remuneration by reason of the agreement; and

(ii) A correction may not be made in one calendar year in respect of any part of an overpayment which was collected from an individual in a prior calendar year unless the domestic corporation has secured the written statement of the individual showing that he has not claimed and will not claim refund or credit of the amount so collected, and retains such receipt as a part of its records. See § 31.6413(c)-1 of subpart G of part 31 of this chapter, relating to claims for special credit or refund.

The correction constitutes an adjustment under this subparagraph only if it is reported on the return for the period in which the error is ascertained or on the return for the next following period, and then only if the correction is reported within the statutory period of limitation upon refund or credit of overpayments of amounts due under the agreement. See paragraph (b)(2)(iii) relating to such statutory period. A claim for credit or refund may be filed in accordance with the provisions of paragraph (b)(2) for any overpayment of an amount due under the agreement which is not adjusted under this subparagraph.

(b) *Errors not adjustable.*—(1) *Underpayments.*—If a domestic corporation fails to report all or any part of the amount for which liability equivalent to the employee and employer taxes is incurred under its agreement with respect to any payment of remuneration, and such underpayment is not reported as an adjustment within the time prescribed by paragraph (a)(2), the amount of such underpayment shall be reported on the domestic corporation's next return, or shall be reported immediately on a supplemental return for the return period in which such payment of remuneration was made. The reporting of an underpayment under this subparagraph does not constitute an adjustment without interest.

(2) *Overpayments.*—(i) If more than the correct amount due from a domestic corporation pursuant to its agreement (including the amount of any interest or addition) is paid to the district director and the amount of the overpayment is not adjusted under paragraph (a)(3), the domestic corporation may file a claim for refund or credit. Except as otherwise provided in this subparagraph, such claim shall be made in the same manner and subject to the same conditions as to allowance of the claim as would be the case if the claim were in respect of an overpayment of taxes under the Federal Insurance Contributions Act. Refund or credit of an amount erroneously paid by a domestic corporation under its agreement may be allowed only to the domestic corporation.

(ii) Any claim filed under this subparagraph shall be plainly marked "Claim under section 3121(l)."

(iii) No refund or credit of an overpayment of the amount due from a domestic corporation under its agreement will be allowed after the expiration of 2 years after the date of payment to the District Director of such overpayment, except upon one or more of the grounds set forth in a claim filed prior to the expiration of such 2-year period.

(c) *Deductions from employees' remuneration.*—If a domestic corporation deducts, or causes to be deducted, from the remuneration of an individual for services covered by the agreement amounts which are more or less than the employee tax which would be deductible therefrom if such remuneration constituted wages, any repayment to the individual (except to the extent otherwise provided in this section), or further collection from the individual, in respect of such deduction is a matter for settlement between the individual and the domestic corporation or such other person as may be concerned.

§ 36.3121(l)(8). STATUTORY PROVISIONS; DEFINITION OF FOREIGN SUBSIDIARY.

SEC. 3121. DEFINITIONS. * * *

(l) AGREEMENTS ENTERED INTO BY DOMESTIC CORPORATIONS WITH RESPECT TO FOREIGN SUBSIDIARIES. * * *

(8) DEFINITION OF FOREIGN SUBSIDIARY.—For purposes of this subsection * * * a foreign subsidiary of a domestic corporation is—

(A) A foreign corporation more than 50 percent of the voting stock of which is owned by such domestic corporation; or

(B) A foreign corporation more than 50 percent of the voting stock of which is owned by the foreign corporation described in subparagraph (A).

[Sec. 3121(l)(8) as added by sec. 209, Social Security Amendments 1954]

§ 36.3121(l)(8)-1. DEFINITION OF FOREIGN SUBSIDIARY.—(a) A foreign corporation is a foreign subsidiary of a domestic corporation, within the meaning of the regulations in this part, if—

(1) More than 50 percent of the voting stock of the foreign corporation is owned by the domestic corporation, or

(2) More than 50 percent of the voting stock of the foreign corporation is owned by a second foreign corporation and more than 50 percent of the voting stock of the second foreign corporation is owned by the domestic corporation.

(b) The application of paragraph (a) may be illustrated by the following examples:

Example (1). P, a domestic corporation, owns 51 percent of the voting stock of S–1, a foreign corporation. S–1 owns 51 percent of the voting stock of S–2, a foreign corporation. S–2 owns 51 percent of the voting stock of S–3, a foreign corporation. S–1 and S–2 are foreign subsidiaries of P for purposes of the regulations in this part. Since neither P nor S–1 owns more than 50 percent of the voting stock of S–3, S–3 is not a foreign subsidiary of P within the meaning of these regulations.

Example (2). Assume the same facts as those stated in example (1) except that S–1 transfers to P one-half of its ownership of the voting stock of S–2. P owns no other voting stock of S–2. Accordingly, after the transfer, P and S–1 together own more than 50 percent of the voting stock of S–2, but neither P nor S–1 alone owns more than 50 percent of such stock. S–2 ceases to be a foreign subsidiary of P when such transfer is effected.

(c) The term "stock", as used in the regulations in this part, has the meaning assigned by paragraph (7) of section 7701(a). Section 7701(a)(7) provides as follows:

SEC. 7701. DEFINITIONS.

(a) When used in this title [Internal Revenue Code of 1954], where not otherwise distinctly expressed or manifestly incompatible with the intent thereof—

* * * * * * *

(7) STOCK.—The term "stock" includes shares in an association, joint-stock company, or insurance company.

(d) Ownership of the voting stock of a foreign corporation which is a foreign subsidiary of a domestic corporation may be transferred from the domestic corporation to another foreign subsidiary of the domestic corporation, from one foreign subsidiary of the domestic corporation to another, or from a foreign subsidiary of the domestic corporation to the domestic corporation itself without affecting the status of the foreign corporation as a foreign subsidiary of the do-

mestic corporation, provided that more than 50 percent of the voting stock of such foreign corporation is at all times owned either (1) by the domestic corporation, or (2) by a foreign corporation more than 50 percent of the voting stock of which is owned by the domestic corporation.

§ 36.3121(l)(9). STATUTORY PROVISIONS; DOMESTIC CORPORATION AS SEPARATE ENTITY.

SEC. 3121. DEFINITIONS. * * *

(l) AGREEMENTS ENTERED INTO BY DOMESTIC CORPORATIONS WITH RESPECT TO FOREIGN SUBSIDIARIES. * * *

(9) DOMESTIC CORPORATION AS SEPARATE ENTITY.—Each domestic corporation which enters into an agreement pursuant to paragraph (1) of this subsection shall, for purposes of this subsection and section 6413(c)(2)(C), relating to special refunds in the case of employees of certain foreign corporations, be considered an employer in its capacity as a party to such agreement separate and distinct from its identity as a person employing individuals on its own account.

[Sec. 3121(l)(9) as added by sec. 209, Social Security Amendments 1954]

§ 36.3121(l)(9)-1. DOMESTIC CORPORATION AS SEPARATE ENTITY.—A domestic corporation which enters into an agreement as provided in § 36.3121(l)(1)-1 shall, for purposes of the regulations in this part and for purposes of section 6413(c)(2)(C), relating to special credits or refunds, be considered an employer in its capacity as a party to such agreement separate and apart from its identity as an employer incurring liability for the employee tax and employer tax on the wages of its own employees. Thus, if a citizen of the United States performs services in employment for the domestic corporation and at any time within the same calendar year performs services covered by the agreement as an employee of one or more foreign subsidiaries named therein, the limitation on wages provided in section 3121(a)(1) has application separately as to the wages for employment performed in the employ of the domestic corporation and as to the remuneration for services covered by the agreement performed in the employ of such foreign subsidiary or subsidiaries. All services covered by the agreement whether performed in the employ of one or more than one such foreign subsidiary are regarded for purposes of the wage limitation as having been performed in the employ of the domestic corporation in its separate capacity as a party to the agreement. Similarly, any remuneration for such services which, if the services were performed in the United States, would be excluded from wages unless a certain amount of such remuneration is paid by a single employer within a specified period (for example, remuneration for agricultural labor) is regarded, for purposes of determining whether the domestic corporation incurs liability under its agreement with respect to such remuneration, as having been paid by the domestic corporation in its separate capacity as a party to the agreement. All remuneration received by an employee for services covered by the agreement is deemed, for purposes of the special credit or refund provisions contained in section 6413(c), to have been received from the domestic corporation as an employer in its separate capacity as a party to the agreement.

§ 36.3121(l)(10). STATUTORY PROVISIONS; REGULATIONS.

SEC. 3121. DEFINITIONS. * * *

(l) AGREEMENTS ENTERED INTO BY DOMESTIC CORPORATIONS WITH RESPECT TO FOREIGN SUBSIDIARIES. * * *

(10) REGULATIONS.—Regulations of the Secetary or his delegate to carry out the purposes of this subsection shall be designed to make the requirements imposed on domestic corporations with respect to services covered by an agreement entered into pursuant to this subsection the same, so far as practicable, as those imposed upon employers pursuant to this title [Internal Revenue Code of 1954] with respect to the taxes imposed by this chapter [chapter 21, I. R. C. 1954].

[Sec. 3121(l)(10) as added by sec. 209, Social Security Amendments 1954]

§ 36.3121(l)(10)-1. REQUIREMENTS IN RESPECT OF LIABILITY UNDER AGREEMENT.—To the extent not inconsistent with, or otherwise provided in, the regulations in this part, the requirements and duties (relating to identification number, account numbers, wage information statements to employees, record keeping, etc.) imposed on an employer for any period with respect to the taxes imposed by the Federal Insurance Contributions Act are hereby made applicable to a domestic corporation with respect to its obligations and liabilities, for the same period, under an agreement entered into as provided in § 36.3121(l)(1)-1.

§ 36.3121(l)(10)-2. IDENTIFICATION.—(a) *Domestic corporation.*—A domestic corporation which has secured, or is required to secure, an identification number as an employer having in its employ one or more individuals in employment for wages is not required to secure an identification number under the regulations in this part.

(b) *Employees.*—Every employee performing services covered by an agreement shall have the same duties in respect of an account number as would be the case if the employee were performing services in employment for the domestic corporation.

§ 36.3121(l)(10)-3. RETURNS.—(a) The forms prescribed for use in making returns of the taxes imposed by the Federal Insurance Contributions Act (except any forms particularly prescribed for use by household employers or by employers filing returns in Puerto Rico or the Virgin Islands) shall be used by a domestic corporation in making returns of its liability under an agreement entered into as provided in § 36.3121(l)(1)-1. Returns of such liability shall be made separate and apart from any returns required of the domestic corporation in respect of the taxes imposed by the Federal Insurance Contributions Act. The domestic corporation shall plainly mark "3121(l) Agreement" at the top of each return, each detachable schedule thereof, and each paper or document constituting a part of the return, filed by the domestic corporation pursuant to the regulations in this part. Returns required under the regulations in this part shall be made by the domestic corporation as if all services covered by the agreement, whether performed in the employ of one or more than one foreign subsidiary, were performed in the employ of the domestic corporation as an employer in its separate capacity as a party to the agreement.

(b) Each return required under the regulations in this part must be filed on or before the last day of the month following the period for which the return is made.

§ 36.3121(l)(10)–4. PAYMENT OF AMOUNTS EQUIVALENT TO TAX.—A domestic corporation which has entered into an agreement as provided in § 36.3121(l)(1)–1 is not required to make deposits with a Federal Reserve bank or authorized commercial bank of any amount for which liability is incurred under its agreement.

O. GORDON DELK,
Acting Commissioner of Internal Revenue.

Approved September 2, 1955.

A. N. OVERBY,
Acting Secretary of the Treasury.

(Filed by the Division of the Federal Register September 7, 1955, 8:51 a. m.)

Services performed for the owner or lessee of farm lands. See Rev. Rul. 55–538, page 313.

CHAPTER 22.—RAILROAD RETIREMENT TAX ACT

SUBCHAPTER A.—TAX ON EMPLOYEES

SECTION 3201.—RATE OF TAX

Credit against income tax liability of employee tax incurred and paid under both the Railroad Retirement Tax Act and the Federal Insurance Contributions Act for the same period. See Rev. Rul. 55–690, page 14.

SUBCHAPTER D.—GENERAL PROVISIONS

SECTION 3231.—DEFINITIONS

(Also Part II, Section 1532(a); Regulations 114, Section 411.202.) Rev. Rul. 55–586

The *N* railroad company, a carrier employer subject to the Railroad Retirement Tax Act, occupies office space in several large buildings which it owns and also rents office and store space therein to its tenants. The *M* terminal buildings corporation, a wholly owned subsidiary of the company, provides cleaning services in the buildings and in the concourse below street level leading to the company's train platforms. *Held*, the *M* terminal buildings corporation is not an employer subject to the Railroad Retirement Tax Act. It is subject, however, to the provisions of the Federal Insurance Contributions Act and the Federal Unemployment Tax Act.

The Internal Revenue Service has been requested to determine the status, under the Railroad Retirement Tax Act (chapter 22, subtitle C,

Internal Revenue Code of 1954), of the *M* terminal buildings corporation, a wholly owned subsidiary of the *N* railroad company, under the circumstances described below.

The *N* railroad company, a railroad carrier and employer as defined in section 3231 of the Railroad Retirement Tax Act, owns and operates several large office buildings which are occupied by miscellaneous tenants. Occupancy at and below the street level is mainly by stores selling a wide variety of goods and services. The railroad company itself occupies a small amount of the office space in these buildings, at and above the street level. Below street level, there is a concourse consisting of several wide aisles, bounded by retail stores and stands selling various goods and services. There are also booths at which railroad tickets may be purchased and change for the railroad company's turnstiles (also located at this level) may be obtained. Stairways leading down from the concourse afford entrance to the railroad company's train platforms, located on a level below the concourse. Traffic on the concourse presumably results from the use by passengers of the railroad company's trains, the transfer of persons between the various subway systems, and from the attractions of the stores themselves to persons employed in the buildings and to the general public. Entrance to the concourse is available to the public without charge, and there is no way of determining the extent to which traffic is divided between the railroad company's passengers and others.

In the past, the railroad company contracted with an outside firm to perform cleaning services in its buildings, including the concourse. However, due to a substantial increase in cleaning costs over a period of years, the *M* terminal buildings corporation was formed as a wholly owned subsidiary of the railroad company, and pursuant to a contract between them *M* provides such services as sweeping, mopping and scrubbing floors, washing windows, removing refuse, cleaning public halls, lobbies and stairways, and dusting furnishings and equipment, as well as numerous other services in the railroad company's buildings, including the concourse, but not the train level below.

Section 3231 of the Railroad Retirement Tax Act, in defining an "employer," provides in part as follows:

> (a) EMPLOYER.—For purposes of this chapter [chapter 22 of the 1954 Code], the term "employer" means any carrier (as defined in subsection (g)), and any company which is directly or indirectly owned or controlled by one or more such carriers * * *, and which operates any equipment or facility or performs any service * * * in connection with the transportation of passengers or property by railroad * * *.

Although the *M* terminal buildings corporation is wholly owned by a carrier employer as defined in section 3231(a) of the Railroad Retirement Tax Act, the services performed by it in rendering cleaning services in the railroad company's buildings and the concourse leading to the company's train platforms do not constitute services performed in connection with the transportation of passengers or property by railroad. Accordingly, the *M* terminal buildings corporation does not qualify as an "employer" within the meaning of that term as defined in the Railroad Retirement Tax Act, and it is not subject to the provisions of that act or liable for the taxes imposed by it. However,

the corporation is subject to the provisions of the Federal Insurance Contributions Act and the Federal Unemployment Tax Act (chapters 21 and 23, respectively, subtitle C, Internal Revenue Code of 1954).

CHAPTER 23.—FEDERAL UNEMPLOYMENT TAX ACT

SECTION 3306.—DEFINITIONS

(Also Part II, Section 1607(c); Regulations 107, Section 403.208.) Rev. Rul. 55-607

Generally, reforestation services do not constitute "agricultural labor" and are not excepted from "employment" under the provisions of the Federal Unemployment Tax Act.

A public utility conducts a reforestation program on its land to obtain timber for wood products, to conserve the land, to stabilize the pond water levels and generally to improve the economic welfare of the area. Such work is seasonal and consists of planting seedlings, pruning and thinning operations, and any other services necessary for the proper care of the trees and land. The company has asked the Internal Revenue Service whether the services in question constitute "agricultural labor" under section 3306(k) of the Federal Unemployment Tax Act (chapter 23, subtitle C, Internal Revenue Code of 1954.)

The definition of "agricultural labor" contained in section 3306(k) of the Act does not specifically mention reforestation operations. However, section 403.208(a) of Regulations 107, applicable to the Internal Revenue Code of 1954 by virtue of Treasury Decision 6091, C. B. 1954–2, 47, specifically provides, in part, that the term "agricultural labor" does not include services performed in connection with forestry or lumbering.

The position of the Internal Revenue Service is that reforestation services performed under the stated circumstances are in connection with forestry or lumbering operations and, therefore, do not come within the meaning of the term "agricultural labor" as used in section 3306(k), *supra*. However, if such services are performed on a farm in connection with the cultivation, operation, maintenance or conservation of a farm, they would constitute such "agricultural labor."

Helpers engaged by employee-drivers of a trucking company. See Rev. Rul. 55–543, page 400.

Services performed on non-American vessels and aircraft while on "idle status." See Rev. Rul. 55–623, page 414.

"Disc jockey" for a radio station. See Rev. Rul. 55–718, page 411.

CHAPTER 24.—COLLECTION OF INCOME TAX AT SOURCE ON WAGES

SECTION 3401.—DEFINITIONS

(Also Section 37.) Rev. Rul. 55–484

Section 37 of the Internal Revenue Code of 1954 allows, under certain conditions, a credit against the Federal income tax based on retirement income. The credit allowed by section 37 has no effect on the requirements for withholding on retirement income, such as pensions or retired pay, under section 3402 of the 1954 Code.

Statutory subsistence allowances paid to police officers. See Rev. Rul. 55–475, page 37.

Amount paid to an individual as a compromise settlement for the cancellation, before the normal expiration date, of an employment contract. See Rev. Rul. 55–520, page 393.

Helpers engaged by employee-drivers of a trucking company. See Rev. Rul. 55–543, page 400.

A State having control of the payment of wages to "State appointed" special peace officer. See Rev. Rul. 55–544, page 401.

Individuals engaged in performing services in connection with a research project established as the result of a grant-in-aid to a State college. See Rev. Rul. 55–583, page 405.

Remuneration paid individuals for "agricultural labor" performed in the employ of commercial greenhouse operators. See Rev. Rul. 55–707, page 420.

House-to-house canvassers or solicitors. See Rev. Rul. 55–734 page 413.

SECTION 3402.—INCOME TAX COLLECTED AT SOURCE

Additional withholding to cover self-employment tax liability. See Rev. Rul. 55–521, page 487.

Remuneration paid individuals for "agricultural labor" performed in the employ of commercial greenhouse operators. See Rev. Rul. 55–707, page 420.

CHAPTER 32.—MANUFACTURERS EXCISE TAXES

SUBCHAPTER B.—HOUSEHOLD TYPE EQUIPMENT, ETC.

PART I.—REFRIGERATION EQUIPMENT

SECTION 4111.—IMPOSITION OF TAX

(Also Part II, Section 3405; Regulations 46, Section 316.70.) Rev. Rul. 55-432

The tax imposed by section 4111 of the Internal Revenue Code of 1954 (section 3405 of the Internal Revenue Code of 1939) on mechanical units for the quick freezing or frozen storage of foods is limited in application to those of the household type. A freezer unit which is suitable for use in rural or urban homes and has a total of less than 25 cubic feet of space for freezing foods or storing frozen foods is considered to be a unit of the household type. A freezer unit which is clearly adapted for purposes other than household use by reason of design and construction is not taxable even though it has a total of less than 25 cubic feet of freezing or storage space. Any freezer unit which has 25 cubic feet or more of space for freezing foods or storing frozen food is considered not of the household type regardless of design or construction.

PART II.—ELECTRIC, GAS AND OIL APPLIANCES

SECTION 4121.—IMPOSITION OF TAX

(Also Part II, Section 3406; Regulations 46, Section 316.110.) Rev. Rul. 55-645

The manufacturers' excise tax on gas water heaters, imposed by section 4121 of the Internal Revenue Code of 1954 (section 3406 of the Internal Revenue Code of 1939), is limited in application to heaters of the household type. *Held*, a gas water heater having a gas input rating less than 50,000 B. T. U. per hour is a heater of the household type and the sale of such a heater by the manufacturer is subject to tax unless the heater by reason of design and construction is primarily adapted for purposes other than household use. This ruling has equal application to water heaters using natural, manufactured or liquified petroleum gas.

PART III.—ELECTRIC LIGHT BULBS

SECTION 4131.—IMPOSITION OF TAX

(Also Section 4218.)
(Also Part II, Sections 3406, 3444; Regulations 46, Sections 316.7, 316.180.) Rev. Rul 55-735

The use by a manufacturer of neon tubing, taxable under section 4131 of the Internal Revenue Code of 1954, as a component in the production of nontaxable lighting and decorative installations leased by him, is subject to tax on the basis of the fair market price of the tubing.

Advice has been requested regarding the basis for computing the manufacturers' excise tax on electric light tubing, imposed by section 4131 of the Internal Revenue Code of 1954, where such tubing is used by the manufacturer thereof in neon lighting and decorative installations. The manufacturer leases the complete installations which, in addition to the tubing with electrodes affixed thereto, include other items such as wire, brackets, transformers and switches.

Section 4131 of the Code imposes a tax on the sale by the manufacturer, producer, or importer of electric light bulbs and tubes. Section 316.180 of Regulations 46, made applicable to the Internal Revenue Code of 1954 by Treasury Decision 6091, C. B. 1954–2, 47, defines an electric light bulb or tube as any device designed for the diffusion of artificial light for illuminative or decorative purposes through the use of electricity.

Section 4218(a) of the Code provides, with certain exceptions not here applicable, that if any person manufactures, produces, or imports an article and uses it, otherwise than as material in the manufacture or production of, or as a component part of, another taxable article manufactured by him, he shall be liable for the tax in the same manner as if such article was sold by him, and the tax shall be computed on the price at which such or similar articles are sold, in the ordinary course of trade, by manufacturers, producers, or importers thereof, as determined by the Secretary or his delegate.

It is held that the lease by the manufacturer of the above-described installations, which include various other articles in addition to the neon tubing manufactured by him, constitutes the lease of nontaxable installations in the production of which taxable tubing is used. Pursuant to the provisions of section 4218(a) of the Code, the use by the manufacturer of the neon tubing, including the electrodes attached thereto, as a component in the production of the installations, is subject to tax. The basis for computing the tax is the fair market price of the taxable tubing used in the nontaxable installations.

SUBCHAPTER C.—ENTERTAINMENT EQUIPMENT

PART I.—RADIO AND TELEVISION SETS, PHONOGRAPHS AND RECORDS

SECTION 4142.—DEFINITION OF RADIO AND TELEVISION COMPONENT

(Also Part II, Section 3404: Regulations 46, Section 316.61.) Rev. Rul. 55–624

The sale by the manufacturer, producer, or importer, of a phonograph mechanism which includes, among other components, a motor, pick-up arm and turntable, but does not include a pick-up cartridge, is considered to be the sale of a radio and television component as defined in section 4142 of the Internal Revenue Code of 1954, and is therefore subject to the manufacturers' excise tax.

Advice has been requested concerning the application of the manufacturers' excise tax, imposed by section 4141 of the Internal Reve-

nue Code of 1954 (section 3404 of the Internal Revenue Code of 1939), to the sale, by the manufacturer, producer, or importer, of a phonograph mechanism which includes, among other components, a motor, pick-up arm, and turntable, but which does not include a pick-up cartridge.

Section 4141 of the 1954 Code imposes a tax upon sales, by the manufacturer, producer, or importer, of radio receiving sets, automobile radio receiving sets, television receiving sets, automobile television receiving sets, phonographs, combinations of any of the foregoing, radio and television components, and phonograph records. Section 4142 defines the term "radio and television components" to include phonograph mechanisms which are suitable for use on or in connection with, or as component parts of any of the articles enumerated in section 4141, whether or not primarily adapted for such use.

It has been the policy of the Internal Revenue Service not to regard as a taxable phonograph mechanism a combination which includes, among other components, a motor, pick-up arm and turntable, but which does not include a pick-up cartridge. The person who placed the cartridge in the pick-up arm has been considered to be the manufacturer of the phonograph mechanism who was liable for the tax.

Upon reconsideration it is now held that a combination which includes, among other components, a motor, pick-up arm and turntable, but which does not include a pick-up cartridge, is a phonograph mechanism within the meaning of section 4142 of the 1954 Code (section 3404 of the 1939 Code), and the sale thereof by the manufacturer, producer or importer is subject to the manufacturers' excise tax.

In view of the policy heretofore maintained, the instant ruling, under the authority contained in section 7805(b) of the 1954 Code, will be applied generally without retroactive effect beginning December 1, 1955. Any tax previously paid on sales of phonograph mechanisms which did not include pick-up cartridges will not be refunded.

SUBCHAPTER E.—OTHER ITEMS

PART II.—PENS AND MECHANICAL PENCILS AND LIGHTERS

SECTION 4201.—IMPOSITION OF TAX

Rev. Rul. 55-467

A writing instrument which has a reservoir or cartridge containing fluid graphite writing compound that is fed to a ball type writing device is essentially a ballpoint pen within the meaning of section 4201 of the Internal Revenue Code of 1954 and is subject to the manufacturers' excise tax imposed by that section.

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SUBCHAPTER F.—SPECIAL PROVISIONS APPLICABLE TO MANUFACTURERS TAX

SECTION 4218.—USE BY MANUFACTURER OR IMPORTER CONSIDERED SALE

Use of a taxable article in the manufacture of a nontaxable installation. See Rev. Rul. 55–735, page 455.

SECTION 4224.—STATE AND LOCAL GOVERNMENTAL EXEMPTION

(Also Section 6416.) Rev. Rul. 55–545

Articles subject to manufacturers' excise tax are considered as being sold for the exclusive use of a State or political subdivision when they are sold to a volunteer fire department or a volunteer rescue squad, which is performing a function ordinarily carried on by governmental units.

Advice has been requested whether relief from manufacturers' excise taxes provided in sections 4224 and 6416(b)(2)(A) of the Internal Revenue Code of 1954 applies where taxable articles are sold for the exclusive use of volunteer fire departments and volunteer rescue squads which were not formed for profit and are engaged in performing the particular civic functions indicated by their titles.

Such organizations in many cases, although not necessarily in every case, receive assistance from governmental units which may consist of direct grants of funds or equipment, or the use of public property, equipment, and supplies, either free or at a nominal charge. Their operations may also be financed directly by the public through a variety of fund-raising projects and drives.

Section 4224 of the Code provides that no manufacturers' excise tax shall be imposed upon the sale of any article for the exclusive use of any State, Territory of the United States, or any political subdivision of the foregoing, or the District of Columbia. Section 6416(b)(2)(A) provides for credit or refund of the tax to the manufacturer where the article is resold by any person for such use.

Inasmuch as a volunteer fire department and a volunteer rescue squad are quasi-governmental organizations performing functions ordinarily carried on by governmental units, it is held that articles subject to manufacturers' excise tax are considered sold for the exclusive use of a State or political subdivision when they are sold for the use of a volunteer fire department or a volunteer rescue squad, either (1) when they are sold to a political subdivision of a State for use by such organization, or (2) when they are sold directly to such organization. Therefore, exemption from the manufacturers' excise tax afforded by law applies to such sales provided the political subdivision or the organization purchasing the articles furnishes its vendor with an exemption certificate properly executed by a duly authorized officer of the purchasing agency, in accordance with prescribed regulations. Compare I. T. 4030, C. B. 1950–2, 23, which holds that contributions or gifts made to organizations of volunteer firemen are deductible for income tax purposes as contributions or gifts made to or for the use of a political subdivision of a State for exclusively public purposes.

CHAPTER 33.—FACILITIES AND SERVICES

SUBCHAPTER A.—ADMISSIONS AND DUES

PART I.—ADMISSIONS

SECTION 4231.—IMPOSITION OF TAX

(Also Part II, Section 1700; Regulations 43, Section 101.2.) Rev. Rul. 55–719

Where admission to a series of scheduled games may be obtained by purchasing at a reduced rate a number of single tickets, one valid for admission to each game, the sale of such single tickets constitutes the sale of admission by season ticket within the meaning of section 4231(1)(B) of the Internal Revenue Code of 1954, and the total amount paid for such tickets is subject to the tax on admissions if the amount which would be charged for one single admission is in excess of 50 cents.

The Internal Revenue Service has been asked whether the sale of tickets of admission, under the following circumstances, constitutes the sale of admission by season ticket.

A baseball club has scheduled 70 games for the season. The regular admission charge to a single game is 75 cents. Admission to all the home games may be obtained for $35 by purchasing at one time 70 single tickets, one ticket valid for admission to each home game.

Section 4231(1)(B) of the Internal Revenue Code of 1954 provides that in the case of a season ticket or subscription the tax will not apply if the amount which would be charged to the holder or subscriber for a single admission is 50 cents or less. Section 101.2 of Regulations 43, made applicable to the 1954 Code by Treasury Decision 6091, C. B. 1954–2, 47, provides that the amount paid for admission by season ticket is a fixed sum which entitles the holder to admission on definite dates to a series of scheduled attractions, or to admission at all times during the season, and the form of the ticket is not controlling.

It is held that under the circumstances described, the sale of the 70 tickets of admission, one valid for admission to each home game, constitutes the sale of admission by season ticket. Accordingly, since in this case the amount charged for a single admission to a game is more than 50 cents, the sum of $35 paid for admission to the 70 home games is subject to the tax on admissions.

SUBCHAPTER B.—COMMUNICATIONS

SECTION 4251.—IMPOSITION OF TAX

(Also Part II, Section 3465; Regulations 42, Section 130.40.) Rev. Rul. 55–646

The tax on amounts paid for local telephone service, imposed by section 4251 of the Internal Revenue Code of 1954 (section 3465(a)(3) of the Internal Revenue Code of 1939), is applicable to charges made for radio telephone dispatch service, including charges for rental and maintenance of transmitting and receiving equipment installed in the subscriber's vehicles.

The Internal Revenue Service has been requested to explain the application of section 4251 of the Internal Revenue Code of 1954 (section 3465(a)(3) of the Internal Revenue Code of 1939) to charges made by a radio corporation to its customers for a mobile radio telephone dispatch service.

The radio corporation is engaged in rendering a mobile communication service to the public on a common carrier basis, pursuant to its tariff on file with the Federal Communications Commission. The service rendered by the corporation is a two-way radio dispatch service. A subscriber may communicate only between his premises or one of his mobile units and the base station maintained by the radio corporations. The operator at this base station then relays the message as directed. All radio communications are over wave lengths and frequencies assigned to the radio corporation and the operations are conducted under Federal Communications Commission licenses granted to such corporation.

The subscriber's mobile units are equipped with transmitters and receivers for which the radio corporation makes a monthly rental and maintenance charge. There is also a monthly service charge covering a specified number of calls, with an additional charge for each one-minute call in excess of the number covered by the minimum monthly charge.

Section 4251 of the 1954 Code imposes a tax upon the amount paid for local telephone service. Section 4252(a) defines "local telephone service" as meaning any telephone service not taxable as long distance telephone service; leased wire, teletypewriter or talking circuit special service; or wire and equipment service. The latter section further provides that amounts paid for the installation of instruments, wires, poles, switchboards, apparatus, and equipment shall not be considered amounts paid for service.

The term "local telephone service" encompasses the facilities and equipment necessary to complete such service. Since transmission is oral, the communication service rendered by the radio corporation is telephonic in nature.

It is held that a radio telephone dispatch service as described herein falls within the category of "local telephone service" subject to the tax imposed by section 4251 of the 1954 Code. The tax applies to the total of the recurring charges for the services and for the facilities necessary to complete the service, including charges for rental and maintenance of the transmitting and receiving equipment.

SUBCHAPTER C.—TRANSPORTATION

PART I.—PERSONS

SECTION 4261.—IMPOSITION OF TAX

(Also Part II, Section 3469; Regulations 42, Section 130.51.) **Rev. Rul. 55-647**

The tax on the transportation of persons applies to tickets sold aboard a ship, while it is still within "United States" waters en route to Canada, for transportation of the passengers by bus between points in Canada.

Term "United States," defined.

Advice has been requested concerning the application of the tax on the transportation of persons, imposed by section 4261(a) of the Internal Revenue Code of 1954, to tickets sold to passengers aboard a ship while it is still in the territorial waters of the United States en route from the United States to Canada. The tickets are used by the passengers for transportation by bus between points in Canada.

Section 4261(a) of the Code imposes a tax upon an amount paid within the United States for the transportation of persons by rail, motor vehicle, water, or air within or without the United States.

It is held that the term "United States," used in the taxing statute, includes the states, Territories of Alaska and Hawaii, and the District of Columbia. It also includes inland waters (such as rivers, lakes, bays, etc.) lying wholly within the United States, and, where an international boundary line divides inland waters, such parts of such inland waters as lie within the boundary of the United States, and also the waters known as a marine league from low tide on the coast line. Ships within these limits, whether of foreign or domestic registry, are considered to be within the United States. Accordingly, payments for transportation between points in Canada, when made aboard a ship while the ship is still within the "United States" as that term is defined above, are subject to tax on the transportation of persons.

Applicability of the tax on the transportation of persons to payments for transportation of faculty and staff members of a state-operated school to national and regional conventions. See Rev. Rul. 55-697, page 470.

PART II.—PROPERTY

SECTION 4271.—IMPOSITION OF TAX

Rev. Rul. 55-546

The delivery of new and used automobiles and trucks by the drive-away method, whereby the only facilities furnished are drivers who deliver the motor vehicles under their own power, does not constitute transportation of property within the meaning of section 4271 of the Internal Revenue Code of 1954. Therefore, the tax does not apply to amounts paid for the delivery of automobiles and trucks by such method.

(Also Part II, Section 3475; Regulation 113, Section 143.13.) Rev. Rul. 55-599

> The tax on the transportation of property does not apply to an amount paid for the hauling of waste oil from storage tanks and spraying it on lease roads located on the same lease as the storage tanks, where the primary purpose of the operation is the disposition of the waste oil.

Advice has been requested concerning the application of the tax on the transportation of property, imposed by section 4271 of the Internal Revenue Code of 1954 (section 3475 of the Internal Revenue Code of

1939), to amounts paid by an oil producing company to a carrier for hauling waste oil by tank truck from the company's storage tanks and spraying it on lease roads located on the same lease as the storage tanks. The waste oil is that containing sediment which accumulates at the bottom of the storage tanks. It must be removed to permit the satisfactory reuse of the storage tanks.

M. T. 45, C. B. 1952–2, 269, holds, in part, that where a person contracts with a carrier for the transportation of material to be disposed of as waste in the course of business from his plant or premises to a designated place within the boundaries of, or adjacent to, such plant or premises, the amount paid to the carrier is not subject to tax on the transportation of property.

It is held that where, as in the instant case, the service of hauling the waste oil from the storage tanks and spraying it on lease roads located on the same lease as the storage tanks is primarily for the purpose of disposing of the waste oil, such service comes within the purview of the above provisions of M. T. 45. Accordingly, an amount paid for such service is not subject to tax on the transportation of property.

(Also Part II, Section 3475; Regulations 113, Section 143.1.) Rev. Rul. 55–614

The service of cleaning and disinfecting cars used for the transportation of livestock is accessorial to the transportation movement. Charges made by a carrier for such service when furnished in connection with a taxable transportation movement are subject to the tax on transportation of property imposed by section 4271 of the Internal Revenue Code of 1954 (section 3475 of the Internal Revenue Code of 1939).

Advice has been requested concerning the application of the tax on transportation of property, imposed by section 4271 of the Internal Revenue Code of 1954 (section 3475 of the Internal Revenue Code of 1939), to charges made by a carrier for the service of cleaning and disinfecting cars used for the transportation of livestock.

The carrier's freight tariff governing the handling of livestock sets forth separate and specific charges for the service of cleaning and disinfecting freight cars that have been or will be loaded with livestock. These charges are assessed against the shipment on account of which such cleaning and disinfecting is made necessary. When the cleaning and disinfecting service is required, the carrier either performs the service or contracts with another party to perform it. When the carrier contracts with another party to perform the service, insofar as the shipper or consignee is concerned such service is furnished to him by the carrier.

Section 143.1(d) of Regulations 113, which is made applicable to the Internal Revenue Code of 1954 by Treasury Decision 6091, C. B. 1954–2, 47, defines the term "transportation" as used in the statute and the regulations to include, in general, accessorial services furnished in connection with a transportation movement, such as loading, unloading, blocking and staking, elevation, transfer in transit, ventilation, handling, feeding and watering livestock, and similar services and facilities.

It is the position of the Internal Revenue Service that the fumigation of products in cars before being shipped into noninsect infested

areas, as required by the Department of Agriculture to prevent the spread of insects, is not accessorial to the transportation movement and that charges for such services, if billed separately from the transportation charges, would not be subject to the tax.

However, the services of cleaning and disinfecting the transportation equipment in this case are directly attributable to the transportation movement of the livestock. Accordingly, it is held that the service of cleaning and disinfecting cars used for the transportation of livestock is accessorial to the transportation of the livestock on account of which such service is made necessary. Therefore, any charge made by a carrier for such service when furnished in connection with a taxable transportation movement is subject to the tax.

Under the authority contained in section 7805(b) of the Code this ruling will not be applied with retroactive effect to payments made prior to November 1, 1955, except that any tax that has been paid on such payments will not be refunded.

Rev. Rul. 55–625

Where a tugboat company furnishes lashing gear to its customer in connection with a taxable transportation movement performed by the company, any rental charge for the lashing gear is considered to be a charge for an accessorial service, and is, therefore, subject to the tax imposed by section 4271(a) of the Internal Revenue Code of 1954.

Rev. Rul. 55–626

A daily charge for the charter of a non-self-propelled barge, scow, or similar vessel for the purpose of holding staging for sand blasting or for painting, or for the storing of a ship's cargo while the ship is being repaired, constitutes an amount paid for the lease of equipment rather than for the transportation of property within the meaning of section 4271(a) of the Internal Revenue Code of 1954 and is, therefore, not subject to the transportation of property tax. Since an additional charge made by the owner of such vessel for delivering it to the point of use and for returning it after use does not constitute an amount paid for services furnished in connection with a taxable transportation movement, it also is not subject to the tax.

Rev. Rul. 55–648

The Act of June 18, 1934, Public Law 397, Seventy-Third Congress, 48 Stat. 998, 19 U. S. C. 81, as amended by the Act of June 17, 1950, Public Law 566, Eighty-First Congress, 64 Stat. 246, provides for the establishment, operation, and maintenance of foreign-trade zones in ports of entry of the United States to expedite and encourage foreign commerce. *Held*, domestic merchandise taken into a "foreign-trade zone" for the sole purpose of exportation is considered to be exported for purposes of the tax on the transportation of property, imposed by section 4271 of the Internal Revenue Code of 1954, and payment for the transportation of the merchandise into such a zone is exempt from tax. In order to establish the exempt character of

the payment, there should be submitted to the carrier at the time the transportation charges are paid, Form 1363, Export Exemption Certificate, modified by entering at the bottom thereof the statement, "Shipped into Foreign-Trade Zone for Export." Further proof of exportation will not be required in such cases.

(Also Section 4272.) Rev. Rul. 55-659

Application of the tax on the transportation of property, imposed by section 4271(a) of the Internal Revenue Code of 1954, to a payment for transportation which includes charges for both taxable and nontaxable transportation.

The Internal Revenue Service has been requested to explain the application of the tax on transportation of property, imposed by section 4271(a) of the Internal Revenue Code of 1954, to a payment for transportation of property under the circumstances described below.

A company provides a forwarding service for persons in the United States who ship a large number of small packages to points in Alaska. The service consists of picking up the packages in the United States, shipping them by water to a port in Alaska, and trucking them from such port to a Post Office for final delivery by the Post Office to various destinations in Alaska. Precanceled postage stamps covering the delivery of the packages from the Post Office in Alaska to their various destinations are purchased by the company from the postmaster in Alaska and are affixed by the company to the packages before they are shipped. The total charges for transportation of the packages from the shipper to the consignee, including the cost of the precanceled stamps, are shown in the company's published tariff rates.

The tax on transportation of property, imposed by section 4271(a) of the Code, applies to any payment for the transportation of property made to a carrier, including an express company, freight forwarder, or similar person. However, where a transportation movement involves the services of two or more carriers, the tax applies only to the payments made by the shipper or consignee for the complete transportation movement and does not apply to the payments made by the carriers between themselves in settlement of their charges for their respective services. Section 4272(e) of the Code provides that the tax on transportation of property shall not apply to amounts paid to the Post Office Department for the transportation of property.

It is held that the company, in providing the above-described service, is considered to be a "freight forwarder or similar person" within the meaning of the statute. Accordingly, it is liable for collecting and reporting tax on the portion of the charges paid to it by the shipper for that part of the forwarding service which is performed by nonexempt transportation which includes, in the instant case, the transportation of the packages from the point of origin in the United States to a Post Office in Alaska. Since the delivery of the packages by the Post Office does not constitute taxable transportation of property, the tax will not apply to the portion of the charges paid by a shipper representing the value of precanceled stamps affixed to the packages delivered to the Post Office, provided the company's records show, with respect to each payment made by a shipper, the total value of the precanceled stamps to be used on the packages shipped.

Rev. Rul. 55–660

The owner of a vessel charters it to a company having material to be transported. The charter agreement sets forth the freight, demurrage and despatch rates, and the number of days allowed the charterer to load and discharge the vessel. A demurrage charge is to be incurred by the charterer for each day the vessel is held by the charterer beyond the time allowed in the agreement for its loading and discharge. On the other hand the charterer is to receive despatch money for each day saved in loading and discharging the vessel out of the number of days allowed in the agreement. Any resultant payment of demurrage by the charterer of the vessel or payment of despatch money by the owner of the vessel is made subsequent to the payment of the freight due under the charter agreement. *Held*, the tax on the transportation of property, imposed by section 4271 of the Internal Revenue Code of 1954, applies to any amount paid by the charterer to the owner of the vessel for demurrage incurred in connection with taxable transportation furnished under the charter. Any payment of despatch money by the owner of the vessel to the charterer thereof is considered to represent an adjustment of the taxable transportation charge paid by the charterer, and the owner of the vessel may, at the time of making such payment, refund to the charterer the tax previously collected on such amount.

Rev. Rul. 55–720

Charges representing the amount of customs duty or entry fee on an import shipment advanced by a carrier to a customhouse broker and collected by the carrier from the consignee are not amounts paid for the transportation of property and, therefore, are not subject to the tax on the transportation of property imposed by section 4271 of the Internal Revenue Code of 1954 if such charges are shown separately from the transportation charges on the bill rendered by the carrier.

(Also Section 4272.)
(Also Part II, Section 3475;
Regulations 113, Section 143.1)

Rev. Rul. 55–751

A mutual cartage association, which was organized as a separate legal entity and is being operated for the purpose of furnishing trucking services to its members in the operation of their separate businesses and makes a charge for such services, is a "person engaged in the business of transporting property for hire" within the meaning of section 4272(a) of the Internal Revenue Code of 1954, even though the charges to the members cover only the actual cost of operating the trucks.

Advice has been requested whether a mutual cartage association organized and operated for the purpose of furnishing a trucking service to its members in the operation of their separate businesses, where the amounts charged the members cover only the actual cost of operating the trucks, is a "person engaged in the business of transporting property for hire" within the meaning of section 4272(a) of the Internal Revenue Code of 1954.

In order to reduce the expense of transporting their merchandise and provisions individually from a warehouse to their respective stores, a number of independent retail merchants formed a mutual cartage association for their joint benefit and service. The association was organized as a separate legal entity under the laws of the state in which it now operates. It purchased a tractor and trailer, the initial cost of which was borne equally by the members. The operating expenses are paid by the members on a prorata basis. The amount charged each member for the trucking services furnished to him is determined by the hundredweight of the merchandise delivered to his store and the hauling distance from the warehouse to the store. The association hauls for members only and all of its activities are confined to one state. The trucking service for members is its only business activity.

Section 4271(a) of the Code imposes a tax upon the amount paid within or without the United States for the transportation of property by rail, motor vehicle, water or air from one point in the United States to another. Under the provisions of section 4272(a) of the Code, the tax applies only to amounts paid to a person engaged in the business of transporting property for hire.

Section 143.1(b) of Regulations 113, made applicable to the 1954 Code by Treasury Decision 6091, C. B. 1954–2, 47, defines the term "person engaged in the business of transporting property for hire" to include a common carrier, contract carrier, local moving or drayage concern, freight forwarder, express company, or other person transporting property for hire wholly or in part by rail, motor vehicle, water, or air. The term "transportation" is defined in section 143.1 (d) of Regulations 113 to mean the movement of property by a person engaged in the business of transporting property for hire, including interstate, intrastate, and intracity or other local movements.

Section 7701(a)(1) of the Code defines the term "person" to mean and include an individual, a trust, estate, partnership, association, company or corporation.

It is held that since the association was organized as a separate entity and is being operated for the purpose of furnishing a trucking service for which it receives remuneration, and since the transportation service furnished to its members is not incidental to any other business activity in which the association is engaged, it is a "person engaged in the business of transporting property for hire" within the meaning of section 4272(a) of the Code. Accordingly, the tax applies to the charges made by the association to its members for the transportation of their merchandise and provisions from the warehouse to their respective stores, even though such charges cover only the actual cost of operating the tractor and trailer. See Rev. Rul. 55–752, below.

(Also Section 4272.) Rev. Rul. 55–752

A cooperative association organized and operated for the purpose of marketing its members' produce is not a "person engaged in the business of transporting property for hire," within the meaning of section 4272(a) of the Internal Revenue Code of 1954, with respect to trucking services furnished by it to its members with its own trucks, where such services are incidental to its business of market-

ing the members' produce. However, with respect to trucking services furnished to the members which are not performed in connection with the marketing of their produce, the association is a "person engaged in the business of transporting property for hire."

Advice has been requested whether the following-described trucking services furnished by a cooperative association are regarded as transportation of property by a "person engaged in the business of transporting property for hire" within the meaning of section 4272(a) of the Internal Revenue Code of 1954, so as to determine whether charges made in connection with such services are subject to the tax on transportation of property imposed by section 4271(a) of the Code.

A cooperative association composed of farmer member patrons was organized under state laws for the purpose of operating a general retail store. The association owns and operates trucks which pick up the members' produce, deliver it to the store, and do such other hauling as is necessary in the conduct of the store's business. The truck drivers are employed by the association. The cost of operating the trucks is deducted pro rata from the members' share of the proceeds.

In addition to the hauling performed in connection with the operation of the store, the trucks of the association pick up milk from some of its farmer members and deliver it to various creameries designated by the members. The association does not buy, process or sell the milk. A charge is made to the members for such hauling. The net earnings derived by the association from this operation are distributed to the members on a patronage basis.

Section 4271(a) of the Code imposes a tax upon the amount paid within or without the United States for the transportation of property by rail, motor vehicle, water, or air from one point in the United States to another. Under the provisions of section 4272(a) of the Code, the tax applies only to amounts paid to a person engaged in the business of transporting property for hire. The tax is payable by the person making the taxable transportation payment and is collectible by the person receiving such payment.

It is held that the cooperative association in the instant case, which was organized and is being operated for the purpose of marketing its members' produce, is not a "person engaged in the business of transporting property for hire," within the meaning of section 4272(a) of the Code, with respect to the trucking services it furnishes to its members with its own trucks, where such services are incidental to its business of marketing the members' produce, and any charges made for such services are not subject to the tax on transportation of property. However, to the extent that the trucking services furnished by the association to its members are not a part of its business of marketing its members' produce and therefore are not considered as being incidental to its business of marketing, it is considered a "person engaged in the business of transporting property for hire" and any charges made for such trucking services are subject to tax.

Under the circumstances described, the trucking by the cooperative association of the members' produce to its general retail store is considered to be incidental to its business of marketing such produce, and any charge made to the members, or cost deducted from the profits inuring to the members, for such services are not subject to the trans-

portation tax. However, since the trucking by the cooperative association of its members' milk to creameries is not a part of its business of operating the retail store, such trucking is not considered incidental to the association's business of marketing the produce of its members, and any charge made for such trucking services is subject to tax. See Rev. Rul. 55–751, page 465.

(Also Part II, Section 3475; Regulations 113, Section 143.13.) Rev. Rul. 55–753

Tax on the transportation of property applies to amounts paid to a person engaged in the operation of a sales agency, repair shop, or service station for the towing of disabled automobiles, where the towing is not incidental to his repair of the automobiles. M. T. 10, C. B. 1943, 1160, modified.

The Internal Revenue Service has been requested to reconsider the conclusion stated in M. T. 10, C. B. 1943, 1160, which concerns the application of the tax on the transportation of property to amounts paid for the towing of disabled automobiles.

M. T. 10 holds that towing of disabled automobiles constitutes "transportation of property" within the meaning of the statute and that a person who is engaged exclusively or primarily in the operation of a towing service is considered a "person engaged in the business of transporting property for hire" and therefore liable for the collection of tax on charges made for such towing service. That ruling further holds, however, that where a person is primarily engaged in the operation of an automobile sales agency, repair shop, or service station he is not considered a "person engaged in the business of transporting property for hire" and an amount paid to such a person for towing an automobile is not subject to tax.

Upon reconsideration of M. T. 10, it is the conclusion of the Internal Revenue Service that it is not necessary for a person to be engaged exclusively or primarily in the operation of a towing service to be regarded a "person engaged in the business of transporting property for hire." In other words, a person who is engaged primarily in the operation of a sales agency, repair shop, or service station may also be a person engaged in the business of transporting property for hire, where he furnishes towing services which are not incidental to his repair business.

Accordingly, it is held that where a person operating a sales agency, repair shop, or service station tows disabled automobiles on which he makes the necessary repairs, the towing is considered incidental to the repair services performed and the tax does not apply to the charges made for such towing. However, where such a person tows disabled automobiles on which he does not make the necessary repairs, he is to that extent engaged in the business of transporting property for hire and the tax applies to the charges made for such towing.

M. T. 10, *supra*, is modified to the extent that the conclusions stated in the ruling are inconsistent with the conclusions stated herein. Under the provisions contained in section 7805 (b) of the Internal Revenue Code of 1954, this ruling, to the extent that it modifies M. T. 10, will not be applied to amounts paid for towing services prior to February 1, 1956.

SECTION 4272.—EXEMPTIONS

(Also Part II, Section 3475; Regulations 113, Section 143.13.) Rev. Rul. 55-501

Applicability of the tax on the transportation of property to the services performed by a trucking exchange in bringing together shippers who have cargos to be transported and truckers who have requested assistance in obtaining loads to transport.

Advice has been requested whether a trucking exchange which conducts its operations in the following described manner is considered to be a person engaged in the business of transporting property for hire within the meaning of section 4272 of the Internal Revenue Code of 1954 (section 3475 of the Internal Revenue Code of 1939) and liable for reporting and remitting to the Government the tax on the transportation of property.

In the instant case the function of the trucking exchange is to bring together shippers who have requested its services in obtaining trucks to haul their cargos and truckers who have requested assistance of the exchange in obtaining loads to transport. When the exchange learns of a trucker who is looking for a load to transport to an area to which a shipper has indicated a desire to make a shipment, it instructs the trucker where to pick up the load. After the property is loaded on the truck the trucker issues to the shipper a uniform straight bill of lading which constitutes the hauling contract between such parties. The trucker and not the exchange is liable to the shipper for any loss of, or damage to, a shipment. No hauling contract is entered into by the exchange and the shipper, nor does the name of the exchange appear on the bill of lading issued to the shipper by the trucker. The freight rate charged is the "going rate" which is charged by truckers engaged in this business. After the shipment has been completed, the exchange bills the shipper for the total transportation charges and the tax thereon. Upon receipt by the exchange of such charges and tax the exchange retains 5 percent of the transportation charges as commission for the services performed for the trucker and remits the remainder of the transportation charges and the total tax to the trucker. The exchange is not liable to the trucker for payment of the trucker's charges and in the event the shipper fails to pay such charges the exchange has no legal right to bring suit, on behalf of the trucker, for their recovery.

Section 4271 of the Code imposes a tax upon the amount paid within or without the United States for the transportation of property by rail, motor vehicle, water, or air from one point in the United States to another. Section 4272 provides that the tax shall apply only to amounts paid to a person engaged in the business of transporting property for hire.

It is held that since, under the circumstances described, the trucking exchange (1) does not contract with the shipper to transport the property nor assume the responsibility for the transportation, (2) does not become liable to the trucker for payment of the trucker's charges, and (3) receives remuneration for its services only from the trucker, it is not a "person engaged in the business of transporting property for hire," within the meaning of the statute and is not liable for reporting and remitting the transportation tax to the Government.

Under the circumstances the trucker, who contracts with and transports the property for the shipper, is liable for so reporting and remitting the tax paid by the shipper on the total transportation charges, including the amount retained by the exchange as commission. Compare with Revenue Ruling 54–54, C. B. 1954–1, 273, which holds, under circumstances materially different from those described above, that a company which contracts with shippers for the transportation of their property and assigns the transportation to another to perform, is engaged in the business of transporting property for hire within the meaning of the statute.

Application of the tax on transportation of property where, in connection with the transportation of packages, a portion of the transportation service is performed by the Post Office Department. See Rev. Rul. 55–659, page 464.

Application of the tax to payments to a mutual cartage association by its members to cover the expense of operating its trucks in transporting the members' merchandise. See Rev. Rul. 55–751, page 465.

Applicability of the tax on the transportation of property to transportation activities of a cooperative association organized for the purpose of marketing its members' produce. See Rev. Rul. 55–752, page 466.

SUBCHAPTER E.—SPECIAL PROVISIONS APPLICABLE TO SERVICES AND FACILITIES TAXES

SECTION 4292.—STATE AND LOCAL GOVERNMENTAL EXEMPTION

(Also Section 4261.) Rev. Rul. 55–697

Payments made by a state-operated school from its own funds for the transportation of its faculty and staff members to national and regional educational conventions constitute payments for transportation furnished to a state under the provisions of section 4292 of the Internal Revenue Code of 1954, and are exempt from the tax on the transportation of persons imposed by section 4261 of the Code. In order to establish such exemption, Form 731, Exemption Certificate, must be presented to the carrier at the time the charges for transportation are paid. Where a portion of the cost of the transportation is paid from funds of the school and the remainder by the faculty or staff members from their own funds, the exemption applies only to the portion of the transportation charges paid from the funds of the school. In such case the exemption certificate must show separately the amount of the exempt transportation paid from funds of the school, and the amount of the nonexempt transportation paid by the faculty or staff members from their own funds.

CHAPTER 34.—DOCUMENTARY STAMP TAXES

SUBCHAPTER A.—ISSUANCE OF CAPITAL STOCK AND CERTIFICATE OF INDEBTEDNESS BY A CORPORATION

PART I.—ISSUANCE OF CAPITAL STOCK AND SIMILAR INTERESTS

SECTION 4304.—AFFIXING OF STAMPS

Rev. Rul. 55–721

Upon a determination of the total amount of documentary stamp tax due with respect to the issuance of a large number of capital stock certificates, stamps in large denominations to cover the total tax due may be purchased from a District Director of Internal Revenue and affixed to the stub of the first certificate to be issued and then properly canceled. In such case, the remaining stubs should bear a legend disclosing that the tax has been paid with respect to that particular issue and that the stamps affixed to the stub of the first certificate cover the tax incurred on all of the shares issued. The legend should show the number of the first and include the number of the last unstamped certificate. This reference or legend may be imprinted on each stub by means of a rubber stamp. This procedure may also be adopted when numerous shares are issued in payment of year-end stock dividends.

CHAPTER 35.—TAXES ON WAGERING

SUBCHAPTER A.—TAX ON WAGERS

SECTION 4401.—IMPOSITION OF TAX

(Also Part II, Section 3285; Regulations 132, Sections 325.25, 325.26.) Rev. Rul. 55–754

> The tax on wagers applies to the total amount actually risked by the bettor. Accordingly, in the case of punchboards with prizes of merchandise, cash, or free plays listed thereon, the cost of all chances taken by a bettor are subject to the wagering tax, including additional chances taken by the bettor in lieu of the acceptance of an equivalent amount in cash or merchandise.

The Internal Revenue Service has been requested to interpret the term "taxable wager" with respect to the operation of merchandise punchboards with prizes in the form of additional chances, merchandise, such as a package of cigarettes, or cash equivalent thereto.

Section 4401 of the Internal Revenue Code of 1954 (section 3285 of the 1939 Code) imposes an excise tax on wagers equal to ten percent of the amount thereof. Section 4421 includes in the definition of a wager any wager placed in a lottery conducted for profit. A punchboard is a "lottery" within the intent of the law. *H. R. Lloyd et al.* v. *Robinson*, 110 Fed. Supp. 540.

The question here involved is whether the excise tax applies to the amount of cash actually received by the operator of the punchboards in payment for the punches, or whether it includes also the value of the free punches used to settle the account with the operator or taken in lieu of merchandise. Specifically, it relates to merchandise punchboards whereby the winner has an option of (a) additional free punches, (b) merchandise, or (c) cash equivalent thereto. The following are examples of the general method of operating these punchboards:

(a) A customer punches 40 punches, five of which are winners. At five cents each, the 35 blank punches cost $1.75 and the five winning punches cost 25 cents. The five winning punches are worth 25 cents each (one pack of cigarettes), a total of $1.25. The customer pays the operator 75 cents, the difference between the total cost of the 40 punches ($2) and the value of the winning punches ($1.25).

(b) A player takes five punches at five cents each, two of which are winners. The prize for each winning punch is either a pack of cigarettes or five additional punches.

(1) He takes only one pack of the cigarettes he won, and gives the operator the other pack in payment for the five punches, or

(2) He pays the 25 cents due for the five punches and takes ten additional punches in lieu of the two packs of cigarettes.

A wager is an amount risked on an uncertain event. Therefore, the tax on wagers is applicable to the amount actually risked by the bettor rather than to the net amount which he pays to the operator of the punchboard after deducting his winnings. In the absence of convincing evidence to the contrary, all punches taken on a punchboard are considered to represent wagers, either accepted and paid for, or taken on credit.

In example (a), the player risked $2. This is therefore the taxable amount. The winnings are immaterial as far as tax liability is concerned.

In example (b) (1), inasmuch as the player did not pay the operator prior to taking the punches, it is considered that he placed wagers on credit in the amount of 25 cents. This is the taxable amount, whether the player paid it in cash or surrendered one of the packs of cigarettes in lieu of the cash. In accordance with section 325.25 (a) of Regulations 132, applicable to the provisions of the Internal Revenue Code of 1954 by virtue of Treasury Decision 6091, C. B. 1954–2, 47, tax attaches to a wager on credit whether or not the amount of the wager is actually collected from the bettor.

In example (b) (2), the taxable wager is 75 cents, the amount actually risked by the bettor. A player who takes free punches in lieu of merchandise is in constructive receipt of the merchandise, and makes a taxable wager equal to the value thereof when he takes the additional punches.

CHAPTER 36.—CERTAIN OTHER EXCISE TAXES

SUBCHAPTER B.—OCCUPATIONAL TAX ON COIN-OPERATED DEVICES

SECTION 4461.—IMPOSITION OF TAX

Applicability of tax on coin-operated amusement devices to coin-operated athletic type machines. See Rev. Rul. 55-649, below.

SECTION 4462.—DEFINITION OF COIN-OPERATED AMUSEMENT OR GAMING DEVICE

(Also Section 4461.) Rev. Rul. 55-649
(Also Part II, Section 3267; Regulations 59, Section 323.1.)

All coin-operated athletic type machines such as punching bags, hitting machines, lifters, shockers, and grip machines are considered to be coin-operated amusement devices within the meaning of paragraph (1) of section 4462(a) of the Internal Revenue Code of 1954. Every person who maintains for use or permits the use of such devices on any premises occupied by him incurs liability for special tax under section 4461 of the Code with respect to each such device.

CHAPTER 52.—TOBACCO, CIGARS, CIGARETTES, AND CIGARETTE PAPERS AND TUBES

SUBCHAPTER A.—DEFINITIONS; RATE AND PAYMENT OF TAX; EXEMPTION FROM TAX; AND REFUND AND DRAWBACK OF TAX

SECTION 5701.—RATE OF TAX

26 CFR 270.61: Classification of large cigars. Rev. Rul. 55-662

A manufacturer or importer must taxpay all cigars of the same brand, shape, and size at the same tax rate, including cigars delivered to salesmen of the manufacturer or importer for free distribution as samples to prospective purchasers.

Advice has been requested as to the tax rate applicable to cigars removed by a manufacturer for distribution to his salesmen for use as free samples to consumers.

In the instant case, the cigars removed as samples are identical to cigars which the manufacturer regularly taxpays at the Class C rate. The question here involved is whether the sample cigars should be

taxpaid at the same rate as identical cigars removed for commercial sale and consumption or whether they may be removed at the Class A rate.

Section 5701(b) of the Internal Revenue Code of 1954 provides seven taxable classes for large cigars (cigars weighing more than 3 pounds per thousand) and requires that, in determining the retail price for tax purposes, regard shall be had to the ordinary retail price of a single cigar in its principal market.

Under the provisions of section 5701(b) of the Code and section 270.61 of the regulations relating to cigars and cigarettes (Manufacturers, Importers, and Dealers), a manufacturer or importer must taxpay all cigars of the same brand, shape, and size at the same rate upon removal for taxable purposes. No exception is made for cigars removed as samples. Accordingly, cigars delivered by a manufacturer or importer to his salesmen for free distribution as samples to prospective purchasers must be taxpaid at the same tax rate as identical cigars when removed for sale.

Rev. Rul. 55-698

A state, city, or municipal tax levied on the wholesale or manufacturer's sale price of large cigars must be included in the ordinary retail price thereof, for Federal tax purposes, if their principal market is in a locality imposing such tax. A state, city, or municipal tax levied on the retail sale price of large cigars would not be included in the ordinary retail price of such cigars for Federal tax purposes.

Advice has been requested whether the increase in the retail sales price on tobacco products as a result of the enactment of Chapter 2, Article V, Section 2, Subdivision 1, of the Minnesota Extra Session Laws of 1955, effective July 1, 1955, will affect the "ordinary retail price" of large cigars for purposes of classifying such cigars to determine the applicable Federal excise tax rate.

The Minnesota statute imposes a tax at the rate of 15 percent of the wholesale sales price on all tobacco products, exclusive of cigarettes, manufactured or brought into Minnesota for sale therein.

Section 5701 of the Internal Revenue Code of 1954 imposes seven different rates of Federal taxes on large cigars (cigars weighing more than three pounds per thousand), based on their retail price, and provides that in determining the retail price of such cigars for tax purposes, regard shall be had to the ordinary retail price of a single cigar in its principal market. Revenue Ruling 55-20, C. B. 1955-1, 516, sets forth the basis or standard for determining the principal market for large cigars for Federal tax purposes.

The "ordinary retail price of a single cigar in its principal market" may fluctuate due to increases or decreases in local taxes which are imposed on the manufacture or wholesale distribution of large cigars. Such changes may result in a change in the classification of the cigars for Federal tax purposes if the change in price causes the cigars to fall into another tax bracket.

It is held that such a change in the price of cigars would not affect the Federal tax paid by manufacturers or importers on large cigars removed from the factory or released from customs *prior* to the effective date of the state, city, or municipal tax imposed on such cigars. However, for the purpose of determining the amount of Federal tax to be paid on large cigars, a state, city, or municipal tax levied on distributions and based on the wholesale or manufacturer's sales price of such articles, similar to that imposed by the State of Minnesota, must be included in ascertaining in the "ordinary retail price" of large cigars if their principal market is in a state or locality imposing such a tax. This situation would not prevail where the state, city, or municipal tax was levied on the *retail* sales price of the cigars.

SECTION 5702.—DEFINITIONS

Rev. Rul. 55-550

A retail dealer in tobacco products desires to extend his business to mixing blends of tobacco. *Held*, a retail dealer who removes tobacco from taxpaid packages and blends it for immediate delivery to waiting customers is not a manufacturer of tobacco under section 5702(b) of the Internal Revenue Code of 1954, and he is not required to pay tax on such tobacco. A retail dealer who removes tobacco from taxpaid packages for the purpose of blending tobacco for other than immediate delivery to waiting customers, or who holds the blended tobacco for future sale or delivery, is a manufacturer of tobacco as defined in section 5702 (b) and is required to give bond and qualify as such. He must also set up his factory, keep records, file inventories and returns, put up the blended product in proper packages, and pay tax on the blended tobacco by the purchase and affixture of the proper internal revenue stamps to the packages thereof.

SECTION 5703.—LIABILITY FOR TAX AND METHOD OF PAYMENT

26 CFR 270.194: Stamps for affixture in foreign countries. (Also 275.183.) Rev. Rul. 55-680

Section 270.194 of the Regulations relating to Cigars and Cigarettes (Manufacturers, Importers, and Dealers), and section 275.183 of the Regulations relating to Manufactured Tobacco (Manufacturers, Importers, and Dealers), provide that internal revenue stamps to denote payment of the tax on cigars, cigarettes, and manufactured tobacco produced in a foreign country and exported to the United States may be affixed to such products in the foreign country in which manufactured, provided the laws of such foreign country grant a like privilege in respect of the affixture of its revenue stamps in the United States to similar products manufactured in this country, and exported to such foreign country.

The foreign countries to which United States internal revenue tobacco products stamps may be shipped for affixture to tobacco products prior to exportation to the United States are as follows:

Algeria	Burma	Italy
Bermuda	Canada	Japan
British Guiana	Costa Rica	Mexico
British Honduras	Cuba*	Netherlands
British West Indies,	Denmark	Northern Ireland
Colonies of—	Dominican Republic	Philippine Islands
Bahamas	Egypt	Saudi Arabia
Barbados	England	Scotland
Jamaica	France	Union of South Africa
Leeward Islands	Haiti	Sweden
Tobago	Honduras	Switzerland
Trinidad	India	Turkey
Windward Islands	Indonesia	West Germany
	Iraq	
	Ireland	

*However, cigar stamps may not be forwarded to Cuba for affixture to cigars produced in that country for export to the United States, since that country does not permit its cigar stamps to be affixed to cigars in the United States before exportation to Cuba.

Inquiries in respect of this Revenue Ruling should refer to the number thereof and should be submitted to the Director, Alcohol and Tobacco Tax Division, marked for the attention of O:AT:T.

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26 CFR 275.183: Stamps for affixture in foreign countries.

The foreign countries to which United States internal revenue tobacco products stamps may be shipped for affixture to tobacco products prior to exportation to the United States are listed. See Rev. Rul. 55-680, page 475.

(Also Section 5752.) Rev. Rul. 55-722

The acquisition of new or unused tobacco products tax stamps or the possession of used tobacco products tax stamps as a collector's or philatelic item is contrary to the intent of the law and regulations governing the sale, issuance, and use of such stamps, and may not be permitted.

Advice has been requested whether internal revenue tobacco products tax stamps may be acquired by philatelists.

Section 5703(b) of the Internal Revenue Code of 1954 provides that stamps may be prescribed to evidence the tax or indicate compliance with chapter 52 of the Code relating to the tax on tobacco, cigars, cigarettes, and cigarette papers and tubes. Section 5752 thereof provides that no person shall (1) empty any package without destroying the stamp; (2) remove, or cause to be removed, any such stamp, or purchase, receive, possess, sell, or dispose of, by gift or otherwise, any such stamp which has been so removed; or (3) purchase, receive, possess, sell, or dispose of, by gift or otherwise, any such package which has been emptied, upon which the stamp has not been destroyed.

Under the Regulations relating to Cigars and Cigarettes (Manufacturers, Importers, and Dealers) and the Regulations relating to

Manufactured Tobacco (Manufacturers, Importers, and Dealers), implementing the provisions of the Internal Revenue Code of 1954, such stamps are issued for sale solely to manufacturers and importers liable to pay Federal tax on tobacco products for the purpose of denoting payment of such tax. The regulations require that every package containing cigars, cigarettes, or manufactured tobacco must bear a warning reading "Law forbids the reuse of the Federal stamps hereon and requires the person who empties this package to destroy such stamps when the package is emptied."

In view of the above requirements of the law and regulations, no person may keep in his possession a tobacco products tax stamp which has been used to denote payment of tax on such products once the package has been emptied. Further, the acquisition of new or unused stamps as a collector's or philatelic item is contrary to the intent of the law and regulations governing the sale, issuance, and use of such stamps, and is not permitted.

SECTION 5704.—EXEMPTION FROM TAX

26 CFR 270.168: Exportation. Rev. Rul. 55-671
(Also section 275.157.)

> Tobacco products may be removed from factories and bonded internal revenue tobacco products warehouses, without payment of tax, for delivery to vessels or aircraft of the Armed Forces for subsequent delivery to radar islands for consumption by members of the Armed Forces of the United States.

Advice has been requested whether nontaxpaid tobacco products may be removed from domestic factories or bonded warehouses for delivery to radar islands built by the Armed Forces of the United States at sea off the coasts of the United States for consumption thereon by the Armed Forces personnel who man such islands. All supplies for such Armed Forces personnel will be delivered to the radar islands by vessels or aircraft of the Armed Forces of the United States.

Section 5704(b) of the Internal Revenue Code of 1954 provides, in part, that a manufacturer may remove articles produced by him, without payment of tax, for consumption beyond the jurisdiction of the internal revenue laws of the United States. Accordingly, tobacco products may be removed from factories and bonded internal revenue tobacco products warehouses, without payment of tax, for delivery to vessels or aircraft of the Armed Forces for subsequent delivery to radar islands, frequently referred to as "Texas Towers," for consumption of the products on such islands by members of the Armed Forces.

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26 CFR 275.157: Exportation.

Removal of tobacco products, tax-free, for delivery to radar islands for consumption by members of the Armed Forces. See Rev. Rul. 55-671, above.

26 CFR 295.53: Packages, and label or notice. Rev. Rul. 55-530

The Regulations covering the Removal of Tobacco Products and Cigarette Papers and Tubes, Without Payment of Tax, for Use of the United States, promulgated under the Internal Revenue Code of 1954, provide that tobacco products shall, before removal, without payment of tax, for use of the United States, be put up by the manufacturer in packages similar to those in which like products are removed for tax purposes. Every package shall bear a label or notice containing in legible letters the words "Tax-exempt. For use of the U. S. Not to be sold." The label or notice must be readily distinguishable from a tax stamp, or a label, notice, or stamp required to evidence tax. Every package of tobacco products shall, before removal, identify the manufacturer thereof by having legibly printed on the package, or on the label or notice required by section 295.53 of the regulations, either the name and location of the manufacturer, or his permit number. These regulations supersede Regulations 8 which required a caution notice and factory brand, and also tax-exempt labels or stickers bearing, in legible letters, the words "Free of tax—Use of U. S., Not to be Sold," on packages of nontaxpaid tobacco products removed for use of the United States. *Held*, since such notice, brand, and labels or stickers provide essential protection to the revenue, the continued use of present stocks of packages, labels, and stickers conforming to the prior regulations in removing tobacco products for use of the United States is authorized until such existing stocks are exhausted.

SECTION 5705.—REFUND OR ALLOWANCE OF TAX

(Also Sections 6511, 6805.) Rev. Rul. 55-708
(Also Part II, Sections 322, 3304, 3313;
Regulations 118, 39.322-7.)

Tobacco products tax stamps purchased prior to January 1, 1955, which are affixed to tobacco products withdrawn from the market or which are spoiled, destroyed, rendered useless, etc., are redeemable in accordance with the applicable provisions of the Internal Revenue Code of 1939; whereas such stamps purchased on or after January 1, 1955, are redeemable under the Internal Revenue Code of 1954.

Advice has been requested whether tobacco tax stamps purchased prior to January 1, 1955, are to be redeemed, or the value thereof refunded, under the provisions of the Internal Revenue Code of 1939 or the 1954 Code.

Section 2198 of the Internal Revenue Code of 1939 provides, with respect to stamps affixed to packages of tobacco products withdrawn from the market, that the stamps so used may be redeemed if claim is presented by the manufacturer or importer within three years after the year of issue, irrespective of the date of their purchase. It provides also that stamps of any issue shall not be sold until those of the previous year's issue have been disposed of or later than one year after the year of issue. Section 3304 of the 1939 Code provides that, except for stamps covered by section 2198, no claim for the redemption of, or allowance for, stamps shall be allowed unless presented within four years after the purchase of such stamps from the Government.

Under section 6805 of the 1954 Code, a claim for redemption must be presented within three years from the date of purchase of the stamps from the Government.

The question here involved relates to the periods of limitation on the filing of claims for redemption of stamps purchased under the Internal Revenue Code of 1939 where such claims are filed subsequent to the date of enactment of the 1954 Code, and it is equally applicable in the case of claims for refund of taxes incurred or paid under the 1939 Code but which were filed subsequent to enactment of the 1954 Code.

It is held that the provisions of sections 5705, 6511, and 6805 of the 1954 Code, with respect to limitations, apply only to taxes imposed by such Code and that the provisions of the 1939 Code relating to limitations continue to apply with respect to taxes imposed, or stamps issued, under the 1939 Code. Accordingly, tobacco products tax stamps purchased prior to January 1, 1955, which are affixed to tobacco products withdrawn from the market, are redeemable in accordance with the provisions of section 2198 of the Internal Revenue Code of 1939. Similar stamps purchased prior to January 1, 1955, which are spoiled, destroyed, or rendered useless or unfit for the purpose intended, or for which the owner may have no use, or which through mistake may have been improperly or unnecessarily used, etc., are redeemable under the provisions of section 3304 of the 1939 Code. Tobacco products tax stamps purchased on or after January 1, 1955, the effective date of the 1954 Code with respect to tobacco taxes, are redeemable in accordance with the provisions of that Code.

To further illustrate, the provisions of section 322 of the 1939 Code would apply to a claim for refund of income tax for the calendar year 1952, whether such claim is filed before or after the date of the enactment of the 1954 Code, and the four-year period of limitations provided by section 3313 of the 1939 Code for the filing of claims for refund of excise taxes will apply to a claim for refund with respect to a return of manufacturers' excise taxes filed for the fourth quarter of 1954 (the tax for such period being imposed by the 1939 Code), even though the return for such quarter is not due until January 1955.

SUBCHAPTER C.—OPERATIONS BY MANUFACTURERS OF ARTICLES

SECTION 5723.—PACKAGES, LABELS, NOTICES, AND STAMPS

26 CFR 270.144: Packages. Rev. Rul. 55-589
(Also 275.134.)

> Existing stocks of approved packages, wraps, and labels for cigars, cigarettes, and manufactured tobacco, withdrawn from the factory taxpaid, conforming to the requirements of Regulations 8, superseded in so far as they relate to these products, may continue to be used until exhausted.

The Internal Revenue Service has recently considered the problem of providing for the disposition of existing stocks of packages and other packing materials used under previous regulations in putting up cigars, cigarettes, and manufactured tobacco.

The Regulations Relating to Manufacturers, Importers, and Dealers in Cigars and Cigarettes, effective June 25, 1955, supersede Regulations 8 in so far as they relate to cigars and cigarettes. The new regulations provide that every package of cigars and cigarettes subject to tax shall, before removal from the factory, have legibly printed thereon, or on a label securely affixed thereto, a mark consisting of the name and location of the manufacturer, or his permit number, and a warning that the law forbids the reuse of the Federal stamps thereon, and requires the person who empties the package to destroy such stamps when the package is emptied. It further provides that packages of large cigars subject to tax shall, before removal, have imprinted thereon, or on a label securely affixed thereto, a class designation, for tax purposes, appropriate to the cigars contained in the package.

Similarly, the Regulations Relating to Manufacturers, Importers, and Dealers in Manufactured Tobacco, effective July 19, 1955, supersede Regulations 8 in so far as they relate to manufactured tobacco. Under the provisions thereof, every package of manufactured tobacco subject to tax shall, before removal from the factory, have legibly imprinted thereon, or on a label securely affixed thereto, a mark consisting of the name and location of the manufacturer, or his permit number, and a warning that the law forbids the reuse of the Federal stamps thereon, and also requires the person who empties the package to destroy such stamps when the package is emptied.

Since the wording of the caution notice, factory brand, and classification clause previously required fill the purpose of the mark (and class designation in the case of packages of large cigars) required in the new regulations, existing stocks of packages, wraps, or labels approved under the superseded regulations may continue to be used for cigars, cigarettes, and manufactured tobacco until such stocks are exhausted. For similar authorization with respect to tobacco products withdrawn free of tax for the use of the United States, see Revenue Ruling 55–530, page — of this Bulletin.

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26 CFR 275.134: Packages.

For continued use of existing stocks of packages and other packing materials authorized under superseded Regulations 8 for manufactured tobacco removed from the factory taxpaid, see Rev. Rul. 55–589, page 479.

SUBCHAPTER F.—GENERAL PROVISIONS

SECTION 5752.—RESTRICTIONS RELATING TO USED LABELS, STAMPS, AND PACKAGES

Acquisition of tobacco tax stamps by philatelists. See Rev. Rul. 55–722, page 476.

CHAPTER 53.—MACHINE GUNS AND CERTAIN OTHER FIREARMS

SUBCHAPTER A.—TAXES

PART II.—TRANSFER TAX

SECTION 5811.—TAX

(Also Section 5848.) Rev. Rul. 55-570

A gunsmith desires to affix a sleeve-type muzzle brake to the muzzle end of a short barreled rifle (a firearm within the purview of the National Firearms Act) in order to lengthen the barrel of the weapon to 18 inches or more, thereby removing it from the classification of a firearm as defined in section 5848 of the Internal Revenue Code of 1954. *Held*, after proper registration of a short barreled rifle, the barrel may be lengthened to 18 inches (or more) by the attachment of an extension, such as a muzzle brake or barrel band, by silver soldering or by other *permanent* means. After the barrel has been lengthened by approved means, subsequent transfer thereof may be effected without incurring liability for the transfer tax imposed under section 5811 of the Internal Revenue Code of 1954.

SUBCHAPTER B.—GENERAL PROVISIONS

SECTION 5848.—DEFINITIONS

26 CFR 179.20: Firearms. Rev. Rul. 55-699
(Also Part II, Federal Firearms Act, Section 1.)

The Internal Revenue Service has had the occasion to examine a burglar alarm device which consists of a metal cylinder 3⅞ inches in length, hinged in the middle so that it can be opened to chamber a 20-gauge shotgun shell after the portion of the shell containing the lead charge has been cut off. A rim inside the barrel prevents a full length shell from being inserted. On one side of the alarm is a wood screw which is a permanent part of the device and is used for attaching the device to a door or window frame. At the end opposite the muzzle is a lever which releases the firing pin when the door or window is opened. *Held*, the above-described device is not a firearm within the purview of the National Firearms Act (Chapter 53 of the Internal Revenue Code of 1954) or of the Federal Firearms Act, 15 U. S. C. 901–909, since it is chambered to accommodate a shell of 20 gauge diameter consisting only of primer, powder, and the necessary wadding to retain the powder charge, and is not capable of firing a shot or projectile by the action of an explosive.

REGULATIONS 88, SECTION 319.12: Firearm. Rev. Rul.55-528

Pursuant to consideration and evaluation of available data respecting Gatling guns, the Internal Revenue Service has concluded that such guns fall within two classifications, as follows:

1. Any crank-operated gear-driven Gatling gun (produced under 1862 to 1893 patents) employing a cam action to perform the functions of repeatedly cocking and firing the weapon, as well as any such gun actuated by an electric motor in lieu of a hand-operated crank (produced under 1893 and later patents), while being a forerunner of fully automatic machine guns, is not designed to shoot automatically or semiautomatically more than one shot with a single function of the trigger. Such weapons are held *not* to be firearms within the purview of the National Firearms Act (Chapter 53 of the Internal Revenue Code of 1954).

2. Any Gatling gun designed or redesigned to employ the hand crank only to sear off the first round of ammunition, thence becoming a gas-operated fully automatic machine gun (adapter patented in 1895) is held to be a firearm within the purview of the National Firearms Act, specifically, section 5848(2) of the Internal Revenue Code of 1954.

Rev. Rul. 55-529

A .38 caliber "pen" gun and a 20 gauge weapon ostensibly designed as tear gas devices, both described herein, are classified as firearms within the purview of the National Firearms Act (Chapter 53 of the Internal Revenue Code of 1954).

The Internal Revenue Service has had the occasion to examine two tear gas devices for the purpose of determining whether they are firearms within the purview of the National Firearms Act (Chapter 53 of the Internal Revenue Code of 1954).

Two devices ostensibly designed to expel a gas mist but chambered to accommodate fixed shotgun shells or pistol and revolver ammunition were examined and tested by the Internal Revenue Service. A description of each and the results of the tests are as follows:

A 20 gauge weapon, 6⅝ inches in overall length with barrel length with a 1⅝ inch tapered barrel and a slip bolt firing pin, bearing no manufacturer's or patent identification, was test fired using a caliber .38 special CF cartridge with 158 gr. lead bullet of standard make. It was found to perform satisfactorily. No structural damage to the device was evident as a result of the test.

A 20 gauge weapon, 6⅝ inches in overall length with barrel length of 2¾ inches and a slip bolt action encased in the handgrip, was test fired using a 20 gauge 2¼-⅞-8 Xpert shotgun shell of standard make. It also was found to perform satisfactorily and no structural damage to the device was evident as a result of the test. This weapon was accompanied by a removable 410 gauge steel insert chamber, 2⅞ inches in length, and was also test fired utilizing the supplemental chamber with a 410 gauge, 2½ inch superseded shotgun shell loaded with No. 4 shot of standard make. It was also found to perform satisfactorily with no structural damage to the device evidenced as a result of the test.

Since the devices are capable of being concealed on the person, they are held to be firearms as defined in sections 5848(1) and 5848(5) of the Internal Revenue Code of 1954.

(Also Part II, Federal Firearms Act, Section 1.) Rev. Rul. 55-569

A device ostensibly designed for submarine spear fishing, but capable of chambering and firing .22 caliber rimfire ammunition, is a firearm within the purview of the National Firearms Act. However, such device, if permanently attached to the speargun shaft by the manufacturer, would not be a firearm.

Advice has been requested whether the following described device, ostensibly designed for submarine spear fishing but capable of chambering and firing .22 caliber rimfire ammunition, is a firearm within the purview of the National Firearms Act and/or the Federal Firearms Act.

The device, referred to as a "powerhead," is approximately 12 inches in overall length and 5/8 inch in diameter. It employs a unique spring-actuated firing mechanism and an off-center .22 caliber chamber opening into a 3/8 inch barrel, 1 and 15/16 inches in length. The barrel must be removed to chamber a cartridge and the device is contact-fired by an outside trigger rod extending beyond the muzzle.

Examination of the powerhead and consideration of the brochures relating thereto results in the conclusion that it is a device from which a shot can be discharged by the action of an explosive and is capable of being concealed on the person. Accordingly, the powerhead, by itself, is a firearm within the purview of the National Firearms Act, specifically, sections 5848(1) and 5848(5) of the Internal Revenue Code of 1954. However, if the powerhead is permanently attached to the speargun shaft by the manufacturer, thereby increasing the overall length of the device to not less than four feet, the speargun with powerhead attached would not be a firearm within the purview of the National Firearms Act or the Federal Firearms Act.

Rev. Rul. 55-590

A firearm, as defined in section 5848 of the Internal Revenue Code of 1954, in the war trophy class which has been deactivated under the supervision of an investigator of the Alcohol and Tobacco Tax Division, is held to be in the category of a harmless ordnance curio not coming within the purview of the National Firearms Act (Chapter 53 of the Internal Revenue Code of 1954).

The Internal Revenue Service has recently established new procedures with respect to its war trophy firearms deactivation program, as described herein.

The war trophy firearms deactivation program was inaugurated in 1945 as a safety measure which would permit, under certain conditions, returning servicemen to retain war trophies and also afford the opportunity to effect the registration, and control of subsequent transfers, of deactivated firearms. Of the many thousands of war trophy firearms registered under this program, a large number were rendered unserviceable by steel welding the breech end of the barrel closed and steel welding the barrel to the frame. Such action, performed under

the supervision of alcohol and tobacco tax investigators, rendered the weapons harmless, did not destroy their trophy value, and permitted subsequent tax free transfer.

Heretofore, a deactivated war trophy firearm had been considered in the category of an "unserviceable" firearm requiring notification on Form 5 (Firearms) for each transfer. Such requirement necessitated a complete investigation in each instance where a deactivated trophy firearm was discovered in the possession of someone other than the registered owner. However, no useful purpose is served as a result of investigations conducted to determine the facts and circumstances under which a deactivated war trophy is transferred since no tax liability is incurred.

Under section 5821 of the Internal Revenue Code of 1954, a tax is levied upon the making of a firearm, whether by manufacture, putting together, alteration, any combination thereof, or otherwise. Thus, any person who restores a deactivated war trophy firearm to a firing condition incurs criminal and civil (tax) liabilities for violation of the National Firearms Act (Chapter 53 of the Internal Revenue Code of 1954).

It is now held that a war trophy firearm which has been registered and deactivated in the prescribed manner comes within the category of a harmless ordnance curio and, therefore, is not a firearm within the purview of the National Firearms Act for the reason that it is incapable of firing a shot. Accordingly, after a firearm has been transformed into a curio by the prescribed method of deactivation, under the supervision of an investigator of the Alcohol and Tobacco Tax Division, such article will be known as a "DEWAT" (coined from *DE*activated *WA*r *T*rophy).

If Government facilities are available to perform the deactivation, such will be rendered as a public service.

Any person possessing a contraband firearm who wishes to have such firearm transformed to a DEWAT should contact the nearest Alcohol and Tobacco Tax Office for the purpose of executing an application for registration on Form 1 (Firearms), in duplicate. After the deactivation is complete, the word "DEWAT" will be inserted in the space designated "kind of firearm," on the Form 1 (Firearms), immediately following the description of the firearm prior to deactivation. The notation "Removed from the classification of a firearm by steel welding in the prescribed manner on (date)" will be inserted in a conspicuous place on the application, together with the signature of the investigator supervising the deactivation. The duplicate copy of the Form 1 (Firearms) will subsequently be returned to the applicant.

Any person possessing a contraband firearm who prefers to have such firearm destroyed in lieu of transforming it into a DEWAT, or anyone desiring other information with respect to firearms, should contact the nearest Alcohol and Tobacco Tax Office.

Procedure for lengthening the barrel of a registered short barreled rifle and subsequent transfer of such weapon. See Rev. Rul. 55-570, page 481.

SUBTITLE F.—PROCEDURE AND ADMINISTRATION

CHAPTER 61.—INFORMATION AND RETURNS

SUBCHAPTER A.—RETURNS AND RECORDS

PART I.—RECORDS, STATEMENTS, AND SPECIAL RETURNS

SECTION 6001.—NOTICE OF REGULATIONS REQUIRING RECORDS, STATEMENTS, AND SPECIAL RETURNS

(Also Sections 6018, 6019.) Rev. Rul. 55-573

Certain Federal tax return forms and schedules may be reproduced and used for filing purposes, in lieu of the applicable official forms, subject, however, to prescribed conditions and requirements. Rev. Rul. 54-64, C. B. 1954-1, 82, superseded.

The purpose of this Revenue Ruling is to restate the policy of the Internal Revenue Service relating to acceptance of reproductions of Federal tax return forms and schedules, for filing purposes, in lieu of the official forms and schedules printed by the Government Printing Office and to supersede Revenue Ruling 54-64, C. B. 1954-1, 82.

Subject to the conditions and requirements described below, the Service will accept, for filing purposes, reproductions of any of the following forms and schedules:

U. S. Estate Tax Return, Form 706.
U. S. Gift Tax Return, Form 709.
Gift Tax: Donee's or Trustee's Information Return of Gifts, Form 710.
Life Insurance Statement, Form 712.
Claim, Form 843.
Continuation Sheet for Forms 941, 941VI, or 943—Report Of Wages Taxable Under The Federal Insurance Contributions Act, Form 941a.
U. S. Exempt Cooperative Association Income Tax Return, Form 990-C.
U. S. Return of Employees' Trust Described in Section 401(a) And Exempt Under Section 501(a) Of The Internal Revenue Code of 1954, Form 990-P.
U. S. Individual Income Tax Return, Form 1040.
Profit (or Loss) from Business or Profession, Schedule C (Form 1040).
Gains and Losses from Sales or Exchanges of Property, Schedule D (Form 1040).
U. S. Departing Alien Income Tax Return, Form 1040C.
Declaration of Estimated Tax, Form 1040-ES.
Schedule of Farm Income and Expenses, Schedule F (Form 1040).
U. S. Fiduciary Income Tax Return, Form 1041.
U. S. Partnership Return of Income, Form 1065.
Statement in Support of Credit Claimed by Domestic Corporation for Taxes Paid or Accrued to a Foreign Country or a Possession of the United States, Form 1118.
U. S. Corporation Income Tax Return, Form 1120.
Schedule of Gains and Losses from Sales or Exchanges of Property, Schedule D (Form 1120).
Computation of U. S. Corporation Excess Profits Tax, Schedule EP (Form 1120).
Return of Information and Authorization and Consent of Subsidiary Corporation Included in a United States Consolidated Income Tax Return, Form 1122.
Statement for the Purpose of Extending Time for Payment of Taxes By Corporations Expecting Carry-Backs, Form 1138.
Application for Tentative Carry-Back Adjustment, Form 1139.

In order to be acceptable for filing purposes, reproductions of such forms must meet the following conditions and requirements:

1. Reproductions must be facsimiles of the complete official form, produced by photo-offset, photoengraving, photocopying, or other similar reproduction process.

2. Reproductions must be on paper of substantially the same weight and texture, and of quality at least as good as that used in the official form.

3. Insofar as possible, reproductions must duplicate the colors of the official form. However, black and white reproductions will be accepted when color is not reasonably available.

4. Reproductions must have a high standard of legibility, both as to original form and as to filled-in matter. The Internal Revenue Service reserves the right to reject any reproductions with poor legibility, and to withdraw the benefits of this ruling from any process or individual which fails to meet these standards.

5. Reproductions must be of the same size as that of the official form, both as to the overall dimensions of the paper and the image reproduced thereon.

6. Reproduction of page 3 of Schedule C (Form 1040) must be on properly perforated paper of substantially the same weight and texture as that used in the official form.

The Internal Revenue Service does not undertake to approve or disapprove the specific equipment or process used in reproducing official forms, but requires only that the reproduced forms satisfy the stated conditions.

While it is preferred that both sides of the paper be used in making reproductions, resulting in the same page arrangement as that of the official form, the Service will not object if only one side of the paper is used, or if the reproduction has a different fold than that provided on the official form.

Reproductions of forms may be made after insertion of the tax-computations and other required information. However, all signatures on forms to be filed with the District of Internal Revenue must be original signatures, affixed subsequent to the reproduction process.

The Internal Revenue Service will, upon application, furnish black and white proofs to be used for intermediate photographic steps in reproducing forms requiring colored ink.

SUBPART A.—GENERAL REQUIREMENTS

PART II.—TAX RETURNS OR STATEMENTS

SECTION 6011.—GENERAL REQUIREMENT OF RETURN, STATEMENT, OR LIST

Rev. Rul. 55-755

The Internal Revenue Service will continue after 1955 to accept excise tax returns on Form 720, Quarterly Federal Excise Tax Return, even though all of the data required by the return have not been

furnished. The return will be acceptable if the taxpayer completes the information called for in items one through five and shows the amount of tax in column six of the appropriate schedule on the form. If the taxpayer omits other data, a statement is required to explain such omission. This is a continuation of the policy stated in Revenue Ruling 54–539, C. B. 1954–2, 403, and the Revenue Rulings cited therein. An appropriate announcement will be made prior to any termination of this policy or any change in the data called for in Form 720.

SUBPART B.—INCOME TAX RETURNS

SECTION 6013.—JOINT RETURNS OF INCOME TAX BY HUSBAND AND WIFE

Status of surviving spouse in Washington, California, and other community property states having similar community property laws. See Rev. Rul. 55–726, page 24.

SECTION 6015.—DECLARATION OF ESTIMATED INCOME TAX BY INDIVIDUALS

Estimated self-employment tax included in declaration of estimated income tax. See Rev. Rul. 55–521, below.

SECTION 6016.—DECLARATIONS OF ESTIMATED INCOME TAX BY CORPORATIONS

Procedure with respect to corporation declaration of estimated tax, Form 1120–ES. See Rev. Proc. 55–9, page 909.

SECTION 6017.—SELF-EMPLOYMENT TAX RETURNS

(Also Sections 3402, 6015, 6315; 26 CFR 301.6315–1.) Rev. Rul. 55–521

> Any self-employed individual may follow the pay-as-you-go plan for paying his self-employment tax by filing a declaration of estimated income tax in sufficient amount to include his estimated self-employment tax and paying the estimated taxes in installments as required.
>
> If a self-employed individual receives wages subject to income tax withholding he may also accomplish the current payment of his self-employment tax by entering into an agreement with his employer providing for additional withholding under the permissive provisions of section 3402(i) of the Internal Revenue Code of 1954.

The Internal Revenue Service has been requested to state whether a person who has elected social security coverage as a self-employed individual under the waiver provisions of section 1402(e) of the Self-Employment Contributions Act of 1954 (chapter 2, subtitle A, Internal Revenue Code of 1954) may pay his self-employment tax on a pay-as-you-go basis.

Section 6017 of the Code provides that every individual (other than a nonresident alien individual) having net earnings from self-employment of $400 or more for the taxable year shall make a return with respect to the self-employment tax imposed by chapter 2 of the Code. He is required to report his self-employment income on separate Schedule C of Form 1040, U. S. Individual Income Tax Return. However, taxes on self-employment income for social security purposes are not required to be included in computing an individual's estimated income taxes.

Section 6315 of the Code provides that payment of the estimated income tax, or any installment thereof, shall be considered payment on account of income taxes imposed by subtitle A, which subtitle includes chapter 2, *supra*.

Section 301.6315–1 of the regulations prescribed by Treasury Decision 6119, C. B. 1955–1, 145, holds that the aggregate amount of the payments on account of estimated income tax shall be entered upon the income tax return for the taxable year as payments to be applied against the tax shown on such return.

An individual is not prevented from filing Form 1040–ES, Declaration of Estimated Income Tax, and paying his Federal income tax currently even though he may not otherwise be required to file such a declaration. Since payments on account of estimated income tax are also considered as payments on self-employment tax, any individual may follow the pay-as-you-go plan for paying his self-employment tax by filing a declaration of estimated income tax in sufficient amount to include his estimated self-employment tax and paying the estimated taxes in installments as required in the particular case.

This Revenue Ruling extends the provisions of law relating to declarations and installment payments of estimated income tax to self-employed persons who have elected social security coverage under the waiver procedure (certain ministers, members of religious orders who have not taken vows of poverty, and Christian Science practitioners). If such a person receives wages from an employer with respect to some other activity and such wages are subject to the withholding of income tax, he may accomplish the current payment of his self-employment tax by entering into agreement with that employer whereby additional amounts of tax may be withheld from his wages under the permissive provisions of sections 3402(i) of the Code; in fact, those provisions may be availed of by any self-employed person working for an employer and receiving wages subject to the withholding of income tax.

SUBPART C.—ESTATE AND GIFT TAX RETURNS

SECTION 6018.—ESTATE TAX RETURNS

New rules for reproducing Federal tax returns and schedules for filing purposes. See Rev. Rul. 55–573, page 485.

SECTION 6019.—GIFT TAX RETURNS

New rules for reproducing Federal tax returns and schedules for filing purposes. See Rev. Rul. 55–573, page 485.

PART III.—INFORMATION RETURNS

SUBPART B.—INFORMATION CONCERNING TRANSACTIONS WITH OTHER PERSONS

SECTION 6041.—INFORMATION AT SOURCE

Rev. Rul. 55-522

A life insurance company sells its insurance policies through an agency system. The actual sales are made by soliciting agents, who are under contract to general agents. The general agents, in turn, are under contract to the company. When a premium is collected, the soliciting agent retains therefrom the commission provided for in his contract and transmits the remainder to the general agent for remittance to the company. Both the soliciting agents and general agents are independent contractors under the common law rules. *Held*, under such circumstances, the general agents are the actual payors of the commission. Therefore, the general agents (not the insurance company) must, under the provisions of section 6041(a) of the Internal Revenue Code of 1954, report commissions totalling $600 or more paid to any of their soliciting agents on the information return, Form 1099, and file the U. S. Annual Information Return, Form 1096, summarizing the payments so reported on the Forms 1099. The general agent must file such forms with respect to all soliciting agents who are under contract to him and who receive $600 or more annually even though some of the independent contractor solicitors may be full-time life insurance agents, and as such, statutory employees under section 3121(d)(3)(B) of the Federal Insurance Contributions Act (chapter 21, subtitle C, Internal Revenue Code of 1954). See the last sentence of G. C. M. 11115, C. B. XI-2, 122 (1932). The commissions retained by the soliciting agents are, in effect, commissions paid to them by the general agents.

Rev. Rul. 55-606

A so-called partnership consisting of officers of a bank was organized for the sole purpose of accepting and holding legal title to personal property, including stocks, bonds, notes and other securities, as nominee or agent of the bank. Under the terms of the agreement, the partnership has no capital, income, expenses or any beneficial interest in any of the personal property or securities held by it as nominee, nor does the partnership or any member thereof receive any compensation for their services. *Held*, a so-called partnership formed under such circumstances for the purpose of acting solely in the capacity of a nominee or agent is not required to file a partnership return. However, such nominee or agent is required to file an information return under the provisions of section 6041 of the Internal Revenue Code of 1954 disclosing the actual owners of the income received from the personal property held by it as nominee or agent, unless the bank in a fiduciary capacity is required to file a fiduciary return. Pending the promulgation of further instructions, Form 1087, Ownership Certificate-Dividends on Stock, will continue to be used to file information

returns disclosing the actual owners of income as set forth in section 39.147–8 of Regulations 118, made applicable under the 1954 Code by T. D. 6091, C. B. 1954–2, 47.

SUBPART C.—INFORMATION REGARDING WAGES PAID EMPLOYEES

PART VI.—EXTENSION OF TIME FOR FILING RETURNS

SECTION 6081.—EXTENSION OF TIME FOR FILING RETURNS

Filing of Form 7004, Application for Automatic Extension of Time to File U. S. Corporation Income Tax Return, in the case of an affiliated group. See Rev. Rul. 55–560, page 379.

Extension of time granted life insurance companies to file declarations of estimated tax and to pay the tax due thereon. See Rev. Proc. 55–3, page 899.

SUBCHAPTER B.—MISCELLANEOUS PROVISIONS

SECTION 6102.—COMPUTATIONS ON RETURNS OR OTHER DOCUMENTS

26 CFR 301.6102–1: Computations on returns or other documents. T. D. 6142 [1]

TITLE 26—INTERNAL REVENUE 1954.—CHAPTER I, SUBCHAPTER F, PART 301.—PROCEDURE AND ADMINISTRATION

Regulations under section 6102 of the Internal Revenue Code of 1954, relating to the use of whole dollar amounts on internal revenue forms.

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

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

The following regulations applicable with respect to the taxes imposed by the Internal Revenue Code of 1954 are hereby prescribed under section 6102 of such Code:

SEC. 301.6102. STATUTORY PROVISIONS; COMPUTATIONS ON RETURNS OR OTHER DOCUMENTS.

SEC. 6102. COMPUTATIONS ON RETURNS OR OTHER DOCUMENTS.—

(a) AMOUNTS SHOWN ON INTERNAL REVENUE FORMS.—The Secretary or his delegate is authorized to provide with respect to any amount required to be shown on a form prescribed for any internal revenue

[1] 20 F.R. 6527.

return, statement, or other document, that if such amount of such item is other than a whole-dollar amount, either—

(1) the fractional part of a dollar shall be disregarded; or

(2) the fractional part of a dollar shall be disregarded unless it amounts to one-half dollar or more, in which case the amount (determined without regard to the fractional part of a dollar) shall be increased by $1.

(b) ELECTION NOT TO USE WHOLE DOLLAR AMOUNTS.—Any person making a return, statement, or other document shall be allowed, under regulations prescribed by the Secretary or his delegate, to make such return, statement, or other document without regard to subsection (a).

(c) INAPPLICABILITY TO COMPUTATION OF AMOUNT.—The provisions subsections (a) and (b) shall not be applicable to items which must be taken into account in making the computations necessary to determine the amount required to be shown on a form, but shall be applicable only to such final amount.

SEC. 301.6102-1. COMPUTATIONS ON RETURNS OR OTHER DOCUMENTS.—(a) *Amounts shown on forms.*—To the extent permitted by any internal revenue form or instructions prescribed for use with respect to any internal revenue return, declaration, statement, other document, or supporting schedules, any amount required to be reported on such form shall be entered at the nearest whole dollar amount. The extent to which, and the conditions under which, such whole dollar amounts shall be entered on any form will be set forth in the instructions issued with respect to such form. For the purpose of the computation to the nearest dollar, a fractional part of a dollar shall be disregarded unless it amounts to one-half dollar or more, in which case the amount (determined without regard to the fractional part of a dollar) shall be increased by $1. The following illustrates the application of this rule:

Exact amount	*To be reported as*
$18.49	$18
18.50	19
18.51	19

(b) *Election not to use whole dollar amounts.*—(1) *Method of election.*—Where any internal revenue form, or the instructions issued with respect to such form, provide that whole dollar amounts shall be reported, any person making a return, declaration, statement, or other document on such form may elect not to use whole dollar amounts by reporting thereon all amounts in full, including cents.

(2) *Time of election.*—The election not to use whole dollar amounts must be made at the time of filing the return, declaration, statement, or other document. Such election may not be revoked after the time prescribed for filing such return, declaration, statement, or other document, including extensions of time granted for such filing. Such election may be made on any return, declaration, statement, or other document which is filed after the time prescribed for filing (including extensions of time), and such an election is irrevocable.

(3) *Effect of election.*—The taxpayer's election shall be binding only on the return, declaration, statement, or other document filed for a taxable year or period, and a new election may be made on the return, declaration, statement, or other document filed for a subsequent taxable year or period. An election by either a husband or a wife not to report whole dollar amounts on a separate income tax return shall be binding on any subsequent joint return filed under the provisions of section 6013(b).

(4) *Fractional part of a cent.*—For treatment of the fractional part of a cent in the payment of taxes, see section 6313 and the regulations thereunder.

(c) *Inapplicability to computation of amount.*—The provisions of paragraph (a) of this section apply only to amounts required to be reported on a return, declaration, statement, or other document. They do not apply to items which must be taken into account in making the computations necessary to determine such amounts. For example, each item of receipt must be taken into account at its exact amount, including cents, in computing the amount of total receipts required to be reported on an income tax return or supporting schedule. It is the amount of total receipts, so computed, which is to be reported at the nearest whole dollar on the return or supporting schedule.

(d) *Effect on accounting method.*—Section 6102 and this section have no effect on any authorized accounting method.

Because the provisions of this Treasury Decision are of a liberalizing character, it is found that it is unnecessary to issue such Treasury Decision with notice and public procedure thereon under section 4(a) of the Administrative Procedure Act, approved June 11, 1946, or subject to the effective date limitation of section 4(c) of that Act.

(This Treasury Decision is issued under the authority contained in sections 6102 and 7805 of the Internal Revenue Code of 1954 (68A Stat. 753, 917; 26 U. S. C. 6102, 7805).)

PAUL K. WEBSTER,
Acting Commissioner of Internal Revenue.

Approved August 29, 1955.

A. N. OVERBY,
Acting Secretary of the Treasury.

(Filed by the Division of the Federal Register September 2, 1955, 8:48 a. m.)

SECTION 6103.—PUBLICITY OF RETURNS AND LISTS OF TAXPAYERS

26 CFR 301.6103(a)-101: Inspection of returns by committees of Congress other than those enumerated in section 6103(d) of the Internal Revenue Code of 1954. E. O. 10620
(Also Part II, Section 55.)

Inspection of income, excess-profits, declared value excess-profits, capital stock, estate, and gift tax returns by the Senate Committee on the Judiciary.

By virtue of the authority vested in me by sections 55(a), 508, 603, 729(a), and 1204 of the Internal Revenue Code of 1939 (53 Stat. 29, 111, 171; 54 Stat. 989, 1008; 55 Stat. 722; 26 U. S. C. 55(a), 508, 603, 729(a), and 1204), and by section 6103(a) of the Internal Revenue Code of 1954 (68a Stat. 753; 26 U. S. C. 6103(a)), it is hereby ordered that any income, excess-profits, declared value excess-profits, capital

stock, estate, or gift tax return for any period to and including 1954, shall, during the Eighty-fourth Congress, be open to inspection by the Senate Committee on the Judiciary, or any duly authorized subcommittee thereof, for the purpose of carrying out those provisions of Senate Resolution 62 (84th Cong., 1st sess.), agreed to March 18, 1955, authorizing a full and complete study of the extent and character of juvenile delinquency in the United States and its causes and contributing factors, such inspection to be in accordance and upon compliance with the rules and regulations prescribed by the Secretary of the Treasury in Treasury Decisions 6132 [C. B. 1955–1, 142] and 6133 [C. B. 1955–1, 335], relating to the inspection of returns by committees of the Congress, approved by me May 3, 1955.

This order shall be effective upon its filing for publication in the Federal Register.

DWIGHT D. EISENHOWER.

THE WHITE HOUSE,
July 1, 1955.

(Filed by the Division of the Federal Register July 1, 1955, 3:19 p. m.)

(Also Part II, Section 55.) E. O. 10627

Inspection of income, excess-profits, declared-value excess-profits, capital-stock, estate, and gift tax returns by the Committee on Un-American Activities, House of Representatives.

By virtue of the authority vested in me by sections 55(a), 508, 603, 729(a), and 1204 of the Internal Revenue Code of 1939 (53 Stat. 29, 111, 171; 54 Stat. 989, 1008; 55 Stat. 722; 26 U. S. C. 55(a), 508, 603, 729(a), and 1204), and by section 6103(a) of the Internal Revenue Code of 1954 (68A Stat. 753; 26 U. S. C. 6103(a)), it is hereby ordered that any income, excess-profits, declared-value excess-profits, capital-stock, estate, or gift tax return for any period to and including 1955, shall, during the Eighty-fourth Congress, be open to inspection by the Committee on Un-American Activities, House of Representatives, or any duly authorized subcommittee thereof, for the purpose of carrying on those investigations authorized by clause 17 of Rule XI of the Rules of the House of Representatives, agreed to January 5, 1955, such inspection to be in accordance and upon compliance with the rules and regulations prescribed by the Secretary of the Treasury in Treasury Decisions 6132 [C. B. 1955–1, 142] and 6133 [C. B. 1955–1, 335], relating to the inspection of returns by committees of the Congress, approved by me May 3, 1955.

This order shall be effective upon its filing for publication in the Federal Register.

DWIGHT D. EISENHOWER.

THE WHITE HOUSE,
August 5, 1955.

(Filed by the Division of the Federal Register August 8, 1955, 12:53 p. m.)

26 CFR 301.6103(a)-100: Inspection by Department of Health, Education, and Welfare of individual income tax returns made under the Internal Revenue Code of 1954. T. D. 6135[1]

TITLE 26—INTERNAL REVENUE, 1954.—CHAPTER I, SUBCHAPTER F, PART 301.—PROCEDURE AND ADMINISTRATION

Inspection by Department of Health, Education, and Welfare of individual income tax returns made under the Internal Revenue Code of 1954.

TREASURY DEPARTMENT,
Washington 25, D. C.

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

SEC. 301.6103(a)-100. INSPECTION BY DEPARTMENT OF HEALTH, EDUCATION, AND WELFARE OF INDIVIDUAL INCOME TAX RETURNS MADE UNDER THE INTERNAL REVENUE CODE OF 1954.—(*a*) Pursuant to the provisions of section 6103(a) of the Internal Revenue Code of 1954 (68A Stat. 753; 26 U. S. C. 6103(a)) and of the Executive order issued thereunder, and in the interest of the internal management of the Government, any individual income tax return made in respect of a tax imposed under chapter 1 or chapter 2 of such Code shall be open to inspection by the Department of Health, Education, and Welfare as may be needed in its administration of the provisions of title II of the Social Security Act, as amended. Upon request, the inspection of an individual income tax return may be made by any officer or employee of the Department of Health, Education, and Welfare duly authorized by the Secretary of such Department to make such inspection. The request to inspect an income tax return or returns of a particular individual shall be made, in writing, by the Secretary or any duly authorized officer or employee of the Department of Health, Education, and Welfare to the Commissioner of Internal Revenue or to any officer or employee of the Internal Revenue Service designated by the Commissioner. The written request shall be in such form and manner as may be prescribed by the Commissioner of Internal Revenue. Upon receipt of such a request, any officer or employee of the Internal Revenue Service duly authorized by the Commissioner of Internal Revenue may make the individual income tax return or returns available for inspection by any duly authorized officer or employee of the Department of Health, Education, and Welfare or may furnish such Department with a copy of the return or with any data on such return. Any information thus obtained shall be held confidential, except to the extent necessary to effectuate the purposes for which the returns are open to inspection.

(*b*) This Treasury Decision shall be effective upon its filing for publication in the Federal Register.

G. M. HUMPHREY,
Secretary of the Treasury.

Approved June 29, 1955.

DWIGHT D. EISENHOWER,
The White House.

(Filed by the Division of the Federal Register June 29, 1955, 5:07 p. m.)

[1] 20 F.R. 4685.

(Also Part II, Section 55.) E. O. 10619

Inspection of individual income tax returns by Department of Health, Education, and Welfare

By virtue of the authority vested in me by section 55(a) of the Internal Revenue Code of 1939 (53 Stat. 29; 54 Stat. 1008; 55 Stat. 722; 26. U. S. C. 55(a)) and by section 6103(a) of the Internal Revenue Code of 1954 (68A Stat. 753; 26 U. S. C. 6103(a)), and in the interest of the internal management of the Government, it is hereby ordered that any individual income tax return made in respect of a tax imposed under chapter 1 of the Internal Revenue Code of 1939 or under chapter 1 or 2 of the Internal Revenue Code of 1954 shall be open to inspection by the Department of Health, Education, and Welfare as may be needed in its administration of the provisions of title II of the Social Security Act, as amended. The inspection of any such individual income tax return shall be in accordance and upon compliance with the rules and regulations prescribed by the Secretary of the Treasury in the Treasury Decisions relating to the inspection of individual income tax returns by the Department of Health, Education, and Welfare, approved by me this date.

This Executive order shall be effective upon its filing for publication in the Federal Register.

DWIGHT D. EISENHOWER.

THE WHITE HOUSE
June 29, 1955.

(Filed by the Division of the Federal Register June 29, 1955, 5:07 p. m.)

CHAPTER 62.—TIME AND PLACE FOR PAYING TAX

SUBCHAPTER B.—EXTENSIONS OF TIME FOR PAYMENT

SECTION 6161.—EXTENSION OF TIME FOR PAYING TAX

Extension of time granted life insurance companies to file declarations of estimated tax and to pay the tax due thereon. See Rev. Proc. 55–3, page 899.

CHAPTER 64.—COLLECTION

SUBCHAPTER B.—RECEIPT OF PAYMENT

SECTION 6311.—PAYMENT BY CHECK OR MONEY ORDER

26 CFR 301.6311–1: Payment by check or money order.

Payment of internal revenue taxes or stamps by check or money order. See Rev. Proc. 55–7, page 905.

SECTION 6315.—PAYMENTS OF ESTIMATED INCOME TAX

26 CFR 301.6315-1: Payments of estimated income tax.

Payments on account of estimated income tax applies to self-employment tax. See Rev. Rul. 55–521, page 487.

SUBCHAPTER D.—SEIZURE OF PROPERTY FOR COLLECTION OF TAXES

SECTION 6331.—LEVY AND DISTRAINT

26 CFR 301.6331–1: Levy and distraint. Rev. Rul. 55–723

Section 6331(a) of the Internal Revenue Code of 1954, which authorizes levy to be made upon the accrued salary or wages of any officer, employee, etc., of the United States to effect collection of Federal taxes due by such individual, upon his failure to pay such taxes upon notice and demand, is applicable to members of the Armed Forces of the United States. See section 301.6331–1(4) of the income tax regulations applicable to section 6331(a), as prescribed by T. D. 6119, C. B. 1955–1, 282. It is, however, the opinion of the Internal Revenue Service that where the collection of income tax of a member of the Armed Forces of the United States has been deferred under section 513 of the Soldiers' and Sailors' Civil Relief Act of 1940, 54 Stat. 1190, 50 U. S. C. App. 573, C. B. 1940–2, 493, such deferment is not nullified or curtailed by the provisions of section 6331(a) of the Internal Revenue Code of 1954.

CHAPTER 65.—ABATEMENTS, CREDITS, AND REFUNDS

SUBCHAPTER A.—PROCEDURE IN GENERAL

SECTION 6407.—DATE OF ALLOWANCE OF REFUND OR CREDIT

26 CFR 301.6407–1: Date of allowance of refund or credit.

Computation of interest when overpayments of tax are credited to additional tax. See Rev. Rul. 55–485, page 499.

SUBCHAPTER B.—RULES OF SPECIAL APPLICATION

SECTION 6416.—CERTAIN TAXES ON SALES AND SERVICES

Credit or refund of manufacturers' excise tax paid on articles which are resold to a volunteer fire department or a volunteer rescue squad which performs a function ordinarily carried on by governmental units. See Rev. Rul. 55–545, page 458.

SECTION 6418.—SUGAR

Rev. Rul. 55-650

Section 6418 of the Internal Revenue Code of 1954 provides that when any manufactured sugar, or article manufactured therefrom, is exported, or is used as livestock feed or in the production of livestock feed, or is used for the distillation of alcohol, there shall be paid by the Secretary of the Treasury or his delegate to the person exporting or so using such manufactured sugar, or article manufactured therefrom, the amount of any tax paid under section 4501(a) of the Code with respect to the manufacture of the sugar. A payment made under this provision does not constitute a refund of tax erroneously, illegally, or otherwise wrongfully collected but is a payment dependent upon the performance of certain acts after the liability for the tax was legally incurred and paid by the manufacturer of the sugar. There is no authority in the law for the allowance of interest on such a payment.

Rev. Rul. 55-651

Section 6418(a) of the Internal Revenue Code of 1954 provides that upon the use of any manufactured sugar, or article manufactured therefrom, as livestock feed, or in the production of livestock feed, there shall be paid by the Secretary of the Treasury or his delegate to the person so using such manufactured sugar, or article manufactured therefrom, the amount of any tax paid under section 4501(a) of the Code with respect to the manufacture of the sugar. For purposes of this provision, cat or dog food is not classified as "livestock feed."

CHAPTER 66.—LIMITATIONS

SUBCHAPTER B.—LIMITATION ON CREDIT OR REFUND

SECTION 6511.—LIMITATIONS ON CREDIT OR REFUND

(Also Part II, Section 322; Regulations 118, Section 39.329-9.) Rev. Rul. 55-523

> Where a bad debt or loss on worthless securities is subsequently determined for a year in which a net operating loss was sustained, the effect of which is to increase the net operating loss, a claim for refund with respect to the carry-back of such bad debt or loss on worthless securities may be filed within seven years from the date prescribed by law for filing the return for the year of the net operating loss.

Advice has been requested whether a claim for refund, with respect to the carry-back of a bad debt or loss on worthless securities subsequently determined, the effect of which is to increase a net operating loss, may be filed within 7 years from the date prescribed by law for filing the return for the year of the net operating loss.

Where a taxpayer sustains a net operating loss for a taxable year, but does not file a claim for refund with respect to any overpayment of tax resulting from the carryback of such loss within the statutory

period prescribed in section 6511(d)(2)(A) of the Internal Revenue Code of 1954, no refund with respect thereto can be allowed. However, where an additional bad debt or loss on worthless securities is determined for such loss year, the effect of which is to increase the net operating loss, section 6511(d)(1) of the Code provides that a claim for refund may be filed with respect to such bad debt or loss on worthless securities within 7 years from the date prescribed by law for filing the return for the year of the net operating loss which results in such carryback. Section 39.322-9(a)(4) of Regulations 118 (applicable by virtue of T. D. 6091, C. B. 1954-2, 47) provides that any portion of the overpayment which is due to items described in such section (bad debts and worthless securities) shall be determined by treating the proper deduction of such items as the first adjustment to be made in computing such overpayment.

Accordingly, where a claim for refund is filed with respect to a bad debt or loss on worthless securities within such 7 year period, but subsequent to the expiration of the statutory period otherwise provided, the taxpayer is entitled to a refund of that portion of the taxes paid, for the year to which the revised net operating loss is carried back, which is attributable to the allowance of the additional bad debt or loss on worthless securities for the year in which the net operating loss arose notwithstanding the fact that the net operating loss carryback, computed without the additional deduction for bad debts or loss on worthless securities, was sufficient in amount to eliminate the net income for the taxable year to which it is carried.

For continued application of limitations on refunds and redemptions under the Internal Revenue Code of 1939. See Rev. Rul. 55-708, page 478.

CHAPTER 67.—INTEREST

SUBCHAPTER A.—INTEREST ON UNDERPAYMENTS

SECTION 6601.—INTEREST ON UNDERPAYMENT, NONPAYMENT, OR EXTENSIONS OF TIME FOR PAYMENT, OF TAX

Computation of interest when overpayments of tax are credited to additional tax. See Rev. Rul. 55-485, page 499.

SUBCHAPTER B.—INTEREST ON OVERPAYMENTS

SECTION 6611.—INTEREST ON OVERPAYMENTS

(Also Part II, Section 3771.) Rev. Rul. 55-477

There is no provision of law for the payment of interest on a tax refund for any period subsequent to the date of the refund check.

Accordingly, claims for additional interest, which are filed by taxpayers as a result of a delay in the delivery of their refund checks, will be rejected by the District Directors of Internal Revenue, *except* in cases where the refund check, because it was erroneously drawn, could not be negotiated upon receipt by the taxpayer. See *Annie J. Pugh et al.* v. *Ladner*, 52 Fed. Supp. 604. Generally, in the latter cases a new check is issued by the Regional Disbursing Officer, Division of Disbursement, United States Treasury. In this event interest is allowable to a date preceding the date of issuance of the new check by not more than 30 days. In some cases a check which could not be negotiated by the taxpayer has been referred to the General Accounting Office and returned to the taxpayer with a notation on the reverse side authorizing the taxpayer to negotiate the same check. This notation is dated and such date is considered the date of the check for interest purposes, since it is on this date that the check is first transmitted to the taxpayer in negotiable form. Accordingly, additional interest is allowable in such cases to a date preceding the date of the authorization by the General Accounting Office by not more than 30 days. See *M. J. Whittall Associates Ltd.* v. *United States*, 50 Fed. (2d) 307. Claims for additional interest on refunds should be filed on Form 843 with the District Director for the Internal Revenue District in which the return was filed.

(Also Sections 6407, 6601; 26 CFR 301.6407-1.) Rev. Rul. 55-485
(Also Part II, Sections 294(b), 3770, 3771.)

Interest on an overpayment of tax, to the extent that the overpayment is credited against a deficiency assessment, will be computed under section 6611(b)(1) of the 1954 Code to the date of the assessment.

On that portion of a deficiency assessment satisfied by the crediting of an overpayment, interest under section 6601(a) of the 1954 Code will be computed from the date of notice and demand to the date of the allowance of the credit, that is, to the date on which the schedule of overassessment is signed.

The purpose of this Revenue Ruling is to prescribe a change in policy as it relates to the allowance of interest under section 6611(b)(1) of the Internal Revenue Code of 1954 (section 3771 (b) (1) of the 1939 Code), and to provide for the assertion of interest under section 6601(a) of the 1954 Code (section 294(b) of the 1939 Code) to the date of allowance provided by section 6407 of the 1954 Code (section 3770 (a) (3) of the 1939 Code), in the case of liabilities satisfied by the crediting of overpayments. For purposes of brevity and clarity, all Code references made below will be to the 1954 Code unless otherwise noted.

Section 6601(a) of the Code provides that if any amount of tax imposed is not paid on or before the last date prescribed for payment, interest on such amount at the rate of 6 percent per annum shall be paid for the period from such last date to the date paid.

Section 6611(b)(1) of the Code relating to interest on overpayments of tax provides that in the case of a credit, interest shall be allowed

and paid from the date of the overpayment 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.

Section 6407 of the Code provides that the date on which the Secretary or his delegate first authorizes the scheduling of an overassessment in respect of any internal revenue tax shall be considered as the date of allowance of refund or credit in respect of such tax.

Heretofore, it has been the policy of the Internal Revenue Service to terminate the interest period on overpayments credited to a deficiency assessment on the date to which interest was charged on the deficiency, even though such date may have been prior to the date of the assessment. In turn, the interest provided by section 6601(a) has not been charged to the date of the allowance of the credit provided by section 6407 on the deficiency satisfied by the credit. These practices were simultaneously adopted on the theory that it was the intent of Congress that the payment and collection of interest should be equalized in the case of mutual indebtedness on the part of the Government and the taxpayer.

It has been held in several recent court decisions, including the cases of *Max Factor and Co.* v. *United States*, decided in the United States District Court for the Southern District of California on January 25, 1951, and *Pan American World Airways, Inc.* v. *United States*, 119 Fed. Supp. 144, that interest is allowable on overpayments of tax credited to deficiencies to the date of assessment of the deficiencies in compliance with the provisions of section 3771(b)(1) of the 1939 Code. In view of these decisions, the Internal Revenue Service has recommended that there be no further defense of cases involving the Internal Revenue Service's policy of terminating the interest period on overpayments credited to deficiency assesments on the date to which interest was charged on the deficiency. Consistent with this position, there is also no basis for the position that interest under section 6601(a) should not be asserted to the date of allowance provided by section 6407 in the case of liabilities satified by credit.

Accordingly it is held that interest on overpayments of tax, to the extent that they are credited against deficiency assessments, will be computed to the date of assessment in compliance with section 6611(b)(1). On that portion of a deficiency assessment satisfied by the crediting of an overpayment, interest provided by section 6601(a) will be computed from the date of notice and demand to the date of allowance of the credit, which is the date on which the schedule of overassessment is signed.

The provisions of this Revenue Ruling apply not only to cases being currently adjusted but will, upon request by the taxpayer, apply to cases previously adjusted. However, before any additional interest, computed to the date of assessment, is allowed, consideration will be given to the possibility of collecting or offsetting additional interest computed from the date of notice and demand to the date of allowance of the credit.

CHAPTER 69.—GENERAL PROVISIONS RELATING TO STAMPS

SECTION 6805.—REDEMPTION OF STAMPS

For continued application of limitations on refunds and redemptions under the Internal Revenue Code of 1939. See Rev. Rul. 55–708, page 478.

CHAPTER 70.—JEOPARDY, BANKRUPTCY AND RECEIVERSHIPS

SUBCHAPTER A.—JEOPARDY

PART I.—TERMINATION OF TAXABLE YEAR

SECTION 6851.—TERMINATION OF TAXABLE YEAR

Rev. Rul. 55–468

Procedures for the issuance of Certificates of Compliance to, and the clearance of, aliens departing from the United States, or any possession of the United States. Mimeograph No. 4633, C. B. 1937–2, 149, superseded.

SECTION 1. PURPOSE.

The purpose of this Revenue Ruling is to establish uniform procedures for the issuance of Certificates of Compliance to, and for the clearance of, aliens departing from the United States or any possession of the United States.

SEC. 2. AUTHORITY.

Section 6851(d) of the Internal Revenue Code of 1954 provides that no alien shall depart from the United States unless he first procures from the District Director of Internal Revenue a certificate that he has complied with all the obligations imposed upon him by the income tax laws.

SEC. 3. SCOPE.

The provisions of this Revenue Ruling, in general, apply to all aliens, both resident and nonresident, departing from the United States, or any possession thereof except as otherwise provided herein. The term "United States," as used in this Revenue Ruling, includes the States, the Territories of Alaska and Hawaii and the District of Columbia.

SEC. 4. FILING OF RETURN AND PAYMENT OF TAX.

.01 An alien, whether resident or nonresident, who intends to depart from the United States or any possession thereof, should procure

from the District Director for the district in which he or his representative is located a certificate that he has complied with all the obligations imposed upon him by the income tax laws. However, if necessary, a certificate may be obtained from the District Director in whose district the point of departure is located. An alien presenting himself at the point of departure without such a Certificate of Compliance will be examined by an Internal Revenue officer at that point, and such taxes as appear to be due and owing will be collected.

.02 The return or statement due from departing aliens should be filed on one of the three following forms:

Form 1040C, "U. S. Departing Alien Income Tax Return," by aliens whose taxable period has been terminated.

Form 1040D, "U. S. Departing Alien Income Tax Information Return," by aliens whose taxable period has not been terminated.

Form 2063, "U. S. Departing Alien Income Tax Statement," for nonresident aliens having no taxable income from United States sources for taxable period.

.03 An alien who is examined and found not to be liable for a return or for the payment of taxes previously assessed will be issued a Certificate of Compliance. Form 2063 (see attachment) will ordinarily be used to obtain this information.

.04 The Commissioner may, upon satisfactory evidence that a taxpayer intends to depart immediately from the United States, or any possession of the United States, declare the taxable period of such taxpayer immediately terminated and make demand for immediate payment of the tax for the taxable period declared terminated, and so much of the tax for the preceding years as is unpaid. Under the Internal Revenue Code of 1954, for taxable years beginning after December 31, 1953, the personal exemption should not be prorated in cases where the taxable year is terminated. Form 1040C will ordinarily be used for this return. See Rev. Rul. 54–428, C. B. 1954–2, 43.

.05 In the case of an alien who is not in default in making any return, or paying any income tax, the Commissioner may waive termination of the taxable period and the alien may procure a Certificate of Compliance by: (1) appointing in writing on Form 934 an attorney-in-fact, resident in the United States, to make his income tax return or returns; (2) making on Form 1040D, a return of information; and (3) either paying the estimated tax as shown on such information return or furnishing security approved by the District Director.

.06. As a general rule, departing aliens will not be permitted to file a joint return. However, if the District Director is reasonably satisfied that a resident alien and his spouse will be eligible to file a joint return at the normal close of their taxable period for which the return is made, he may permit the filing of a joint return if (1) the departing alien and his spouse are both required to file a return on Form 1040C for the period ending with the intended date of de-

parture, or (2) the departing alien is permitted to file a return on Form 1040D and the taxable year of his spouse is not terminated.

.07 The tax liability of the spouses making such a joint return is joint and several, and consequently the entire tax on such return should be paid or security therefor furnished prior to the issuance of a Certificate of Compliance. The spouse of the departing alien should sign the joint return or authorize the departing alien to affix such spouse's signature.

SEC. 5. REPRESENTATIVES OF FOREIGN GOVERNMENTS.

.01 Representatives of foreign governments bearing diplomatic passports, whether accredited to the United States or other countries, and members of their households, shall not be examined as to their income tax liability and shall be permitted to depart from the United States or any of its possessions without obtaining a Certificate of Compliance. If a foreign government does not issue diplomatic passports but merely indicates on passports issued to its diplomatic service the diplomatic status of the bearer in the service, such passports are considered as diplomatic passports for Federal income tax purposes.

.02 This courtesy is further extended to the servant of a foreign representative when he accompanies upon departure any person bearing a diplomatic passport. If the servant does not accompany such representative upon his departure from this country, the servant may obtain a Certificate of Compliance without an examination provided he furnishes a letter from the chief of the mission concerned certifying that no tax is due and that the name of the servant appears on the "White List," a list of employees of diplomatic missions. See Rev. Rul. 54–551, C. B. 1954–2, 234.

SEC. 6. FOREIGN NEWSPAPER CORRESPONDENTS AND RESIDENT ALIEN EMPLOYEES.

Certificates of Compliance may be issued to certain classes of aliens who are required to leave the United States or any possession of the United States from time to time, such as alien foreign newspaper correspondents, resident alien employees of domestic corporations and partnerships, and resident alien employees, owners, and partners of established domestic businesses or professional enterprises, without payment of the tax or appointment of an attorney-in-fact or posting of security, provided the District Director is satisfied that collection of the tax will not be jeopardized. In the case of a resident alien employee, a bona fide promise by his employer to pay the tax if the alien employee defaults may be considered as satisfactory evidence of collectibility. District Directors should consider the anticipated duration of absence from the United States, the due date of the income tax return, the payment of income tax or installment thereof already due, and the extent of the business interest of the taxpayer in the United States and its possessions. In such cases the alien should be required to submit a written statement of the facts warranting such treatment. This statement should be attached to the Form 1040C which he executes.

SEC. 7. ALIENS IN TRANSIT THROUGH THE UNITED STATES.

Aliens in transit through the United States or any of its possessions without stopover privileges, who solely because of transportation difficulties in making continuing connections are obliged to remain therein for a period not to exceed 5 days in any one trip, may depart without obtaining a Certificate of Compliance unless there is evidence available indicating taxable income. Aliens in transit between the continental United States and the Territory of Alaska or Hawaii without stopover privileges in a foreign country are not required to obtain Certificates of Compliance.

SEC. 8. ALIEN COMMUTERS.

Alien residents of Canada and Mexico who commute to the United States at frequent intervals for the purpose of employment and whose wages are subject to the withholding of tax will ordinarily not be required to obtain a Certificate of Compliance.

SEC. 9. CITIZENS OF THE UNITED STATES.

No citizen of the United States or citizen of a possession of the United States, whether resident or nonresident as to the United States, is required to secure a Certificate of Compliance before departing from the United States or its possessions.

SEC. 10. PERIOD DURING WHICH CERTIFICATE MAY BE ISSUED.

Certificates of Compliance may be issued within a period of 30 days prior to the alien's departure, provided the District Director is satisfied that all taxable income has been reported.

SEC. 11. PREPARATION OF RETURNS.

Departing aliens and their authorized representatives should not only be permitted but also encouraged to prepare returns on Forms 1040C and 1040D where, in the opinion of the District Director, they are qualified to do so. In such cases, it may or may not be necessary for departing aliens to appear in the District Director's Office, depending on the facts in each case.

SEC. 12. EFFECT ON OTHER DOCUMENTS.

.01. This Revenue Ruling supersedes Mimeograph No. 4633, C. B. 1937-2, 149.

.02 Any other internal management documents, the provisions of which are inconsistent or in conflict with the provisions of this Revenue Ruling are hereby amended or superseded accordingly.

Form **2063** (3-55)
U. S. TREASURY DEPARTMENT
INTERNAL REVENUE SERVICE

U. S. DEPARTING ALIEN INCOME TAX STATEMENT
For A Nonresident Alien
Having No Taxable Income From United States Sources
FOR TAXABLE PERIOD
beginning _____, 19__, and ending _____, 19__

Do not write in this space

Passport Number

Place of Departure

Mode of Transportation

Date of Departure

Country of Destination

Total Number of Persons

PLEASE TYPE OR PRINT PLAINLY

Name

Home Address (Street and number or rural route)

(Post office) (State or country)

Occupation

1. Of what country are you a
citizen or subject? _____
resident? _____

2. Date on which you last arrived in the United States

3. Purpose of entry into the U. S.

4. Principal address while in the U. S.

5. Did you receive (or do you expect to receive) any taxable income from U. S. sources during the period January 1st to the intended date of departure?
☐ Yes ☐ No

6. (a) Did you receive any taxable income from U. S. sources during the past three years?
☐ Yes ☐ No
(b) If "Yes," furnish the following information:

Year	Taxable Income	Tax Paid	Balance Due	District in Which Return Was Filed
19	$	$	$	
19				
19				

7. Are you liable for the filing of any tax returns or the payment of any taxes to the U. S. for any prior year, other than shown in 6(b) above? ☐ Yes ☐ No

DECLARATION

I declare under the penalties of perjury that the above statements have been examined by me and to the best of my knowledge and belief are true and correct.

(Signature of departing alien) (Date)

Certificate prepared and detached by: (Name and Title) (Date)

CERTIFICATE OF COMPLIANCE

District Director's Stamp

This certifies that _____ has satisfied all United States income tax obligations with respect to income received or to be received up to and including the intended date of departure, _____, 19__, determined to the extent practicable based on all information available to me at this date.

(District Director of Internal Revenue)

By _____
(Name and Title)

IMPORTANT: Please keep this Certificate with your Passport.

877501°—56——33

Rev. Rul. 55-661

Resident aliens who have substantial blocked income from foreign sources which they have deferred reporting under the provisions of Mimeograph 6475, C. B. 1950-1, 50, as amended, ordinarily will be required to furnish security for the amount of tax computed on the deferred blocked income upon departing from the United States. It is incumbent upon the District Director of Internal Revenue to require such security as will, in his opinion, adequately protect the interests of the United States Government.

Advice has been requested whether it is possible to permit the issuance of certificates of compliance to resident aliens departing from the United States without furnishing the security required under section 39.146-1(c) of Regulations 118, made applicable herein by Treasury Decision 6091, C. B. 1954-2, 47, in cases where such aliens are entitled to receive substantial amounts of blocked foreign income which they have chosen to defer reporting under the provisions of Mimeograph 6475, C. B. 1950-1, 50, as amended by Mimeograph 6494, C. B. 1950-1, 54, and Mimeograph 6584, C. B. 1951-1, 19.

Several citizens of a foreign country became residents of the United States. They are entitled to receive substantial foreign income from their native country and another country. Strict foreign exchange controls, however, prevent the transfer to the United States or the conversion into American dollars of such income. Therefore, they have duly filed returns setting forth their deferable income from foreign sources under the provisions of Mimeograph 6475, as amended, *supra*.

Each year these resident aliens find it of the utmost importance for them to visit their native country. Upon each departure, in order to defer payment of taxes, they have complied with the law and regulations requiring, among other things, the furnishing of approved security by depositing with the District Director of Internal Revenue an amount of marketable securities sufficient to insure collection by the United States Government of all taxes payable by them. See section 39.146-1(c) of Regulations 118. Upon each return to the United States, the securities have been returned to them by the District Director.

Prior to the most recent visit by the aliens to their native country, the Alien Tax Division of the District Director's Office agreed to accept security in an amount 10 percent in excess of the tax computed on the deferred income. However, as the total amount of the deferred income increases, it will reach a point where they will not be able to furnish liquid assets sufficient to comply with such a requirement.

Section 6851(d) of the Internal Revenue Code of 1954 provides that no alien shall depart from the United States unless he first procures a certificate that he has complied with all the obligations imposed upon him by the income tax laws.

Section 39.146-1(c) of Regulations 118 prescribes the procedure whereby an alien whose taxable year has not been terminated and who intends to depart from the United States may procure a certificate of compliance. The procedure includes the furnishing of adequate security for the making of required returns and payment of any taxes

that may become payable for the current taxable year, as well as any taxes for the preceding taxable year (if not previously paid).

Mimeograph 6475, *supra*, specifies that a resident alien may defer the reporting for taxation of his blocked income, in which case it will be included in gross income for the year in which it ceases to be deferable. Such blocked income ceases to be deferable and must be so included in gross income (1) if it becomes readily convertible, or is actually converted, into United States dollars or property readily convertible into such dollars, (2) if it is used for nondeductible personal expenses or disposed of by gift, bequest, devise or inheritance, or (3) if the resident alien taxpayer terminates his residence in the United States.

In general, the United States has no jurisdiction over an alien outside its territory, so that proper steps must be taken to insure the collection of tax on the deferred income of such an alien should the income cease to be deferable while he is outside the United States. Accordingly, it is held that it will be necessary for resident aliens, upon departing from the United States, to furnish security for the amount of tax which may become payable on the deferred blocked income during the period of the alien's absence from the United States. Since, however, the tax liability of the departing alien in relation to deferable income differs from the liabilities to which section 6851(d) ordinarily is otherwise applicable, in that such liability is contingent upon the deferable income ceasing to be deferable, a realistic application of the statutory requirement should be based upon reasonable probabilities as to the occurrence of events which would terminate the deferable character of the income in whole or in part during the alien's expected stay abroad. It is the function of the District Director of Internal Revenue to determine the amount of the security required adequately to protect the interest of the United States Government in such cases. However, before the Director may permit departure without requiring security for the full amount of tax payable on the deferred blocked income, he must ascertain with a reasonable degree of certainty that the alien is not terminating his residence in the United States. For a general discussion with respect to aliens departing from the United States or its possessions, see Revenue Ruling 55-468, page 501 of this Bulletin.

CHAPTER 78.—DISCOVERY OF LIABILITY AND ENFORCEMENT OF TITLE

SUBCHAPTER A.—EXAMINATION AND INSPECTION

SECTION 7602.—EXAMINATION OF BOOKS AND WITNESSES

Procedure for the use, issuance and enforcement of one standard form of summons. See Rev. Proc. 55-6, page 903.

NARCOTICS

26 CFR 151.172a: Narcotic drugs and compounds for which oral prescription is authorized. (NARCOTICS) T. D. 53[1]

TITLE 26—INTERNAL REVENUE—CHAPTER I, SUBCHAPTER C, PART 151—REGULATIONS UNDER THE HARRISON NARCOTIC LAW, AS AMENDED

Finding and designation of narcotic drugs and compounds of narcotic drugs subject to oral prescription procedure.

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

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

Pursuant to authority delegated by Treasury Department Order No. 180–2 (19 F. R. 6399), and under section 7 of the act of August 31, 1954 (68 Stat. 1001; 26 U. S. C. 4705), and article 172 of Narcotics Regulations 5 (26 CFR 151.172; 20 F. R. 1132) [(Narcotics) T. D. 49, [C. B. 1955–1, 201], the following narcotic drugs and compounds of narcotic drugs are hereby found and designated to possess relatively little or no addiction liability:

SEC. 151.172a NARCOTIC DRUGS AND COMPOUNDS FOR WHICH ORAL PRESCRIPTION IS AUTHORIZED.—(a) Any isoquinoline alkaloid of opium or any salt of any such isoquinoline alkaloid, alone or in combination with other active, non-narcotic medicinal ingredients.

(b) Apomorphine or any salt thereof, alone or in combination with other active, non-narcotic medicinal ingredients.

(c) N-allyl-normorphine (Nalorphine, Nalline) or any salt thereof, alone or in combination with other active, non-narcotic medicinal ingredients.

(d) Any compound consisting of methylmorphine (codeine) or of any salt thereof with an equal or greater quantity of any isoquinoline opium alkaloid or salt thereof, where the content of methylmorphine or any salt thereof does not exceed eight grains per fluid ounce or one grain per dosage unit of the compound.

(e) Any compound consisting of methylmorphine (codeine) or of any salt thereof with one or more active, non-narcotic ingredients in recognized therapeutic amounts, where the content of methylmorphine or salt thereof does not exceed eight grains per fluic ounce or one grain per dosage unit of the compound.

(f) Any compound consisting of di-hydrocodeinone (Hydrocodone, Dicodid, Hycodan) or of any salt thereof with a four-fold or greater quantity of any isoquinoline opium alkaloid or salt thereof, where the content of dihydrocodeinone or any salt thereof does not exceed one and one-third grains per fluid ounce or one-sixth grain per dosage unit of the compound.

(g) Any compound consisting of di-hydrocodeinone (Hydrocodone, Dicodid, Hycodan) or any salt thereof with one or more active, non-narcotic ingredients in recognized therapeutic amounts, where

[1] 20 F.R. 6526.

the content of dihydrocodeinone or of any salt thereof does not exceed one and one-third grains per fluid ounce or one-sixth grain per dosage unit of the compound.

(h) Any compound consisting of di-hydrohydroxycodeinone (Oxycodone, Eucodal) or any salt thereof with one or more active, nonnarcotic ingredients in recognized therapeutic amounts, where the content of dihydrohydroxycodeinone or of any salt thereof does not exceed two-thirds grains per fluid ounce or one-twelfth grain per dosage unit of the compound.

(i) Any compound consisting of ethylmorphine (Dionin) or of any salt thereof with one or more active, nonnarcotic ingredients in recognized therapeutic amounts, where the content of ethylmorphine or any salt thereof does not exceed one and one-third grains per fluid ounce or one-sixth grain per dosage unit of the compound.

Because the finding and designation made by this Treasury decision relieves restrictions, it is found unnecessary to issue the decision with notice and public procedure thereon under section 4(a) of the Administrative Procedure Act, approved June 11, 1946, or subject to the effective date limitation of section 4(c) of that act.

This Treasury decision shall be effective upon its filing for publication in the Federal Register.

G. W. CUNNINGHAM,
Acting Commissioner of Narcotics.

September 1, 1955.

(Filed by the division of the Federal Register September 2, 1955, 8:56 a. m.)

PART II

RULINGS AND DECISIONS UNDER THE INTERNAL REVENUE CODE OF 1939 AND RELATED PUBLIC LAWS

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

CHAPTER 1.—INCOME TAX

SUBCHAPTER B.—GENERAL PROVISIONS

PART II.—COMPUTATION OF NET INCOME

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

REGULATIONS 118, SECTION 39.22(a)-1: What included in gross income. (Also Section 117(a); Section 39.117(a)-1.) — Ct. D. 1787

INCOME TAX—INTERNAL REVENUE CODE—DECISION OF SUPREME COURT

1. CAPITAL GAINS AND LOSSES VS. ORDINARY INCOME AND LOSSES—TRANSACTIONS IN COMMODITY FUTURES.

Where taxpayer's transactions in commodity futures were an integral part of its business designed to protect its manufacturing operations against a price increase in its principal raw material and to assure a ready supply for future manufacturing requirments, such transactions resulted in ordinary income and losses and not capital gains and losses under section 117 of the 1939 Code.

The preferential treatment provided by section 117 applies to transactions in property which are not the normal source of business income. Since this section is an exception from the normal tax requirements, the definition of a capital asset must be narrowly applied and its exclusions interpreted broadly.

2. JUDGMENT AFFIRMED.

Judgment of the United States Court of Appeals for the Second Circuit, 215 F. 2d 513, affirmed.

SUPREME COURT OF THE UNITED STATES

Corn Products Refining Company, petitioner, v. *Commissioner of Internal Revenue*

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

[November 7, 1955]

OPINION

Mr. Justice CLARK delivered the opinion of the Court.

This case concerns the tax treatment to be accorded certain transactions in commodity futures.[1] In the Tax Court, petitioner Corn Products Refining Company contended that its purchases and sales of corn futures in 1940 and 1942 were capital asset transactions under section 117(a) of the Internal Revenue Code of 1939. It further contended that its futures transactions came within the "wash sales" provisions of section 118. The 1940 claim was disposed of on the ground that section 118 did not apply, but for the year 1942 both the Tax Court and the Court of Appeals for the Second Circuit, 215 F. 2d 513, held that the futures were not capital assets under section 117. We granted certiorari, 348 U. S. 911,[2] because of an asserted conflict with holdings in the Courts of Appeal for the Third, Fifth, and Sixth Circuits.[3] Since we hold that these futures do not constitute the capital assets in petitioner's hands, we do not reach the issue of whether the transactions were "wash sales."

Petitioner is a nationally known manufacturer of products made from grain corn. It manufactures starch, syrup, sugar, and their byproducts, feeds and oil. Its average yearly grind of raw corn during the period 1937 through 1942 varied from thirty-five to sixty million bushels. Most of its products were sold under contracts requiring shipment in thirty days at a set price or at market price on the date of delivery, whichever was lower. It permitted cancellation of such contracts, but from experience it could calculate with some accuracy future orders that would remain firm. While it also sold to a few customers on long-term contracts involving substantial orders, these had little effect on the transactions here involved.[4]

In 1934 and again in 1936 droughts in the corn belt caused a sharp increase in the price of spot corn. With a storage capacity of only 2,300,000 bushels of corn, a bare three weeks supply, Corn Products found itself unable to buy at a price which would permit its refined corn sugar, cerelose, to compete successfully with cane and beet sugar. To avoid a recurrence of this situation, petitioner, in 1937, began to establish a long position in corn futures "as a part of its corn buying program" and "as the most economical method of obtaining an adequate supply of raw corn" without entailing the expenditure of large sums for additional storage facilities. At harvest time each year it would buy futures when the price appeared favorable. It would take delivery on such contracts as it found necessary to its manufacturing operations and sell the remainder in early summer if no shortage was imminent. If shortages appeared, however, it sold

[1] A commodity future is a contract to purchase some fixed amount of a commodity at a future date for a fixed price. Corn futures, involved in the present case, are in terms of some multiple of five thousand bushels to be delivered eleven months or less after the contract. Cf. Hoffman, Future Trading (1932), 118.

[2] The grant was limited to the following two questions:

"1. Are transactions in commodity futures which are not 'true hedges' capital asset transactions and thus subject to the limitations of section 117 of the Internal Revenue Code of 1939, or do the resulting gains and losses from such transactions give rise to ordinary income and ordinary deductions?

"2. Are commodity futures contracts 'securities' and thus subject to the 'wash sales' provisions of section 118 of the Internal Revenue Code of 1939?"

[3] *Makransky's Estate* v. *Commissioner,* 154 F. 2d 59 (C. A. 3d Cir.); *Commissioner* v. *Farmers & Ginners Cotton Oil Co.,* 120 F. 2d 772 (C. A. 5th Cir.); *Trenton Cotton Oil Co.* v. *Commissioner,* 147 F. 2d 33 (C. A. 6th Cir.).

[4] Petitioner had contracts with three consumers to furnish, for a period of ten years or more, large quantities of starch or feed. In January 1940, petitioner had sold 2,000,000 bags of corn sugar, delivery to be made several months in the future. Also, members of the canning industry on the Pacific Coast had contracts to purchase corn sugar for delivery in more than thirty days.

futures only as it bought spot corn for grinding.[5] In this manner it reached a balanced position with reference to any increase in spot corn prices. It made no effort to protect itself against a decline in prices.

In 1940 it netted a profit of $680,587.39 in corn futures, but in 1942 it suffered a loss of $109,969.38. In computing its tax liability Corn Products reported these figures as ordinary profit and loss from its manufacturing operations for the respective years. It now contends that its futures were "capital assets" under section 117 and gains and losses therefrom should have been treated as arising from the sale of a capital asset.[6] In support of this position it claims that its futures trading was separate and apart from its manufacturing operations and that in its futures transactions it was acting as a "legitimate capitalist," *United States* v. *New York Coffee & Sugar Exchange*, 263 U. S. 611, 619. It denies that its futures transactions were "hedges" or "speculative" dealings as covered by the ruling of General Counsel Memorandum 17322, XV-2 Cum. Bull. 151 (1936), and claims that it is in truth "the forgotten man" of that administrative interpretation.

Both the Tax Court and the Court of Appeals found petitioner's futures transactions to be an integral part of its business designed to protect its manufacturing operations against a price increase in its principal raw material and to assure a ready supply for future manufacturing requirements. Corn Products does not level a direct attack on these two-court findings but insists that its futures were "property" entitled to capital asset treatment under section 117 and as such were distinct from its manufacturing business. We cannot agree.

We find nothing in this record to support the contention that Corn Products' futures activity was separate and apart from its manufacturing operation. On the contrary, it appears that the transactions were vitally important to the company's business as a form of insurance against increases in the price of raw corn. Not only were the purchases initiated for just this reason, but the petitioner's sales policy, selling in the future at a fixed price or less, continued to leave it exceedingly vulnerable to rises in the price of corn. Further, the purchase of corn futures assured the company a source of supply which was admittedly cheaper than constructing additional storage facilities for raw corn. Under these facts it is difficult to imagine a program more closely geared to a company's manufacturing enterprise or more important to its successful operation.

Likewise the claim of Corn Products that it was dealing in the market as a "legitimate capitalist" lacks support in the record. There can be no quarrel with a manufacturer's desire to protect itself against increasing costs of raw materials. Transactions which provide such protection are considered a legitimate form of insurance. *United States* v. *New York Coffee & Sugar Exchange*, 263 U. S., at 619; *Brown* v. *Thorn*, 260 U. S. 137, 139–140. However, in labeling its activity as that of the "legitimate capitalist" exercising "good judgment" in the futures market, petitioner ignores the testimony of its own officers that in entering that market the company was "trying to protect a part of [its] manufacturing costs;" that its entry was not for the purpose of "speculating and buying and selling corn futures" but to fill an actual "need for the quantity of corn [bought] * * * in order to cover * * * what [products] we expected to market over a period of fifteen or eighteen months." It matters not whether the label be that of "legitimate capitalist" or "speculator"; this is not the talk of the capital investor but of the far-sighted manufacturer. For tax purposes petitioner's purchases have been found to "constitute an integral part of its manufacturing business" by both the Tax Court and the Court of Appeals, and

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[5] The dispositions of the corn futures during the period in dispute were as follows:

	Sales of futures thousand bushels	*Delivery under futures thousand bushels*
1938	17,400	4,975
1939	14,180	2,865
1940	14,595	250
1941	2,545	2,175
1942	5,695	4,460

[6] "(1) CAPITAL ASSETS.—The term 'capital assets' means property held by the taxpayer (whether or not connected with his trade or business), but does not include stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business, or property, used in the trade or business, of a character which is subject to the allowance for depreciation provided in section 23(l); * * *."

on essentially factual questions the findings of two courts should not ordinarily be distributed. *Comstock* v. *Group of Investors*, 335 U. S. 211, 214.

Petitioner also makes much of the conclusion by both the Tax Court and the Court of Appeals that its transactions did not constitute "true hedging." It is true that Corn Products did not secure complete protection from its market operations. Under its sales policy petitioner could not guard against a fall in prices. It is clear, however, that petitioner feared the possibility of a price rise more than that of a price decline. It therefore purchased partial insurance against its principal risk, and hoped to retain sufficient flexibility to avoid serious losses on a declining market.

Nor can we find support for petitioner's contention that hedging is not within the exclusions of section 117(a). Admittedly, petitioner's corn futures do not come within the literal language of the exclusions set out in that section. They were not stock in trade, actual inventory, property held for sale to customers or depreciable property used in a trade or business. But the capital asset provisions of section 117 must not be so broadly applied as to defeat rather than further the purpose of Congress. *Burnet* v. *Harmel*, 287 U. S. 103, 108. Congress intended that profits and losses arising from the every-day operation of a business be considered as ordinary income or loss rather than capital gain or loss. The preferential treatment provided by section 117 applies to transactions in property which are not the normal source of business income. It was intended "to relieve the taxpayer from * * * excessive tax burdens on gains resulting from a conversion of capital investments, and to remove the deterrent effect of those burdens on such conversions." *Burnet* v. *Harmel*, 287 U. S., at 106. Since this section is an exception from the normal tax requirements of the Internal Revenue Code, the definition of a capital asset must be narrowly applied and its exclusions interpreted broadly. This is necessary to effectuate the basic congressional purpose. This Court has always construed narrowly the term "capital assets" in section 117. See *Hort* v. *Commissioner*, 313 U. S. 28, 31 [Ct. D. 1502, C. B. 1941-1, 319]; *Kieselbach* v. *Commissioner*, 317 U. S. 399, 403 [Ct. D. 1570, C. B. 1943, 1008].

The problem of the appropriate tax treatment of hedging transactions first arose under the 1934 Tax Code revision.[7] Thereafter the Treasury issued GCM 17322, *supra*, distinguishing speculative transactions in commodity futures from hedging transactions. It held that hedging transactions were essentially to be regarded as insurance rather than a dealing in capital assets and that gains and losses therefrom were ordinary business gains and losses. The interpretation outlined in this memorandum has been consistently followed by the courts as well as the Commissioner.[8] While it is true that this Court has not passed on its validity it has been well recognized for 20 years, and Congress has made no change in it though the Code has been re-enacted on three subsequent occasions. This bespeaks congressional approval. *Helvering* v. *Winmill*, 305 U. S. 79, 83 [Ct. D. 1365, C. B. 1938-2, 212]. Furthermore, Congress has since specifically recognized the hedging exception here under consideration in the short sale rule of section 1233(a) of the 1954 Code.[9]

We believe that the statute clearly refutes the contention of Corn Products. Moreover, it is significant to note that practical considerations lead to the same conclusion. To hold otherwise would permit those engaged in hedging transactions to transmute ordinary income into capital gain at will. The hedger may either sell the future and purchase in the spot market or take delivery

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[7] Section 208(8) of the Revenue Act of 1924 limited "capital assets" to property held more than two years. This definition was retained until the Act of 1934. Since the rules of the various commodity exchanges required that futures contracts be closed out in periods shorter than two years, these contracts could not qualify as capital assets.

[8] *Stewart Silk Corp.* v. *Commissioner*, 9 T. C. 174; *Battelle* v. *Commissioner*, 47 B. T. A. 117; *Grote* v. *Commissioner*, 41 B. T. A. 247. See *Estate of Makransky* v. *Commissioner*, 5 T. C. 397, 412, aff'd *per curiam*, 154 F. 2d 59; *Trenton Cotton Oil Co.* v. *Commissioner*, 147 F. 2d 33, 35; *Commissioner* v. *Farmers & Ginners Cotton Oil Co.*, 120 F. 2d 772, 774; *Tennessee Egg Co.* v. *Commissioner*, 47 B. T. A. 558, 560; G. C. M. 18383, 1937-2 Cum. Bull. 244, 245; I. T. 3137, 1937-2 Cum. Bull. 164, 166. Cf. *Commissioner* v. *Banfield*, 122 F. 2d 1017, 1019-1020; G. C. M. 18658, 1937-2 Cum. Bull. 77.

[9] Section 1233 (a) provides that gain or loss from "the short sale of property, other than a hedging transaction in commodity futures," shall be treated as gain or loss from the sale of a capital asset to the extent "that the property, including a commodity future, used to close the short sale constitutes a capital asset in the hands of a taxpayer." The legislative history recognizes explicitly the hedging exception. H. R. Rep. No. 1337, 83d Cong., 2d Sess., p. A278; S. Rep. No. 1622, 83d Cong., 2d Sess., p. 437: "Under existing law bona fide hedging transactions do not result in capital gains or losses. This result is based upon case law and regulations. To continue this result hedging transactions in commodity futures have been specifically excepted from the operation of this subsection."

under the future contract itself. But if a sale of the future created a capital transaction while delivery of the commodity under the same future did not, a loophole in the statute would be created and the purpose of Congress frustrated.

The judgment is affirmed.

Mr. Justice HARLAN took no part in the consideration or decision of this case.

(Also Sections 117(a), 117(f); Regulations 118, Section 39.117(a)-1.) Rev. Rul. 55-433

Where a taxpayer has purchased interest-bearing bonds with certain unpaid accrued interest "flat" and he subsequently, when there is reasonable expectancy that their principal will ultimately be collected, receives aggregate payments of such interest in excess of the purchase price, the excess amount, although not interest income to him since the interest involved accrued before he purchased the bonds, constitutes gain that is taxable as ordinary income under section 22(a) of the Internal Revenue Code of 1939 and not as "capital gain" under section 117 thereof since the gain is not from a "sale or exchange" and the payments involved are not "amounts received by the holder upon the retirement of bonds."

Advice is requested with respect to the Federal income tax treatment to be accorded payments of interest received by the holder of interest-bearing bonds, where the interest had accrued thereon before he purchased them "flat" and the aggregate of the payments exceed the purchase price.

The taxpayer in this case purchased, on July 1, 1943, corporation 5 percent bonds due January 1, 1967, having a face value of $50x$ dollars, upon which $20x$ dollars interest, accrued from July 1, 1935, payable semiannually, was in default, for $14x$ dollars "flat," that is, without allocation of the purchase price between principal and unpaid accrued interest. During the years 1945 to 1949, inclusive, when there was reasonable expectancy that their principal would ultimately be paid in full, he received from the corporation interest payments, aggregating $17\frac{1}{2}x$ dollars, specifically covering the semiannual interest periods from July 1, 1935, to June 30, 1942.

Section 22(a) of the Internal Revenue Code of 1939 defines "gross income" as including "gains, profits, and income derived from * * * dealings in property * * *; also * * * gains or profits and income from any source whatever." Section 22(b) provides for certain exclusions from taxable gross income, but none are pertinent in the instant case. Section 113(a) provides that the basis of property for determining gain shall be its "cost," with certain exceptions not applicable in the instant case. Section 113(b)(1) provides for various adjustments of such basis, including (in subparagraph A thereof) "For expenditures, receipts, losses, and other items properly chargeable to capital account * * *." A gain is generally taxable as ordinary income under section 22(a), as distinguished from "capital gain" under section 117, unless it is specifically so defined or to be considered. See *M. N. Avery* v. *Commissioner*, 111 Fed. (2d) 19, Ct. D. 1572, C. B. 1941-1, 326. Section 117(a)(2) and (4) provides that "capital gain" means "gain from the sale or exchange of a capital asset * * *, if and to the extent such gain is taken into account in computing gross income." Section 117(f) provides as follows:

RETIREMENT OF BONDS, ETC.—For the purpose of this chapter, amounts received by the holder upon the *retirement of bonds, debentures, notes, or cer-*

tificates or other evidences of indebtedness issued by any corporation (including those issued by a government or political subdivision thereof), with interest coupons or in registered form, shall be considered as amounts received in exchange therefor. [Italics supplied.]

The reference in section 117(f), *supra*, to bonds and other evidences of indebtedness *issued* by a corporation manifestly is to their principal and not to interest thereon; hence, receipts in order to be within its ambit must be actually or in effect payments or other collections in discharge of their principal and not of interest thereon. See G. C. M. 21890, C. B. 1940–1, 85, and *District Bond Company* v. *Commissioner*, 1 T. C. 837. However, payments, in order to constitute "amounts received by the holder upon the retirement of" such evidences of indebtedness, need not be final or single full payments of their principal but may be partial payments thereof. See *Edith K. Timken* v. *Commissioner*, 6 T. C. 483, acquiescence, C. B. 1946–2, 5; *Howard Carleton Avery* v. *Commissioner*, 13 T. C. 351, acquiescence, C. B. 1950–1, 1; and *Adolph Klein* v. *Commissioner*, 15 T. C. 261, acquiescence, C. B. 1950–2, 3. Whether payments, or portions thereof, are "amounts received by the holder upon the retirement of" such evidences of indebtedness, *i. e.*, their principal, in whole or in part, or are of interest thereon, is largely a question of fact. See, generally, I. T. 2986, C. B., XV–1, 136 (1936), and *McClain* v. *Commissioner* and *Helvering* v. *Thomson, Executrix*, 311 U. S. 527, Ct. D. 1481, C. B. 1941–1, 378. Actual collections of *principal* of bonds are, *ipso facto*, amounts received by the holder upon *their retirement;* whereas, actual collections of *interest* on bonds are, just as matter-of-fact, *not* amounts received by the holder upon *their retirement* but of interest thereon, irrespective of whether the interest accrued before he purchased them, he purchased them "flat," or the interest was received together with payments of principal in whole or in part. See G. C. M. 21890, *supra*, and I. T. 3312, C. B. 1939–2, 168.

Where a taxpayer has purchased interest-bearing securities with certain unpaid accrued interest at a "flat" price, the Internal Revenue Service has followed the principles (1) that subsequent payments of such interest do not constitute interest income to him since it accrued before his purchase, but are returns of capital applicable to his cost or adjusted basis to the extent of such basis; (2) that any excess of such interest payments over such basis is taxable gain; and (3) that such gain is taxable as ordinary income under section 22(a), *supra*, and not as "capital gain" under section 117, *supra*, unless there is no reasonable expectancy, when such interest payments in excess of such basis are received, that those payments and ultimate collections on principal of the securities will exceed their principal and, therefore, the "interest" payments involved are regarded as collections of principal and, as such, "amounts received by the holder upon the retirement of" the securities to be "considered as amounts received in exchange therefor" under section 117(f), *supra*. These principles are embodied in the following lines of rulings and decisions:

1. Where payments received by the taxpayer of interest which had accrued on interest-bearing securities before he purchased them "flat" are not more than his cost or adjusted basis thereof, such receipts have been held to be returns of capital applicable as adjustments (reductions) of such basis. See I. T. 3689, C. B. 1944, 65; *Erskine Hewitt* v. *Commissioner*, 30 B. T. A. 962, acquies-

cence, C. B. XIII-2, 9 (1934); *Adrian & James, Inc.* v. *Commissioner*, 4 T. C. 708, acquiescence, C. B. 1945, 1; and *National City Lines, Inc.* v. *United States*, 197 Fed. (2d) 754.

Inasmuch as interest which had accrued on securities before they were purchased by the taxpayer was not earned on his investment, receipts thereof, even though labelled "interest," are *not interest income to him* regardless of whether (a) his purchase was at a "flat" price, or a certain portion of the purchase price was allocated to accrued unpaid interest; (b) his purchase was through an exchange or direct from the seller; (c) the interest was on principal, on past due interest, or on both; (d) the interest was in default or not, either at the time of his purchase or when he collected it; (e) its collectibility was considered good or poor at either time; and (f) receipts thereof are in excess or not of his cost or adjusted basis to which applicable. However, as already indicated, this does not mean that any such excess is not taxable gain or that it is taxable as capital gain under section 117, *supra*, rather than as ordinary income under section 22(a), *supra*.

2. Where total receipts on account of interest-bearing securities purchased "flat" include not only payments of interest which had accrued thereon before their purchase by the taxpayer but also proceeds from his subsequent sale of the securities, and the sale proceeds exceed his basis thereof adjusted (reduced) on account of such interest payments, the excess has been held to constitute gain that is taxable as "capital gain" under section 117, *supra*, or corresponding prior statutory provisions. See *Clyde C. Pierce Corporation* v. *Commissioner*, 120 Fed. (2d) 206; and *R. O. Holton* v. *Commissioner*, 44 B. T. A. 202.

In the instant case, however, the excess involved is not attributable to either a sale or an exchange. Therefore, this principle does not apply to such case. Compare *Peggy H. Ogilvie, admx., et al.* v. *Commissioner*, 216 Fed. (2d) 748, affirming 20 T. C. 734.

(3) Where the taxpayer, when there was no reasonable expectancy that collections both of principal and interest would ultimately exceed the principal of interest-bearing bonds which he had previously purchased with certain unpaid accrued interest "flat," received payments, designated as part of principal and part of such interest, aggregating in excess of his cost or adjusted basis thereof, the entire payments have been found to constitute "amounts received by the holder upon the retirement of bonds" to be "considered as amounts received in exchange therefor" under statutory provisions corresponding to section 117(f), *supra*, and the entire excess has been held, accordingly, to be gain that is taxable as capital gain. See *William H. Noll* v. *Commissioner*, 43 B. T. A. 496; *Gertrude B. Chase*, 44 B. T. A. 39; and I. T. 3531, C. B. 1942-1, 223.

In the Noll case, the taxpayer had purchased in 1933 Chicago Joint Stock Land Bank interest-bearing bonds "flat" at about 20 percent of their principal and certain unpaid interest accrued prior and up to (but unmatured) October 1, 1932, at which date a receiver had been appointed for the bank and after which he considered no interest

accrued. In 1934, 1935, and 1936, the taxpayer received from the receiver six payments of 30, 10, 10, 10, 5, and 5 percent, respectively, or a total of 70 percent, of the aggregate of the principal of his bonds and such accrued interest thereon, accompanied by statements that each payment was a "dividend equal to" the respective percent of principal and such interest. The record of the case indicated that the bank, upon being placed in receivership, had bonds outstanding of $42,724,100 and assets of less than $35,000,000, and had been directed to discontinue operations and turn over its assets to the receiver. Also, that as of June 30, 1939, it had liabilities of $10,430,508.78 and assets of only $4,143,030.86 (book value). Of these liabilities, over $10,000,000 represented principal of its bonds then remaining unpaid, after three further liquidation dividends had been distributed in 1937, 1938, and 1939 of 2½, 2½, and 1½ percent, respectively, or a grand total of 76½ percent. It was evident therefrom that there was no reasonable expectancy, when the payments involved were received, that collections, including the portions of the liquidating dividends designated as part payments of interest accrued and unpaid at October 1, 1932, would ultimately exceed the principal of the bonds. Accordingly, the *entire* payments involved, although designated to be in part of interest, were in reality, at least for Federal income tax purposes of the recipient, of *principal* and, therefore, "amounts received by the holder upon the retirement of bonds." The Noll decision was thus applied in the Chase case, and I. T. 3531, *supra*, both of which also involved Chicago Joint Stock Land Bank bonds and liquidation distributions. In the instant case, however, there was reasonable expectancy, when the taxpayer received the interest payments involved, that the principal of the bonds involved would ultimately be collected.

Whether there is, at the time "interest" payments on interest-bearing bonds or other securities are received, reasonable expectancy that further collections will equal their remaining principal is dependent upon the pertinent facts and circumstances in each particular case. Actual insolvency of the debtor cannot be conclusively presumed merely from default in principal or interest, or from receivership, inasmuch as either may arise, even in the case of a solvent debtor, from causes such as temporary business depression, financial panic, shortage of liquid assets, inefficient or improper management, and controversy over the debt. Furthermore, insolvency of the debtor is immaterial if it appears that the previously unpaid principal is collectible out of security or from a surety or guarantor.

In view of the foregoing, it is held that where a taxpayer has purchased interest-bearing bonds with certain unpaid accrued interest "flat" and he subsequently, when there is reasonable expectancy that their principal will ultimately be collected, receives payments of such interest in excess of the purchase price, the excess amount, although not interest income to him since the interest involved accrued before he purchased the bonds, constitutes gain that is taxable as ordinary income under section 22(a), *supra*, and not as "capital gain" under section 117, *supra*, since the gain is not from a "sale or exchange" and the payments involved are not "amounts received by the holder upon the retirement of bonds."

Rev. Rul. 55-469

Where a grandparent makes a bona fide gift of shares of stock to his minor grandchildren, no trust is created where the stock is registered in the names of the parents of such minor children merely because the State law does not permit securities to be registered in the names of minors. The income and any capital gain from the sale of the stock, which are placed in a separate bank account under the names of the parents as "trustees", are taxable to the grandchildren as beneficial owners thereof.

Advice has been requested relative to the taxability of the income from certain shares of stock which were a bona fide gift by a grandparent to his minor grandchildren under the circumstances described below.

In the instant case, a grandparent gave certain shares of stock to his grandchildren. The transfer was an outright gift. No trust was created or intended to be created. The donor intended the shares of stock to be owned by the grandchildren with the income therefrom to be solely for their benefit. Due to the provisions of the law of the State in which the grandchildren reside, securities cannot be registered in the names of minors. Consequently, the parents of the children were registered as owners of the stock. Dividends on the stock are placed in a separate bank account under the names of the parents as "trustees". Proceeds from the sale of the stock were also deposited in the separate bank account.

A situation of this nature is primarily one of fact; and under facts substantially similar to those outlined above, it has been held that no taxable trusts existed and that income from the stock was taxable to the minor grandchildren. See *Prudence Miller Trust et al.* v. *Commissioner*, 7 T. C. 1245, acquiescence, C. B. 1947-1, 3.

Accordingly, it is held that where a grandparent makes a bona fide gift of shares of stock to his minor grandchildren, no trust is created where the stock is registered in the names of the parents of such minor children merely because the State law does not permit securities to be registered in the names of minors. The income and any capital gain from the sale of the stock, which are placed in a separate bank account under the names of the parents as "trustees", are taxable to the grandchildren as beneficial owners thereof.

Taxability of credits under section 7(d) of the Federal Deposit Insurance Act, 64 Stat. 873, at 877, 12 U. S. C. 1817(d), received or accrued in taxable years beginning after December 31, 1951, by mutual savings banks not having capital stock represented by shares. See Rev. Rul. 55-478, page 18.

Excess of amounts received over the cost basis of office equipment transferred to lessee through a leasing agreement. See Rev. Rul. 55-541, page 19.

Property transferred to third party subject to liabilities. See Rev. Rul 55-675, page 567.

Insurance premiums paid by an employer to the extent of the annual increases in the cash surrender value of an insurance policy covering the life of the employee. See Rev. Rul. 55-713, page 23.

REGULATIONS 118, SECTION 39.22(a)-5: Gross income from business.

Gift of property held for sale in ordinary course of business. See Rev. Rul. 55-531, below.

Regulations 118, Section 39.22(a)-7: Gross income of farmers. Rev. Rul. 55-531

(Also Sections 22(a), 23(a), 113(a); Regulations 118, Sections 39.22(a)-5, 39.23(a)-1, 39.113(a)(2)-1.)

The fair market value of agricultural or manufactured products or property held for sale in the ordinary course of business which is made the subject of a gift is not includible in the gross income of the donor for Federal income tax purposes. There must be an adjustment to the opening inventory in the year of the gift effecting the removal of the cost or other basis of the donated asset. Items of cost applicable to such property are not deductible by the donor as an ordinary and necessary expense in the current or in any subsequent year. The basis of the gift in the hands of the donee is the same as in the hands of the donor, that is, the cost of such gift which is not allowable as a deduction to the donor in the current year plus items of cost which have properly not been deducted by the donor in prior years, or in the case of inventoried property the last inventoried basis plus the current year's cost, if any, applicable to the gift, except that if such basis as computed above is greater than the fair market value of the property at the time of gift then for the purposes of determining loss the donee's basis shall be such fair market value.

I. T. 3932, C. B. 1948-2, 7, revoked.

I. T. 3932, C. B. 1948-2, 7, has been reconsidered in the light of the decisions in *Mamie F. Farrier* v. *Commissioner*, 15 T. C. 277, acquiescence, C. B. 1955-1, 4, and *Elsie SoRelle* v. *Commissioner*, 22 T. C. 459, acquiescence, C. B. 1955-1, 6, and Revenue Ruling 55-138, C. B. 1955-1, 223.

In I. T. 3932, *supra*, a livestock raiser made a bona fide gift to his son of cattle which the father had raised and which had a fair market value of $1,500 at the time of the gift. When the cattle were sold about eight months later for $2,100, the proceeds of the sale were received by the son. The ruling holds that (1) the fair market value of the cattle on the date of the gift is includible in computing the father's gross income for the taxable year in which the gift was made, and (2) the excess of the selling price of the cattle over the fair market value on the date of the gift represents ordinary income to the son.

The foregoing ruling was based upon the decision of the Supreme Court of the United States in *Helvering* v. *Paul R. G. Horst*, 311 U. S. 112, Ct. D. 1472, C. B. 1940-2, 206. In that case the owner of negotiable bonds detached interest coupons therefrom shortly before their due date and delivered them as a gift to his son, who procured their payment. The Court held the donor taxable on the amount received by the son. In support of the conclusion reached, the Court said in part:

Although the donor here, by the transfer of the coupons, has precluded any possibility of his collecting them himself he has nevertheless, by his act, procured payment of the interest, as a valuable gift to a member of his family. Such a use of his economic gain, the right to receive income, to procure a satisfaction which can be obtained only by the expenditure of money or property, would seem to be the enjoyment of the income whether the satisfaction is the purchase of goods at the corner grocery, the payment of his debt there, or such nonmaterial satisfactions as may result from the payment of a campaign or community chest contribution, or a gift to his favorite son. * * * The enjoyment of the economic benefit accruing to him by virtue of his acquisition of the coupons is realized as completely as it would have been if he had collected the interest in dollars and expended them for any of the purposes named.

In the Farrier case, the court considered the question whether the fair market value of cattle given by the taxpayer to her daughter represented taxable income to the donor as a result of the gift. In this case, there had been no sale of the cattle in the taxable year involved. The court held that the rule in the Horst case, which the Commissioner had relied upon, was not applicable. The court pointed out that in the Horst case the donor had two independent and separable kinds of property rights in the bonds, one the right to receive the principal at maturity of the bonds and the other to receive the interest payments. It was the "power to command its (the interest) payment to others which constituted an economic gain to him." The question in the Horst case was "whether because one who in fact receives payment for services or interest payments is taxable only on his receipt of the payments, he can escape all tax by giving away his right to income in advance of payment." The court then stated that in the Farrier case there was no such question. It said, "No income is involved. There has been no sale of the cattle and no income realized either by the donor or anyone else. The donor simply made a gift of the property itself before realization of any income thereon. The income, if there was ever to by any, had to await the sale of the cattle * * *." The court held that the gift by the taxpayer to her daughter did not result in taxable gain to the donor.

In the SoRelle case, the taxpayer, a farmer and rancher, gave a parcel of land to each of his four children together with its unharvested wheat crop. The court held that the gifts of four parcels of land and the matured wheat crops thereon, which gifts were made just prior to harvest, did not result in the donor realizing income to the extent of the market value of the wheat. The court said, "We are not here concerned with a mere reallocation of business income within the family group. We have instead an actually completed and admittedly bona fide gift of income producing property, and the gift of that property carried with it the unharvested wheat crop which was still on the land. This wheat became the property of the four children to whom the land was given and when the wheat was harvested and later sold the income resulting therefrom belonged to the children and was taxable to them * * *."

In the light of the above cases, it follows that no income is realized by a farmer or other producer by reason of his gifts of farm or other products. Revenue Ruling 55–138, *supra*, reached a similar conclusion with respect to charitable contributions of farm or other inventoriable products.

In many instances, the taxpayer has deducted at least some items representing cost of the donated property in the years in which such

costs were paid or incurred. In other cases involving inventoriable property, such costs have been reflected as a part of the "cost of goods" thereby, under permissible accounting methods, providing in effect for the deduction of such costs upon sale of the goods. This has been done on the assumption that such costs have been a part of the costs incurred in the business of the taxpayer. When the goods become the subject of a gift, they are removed from the business operations of the taxpayer and such costs attributable thereto should likewise be eliminated from business costs. If, for example, the products or goods were grown or manufactured in the year of the gift, such costs applicable thereto should be disallowed. If the cost has been paid or incurred in an earlier year and is reflected in cost of goods carried in opening inventory of the year in which the gift is made, it becomes evident that an inventory adjustment should be made as of the time of the gift of property included therein to reflect the removal from the business of the donated asset and its cost, thereby counterbalancing the reduction of income caused by the removal of the goods from the business.

In view of the foregoing, the following treatment should be accorded gifts of agricultural or manufactured products or property held for sale in the ordinary course of business:

(1) The fair market value of the donated property is not includible in the gross income of the donor for Federal income tax purposes.

(2) There must be an adjustment to the opening inventory in the year of the gift effecting the removal of the cost or other basis of the donated asset. Items of cost applicable to such property are not deductible by the donor as an ordinary and necessary expense in the current or in any subsequent year.

(3) The basis of the gift in the hands of the donee is the same as in the hands of the donor, that is, the cost of such gift which is not allowable as a deduction to the donor in the current year plus items of cost which have properly not been deducted by the donor in prior years, or in the case of inventoried property the last inventoried basis plus the current's cost, if any, applicable to the gift, except that if such basis as computed above is greater than the fair market value of the property at the time of gift then for the purpose of determining loss the donee's basis shall be such fair market value.

Accordingly, I. T. 3932, C. B. 1948–2, 7, is hereby revoked.

Rev. Rul. 55–736

Revenue Ruling 55–188 applies not only to inventoried animals born and raised on the farm and held for breeding purposes, but also to all draft, breeding and dairy animals, whether purchased or raised, included in inventory by an accrual method farmer. As used in that ruling, the term "normal costs" means those costs of raising animals to maturity which are normally taken into account in arriving at their closing inventory values. Thus, the contemplated adjustment for "normal costs" is not required in the case of a "farm-price method" taxpayer.

Revenue Ruling 55–188, C. B. 1955–1, 226, amplified.

The Internal Revenue Service has been requested to clarify Revenue Ruling 55–188, C. B. 1955–1, 226, to indicate the taxpayers to whom it applies, the livestock covered, and the meaning to be attributed to the term "normal costs" as used in that Revenue Ruling.

Revenue Ruling 55–188, *supra*, holds that, where livestock farmers employing the accrual method of accounting for farm income use separate Schedule D (Form 1040) to compute gain or loss on the sale of animals born and raised on the farm, and held for a period of more than 12 months for breeding purposes, the cost or other basis of such animals is an amount representing the inventory value of the animals at the beginning of the year of sale together with any additional normal costs incurred with respect to these animals during that taxable year. It also holds that the inventory value of the animals at the beginning of the taxable year must be eliminated from the opening inventory of such year, and the additional normal costs incurred during the taxable year with respect to the animals, must be eliminated from the farm expenses of that year.

Revenue Ruling 55–188 has application only to farmers employing the accrual method of accounting who have elected (under section 39.22 (a)–7 (b) of Regulations 118) to include their livestock held for draft, breeding, or dairy purposes in inventory. It applies to all livestock held by farmers for draft, breeding, or dairy purposes, whether purchased or raised, which have been included in inventory.

To the extent that it provides for an adjustment for "normal costs" incurred during the year of sale, Revenue Ruling 55–188 applies only to inventoried animals which were immature at the beginning of the year. It contemplates that an adjustment be made to the basis of the animal and to farm expenses of the year of sale for costs incurred during such year in raising the animal to maturity. The amount of the adjustment should be determined by the same method regularly employed by the taxpayer in determining closing inventory values.

Thus, if the farmer has selected the cost method ("cost" or "cost or market, whichever is lower") for valuing inventories, he should add to the amount representing inventory value of the animals at the beginning of the year of sale the actual costs incurred during that year in raising the animals to maturity. These include such items as feed, direct labor, etc., together with that portion of any indirect costs properly attributable to the particular animals.

For the farmer who has selected the unit-livestock-price method for valuing inventories, the adjustment for normal costs is an amount representing a pro rata portion of the differential between the unit price at which the animals were included in the opening inventory for the year of the sale and the unit price of the next older classification of animals.

Farmers regularly employing the "farm-price method" of valuing inventories, will use as their basis the opening inventory values of the animals sold, without any adjustment for costs incurred in the year of sale in raising the animals to maturity.

REGULATIONS 111, SECTION 29.22(a)-15: Acquisition or disposition by a corporation of its own capital stock. (Also Regulations 118, Section 39.22(a)-15.) Ct. D. 1788

INCOME TAX—INTERNAL REVENUE CODE—DECISION OF SUPREME COURT.

1. GROSS INCOME—ACQUISITION OR DISPOSITION BY CORPORATION OF ITS OWN CAPITAL STOCK.

In 1931 taxpayer corporation and its common stockholders entered into a written agreement to restrict ownership of common stock to the management group and to adjust the respective interests in the common stock among that group as responsibility changed. Such stock could not be disposed of except by written consent of the owners of 75 percent of the common stock. Upon death of any party to the agreement the corporation agreed to purchase the stock of the deceased at its book value. In 1939 one of the stockholders died and taxpayer purchased 18,574 shares of his stock. This stock was not retired but was held as treasury stock. While in the treasury, it could not be voted nor were dividends paid on it. In 1944 taxpayer sold 6,500 shares of this stock to five of its junior officials.

Held, Taxpayer did not realize a taxable gain from the sale of its treasury stock, since the transaction, limited to a wholly intracorporate purpose with no element of speculation or gain envisioned, does not constitute dealing by the corporation in its own shares as it might deal in the shares of another corporation.

2. JUDGMENT AFFIRMED.

Judgment of the United States Court of Claims, 122 F. Supp. 837, affirmed.

SUPREME COURT OF THE UNITED STATES

United States of America, petitioner, v. *Anderson, Clayton & Co.*

On writ of certiorari to the United States Court of Claims

[November 7, 1955]

OPINION

Mr. Justice MINTON delivered the opinion of the Court.

Anderson, Clayton & Co., a Delaware corporation, was organized in 1929. Its capital structure consisted of preferred stock and 100,000 shares of common stock, the capital value of which was fixed at one dollar per share. By April 21, 1930, all of the common stock had been issued, in varying amounts, to the corporation's managing officials, in consideration of their worth and responsibility to the company, which is engaged in the highly technical and skilled business of cotton merchandising.

In 1931 a written agreement was entered into between the corporation and the common stockholders, the purpose of which was to restrict the ownership of the common stock to the management group and to adjust the respective interests in the common stock among that group as responsibility changed. Accordingly, the agreement provided that the stock could not be disposed of except by written consent of the owners of 75 percent of the common stock. Upon the death of any party to the agreement the corporation agreed to purchase the common stock of the deceased at its book value as of July 31 preceding the stockholder's death.

One M. D. Anderson, one of the chief officers of the company, was originally issued 31,000 shares. During the development of the corporation, Mr. Anderson had transferred shares of his stock, pursuant to the agreement, to junior officials as they assumed more duties and responsibilities, until at the time of his death in 1939 he owned 18,574 shares. These shares the corporation purchased at their book value of $50.79 per share. This stock was not retired, but was retained as treasury stock. While in the treasury, it could not be voted nor were dividends paid on it.

The company in 1944 sold 6,500 of these shares to junior officials at the then book value of $112.68 per share. The difference between the price paid Anderson's estate and that received from the sale of the shares to the junior officials was $402,285, on which the United States imposed a long-term capital gains tax of $100,571.25. Respondent paid the tax and sued in the Court of Claims to recover the amount. The respondent took the position that no long-term capital gain resulted because it was not dealing in its stock "as it might in the shares of another corporation," as contemplated in Treasury Regulations 111, section 29.22(a)-15.[1] The Court of Claims agreed with respondent and entered judgment for recovery of the tax paid, with interest. We granted certiorari because the claim of conflict with decisions of the Courts of Appeals.[2]

The sole question therefore is whether, in the circumstances of this case, Treasury Regulations 111, section 29.22(a)-15 makes the sale of this treasury stock of the corporation a taxable transaction under section 22(a) of the Internal Revenue Code of 1939.[3]

Article 66 of Treasury Regulations 74, promulgated under the Revenue Act of 1928, provided that a corporation which purchases its own stock, holds it as treasury stock, and later sells it "realizes no gain or loss" from such transactions. This Court upheld that regulation as a proper one interpretive of the general terms of section 22(a) of the Internal Revenue Code. *Helvering* v. *Reynolds Co.*, 306 U. S. 110, 114 [Ct. D. 1383, C. B. 1937-1 (Part 1), 225]. The present regulation was promulgated in 1934. Its effect was to remove the categorical exclusion of taxable gains or losses arising out of the purchase and sale by a corporation of its own stock accorded such transactions by Article 66 of Treasury Regulations 74. The amended regulation specifically excludes from tax consequences a corporation's sale of its stock upon original issue whether sold for more or less than par or stated value. On the other hand, the regulation specifically provides that tax consequences flow from the receipt by the corporation of its own stock as consideration for sales of its property or in satisfaction of indebtedness to it. With regard to all other dealings by a corporation in its own stock, whether or not tax consequences result depends generally upon the "real nature of the transaction, which is to be ascertained from all its facts and circumstances." The regulation provides further that "if a corporation deals in its own shares as it might in the shares of another corporation," such dealings are considered, for tax purposes, as though the corporation were in fact dealing in the other corporation's stock. Thus, whether the transaction here in question is taxable depends, in the final analysis, on whether respondent corporation dealt with its shares of treasury stock "as it might" have dealt with another corporation's stock.

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[1] "SEC. 29.22(a)-15. *Acquisition or Disposition by a Corporation of its Own Capital Stock.*—(a) Whether the acquisition or disposition by a corporation of shares of its own capital stock gives rise to taxable gain or deductible loss depends upon the real nature of the transaction, which is to be ascertained from all its facts and circumstances. The receipt by a corporation of the subscription price of shares of its capital stock upon their original issuance gives rise to neither taxable gain nor deductible loss, whether the subscription or issue price be in excess of, or less than, the par or stated value of such stock.

"(b) But if a corporation deals in its own shares as it might in the shares of another corporation, the resulting gain or loss is to be computed in the same manner as though the corporation were dealing in the shares of another. So also if the corporation receives its own stocks as consideration upon the sale of property by it, or in satisfaction of indebtedness to it, the gain or loss resulting is to be computed in the same manner as though the payment had been made in any other property. Any gain derived from such transactions is subject to tax, and any loss sustained is allowable as a deduction where permitted by the provisions of the Internal Revenue Code."

[2] *Commissioner* v. *Landers Corp.*, 210 F. 2d 188; *Commissioner* v. *H. W. Porter & Co.*, 187 F. 2d 939; *Commissioner* v. *Rollins Burdick Hunter Co.*, 174 F. 2d 698; *Commissioner* v. *Batten, Barton, Durstine & Osborn*, 171 F. 2d 474.

[3] "SEC. 22. GROSS INCOME.

"(a) *General Definition.* 'Gross income' includes gains, profits, and income derived from salaries, wages, or compensation for personal service (including personal service as an officer or employee of a State, or any political subdivision thereof, or any agency or instrumentality of any one or more of the foregoing), of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, and income derived from any source whatever. * * *" For tax years after 1953, transactions such as the one here involved carry no tax consequences by virtue of congressional enactment of section 1032 of the Internal Revenue Code of 1954, which provides: "No gain or loss shall be recognized to a corporation on the receipt of money or other property in exchange for stock (including treasury stock) of such corporation."

The Court of Claims ruled, after a thorough examination of all of the facts and circumstances surrounding the transaction, that the corporation was not dealing in its shares as it might in the shares of another corporation. This conclusion is abundantly supported by the subsidiary findings, which are all supported by the evidence in this case.

We agree with the Court of Claims. Here the purchase and sale was made pursuant to a contract entered into without any shown purpose of advantageous investment. Instead the purpose of the agreement was found to be to maintain the distribution of the stock among responsible and active members of the organization in a manner designed to reflect their worth to the corporation. Indicative of this singleness of purpose is the fact that some of the stock purchased from Mr. Anderson's estate was sold to the corporation's other executives at a price below that for which it was acquired. No consideration was given to the opportune time for purchase or sale. The purchase of Mr. Anderson's stock by the corporation was dictated by the terms of the contract upon the fortuitous circumstance of his death. Moreover, when purchased, the stock was lodged in the treasury. It could not be taken into account in any payment of dividends, nor voted in shareholder meetings nor counted for the purpose of establishing a quorum. These unrecognized rights are all incident to the ownership of common stock of other corporations. It is thus clear that respondent was not dealing in its shares as it might in the shares of others.

The Government urges that the crucial inquiry as to whether the transaction is taxable under the regulation depends for its answer upon whether the reacquired shares are resold or retired and new shares issued. Since the shares were not retired, the resale at a price greater than cost results in a taxable gain under section 22(a) of the Code and the applicable regulation. The Government receives comfort for its position in the language of *Commissioner* v. *Batten, Barton, Durstine & Osborne, Inc.*, 171 F. 2d 474, 476, and *Commissioner* v. *Landers Corp.*, 210 F. 2d 188, 191. But we do not think formalities should be raised to such an important position. Moreover, the applicable regulation provides that tax consequences depend upon "the real nature of the transaction, which is to be ascertained from all its facts and circumstances," and not upon the sole circumstance that the stock is not retired. When viewed in its entirety, the instant transaction, limited to a wholly intracorporate purpose with no element of speculation or gain envisioned from dealing in its shares, does not constitute dealing by the corporation in its own shares as it might deal in the shares of another corporation within the meaning of the regulation.

The judgment is affirmed.

Mr. Justice Douglas and Mr. Justice Burton dissent.

Regulations 118, Section 39.22(a)-15: Acquisition or disposition by a corporation of its own capital stock.

Purchase and sale of treasury stock for wholly intracorporate purpose. See Ct. D. 1788, page 524.

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

Regulations 118, Section 39.22(b)(1)-1: Life insurance; amounts paid by reason of the death of the insured.

Proceeds of a life insurance policy payable upon death of an employee where the employer has paid the premiums on such policy to the extent of the annual increases in the cash surrender value of the policy. See Rev. Rul. 55-713, page 23.

REGULATIONS 118, SECTION 39.22(b)(1)-2: Death payment by employer; amounts paid by reason of the death of an employee.

Death benefit payments to widows of retired employees under a binding obligation between the employer and its retired employees. See Rev. Rul. 55-436, page 541.

REGULATIONS 118, SECTION 39.22(b)(2)-5: Employees' annuities.

Funds under a nontrusteed retirement plan transferred to a plan meeting the requirements of section 165(a) of the 1939 Code. See Rev. Rul. 55-427, page 27.

SECTION 22(b)(3).—GROSS INCOME: EXCLUSION FROM GROSS INCOME

REGULATIONS 118, SECTION 39.22(b)(3)-1: Gifts and bequests.

Treatment of death gratuity payment appropriated by Act of Congress. See Rev. Rul. 55-609, page 34.

SECTION 22(k).—GROSS INCOME: ALIMONY, ETC., INCOME

REGULATIONS 118, SECTION 39.22(k)-1: Alimony and separate maintenance payments; income to former wife. Rev. Rul. 55-457

> The part of the lump-sum payment made to a wife under an agreement with the executor of the estate of her divorced husband, representing arrearages in periodic alimony payments required by an amended decree of divorce, constitutes "periodic payments" includible in the gross income of the taxpayer in the year of receipt within the meaning of section 22(k) of the Internal Revenue Code of 1939. The balance of the amount received represents a lump-sum payment and does not come within the intendment of such section and, therefore, is not includible in her gross income for Federal income tax purposes.

Advice has beeen requested concerning the tax consequences of certain payments received by a wife in compromise of her existing claims against the estate of her divorced husband.

In the instant case pursuant to a decree of divorce the husband was required to pay his former wife a stipulated amount each month for the support of two children of the marriage, permanent alimony for the wife, and an amount in lieu of any rights of the wife in any of the husband's property.

After the youngest child became 21 years of age a stipulated amount was to be paid to the wife each month for the remainder of her life. In addition she was to receive certain lump-sum payments. To secure the payments the husband was required to carry insurance on his life.

By later amendments to the original divorce decree, and as further security for the payments required to be made to the wife, a bank was made escrow agent and the husband was required to assign to the wife and deposit in escrow a certain number of shares of the stock which he owned in a certain corporation and also to appoint the bank as trustee of his life insurance. The amended decree also required the husband to pay to his wife a monthly sum as long as she lived.

Subsequently the husband died and payments to the wife from the proceeds of the insurance policy were made each month by the bank but no payments were made by the estate. The wife filed a claim against her husband's estate alleging default in certain of the payments required under the amended decree. A compromise was entered into between the wife and the executor of the estate and court orders were procured to the effect that all remaining proceeds of the insurance upon the life of the husband which had been turned over to the bank would be paid to the wife together with an additional stated amount; and that the wife in consideration therefor would release from escrow and assign to the estate the shares of stock held by the bank and would also release the estate and executor from all claims including specified arrearages in alimony payments.

Section 22(k) of the Internal Revenue Code of 1939 provides in part as follows:

> * * * In the case of a wife who is divorced or legally separated from her husband under a decree of divorce or of separate maintenance, periodic payments (whether or not made at regular intervals) received subsequent to such decree in discharge of, or attributable to property transferred (in trust or otherwise) in discharge of, a legal obligation which, because of the marital or family relationship, is imposed upon or incurred by such husband under such decree or under a written instrument incident to such divorce or separation shall be includible in the gross income of such wife, * * *.

Section 39.22(k)-1(a) of Regulations 118 provides, in part, that periodic payments are includible in the wife's income under section 22(k) of the Code only for the taxable year in which received by her. As to such amounts the wife is to be treated as if she makes her income tax returns on the cash receipts and disbursements basis regardless of whether she normally makes such returns on the accrual basis. However, if the periodic payments described in section 22(k) are to be made by an estate or trust, such periodic payments are to be included in the wife's taxable year in which they are includible according to the rules as to income of estates and trusts provided in sections 162, 164 and 171(b) of the Code whether or not such payments are made out of the income of such estates or trusts.

Section 39.22(k)-1(b) of Regulations 118 provides, in part, that the full amount of periodic payments received under the circumstances described in section 22(k) of the Code is required to be included in the gross income of the recipient whether such amounts are derived in whole or in part from income received or accrued by the source to which such payments are attributable. Thus, it matters not that such payments are attributable to property in trust, to life insurance, endowment or annuity contracts or to any other interest in property, or are paid directly or indirectly by the obligor husband from his income or capital.

Section 171(b) of the Code provides as follows:

* * * For the purposes of computing the net income of the estate or trust and the net income of the wife described in section 22(k) or subsection (a) of this section, such wife shall be considered as the beneficiary specified in this supplement. A periodic payment under section 22(k) to any part of which the provisions of this supplement are applicable shall be included in the gross income of the beneficiary in the taxable year in which under this supplement such part is required to be included.

Where arrearages in periodic alimony payments are paid by the husband or his estate in a lump sum such sum is to be treated for tax purposes in the same manner as the periodic payments would have been treated if paid when due. Section 22(k) of the Code expressly declares that payments may still be periodic even though they are not made at regular intervals. That such payments are not made and later the aggregate of the arrears is paid obviously does not alter the nature of the payment. The amount paid represents the sum of past due and unpaid amounts which the husband was obligated to pay periodically. See *Sarah L. Narischkine Estate* v. *Commissioner*, 14 T. C. 1128, affirmed, 189 Fed. (2d) 257.

In *Antoinette L. Holahan et al.* v. *Commissioner*, 21 T. C. 451, affirmed, 222 Fed. (2d) 182, the Tax Court stated with respect to the Narischkine Estate case and other cases as follows:

While the opinions in each of these cases did not discuss the precise contentions presented herein, the facts so clearly encompassed the question it is to be presumed it was taken into consideration. We there held that the alimony payments for prior years were periodic payments, even though the entire amounts were paid in the taxable year, and that they constituted taxable income to the wives in the year received under the provisions of section 22(k) of the Internal Revenue Code. Our attention has not been called to any authority holding to the contrary.

Accordingly, it is held that the part of the lump-sum payment made to a wife under an agreement with the executor of the estate of her divorced husband, representing arrearages in periodic payments required by an amended decree of divorce, constitutes "periodic payments" includible in the gross income of the taxpayer in the year of receipt within the meaning of section 22(k) of the Internal Revenue Code. The balance of the amount received represents a lump-sum payment and does not come within the intendment of such section and, therefore, is not includible in her gross income for Federal income tax purposes.

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

REGULATIONS 118, SECTION 39.23(a)-1: Business expenses. Rev. Rul. 55-442

Preliminary expenses incurred in search of a camp site for the purpose of establishing a boys' camp and expenses attributable to the promotion of the business to be acquired, do not constitute ordinary and necessary business expenses within the meaning of section 23(a) of the Internal Revenue Code of 1939. The expenses incurred in the acquisition of the selected camp site are capital in nature and as such are amortizable over the life of the lease.

Advice has been requested with respect to the treatment of expenses incurred in establishing a boys' camp.

A taxpayer, in connection with the selection of a site and the establishment of a sales program for a boys' camp which he is acquiring and will operate, incurred traveling expenses and other preliminary and promotional expenses with respect thereto. After considering several locations a site was chosen, an advance payment was made, and a lease on the site was signed. Before the lease was signed the taxpayer staked out the building locations, planned buildings and other necessary facilities, secured pictures to be used in interesting boys in the project, interviewed people who would be influential in making the camp successful, prepared and mailed out descriptive folders relative to the advantages of the camp and through correspondence with the state board of standards for child care obtained information relative to the regulations concerning boys' camps.

Expenditures incurred by the taxpayer fall into three general categories; namely, (1) traveling expenses incurred in search of a business, (2) expenses incurred relative to the advance promotion of the business to be acquired, and (3) expenses incurred in the acquisition of the specific business property. Whether expenditures are capital in nature depends on the facts of the particular case. See *George C. Westervelt* v. *Commissioner*, 8 T. C. 1248. In the Westervelt case the Tax Court was primarily concerned with the current deductibility of expenses incurred preparatory to a taxpayer's entering the cattle business.

With respect to allowable deductions from gross income for certain expenses, section 23(a) of the Internal Revenue Code of 1939 provides, in part, as follows:

> (1) TRADE OR BUSINESS EXPENSES.—
> (A) In General.—All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, * * *
> * * * * * * *
> (2) NON-TRADE OR NON-BUSINESS EXPENSES.—In the case of an individual, all the ordinary and necessary expenses paid or incurred during the taxable year for the production or collection of income, or for the management, conservation, or maintenance of property held for the production of income.

Section 39.23(a)-15(f) of Regulations 118 provides in part that among expenditures not allowable as deductions under section 23(a)(2) of the Code are expenses such as expenses incurred in seeking employment or in placing one's self in a position to begin rendering personal services for compensation. Expenses in category (1) relating to expenses incurred in search of a business, which are comparable to expenses incurred in seeking employment, are not deductible under section 23 (a) or any other section of the Code.

Expenses attributable to the advance promotion of the business to be acquired, such as interviewing influential people and advertising through distribution of descriptive literature, are not deductible as ordinary and necessary expenses under section 23(a)(1)(A) of the Code because such expenses were not incurred in carrying on an established trade or business. Neither are such expenses deductible as nontrade or nonbusiness expenses under section 23 (a)(2) of the Code because they were not incurred for the production or collection of income, or for the management, conservation, or maintenance of property held for the production of income.

Expenses in category (3), such as attorney's fees and legal expenses, or bonuses paid for signing the lease, or appraisal costs in connection with obtaining possession of the premises, incurred in the acquisition of the specific property are capital in nature and as such are amortizable over the life of the lease on the camp site.

Accordingly, it is held that the preliminary expenses incurred in search of a camp site for the purpose of establishing a boys' camp and expenses attributable to the promotion of the business to be acquired do not constitute ordinary and necessary business expenses within the meaning of section 23(a) of the Internal Revenue Code of 1939; further, that expenses incurred in the acquisition of the selected site are capital in nature and as such are amortizable over the life of the lease.

(Also Section 23(p); Regulations 118, Section 39.23(p)-1.) Rev. Rul. 55-446

Bonuses payable under an incentive compensation plan, the exact amounts of which cannot be determined and paid by an accrual basis taxpayer until early in the year immediately following the close of the taxable year of accrual, would properly be accruable and deductible for Federal income tax purposes, subject to the test of "reasonableness" under section 23(a) of the Internal Revenue Code of 1939, for the year to which they relate, provided the total bonuses are definitely determinable through a formula in effect prior to the end of the taxable year and the employer has definitely obligated itself, prior to the close of such taxable year, to make payment thereof by delivering to each employee concerned either a written or oral notice of the percentage of such total to be awarded to him and payment of such bonuses is made as soon after the close of the taxable year as is administratively feasible.

Advice has been requested whether bonus payments under an incentive compensation plan which cannot be determined or paid by the employer until after the close of the taxable year will be properly accruable and deductible for income tax purposes under section 23(a) of the Internal Revenue Code of 1939 as business expenses in the year to which they relate, or under section 23(p) of the Code as payments under a deferred compensation plan.

It has been the policy of the taxpayer, a company on the accrual basis of accounting, to compensate its salaried employees by means of regular annual salaries plus a year-end bonus dependent upon the profits earned by the company. Recently, this procedure was formalized by the approval of an incentive compensation plan whereby a formula specifies the amount of profits available for bonus payments. When the net income of the company exceeds the dividend requirements there will be set aside, out of such excess, a percentage of the total net income as a general incentive fund. An employee's participation, generally, will not exceed 16⅔ percent of his base salary, but in exceptional cases of meritorious performance participation not to exceed 100 percent of base salary will be allowed.

From the balance of the net income, including the provision for the general incentive fund, there is set aside a graduated percentage as an executive incentive fund in an amount not in excess of 100 percent of the aggregate base salaries (in respect of the year for which the incentive payments are made) of the key executives who participate in such fund, but in no event to exceed a net cost to the company of $200,000 *a*.

A salary and incentive committee meets in early December of each year to decide how much of each fund will be distributed to whom, and in what amounts. Its action is approved by the company's board of directors. Each employee is advised before the end of the year as to the percentage of the total bonus which he will receive. Payment of the bonuses is made early in the following year, after the company's auditors have determined the net income or have certified that the earnings were sufficient to pay the schedule of proposed bonuses, but in any event prior to the due date of the company's Federal income tax return for the year in which the bonuses were earned.

Section 23(a) of the Code provides that in computing net income there shall be allowed as deductions:

> 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 * * *.

Section 23(p) of the Code provides in part as follows:

> * * * if compensation is paid or accrued on account of any employee under a plan deferring the receipt of such compensation, such * * * compensation shall not be deductible under subsection (a) but shall be deductible, if deductible under subsection (a) without regard to this subsection, under this subsection * * *
>
> * * * * * * *
>
> (D) In the taxable year when paid, if the plan is not one included in paragraph (A), (B), or (C), if the employees' rights to or derived from such * * * compensation are nonforfeitable at the time the * * * compensation is paid.

In the instant case, it appears that the payments are current payments for current services rendered and therefore are not deferred compensation within the contemplation of section 23(p) of the Code.

Accordingly, it is held that bonuses payable under an incentive compensation plan, the exact amounts of which cannot be determined and paid by an accrual basis taxpayer until early in the year immediately following the close of the taxable year of accrual, would properly be accruable and deductible for Federal income tax purposes, subject to the test of "reasonableness" under section 23(a) of the Code, for the year to which they relate, provided the total bonuses are definitely determinable through a formula in effect prior to the end of the taxable year and the employer has definitely obligated itself, prior to the close of such taxable year, to make payment thereof by delivering to each employee concerned either a written or oral notice of the percentage of such total to be awarded to him and that payment of such bonuses is made as soon after the close of the taxable year as is administratively feasible.

This ruling is not applicable to payments made to a beneficiary because of the death of an employee.

Payment made by an executor of an estate from his own funds to coexecutors of the estate for their assistance to him in the administration of the estate. See Rev. Rul. 55-447, page 533.

Deductibility of lump sum payment into the Wisconsin unemployment reserve fund in excess of the amount otherwise required to be paid. See Rev. Rul. 55-452, page 38.

Costs and expenses applicable to property held for sale in ordinary course of business made the subject of a gift. See Rev. Rul. 55-531, page 520.

Expenses paid by lessee during use of leased industrial equipment and business machinery. See Rev. Rul. 55-540, page 39.

Life insurance carried by farmers' cooperative on members. See Rev. Rul. 55-558, page 270.

Deductibility of expenditures required to be made by a postmaster for the purchase or rental of lock boxes and fixtures for the general use of the public. See Rev. Rul 55-579, page 47.

Payments by a corporation to a hospital association in return for facilities and services for the treatment of its employees. See Rev. Rul. 55-616, page 545.

Federal stamp taxes paid on transfers or conveyances of securities or real estate upon sales thereof as a dealer. See Rev. Rul. 55-756, page 536.

REGULATIONS 118, SECTION 39.23(a)-10: Rentals.

Rentals paid by lessee for use of leased industrial equipment and business machinery. See Rev. Rul. 55-540, page 39.

REGULATIONS 118, SECTION 39.23(a)-15: Nontrade or nonbusiness expenses. (Also Section 23(a); Regulations 118, Section 39.23(a)-1.) — Rev. Rul. 55-447

Where an executor of an estate, not being in the trade or business of estate administration, but entitled to commissions from the estate for his services, makes payments individually from his own funds to coexecutors of the estate or others for their experienced assistance to him in the administration of the estate, such assistance made necessary because of their greater familiarity with the problems of the estates, the payments so made are deductible, for the taxable year paid in computing his net income, as nontrade or nonbusiness expenses incurred for the production of income as provided in section 23(a)(2) of the Internal Revenue Code of 1939.

Advice has been requested as to the deductibility under section 23(a) of the Internal Revenue Code of 1939 of certain payments made by an executor of an estate to two other coexecutors of the estate for services rendered by them to him in the performance of his duties as executor.

In the instant case, a deceased member of a business firm left a substantial estate, naming his son and two business associates in the firm as coexecutors. The son is not a member of the business firm. His experience in financial and business matters is limited and he is

required to be absent from time to time for reasons of health. The administration of the estate requires financial and business skill and experience ordinarily associated with the conduct of large enterprises, and available only in persons who have had years of intimate knowledge of the details of the business. The two other coexecutors possessed such skill and experience, and their assistance, advice and initiative are vital to the son to enable him to discharge properly his duties as executor, not only to administer the estate to enhance the value thereof, but to avoid losses and judicial surcharge therefor upon the accounting before the court. Under the laws of the state, each of the executors is entitled to commissions based upon the gross estate, and the will of the deceased does not contain any direction limiting the rights of the executors to full statutory commissions.

In order to advance the orderly administration of the estate and to induce the two coexecutors to perform such duties as the son might lawfully delegate to them, the son made an agreement with them for extra compensation for their services, to be paid by him from his own funds, represented by a percentage of the executor's fees received by him.

Subsection (1) of section 23(a) of the 1939 Code provides that in computing net income there shall be allowed as deductions all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business. Subsection (2) of section 23(a) provides that, in the case of an individual, nontrade or nonbusiness expenses paid or incurred during the taxable year for the production or collection of income or for the management, conservation, or maintenance of property held for the production of income shall be allowed as deductions in computing net income.

In *United States* v. *Herbert Rivington Pyne et al.*, 313 U. S. 127, Ct. D. 893, C. B. 1941-1, 342, the Court held that estate administration *per se* is not a business, and that "Executors who engaged actively in trade or business are the exception and not the rule." In *Trust u/w of Mary L. (Flagler) Bingham* v. *Commissioner*, 325 U. S. 365, Ct. D. 1643, C. B. 1945, 103, it was held that counsel fees and expenses paid by trustees of a testamentary trust in connection with tax and other problems were deductible from gross income of the trust as nontrade or nonbusiness expenses within the meaning of section 23(a)(2) of the 1939 Code; that the effect of section 23(a)(2) was to provide for a class of nonbusiness deductions coextensive with the business deductions allowed by section 23(a)(1), except for the fact that, since they were not incurred in connection with a business, the section made it necessary that they be incurred for the production of income or in the management or conservation of property held for the production of income.

Accordingly, based upon the facts in this case as stated above, it is held that the activities of the executor in administering the estate did not constitute the carrying on of a trade or business; however, the amounts paid by him from commissions received from the estate to two coexecutors for their assistance to him in the performance of his duties are deductible by him for the taxable year paid in computing his net income as nontrade or nonbusiness expenses incurred for the production of income under the provisions of section 23(a)(2) of the Internal Revenue Code of 1939.

(Also Section 812(b); Regulations 105, Section 81.32.) Rev. Rul. 55-524

That portion of expenses paid or incurred in the administration of a community estate as are allowed by the laws of the jurisdiction under which the estate is being administered, which are not deductible by the estate of the decedent because paid or incurred in respect of the share of the community property belonging to the surviving spouse, may be deducted by the surviving spouse under section 23(a)(2) of the Internal Revenue Code of 1939 to the extent that the expenses are of the character deductible under that section.

Advice has been requested whether administration expenses which are not deductible by the estate of the decedent, because they were paid or incurred in respect of the share of the community property belonging to the surviving spouse, may be deducted by the surviving spouse in her individual income tax return.

In the Federal estate tax return filed on behalf of the estate of the decedent, there was claimed and allowed a deduction of only one-half of those expenditures, consisting of executor's commissions and miscellaneous administration expenses, because one-half of such expenditures were made on behalf of the community estate of the surviving spouse. The question presented is whether the surviving spouse may deduct the expenditures incurred in respect of her share of the community property in her individual income tax return.

Section 812(b) of the Internal Revenue Code of 1939 allows a deduction for various expenses, including administration expenses, in "such amounts * * * as are allowed by the laws of the jurisdiction, * * * under which the estate is being administered * * *."

In the case of *Worth S. Lee* v. *Commissioner*, 11 T. C. 141, acquiescense C. B. 1948-2, 3, the court held that the decedent's gross estate is entitled to a deduction of only one-half of those expenditures consisting of executrix's commission and the miscellaneous administration expenses, because one-half of such expenditures were made on behalf of the surviving wife's one-half of the community property.

Section 23(a)(2) of the Internal Revenue Code of 1939 provides that in computing net income there shall be allowed as deductions, in the case of an individual, all the ordinary and necessary expenses paid or incurred during the taxable year for the production or collection of income, or for the management, conservation, or maintenance of property held for the production of income.

In view of the foregoing, it is held that expenses paid or incurred in the administration of a community estate as are allowed by the laws of the jurisdiction under which the estate is being administered, which are not deductible by the estate of the decedent because paid or incurred in respect of the share of the community property belonging to the surviving spouse, may be deducted by the surviving spouse under section 23(a)(2) of the Internal Revenue Code of 1939 to the extent that the expenses are of the character deductible under that section.

This ruling does not extend to community estates taxable under the provisions of section 811(e)(2) of the Internal Revenue Code of 1939, as amended by section 402(b) of the Revenue Act of 1942, which remained in effect until repealed by section 351(a) of the Revenue Act of 1948.

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

REGULATIONS 118, SECTION 39.23(c)-2: Federal duties and excise taxes. (Also Section 23(a), 24(a), 111; Sections 39.23(a)-1, 39.24(a)-2, 39.111-1.) — Rev. Rul. 55-756

The Internal Revenue Service will continue to follow I. T. 3806, C. B. 1946-2, 41, notwithstanding the decision in *Walter Hirshon* v. *United States*, 116 Fed. Supp. 135.

I. T. 3806, C. B. 1946-2, 41, has been reconsidered in the light of the decision of the United States Court of Claims in *Walter Hirshon* v. *United States*, 116 Fed. Supp. 135.

The Court held in the Hirshon case that Federal stock transfer taxes imposed on one who is carrying on the business of buying and selling stock as a trader on his own account were "ordinary and necessary business expenses" under section 23(a) of the Internal Revenue Code of 1939 and were, therefore, deductible for Federal income tax purposes. This decision is in conflict with the position of the Internal Revenue Service as expressed in I. T. 3806, *supra*.

I. T. 3806, *supra*, holds that where Federal stamp taxes are paid on transfers or conveyances of securities or real estate upon sales thereof by a trader or other non-dealer, such taxes are selling costs or offsets against selling prices to be taken into account only in determining the net amount realized and gains or losses, on the particular transaction involved, under section 111 of the Internal Revenue Code.

Where a taxpayer purchases and sells securities as a trader or other non-dealer, the Internal Revenue Service considers the Federal stock transfer taxes as selling charges or offsets against selling prices in the same manner as attorney's fees, brokers' fees, or selling commissions. *Helvering* v. *Robert C. Winmill*, 305 U. S. 79, Ct. D. 1365, C. B. 1938-2, 212; *Adolph B. Spreckles* v. *Commissioner*, 315 U. S. 626, Ct. D. 1547, C. B. 1942-1, 198. The basis for this position is that the liability for Federal stock transfer taxes is a charge specifically attributable to the transaction of the particular sale involved, whether it be an isolated transaction on the part of taxpayer or one of a series of transactions, rather than a general ordinary and necessary expense under section 23(a) of the Code.

In view of the above, the Internal Revenue Service feels constrained to adhere to the position expressed in I. T. 3806, *supra*, and will not follow the decision in the Hirshon case.

SECTION 23(d).—DEDUCTIONS FROM GROSS INCOME: TAXES OF SHAREHOLDER PAID BY CORPORATION

REGULATIONS 118, SECTION 39.23(d)-1: Tax on bank or other stock. — Rev. Rul. 55-615

Revenue Ruling 92, which holds that the tax imposed by the Commonwealth of Pennsylvania on the shares of banks and certain other corporations is allowable as a deduction, by corporations employing

the accrual method of accounting, in the taxable year such tax is imposed even though paid in a later year, will not be applied retroactively to taxable years ended prior to June 8, 1953. For the first taxable year ended after June 8, 1953, such taxpayers may deduct both the tax paid in that year which is attributable to prior years and the tax imposed for such year.

Revenue Ruling 92, C. B. 1953-1, 39, is modified accordingly.

Revenue Ruling 92, C. B. 1953-1, 39, published June 8, 1953, holds that, with respect to corporations employing the accrual method of accounting, the tax on shares of banks and certain other corporations imposed by the Commonwealth of Pennsylvania is allowable as a deduction under section 23(d) of the Internal Revenue Code of 1939 in the year for which imposed even though paid in a later year. Since the tax is imposed on the actual value of the shares as of December 31 of each year, it accrues at that time. Revenue Ruling 92, *supra*, revoked G. C. M. 21329, C. B. 1939-2, 179, which established the prior position of the Service that such tax was allowable as a deduction, for Federal income tax purposes, in the year in which paid regardless of the bank's method of accounting.

In view of the fact that Revenue Ruling 92, *supra*, was not published until June 8, 1953, many corporations in filing their Federal income tax returns for taxable years ended prior to such date had deducted such taxes in accordance with the provisions of G. C. M. 21329, *supra*.

If Revenue Ruling 92, *supra*, were to be strictly applied, a corporation employing the accrual method of accounting, which filed its Federal income tax return for the calendar year 1952 on March 15, 1953, and which, under the authority of G. C. M. 21329, *supra*, had taken a deduction for taxes paid in 1952 attributable to 1951, would not be permitted to take such deduction in 1952 but would be permitted to take the deduction only in 1951. If the taxable year 1951 is now barred by the statute of limitations, the corporation would lose the benefit of the deduction in 1951 and to that extent Revenue Ruling 92, *supra*, would work to its detriment.

In view of the inequity resulting from the application of Revenue Ruling 92, *supra*, to corporations employing the accrual method of accounting as indicated above, the Commissioner under the authority of section 3791(b) of the Internal Revenue Code of 1939, and section 7805(b) of the Internal Revenue Code of 1954, will not apply Revenue Ruling 92, *supra*, retroactively to taxable years ended prior to June 8, 1953.

Accordingly, with respect to taxable years ended prior to June 8, 1953, deductions for the tax paid which were taken in the year of payment will not be disturbed. For taxable years ending after June 8, 1953, taxpayers using the accrual method of accounting will be required to deduct the tax in the year in which it accrues. For the first taxable year ended after June 8, 1953, such taxpayers will also be permitted to deduct the tax paid in that year which was imposed for, but not deducted in, a prior taxable year.

Revenue Ruling 92, *supra*, is modified accordingly.

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

REGULATIONS 118, SECTION 39.23(e)-1: Losses by individuals.

Treatment by stockholders of assessments paid by them on worthless double liability bank stock. See Rev. Rul. 55-619, page 52.

SECTION 23(g).—DEDUCTIONS FROM GROSS INCOME: CAPITAL LOSSES

REGULATIONS 118, SECTION 39.23(g)-1: Capital losses.

Treatment by stockholders of assessments paid by them on worthless double liability bank stock. See Rev. Rul. 55-619, page 52.

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

REGULATIONS 118, SECTION 39.23(k)-3: Uncollectible deficiency upon sale of mortgaged or pledged property. Rev. Rul. 55-434

Where a mutual savings bank, which was exempt from Federal income tax for years beginning prior to January 1, 1952 and obtained no tax benefit from bad debt losses in those years acquired at foreclosure sale in 1949 property on which it held a nonliquidating mortgage, it may not claim as the unadjusted basis of the property the amount of the mortgage indebtedness remaining unsatisfied at the time of foreclosure. The unadjusted basis of the property foreclosed for the purpose of determining gain or loss on its subsequent sale in 1953 is the fair market value of the property at the date of acquisition by the bank, as provided in section 39.23(k)-3 of Regulations 118.

Advice has been requested as to whether the unadjusted basis of real property acquired at a foreclosure sale by a mutual savings bank in 1949, when the income of the bank was not subject to Federal income tax and no tax benefit was obtained from the loss on the foreclosure sale, is the fair market value of the property upon acquisition in 1949 or the amount of the mortgage debt immediately prior to the foreclosure sale, for the purpose of determining gain or loss when the bank subsequently sold the property in 1953, in which year its income was subject to Federal income tax.

In 1930, the X savings bank loaned the owners of a parcel of improved real property the sum of $115x$ dollars, accepting as security a nonliquidating mortgage upon the premises. The grantors being in default in 1948, foreclosure proceedings were instituted by the bank in 1949 and the property was bid in at a nominal amount. At that time the entire principal amount of the loan remained outstanding. One

month after the foreclosure sale, taxpayer obtained from a firm of real estate specialists an appraisal of the property which amounted to $91x$ dollars. The property was sold by the bank for $90x$ dollars in January, 1953, a year in which the bank was subject to Federal income tax.

Section 313 of the Revenue Act of 1951 repealed section 101(2) of the Internal Revenue Code of 1939 with respect to the exemption from Federal income tax of the income of mutual savings banks, domestic building and loan associations, and cooperative banks for taxable years beginning after December 31, 1951, and permitted such organizations to deduct for taxable years beginning after that date reasonable amounts credited to a reserve for bad debts. Since income tax deductions for bad debts were not available to such institutions for the years beginning prior to January 1, 1952, the X savings bank did not claim or obtain the benefit of any bad debt or other deduction for a loss resulting from the foreclosure in 1949.

Section 39.23(k)-3 of Regulations 118 provides that the unadjusted basis of property acquired upon foreclosure is the fair market value of such property at the date of the acquisition thereof; that the fair market value of the property shall be presumed to be the amount for which it is bid in by the taxpayer in the absence of clear and convincing proof to the contrary. There is no provision in Federal income tax law making section 39.23(k)-3, *supra*, inapplicable to years during which mutual savings banks were not subject to tax. Consequently, even though the taxpayer received no tax benefit from the loss sustained, the basis of the property foreclosed must be determined in accordance with the provisions of section 39.23(k)-3. In the instant case, the value of the property was appraised 1 month after the foreclosure at $91x$ dollars rather than the nominal amount at which the property was bid in. A bid price less than the full amount of the claim is not conclusive evidence of the value of property acquired under foreclosure as a basis for the property upon future disposition. See *Highland Creek Coal Co., Inc.*, v. *Commissioner*, Board of Tax Appeals Memorandum Opinion, entered November 30, 1940; *Stormfeltz-Lovely Company Trust et al.* v. *Commissioner*, Tax Court Memorandum Opinion, entered May 27, 1943. Therefore, the unadjusted basis of the property foreclosed, in this instance, is $91x$ dollars, the amount determined to have been the fair market value 1 month after foreclosure, and not the amount of the debt immediately prior to the foreclosure in 1949.

Accordingly, it is held that where a mutual savings bank, which was exempt from Federal income tax for years beginning prior to January 1, 1952, and obtained no tax benefit during those years from bad debt losses, acquired at foreclosure sale in 1949 property on which it held a nonliquidating mortgage, it may not claim as the unadjusted basis of the property the amount of the mortgage indebtedness remaining unsatisfied at the time of foreclosure. The unadjusted basis of the property foreclosed, for the purpose of determining gain or loss on its subsequent sale in 1953, is the fair market value of the property at the date of acquisition by the bank, as provided in section 39.23(k)-2 of Regulations 118.

REGULATIONS 118, SECTION 39.23(k)-5: Reserve for bad debts. Rev. Rul. 55-435

Accounts denominated as "mortgagers' escrow deposit accounts," covering amounts required to be deposited by the mortgagor with a mortgagee bank (an institution as defined in section 39.23(k)-5(b)(2)(i) of Regulations 118) for the purpose of meeting the mortgagor's obligation for taxes, water rates, special assessments and insurance premiums on the mortgaged property, constitute "deposits" within the meaning of section 39.23(k)-5(b)(2)(iv) of Regulations 118, where such accounts are segregated as to amounts and included as an asset of the bank on its balance sheet and such amounts are held at the general risk of the bank's business. Accordingly, such a bank, in computing a reasonable addition to its reserve for bad debts under section 23(k)(1) of the Internal Revenue Code of 1939, may include the amounts of its "mortgagors' escrow deposit accounts" as part of its total deposits or withdrawable accounts.

Adjustments to basis of mortgages held by a mutual savings bank for purpose of determining addition to bad debt reserve where the bank canceled a portion of mortgage indebtedness. See Rev. Rul. 55-704, page 274.

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

REGULATIONS 118, SECTION 39.23(l)-1: Depreciation.

Depreciation on industrial equipment and business machinery acquired through leasing transactions. See Rev. Rul. 55-540, page 39.

Depreciation on office equipment acquired through a leasing transaction. See Rev. Rul. 55-541, page 19.

Depreciation on business equipment acquired through a leasing transaction. See Rev. Rul. 55-542, page 59.

SECTION 23(m).—DEDUCTIONS FROM GROSS INCOME: DEPLETION

REGULATIONS 118, SECTION 39.23(m)-5: Computation of depletion based on percentage of income in case of certain mines or other natural deposits.

Application of an end-use test with respect to the depletion rate allowable on minerals which are used as common dimension, or crushed or broken stone. See Rev. Rul. 55-700, page 569.

SECTION 23(p).—DEDUCTIONS FROM GROSS INCOME: CONTRIBUTIONS OF AN EMPLOYER TO AN EMPLOYEES' TRUST OR ANNUITY PLAN AND COMPENSATION UNDER A DEFERRED-PAYMENT PLAN

REGULATIONS 118, SECTION 39.23(p)-1: Contributions of an employer to an employees' trust or annuity plan and compensation under a deferred-payment plan; in general. (Also Section 22(b), Section 39.22(b)(1)-2.)

Rev. Rul. 55-436

Where an employer puts into effect a self-insured, death benefits plan whereby it is agreed that upon the death of a retired employee the widow will be paid an amount equal to the monthly retirement pension of the employee, subject to a maximum amount per month, for a limited number of months, the payments under a binding obligation are considered to be pensions paid under a plan deferring the receipt of compensation for which deductions of amounts paid are allowable under section 23(p) of the Internal Revenue Code of 1939. The payments, not in excess of $5,000, are excludable from the gross income of the widow as amounts paid by reason of the death of an employee under section 22(b)(1)(B) of the Code where the deceased employee did not possess a nonforfeitable right to receive any part of such payments while living.

Advice has been requested whether, under the facts indicated below, death payments which may be made to widows of deceased retired employees are deductible under section 23(p) of the Internal Revenue Code of 1939, as pensions paid under a deferred compensation plan and whether such payments are excludable from the gross income of the widow as amounts paid by reason of the death of an employee under section 22(b)(1)(B) of the Code.

The taxpayer entered into a binding obligation with its retired employees under which, in lieu of continuing group insurance after the retirement of an employee, it will be required to pay, through self-insurance, monthly payments to the widow upon the death of a retired employee. Such payments will be equal to the retired employee's monthly pension, subject to a maximum amount per month, for a limited number of months or until the death of the widow, whichever occurs first. The payments will not be paid to any other person nor to the estate of the retired employee. The obligation will be evidenced by a written certificate and the retired employee has no other claim or vested right in the amount which may be distributed.

Section 23(p) of the Code provides, in effect, that if compensation is paid or accrued on account of any employee under a plan deferring the receipt of such compensation, then such compensation shall be deductible when paid under this section, but only to a certain limited extent not here applicable.

Section 39.23(p)-1(c) of Regulations 118 provides, in part, that section 23(p) is not confined to formal stock bonus, pension, profit-sharing, and annuity plans, but it includes any method of contribution or compensation having the effect of a stock-bonus, pension, profit-sharing, or annuity plan, or similar plan deferring the receipt of compensation. Thus, where a corporation is under an obligation, whether funded or unfunded, to pay a pension or other deferred com-

pensation to an employee, there is a method having the effect of a plan deferring the receipt of compensation for which deductions are governed by section 23(p). If an employer on the accrual basis defers paying any compensation under such an arrangement, a deduction therefor is not allowable until the year in which the compensation is paid.

Section 22(b)(1)(B) of the Code provides that amounts received under a contract of an employer providing for the payment of such amounts to the beneficiary of an employee, paid by reason of the death of an employee, whether in a lump sum or otherwise, shall be excluded from gross income. The aggregate amount thus excludable by all the beneficiaries of the employee under all such contracts of any one employer may not exceed $5,000.

Section 39.22(b)(1)-2(d) of Regulations 118 provides that the exclusion from gross income provided by section 22(b)(1)(B) of the Code is limited solely to those amounts paid by or on behalf of an employer which, by the terms of the contract with the employee are specifically designated and intended as a death payment, paid only by reason of the death of the employee. The exclusion does not apply to amounts with respect to which the deceased employee possessed, immediately prior to his death, a nonforfeitable right to receive the amounts while living.

In view of the foregoing, it is held that where an employer enters into a binding obligation under which it will be required to pay death benefits, through self-insurance, consisting of monthly payments to the widow of a retired employee, in an amount equal to the retired employee's monthly pension, subject to a maximum amount per month, for a limited number of months, and where the employee had no claim or vested right to such amounts while living, the payments are considered to be pensions paid under a plan deferring the receipt of compensation for which deductions of amounts paid are allowable under section 23 (p) of the Code. See Rev. Rul. 55-212, C. B. 1955-1, 299. Payments, not in excess of $5,000, are excludable from the gross income of the widow as amounts paid by reason of the death of an employee under section 22(b)(1)(B) of the Code.

Bonus payments under an incentive compensation plan paid after the close of the taxable year. See Rev. Rul. 55-446, page 531.

Bases of deduction limits for a pension plan providing fixed benefits and a stated rate of contributions. See Rev. Rul. 55-681, page 585.

REGULATIONS 118, SECTION 39.23(p)-2: Information to be furnished by employer claiming deductions.

Information to be filed by trustees of employees' trusts established by tax-exempt organizations. See Rev. Rul. 55-758, page 587.

REGULATIONS 118, SECTION 39.23(p)-4: Contributions of an employer to or under an employees' pension trust or annuity plan that meets the requirements of section 165(a); application of section 23(p)(1)(A).

Proration of employer's annual contribution, to a qualified employees' trust, for the short taxable year resulting from a change in the employer's accounting period. See Rev. Rul. 55-428, page 230.

Contributions of an employer used to purchase retirement income contracts containing life insurance benefits. See Rev. Rul. 55-748, page 234.

REGULATIONS 118, SECTION 39.23(p)-7: Pension and annuity plans; limitations under Section 23(p)(1)(A)(iii).

Deductions by an employer for contributions to fund past service benefits in a pension plan where employee transfers to the employment of a subsidiary corporation. See Rev. Rul. 55-629, page 588.

REGULATIONS 118, SECTION 39.23(p)-11: Contributions of an employer under a plan that does not meet the requirements of section 165(a); application of section 23(p)(1)(D). Rev. Rul. 55-525

Where a corporation sets up a revocable trust merely to act as the custodian of deferred compensation bonus funds, payments of which are to be made to key employees upon retirement, the trust funds will be treated as assets of the corporation and income derived therefrom will be includible in the net income of the corporation in accordance with section 166 of the Internal Revenue Code of 1939. Deduction for such deferred compensation bonus payments will be allowed the corporation only in the year in which paid to the employee or his beneficiaries and then only to the extent they may be deemed reasonable compensation for services rendered, as provided in section 23(p) of the Code.

Advice has been requested whether the income derived by a revocable trust set up by a corporation merely for administrative convenience to act as custodian of deferred compensation bonus payments, with respect act as custodian of deferred compensation bonus payments, with respect to key employees, is taxable to the corporation and whether payments made on a deferred, contingent basis are deductible under section 23 (p) of the Internal Revenue Code of 1939.

For a number of years a corporation maintained a policy of paying cash bonuses to key employees at the close of each taxable year. It has now instituted a deferred compensation plan whereby only a part of the cash bonuses are actually paid to the employees, the balance being made payable in common stock of the corporation on a deferred, contingent basis. These deferred compensation shares of common

stock are not delivered to the key employees at the time of issuance, nor do the employees at that time acquire any fixed or vested rights in such shares or in any dividends paid thereon. The shares are placed in the hands of a trustee set up by the corporation for administrative reasons to act as its custodian and paying agent. The corporation's right to revoke the trust is absolute and may be invoked at any time for any reason.

Section 166 of the Code provides that—

> Where at any time the power to revest in the grantor title to any part of the corpus of the trust is vested—(1) in the grantor, either alone or in conjunction with any person not having a substantial adverse interest in the disposition of such part of the corpus or the income therefrom, or (2) in any person not having a substantial adverse interest in the disposition of such part of the corpus or the income therefrom, then the income of such part of the trust shall be included in computing the net income of the grantor.

Subparagraph (c) of section 39.23(p)-1 of Regulations 118 provides in part that section 23(p) of the Code is not confined to formal stock bonus, pension, profit-sharing, and annuity plans, or deferred compensation plans, but it includes any method of contributions or compensation having the effect of a stock bonus, pension, profit-sharing, or annuity plan, or similar plan deferring the receipt of compensation. Thus, where a corporation is under an obligation, whether funded or unfunded, to pay a pension or other deferred compensation to an employee, there is a method having the effect of a plan deferring the receipt of compensation for which deductions are governed by section 23(p) of the Code.

Thus, section 23(p) of the Code is applicable in any case where "compensation is paid or accrued on account of any employee under a plan deferring the receipt of such compensation." Since the plan defers the receipt of the compensation provided thereunder, deductions for such payments are subject to the provisions and limitations of section 23(p)(1)(D) of the Code. Such provision limits the deduction of the employer to amounts paid.

Accordingly, it is held that since the trust is revocable and deemed to be merely an agency of the corporation, the trust funds are considered as assets of the corporation and income derived therefrom will be includible in the net income of the corporation in accordance with section 166 of the Code. Also, deduction for the deferred compensation bonus payments will be allowed the corporation only in the year in which distributions or payments are made to the employee or his beneficiary by the trust and then only to the extent they may be deemed reasonable compensation for services rendered, as provided in section 23(p) of the Code.

SECTION 23(q).—DEDUCTIONS FROM GROSS INCOME: CHARITABLE AND OTHER CONTRIBUTIONS BY CORPORATIONS

REGULATIONS 118, SECTION 39.23(q)-1: Contributions or gifts by corporations.

Payments by a corporation to a hospital association in return for facilities and services for the treatment of its employees. See Rev. Rul. 55-616, page 545.

SECTION 24(a).—ITEMS NOT DEDUCTIBLE: GENERAL RULE

REGULATIONS 118, SECTION 39.24(a)-2: Capital expenditures. Rev. Rul. 55-616

(Also Sections 23(a), 23(q); Regulations 118, Sections 39.23(a)-1, 39.23(q)-1.)

Payments made by a taxpayer corporation to a hospital association, under an agreement which furnished the taxpayer with particular rights and interests, for a period of 10 years, in certain properties and facilities of a hospital to be constructed, constitute capital expenditures which are recoverable through ratable deductions during the 10-year period.

Advice has been requested regarding the Federal income tax consequences of payments made by a taxpayer corporation to a hospital association under an agreement whereby the latter in consideration thereof would cause a hospital to be constructed and, after completion thereof, make available to the taxpayer for a period of ten years certain facilities and services of the hospital for the care and treatment of its employees.

During the past years, whenever employees of the corporation have required surgical attention or hospital treatment, it has been necessary to send them a distance of more than 15 miles to the nearest hospital. Traveling such a distance has proven costly to the corporation and also detrimental to sound business relations between the corporation and its employees. Under arrangements prevailing with that hospital, certain rooms and facilities were reserved for the exclusive use of the corporation's employees at its expense.

The city in which the taxpayer corporation is located was developed under the corporation's direction and has grown under its financial and civic support in various ways. A public campaign was completed by a hospital association, a nonprofit corporation, located in that city. Funds were raised and pledges received for the construction and operation of a general hospital in the city. The taxpayer corporation participated in the campaign by making a pledge during the taxable year to pay to the hospital association amounts equal in the aggregate to like payments made in subscriptions by the taxpayer's employees and by employees of other businesses in the community. The taxpayer's pledge and payments thereunder were part of an agreement with the hospital association whereby the latter in consideration thereof, agreed to make available to the taxpayer for a period of ten years after completion of the hospital (1) the facilities and services of the hospital for consultation, diagnosis, physiotherapy and laboratory studies, and (2) not less than twenty hospital beds for the care and treatment of the taxpayer's employees. The taxpayer concluded that the payments were justified in consideration of the services to be made available to its employees. The charges for such services would be at the regular established rates of the hospital. The board of directors of the hospital association is composed of 12 individuals, four of whom are employees of the taxpayer corporation. The number of the taxpayer's employees, together with members of their families, residing in the city and the immediate vicinity represents 95 percent of the population of the area, thus

indicating that they will derive almost the exclusive benefits from the facilities of the new hospital.

Since the agreement made with the hospital association furnished the taxpayer with particular rights and interests in the properties and facilities of the hospital for a period of 10 years over which the taxpayer can exert certain control, it is held that the payments are not deductible either as charitable contributions under section 23(q) of the Internal Revenue Code of 1939 or as ordinary and necessary business expenses under section 23(a)(1)(A) of the Code. Instead, the payments constitute capital expenditures which are recoverable over the 10-year period of economic usefulness to the taxpayer corporation of the facilities and services and the twenty beds to be made available for the treatment of its employees. See *Commodore's Point Terminal Company* v. *Commissioner*, 18 B. T. A. 385, acquiescence, C. B. IX-2, 13 (1930); *New Idria Quicksilver Mining Company, et al.* v. *Commissioner*, 2 T. C. 412, modified, 144 Fed. (2d) 918. Compare Rev. Rul. 160, C. B. 1953-2, 114, in which there was involved a contribution by a taxpayer who did not retain either ownership in or control over the fund or the assets of the project.

Amounts paid as "rental" for business equipment acquired in a leasing transaction. See Rev. Rul. 55-542, page 59.

Federal stamp taxes paid by a corporation on issuance of its bonds and on issuance or transfers of its stocks. See Rev. Rul. 55-756, page 536.

REGULATIONS 118, SECTION 39.24(a)-3: Premiums on business insurance.

Life insurance carried by farmers' cooperatives on members. See Rev. Rul. 55-558, page 270.

SECTION 24(c).—ITEMS NOT DEDUCTIBLE: UNPAID EXPENSES AND INTEREST

REGULATIONS 118, SECTION 39.24(c)-1: Disallowance of deductions for unpaid expenses and interest. Rev. Rul. 55-608

Where a solvent taxpayer, on the accrual basis, issues its notes or other evidences of indebtedness in liquidation of expenses incurred under section 23(a) of the Internal Revenue Code of 1939, or for interest accrued under section 23(b), and such notes or other evidences of indebtedness are issued by the taxpayer within its taxable year, or within two and one-half months after the close thereof, and such notes or other evidences of indebtedness have fair market value at the time when issued equal to their face values, then the face values of such notes or other evidences of indebtedness are deductible by the taxpayer in computing net income of the taxable year in which the expenses were incurred, or in which the interest accrued, as having been paid within the meaning of section 24(c) of the Code.

Reconsideration has been given to the nonacquiescences by the Internal Revenue Service in the decisions in *The Akron Welding and Spring Company* v. *Commissioner*, 10 T. C. 715, nonacquiescence, C. B. 1948–2, 5; and *Heatbath Corporation* v. *Commissioner*, 14 T. C. 332, nonacquiescence, C. B. 1950–2, 5, with the result that it has been decided to substitute acquiescences therefor. The change in position by the Service with respect to these cases is impelled by the decisions in *Musselman Hub-Brake Company* v. *Commissioner*, 139 Fed. (2d) 65, reversing Tax Court Memorandum Opinion, entered November 10, 1942; *Celina Manufacturing Company* v. *Commissioner*, 142 Fed. (2d) 449, reversing 47 B. T. A. 967; *Anthony P. Miller, Inc.* v. *Commissioner*, 164 Fed. (2d) 268, reversing 7 T. C. 729, certiorari denied, 333 U. S. 861; and *Industrial Equipment Company* v. *United States*, an unreported decision of the United States District Court for the Northern District of Oklahoma on November 1, 1954.

Each of the cases cited in the preceding paragraph involved the interpretation of the word "paid" as used in section 24(c) of the Internal Revenue Code of 1939. That section of the Code reads as follows:

> (c) UNPAID EXPENSES AND INTEREST.—In computing net income no deduction shall be allowed under section 23(a), relating to expenses incurred, or under section 23(b), relating to interest accrued—
>
> (1) If within the period consisting of the taxable year of the taxpayer and two and one-half months after the close thereof (A) such expenses or interest are not paid, and (B) the amount thereof is not includible in the gross income of the person to whom the payment is to be made; and
>
> (2) If, by reason of the method of accounting of the person to whom the payment is to be made, the amount thereof is not, unless paid, includible in the gross income of such person for the taxable year in which or with which the taxable year of the taxpayer ends; and
>
> (3) If, at the close of the taxable year of the taxpayer or at any time within two and one-half months thereafter, both the taxpayer and the person to whom the payment is to be made are persons between whom losses would be disallowed under section 24(b).

In Musselman Hub-Brake, Celina Manufacturing, and Anthony P. Miller cases, the Service took the position before the Tax Court of the United States that the issuance of notes did not constitute "payment" within the meaning of section 24(c) of the Code; and the contentions advanced in this respect by the Service were accepted by that court. On appeal, however, the appellate courts reversed the Tax Court in each of these decisions. Subsequently, the Service advanced the same arguments before the Tax Court in The Akron Welding and Spring Company, and Heatbath Corporation cases; but in these two cases the Tax Court ruled against the Service. In the Akron Welding case, the Court pointed out that its decision in Anthony P. Miller was reversed by the United States Court of Appeals for the Third Circuit; and the Tax Court then said that *its* "decision in the *Miller* case will no longer be followed."In the Heatblath case the Tax Court said, "The present case is not distinguishable from the following cases which held that the issuance of *demand and time notes* constituted payment within the meaning of section 24(c)(1)." [Italics supplied.] Akron Welding and Spring Company; Musselman Hub-Brake Company; Celina Manufacturing Company; Anthony P. Miller; and *Commissioner* v. *Mundet Cork Corporation*, 173 Fed. (2d) 757, affirming Tax Court Memorandum Opinion, entered June 30, 1948.

The Service, as previously indicated, nonacquiesced in both the Akron Welding and Heatbath cases. Due to the adverse decisions of the courts in the above cases, as well as the decision in the Industrial Equipment Co. case, the Service withdraws the nonacquiescences and substitutes acquiescences in the Akron Welding and Heatbath cases. See pages 3 and 6 of this Bulletin.

Accordingly, it is now the position of the Service that where a solvent taxpayer, on the accrual basis, issues its notes or other evidences of indebtedness in liquidation of expenses incurred under section 23(a) of the Code, or for interest accrued under section 23(b), and such notes or other evidences of indebtedness are issued by the taxpayer within its taxable year, or within two and one-half months after the close thereof, and such notes or other evidences of indebtedness have fair market value at the time when issued equal to their face values, then the face values of such notes or other evidences of indebtedness are deductible by the taxpayer in computing net income of the taxable year in which the expenses were incurred, or in which the interest accrued, as having been paid within the meaning of section 24(c) of the Code.

Section 24(c) of the Code is expressly limited in its application to sections 23(a) and 23(b). Hence, the rule presented in the preceding paragraph has no application to contributions, under section 23(p) of the Code, to an employees' trust. *Logan Engineering Co.* v. *Commissioner*, 12 T. C. 860, taxpayer's appeal to the United States Court of Appeals for the Seventh Circuit dismissed October 4, 1949; and *Freer Motor Transfer Co.* v. *Commissioner*, Tax Court Memorandum Opinion, entered May 27, 1949.

PART IV.—ACCOUNTING PERIODS AND METHODS OF ACCOUNTING

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

REGULATIONS 118, SECTION 39.42–1: When included in gross income. Rev. Rul. 55–437

> Where a building and loan association, for its first taxable year beginning after December 31, 1951, adopted the accrual method of accounting as permitted under section 39.104–2 of Regulations 118, amounts collected on installment contracts during such and subsequent taxable years, which installment contracts were entered into during its years beginning prior to January 1, 1952, do not constitute taxable income to the association insofar as the right to receive such installment payments accrued in a year during which the association was not subject to Federal income taxation. However, if the association adopts the cash or installment method of accounting for its first taxable year beginning after December 31, 1951, the payments received in its taxable years beginning after such date, to the extent of the previously unrealized profits on installment contracts entered into during its years beginning prior to January 1, 1952, constitute taxable income in the year received.

Advice has been requested with respect to the treatment, for Federal income tax purposes, of income from installment contracts which a building and loan association had on its books at the first day of the

taxable year beginning after December 31, 1951, when such association became taxable and which installments were collected in such and subsequent taxable years.

A building and loan association, as of the beginning of its first taxable year beginning after December 31, 1951, had outstanding balances of installment accounts receivable of $500x$ dollars of which $200x$ dollars represented unrealized profit with respect to such contracts. The specific question presented is whether the $200x$ dollars of unrealized profit on such contracts is income to the association if received in any of its taxable years beginning after December 31, 1951, for which years the association is subject to Federal income taxation.

Section 313(h) of the Revenue Act of 1951, 65 Stat. 452, 26 U. S. C. 104, amended section 104 of the Code of 1939 to include, within the definition of a bank which is taxable as a corporation, a domestic building and loan association. Under section 313(j) of that Act, such amendment is applicable only with respect to taxable years beginning after December 31, 1951.

Section 39.104–2(c) of Regulations 118 provides in part:

* * * in computing net income, the determination of the taxable year for which an item of income or expense is taken into account shall be made under the provisions of sections 41, 42, and 43, and the regulations thereunder, whether or not the item arose during a taxable year beginning before, on, or after December 31, 1951. For the purpose of determining, under section 41, the method of accounting of the mutual savings bank, the building and loan association, or the cooperative bank, *a method of accounting recognized under section 41 and under the regulations prescribed thereunder and utilized in the return of such institution filed for the first taxable year beginning after December 31, 1951, shall be deemed to constitute the method of accounting regularly employed by the institution.* The method selected shall be subject to the approval of the Commissioner upon the examination of the return * * * [Italics supplied.]

Section 41 of the Code provides in part as follows:

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 * * *

Section 42(a) of the Code provides in part as follows:

The amount of all items of gross income shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under methods of accounting permitted under section 41, any such amounts are to be properly accounted for as of a different period * * *

Section 39.41–2 of Regulations 118 relating to the bases of computation and changes in accounting methods provides in part:

(d) Section 44 contains special provisions for reporting the profit derived from the sale of property on the installment plan.

Thus the installment method of reporting income comes within the purview of section 41 of the Code and the reference to section 41 of the Code contained in section 39.104–2(c) of Regulations 118 encompasses the provisions of section 44 of the Code.

In view of the above the only election of accounting method binding upon the association is that made in the return filed by it for its first taxable year beginning after December 31, 1951. The installment basis of computing gains is permissive to the taxpayer at his election and may not be imposed upon him by the Commissioner. *Max Viault et al.* v. *Commissioner*, 36 B. T. A. 430.

Accordingly, if the association selects the accrual method of accounting in the return for its first taxable year beginning after December 31, 1951, the 200x dollars of unrealized profit received in such and subsequent taxable years under the installment contracts which were entered into in taxable years beginning prior to January 1, 1952, would not constitute taxable income insofar as the right to receive such installment payments accrued during a taxable year in which the association was exempt from Federal income taxation. However, if the taxpayer selects the cash or installment method of accounting in such return, the payments received, to the extent of the previously unrealized profits included therein, would constitute taxable income in the year received.

Amounts withheld from compensation of veterans pursuant to the Act of August 8, 1946, 60 Stat. 908, 38 U. S. C. 739. See Rev. Rul. 55–628, page 555.

REGULATIONS 118, SECTION 39.42–6: Non-interest-bearing obligations issued at discount.

Taxable year affected by election of a cash basis taxpayer to treat increment in value of obligations issued at a discount as income in the year in which it accrues. See Rev. Rul. 55–655, page 253.

SECTION 44.—INSTALLMENT BASIS

REGULATIONS 118, SECTION 39.44–5: Gain or loss upon disposition of installment obligations. Rev. Rul. 55–627

Income tax bonds, which have been executed under section 44(d) of the Internal Revenue Code of 1939 for the purpose of deferring gain to the recipient from installment obligations transmitted at death, remain in full force and effect until fulfillment of the obligation under the bond. Under sections 453(d)(3) and 691(a)(4)(A) of the Internal Revenue Code of 1954, the counterpart of section 44(d) of the 1939 Code in this respect, the requirement of filing a bond by the recipient in such cases has been eliminated. Since those sections of the 1954 Code have no retroactive effect, no authority exists for release of a bond executed under section 44(d) of the 1939 Code. However, as the tax liability which may be asserted under a bond executed under section 44(d) of the 1939 Code decreases, requests may be made for approval of corresponding decreases in the amount of the bond at any time where a substantial reduction in the amount of installment obligations outstanding has been effected. Such a request should be submited to the appropriate District Director of Internal Revenue with evidence indicating that the installment obligations transmitted at death have been substantially reduced and the gain realized upon the receipt of the payments thereon has been reported as income by the recipients.

Rev. Rul. 55-672

The unrealized profit on installment sales is taxable to a corporation upon distribution of its installment obligations to a partnership which succeeded the corporation.

Advice has been requested whether the unrealized profit on installment sales is taxable to a corporation upon distribution of its installment obligations to a successor partnership.

The corporation was engaged in the retail clothing business and had adopted the installment basis of accounting under the provisions of section 44(a) of the Internal Revenue Code of 1939. It transferred all of its assets and liabilities to a partnership whose members were the stockholders of the corporation.

Section 44 of the Internal Revenue Code of 1939 provides, in part, as follows:

(d) GAIN OR LOSS UPON DISPOSITION OF INSTALLMENT OBLIGATIONS.—If an installment obligation is * * * distributed, transmitted, sold, or otherwise disposed of, gain or loss shall result to the extent of the difference between the basis of the obligation and * * * the amount realized * * *. Any gain or loss so resulting shall be considered as resulting from the sale or exchange of the property in respect of which the installment obligation was received. The basis of the obligation shall be the excess of the face value of the obligation over an amount equal to the income which would be returnable were the obligation satisfied in full. * * * If an installment obligation is distributed by one corporation to another corporation in the course of a liquidation, and under section 112(b)(6) no gain or loss with respect to the receipt of such obligation is recognized in the case of the recipient corporation, then no gain or loss with respect to the distribution of such obligation shall be recognized in the case of the distributing corporation.

Section 39.44-5 of Regulations 118 provides that the entire amount of gain or loss resulting from the disposition or satisfaction of installment obligations, computed in accordance with section 44(d), is recognized unless the disposition is within one of the exceptions made by the Code. Such an exception is provided in section 44(d) with respect to distributions under section 112(b)(6), and in section 112(b)(4) and (5) with respect to exchanges.

The exceptions under section 112(b)(6) and section 112(b)(4) and (5) of the Code of 1939 are not applicable where the distribution is from a corporation to a partnership, since subsections (b)(4), (b)(5) and (b)(6) of section 112 of the Code relate to exchanges between corporations and to transfers of property by individuals or a partnership to a corporation in exchange for stock or securities in such corporation. Accordingly, it is held that the unrealized profit on installment obligations held by a corporation is taxable to the corporation upon distribution of the obligation to a partnership which succeeded the corporation. Compare I. T. 3293, C. B. 1939-1, 183.

SECTION 46.—CHANGE OF ACCOUNTING PERIOD

REGULATIONS 118, SECTION 39.46-1: Change of accounting period.

Change of accounting period by subsidiary corporation filing a consolidated return. See Rev. Rul. 55-566, page 580.

PART V.—RETURNS AND PAYMENT OF TAX

SECTION 55.—PUBLICITY OF RETURNS

T. D. 6136 [1]

TITLE 26—INTERNAL REVENUE, 1939.—CHAPTER I, SUBCHAPTER E, PART 458.—INSPECTION OF RETURNS

Inspection by Department of Health, Education, and Welfare of individual income tax returns made under the Internal Revenue Code of 1939.

TREASURY DEPARTMENT,
Washington 25, D. C.

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

SEC. 458.323. INSPECTION BY DEPARTMENT OF HEALTH, EDUCATION, AND WELFARE OF INDIVIDUAL INCOME TAX RETURNS MADE UNDER THE INTERNAL REVENUE CODE OF 1939.—(*a*) Pursuant to the provisions of section 55(a) of the Internal Revenue Code of 1939 (53 Stat. 29; 254 Stat. 1008; 55 Stat. 722; 26 U. S. C. (55a)) and of the Executive order issued thereunder, and in the interest of the internal management of the Government, any individual income tax return made in respect of a tax imposed under chapter 1 of such Code shall be open to inspection by the Department of Health, Education, and Welfare as may be needed in its administration of the provisions of title II of the Social Security Act, as amended. Upon request, the inspection of an individual income tax return may be made by any officer or employee of the Department of Health, Education, and Welfare duly authorized by the Secretary of such Department to make such inspection. The request to inspect an income tax return or returns of a particular individual shall be made, in writing, by the Secretary or any duly authorized officer or employee of the Department of Health, Education, and Welfare to the Commissioner of Internal Revenue or to any officer or employee of the Internal Revenue Service designated by the Commissioner. The written request shall be in such form and manner as may be prescribed by the Commissioner of Internal Revenue. Upon receipt of such a request, any officer or employee of the Internal Revenue Service duly authorized by the Commissioner of Internal Revenue may make the individual income tax return or returns available for inspection by any duly authorized officer or employee of the Department of Health, Education, and Welfare or may furnish such Department with a copy of the return or with any data on such return. Any information thus obtained shall be held confidential, except to the extent necessary to effectuate the purposes for which the returns are open to inspection.

(*b*) This Treasury Decision shall be effective upon its filing for publication in the Federal Register.

G. M. HUMPHREY,
Secretary of the Treasury.

Approved June 29, 1955.

DWIGHT D. EISENHOWER,
The White House.

(Filed by the Division of the Federal Register June 29, 1955, 5 : 07 p. m.)

[1] 20 F.R. 4685.

Inspection of individual income tax returns by the Department of Health, Education, and Welfare. See E. O. 10619, page 495.

Inspection of certain returns by the Senate Committee on the Judiciary. See E. O. 10620, page 492.

Inspection of certain returns by the Committee on Un-American Activities, House of Representatives. See Executive Order 10627, page 493.

SUBCHAPTER C.—SUPPLEMENTAL PROVISIONS

SUPPLEMENT A.—RATES OF TAX

SECTION 101.—EXEMPTIONS FROM TAX ON CORPORATIONS

REGULATIONS 118, SECTION 39.101(7)-1: Business leagues, chambers of commerce, real estate boards, and boards of trade.

Exempt status of a business league which conducts an advertising campaign for the benefit of an industry as a whole but serves to a minor extent in the conduct of the business of its members. See Rev. Rul. 55-444, page 258.

REGULATIONS 118, SECTION 39.101(12)-1: Farmers' cooperative marketing and purchasing associations; requirements for exemption under section 101(12)(A). Rev. Rul. 55-591

The allocation of income of a farmers' cooperative marketing association resulting from the handling and storage of grain of the Commodity Credit Corporation during the fiscal year ended May 31, 1954, which is distributed on a patronage basis to persons who have done business with the association during any or all of the fiscal years 1949 through 1954, will not affect the exempt status to which the association is otherwise entitled under section 101(12)(A) of the Internal Revenue Code of 1939.

Amounts allocated with respect to income from the handling and storage of Commodity Credit Corporation grain, if distributed on a patronage basis in the manner indicated in the foregoing paragraph, may be deducted from gross income of the association for the year ended May 31, 1954, provided the distribution is made on or before the 15th day of the ninth month following the close of the year.

Advice has been requested with respect to the distribution as patronage dividends of net savings which a farmers' cooperative marketing association has for the fiscal year ended May 31, 1954, as the result of handling and storing grain of the Commodity Credit Corporation during such year.

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The instant association is exempt from Federal income tax under the provisions of section 101(12)(A) of the Internal Revenue Code of 1939. It is engaged primarily in the business of storing and marketing grain for members and patrons. Due to severe drought conditions in the territory served by the association, there was an unprecedented low production of grain during the fiscal year 1954 and a resultant unprecedented small quantity of grain stored by members and patrons in the association's storage facilities.

The Commodity Credit Corporation acquired an abnormally heavy surplus of grain during the fiscal year 1954 which had been produced in other vicinities for which it lacked storage space. Such grain was moved into the drought area to utilize the available storage space there. The association furnished some of the needed storage space and was the recipient of emoluments for the handling and storage of this grain during the fiscal year ended May 31, 1954. Comparative figures for the fiscal years 1949 through 1954 show that the number of patrons and the quantity of grain stored by the patrons of the association in the fiscal year 1954 are abnormally low as compared with the prior years.

The association has allocated and distributed to its patrons who have done business with it during the fiscal year ended May 31, 1954, the net savings resulting from the business done by them during such year. However, the revenue resulting from the handling and storage of grain of the Commodity Credit Corporation during the fiscal year 1954 has been allocated on a patronage basis to its patrons who have done business with it during the fiscal years 1949 through 1954.

Section 39.101(12)-1(c) of Regulations 118 provides that business done with the United States or any of its agencies shall be disregarded in determining the right to exemption under section 101(12) of the Code.

Section 39.101(12)-3(d) of Regulations 118 provides that business done with the United States shall constitute income not derived from patronage. This section of the Regulations allows as a deduction from the gross income of an exempt cooperative association amounts allocated during the year to patrons with respect to its income not derived from patronage. However, the section requires, in order that the deduction for allocations with respect to income not derived from patronage may be applicable, that the amount sought to be deducted be allocated on a patronage basis in proportion, insofar as practicable, to the amount of business done by or for patrons during the period to which such income is attributable.

Based upon the foregoing facts, it is held that the allocations of income resulting from the handling and storage of the grain of the Commodity Credit Corporation during the year ended May 31, 1954, which is distributed on a patronage basis to patrons who have done business with the association during any or all of the fiscal years 1949 through 1954, will not affect the exempt status to which the association is otherwise entitled under section 101(12)(A) of the Code.

It is further held that the amounts allocated with respect to the income from the handling and storage of Commodity Credit Corporation grain, if distributed on a patronage basis in the manner indicated in the foregoing paragraph, may be deducted from gross income of

the association for the year ended May 31, 1954, provided the distribution is made on or before the 15th day of the ninth month following the close of the year.

Marketing of products for members where the member acts as agent for nonmember producers. See Rev. Rul. 55-496, page 268.

Effect on exempt status of life insurance carried on members. See Rev. Rul. 55-558, page 270.

SUBCHAPTER C.—SUPPLEMENTAL PROVISIONS

SUPPLEMENT A.—RATES OF TAX

SECTION 107.—COMPENSATION FOR SERVICES RENDERED FOR A PERIOD OF THIRTY-SIX MONTHS OR MORE AND BACK PAY

REGULATIONS 118, SECTION 39.107-3: Back pay attributable to prior taxable year. Rev. Rul. 55-628

(Also Section 42; Regulations 118, Section 39.42-1.)

Where amounts are withheld from the taxable retirement pay, pensions or compensation paid to veterans being furnished hospitalization, institutional or domiciliary care by the Veterans' Administration, and subsequently a lump-sum payment of the amounts withheld is made to the veteran, such amount received in the current taxable year as is attributable to a prior taxable year constitutes "back pay" within the meaning of section 107(d)(2) of the Internal Revenue Code of 1939. Such "back pay" qualifies for the treatment provided in section 107(d)(1) of the 1939 Code if the amount received during the current taxable year exceeds 15 percent of the recipient's gross income for such year.

Advice has been requested whether amounts withheld from the taxable retirement pay, pensions, or compensation paid to veterans being furnished hospitalization, institutional, or domiciliary care by the Veterans' Administration should be included in taxable income in the year withheld or whether the lump-sum payment is taxable to the recipient in the year paid.

Under the Act of August 8, 1946, Public Law 662, Seventy-ninth Congress, 60 Stat. 908, as amended, 38 U. S. C. 739, provisions were made for withholding an amount from the retired pay, pensions, or compensation paid to veterans being furnished hospitalization, institutional or domiciliary care by the Veterans' Administration which would limit the amount of such retired pay retained by the Veterans' Administration to $30 or 50 percent of such pay (whichever is greater) and for paying this withheld amount in a lump sum at a later date.

Such Act provides in part as follows:

* * * (A)(1) where any veteran having neither wife, child, nor dependent parent is being furnished hospital treatment, institutional or domiciliary care by the Veterans' Administration, * * * the pension, compensation, or retirement pay, if $30 per month or less, shall continue without reduction, but if

greater than $30 per month, the pension, compensation, or retirement pay shall not exceed 50 per centum of the amount otherwise payable or $30 per month, whichever is greater; *Provided*, That if such veteran is discharged from such treatment or care upon certification by the officer in charge * * * that maximum benefits have been received or that release is approved, he shall be paid in a lump sum such additional amount as would equal the total sum by which his pension, compensation, or retirement pay has been reduced under this section: * * *.

(B) Where any veteran having neither wife, child nor dependent parent is being furnished hospital treatment, institutional or domiciliary care by the Veterans' Administration, and shall be rated by the Veterans' Administration in accordance with regulations as being incompetent by reason of mental illness, the pension, compensation, or retirement pay for such veteran shall be subject to the provisions of subsection (A) of this section: *Provided*, That no payment of a lump sum herein authorized shall be made until after the expiration of six months following a finding of competency: *Provided further*, That in any case where the estate of such incompetent veteran derived from any source equals or exceeds $1,500, further payment of such benefits shall not be made until the estate is reduced to $500: * * *.

From the foregoing, it can be seen that the character of the payments to a veteran is not changed by reason of being furnished hospital treatment, institutional or domiciliary care by the Veterans' Administration. Upon certification by the officer in charge, the law authorizes the veteran to receive the same total amount that he would have received if the statutory suspension had not occurred.

Section 42(a) of the Internal Revenue Code of 1939 provides, in part, that the amount of all items of gross income shall be included in gross income for the taxable year in which received by the taxpayer, unless, under other methods of accounting permitted by section 41, any such amounts are to be accounted for as of a different period. Inasmuch as the amounts that are due such veteran are not available to him prior to actual payment, such amounts are not includible in his gross income until the year of actual payment to him. See section 39.42-2 of Regulations 118.

Section 107(d)(1) of the 1939 Code provides in part as follows:

> (1) IN GENERAL.—If the amount of the back pay received or accrued by an individual during the taxable year exceeds 15 per centum of the gross income of the individual for such year, the part of the tax attributable to the inclusion of such back pay in gross income for the taxable year shall not be greater than the aggregate of the increases in the taxes which would have resulted from the inclusion of the respective portions of such back pay in gross income for the taxable years to which such portions are respectively attributable, * * *.

Section 107(d)(2) of the Code defines "back pay," for the purposes of section 107 of the Code, as:

> * * * (A) remuneration, including wages, salaries, retirement pay, and other similar compensation, which is received or accrued during the taxable year by an employee for services performed prior to the taxable year for his employer and which would have been paid prior to the taxable year except for the intervention of one of the following events: (i) bankruptcy or receivership of the employer; (ii) dispute as to the liability of the employer to pay such remuneration, which is determined after the commencement of court proceedings; (iii) if the employer is the United States, * * * lack of funds appropriated to pay such remuneration; or (iv) any other event determined to be similar in nature under regulations prescribed by the Commissioner with the approval of the Secretary; * * *.

Section 39.107-3(b) of Regulations 118 provides, in part, that an event will be considered similar in nature to those events specified in section 107(d)(2)(A)(i), (ii), and (iii) only if the circumstances are unusual, if they are of the type specified therein, if they operate

to defer payment of the remuneration for the services performed, and if payment, except for such circumstances, would have been made prior to the taxable year in which received or accrued.

The provisions of the Act, *supra*, indicate that the amounts withheld from compensation due mentally incompetent veterans and paid to them in subsequent years would qualify under section 107(d)(2)(A)(iv) of the Code as "back pay." The same is true with respect to amounts withheld from compensation due mentally competent veterans under the provisions of that Act.

Accordingly, where pursuant to the provisions of the Act of August 8, 1946, *supra*, amounts are withheld from the taxable retirement pay, pensions, or compensation paid to veterans being furnished hospitalization, institutional or domiciliary care by the Veterans' Administration, and subsequently a lump-sum payment of the amounts withheld is made to the veteran in accordance with the provisions of such Act, such amount received in the current taxable year as is attributable to a prior taxable year is taxable to the recipient in the year paid. However, such amount constitutes "back pay" within the meaning of section 107(d)(2) of the Internal Revenue Code of 1939 and qualifies for the treatment provided in section 107(d)(1) of the 1939 Code if such "back pay" received during the current taxable year exceeds 15 percent of the recipient's gross income for such year.

SUPPLEMENT B.—COMPUTATION OF NET INCOME

SECTION 111.—DETERMINATION OF AMOUNT OF, AND RECOGNITION OF, GAIN OR LOSS

REGULATIONS 118, SECTION 39.111-1: Computation of gain or loss.

Amounts distributed in liquidation to members of a club, taxable as a corporation. See Rev. Rul. 55-737, page 570.

Federal stamp taxes paid on transfers or conveyances of securities or real estate upon sales thereon as a trader or other non-dealer. See Rev. Rul. 55-756, page 536.

SECTION 112(a).—RECOGNITION OF GAIN OR LOSS: GENERAL RULE

Rev. Rul. 55-757

REGULATIONS 118, SECTION 39.112(a)-1: Sales or exchanges.

An exchange in 1945 by an American investor of marketable French National Defense 4 percent coupon bearer Rentes (Bonds) of 1917 and 1918 for marketable French registered 3 percent Rentes of 1945 constituted a closed transaction upon which gain or loss was (actually and timely) recognized in such year. Therefore, the basis of the new rentes thus acquired is their fair market value at the date of the exchange. Accordingly, any gain or loss upon subsequent sale or redemption thereof is measured by the difference between such basis and the amount realized from such disposition. Where such

rentes in the hands of a particular taxpayer are "capital assets," any gain or loss constitutes a capital gain or loss under section 117 of the 1939 Code and is subject to the provisions of that section. I. T. 2212, C. B. IV-2, 118 (1925), modified.

Advice has been requested as to the criteria to be used in computing gain or loss upon a sale or redemption of certain marketable French Rentes (Bonds) which a taxpayer acquired in an exchange in 1945 for certain other marketable French Rentes previously purchased.

In 1919, the taxpayer, an American investor, purchased certain marketable French National Defense 4 percent Rentes of 1917 and 1918 for cash. In 1945, such rentes were called under their terms by the French Government and the taxpayer received in exchange therefor its new marketable registered 3 percent consolidated issue rentes due in 2005. The primary questions presented are whether such exchange in 1945 constituted a closed transaction upon which gain or loss is recognized at that time for Federal income tax purposes and what is the basis of the new rentes for determining any gain or loss upon their subsequent sale or redemption.

The National Defense 4 percent Rentes of France that were issued in 1917 had no fixed date of maturity and were issued in denominations of 100 francs or multiples thereof up to 100,000 francs. Interest was payable on such bonds on March 16, June 16, September 16 and December 16 of each year, and they were redeemable, in whole or in part, at par on or after January 1, 1943, at the option of the French Government.

The National Defense 4 percent Rentes of France that were issued in 1918 (Liberation Loan) also had no fixed date of maturity and were issued in denominations of 100 francs or multiples thereof up to 100,000 francs, and interest was payable thereon at the same rate and on the same quarterly dates as on the National Defense 4 percent Rentes of 1917. They were redeemable, in whole or in part, at par after January 1, 1944, at the option of the French Government.

The registered 3 percent Rentes of France were issued by the French Government in November 1945 for conversion of its 4 percent Rentes of 1917 and 1918 and 4½ percent Rentes of 1932, A and B Tranches (Series). They are redeemable in 60 years by semi-annual drawings, or by purchase in the market, and were issued in denominations of 1000, 2000, 5000, 10,000 and 100,000 francs. They were to yield an income of 30 francs or multiples thereof per annum and are acceptable for subscription to the 5 percent perpetual loan of 1949.

It is evident from the above that the rentes of 1917 and 1918 were substantially different from those of 1945, particularly with respect to interest rates and maturity and redemption dates. Also, the exchange in 1945 of the former for the latter does not come within any of the exceptions provided in section 112(b) of the Internal Revenue Code of 1939. Therefore, such exchange was a closed transaction when it was made in 1945 which then resulted in gain or loss, computed under section 111(a) of the Code and recognized under section 112(a) of the Code, of the difference between the basis, under section 113(a) of the Code of the 4 percent rentes surrendered therein, namely their "cost" (purchase price), and the "amount realized" from such disposition, namely the fair market value, at the date of the exchange, of the 3 percent rentes received therefor, as provided in

section 111(b) of the Code. See I. T. 2359, C. B. VI-1, 51 (1927); G. C. M. 1455, C. B. VI-1, 87 (1927); I. T. 2734, C. B. XII-2, 73 (1933), and I. T. 3523, C. B. 1941-2, 124. Where such fair market value was treated in a timely determination of the gain or loss from the exchange as the amount realized from the disposition therein of the 4 percent rentes, as permitted and required under sections 111 (a) and (b) and 112(a) of the Code, such fair market value is deemed to be the "cost" of the 3 percent rentes acquired therein and, hence, is their basis under section 113(a) of the Code. See G. C. M. 1022, C. B. VI-1, 12 (1927); I. T. 3523, *supra;* I. T. 3721, C. B. 1945, 164, 166, and Rev. Rul. 55-641, page 294 of this Bulletin. Compare *Continental Oil Co.* v. *Jones*, 177 Fed. (2d) 508; *Therese C. Johnson* v. *Commissioner*, 162 Fed. (2d) 844; *H. H. Timken, deceased* v. *Commissioner*, 141 Fed. (2d) 625; *Alamo National Bank* v. *Commissioner*, 95 Fed. (2d) 622, certiorari denied 304 U. S. 577; *Commissioner* v. *Monica R. Farren, executrix, et al.*, 82 Fed. (2d) 141; *Henry B. Robbins* v. *United States*, 21 Fed. Supp. 403, and *J. J. Larkin et al.* v. *United States*, 78 Fed. (2d) 951, Ct. D. 1077, C. B. XV-I, 288 (1936). Accordingly, any gain or loss upon the subsequent sale or redemption of the 3 percent rentes is measured by the difference between such basis and the amount realized from such disposition. Where such rentes in the hands of a particular taxpayer are "capital assets," as defined in section 117(a) of the Code, any gain or loss thus determined constitutes capital gain or loss under section 117 of the Code and is subject to the loss allowance limitation and other provisions of that section.

One of the conclusions in I. T. 2212, C. B. IV-2, 118 (1925), is that the basis of stock of a corporation which was acquired from it by a taxpayer for the assets of his going business in an exchange upon which gain or loss was recognized, is the fair market value of the assets at the time of the exchange and not the then fair market value of the stock. This principle was involved in G. C. M. 1022, I. T. 3523 and I. T. 3721, *supra*, and, because of these subsequent publications, I. T. 2212 has been in effect modified, at least by implication. Accordingly, I. T. 2212 is now specifically modified so that it conforms to the foregoing.

Gain or loss upon exchange, at maturity, of United States Treasury Certificates of Indebtedness for a like face amount of such certificates with a later maturity date. See Rev. Rul. 55-641, page 294.

Distribution in liquidation by a club, taxable as a corporation, to its members. See Rev. Rul. 55-737, page 570.

SECTION 112(b).—RECOGNITION OF GAIN OR LOSS: EXCHANGES SOLELY IN KIND

REGULATIONS 118, SECTION 39.112(b)(1)-1:
Property held for productive use in trade or business or for investment.

Tax consequences of the exchange of perpetual water rights for land. See Rev. Rul. 55-749, page 295.

SECTION 113(a).—ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS: BASIS (UNADJUSTED) OF PROPERTY

REGULATIONS 118, SECTION 39.113(a)(2)-1: Property transmitted by gift after December 13, 1920.—Property included.

Basis of property made the subject of a gift in the hands of the donee. See Rev. Rul. 55-531, page 520.

REGULATIONS 118, SECTION 39.113(a)(5)-1: Basis of property acquired by bequest, devise or inheritance. Rev. Rul. 55-502

Where the grantor of an inter vivos trust who has reserved the right to receive or direct the payment of the income for life dies, the basis of trust property in the hands of the trustee is the fair market value at the date of death (or optional valuation date) as provided in section 113(a)(5) of the Internal Revenue Code of 1939 only if the right to revoke or change the trust was completely and unqualifiedly in the grantor.

Advice has been requested whether by reason of the death of the grantor the trustee under the trust instrument described below is entitled to a new cost basis under section 113(a)(5) of the Internal Revenue Code of 1939 on securities sold subsequent to the grantor's death to obtain funds to pay estate tax.

Under the trust instrument, the grantor provides for payment of $10x$ dollars per annum to her husband. The balance of the net income of the trust is payable to the grantor during her lifetime and, after her death, to her husband during his lifetime. The trust instrument further provides that the grantor and her husband, and in case of the husband's death the grantor alone, shall have the right at any time by instrument in writing delivered to the trustee to modify, alter, or revoke this trust agreement either in whole or in part, provided that, so long as the grantor's husband is living, no modification or alteration shall be made to benefit any person or persons other than a person or persons within a class including only the grantor, descendants of the grantor, and spouses of such descendants; that the duties, powers, and liabilities of the trustee shall not be substantially changed without its consent; and that in the event of the revocation of the trust agreement the title to the trust estate shall vest in and be paid, transferred, and delivered to grantor. The grantor's husband survived her.

Section 113(a)(5) of the Code of 1939 as amended by section 203(a) of the Technical Changes Act of 1953, 67 Stat. 615 at 618, provides in part as follows:

PROPERTY TRANSMITTED AT DEATH.—If the property was acquired by bequest, devise, or inheritance, or by the decedent's estate from the decedent, the basis shall be the fair market value of such property at the time of such acquisition. 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 or to make any change in the enjoyment thereof through the exercise of a power to alter, amend, or terminate 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. * * *

The following language was used in Senate Report No. 685, 83d Congress, C. B. 1953-2, 526, at 528, which was submitted with the Technical Changes Act of 1953, *supra.*

> Section 113(a)(5) of existing law contains a provision to the effect that where the grantor retains the income from property in trust for his life with power to revoke the trust, the basis of the property in the hands of the persons entitled to take the property under the terms of the trust instrument after the grantor's death shall, after such death, be the same as if the property had passed under a will executed on the day of the grantor's death. This results in the basis of the property in the hands of the recipients being its fair market value at the date of the grantor's death or, at the election of the executor, the value 1 year from the date of death. Your committee believes that this same rule should apply to situations where the grantor with a reserved life estate has the power to make any change in the enjoyment of the corpus of the trust through the power to alter, amend, or terminate the trust. In both cases, the trust property is required to be included in the gross estate of the grantor for estate tax purposes. The amendment applies only to grantors dying after December 31, 1951, and only with respect to taxable years ending after December 31, 1951.

The provisions of section 113(a)(5) of the Code are narrowly limited. As amended in 1953 they provide exception to the general rule of section 113(a)(2) of the Code that the basis for determining gain is the same as it would be in the hands of the grantee only where property was transferred in trust with two types of rights reserved to the grantor: (1) the right to receive income for life or to determine who shall receive it, and (2) the right reserved to the grantor at all times prior to his death to revoke the trust or to make changes in the enjoyment thereof through the exercise of a power to alter, amend, or terminate the trust. It is not applicable to all revocable trusts nor to all trusts the income of which is taxed to the grantor by reason of retention of control or because of benefits received by the grantor through the application of the corpus or the income of the fund. It is strictly limited to property transferred in trust to pay the income for life to or on the order or direction of the grantor in a case in which the grantor reserved the right to revoke or change the trust. Situations have arisen where inter vivos transfers (which are testamentary in nature) are includible in the decedent's gross income, but the property so transferred does not get a fair market value basis under section 113(a)(5) of the Code. The fact that the property is includible in the decedent's gross estate for Federal estate tax purposes is not controlling as to the basis of the property in the hands of the trustee or beneficiaries.

In order that section 113(a)(5) of the Code of 1939 may be applicable, the right to revoke or change must be entirely in the grantor. Only in such circumstances is the corpus of the trust to be viewed in practicable effect as belonging to the grantor. A right to revoke or change in conjunction with another party is not completely in the grantor particularly where, as in this case, the right was at all times until the grantor's death exercisable only in conjunction with one having an adverse interest. Accordingly, in the instant case, the basis of the trust property will not be the fair market value of such property at the date of the grantor's death (or optional valuation date) under the provisions of section 113(a)(5) of the 1939 Code. The basis of such property will be determined under the provisions of section 113(a)(2) of the 1939 Code.

REGULATIONS 118, SECTION 39.113(a)(7)-1: Prop- Rev. Rul. 55-443
erty acquired by corporation in reorganization
after December 31, 1917.
(Also Section 437; Regulations 130, Section
40.437-3.)

In 1930, two state banks, *Y* and *Z* united with *X*, a National bank, under the name and charter of *X*. Union was effected under the provisions of an Act of Congress approved November 7, 1918 (an Act to Provide for the Consolidation of National Banking Associations—40 Stat., 1043) as amended (Act of February 25, 1927—44 Stat., 1224). *Held:* the union was a "merger" as distinguished from a "consolidation"; only *Y* and *Z* were transferors, and, since neither they nor their stockholders possessed, immediately after the transfer, an interest or control in the property transferred of 50 percent or more, basis of property to *X* is cost; under the facts set forth herein cost determined to be the fair market value of the property received, not the value of *X*'s securities issued in exchange for such property.

Advice has been requested with regard to the basis of the assets received by the *X* bank as a result of a reorganization in 1930.

In 1930, an agreement was entered into by the boards of directors of *X* bank, *Y* bank and *Z* bank providing for a union of the three banks in accordance with the provisions of an Act of Congress of the United States approved November 7, 1918, entitled "An Act to Provide for the Consolidation of National Banking Associations," 40 Stat., 1043, as amended by the Act of February 25, 1927, 44 Stat., 1224. At the time of the agreement, *X*, a national bank chartered pursuant to the laws of the United States, had a capital of $105x$ dollars, consisting of $525x$ shares of common stock and possessed net assets of $245x$ dollars. *Y* bank, a corporation organized under the laws of the State of New York, had a capital stock of $50x$ dollars composed of $250x$ shares of common stock and possessed net assets of $115x$ dollars. *Z* bank, also organized under the laws of the State of New York, had a capital of $7x$ dollars composed of $36x$ shares of common stock and possessed net assets of $8x$ dollars.

The agreement provided for a "consolidated association," to be known as the *X* bank, to continue under the name and charter of such bank as a national banking institution. It also provided that the capital stock of the consolidated association would be $148x$ dollars, divided into $740x$ shares of common stock. Its undivided profit was to be not less than $72x$ dollars. The aggregate capital, surplus, and undivided profits was to be $368x$ dollars, which was to be contributed, $245x$ dollars by *X* bank; $115x$ dollars by *Y* bank; and $8x$ dollars by *Z* bank. Of the capital stock, $525x$ shares were allotted to the shareholders of *X* bank; $200x$ shares to the shareholders of *Y* bank; and $12x$ shares to the shareholders of *Z* bank. To round out its capitalization $3x$ shares were to be issued and sold at the fair market value (but not less than par) in such a manner and to such parties as the board of directors of *X* bank approved.

The agreement, by its terms, was to become effective only after ratification and confirmation by the shareholders owning at least $\frac{2}{3}$ of the outstanding capital stock of each institution and after approval by the Comptroller of the Currency. It was ratified by the stockholders in 1930 and later in the same year the Comptroller of the Currency gave his approval to the consolidation. The physical union

of the three banks became effective after the close of business on May 31, 1930. The banks concluded business as separate institutions on that date and reopened on the following business day under the name and charter of X bank.

Each of the three banks had security affiliates, all organized under the laws of the State of New York. The capital stock of each of the security affiliates was transferable only on a unitary share for share basis with that of their respective bank in order to preserve an identity of share ownership. Therefore, simultaneously with the agreement for consolidation, separate provision was made for the acquisition by the security affiliate of X bank of all of the capital stock of the security affiliates of Y and Z banks.

The $3x$ shares of common stock authorized to round out the banks' capitalization were sold at public auction for cash in unit lots at a minimum upset price of not less than a specified price per share. Of the net amount received, 75 percent thereof was allocated by the board of directors of X bank to the common stock of X bank, the remaining 25 percent being allocated to the capital stock of its security affiliate.

Based upon their book value at the time of transfer, the assets contributed to the union by X bank approximated 66 percent for which it received approximately 71 percent of the capital stock. Y bank contributed assets approximating 31 percent and received approximately 27 percent of the capital stock. Z bank contributed assets approximating 3 percent and received approximately 2 percent of the capital stock.

Approximately 20 percent of the stock of X bank was owned by the stockholders of Y and Z banks immediately prior to the union of the three banks in 1930 and less than 43 percent of its stock was owned by the same persons, or any of them, immediately after union of the banks was consummated.

The properties acquired by X bank from the Y and Z banks were carried on its books at the same basis which such properties had in the hands of the transferors, the Y bank and the Z bank. Gain or loss on dispositions and the allowance for depreciation were computed on that basis. The basis of the properties in the hands of the transferors was also used by X bank in the determination of its equity invested capital for the years 1940 and 1945, inclusive, under section 718 of the Internal Revenue Code of 1939, upon which its excess profits credit for those years, computed under section 714 of the Code, was based. The net assets acquired from the Y bank and the Z bank were recorded on the books of X bank at $115x$ dollars and $8x$ dollars, respectively, and these amounts were reflected in invested capital, determined under section 437 of the Code for the years 1950 and 1951, upon which its excess profits credit disclosed by its income tax returns for those years was computed.

Section 113(a)(7) of the Revenue Act of 1934, made applicable under the 1939 Code by section 113(a)(16) of the latter, provides, although generally the basis of property is the cost of such property, except that if the property was acquired:

> (A) 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. * * *

The union taking place between these three banks was either a statutory merger or a consolidation, and was therefore, a reorganization within the meaning of section 112(g) of the 1934 Act (see section 113(a)(16) of the Code and 113(a)(7) of the 1934 Act).

If this was a consolidation, the percentage requirement of section 113(a)(7), *supra*, was clearly met for the courts have held that the prereorganization groups are to be considered collectively for the purpose of determining whether the prerequisite interest or control remains in the same persons. *Fairbanks Court Wholesale Grocery Co.* v. *Commissioner* 84 Fed. (2d) 18, certiorari denied, 299 U. S. 582. *Irving Trust Company* v. *United States* 90 Ct. Cl. 310, 30 F. Supp. 696. If this was a merger, with the *X* bank the continuing entity, then the only transferors were the *Y* and *Z* banks. The courts have held that unless the transferors retain the prerequisite interest after transfer, the cost basis, not the carryover basis, is to be used. *Irving Trust Company* v. *United States*, *supra*.

It has long been the position of the Internal Revenue Service that a union of banks under the Act of November 7, 1918, *supra*, prior to its amendment in 1927, constituted a merger as distinguished from a consolidation. I. T. 1850, C. B. II-2, 8 (1923); and G. C. M. 1880, C. B. VI-1, 92 (1927). Unless then, some substantive change was made by the amendment of February 25, 1927, *supra*, or unless there have been developments in case law which cast doubt on the correctness of these rulings, they should apply with equal force to the transaction which is here involved.

An examination of the changes made by the amendment of February 25, 1927, fails to disclose any change which should occasion any difference in treatment between cases falling under the Act prior to amendment and subsequent to amendment. If a merger resulted under the Act prior to the amendment, then under a similar state of facts, a merger should result under the Act as amended. In case law, the weight of the decided cases supports the prior rulings; however, one case has held *contra*.

In *Northwest Bancorporation* 33 B. T. A. 160, the board was called upon to decide whether a union between two national banks and a state bank, pursuant to the provisions of the Act of November 7, 1918, as amended, was a merger or a consolidation. The board stated that while the courts had differed on their answer to this question, it found that the weight of authorities favored a consolidation.

The taxpayer prosecuted an appeal to the Eighth Circuit. While this appeal was pending, the case was remanded (93 Fed. (2d) 1011) pursuant to stipulation of counsel to the board for entry of an order granting the taxpayer the loss which it had been denied by the board because of its prior determination that a consolidation and not a merger had occurred. Under these circumstances, little reliance can be placed upon this decision of the board in determining the issue in this case.

Courts of two states have dealt with unions between banks pursuant to the Act of November 7, 1918, as amended. Two cases arose from

the union of the Merchants' National Bank of Worcester (Mass.) with the Fitchburg Bank & Trust Company (a Massachusetts Corporation) under the name Worcester County National Bank of Worcester, and the charter of Merchants' National. In the first of these, in re: *Parsons' Estate*, 263 Mass. 394, 161 N. E. 797, the Merchants' National Bank had, prior to the union, duly qualified as administrator of a Massachusetts estate. The Worcester County National Bank then sought to render the final account. The question presented was whether it was entitled to do so. In finding that it was so entitled, the court examined the transaction which took place in the light of the enabling Act which permitted it and found that what occurred was a merger, with the national bank continuing under its same corporate charter with the same powers, enlarged merely by the assets it had received.

In the second, in re: *Legnard's Estate*, 263 Mass. 444, 162 N. E. 217, affirmed, 279 U. S. 347, the state bank, prior to the union, had duly qualified as executor of a Massachusetts estate. The Worcester County National Bank sought to file the final accounting. It was held that it could not do so. The Court, in reaching this conclusion, found that the national bank continued as the same corporate entity but that the state bank had ceased to exist. The Court relied upon its previous decision, in re: Parsons' Estate, *supra*.

The Supreme Court of Appeals of Virginia, commenting in *Hofheimer* v. *Seaboard Citizens Nat. Bank of Norfolk*, 154 Va. 392, 153 S. E. 656, upon the legal aspects of a union of a state and national bank under the Act of November 7, 1918, as amended, said:

> These mergers of state banking and trust companies with national banks are not consolidations in any true sense. The state bank is absorbed, and the national bank continues to function with powers limited and defined by Congress. When the merger was effected, the state bank ceased to function.

Finally, the holding of the court in Irving Trust Company, *supra*, (a case involving the application of the predecessor of section 113(a)(7) of the Code) lends strong support to the conclusion that a merger and not a consolidation resulted. In that case, in dealing with a union of two state banks under an Act of the State of New York, in all material respects identical with the Act under which the taxpayer united with *Y* and *Z* the Court found that the continuing bank retained its identity and remained the same taxpayer which it had been previously. The merged bank ceased to exist. By way of dicta, the Court concluded that the transaction was a statutory merger and not a consolidation.

Accordingly, it is held that the union between these three banks was a statutory merger and that the basis to *X* bank of the assets acquired from the *Y* and *Z* banks is cost.

Another question to be resolved is whether the cost of the assets to *X* shall be measured by the then current market price of its previously issued shares of capital stock, with the excess of the amount thus determined over the amount assigned to tangible assets allocated to good will.

The value of property in any case shall be determined by evidence, and a formula is only recognized as a "makeweight" or as a last resort. *Pierce Oil Corporation, et al.* v. *Commissioner*, 32 B. T. A. 403. If

the value of the property received, determined upon the basis of all of the surrounding facts, is better evidence of the fair market value of the shares of capital stock issued therefor then the sale price on such date of previously issued shares of the same stock, then the cost of the property to the corporation will be the value of the property received and not the value of its presently issued and outstanding shares. *Amerex Holding Corporation* v. *Commissioner*, 37 B. T. A. 1169, affirmed, 117 Fed. (2d) 1009, certiorari denied 314, U. S. 620.

In Amerex Holding Corporation, (Formerly The Chase Corporation formerly Chase Securities Corporation) *supra*, the Board of Tax Appeals had before it the question of the value of property received by Chase Securities Corporation as a result of the merger of the Mechanics and Metals National Bank of the City of New York with Chase Securities Corporation. The Mechanics and Metals National Bank of the City of New York had not segregated its investment assets into a security affiliate in the same manner as the *X*, *Y* and *Z* banks. The plan of reorganization provided for a transfer of a portion of the assets of the Mechanics and Metals National Bank of the City of New York to the Mechanics Securities Corporation, a new corporation to be formed for that purpose, and the acquisition of the remaining assets of Mechanics and Metals National Bank of the City of New York and the capital stock of the Mechanics Securities Corporation by the Chase Securities Corporation in exchange for its capital stock. In that case, the taxpayer sought to establish as cost of the assets acquired an amount equal to the book value of its capital stock, supported by the sale price of previously issued stock. The Board of Tax Appeals determined that the transaction would have to be considered as a whole and found that the Mechanics Securities Corporation stock and other assets acquired by the Amerex Holding Corporation on behalf of its stockholders as additional capital approximated the amount claimed by the Amerex Holding Corporation as the fair market value of the stock in question. Before arriving at his conclusion, however, the Board considered the question of whether the restriction placed on the number of shares of capital stock to be issued under the plan of reorganization was sufficient to warrant a valuation of the stock on the basis of the value of assets received rather than the sales price of previously issued shares of stock upon the market. Although the Board did not specifically pass on this question, the discussion of the matter in its opinion supports a conclusion that such restriction would warrant a valuation based upon the value of the assets received.

Accordingly, it is held that the cost to *X* bank of the assets acquired from the *Y* and *Z* banks is an amount equal to the fair market value of the assets at the time of the merger. To the extent that good will was acquired in the reorganization, it should be valued in accordance with the existing rules which have been established for the valuation of good will and included among the assets for Federal tax purposes.

Property acquired by corporation by assumption of obligations under lease. See Rev. Rul. 55–675, page 567.

SECTION 114.—BASIS FOR DEPRECIATION AND DEPLETION

REGULATIONS 111, SECTION 29.114–1: Basis for allowance of depreciation and depletion. (Also Sections 22(a), 113(a); Regulations 118, Sections 39.22(a)-1, 39.113(a)(7)-1.) Rev. Rul. 55-675

A transfer by a lessee of certain assets and cash in consideration of the transferee's assumption of the lessee's liabilities under a lease will not result in taxable income to the transferee. The assets received have a basis to the transferee recipient, for purposes of gain or loss, depreciation, and invested capital, of cost, which cost is based upon the obligations assumed by the transferee and does not include any amount with respect to any obligations which are so contingent and indefinite in nature that they are not susceptible of present valuation.

Advice has been requested relative to the treatment, for Federal income tax purposes, of property acquired by the taxpayer pursuant to an agreement whereby property was transferred to the taxpayer in consideration of the assumption by it of the transferor's liabilities under a lease.

The instant taxpayer and taxpayer *B* (in no way related to each other) were parties to similar leases with the same lessor for the same period of time covering adjoining lands. Both leases contained provisions to the effect that in the event of termination each lessee, at its own expense, would be required to place the property in standby condition. Both lessees were engaged in similar businesses, but taxpayer *B's* operation on the leased properties proved unprofitable. Desiring to discontinue its operations and to be relieved of its liabilities under the lease, taxpayer *B* entered into an agreement with the instant taxpayer under which, in consideration of the assumption of these liabilities, taxpayer *B* transferred to the instant taxpayer substantial quantities of supplies and equipment belonging to it and located on the leased land, plus a payment of cash. The questions presented are (1) whether the instant taxpayer realized any taxable income on the property transferred to it in consideration for the assumption of the transferor's liabilities under the lease and (2) the determination of the basis for depreciation of the property acquired by the taxpayer pursuant to the agreement.

Since the assets here concerned were not acquired pursuant to a transaction falling within any of the exceptions to the general rule of section 113(a) of the Internal Revenue Code of 1939, their basis in the hands of the taxpayer for the purpose of depreciation is the cost of acquiring said assets, in accordance with section 114(a) of the Code.

Where a lessee desires to be released from the obligations of a lease and pays cash, property, or both to the lessor in order to obtain a cancellation, the cash and the fair market value of the property are income to the lessor, the theory being that since such payments represent a substitute for rental payments which are expressly characterized as gross income they are also reportable as gross income for Federal income tax purposes. See *Walter M. Hort* v. *Commissioner*, 315 U. S. 28, Ct. D. 1502, C. B. 1941–1, 319. It follows that once the fair market value of property is properly included in income, the property thereafter has a basis for depreciation and other purposes equal to the

value at which it was included in income. See *Samuel A. Salvage* v. *Commissioner*, 297 U. S. 106, Ct. D. 1075, C. B. XV-1, 207 (1936).

On the other hand, absent the realization of income upon the acquisition of property, the basis of such property for Federal income tax purposes is, insofar as pertinent to the issue here concerned, the cost to the purchaser of acquiring the property. It thus becomes necessary to determine the nature of the transaction whereby the taxpayer acquired the instant property in the light of the above stated two rules.

In this connection, it is apparent that the instant transaction is not analogous to the lessor-lessee situation involved in the Hort case, *supra*, since the taxpayer here concerned is not the lessor and there was no cancellation of the lease or payment to the taxpayer of an advance rental payment which can be considered a substitute for ordinary income payments which would have been received by taxpayer under the lease.

The case of *Commissioner* v. *Oxford Paper Company*, 194 Fed. (2d) 190, involved a situation similar to the instant case. In that case, the lessee in perpetuity of certain water power properties, being in a weak financial condition, assigned the lease to Oxford Paper Company in consideration of assumption by said assignee of the rental obligations under the lease. In addition, the assignor of the lease paid the assignee $100,000 in cash and transferred to it stock in another corporation worth $6,000, and land, buildings, machinery, and equipment which had a fair market value, exclusive of the land, of $350,000. Oxford Paper Company reported the cash and the value of the other property received as gross income and claimed depreciation on the property thereafter based on the fair market value of the property included in income. The court stated that the property the taxpayer received was acquired by purchase for which it paid the obligations it assumed under the lease less the cash received and held that the value of the property acquired by Oxford did not constitute taxable income to it and that the basis of such property for Federal income tax purposes was the portion of the assumed obligations, which represented its costs, allocable to the property.

The distinction between this case and the Oxford Paper Company case is that some of the liabilities here assumed by the taxpayer appear to be so contingent and indefinite that they are not susceptible to present evaluation, whereas in the Oxford Paper Company case all of the liabilities assumed were definite in amount. Therefore, cost in the instant case is equal to the obligations assumed by the taxpayer less the cash received; however, no amount is to be included in cost with respect to those obligations which are so contingent and indefinite that they are not susceptible to present valuation, until such time as they become fixed and absolute and capable of determination with reasonable accuracy. The cost, determined in accordance with the foregoing, is to be allocated among the various properties received in the ratio which the fair market value of each particular property bears to the fair market value of the whole.

In view of the foregoing, it is held that (1) the taxpayer did not realize taxable income upon acquisition of the property pursuant to the above-described transaction; (2) the buildings, machinery and equipment thus acquired by the taxpayer have basis to it for gain or loss, depreciation, and invested capital purposes of cost which cost

is based upon the obligations assumed by the taxpayer; and (3) cost will not include any amount with respect to any obligations which are so contingent and indefinite in nature that they are not susceptible of present valuation.

(Also Section 23(m); Regulations 118, Section 39.23(m)-5. Rev. Rul. 55-700

The application of an end-use test in the determination of the percentage depletion rate allowable for dolomite used or sold for use as metallurgical grade or chemical grade limestone or as stone is proper and is also applicable to other natural deposits that are used or sold for use by the mine owner or operator as common dimension, crushed or broken stone.

Consideration has been given to whether dolomite is entitled to the 10 percent depletion rate prescribed by section 114(b)(4) of the Internal Revenue Code of 1939, notwithstanding that it is used or sold for use as metallurgical grade, or chemical grade limestone, or as common stone.

Section 114(b)(4) of the Code provides a percentage depletion allowance of 5 percent for "stone," 10 percent for "dolomite," and 15 percent for "metallurgical grade limestone" and "chemical grade limestone." In Section 39.23(m)-5 of Regulations 118, "stone" is defined as "all common dimension, crushed or broken stone within the ordinary meaning of these terms"; "limestone, chemical grade" is defined as "limestone used or sold for use in the chemical trade"; and "limestone, metallurgical grade" is defined as "limestone used or sold for use in the production of metals." The regulations do not define the term "dolomite."

Although there is no clear line of distinction between limestone and dolomite, as one grades into the other in relation to the amount of magnesium that it contains, the term "dolomite" has a definite mineralogical meaning. The mineral dolomite ($(CaMg)\ CO_3$), *i. e.*, within its strict mineralogical meaning, is not very common. However, the term "dolomite" has a broad commercial meaning, applying to a wide range of calcium-magnesium carbonates in which the percentages of the carbonates of calcium and magnesium vary from those in the mineral dolomite in its strict mineralogical sense, namely 54.2 percent calcium carbonate and 45.8 percent magnesium carbonate, to almost no magnesium carbonate and nearly all calcium carbonate.

While it seems improbable that Congress intended to limit the term "dolomite" to the pure mineral dolomite as distinguished from dolomite commonly used in commerce, Congress manifestly did not intend to classify a limestone as dolomite merely because it contains some magnesium. If the latter were intended, limestone relatively high in magnesium content and used in the production of metals would be denied the 15 percent rate of depletion allowed for "metallurgical grade limestone" and would be limited to 10 percent depletion as "dolomite" or "magnesite" ($MgCO_3$). On the other hand, a limestone, either high or low in magnesium content, that is used as crushed stone on roads or as concrete aggregate, would be allowed 10 percent depletion instead of the 5 percent allowed on "stone." In other words, employment of the end-use test is inherently necessary, and therefore was

intended, where several natural deposits are *specifically* named in a statute which provides that *each* is entitled to percentage depletion at a *different* rate, but they can not be distinguished so as to effectuate that statutory purpose unless such test is employed.

The use of rock as concrete aggregate, common dimension, or crushed or broken stone, does not primarily depend on its mineralogical or chemical content or composition but on its physical characteristics. Since section 114(b)(4) of the Code *specifically* names "stone" as entitled to a 5 percent depletion rate. Dolomite, regardless of its chemical composition, that is used or sold for use as common dimension, or crushed or broken stone, within the ordinary meaning of those terms, is considered to be stone on which the rate of percentage depletion allowable is limited to 5 percent. Conversely, on limestone used or sold for use as metallurgical grade limestone, such as for blast furnace flux, or as chemical grade limestone, such as for the manufacture of lime, the 15 percent rate for percentage depletion purposes is allowable.

The above principle is equally applicable to other natural deposits specifically named in the statute if they are used or sold for use by a mine owner or operator as concrete aggregate or common dimension, or crushed or broken stone. See, generally, Rev. Rul. 54–443 and 54–550, C. B. 1954–2, 164. Compare Rev. Rul. 55–67, C. B. 1955–1, 357.

SECTION 115(c).—DISTRIBUTIONS BY CORPORATIONS: DISTRIBUTIONS IN LIQUIDATION

REGULATIONS 118, SECTION 39.115(c)-1: Distributions in liquidation. Rev. Rul. 55–737

(Also Sections 111, 112(a), 117(a); Regulations 118, Sections 39.111–1, 39.112(a)–1, 39.117(a)–1.)

Amounts distributed on dissolution of a club organized as a nonstock corporation for the purpose of providing athletic facilities and entertainment are treated, in effect, as a sale of stock within the purview of section 115(c) of the Internal Revenue Code of 1939. Since the annual dues paid by the members do not constitute a capital investment, and in the absence of any original membership fee, the basis of each member's interest in the club is zero. Therefore, the entire amount received by each member is taxable subject to the provisions of section 117.

Advice has been requested with respect to the tax treatment of amounts received by members of a club upon dissolution.

In 1946, a group of persons organized a social club for the purpose of providing athletic facilities and entertainment for members. No initial membership fee was required but annual dues from members were collected. Proceeds were also received from the admission fees which the club charged at the several dances, parties and other public functions which it held. These proceeds, together with the annual dues from members, constituted the only source of the club's income and were reported on the tax returns which it filed. In 1951, the members incorporated the club as a nonstock corporation, subject to a limited liability, under the laws of the state in which it operated. In 1953, the corporation was dissolved and the amount of money in

its treasury was distributed equally to members. The club neither held nor owned any other property.

The question presented is whether the amounts received by the members upon dissolution constituted amounts distributed in liquidation of a corporation under section 115(c) of the Internal Revenue Code of 1939 so as to be treated as capital gains to the recipients, even though no stock was ever issued by the corporation.

Section 115 of the Internal Revenue Code of 1939 provides in part:

"(c) Distributions in Liquidation.—Amounts distributed in complete liquidation of a corporation shall be treated as in full payment in exchange for the stock, * * *. The gain or loss to the distributee resulting from such exchange shall be determined under section 111, but shall be recognized only to the extent provided in section 112."

It is a well established principle that it is not necessary for the proprietary interest of the members of an association or organization to be represented by stock or a certificate in order that the organization may be held to be a corporation for purposes of Federal income taxation. See section 39.3797-2 of Regulations 118. Therefore, the club concerned is a corporation and upon liquidation section 115(c) of the Code applies. See *Charles N. Spratt* v. *Commissioner*, 43 B. T. A. 503, acquiescence, C. B. 1942-1, 15; *Henry S. Sherman et al.* v. *Commissioner*, 146 Fed. (2d) 219; *W. C. Tyrrell et al.* v. *Commissioner*, 191 Fed. (2d) 500, Ct. D. 1313, C. B. 1938-1, 334, certiorari denied, 302 U. S. 747.

The annual dues paid into the club by its members do not constitute a capital investment by them but represent amounts paid for the club's services and facilities. Under such circumstances, and in the absence of any original membership fee, the basis of each member's interest in the club is zero.

Since, upon liquidation of the club, section 115(c) of the 1939 Code is applicable, the entire amount received by each member will be considered as received in exchange for his membership interest and will be taxable as gain subject to the provisions of section 117 of the 1939 Code.

SECTION 115(g).—DISTRIBUTIONS BY CORPORATIONS: REDEMPTION OF STOCK

REGULATIONS 118, SECTION 39.115(g)-1: Distribution in redemption or cancellation of stock taxable as a dividend. Rev. Rul. 55-547

The redemption by a corporation of a portion of its stock held by a testamentary trust, in which corporation a son of the deceased held shares in his own right and also had a substantial fiexed interest as a remainderman under the trust, constitutes a distribution essentially equivalent to a dividend under section 115(g)(1) of the Internal Revenue Code of 1939.

Advice has been requested whether, under the following circumstances, the redemption by a corporation of a portion of its stock held by a testamentary trust constitutes a distribution essentially equivalent to a dividend.

The instant corporation has 1,500 shares of capital stock outstanding. Such stock was owned by one family, *i. e.*, husband (999 shares),

wife (1 share), and one son (500 shares). The husband died leaving a last will and testament which provided for placing his stock in a trust. The widow of the deceased is a life beneficiary under the trust. Upon her death, the trustee is to distribute out of the remainder of the principal plus accumulated income, 5/12 portions each to the son and daughter of the deceased. The trustee is empowered to invade the trust principal on behalf of the life beneficiary. No dividends have ever been paid with respect to the stock.

The deceased was in ill health during the last years of his life and his son had been operating the business entirely. However, the son had been unwilling since his father's death to assume full responsibility for operating the business unless he owned and controlled all the outstanding capital stock. Accordingly, the corporation redeemed the 999 shares of stock held by the trust at slightly less than the book value of the stock.

Section 115 of the Internal Revenue Code of 1939 provides, in part:

> (c) DISTRIBUTION IN LIQUIDATION.—* * * amounts distributed in partial liquidation of a corporation shall be treated as in part or full payment in exchange for the stock. * * *
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> * * * * * * *
>
> (g) REDEMPTION OF STOCK.—
>
> (1) IN GENERAL.—If a corporation cancels or redeems its stock * * * at such time and in such manner as to make the distribution and cancellation or redemption in whole or in part essentially equivalent to the distribution of a taxable dividend, the amount so distributed * * *, to the extent that it represents a distribution of earnings or profits * * * shall be treated as a taxable dividend.
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> * * * * * * *
>
> (i) DEFINITION OF PARTIAL LIQUIDATION.—As used in this section the term 'amounts distributed in partial liquidation' means a distribution by a corporation in complete cancellation or redemption of a part of its stock, * * *.

In general, it is essentially a question of fact whether section 115(c) or section 115(g) of the Internal Revenue Code of 1939 is applicable to a particular redemption of stock. The courts have construed section 115(g) broadly at times (*M. A. Flanagan et al.* v. *Helvering*, 116 Fed. (2d) 937), and narrowly at other times (*Estate of Ira F. Searle* v. *Commissioner*, Tax Court Memorandum Opinion entered October 31, 1950).

In the instant case, the corporation had no prior record of dividend distributions (*Stanley Goldstein* v. *Commissioner*, 113 Fed. (2d) 363), no contraction of its business activities (*Commissioner* v. *Henry B. Babson*, 70 Fed. (2d) 304, certiorari denied, 293 U. S. 571), and the distribution resulted from the initiative of the stockholder-son, (*Joshua E. Smith* v. *United States*, 121 Fed. (2d) 692; *A. E. Levit et al.* v. *Commissioner*, 122 Fed. (2d) 411). No discernible business purpose for the redemption had been established (*Flanagan* v. *Helvering supra; William T. Brown, Jr.* v. *Commissioner*, 79 Fed. (2d) 73, Ct. D. 1102 C. B. XV-1, 222 (1936)), and the fact that no other market existed for the stock was not determinative. In the case of *James F. Boyle* v. *Commissioner*, 187 Fed. (2d) 557, certiorari denied, 342 U. S. 817, the court held that the proceeds of a redemption constituted dividends even though conditions prevented a sale to outsiders. Further, in the instant case the amount involved in the redemption was approximately the amount of the surplus of the corporation. A distribution was held to be essentially equivalent to a dividend under circumstances where the distribution was made chiefly for the advan-

tage of stockholders or to provide them with funds. See *De Nobili Cigar Co.* v. *Commissioner*, 143 Fed. (2d) 436; *Pullman, Inc.* v. *Commissioner*, 8 T. C. 292, acquiescence, C. B. 1947-1, 3.

The discretion of the trustee to invade the principal on behalf of the life beneficiary was considered an additional hazard to the son's acquiring control of the corporation and he desired to have the shares redeemed by the corporation which might otherwise be sold to outsiders. Since the son, who held shares in the corporation in his own right, also had a substantial and fixed interest as a remainderman under the will with respect to the stock hold in trust, the redemption of the estate's shares cannot be considered a complete severance with the corporation.

Under the foregoing circumstances, it is held that the cancellation or redemption by the corporation of a portion of its stock constitutes a distribution essentially equivalent to a dividend within the purview of section 115(g)(1) of the Internal Revenue Code of 1939.

Rev. Rul. 55-592

The amount received by the executors of an estate with respect to certain stock of a corporation which was sold to its wholly-owned subsidiary does not constitute a dividend, under section 115(g)(3) of the Internal Revenue Code of 1939, to the estate to the extent that the amount received does not exceed the amount of the estate, inheritance, legacy and succession taxes including interest.

Advice has been requested with respect to the tax consequence of a proposed sale by the executor of an estate of common stock of a corporation to its wholly-owned subsidiary corporation.

In the instant case, a decedent owned at the time of death certain shares of common and preferred stock of a corporation. The Federal estate tax return filed for the estate included the value of such stock which exceeds 35 percent of the value of the gross estate. The value of the common stock did not exceed the finally determined Federal estate tax liability. The executors of the estate sold the common stock to a wholly-owned subsidiary of the corporation issuing the stock. The sale was made after the decedent's death and within the time limit prescribed by section 115(a)(3) of the Internal Revenue Code of 1939.

The decedent bequeathed to his nephew all of the common stock and one-fourth of the preferred stock owned by him at the time of death. By virtue of this bequest and an additional bequest by the decedent's wife who predeceased her husband, the nephew owned all of the outstanding common stock of the corporation.

Section 115(g) of the Internal Revenue Code provides, in part:

(3) REDEMPTION OF STOCK TO PAY DEATH TAXES.—The provisions of this subsection shall not apply to such part of any amount so distributed with respect to stock the value of which is included in determining the value of the gross estate of a decedent in accordance with section 811, as is distributed after such decedent's death and within the period of limitations for the assessment of estate tax provided in section 874(a) (determined without the application of section 875) or within 90 days after the expiration of such period, and as is not in excess of the estate, inheritance, legacy, and succession taxes (including any interest collected as a part of such taxes) imposed because of such decedent's death: Provided, That the value of the stock in such corporation for estate tax purposes comprises more than 35 per centum of the value of the gross estate of such decedent.

Section 39.115(g)-1 of Regulations 118 provides in part that section 115(g)(3) of the Internal Revenue Code states that in certain cases a distribution in cancellation or redemption of stock, the value of which is included in determining the value of the gross estate of a decedent, shall not be treated as a dividend under section 115(g)(1). In the instant case the transaction meets all of the conditions imposed in section 39.115(g)-1.

In view of the foregoing, it is held that the amount received by the executors of the decedent's estate, as a result of the sale of the common stock of the corporation to its wholly-owned subsidiary, will not be treated as a dividend to the estate to the extent that such amount is less than the amount of the estate, inheritance, legacy and succession taxes, including any interest thereon, imposed because of the death of the decedent.

Gain or loss will be recognized in accordance with the provisions of section 111 and the applicable provisions of section 117 of the Code. In determining the amount of the gain or loss, regardless of the actual number of shares of stock (as indicated by the certificates) sold, the total number of shares deemed to have been sold will be the number of shares which will bear the same ratio to the total number of shares outstanding as the amount of the purchase price bears to the amount of the net assets of the corporation applicable to the common stock at the time of the sale. The fair market value of the outstanding preferred stock should be deducted from the net assets of the corporation in determining the amount of the net assets applicable to the common stock.

SECTION 116.—EXCLUSIONS FROM GROSS INCOME

Regulations 118, Section 39.116-1: Earned income from sources without the United States.

Furlough allowance of United States nonresident missionaries. See Rev. Rul. 55-464, page 291.

SECTION 117(a).—CAPITAL GAINS AND LOSSES: DEFINITIONS

Regulations 118, Section 39.117(a)-1: Meaning of terms. Rev. Rul. 55-526

(Also Section 117(j); Regulations 118, Section 39.117(j)-1.)

A royalty interest in oil and gas in place constitutes real property for Federal income tax purposes. Compare I. T. 3693, C. B. 1944, 272. If the owner of the royalty uses it in his trade or business, the royalty interest is not a capital asset under the provisions of section 117(a)(1)(B) of the Internal Revenue Code of 1939. However, if the owner has held for more than 6 months a royalty interest so used, it will be treated as "property used in the trade or business" for the purpose of section 117(j) of the 1939 Code and, subject to the application of that section, gain on the sale of the royalty may constitute gain from the sale of a capital asset held for more than 6 months.

A loss on the sale of an oil and gas royalty used by the taxpayer in his trade or business is also subject to the application of section 117(j).

If an oil and gas royalty is held by the taxpayer for investment, such royalty is a capital asset for Federal income tax purposes, and gain or loss on the sale of the royalty will be treated as a short term capital gain or loss or a long term capital gain or loss, depending upon whether the interest has been held by the taxpayer for more than 6 months. On the other hand, if an oil and gas royalty is held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business, such royalty is not a capital asset and gain or loss on the sale of the royalty will be treated as ordinary gain or ordinary loss, as the case may be.

Certain transactions in commodity futures. See Ct. D. 1787, page 17.

Redemption of securities purchased "flat" with defaulted interest. See Rev. Rul. 55–433, page 515.

Amounts distributed in liquidation to members of a club, taxable as a corporation, treated as a sale. See Rev. Rul. 55–737, page 570.

SECTION 117(f).—CAPITAL GAINS AND LOSSES: RETIREMENT OF BONDS, ETC.

Payments received on securities purchased "flat" with defaulted interest. See Rev. Rul. 55–433, page 515.

SECTION 117(j).—CAPITAL GAINS AND LOSSES: GAINS AND LOSSES FROM INVOLUNTARY CONVERSION AND FROM THE SALE OR EXCHANGE OF CERTAIN PROPERTY USED IN THE TRADE OR BUSINESS

REGULATIONS 118, SECTION 39.117(j)–1: Gains and losses from involuntary conversions and from the sale or exchange of certain property used in the trade or business.

Treatment of a royalty interest in oil and gas in place. See Rev. Rul. 55–526, page 574.

SECTION 117(k).—CAPITAL GAINS AND LOSSES: GAIN OR LOSS IN THE CASE OF TIMBER OR COAL

REGULATIONS 118, SECTION 39.117(k)–1: Gain or loss upon the cutting and disposal of timber and the disposal of coal.

Treatment accorded a sublessor of coal properties upon disposal of coal. See Rev. Rul. 55–621, page 277.

SECTION 119(b).—INCOME FROM SOURCES WITHIN UNITED STATES: NET INCOME FROM SOURCES IN UNITED STATES

REGULATIONS 118, SECTION 39.119(b)-1: Apportionment of deductions.

Taxes paid to Great Britain by British insurance companies (other than life or mutual) doing business in the United States. See Rev. Rul. 55–532, page 592.

SECTION 122.—NET OPERATING LOSS DEDUCTION

REGULATIONS 118, SECTION 39.122–3: Computation of net operating loss in case of a taxpayer other than a corporation. Rev. Rul. 55–600

Salaries and fees received by a taxpayer as compensation for services rendered represent income from a trade or business for purposes of computing net operating loss as provided by section 122 of the Internal Revenue Code of 1939. Acquiescence "in result only," C. B. 1954–2, 4, in the decision in *Joe B. Luton* v. *Commissioner*, 18 T. C. 1153, does not constitute agreement to the rationale of the case.

Advice has been requested regarding the tax treatment of salaries and fees, received by a taxpayer, in computing net operating loss under the provisions of section 122 of the Internal Revenue Code of 1939, in view of the acquiescence "in result only," C. B. 1954–2, 4, in the case of *Joe B. Luton* v. *Commissioner*, 18 T. C. 1153.

The Luton case dealt with a net operating loss under section 122 of the Internal Revenue Code of 1939. During a portion of the year in issue, the taxpayer owned and operated a restaurant which was closed early in the year when the taxpayer sold its equipment at a loss. During the year he also was employed at a salary to manage a restaurant owned by another. The Tax Court of the United States found that he suffered a net operating loss during the year, calculated by excluding the loss on the sale of the restaurant equipment, the salary and certain interest income from the computation.

Section 122 of the Internal Revenue Code of 1939 provides in part as follows:

(a) DEFINITION OF NET OPERATING LOSS.—As used in this section, the term "net operating loss" means the excess of the deductions allowed by this chapter over the gross income, with the exceptions, additions, and limitations provided in subsection (d).

* * * * * * *

(d) EXCEPTIONS, ADDITIONS AND LIMITATIONS.—The exceptions, additions and limitations referred to in subsections (a), (b), and (c) shall be as follows:

* * * * * * *

(5) Deductions otherwise allowed by law not attributable to the operation of a trade or business regularly carried on by the taxpayer shall (in the case of a taxpayer other than a corporation) be allowed only to the extent of the amount of the gross income not derived from such trade or business. * * *

It is the position of the Revenue Service that salary or wages received by a taxpayer constitutes income derived from the operation of a trade or business regularly carried on by him and are to be so treated in computing a net operating loss. This position has been supported by the following cases: In *Samuel H. Ranson, Jr.* v. *Com-*

missioner, Tax Court Memorandum Opinion entered June 30, 1952, the court decided that the taxpayer could not offset compensation received as an executive from a corporation engaged in investment securities business against nonbusiness expenses, since such compensation was considered business income. In the case of *James H. Cunningham* v. *Commissioner*, 20 T. C. 65, the court held that the salary of a wife derived from her husband's business was business income and could not be applied against nonbusiness losses in computing net operating loss on a joint return filed by the taxpayers. In *Anders I. Lagriede* v. *Commissioner*, 23 T. C. No. 62, a wife in her capacity as a salaried teacher was considered as operating a trade or business regularly carried on by her and therefore any compensation received by her should be included with other business income in computing net operating loss. Thus, the position taken by the Tax Court in the Luton case was declared to be in error.

Acquiescence "in result only" merely means that the Commissioner, while disagreeing with the treatment by the court of one or more issues, will not file an appeal in the case.

REGULATIONS 118, SECTION 39.122-4: Computation of net operating loss carry-overs and net operating loss carry-back. Rev. Rul. 55-503

Where a corporation has a net operating loss for a taxable year beginning after December 31, 1947 and before January 1, 1950, the loss sustained is carried back to the 2 preceding taxable years and forward to the 3 succeeding taxable years.

Under the provisions of section 122(b)(2)(F) of the Internal Revenue Code of 1939, where a corporation has a taxable year beginning in 1949 and ending in 1950 and such taxable year is the corporation's first taxable year, a net operating loss for such first taxable year may be carried forward to the 5th succeeding taxable year (subject to some limitations with respect to the 4th and 5th succeeding taxable years). However, it is the position of the Revenue Service that for purposes of section 122(b)(2)(F) such first taxable year does not include any period during which, even though the corporation is nominally in existence and may have filed a return, it has not perfected its organization, transacted any business, received income from any source, or incurred expenses.

Carryback of consolidated net operating losses to preceding taxable year where affiliated group merged during 1953 and new affiliated group formed. See Rev. Rul. 55-724, page 581.

SECTION 126(c).—INCOME IN RESPECT OF DECEDENTS: DEDUCTION FOR ESTATE TAX

REGULATIONS 118, SECTION 39.126(c)-1: Deduction for estate tax attributable to income in respect of decedent.

Capital gain included in gross estate is deductible under section 126(c). See Rev. Rul. 55-481, page 279.

SECTION 131(a).—TAXES OF FOREIGN COUNTRIES AND POSSESSIONS OF UNITED STATES: ALLOWANCE OF CREDIT

REGULATIONS 118, SECTION 39.131(a)-1: Analysis of credit for taxes. Rev. Rul. 55-504

(Also Section 205.)

Cuban Decree No. 3253 of November 16, 1937, as modified by Decree No. 245 of February 1, 1938, and Decree No. 2246 of July 29, 1944, are decrees which impose a single license or *patents unica* as a prerequisits for beginning certain operations on which an income tax is levied. The license is not a substitute for an income tax and the amount of the license is in no way based on the taxpayer's income. *Held*, such decrees do not impose income taxes or taxes imposed in lieu thereof within the meaning of section 131 of the Internal Revenue Code of 1939.

The Cuban tax on insurance companies based on gross premiums received, which tax originated under Military Order No. 463 of November 13, 1900 (the basic Cuban income tax law) and was continued in the Emergency Tax Law of January 29, 1931, as amended by the law of June 23, 1938, regulations for which were promulgated by Decree No. 1117 of May 15, 1939, is a tax imposed in lieu of an income tax within the meaning of section 131 of the Internal Revenue Code. Credit is therefore allowable to an insurance company, as provided in section 205 of the Code, for such taxes paid or accrued on gross premiums, subject to the limitations of section 131(b) of the Code.

(Also Section 205.) Rev. Rul. 55-505

The Law of 1942 of Venezuela and Law No. 52 of May 23, 1941, of Panama each imposes an income tax upon life insurance companies but includes in their taxable income certain items which are not subject to taxation in the United States. *Held*, such taxes are income taxes within the meaning of section 131 of the Internal Revenue Code of 1939. The fact that Venezuela and Panama include in taxable income items which are not subject to taxation in the United States will not limit the amount of credit allowable under section 131(a) of the Code except through the limiting fraction of section 131(b) of the Code, which includes in both the numerator and denominator only those items constituting net income of a life insurance company within the provisions of the Code. See Rev. Rul. 54-15, C. B. 1954-1, 129. Credit is, therefore, allowable to a life insurance company, as provided in section 205 of the Code, for taxes paid pursuant to the Law of 1942 of Venezuela or Law No. 52 of May 23, 1941, of Panama, subject to the limitations of section 131(b) of the Code.

Credit for taxes paid under contract with the Costa Rican Government. See Rev. Rul. 55-454, page 287.

Credit allowable to an individual for taxes paid to Cuba. See Rev. Rul. 55-455, page 288.

SECTION 141.—CONSOLIDATED RETURNS

REGULATIONS 118, SECTION 39.141-1: Consolidated income and excess profits tax returns of affiliated corporations. Rev. Rul. 55-458

Where a parent corporation purchased all the outstanding shares of stock of another corporation, all the stock being held in escrow by a trust company as security for the purchase price, the fact that all the shares of stock are held in escrow during a taxable year will not deprive the parent company of the right to include the subsidiary whose stock has been acquired in the consolidated income tax returns to be filed by the affiliated group.

Advice has been requested as to whether a corporation may be included in consolidated income tax returns to be filed by an affiliated group where the shares of stock of the corporation have been purchased by the parent corporation but are held in escrow as security for the purchase price of the stock.

X company purchased for cash, payable in installments, all of the outstanding shares of stock of the *Y* company. The shares consist of Class A common and Class B common. The purchase agreement provided that the stock of *Y* company should be transferred in escrow to a trust company as security for the purchase price of the stock. The agreement further provided that the stock be transferred to the trust company's name as escrow agent, but that notwithstanding such transfer, the purchaser, *X* company, shall have all rights of ownership including voting of the stock and the receipt of the amount of dividends paid on the stock, unless and until an event of default shall have occurred and be continuing.

Section 39.141-1(b) of Regulations 118 provides that an affiliated group of corporations is formed for Federal income tax purposes at the time that the common parent corporation, which is an includible corporation, becomes the owner directly of stock possessing at least 95 percent of the voting power of all classes of stock and at least 95 percent of each class of the nonvoting stock (not including nonvoting stock which is limited and preferred as to dividends) of another includible corporation. In the instant case, all of the outstanding shares of stock of *Y* corporation were purchased by the parent corporation, and although legal title to the shares of stock is in an escrow agent, the entire beneficial, or equitable, ownership of the stock is, by the terms of the agreement, in the parent corporation. Ownership directly by one corporation of the stock of another corporation comprehends beneficial ownership of such stock. See G. C. M. 7331, C. B. VIII-2, 135 (1929). Consequently, it is the right of ownership with respect to such stock during the taxable year that controls rather than the possibility that under certain circumstances nonexisting during such period, such right of ownership might be forfeited.

Accordingly, it is held that where all the outstanding stock of *Y* company is purchased by *X* company, all the stock held being in escrow by a trust company as security for the purchase price, the fact that all the stock is held in escrow during a taxable year will not

deprive X company of the right to include Y company in the consolidated income tax returns to be filed by the affiliated group of which X company is the common parent.

REGULATIONS 129, SECTION 24.10: Exercise of privilege.

Filing of Form 7004, Application for Automatic Extension of Time to File U. S. Corporation Income Tax Return, in the case of an affiliated group. See Rev. Rul. 55–560, page 379.

REGULATIONS 129, SECTION 24.11: Consolidated returns for subsequent years.

Adjustments to consolidated net operating loss carryback where subsidiaries change but affiliated group is considered as remaining in existence in a subsequent loss year. See Rev. Rul. 55–499, page 379.

REGULATIONS 129, SECTION 24.13: Change in affiliated group during taxable year.

Carryback of consolidated net operating losses to preceding taxable year where affiliated group merged during 1953 and new affiliated group formed. See Rev. Rul. 55–724, page 581.

REGULATIONS 129, SECTION 24.14: Accounting period of an affiliated group. (Also Section 46; Regulations 118, Section 39.46–1.) Rev. Rul. 55–566

Section 24.14(a) of Regulations 129 provides that the taxable year of an affiliated group which makes a consolidated return shall be the same as the taxable year of the common parent corporation. Except as provided in section 24.13 of Regulations 129, the consolidated return must include the income of the common parent corporation and of each subsidiary for the entire taxable year of the group. Where the taxable year of a subsidiary corporation is not the same as that of the common parent, the separate return filed by such subsidiary for the short period immediately preceding the date on which its income is included in the consolidated return is not attributable to a change of accounting period within the meaning of section 46 of the Internal Revenue Code of 1939. Accordingly, the net income for such short period is not required to be annualized. However, the excess profits net income for the short taxable year is required to be annualized in the manner prescribed in section 433(a)(2) of the 1939 Code. See section 24.31(f) of Regulations 129.

REGULATIONS 129, SECTION 24.31: Bases of tax computation.
(Also Section 24.13.)
(Also Section 122; Regulations 118, Section 39.122–4.)

Rev. Rul. 55–724

Computation of consolidated net operating loss carryback from the taxable year 1953, during which a parent corporation merged into a subsidiary, the former subsidiary becoming the parent corporation of a new affiliated group, where the carryback is to the taxable year 1952, a year for which consolidated income tax returns were filed.

Advice has been requested as to the extent to which net operating losses sustained by two corporations after a change in affiliation, as described below, may be carried back to a year in which consolidated returns were filed.

Corporation *M*, a subsidiary, and corporation *N*, the parent, which filed consolidated income tax returns on the calendar year basis for the taxable year 1952, merged on June 30, 1953, the parent corporation ceasing to exist on that date. On the same date, *M*, the surviving corporation, acquired all the outstanding capital stock of corporation *P*, thus creating a new affiliated group. Corporation *P*, prior to affiliation, also maintained its records and reported income on the calendar year basis. *N*, the former parent corporation, had net income for the period from January 1, 1953, to June 30, 1953, but *M* and *P* each sustained net operating losses for the entire taxable year 1953.

Under section 24.13(c) of Regulations 129, a consolidated return is required to be filed by *M* and *N* for the period from January 1, 1953, to June 30, 1953, unless such affiliated group elected to file separate returns for the taxable year 1953 pursuant to Revenue Ruling 152, C. B. 1953–2, 184.

Section 122(b)(1)(B) of the Internal Revenue Code of 1939 provides that a net operating loss for any taxable year beginning after December 31, 1949, shall be a net operating loss carryback to the preceding taxable year. Section 24.31(a)(4)(ii) of Regulations 129 provides that a consolidated net operating loss carryback to the taxable year, with respect to a corporation which for the succeeding taxable year files a separate return or joins in a consolidated return filed by another affiliated group, shall (subject to prescribed limitations) include the net operating loss of such corporation for the succeeding taxable year.

Accordingly, if *M* filed a separate return for 1953, the net operating loss for that year may be carried back and used in the computation (subject to prescribed limitations) of the consolidated net operating loss deduction for 1952. If a consolidated return is filed for the taxable year ended June 30, 1953, and such return results in a consolidated net operating loss, the loss may be carried back and used in the computation of the consolidated net operating loss deduction for 1952. In the latter case, however, the loss sustained by *M* for the taxable period July 1, 1953, to December 31, 1953, cannot be carried back to 1952 since the latter taxable year is considered the second preceding taxable year. None of the losses for 1953 of corporation *P* may be used in the computation of the consolidated net operating loss deduction for 1952 inasmuch as *P* was not a member of the affiliated group of which *N* was the common parent corporation in 1952.

Adjustment to consolidated net operating loss carryback where subsidiaries change but affiliated group is considered as remaining in existence in a subsequent loss year. See Rev. Rul. 55–499, page 379.

SECTION 142.—FIDUCIARY RETURNS

REGULATIONS 118, SECTION 39.142–4: Return by receiver. Rev. Rul. 55–459

(Also Section 161; Regulations 118, Section 39.161–1.)

A receiver for each of two receiverships appointed under the laws of the State of Texas, or any other state having equivalent laws, to administer oil lands devised by a decedent to his daughter with a contingent interest over, should file a fiduciary return for each of the receiverships covering the income received by each during the taxable year. Separate fiduciary returns will not be required with respect to the interest of the beneficiary under the original owner's will, if only part of her property is included in each receivership.

The income impounded by each receivership for distribution after the death of the beneficiary to persons then held to be heirs of the original owner is taxable to the receivership, as well as the income attributable to the interest of the beneficiary which is not paid or which does not become payable to her during the taxable year of the receivership or within 65 days of the subsequent taxable year. Income which becomes payable to the beneficiary during such period will be deductible by each receivership on its return and will be taxable to her.

Advice is requested relative to the manner of reporting, for Federal income tax purposes, the income from oil lands, devised by a decedent to his daughter with a contingent interest over, impounded by two receiverships (having the same receiver) under the laws of the State of Texas.

In the instant case a decedent had acquired lands in Texas, a portion of which was his separate property and a portion community property. He left surviving him his wife, who has since died, and a daughter. Under the terms of the will he devised and bequeathed a life estate in his property to his wife and provided that at her death all income from his property (real, personal or mixed) should go to the daughter for as long as she lived. The will also provided that, in the event no child or children survived the daughter, all of his estate should pass to his brothers and sisters or their children, "as provided by the law of Descent and Distribution of the State of Texas."

A United States district court in Texas has found that certain of the lands and premises bequeathed to the daughter, who has never married, are subject to contingent future interests arising by way of devise under her father's will.

Articles 2320b and 2320c, Volume 7, Vernon's Texas Revised Civil Statutes Annotated, provide that where lands or any estate therein are subject to contingent future interests, legal or equitable, and it appears that such lands are liable to drainage of oil, gas or other minerals, the District Court for the county in which such lands lie may, upon application of any person having a vested, contingent or possible interest in such lands, appoint a receiver for such lands or

estate and authorize the receiver to lease said lands for development of the oil, gas, or minerals, and in such case, authorize the receiver to receive, hold and invest the proceeds under the direction of the court for the benefit of the persons entitled, or who may become entitled thereto according to their respective rights and interests.

In the instant case, before there was any nearby oil development, two suits were filed by contingent remaindermen, the main purpose being the desire to lease certain portions of the lands for oil and gas development. The lands are entirely different in each suit; the parties are not the same, and the interest in the lands, that is, the percentage of title to the lands being leased by the receiver, is not the same. It happens that the court appointed the same person as receiver in both cases. Wells have now been drilled and oil has been found on the lands.

Section 39.142–4 of Regulations 118 provides in part as follows:

> Return by Receiver. A receiver who stands in the place of an individual or corporation must render a return of income and pay the tax for his trust, but a receiver of only part of the property of an individual or corporation need not.

In *Commissioner* v. *O. O. Owens, et al.*, 78 Fed. (2d) 768, it was held that a receiver appointed by a District Court for the purpose of impounding royalty income received during litigation to determine the unknown heirs of the original owner is a fiduciary for Federal income tax purposes. It appears that in the instant case only a portion of the property owned by the beneficiary of the original owner is included in each receivership.

Section 161(a)(1) of the Internal Revenue Code provides in part that the Federal income tax at the rates applicable to individuals shall apply to income accumulated in trust for the benefit of unborn or unascertainable persons or persons with contingent interests.

In view of the foregoing, it is held that (1) the receiver should file a fiduciary return for each of the two receiverships covering the income received by each during the taxable year, but that separate fiduciary returns will not be required with respect to the interests of the beneficiary under the original owner's will if only part of her property is included in each receivership, and (2) the income impounded by each receivership for distribution after the death of the beneficiary to persons then held to be heirs of the original owner is taxable to the receivership, as well as the income attributable to the interests of the beneficiary which is not paid or which does not become payable to her during the taxable year of the receivership or within the first 65 days of the subsequent taxable year. Income which becomes payable to the beneficiary during such period will be deductible by the receivership on its return and will be taxable to her.

SECTION 143.—WITHHOLDING OF TAX AT SOURCE

REGULATIONS 118, SECTION 39.143–1: Withholding tax at source.

Treatment of copyright royalties under the United States-Canada income tax convention, Treasury Decision 6047, C. B. 1953–2, 59. See Rev. Rul. 55–482, page 316.

SECTION 144.—PAYMENT OF CORPORATION INCOME TAX AT SOURCE

REGULATIONS 118, SECTION 39.144-1: Withholding in the case of nonresident foreign corporations.

Treatment of copyright royalties under the United States-Canada income tax convention, Treasury Decision 6047, C. B. 1953-2, 59. See Rev. Rul. 55-482, page 316.

SUPPLEMENT E.—ESTATES AND TRUSTS

SECTION 161.—IMPOSITION OF TAX

REGULATIONS 118, SECTION 39.161-1: Imposition of the tax.

Income from oil lands, devised by the decedent to his daughter with a contingent interest over, impounded by receivership under laws of the State of Texas. See Rev. Rul. 55-459, page 582.

SECTION 162.—NET INCOME

REGULATIONS 118, SECTION 39.162-1: Income of estates and trusts. Rev. Rul. 55-574

Amounts which are properly chargeable only to the corpus of a trust as nonbusiness expenses incurred by the trustees are available as a deduction only to the trustees and may not serve to reduce the amount of distributable capital gain which is taxable to the beneficiaries.

Advice has been requested whether amounts which are properly chargeable only to the corpus of a trust as nonbusiness expenses incurred by the trustees may be used to reduce the amount of distributable capital gain taxable to the beneficiaries upon termination of the trust.

In the instant case the decedent died a resident of the State of New Jersey. He had created under the terms of his will a trust of the residue of his estate. The entire income from the trust was payable to his wife for life and on her death the balance of the trust estate was devised among nephews, nieces, grandnephews and grandnieces.

After the death of the widow, the life tenant, the trustees converted all assets into cash to facilitate the distribution of the trust property. The sale of securities resulted in an amount (in addition to the income earned by the trust) being available for distribution.

An expense incurred by the trustees is chargeable against the corpus of a trust only where provision therefor is made in the trust instrument or under State law, where ordered under court decree, or where the amount constitutes a capital expenditure chargeable to corpus. The capital gain of a trust, which is currently distributable to the beneficiaries, is not considered to be corpus for Federal income tax purposes.

Section 7 of Chapter 14A, Title 3A, of New Jersey Statutes Annotated provides in pertinent part that any profit or loss arising from a sale, exchange or other disposition of securities held in an estate shall inure or fall upon principal.

In the case of *Trust u/w of Mary L. (Flagler) Bingham et al.* v. *Commissioner*, 325 U. S. 365, Ct. D. 1643, C. B. 1945, 103, it was held that in computing the taxable income of a trust, the expenses incurred by the trustee in the distribution of the corpus were deductible as expenses of management; but in that case the court was not considering the tax liability of the distributees. It is the general rule supported by many court decisions, however, that deductions allowable to an estate or trust are not available to the beneficiaries unless the tax statute so provides.

In *Edith M. Bryant* v. *Commissioner*, 14 T. C. 127, affirmed, 185 Fed. (2d) 517, the terms of the will directed the trustees of a trust fund to pay the income therefrom to the widow of the testator, and upon her death to pay over the principal to his daughter as remainderman. The court held that after death of the life beneficiary income of the corpus, less expenses properly chargeable to income, was deductible and taxable to the remainderman. The remainderman could not claim a deduction for expenses incurred by the trustee in terminating the trust which were properly chargeable to corpus.

The fact that an expense of the trustees is required to be paid out of the principal of the trust does not affect its allowance under section 23(a)(2) of the Internal Revenue Code of 1939 as a deduction in computing the net income of the trust. In computing the beneficiaries' share of distributable income, however, the amount distributable and taxable to the beneficiaries may not be reduced by deductible expenses which are chargeable only to corpus. If a trust has deductible expenses which are properly chargeable only to corpus, and all of the income of the trust is distributable so that no income is taxable to the trust, benefit of the deduction allowable with respect to such expenses would be lost, since the deduction may not be transferred to the beneficiary. See *Marian Steedman Wilson, et al.* v. *Anderson*, 289 U. S. 20, Ct. D. 650, C. B. XII–1, 253 (1933).

In view of the foregoing, it is held that amounts which are properly chargeable only to the corpus of a trust as nonbusiness expenses incurred by the trustees are available as a deduction only to the trustees and may not serve to reduce the amount of distributable capital gain which is taxable to the beneficiaries.

SECTION 165.—EMPLOYEES' TRUSTS

REGULATIONS 118, SECTION 39.165–1: Employees' trusts. (Also Section 23 (p), Regulations 118, Section 39.23 (p)–1.) — Rev. Rul. 55–681

A pension plan will qualify under section 165(a) of the Internal Revenue Code of 1939 even though it provides for fixed benefits and a stated rate of contributions and is negotiated pursuant to a union contract which may be terminated at the end of five years, provided a certification is made that actuarial computations indicate the ex-

pected contributions will not be less than the full costs of prospective pensions for employees expected to retire under the plan during the first five years, nor less than the normal costs plus interest accruing on unfunded past service costs for *all* employees under the plan during that period. The limits under section 23(p) of the Code will be based on the fixed benefits without reference to the contributions and on the assumption that the plan will be continued beyond the five-year control period. The principles set forth herein are equally applicable to the unit benefit type of pension plan.

P. S. No. 64, dated November 9, 1950, supplemented.

Advice has been requested as to the qualification under section 165(a) of the Internal Revenue Code of 1939 and as to the bases of deduction limits under section 23(p) of the Code of a trusteed pension plan established pursuant to a union contract which requires that the plan be maintained without change for five years and then may be modified in accordance with the terms of a contract then to be renegotiated.

All employees of the company in the instant case who are compensated on an hourly wage basis are covered under a plan which provides for a fixed benefit of $100.00 per month, without offset by social security benefits, commencing at normal retirement age 65 for those employees who have completed 25 years of service at such time and proportionate benefits for those who have then completed at least 15 years of service but less than 25 years. The entire cost of the plan is funded by company contributions which are equal to a fixed percentage of wages paid to all participating employees. An officer of the company certifies that actuarial computations have been prepared which indicate that the expected contributions during the first five years of the plan will be not less than the full costs of prospective pensions for employees expected to retire under the plan during the first five years, nor less than the normal costs plus interest accruing on unfunded past service costs for *all* employees under the plan during that period. He also certifies that the methods and assumptions used in such computations and the results thereof are accepted by the company as reasonable.

On the basis of the foregoing, two issues have been found to be present, namely, (1) whether the requirements in section 39.165–1(a) of Regulations 118 that a qualified plan must be permanent, as distinguished from a temporary program, is affected by a five–year contract limitation, and (2) whether the provision in the plan for a fixed benefit and a stated rate of contributions violates the requirement in such section 39.165–1(a) that benefits must be definitely determinable. The plan has been found to meet the requirements of section 165(a) of the Code in all other respects. In particular, it is noted that the plan could not discriminate in favor of employees who are officers, directors, supervisors, or highly compensated whether the plan is continued or terminated.

As to permanence, it is observed in the instant case that it is the contract between the company and the union which is to terminate at the end of five years, but that the plan itself does not provide for cessation at the end of the stated time. It is intended to be a continuing and permanent program. Upon renegotiation of the union contract, it may be agreed to maintain the plan without change, it may be modified in some respects, or it may be terminated. In this respect, it is similar to plans generally in which provision is made for

amendment and discontinuance. As far as can be determined at the inception of the plan, it is intended as a permanent program within the purview of section 165(a) of the Code.

Regarding definiteness, it is noted that the relationship between the fixed benefits and the stated rate of contributions is supported by an actuarial computation which the employer certified it accepted as reasonable. Further, it is similar to other plans in that it may later be changed or terminated. Accordingly, it is held that the definiteness of the company's pension plan is not adversely affected merely because it provides for a fixed benefit and a stated rate of contributions. This determination, however, is not to be taken as an indication that the Internal Revenue Service is in any way passing on the actuarial soundness of the plan or on the reasonableness of the actuarial computations.

In view of the above, the pension plan of the company in the instant case is held to meet the requirements of section 165(a) of the Code, and the trust forming a part thereof is held to be entitled to exemption under the provisions of such section.

In this type of plan, the deduction limitations under section 23(p) of the Code will be based on the fixed benefits without reference to the contributions and on the assumption that the plan will be continued beyond the five-year contract period.

The principles set forth herein are equally applicable to the unit benefit type of pension plan, such as a plan providing a pension based on a percentage of compensation for each year of service.

P. S. No. 64, dated November 9, 1950, which was concerned only with the application of the foregoing principles to plans of the fixed benefit type, is hereby supplemented.

(Also Section 23(p); Section 39.23(p)–2.) Rev. Rul. 55–758

Unless request is made by the Commissioner for additional information, the trustees of employees' trusts established by tax-exempt organizations need file, for years subsequent to that for which the complete information required under section 39.23(p)–2 of Regulations 118 has been filed, only the latest financial statement showing the assets, liabilities, receipts and disbursements of the trusts as specified in section 39.23(p)–2(a)(6) and the information required by section 39.23(p)–2(b) relating to any change in the plans or their operation upon which the data specified in section 39.23(p)–2(a)(1), (2) or (7) are based.

P. S. No. 17, dated August 24, 1944, modified.

Advice has been requested whether the filing of information set forth under section 39.23(p)–2 of Regulations 118 is required each year of trustees of employees' trusts, which meet the requirements for qualification under section 165(a) of the Internal Revenue Code of 1939 and are established by tax-exempt organizations.

Organizations of the type which are exempt from Federal taxation under section 101 of the Code have established employees' pension trusts which meet the requirements for qualification under section 165(a) of the Code. The trustees of the pension trusts have filed the complete information required by section 39.23(p)–2 of Regulations 118 or similar provisions of earlier regulations.

P. S. No. 17, dated August 24, 1944, states that the information required to be furnished under section 29.23(p)–2 of Regulations 111 is to be submitted by a corporation which seeks to qualify its employees'

plan under section 165(a) of the Code, even though it has no need for a deduction based on contributions to its employees' trust.

Section 39.165-1(c) of Regulations 118 specifies the information to be filed annually by trusts that meet the requirements of section 165(a) of the Code, which is that set forth in section 39.23(p)-2 of the Regulations, or in the alternative, if the employers have filed such information for a particular year, that information which is set out in section 39.165-1(c) of the Regulations. However, under paragraph (e) of section 39.23(p)-2 of the Regulations, the Commissioner is given the authority to waive the filing of any information which, in his opinion, is unnecessary in a particular case.

It is held that since organizations which are tax-exempt under section 101 of the Code have no occasion to claim deductions under section 23(p) of the Code, unless request is made by the Commissioner for additional information, the trustees of employees' trusts which are qualified under section 165(a) of the Code and are established by such tax-exempt organizations need file, for years subsequent to that for which the complete information required under section 39.23(p)-2 of the regulations has been filed, only the latest financial statement showing the assets, liabilities, receipts and disbursements of the trusts as specified in section 39.23(p)-2(a)(6) and the information required by section 39.23(p)-2(b) relating to any change in the plans or their operation upon which the data specified in section 39.23(p)-2(a)(1), (2) or (7) are based. P. S. No. 17, dated August 24, 1944, is hereby modified.

For taxable years to which the Internal Revenue Code of 1954 is applicable such information must be filed on Form 990-P, U. S. Return of Employees' Trust Described in Section 401(a) and Exempt Under Section 501(a) of the Internal Revenue Code of 1954, except to the extent that some of the information called for on that form may not be required under the regulations to be promulgated under section 6033 of the 1954 Code.

REGULATIONS 118, SECTION 39.165-3: Requirements as to coverage. Rev. Rul. 55-629

(Also Section 39.165-2; Section 23(p); Regulations 118, Section 39.23(p)-7.)

A corporation cannot have a qualified employees' pension trust or plan at a time when such corporation does not have any employees, active or retired, who are covered by the plan; nor will the pension plan of a particular corporation, once qualified under section 165(a) of the Internal Revenue Code of 1939, continue to meet the requirements of such section after such time as the employer involved ceases to have any employees, active or retired, who are participants under the plan.

A parent corporation may claim a deduction for contributions made to a pension plan to complete the funding of prior service benefits for a former employee who has transferred to a subsidiary corporation but who continues to be a participant under the pension plan by reason of his employment by the subsidiary which has adopted the pension plan of the parent corporation.

Advice has been requested (1) with respect to the qualification, under section 165(a) of the Internal Revenue Code of 1939, of the pension plan of a parent corporation to the extent that the plan is

adopted by one of its separately incorporated, wholly-owned subsidiaries at a time when the adopting subsidiary has no employees who are eligible for participation under the plan; (2) whether the plan, once it has qualified under section 165(a) as the plan of a subsidiary, may continue in effect, without termination, as a qualified plan of the subsidiary after such time as the subsidiary shall cease to have any employees, active or retired, who are covered under the plan; and (3) whether the parent corporation, after one of its participating employees has transferred to employment by (and participation under the plan as adopted by) one of the subsidiaries, but before the benefit based on the past service of such employee has been fully funded, may complete the funding of such prior service benefit for its former employee and properly claim a deduction for such prior service.

A corporation has numerous wholly-owned subsidiaries operating as retail outlets in a number of different states. It established an employees' pension plan providing prior and future service benefits for those of its employees who had rendered a minimum of five years of service and who had attained 30 years of age. The plan as adopted by the parent corporation has been held to meet the requirements of section 165(a) of the Code. A number of the subsidiary corporations with employees eligible for participation have also adopted the plan. Upon such adoption, employees of those subsidiaries were afforded the same rights under the plan as employees of the parent corporation. Accordingly, an employee moving from employment by one of the adopting employers to employment by another of the same group would have no interruption of his participation in the plan, or break in service to be counted toward eligibility for participation or benefits under the plan. This type of a plan seemed best suited to the purpose of creating an incentive for continued employment and to attracting and keeping employees of the quality needed by the various affiliated employers. In order that they might likewise benefit from the incentives afforded by the plan, several of the subsidiary corporations petitioned the parent corporation for permission to adopt the plan for their employees even though at that time they had no employees then eligible, or who would soon become eligible, to participate under the plan.

Section 165(a) of the Code provides, in effect, that a trust forming a part of an employer's pension plan for the exclusive benefit of his employees or their beneficiaries shall not be taxable if, among other things, as provided in paragraph (1) thereof, contributions were made to the trust by the employer, or employees, or both, for the purpose of distributing to such employees or their beneficiaries the corpus and income of the fund accumulated by the trust in accordance with the plan and, as required by paragraph (3) thereof, the trust was designated as a part of a plan which benefits either a specified percentage of all of the employees of such employer or such employees of the employer as qualify under a classification set up by the employer and found by the Commissioner of Internal Revenue not to be discriminatory in favor of employees who are officers, shareholders, persons whose principal duties consist in supervising the work of other employees, or highly compensated employees.

While an employer may take the necessary action to adopt a pension plan for employees long before such employer has any employees eligible to participate thereunder, an employer could not have in effect a plan which met *all* of the requirements of section 165(a) of the 1939 Code unless and until such employer had one or more employees who not only satisfied the eligibility requirements of the plan but were also actually covered by it so that they might ultimately be eligible for benefits thereunder. Aside from the evident over-all purpose and intent of section 165(a) of the Code, it seems clear that a plan completely lacking in covered employees was not, during the continuance of such condition, a plan which satisfied the requirements of paragraphs (1) and (3), in particular, of that section. It is equally evident that a plan established by an employer and found to meet all of the requirements of section 165(a) of the Code failed to meet all such requirements from and after such subsequent date as of which the plan ceased to cover any employees of that employer. To hold otherwise would result in permitting a trust to qualify for tax exemption under section 165(a) of the Code which had no potential beneficiaries, but which held a substantial corpus (consisting entirely of forfeitures by former participants who had terminated their services with the employer before acquiring a vested interest in any of the employer's contributions to the trust on their behalf) and continued to enjoy a tax-exempt status with respect to its earnings. Any funds remaining in an employer's trust after the trust ceases to cover any present or former employees of the grantor should be treated as amounts remaining in the trust because of "erroneous actuarial computations" after "the satisfaction of all liabilities with respect to employees and their beneficiaries under the trust," within the meaning of those expressions as used in section 165(a)(2) of the Code and section 39.165-2 of Regulations 118. As such, the funds so remaining in the trust should be regarded as having reverted to the employer involved and, whether or not actually distributed to the employer, should be treated as income to the employer in the taxable year of the employer during which the plan ceased to cover any of such employer's current or former employees.

Under section 23(p)(1)(A)(iii) of the Code, but subject to certain limitations therein, an employer who had a pension plan in effect which satisfied all of the applicable requirements of section 165(a) of the Code and which, in addition to current service pension or annuity credits, also provided past service or other supplementary pension or annuity credits, may, to the extent that the cost of such credits had been contributed or "paid" by the employer, claim a deduction of an amount equal to the normal cost of the plan, plus an amount not in excess of 10 percent of the cost which would be required to completely fund or purchase such past service or other supplementary pension or annuity credits as of the date when they were included in the plan. If at the time a particular employee first became eligible to participate under the instant plan he was a bona fide employee of the parent corporation and, promptly upon such employee's becoming a participant under the plan, the employer funded in full the entire prior service benefit cost for such employee, the employer, in addition to being entitled to a deduction annually for the normal cost (if paid) of the plan as to such employee so long as he continued to be employed

by such employer and to be covered by the plan, could properly claim deductions under such section 23(p)(1)(A)(iii) for such past service cost at the rate of 10 percent thereof per year until the full amount thereof had been deducted. That would be so even though the employee left the service of the employer shortly after the employer had funded such past service cost. That being so, and since it is possible, as provided in section 39.165–1(a)(5) of Regulations 118, for an employer to establish a qualified plan for former employees, a corporation may, if the terms of its plan so permit, fund, or complete the funding of, past service benefits for a former employee after such employee has transferred to employment by an affiliated employer, and it may properly claim a deduction for such past service cost the same as if the employee had remained in the service of the funding employer, provided that the contributions or benefits for the former employee do not result in prohibited discrimination.

In view of the foregoing, it is held, where a parent corporation has in effect a pension plan for its employees which may also be adopted by any subsidiary of the parent for the eligible employees of the latter, that a subsidiary cannot adopt the plan for its employees and have the plan "qualify" under section 165(a) of the Code at a time when the subsidiary has no employees eligible for participation under the plan; nor will the plan, after it has once qualified under such section 165(a), continue to meet the requirements of that section after the date on which the employer ceases to have any employees, active or retired, who are actually covered by the plan. It is further held that a corporation may deduct its contributions to a pension plan to complete the funding of prior service benefit costs for one of its former employees who has transferred to employment by a related participating corporation.

REGULATIONS 118, SECTION 39.165–6: Taxability of beneficiary under a trust which meets the requirements of Section 165(a). (Also Section 1006; Regulations 108, Section 86.20.) Rev. Rul. 55–460

Where, upon the death of a participant in an employees' pension plan, which has been held to meet the qualification for tax exemption under section 165(a) of the Internal Revenue Code of 1939, a lump sum distribution is made to the named beneficiary, who has been a dependent of another taxpayer, but who immediately turns over *in toto* the amount of the payment to the widow of the deceased employee, by reason of whose death the payment was made, the beneficiary must include in gross income the amount of the payment that constitutes income and, if the aggregate gross income amounts to $600 or more, must file a Federal income tax return and pay any tax due thereon.

In such case, the taxpayer contributing the support of the beneficiary will not be entitled to claim the beneficiary as a dependent for the year in which such distribution was made. Should the amount turned over to the widow, by the beneficiary, be in excess of $3,000, Form 709, Federal Gift Tax Return, must be filed by the beneficiary and a donee's information return, Form 710, by the widow.

Bases for computing one-year term premiums in determining the amount required to be included in the income of an employee on account of current life insurance protection provided under a life or endowment insurance contract held by an employees' trust. See Rev. Rul. 55-747, page 228.

SUPPLEMENT G.—INSURANCE COMPANIES

SECTION 204.—INSURANCE COMPANIES OTHER THAN LIFE OR MUTUAL

REGULATIONS 118, SECTION 39.204-2: Gross income.

Deduction of unallocated "loss adjustment expenses" relating to losses which have occurred but have not been examined and settled. See Rev. Rul. 55-580, page 282.

SECTION 205.—TAXES OF FOREIGN COUNTRIES AND POSSESSIONS OF UNITED STATES

Credit allowable to an insurance company for taxes paid pursuant to Cuban law. See Rev. Rul. 55-504, page 578.

Credit allowable to an insurance company for taxes paid pursuant to Venezuelan and Panamanian law. See Rev. Rul. 55-505, page 578.

SUPPLEMENT I.—FOREIGN CORPORATIONS

SECTION 232.—DEDUCTIONS

REGULATIONS 118, SECTION 39.232-1: Deductions allowed foreign corporations. Rev. Rul. 55-532
(Also Section 119(b); Regulations 118, Section 39.119(b)-1.)

Determination of the ratable part of United Kingdom taxes paid by British insurance companies (other than life or mutual), doing business in the United States, which is deductible under section 204(c)(3) of the Internal Revenue Code of 1939, as limited by sections 119(b), 204(d), and 232 of the 1939 Code and as affected by article XIII of the income tax convention and supplementary protocol between the United States and the United Kingdom of Great Britain and Northern Ireland, effective for taxable years beginning on or after January 1, 1945.

I. T. 3833, C. B. 1947-1, 70, amplified.

Advice has been requested as to the method of determining the amount of deduction allowable to British insurance companies other than life or mutual, operating branches in the United States, for taxes paid to Great Britain upon income from sources within the United States.

Under the terms of article XIII of the income tax convention and supplementary protocol between the United States and the United Kingdom of Great Britain and Northern Ireland, effective for taxable years beginning on or after January 1, 1945, residents of the United Kingdom are allowed a credit for income taxes paid to the United States. See T. D. 5569, C. B. 1947-2, 100. This credit is similar to that allowed United States taxpayers under section 131 of the 1939 Code for income taxes paid to foreign countries and possessions of the United States. The allowance of the United States tax as a credit in computing the United Kingdom tax liability of a British corporation engaged in business in the United States, coupled with the allowance of the United Kingdom tax attributable to the United States income as a Federal income tax deduction, makes the two taxes interdependent.

Under the provisions of section 204(c)(3) of the Internal Revenue Code of 1939, insurance companies other than life or mutual, subject to the tax imposed by section 204(a) of the 1939 Code, in computing net income, are allowed to deduct taxes as provided in section 23(c) of the 1939 Code.

Other pertinent provisions of the Code are as follows:

SECTION 23. DEDUCTIONS FROM GROSS INCOME.

* * * * * * *

(c) TAXES GENERALLY.—

(1) ALLOWANCE IN GENERAL.—Taxes paid or accrued within the taxable year, except—

* * * * * * *

(C) income, war profits, and excess-profits taxes imposed by the authority of any foreign country or possession of the United States, if the taxpayer chooses to take to any extent the benefits of section 131;

SECTION 204. INSURANCE COMPANIES OTHER THAN LIFE OR MUTUAL

* * * * * * *

(d) DEDUCTIONS OF FOREIGN CORPORATIONS.—In the case of a foreign corporation the deductions allowed in this section shall be allowed to the extent provided in Supplement I in the case of a foreign corporation engaged in trade or business within the United States.

SECTION 232. [SUPPLEMENT I; FOREIGN CORPORATIONS]: DEDUCTIONS.

(a) IN GENERAL.—In the case of a foreign corporation the deductions shall be allowed only if and to the extent that they are connected with income from sources within the United States; and the proper apportionment and allocation of the deductions with respect to sources within and without the United States shall be determined as provided in section 119, under the rules and regulations prescribed by the Commissioner with the approval of the Secretary.

SECTION 119. INCOME FROM SOURCES WITHIN UNITED STATES.

* * * * * * *

(b) NET INCOME FROM SOURCES IN UNITED STATES.—From the items of gross income specified in subsection (a) of this section there shall be deducted the expenses, losses, and other deductions properly apportioned or allocated thereto and a ratable part of any expenses, losses, or other deductions which can not definitely be allocated to some item or class of gross income. The remainder, if any, shall be included in full as net income from sources within the United States.

The ratable part of the United Kingdom tax which is allowed as a deduction in computing net income from United States sources is *based* on the ratio of gross income from sources within the United States to total gross income. See section 39.119(b)-1 of Regulations

118. In computing this ratio, tax exempt interest and 85 percent of the dividends from domestic corporations are not included as part of gross income from sources within the United States, but are included in total gross income from all sources. See *Commercial Union Assurance Co., Ltd.* v. *Commissioner*, 144 Fed. (2d) 994, and, on further appeal, 151 Fed (2d) 98; *The London and Lancashire Insurance Company, Ltd.* v. *Commissioner*, 34 B. T. A. 295; *Royal Insurance Company Ltd.* v. *Commissioner*, 38 B. T. A. 955, acquiescence, C. B. 1939–1, (Part 1), 30; and *Palatine Insurance Company, Ltd.* v. *Commissioner*, 4 T. C. 239, acquiescence, C. B. 1946–2, 4.

In the case of a United Kingdom corporation which derives part of its income from sources within the United States, the United Kingdom tax paid in respect of United States income is determined as the amount by which a certain portion of the United Kingdom tax exceeds the amount of credit for Federal taxes provided by article XIII, *supra*. That portion is determined as the part of the United Kingdom tax, computed without the benefit of the credit for Federal income tax provided pursuant to article XIII, which bears the same ratio to its total United Kingdom tax, computed without the benefit of any foreign tax credit, as its United States gross income bears to its total gross income from all sources. However, in determining such United States gross income, tax-exempt interest and 85 percent of the dividends received from domestic corporations are excluded.

The above may be more clearly explained by the following illustration:

A British insurance company engaged in trade or business within the United States has gross income from all sources of $1,000,000.00 and deductions of $600,000.00, resulting in a net income from all sources of $400,000.00. Included in these figures are $100,000.00 gross income from United States sources and $50,000.00 expenses from United States sources (excluding the United Kingdom tax apportioned to United States income). For the purpose of this illustration, it is assumed that the effective Federal tax rate is 30 percent and the effective United Kingdom tax rate is 40 percent.

The first computation required is the total United Kingdom tax liability before any tax credit. This liability is $160,000.00 (40 percent of $400,000.00). Of this figure $16,000.00 is the United Kingdom tax attributable to income from United States sources ($100,000.00/$1,000,000.00×$160,000.00). The correct interrelation of the deduction for taxes for Federal tax purposes and the credit for United Kingdom tax is as follows:

UNITED KINGDOM TAX COMPUTATION

Total Gross Income	$1,000,000.00
Deductions	600,000.00
Net Income	400,000.00
Tax before credit 40%	160,000.00
Less: Federal income tax	14,571.42
United Kingdom tax actually paid	145,428.58
United Kingdom tax attributable to United States income before credit (10% of $160,000.00)	16,000.00
Less: Federal income tax	14,571.42
United Kingdom tax actually paid on United States income	1,428.58

FEDERAL INCOME TAX COMPUTATION

Gross income	100,000.00
Deductions (other than United Kingdom tax)	50,000.00
Net income before tax deduction	50,000.00
Less: United Kingdom income tax	1,428.58
Net Income	48,571.42
Tax at 30%	14,571.42

In the above illustration, the deduction for United Kingdom income tax is identical to the amount of tax actually payable to the United Kingdom which is attributable to the corporation's United States income. The amount of each of the interdependent taxes may be ascertained by an arithmetic, algebraic, or other appropriate method.

If the effective rate of United States income tax equals or exceeds the effective rate of United Kingdom tax, the credit provided by article XIII of the convention will result in the complete extinguishment of the United Kingdom tax liability to the extent that it pertains to the corporation's United States income, and therefore no deduction for United Kingdom tax would be allowable in the computation of its net income for the purpose of United States income tax.

No method of computation can be approved for universal application, especially since the amount of the corporation's United States net income before deduction of the foreign income tax may not be accepted at an identical amount by the taxing authorities of both jurisdictions. However, the above illustration may be helpful in the solution of similar problems.

SUPPLEMENT M.—INTEREST AND ADDITIONS TO THE TAX

SECTION 292.—INTEREST ON DEFICIENCIES

(Also Section 322; Regulations 118, Section 39.322-3.) Rev. Rul 55-448

> Where a taxpayer elects on his Federal income tax return, Form 1040, to have the overpayment in income tax indicated thereon credited to his estimated tax for the succeeding taxable year, interest may properly be assessed, in accordance with the provisions of section 292 of the Internal Revenue Code of 1939, on a deficiency in income tax for the year for which the return was filed, determined subsequent to the election but before the return for the succeeding taxable year is due.

Advice has been requested whether interest is properly assessable on a deficiency in income tax determined under the circumstances set forth below.

The taxpayer filed an income tax return for the year 1951 showing a tax liability of $175x$ dollars and $200x$ dollars paid on estimated tax; he indicated on his return that the overpayment of $25x$ dollars was to be credited on his 1952 estimated tax. This overpayment was credited by the Internal Revenue Service to the taxpayer's 1952 estimated tax. Subsequently, after the first installment of such estimated tax had become due, but prior to the due date of the tax return for the year 1952, the 1951 return was examined and the taxpayer consented to a

deficiency in tax of $20x$ dollars for that year, together with interest thereon of $2x$ dollars.

The taxpayer has not paid the interest charge, alleging that the 1951 deficiency was determined before the 1952 return was due and that the $25x$ dollars excess payment had been in the Internal Revenue Service's possession and use; that inasmuch as the original 1951 tax, the 1951 deficiency and the 1952 tax had all been paid in full before the 1952 return was due, no interest is due on the deficiency item; and, that at no time did a debt exist as a basis for an interest charge.

These contentions of the taxpayer fail to take into consideration the provisions of section 59 of the Internal Revenue Code of 1939 under which the first installment of estimated tax becomes due as of the same date from which interest accrues on a deficiency in tax or any overpayment made for the preceding taxable year. See sections 294 and 3771(f) of the Code. Regulations 118, section 39.322-3, provides in part that if the taxpayer elects to have all or part of the overpayment shown by his return applied to his estimated tax for his succeeding taxable year, no interest shall be allowed on such portion of the overpayment credited, and such amount shall be applied as a payment on account of the estimated tax for such year or the installments thereof.

The taxpayer thus has the option on Form 1040 to elect to have the overpayment credited against his estimated tax for the succeeding taxable year. The election shall be made on Form 1040 and, when made, is binding on the Commissioner and must be credited. Such election shall also be binding upon the taxpayer, except that it may be changed on or before the last day prescribed for the filing of the tax return and declaration of estimated tax.

Accordingly, it is held that where a taxpayer makes an election on his Federal income tax return, Form 1040, to have an overpayment shown thereon credited to his estimated tax for the succeeding taxable year, interest may properly be assessed on a deficiency in income tax for the year for which the return was filed, determined subsequent to the election but before the return for the succeeding year is due, in accordance with the provisions of section 292 of the Internal Revenue Code of 1939.

SECTION 294(b).—ADDITIONS TO THE TAX IN CASE OF NONPAYMENT: DEFICIENCY

Computation of interest when overpayments of tax are credited to additional tax. See Rev. Rul. 55-485, page 499.

SECTION 294(d).—ADDITIONS TO THE TAX IN CASE OF NONPAYMENT: ESTIMATED TAX

REGULATIONS 118, SECTION 39.294-1: Additions to the tax. Rev. Rul. 55-673

The additions to the tax, with respect to a failure to file a declaration of estimated tax or a failure to pay installments of estimated

tax declared, imposed under section 294(d)(1) of the Internal Revenue Code of 1939, cease to accrue on the date the tax is paid or the date prescribed for payment of the tax whichever is the earlier.

Advice has been requested whether the decision in the case of *Carl Stephan et ux.* v. *Commissioner*, 197 Fed. (2d) 712, will be followed in determining the additions to the tax under section 294(d)(1) of the Internal Revenue Code of 1939 with respect to a failure to file a declaration of estimated tax or a failure to pay installments of estimated tax declared.

Section 294(d)(1)(B) of the Code provides in part as follows:

> Where a declaration of estimated tax has been made and filed within the time prescribed, or where a declaration of estimated tax has been made and filed after the time prescribed and the Commissioner has found that failure to make and file such declaration within the time prescribed was due to reasonable cause and not to willful neglect, in the case of a failure to pay an installment of the estimated tax within the time prescribed, unless such failure is shown to the satisfaction of the Commissioner to be due to reasonable cause and not to willful neglect, there shall be added to the tax 5 per centum of the unpaid amount of such installment, and in addition 1 per centum of such unpaid amount for each month (except the first) or fraction thereof during which such amount remains unpaid. In no event shall the aggregate addition to the tax under this subparagraph with respect to any installment due but unpaid, exceed 10 per centum of the unpaid portion of such installment.

Section 294(d)(1)(A) of the Code provides for like additions to the tax in the case of a failure to make and file a declaration of estimated tax within the time prescribed.

The taxpayers in the Stephan case asked the court to redetermine the additions to the tax, asserting that the one percent monthly additions to the tax, as provided by section 294(d)(1)(B), were not applicable after the date of filing of the final income tax return for the taxable year.

The Court decided in favor of the taxpayer and, referring to section 294(d)(1)(B) of the Code, stated:

> We can see no reason why the word "unpaid" as used in subparagraph (B) should be given any different construction than the words "due but unpaid" used throughout the preceding subparagraph (A) and also in the final sentence of subparagraph (B). To say that an installment of the estimated tax remains unpaid presupposes a continuing duty to pay such installment. The declaration of estimated tax had served its function when the final return was filed. There was then no longer any uncertainty, and the tax should thereafter be paid on the basis of the final return rather than as estimated. It follows that installments of the estimated tax were then no longer due.

This decision is considered to be a fair and reasonable interpretation of section 294(d)(1) to the extent that it holds that estimated tax installments remain due and payable until the due date of the tax, on and after which date the tax imposed becomes due and payable on the basis of the final return rather than as estimated. Accordingly, the Stephan decision will be followed in computing additions to the tax under section 294(d)(1)(A) and (B) where, as in that case, the final return is filed on the due date (the date prescribed for the payment of the tax). However, in cases where the final return is filed before the due date without being accompanied by payment of the

tax, the monthly additions for failure to file a timely declaration of estimated tax, or for nonpayment of the estimated tax continue to accrue, subject to the ten percent limitation, until the date prescribed for payment of the tax or the date the tax is paid, whichever is the earlier. If the tax is not paid on or before the due date (whether the final return is filed on, before or after that date), in lieu of the accrual from that date of additions for failure to file a timely declaration of estimated tax, or for nonpayment of estimated tax, additions accrue for nonpayment of the tax imposed as provided in section 294(a) and (b).

SUPPLEMENT O.—OVERPAYMENTS

SECTION 322.—REFUNDS AND CREDITS

REGULATIONS 118, SECTION 39.322-3: Claims for refund by taxpayers.

The election of taxpayers to credit his overpayment to next year's estimated tax. See Rev. Rul. 55-448, page 595.

REGULATIONS 118, SECTION 39.322-7: Limitations upon crediting and refunding of taxes paid; general rule.

Continued application of limitations upon refunding provisions of the 1939 Code where the claim is filed after the date of enactment of the 1954 Code. See Rev. Rul. 55-708, page 478.

REGULATIONS 118, SECTION 39.322-9: Limitations upon crediting and refunding of taxes paid; overpayment on account of bad debts, worthless securities, etc.

Effect upon a net operating loss of a bad debt or loss on worthless securities determined subsequent to the 15th day of the 39th month following the end of the taxable year of the net operating loss. See Rev. Rul. 55-523, page 497.

SUPPLEMENT U.—TAXATION OF BUSINESS INCOME OF CERTAIN SECTION 101 ORGANIZATIONS

SECTION 421.—IMPOSITION OF TAX

REGULATIONS 118, SECTION 39.421-2: Organizations subject to tax.

Unrelated trade or business of a charitable foundation. See Rev. Rul. 55-499, page 599.

SECTION 422.—UNRELATED BUSINESS NET INCOME

REGULATIONS 118, SECTION 39.422-3: Definition of unrelated trade or business. (Also Section 421; Regulations 118, Section 39.421-2.) Rev. Rul. 55-449

The construction and sale of 80 houses by a charitable foundation, otherwise exempt from tax under section 101(6) of the Internal Revenue Code of 1939, over a period of 18 months for the sole purpose of raising funds for the support of a church constitute an unrelated trade or business within the meaning of section 422 of the Internal Revenue Code of 1939, notwithstanding the foundation does not contemplate engaging further in such activity. Where, however, such activity constitutes the primary activity of the foundation, it is not entitled to exemption from tax under section 101(6) of the Code.

Advice has been requested whether the construction and sale of 80 houses by a charitable foundation under the circumstances set forth below constitute an unrelated trade or business within the meaning of section 422 of the Internal Revenue Code of 1939.

The instant foundation is exempt from Federal income tax under section 101(6) of the Code. It has assets of $2x$ dollars and its chief support consists of gifts from its founders. In order to assist a church in obtaining financial support, the foundation with the managerial and financial assistance of its founders constructed 80 houses over a period of 18 months. Such project involved expenditures of $40x$ dollars. The houses were sold to the church at cost of construction to the foundation, plus a small sales commission. The foundation does not contemplate engaging further in the construction and sale of houses.

Section 421 of the Code imposes a tax on the supplement U net income derived by certain organizations otherwise exempt from tax under section 101 of the Code from any unrelated trade or business regularly carried on by such organizations. Section 39.422-3 of Regulations 118 provides generally that the income of an exempt organization is subject to the supplement U tax only if two conditions are present with respect to such income. The first condition is that the income must be from a trade or business which is regularly carried on by the organization. The second condition is that the trade or business must not be substantially related (aside from the need of the organization for income or funds or the use it makes of the profits derived) to the exercise or performance by such organization of its charitable, educational, or other purpose or function constituting the basis for its exemption under section 101 of the Code.

The regulations further provide that a trade or business is considered to be regularly carried on when the activity is conducted with sufficient consistency to indicate a continuing purpose of the organization to derive some of its income from such activity. An activity may be regularly carried on even though its performance is infrequent or seasonal. A trade or business is considered to be substantially related to the activities for which an organization is granted exemption if the principal purpose of such trade or business is to further (other than through the production of income) the purpose for which the organization is granted exemption. In the usual case the nature

and size of the trade or business must be compared with the nature and extent of the activities for which the organization is granted exemption in order to determine whether the principal purpose of such trade or business is to further (other than through the production of income) the purpose for which the organization was granted exemption. Whether or not an organization is subject to the supplement U tax shall be determined by the application of these tests to the particular circumstances involved in each individual case.

The construction and sale of houses to the extent herein involved, with all of the attendant operations, cannot be considered as an isolated transaction. Such activity extended over a sufficient period of time to be considered as regularly carried on for the purpose of earning income within the meaning of the applicable law and regulations.

The construction and sale of houses is a business of a kind ordinarily carried on for profit and such activity cannot be said to be substantially related to the functions constituting the basis for the tax exemption of the instant foundation, other than through the accrual of earnings through the sale thereof to the church.

Accordingly, it is held that the construction and sale of houses by the instant foundation under the circumstances stated constitute an unrelated trade or business within the meaning of section 422 of the Code.

Even though the instant foundation qualifies for exemption under section 101(6) of the Code, a foundation which engages in the construction and sale of houses as its primary activity is not eligible for such exemption, since in that case it would not be operated exclusively for charitable purposes within the meaning of the section.

SUBCHAPTER D.—EXCESS PROFITS TAX

PART I.—RATE AND COMPUTATION OF TAX

SECTION 437.—INVESTED CAPITAL CREDIT

REGULATIONS 130, SECTION 40.437-3. Adjusted invested capital.

Basis of assets acquired as a result of a reorganization under the provisions of section 112(g) of the Revenue Act of 1934. See Rev. Rul. 55-443, page 562.

SUBCHAPTER E.—TAX ON SELF-EMPLOYMENT INCOME

SECTION 481(a).—DEFINITIONS: NET EARNINGS FROM SELF-EMPLOYMENT TAX

REGULATIONS 118, SECTION 39.481-1: Net earnings from self-employment.

Honorariums or fees received for speeches. See Rev. Rul. 55-431, page 312.

Income received by an individual, who is not a real estate dealer, from the rental of real estate. See Rev. Rul. 55–559, page 315.

REGULATIONS 118, SECTION 39.481–3: Trade or business.

Income from carpentry and masonry services. See Rev. Rul. 55–582, page 403.

CHAPTER 3.—ESTATE TAX

SUBCHAPTER A.—BASIC ESTATE TAX

PART II.—ESTATES OF CITIZENS OR RESIDENTS OF THE UNITED STATES

SECTION 811(a).—GROSS ESTATE: DECEDENT'S INTEREST

REGULATIONS 105, SECTION 81.3: Gross estate. Rev. Rul. 55–438

Where the interest retained by a decedent in transferred property is a possibility of reverter which is obliterated by his death, or, where the interest of a decedent in a trust created by another person is a contingent remainder which lapses at his death, such interest is not considered as an interest in property for the purposes of section 811(a) of the Internal Revenue Code of 1939. But see section 811(c)(1) of the Internal Revenue Code of 1939, under which the retention of a reversionary interest may cause inclusion of the transferred property in the gross estate.

SECTION 811(c).—GROSS ESTATE: TRANSFERS IN CONTEMPLATION OF, OR TAKING EFFECT AT, DEATH

REGULATIONS 105, SECTION 81.17: Transfers intended to take effect at or after the decedent's death. Rev. Rul. 55–682

> Where a Federal civil service employee elects at the time of his retirement to apply voluntary contributions to the purchase of a reduced life annuity for himself and after his death one-half thereof to his beneficiary, the value of the survivorship annuity passing to his beneficiary at his death prior to January 1, 1954, is includible in his gross estate under section 811(c)(1)(B) of the Internal Revenue Code of 1939.

Advice has been requested whether the value of a voluntary annuity payable to a survivor annuitant is includible in the gross estate of a retired Federal civil service employee who died prior to January 1, 1954, where the decedent elected to take a reduced annuity on his retirement and a survivorship annuity for his wife.

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The voluntary annuity is authorized by the second paragraph of section 10 of the Civil Service Retirement Act, 46 Stat. 468, as amended by the Act of February 28, 1948, 62 Stat. 48, 5 U. S. C. 719–1. The most pertinent provisions of section 10 read as follows:

> Any officer or employee may at his option and under such regulations as may be prescribed by the Civil Service Commission deposit additional sums * * * which amount together with interest * * * shall, at the date of his retirement, be available to purchase, as he shall elect and in accordance with such rules and regulations as may be prescribed by the Civil Service Commission, an annuity in addition to the annuity provided by this Act. * * * In the event of death or separation from the service of such officer or employee before becoming eligible for retirement on annuity, the total amount so deposited, with interest * * * shall be refunded in accordance with the provisions of section 12 of this Act. In case a retired employee who is receiving a life annuity under this paragraph shall die without having received in[1] annuity purchased by the total amount so deposited, with interest at 3 per centum per annum compounded on December 31 of each year, to date of retirement, the difference shall be paid, upon the establishment of a valid claim therefor, in the order of precedence prescribed in section 12(e).

Title 5, section 29.14 of the Code of Federal Regulations provides in part:

> (a) Voluntary contributions may be used to purchase only one of the following types of annuity:
>
> (1) Life annuity; or
>
> (2) Reducer annuity payable during the life of the employee and after his death one-half of such reduced annuity to be payable to a survivor annuitant designated at time of retirement during the life of such survivor.
>
> (b) Any natural person may be designated as beneficiary under paragraph (a)(2) of this section.

If before retirement the employee dies, the entire amount of the voluntary contributions is refunded with applicable interest to the beneficiary named by him, or his widow, children, parents, or executor (section 12(e) of Act). If at the time of his retirement he elects to purchase a life annuity for himself with the voluntary contributions, but dies before recovering as annuity payments the full amount deposited, the difference with applicable interest is refunded in the same order as above under section 12(e). The amounts so refundable upon the death of the employee under section 12(e) are includible in his gross estate for the purposes of estate tax under section 811(c) of the Internal Revenue Code of 1939.

In view of the foregoing, it is held that where a Federal civil service employee elects at the time of his retirement to apply voluntary contributions to the purchase of a reduced life annuity for himself and after his death one-half thereof to his beneficiary, the value of the survivorship annuity passing to his beneficiary at his death prior to January 1, 1954, is includible in his gross estate under section 811(c)(1)(B) of the Internal Revenue Code. See *Commissioner* v. *Estate of A. M. Wilder*, 118 Fed. (2d) 281, certiorari denied, 314 U. S. 634; *Commissioner* v. *Charles F. Clise et al.*, 122 Fed. (2d) 998, certiorari denied, 315 U. S. 821; *Estate of Harry L. Mearkle* v. *Commissioner*, 129 Fed. (2d) 386.

[1] So in original. Probably should read "an."

SECTION 811(d).—GROSS ESTATE: REVOCABLE TRANSFERS

REGULATIONS 105, SECTION 81.20: Transfers with power to change the enjoyment. Rev. Rul. 55-683

The value of property contributed by the decedent to a trust created by his wife is includible in his gross estate under the provisions of section 811(d) of the Internal Revenue Code of 1939 where the wife could not modify or revoke the trust without the consent of the decedent.

Advice has been requested whether the value of property contributed by the decedent to a trust created by his wife is includible in his gross estate under the following circumstances.

The decedent's wife created a trust on March 1, 1920. The grantor retained the right to the income for life and the right at any time during the life of her husband to revoke or modify the trust in whole or in part with the approval of her husband. Upon the grantor's death, the entire trust estate was to be distributed to her husband if he survived her, otherwise the trust was to continue for the benefit of their children.

On March 1, 1935, the grantor in conjunction with the decedent eliminated the provision for distribution of corpus upon the grantor's death to her husband and, in lieu thereof, provided that upon the grantor's death the entire income was to be paid to her husband during his lifetime. In addition, the trustee was authorized and empowered to pay to the husband, at any time or from time to time, such sum or sums from the principal of the trust estate as in its sole discretion it shall deem necessary or proper to provide for his suitable support, maintenance, comfort and enjoyment, to assist him in business, and/or promote his general welfare and best interests in life. Also, the provision with respect to the grantor's right to modify or revoke the trust with the approval of her husband was amended not only to include the approval of her husband but as well the written approval of at least one of her children. The decedent made substantial contributions to the trust during his lifetime. At the date of decedent's death, the income from the trust estate was more than adequate to support the surviving spouse.

It is well established that for Federal tax purposes one who contributes property to a trust created by another is the real grantor of the trust to the extent of his contributions. In such case, where a contributor is himself a beneficiary, to the extent of his contributions he is considered as having retained or reserved to himself the interests and powers given to him as beneficiary under the terms of the trust. Moreover, the application of section 811(d) of the Internal Revenue Code of 1939 is not restricted to cases in which a decedent expressly reserves a power. Such section applies to property transferred by the decedent "where the enjoyment thereof was subject at the date of his death to any change through the exercise of a power, either by the decedent alone or in conjunction with any person, to alter, amend, or revoke."

The case of *Estate of Charles M. Thorp* v. *Commissioner*, 7 T. C. 921, affirmed 164 Fed. (2d) 966, certiorari denied 333 U. S. 843, involved a trust created by the decedent prior to the effective date of the Revenue Act of 1924 which was subject to termination upon the request of the life beneficiaries, with the decedent's consent. It was held that the decedent retained a power to alter, amend, or revoke in the form of a power of termination and, as such power was exercisable in conjunction with beneficiaries having no substantial adverse interest in the remainder, the remainder was includible in the decedent's gross estate under section 811(d)(2) of the Internal Revenue Code.

The trust involved in *Du Charme's Estate* v. *Commissioner*, 164 Fed. (2d) 959, modified 169 Fed. (2d) 76, provided that "The provisions of this trust may be changed or amended during the lifetime of the Settlor upon the written request of the Settlor's wife * * * with the written approval of the Settlor." In holding the transfer taxable under section 811(d) of the Code, the Court said:

> The provisions of Paragraph 12 of the trust instrument also bring the trust property within the statutory provisions. That paragraph expressly provides that the trust may be changed or amended upon the written request of the settlor's wife and with his written approval. It is not necessary in order to come within the statute that the other person who acts in conjunction with the settlor be a person other than a beneficiary; the statute says "any person." *Helvering* v. *City Bank Farmers Trust Co.*, 296 U. S. 85, 56 S. Ct. 70, 80 L. Ed. 62 [Ct. D. 1042, C. B. XIV-2, 392 (1935)]; *Commissioner* v. *Stevens*, 3 Cir., 79 F. 2d 490; reversed 297 U. S. 693, 56 S. Ct. 443, 80 L. Ed. 985. Petitioner contends, however, that Paragraph 12 did not give the decedent the right, in conjunction with another person, to designate the persons who shall enjoy the property, but that it merely gave the decedent the power to veto a change requested by the wife. The contention is supported by a strict construction of the phraseology of Paragraph 12, but in our opinion places emphasis upon form rather than upon substance. Regardless of who initiates or requests such a change, the consent of both parties is required to make the change effective. As a practical matter, if the settlor desired to make a change and the other party was willing that the change be made, the change could be accomplished under the provisions of Paragraph 12 by having the wife request the change agreed upon, even though it was originally suggested by the settlor.

In this case, the decedent's wife had the power to modify or revoke the trust with his consent. Therefore, to the extent of the decedent's contributions to the trust, he made transfers in trust reserving a power to modify or revoke in conjunction with another person.

Section 81.20(b)(1) of Regulations 105 provides as follows:

> (1) If the transfer was made prior to the enactment of the Revenue Act of 1924 (4:01 p. m., eastern standard time, June 2, 1924), and the power was reserved at the time of the transfer and was exercisable by the decedent alone or in conjunction with a person or persons having no substantial adverse interest or interests in the transferred property, or if exercisable in conjunction with a person having a substantial adverse interest or with several persons some or all of whom held such an adverse interest, then to the extent of any interest or interests held by a person or persons not required to join in the exercise of the power and to the extent of any adverse interest which was not substantial.

The decedent's wife is entitled to the income from the trust. Also, the trustee is authorized in its sole discretion to use principal, if necessary, for her maintenance, support, and comfort. The right of the wife enforceable in a court of equity to compel the trustee to use principal for her support if the necessity therefor arises is an adverse interest in the principal. Inasmuch as the value of the corpus of the trust was such that the income therefrom would be more than adequate for the maintenance, support and comfort of the wife, the likeli-

hood of any invasion of principal for this purpose was so remote as to be negligible. In the circumstances, the wife did not have a substantial adverse interest in the principal.

By the 1935 amendment, any modification or revocation of the trust required the consent also of a child who did have a substantial adverse interest in the remainder. However, this provision may be disregarded as such amendment was made after the effective date of the Revenue Act of 1924. The provisions of section 81.20(b)(1) of Regulations 105 apply only to substantial adverse interests created before the Revenue Act of 1924. *Estate of George W. Sweeney* v. *Commissioner*, 4 T. C. 265.

In view of the foregoing, the value of any property transferred by the decedent to the trust prior to June 2, 1924, less the value of the life estate therein of his wife, is includible in his gross estate under section 811(d)(2) of the Code. *Estate of Charles M. Thorp* v. *Commissioner*, *supra*, and *Estate of Abraham Koshland* v. *Commissioner*, 11 T. C. 904.

The entire value of any property transferred by the decedent to the trust after June 2, 1924, is includible in his gross estate under section 811(d) of the Code as a transfer in respect of which decedent retained a power exercisable in conjunction with another person to alter, amend, or revoke.

SECTION 811(f).—GROSS ESTATE: POWERS OF APPOINTMENT

REGULATIONS 105, SECTION 81.24: Property subject to power of appointment by decedent. Rev. Rul. 55–486

A trust created in 1923 by the decedent's mother provides that if the decedent predeceases her sister *A*, the principal of the trust is to be distributed, on the death of *A*, in equal shares to such brother or sister of the decedent as shall survive *A*. If no brother or sister survives *A*, the principal is to be distributed on the death of *A*, to such persons as the decedent appoints by deed or by will. In default of appointment, the property is to be given to the next of kin of the decedent who survives *A*. The decedent did not appoint by deed. Her will, however, provides that the residue of her estate is to be distributed in equal shares to her sister *A*, her sister *B* and her brother *C*, the issue of a predeceased beneficiary to take by representation, with cross remainders in the event of the predecease of a beneficiary without issue. The decedent died survived by *A*, *B* and *C*. *Held*, the condition in the trust instrument relating to the deaths of *B* and *C* prior to that of *A* did not in any way restrict the exercise of the power; it merely qualified the property interest subject to the power. Accordingly, the decedent possessed at her death a general power of appointment within the meaning of section 811(f) of the Internal Revenue Code of 1939. *Held further*, inasmuch as under applicable law a residuary testamentary clause carries with it all property of a testator not otherwise effectively disposed of, the decedent is deemed to have exercised the power of appointment despite the lack of a specific reference thereto in her will. Accordingly, the property subject to the power is includible in her gross estate under the provisions of section 811(f)(1) of the Code to the extent of the value of the interest therein involved, actuarially computed.

SECTION 812(b).—NET ESTATE: EXPENSES, LOSSES, INDEBTEDNESS, AND TAXES

REGULATIONS 105, SECTION 81.32: Administration expenses.

Treatment of administration expenses where the decedent's estate consisted of community property. See Rev. Rul. 55–524, page 535.

REGULATIONS 105, SECTION 81.37: Taxes. Rev. Rul. 55–601

In determining the net value of the assets of an inter vivos trust created by the decedent and included in his gross estate, allowance should be made for any income tax liability incurred by the trust prior to the date of decedent's death. No allowance should be made for any income tax liability incurred by the trust subsequent to that date, regardless of the valuation date applicable.

Advice has been requested whether the value of the assets of an inter vivos revocable trust includible in the decedent's gross estate for Federal estate tax purposes should be reduced by any of the income taxes incurred by the trust before and after the date of decedent's death, in view of the estate's election to have the estate property valued under the optional valuation provisions of section 811(j) of the Internal Revenue Code of 1939.

The decedent created an inter vivos revocable trust the value of which was includible in his gross estate for Federal estate tax purposes. As a result of capital gains realized by the trust both before and after the date of decedent's death, Federal income tax liabilities were incurred by the trust in the year before and the year following the death of the decedent. The estate elected to have the property of the estate valued in accordance with the optional valuation provisions of section 811(j) of the Code.

The allowance of claims and expenses as a reduction in the net value of an inter vivos trust which is included in the gross estate is governed by the same rules which apply to allowance of claims and expenses of administration as deductions from the gross estate under section 812(b) of the Code. Section 812(b) authorizes the allowance of deductions for claims against the estate, but such deductions do not include any income taxes upon income received after the death of the decedent. Section 81.37 of Estate Tax Regulations 105 provides that unpaid taxes upon income received during the decedent's lifetime are deductible but taxes upon income received after death are not deductible.

In Revenue Ruling 293, C. B. 1953–2, 257, it is held that attorney's fees incurred by the trustee of an inter vivos trust in connection with the usual issues involved in a trust accounting made necessary by the decedent grantor's death are deductible in determining the net value of the trust property includible in the grantor's gross estate. In the instant case, the income tax liability of the trust incurred as a result of capital gains realized by the trust prior to the date of decedent's death was a liability of the trust as of the date of death. Accordingly, under the rationale of Revenue Ruling 293, the value of the trust property as of the applicable valuation date should be reduced by the amount of

the income tax liability incurred by the trust prior to the date of decedent's death. On the other hand, although the income tax liability incurred by the trust resulting from income realized by the trust during the year subsequent to the date of decedent's death would be a charge against the trust, it would not be deductible in determining the net value of the trust property as of either the date of death or the optional valuation date. Compare Section 81.36 of Regulations 105.

In view of the foregoing, it is held that in determining the net value of the assets of an inter vivos trust created by the decedent and included in his gross estate, allowance should be made for any income tax liability incurred by the trust prior to the date of decedent's death. No allowance should be made for any income tax liability incurred by the trust subsequent to that date, regardless of the valuation date applicable.

SECTION 812(d).—NET ESTATE: TRANSFERS FOR PUBLIC, CHARITABLE, AND RELIGIOUS USES

REGULATIONS 105, SECTION 81.44: Transfers for public, charitable, religious, etc., uses. Rev. Rul. 55-759

The decedent died in 1952 and, by will executed in 1945, bequeathed his entire estate to his three sons, *A*, *B*, and *C*. In 1944, *B* entered a religious order the rules of which required, as a prerequisite to membership, the taking of a vow of poverty and a renunciation of all property rights in favor of the order. *B* took his final vows of poverty in 1949 and the property bequeathed to him under his father's will passed to the religious order. *Held*, since the property bequeathed to *B* passed to the religious order by virtue of *B*'s contractual agreement with the order, rather than by way of a bequest, legacy or device under the decedent's will, the value of the property is not deductible from the decedent's gross estate as a transfer for public, charitable, or religious uses under section 812(d) of the Internal Revenue Code of 1939. See *G. Peabody Gardner et al.* v. *Delaney*, 204 Fed. (2d) 855; Rev. Rul. 55-335, C. B. 1955-1, 455.

Rev. Rul. 55-760

The decedent died intestate and his property passed, under laws of descent and distribution, to his three children, his only heirs at law and next of kin. At the time of the decedent's death, each child was a member of a religious community the rules of which required, as a prerequisite to membership, the taking of a vow of poverty and a renunciation of all property rights in favor of the order. Consequently, the property inherited by the decedent's three children inured to the benefit of the order. *Held*, the property received by the order does not constitute a transfer made by the decedent during his lifetime nor is it a bequest, legacy, or devise within the meaning of section 812(d) of the Internal Revenue Code of 1939. Accordingly, the value of the property is not deductible from the decedent's gross estate as a transfer for public, charitable, or religious uses.

CHAPTER 4.—GIFT TAX

SECTION 1000.—IMPOSITION OF TAX

REGULATIONS 108, SECTION 86.1: Imposition of tax. Rev. Rul. 55-461

The transfer to the spouse of an amount equal to one-half of the net income received from real property purchased in Louisiana by a person who took title thereto in his own name will not constitute a gift for Federal gift tax purposes unless it was stipulated that the property was purchased with his separate funds and for his separate use. The spouse is presumed to have acquired a one-half community interest in the property at the date of purchase.

Advice has been requested whether a transfer by *H* in 1950 of 200*x* dollars to his wife in lieu of her interest in the income received from real property acquired by *H* in Louisiana with his separate funds, is subject to gift tax.

In 1930, *H*, a resident of a noncommunity property state, purchased real estate in Louisiana with his separate funds and took title thereto in his own name. During the period between 1930 and 1950, *H* received net income from the property, after payment of income taxes, aggregating 400*x* dollars. In 1950, *H* transferred 200*x* dollars to his wife in satisfaction of her one-half community interest in the accrued income.

In the case of *Coral L. Noble* v. *Commissioner*, 138 Fed. (2d) 444, it was held that where a resident of a noncommunity property state acquires real property in a community property state with his separate funds, the property becomes his separate property without expressly designating it as such in the deed. The court said:

The general rule in the community property states that marital rights in lands, regardless of the residence of the husband and wife, are regulated by the law of the situs is subject to the qualification that where property is acquired in a community property state, through purchase by funds which are the separate property of one of the spouses, the character of the funds or of the property given in exchange is transmitted to the property acquired. Separate property remains separate through all its mutations and changes so long as it can be clearly and indisputably traced and identified.

However, under the law of Louisiana, when a married man purchases real estate in his own name without stipulating that it is purchased with his separate property and for his separate use, the property becomes community property. The presumption in favor of the community is not rebuttable. This rule applies also to real property acquired in Louisiana by nonresidents of that State. *Succession of Chapman*, (La.) 73 So. (2d) 789.

In the instant case, in acquiring the real estate in Louisiana in 1930 with his separate funds, *H* did not stipulate that it was purchased with his separate funds and for his separate use and, therefore, the property became community property in which his wife acquired a one-half community interest. The decision in the Noble case is distinguishable in that there the real estate acquired in Texas with the separate funds of a husband domiciled in a noncommunity property state, remained the husband's separate property under Texas law.

In view of the foregoing, it is held that the transfer to the spouse of an amount equal to one-half of the net income received from real property purchased in Louisiana by a person who took title thereto

in his own name will not constitute a gift for Federal gift tax purposes unless it was stipulated that the property was purchased with his separate funds and for his separate use. The spouse is presumed to have acquired a one-half community interest in the property at the date of purchase. Of course, to the extent that the spouse receiving such community income expended the same for the support of the family and the payment of community debts, the wife's interest in such community income which may be transferred to her without gift tax consequences would be reduced.

SECTION 1000(f).—IMPOSITION OF TAX: GIFT OF HUSBAND OR WIFE TO THIRD PARTY

REGULATIONS 108, SECTION 86.3a: Gift of husband or wife to third party after April 2, 1948.. Rev. Rul. 55–506

A consent to the application of the gift-splitting benefits under the provisions of section 1000(f) of the Internal Revenue Code of 1939 executed by the executors of the estate of the donor's spouse does not apply to gifts which became effective during that portion of the calendar year during which the donor is a widow or widower. Compare Rev. Rul. 55–334, C. B. 1955–1, 449.

SECTION 1004.—DEDUCTIONS

REGULATIONS 108, SECTION 86.12: Specific exemption. Rev. Rul. 55–709

In 1943 and 1945, the taxpayer effected an equal division of community property and reported the transactions for Federal gift tax purposes as provided by the regulations then in effect. Specific exemption of $30,000.00 was applied by the taxpayer in determining the amount of net gifts for those years. No other gifts were reported for 1943 and 1945. The provision to the effect that a division of community property between husband and wife (after 1942 and on or before April 2, 1948) into the separate property of each constituted a gift was eliminated from section 86.2(c) of Regulations 108 following the decisions by the Court of Appeals for the Ninth Circuit in *Estate of Edwin W. Rickenberg* v. *Commissioner*, 177 Fed. (2d) 114, and *Commissioner* v. *Edward M. Mills*, 183 Fed. (2d) 32. See T. D. 6015, C. B. 1953–1, 396. Accordingly, as the division of such property between husband and wife did not result in a gift, it follows that such division did not result in the use by the taxpayer of any portion of his specific exemption. It is therefore held that the specific exemption provided under the gift tax law may be claimed by the taxpayer with respect to gifts made in subsequent years.

REGULATIONS 108, SECTION 86.13: Charitable, etc., gifts.

Deductibility of contingent remainder of trust as gift to charitable institution. See Rev. Rul. 55–483, page 391.

SECTION 1006.—RETURNS

REGULATIONS 108, SECTION 86.20: Persons required to file return.

Beneficiary in receipt of lump sum distribution under an employees' pension plan immediately turns over *in toto* the amount of the payment to the widow of the deceased employee by reason of whose death the payment was made. See Rev. Rul. 55–460, page 591.

CHAPTER 9.—EMPLOYMENT TAXES

SUBCHAPTER A.—EMPLOYMENT BY OTHERS THAN CARRIERS [FEDERAL INSURANCE CONTRIBUTIONS ACT]

PART III.—GENERAL PROVISIONS

SECTION 1426(a).—DEFINITIONS: WAGES

REGULATIONS 128, SECTION 408.226: Wages.

Amount paid to an individual as a compromise settlement for the cancellation, before the normal expiration date, of an employment contract. See Rev. Rul. 55–520, page 393.

REGULATIONS 128, SECTION 408.227: Exclusions from wages.

Wages paid by predecessor attributed to successor. See Rev. Rul. 55–584, page 15, and Rev. Rul. 55–585, page 395.

Fair value of living quarters and meals furnished to employees of an organization exempt from Federal income tax under section 101(6) of the Code which has waived its exemption from the taxes imposed under the Federal Insurance Contributions Act. See Rev. Rul. 55–630, page 616.

Fair value of living quarters and meals furnished individuals who perform services of a household nature in or about a local chapter house of a college fraternity. See Rev. Rul. 55–631, page 619.

SECTION 1426(d).—DEFINITIONS: EMPLOYEE

REGULATIONS 128, SECTION 408.204: Who are employees. (Also Section 408.205.) Rev. Rul. 55–593

Owner-drivers of trucks and drivers of rented trucks who, pursuant to written agreements, deliver articles of merchandise for a company at specified rates, receive no payment for articles not de-

livered, pay all their operating expenses including insurance coverage, and are not subject, in the performance of the services, to the direction and control of the company are not employees thereof for Federal employment tax purposes. The drivers are independent contractors and are the employers for Federal employment tax purposes of any individuals engaged by them to perform services under their direction and control.

An inquiry has been received whether owner-drivers of trucks and drivers of rented trucks who deliver merchandise for a company are its employees for purposes of the Federal Insurance Contributions Act (subchapter A, chapter 9, Internal Revenue Code of 1939).

A company operates a number of appliance stores and, until the latter part of 1953, owned trucks and employed drivers to deliver merchandise purchased by its customers. At that time, the company offered the drivers and their helpers an opportunity to purchase the trucks and to make deliveries at certain rates established for each type of appliance and merchandise delivered. Some of the drivers purchased trucks from the company by executing a promissory note for the value of the truck purchased, payable at a minimum rate each week for a period of three years. Each note was secured by a mortgage executed on a standard form on which the owner-driver agreed to operate exclusively for the company for 3 years pursuant to a trucking agreement. It was further agreed that in the event of default in the performance of the services, or the provisions of the agreement, the entire balance remaining unpaid under the mortgage shall immediately become due and payable.

Under the trucking contract, the company agreed to pay and the owner-driver agreed to accept a certain flat rate for each type of appliance and merchandise delivered by the owner-driver. The contract specified there would be no charge for merchandise not delivered; the owner-driver would keep the truck in his own custody, exercise reasonable care in using it, and, at his own expense, keep it clean, polished and in good working order; the owner-driver would pay for all gasoline, oil and other supplies needed to operate the truck efficiently, and would pay all license fees and taxes required for the trucking operations; the owner-driver would employ as helpers, during the period of the agreement, only members in good standing of a local union; the owner-driver would provide and pay for certain insurance coverage specified in the agreement, the policies of which would be submitted to an outside firm for approval; and all money collected by the owner-driver from the company's customers would be considered a trust fund and would not be mingled with the funds of the owner-driver. The contract is effective for 3 years from the date of execution, may not be assigned or sublet without the written consent of the company, and may not be modified except by consent of the parties thereto in writing.

Under section 1426(d)(2) of the Act the term "employee" means any individual who, under the usual common law rules, has the status of an employee.

Section 408.204 of Regulations 128 provides that generally the legal relationship of employer and employee exists when the person for whom services are performed has the right to control and direct the individual who performs the services, not only as to the result to be accomplished by the work but as to the detail and means by

which the result is accomplished. An individual who is subject to the control or direction of another merely as to the result to be accomplished by the work and not as to the means and methods for accomplishing the result is an independent contractor and is not, as to such services, an employee under the usual common law rules.

In the case of the *United States* v. *Mutual Trucking Co.*, 141 F. (2d) 655, the taxpayer, a common carrier by motor vehicle, engaged truck owner-operators, under contracts, to transport loaded trailers in interstate commerce between points designated by the trucking company. The owner-operators hauled exclusively for the company and were paid a flat rate for each trip in accordance with a printed schedule. The compensation of such drivers, the cost of maintenance and repairs, and the cost of operation were borne solely by the truck owners. In compliance with contractual obligations, insurance coverage, both property damage and personal liability, was carried by the individual owner-operators. The trucks carried plates secured by the trucking company from the Interstate Commerce Commission, but each owner-operator obtained his own State license plates and driver's license. All drivers of trucks were required to register at stations maintained by the company on principal routes for the purpose of checking the time of trips. Drivers were required to file "daily logs" indicating the number of driving hours, thus enabling the company to ascertain the progress of loads at a given time. The Court held that, on the basis of these facts, the owner-operators were independent contractors. The facts in the case of *Carter II. Harrison* v. *Greyvan Lines, Inc.*, 331 U. S. 704, Ct. D. 1688, C. B. 1947–2, 167, are substantially similar to those in the case of the Mutual Trucking Co., and the Supreme Court of the United States held that the drivers in that case were likewise not employees.

In a ruling published as S. S. T. 403, C. B. 1940–2, 250, certain truck owners and drivers performing services in delivering coal for a company were held to be employees of the company for Federal employment tax purposes. Although the drivers in that case paid the expenses incurred in their operations, they were under the direction and control of the company and were required to observe the same rules, regulations, and instructions as were the drivers of the company-owned trucks who were conceded to be the company's employees.

In the instant case, no control over the owner-drivers is contemplated by the agreement or practiced in the performance thereof. The default provisions of the contracts impose no more restraint than exists generally in the cases of contractors who furnish performance bonds or who execute similar contracts containing forfeiture clauses whereby they may be penalized in the event of default or sued to fulfill their obligations under such contracts. It is held therefore that the owner-drivers are not employees of the company for Federal employment tax purposes but are independent contractors and are employers, for purposes of such taxes, of any assistants they engage to perform services under their direction and control.

In addition to the owner-drivers referred to above, the company engages other drivers who rent their trucks from a trucking firm. They pay the firm a flat rate each day for the use of the trucks and perform their services under circumstances substantially the same as

those present in the case of the owner-drivers. Accordingly, the drivers of the rented trucks are held not to be employees of the company for Federal employment tax purposes and are the employers for purposes of such taxes of any assistants they may engage to perform services under their direction and control.

An individual performing gardening services about a private home or residence. See Rev. Rul. 55–445, page 396.

An individual engaged to assist a firm of consulting engineers in the solution of engineering problems. See Rev. Rul. 55–466, page 397.

College students performing services for a manufacturing corporation under an agreement between the college and the corporation. See Rev. Rul. 55–500, page 398.

Helpers engaged by employee-drivers of a trucking company. See Rev. Rul. 55–543, page 400.

Special peace officers appointed by the Governor of a State to protect the property of property owners. See Rev. Rul. 55–544, page 401.

An individual performing services for a company to which he assigned his rights to an invention for exploitation purposes. See Rev. Rul. 55–561, page 402.

Individual performing carpentry and masonry services. See Rev. Rul. 55–582, page 403.

Individuals engaged in performing services in connection with a research project established as the result of a grant-in-aid to a State college. See Rev. Rul. 55–583, page 405.

An individual operating a remnant store as a factory outlet of a fabric manufacturing corporation. See Rev. Rul. 55–613, page 406.

An individual performing printing services on a continuing basis for a company and, in addition, operating his own printing business. See Rev. Rul. 55–658, page 407.

An individual who, upon reaching retirement age, is retained by her "former" employer as a consultant. See Rev. Rul. 55–695, page 410.

"Disc jockey" for a radio station. See Rev. Rul. 55–718, page 411.

House-to-house canvassers or solicitors. See Rev. Rul. 55–734, page 413.

REGULATIONS 128, SECTION 408.205: Who are employers.

Employing unit for joint employers of household employee. See Rev. Rul. 55–669, page 409.

SECTION 1426(g).—DEFINITIONS: AMERICAN VESSEL AND AIRCRAFT

REGULATIONS 128, SECTION 408.212: Non-American vessel or aircraft.

Service on non-American vessels and aircraft while on "idle status." See Rev. Rul. 55–623, page 414.

SECTION 1426(h).—DEFINITIONS: AGRICULTURAL LABOR

REGULATIONS 128, SECTION 408.208: Agricultural labor.

Operation of a hatchery. See Rev. Rul. 55–441, page 417.

Services performed in connection with a beekeeping enterprise. See Rev. Rul. 55–456, page 418.

Services in connection with custom butchering operations. See Rev. Rul. 55–696, page 419.

REGULATIONS 128, SECTION 408.208(a): Services performed by certain agricultural workers from the Republic of Mexico.

Services performed in the United States by a Canadian agricultural worker. See Rev. Rul 55–750, page 424.

SECTION 1426(i).—DEFINITIONS: AMERICAN EMPLOYER

REGULATIONS 128, SECTION 408.203: Employment after December 31, 1950.

Services performed in the employ of an employees' beneficiary association organized in the Canal Zone. See Rev. Rul. 55–644, page 425.

SECTION 1426(1).—DEFINITIONS: EXEMPTION OF RELIGIOUS, CHARITABLE, ETC., ORGANIZATIONS

REGULATIONS 128, SECTION 408.215: Ministers of churches and members of religious orders. Rev. Rul. 55–471

The domestic or foreign missionary services performed by an ordained minister for either a denominational or nondenominational agency, regardless of whether or not the services are performed pursuant to an assignment or designation by ecclesiastical superiors and regardless of the actual types of services performed, are considered to be "in the exercise of his ministry" and, therefore, excepted from "employment" under section 1426(b)(9)(A) of the Federal Insurance Contributions Act (subchapter A, chapter 9, Internal Revenue Code of 1939). See Mim. 6633, C. B. 1951–1, 106.

REGULATIONS 128, SECTION 408.216: Religious, charitable, educational, or other organizations exempt from income tax under section 101(6) of the Internal Revenue Code. Rev. Rul. 55–470

> Foreign and home mission boards sponsored by and operating under the jurisdiction of a particular religious organization are not separate autonomous entities for purposes of the taxes imposed under the Federal Insurance Contributions Act. Accordingly, such an organization exempt from Federal income tax under section 101(6) of the Internal Revenue Code of 1939 and desiring to have the insurance system established by Title II of the Social Security Act extended to service performed by its employees, must obtain the concurring signatures of at least two-thirds of the total number of all its employees (including foreign as well as home employees) computed at the time waiver forms are filed.

Advice has been requested whether foreign and home mission boards sponsored by a particular religious organization may be considered separate autonomous entities for purposes of waiving exemption from the taxes imposed under the Federal Insurance Contributions Act (subchapter A, chapter 9, Internal Revenue Code of 1939) as provided by section 1426(1) of the Act.

In the instant case, a religious organization engages persons to serve on the home and foreign mission boards which it operates. It has filed a waiver of exemption certificate (Form SS–15) pursuant to section 1426(1) of the Act certifying that it desires to have the insurance system established by Title II of the Social Security Act extended to services performed by its employees. However, in filing such certificate, only employees in the organization's home office were considered to be eligible for coverage under the Act and were listed on the accompanying Form SS–15a.

Section 1426(1) of the Act relating to the exemption of religious, charitable, etc., organizations provides, in part, that an organization exempt from income tax under section 101(6) of the Internal Revenue Code of 1939 may file a certificate certifying that it desires to have the insurance system established by Title II of the Social Security Act extended to services performed by its employees and that at least two-thirds of its employees concur in the filing of the certificate. Such certificate may be filed only if it is accompanied by a list containing the

signature, address, and social security account number (if any) of each employee who concurs in the filing of the certificate.

Although the home and foreign staffs of the instant organization operate on separate budgets and the qualifications respecting the employment and remuneration of their personnel may vary, the ultimate control over employees on the staffs of foreign missions is vested in the organization in the United States and the foreign missions are not separate entities, but are in effect branches or departments of the home (United States) missions or offices.

Since the organization in this case is an organization exempt from Federal income taxes under section 101(6) of the Internal Revenue Code which desires to have the insurance system established by Title II of the Social Security Act extended to services performed by its employees, it must have obtained the concurring signatures of at least two-thirds of the total number of all its employees (including foreign as well as home employees) computed at the time of filing. See T. D. 5823, C. B. 1951–1, 89. In the absence of meeting this requirement, social security coverage may not be extended to its employees. However, if it can meet the conditions specified by section 3121(k) of the Internal Revenue Code of 1954, as amended by the Social Security Amendments of 1954, social security coverage may be available for certain periods of such services.

(Also Section 408.227.) Rev. Rul. 55–630

A nonprofit charitable organization, exempt from Federal income tax under section 101(6) of the Internal Revenue Code of 1939, which has waived its exemption from the taxes imposed under the Federal Insurance Contributions Act pursuant to the provisions of section 1426(1) of such Act, should include the fair value of living quarters and meals furnished to its employees in computing their wages subject to the taxes imposed under the Act.

The question has been presented whether a nonprofit charitable organization that is exempt from Federal income tax under section 101(6) of the Internal Revenue Code of 1939, but which has waived its exemption from the taxes imposed under the Federal Insurance Contributions Act (subchapter A, chapter 9, Internal Revenue Code of 1939), pursuant to the provisions of section 1426(1) of the Act, should include the fair value of living quarters and meals furnished to its employees in computing their wages subject to the taxes imposed under the Act.

A nonprofit charitable organization, exempt from Federal income tax under section 101(6) of the Code, filed a waiver of exemption certificate, pursuant to section 1426(1) of the Federal Insurance Contributions Act, certifying that it desired to have the insurance system established by Title II of the Social Security Act extended to services performed by its employees. The organization maintains a home for aged blind persons who cannot continue to live in their own homes because of financial or other reasons and it furnishes living quarters and meals to certain of its employees, including employees performing services of a domestic nature in or about the home. The question has arisen whether, under the provisions of section 1426(a)(7)(A) of the Act, the value of the living quarters and meals so furnished should be

excluded in computing the wages of the organization's employees for Federal Insurance Contributions Act purposes.

Section 1426(a) of the Act provides that the term "wages" means all remuneration for employment, including the cash value of all remuneration paid in any medium other than cash; except that such term shall not include—

* * * * * * *

(7)(A) Remuneration paid in any medium other than cash to an employee for service not in the course of the employer's trade or business or for domestic service in a private home of the employer * * *.

The organization has expressed the opinion that section 1426(a)(7)(A) of the Act is applicable to service performed in the employ of any organization exempt from Federal income tax under section 101(6) of the Code, on the theory that a nonprofit charitable organization is not engaged in a "trade or business." It contends, therefore, that the services performed by its employees are "not in the course of the employer's trade or business." It also contends that the value of living quarters and meals furnished the individuals performing services of a domestic nature in the home maintained by the organization is not subject to the taxes imposed under the Act because such value represents remuneration paid in a medium other than cash "for domestic service in a private home of the employer" within the meaning of section 1426(a)(7)(A), *supra*.

Section 1426(b) of the Act provides that the term "employment" means * * * any service, of whatever nature, performed after 1950 * * * except that * * * such term shall not include—

* * * * * * *

(9)(B) Service performed in the employ of a religious, charitable, educational, or other organization exempt from income tax under section 101(6), but this subparagraph shall not apply to service performed during the period for which a certificate, filed pursuant to subsection (1), is in effect if such service is performed by an employee (i) whose signature appears on the list filed by such organization under subsection (1), or (ii) who became an employee of such organization after the calendar quarter in which the certificate was filed;

* * * * * * *

(11)(A) Service performed in any calendar quarter in the employ of any organization exempt from income tax under section 101, if the remuneration for such service is less than $50;

The exceptions set forth in section 1426(a)(7)(A) of the Act are not applicable to the factual situation here under consideration for the reasons that:

(1) The employees of the organization who perform services in connection with the maintenance of a home for, and care of, persons admitted to the organization's home for aged blind persons are promoting or advancing the purposes for which the organization was established, *i. e.*, they are performing services in the course of the organization's "trade or business" within the meaning of that term as used in the Federal employment tax statutes. Although an organization exempt from Federal income tax under section 101(6) of the Code must be organized and operated exclusively for one or more of the purposes specified, and an organization organized or operated for the primary purpose of carrying on a trade or business *for profit* is not exempt thereunder, it does not follow that the usual and regular activities of a nonprofit charitable organization in carrying out

the purpose for which it was organized do not constitute a "trade or business" within the meaning of that term as used in section 1426(a)(7)(A) of the Act. "Business" is defined in Black's Law Dictionary as embracing everything about which a person can be employed. Thus, in the instant case, the maintenance of a residence for aged blind persons who cannot continue to live in their own homes is, for Federal employment tax purposes, the "trade or business" of the organization. Since this "trade or business" is not carried on for profit and as the organization otherwise meets the tests required by section 39.101(6)-1 of Regulations 118, it qualifies for exemption from Federal income tax. Such exemption, therefore, is not based upon the fact that the organization is not engaged in a trade or business, but in part upon the fact that it is not engaged in a trade or business *for profit.*

(2) Section 1426(b)(9)(B) of the Act is applicable to service performed in the employ of an organization exempt from income tax under section 101(6) of the Code, if the organization has not filed a certificate, pursuant to section 1426(1) of the Act, waiving its exemption from the taxes imposed under the Act. Conversely, section 1426(b)(11)(A) of the Act is applicable in the case of employees of a section 101(6) organization which has filed such a certificate waiving its exemption from the taxes imposed under the Act. Furthermore, section 1426(b)(11)(A) excepts from employment service performed in any calendar quarter in the employ of any section 101 organization if the remuneration (including the cash value of all remuneration paid in any medium other than cash) for such service is less than $50. However, section 1426(a)(7)(A) provides a different test by excluding from wages remuneration paid in any medium other than cash to an employee for service not in the course of the employer's trade or business (see also section 1426(b)(3)), or for domestic service in a private home of the employer (see also section 1426(a)(7)(B)). This distinction within the framework of the statute is believed to be a clear indication of the intent of Congress that service performed in the employ of any organization exempt from income tax under section 101 of the Code should not be considered as "service not in the course of the employer's trade or business or for domestic service in a private home of the employer."

(3) Section 408.227(h), Regulations 128, provides that a private home is a "fixed place of abode of an individual or family." Individuals employed to perform services of a domestic nature in or about eleemosynary institutions are not performing services in the "private home of the employer" as contemplated by the Federal employment tax statutes. The organization, and not the beneficiaries of the charitable purposes of the organization, is the employer of the employees concerned.

Accordingly, it is concluded that a nonprofit charitable organization, exempt from Federal income tax under section 101(6) of the Internal Revenue Code of 1939, which has waived its exemption from the taxes imposed under the Federal Insurance Contributions Act pursuant to the provisions of section 1426(1) of such Act, should include the fair value of living quarters and meals furnished to its employees in computing their wages subject to the taxes imposed under the Act.

Procedures for the social security coverage of individuals employed by certain exempt organizations. See Rev. Rul. 55–473, page 425.

REGULATIONS 128, SECTION 408.218: Organizations exempt from income tax; remuneration less than $50 for calendar quarter. (Also Section 408.227.) Rev. Rul. 55-631

The value of living quarters and meals furnished to non-student individuals who perform services of a household nature in or about a local chapter house of a college fraternity, which is exempt from Federal income tax under section 101 of the Internal Revenue Code of 1939, constitutes "wages" for Federal Insurance Contributions Act purposes, and should be included in determining the $50 wage limitation prescribed by section 1426(b)(11)(A) of the Act.

Advice has been requested whether the value of living quarters and meals furnished to various non-student individuals, who perform services of a household nature in a local chapter house of a college fraternity, should be considered in computing wages for purposes of the taxes imposed under the Federal Insurance Contributions Act (subchapter A, chapter 9, Internal Revenue Code of 1939.)

In the instant case the local chapter of a college fraternity, exempt from Federal income tax under section 101 of the Internal Revenue Code of 1939, employs various non-student individuals to perform services in the chapter house as cooks, waiters, cleaners and a housemother. In addition to cash remuneration, a number of them are furnished living quarters and meals in payment for services rendered. Since section 1426(a)(7)(A) of the Federal Insurance Contributions Act excepts from "wages" remuneration paid in any medium other than cash to employees for domestic service in a private home of the employer, the question has been presented whether such exception also applies to the same type of service performed in or about a local chapter house of a college fraternity.

The exception of remuneration paid in any medium other than cash for domestic service provided by section 1426(a)(7)(A) of the Act is applicable only to such services when performed in a private home of the employer. See Rev. Rul. 55–630, page 616.

Section 1426(b)(11)(A) excepts from the term "employment" service performed in any calendar quarter in the employ of any organization exempt from income tax under section 101, if the remuneration for such service is less than $50.

Section 1426(b)(11)(A), applicable to services performed for section 101 organizations, does not except from "wages" remuneration paid in any medium other than cash. Therefore, the value of living quarters and meals furnished to non-student individuals who perform services of a household nature in a local chapter house of a college fraternity, which is exempt from Federal income tax under section 101 of the Internal Revenue Code of 1939, constitues "wages" for Federal Insurance Contributions Act purposes, and should be included in determining the $50 wage limitation prescribed by section 1426(b)(11)(A) of the Act.

SUBCHAPTER B.—EMPLOYMENT BY CARRIERS

PART IV.—GENERAL PROVISIONS

SECTION 1532(a).—DEFINITIONS: EMPLOYER

REGULATIONS 114, SECTION 411.202: Who are employers.

A wholly owned subsidiary of a railroad company engaged in performing cleaning services in buildings owned and occupied, in part, by such railroad company. See Rev. Rul. 55–586, page 451.

SUBCHAPTER C.—TAX ON EMPLOYERS OF EIGHT OR MORE

SECTION 1607(c).—DEFINITIONS: EMPLOYMENT

REGULATIONS 107, SECTION 403.211: Maritime services.

Service on non-American vessels and aircraft while on "idle status." See Rev. Rul. 55–623, page 414.

REGULATIONS 107, SECTION 403.208: Agricultural labor.

Reforestation services performed by employees of landowner. See Rev. Rul. 55–607, page 453.

SECTION 1607(i).—DEFINITIONS: EMPLOYEE

REGULATIONS 107, SECTION 403.204: Who are employees.

Helpers engaged by employee-drivers of a trucking company. See Rev. Rul. 55–543, page 400.

"Disc jockey" for a radio station. See Rev. Rul. 55–718, page 411.

SUBCHAPTER D.—COLLECTION OF INCOME TAX AT SOURCE ON WAGES

SECTION 1621(a).—DEFINITIONS: WAGES

REGULATIONS 120, SECTION 406.207: Wages.

Amount paid to an individual as a compromise settlement for the cancellation, before the normal expiration date, of an employment contract. See Rev. Rul. 55–520, page 393.

SECTION 1621(c).—DEFINITIONS: EMPLOYEE

REGULATIONS 120, SECTION 406.203: Employee.

Helpers engaged by employee-drivers of a trucking company. See Rev. Rul. 55-543, page 400.

Individuals engaged in performing services in connection with a research project established as the result of a grant-in-aid to a State college. See Rev. Rul. 55-583, page 405.

House-to-house canvassers or solicitors. See Rev. Rul. 55-734, page 413.

SECTION 1621(d).—DEFINITIONS: EMPLOYER

REGULATIONS 120, SECTION 406.205: Employer.

A State having control of the payment of wages to "State appointed" special peace officers. See Rev. Rul. 55-544, page 401.

CHAPTER 9A.—WAR TAXES AND WAR TAX RATES [TERMINATED]

REGULATIONS 46, SECTIONS 316.0, 316.2, 316.9, 316.51, 316.56, 316.74, 316.111, 316.122, 316.181, 316.199, 316.204

The above sections have been amended to reflect changes required by the Excise Tax Reduction Act of 1954. See T. D. 6139, page 674.

SECTION 1657.—FLOOR STOCKS REFUNDS ON ELECTRIC LIGHT BULBS

REGULATIONS 46, SECTION 316.204a: Credits or refunds of tax on floor stocks of electric light bulbs, refrigerators, and appliances. (Also Section 3416.) — T. D. 6141 [1]

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER C, PART 316.—EXCISE TAXES ON SALES BY THE MANUFACTURER

Extension of time for filing claims for credit or refund of tax on floor stocks of refrigerators, quick-freeze units, refrigerating and freezing apparatus, and electric, gas, and oil appliances.

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

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

In order to conform Regulations 46, 1940 edition (26 CFR (1939) part 316), relating to excise taxes on sales by the manufacturer under

[1] 20 F. R. 6498.

subchapter A of chapter 29 of the Internal Revenue Code of 1939, to Public Law 303[page 758 of this Bulletin], Eighty-fourth Congress, approved August 9, 1955, such regulations are amended as follows:

PARAGRAPH 1. There is inserted immediately preceding section 316.204a the following:

PUBLIC LAW 303, EIGHTY-FOURTH CONGRESS APPROVED AUGUST 9, 1955

* * * That section 3416(a)(2) of the Internal Revenue Code of 1939 (relating to period for filing claims for certain floor stocks refunds) is hereby amended by striking out "before August 1, 1954" and inserting in lieu thereof "on or before the sixtieth day after the date of the enactment of H. R. 3712, Eighty-fourth Congress".

PAR. 2. Subparagraph (2) of section 316.204a(a), as added by Treasury Decision 6072 [C. B. 1954–1, 228], approved June 3, 1954, is amended by striking out the period at the end of the subparagraph and by adding in lieu thereof the following: "and as amended by Public Law 303, Eighty-fourth Congress, approved August 9, 1955."

PAR. 3. Paragraph (f) of section 316.204a, as added by Treasury Decision 6072, is amended as follows:

(A) By striking out the designation and heading of subparagraph (1) and inserting in lieu thereof the following: "(1) *Electric light bulbs.*—(i) *Refund.*";

(B) By striking out in the first sentence of subparagraph (1) the words "for refund" and inserting in lieu thereof the following: "for refund with respect to the tax on floor stocks of electric light bulbs";

(C) By striking out the designation and heading of subparagraph (2) and inserting in lieu thereof the following: "(ii) *Credit.*";

(D) By striking out in the first sentence of the redesignated subdivision (ii) the words "for credit" and inserting in lieu thereof the following: "for credit with respect to the tax on floor stocks of electric light bulbs";

(E) By striking out in the eighth sentence of the redesignated subdivision (ii) the parenthetical phrase "(as provided in subparagraph (1) of this paragraph)" and inserting in lieu thereof the following: "(as provided in subdivision (i) of this subparagraph)"; and

(F) By adding at the end thereof the following new subparagraph:

(2) *Refrigerators and appliances.*—(i) *Refund.*—A claim for refund with respect to the tax on floor stocks of refrigerators and appliances shall be filed on Form 843 on or before October 10, 1955, with the district director of internal revenue for the district in which is located the claimant's principal place of business. The claim shall contain a statement that the amount claimed has not been and will not be taken as a credit against tax.

(ii) *Credit.*—A claim for credit with respect to the tax on floor stocks of refrigerators and appliances against tax due shall be taken on the appropriate tax return filed with the District Director of Internal Revenue on or before October 10, 1955. A credit against tax due may be taken on the tax return, Form 720, filed on or before October 10, 1955 (for any reimbursements made before filing such return), by the claimant for the quarter covering the months of July, August, and September 1955. If a monthly return is filed, such credit may be taken on the return

for a month not later than September 1955, if such return is filed on or before October 10, 1955. The return on which the credit is taken must have attached a statement that a refund claim has not been and will not be filed covering the amount taken as a credit. Any amount claimed under this section may be taken as a credit on the required tax return even though the amount of the credit is in excess of the total tax liability shown on such return. In such case, the entire amount of the credit not previously claimed must be shown on the return, but the amount in excess of the total tax liability shown on such return will be processed as if it were a claim for refund filed on Form 843 (as provided in subdivision (i) of this subparagraph). For example, if the tax return for the third quarter of 1955 (covering the months of July, August, and September 1955, and filed on or before October 10, 1955) shows a total tax liability of $40,000 and a claimant has reimbursed holders to the extent of $100,000 during that or any previous quarter, the claimant may claim a credit on that return in the full amount of $100,000 but the amount in excess of the total tax liability shown on such return ($60,000) will be processed as if such excess had been claimed as a refund on Form 843. A claimant who is required to make monthly deposits with a Federal Reserve Bank may reduce his monthly liability by the total reimbursements made by him to holders during that month. However, it should be noted that the mere reduction of the monthly liability in such case is not a filing of a claim for credit within the meaning of this section. Where reimbursements are made to holders during the month of October 1955 (but not later than October 10, 1955), the liability for such month should not be reduced by the total of such reimbursements. The amount of such October 1955 reimbursements may be claimed as a credit on the return covering July, August, and September 1955, or on the return for the month of September 1955, if the return is filed monthly, or as a refund on Form 843, if such return or claim is filed on or before October 10, 1955.

Because this Treasury Decision applies to refrigerators, and appliances held on April 1, 1954, and prescribes the procedures respecting the filing of claims on or before October 10, 1955, for refund or credit with respect to the tax on floor stocks of such articles, it is hereby found that it is impracticable to issue this Treasury Decision with notice and public procedure thereon under section 4(a) of the Administrative Procedure Act, approved June 11, 1946, or subject to the effective date limitation of section 4(c) of said Act.

(This Treasury Decision is issued pursuant to the authority contained in sections 3416, 3450, and 3791 of the Internal Revenue Code of 1939 (68 Stat. 40, 69 Stat. 594, 53 Stat. 419, 467; 26 U. S. C. 3416, 3450, and 3791).)

PAUL K. WEBSTER,
Acting Commissioner of Internal Revenue.

Approved August 29, 1955.

A. N. OVERBY,
Acting Secretary of the Treasury.

(Filed by the Division of the Federal Register September 1, 1955, 8:48 a. m.)

CHAPTER 10.—ADMISSIONS AND DUES

SUBCHAPTER A.—ADMISSIONS

SECTION 1700.—TAX

REGULATIONS 43, SECTION 101.2: Meaning of "admission." T. D. 6147 [1]

TITLE 26—INTERNAL REVENUE, 1939.—CHAPTER I, SUBCHAPTER C, PART 101.—TAXES ON ADMISSIONS, DUES, AND INITIATION FEES

Regulations 43 (1941 edition) amended to conform to the Excise Tax Reduction Act of 1954.

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

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

On June 7, 1955, a notice of proposed rulemaking regarding amendments to conform Regulations 43 (1941 edition) (26 CFR, Part 101), relating to the excise tax on admissions, dues, and initiation fees, to the Excise Tax Reduction Act of 1954 [C. B. 1954–1, 343], approved March 31, 1954, was published in the Federal Register (20 F. R. 3935). No objections to the rules proposed having been received during the 30-day period prescribed in the notice, the following regulations as so published are hereby adopted.

PARAGRAPH 1. Section 101.0, as amended by Treasury Decision 6007 [C. B. 1953–1, 412], approved April 15, 1953, is further amended as follows:

(A) By striking out the words "and the Excise Tax Act of 1947" at the end of the first sentence and adding in lieu thereof the following: "the Excise Tax Act of 1947, and sections 201, 202, 203, 504(a), 505(c)(1) and (2), and 506 of the Excise Tax Reduction Act of 1954".

(B) By changing the last paragraph of the section to read as follows:

The statutory references are to the Internal Revenue Code of 1939 (53 Stat., part 1) unless otherwise stated.

PAR. 2. Immediately preceding section 101.1 there is inserted the following:

SEC. 203. EFFECTIVE DATE OF TITLE II [EXCISE TAX REDUCTION ACT OF 1954, APPROVED MARCH 31, 1954].

The amendments made by section 201 (other than subsection (b) thereof) shall apply only with respect to amounts paid for admissions on or after April 1, 1954. In addition, such amendments shall apply—

(1) in the case of any season ticket or subscription; only if all the admissions under such ticket or subscription can occur only on or after April 1, 1954; and

(2) in the case of the permanent use of a box or seat or a lease for the use of such box or seat, only if all the performances or exhibitions at which the box or seat is used or reserved by or for the lessee or holder can occur only on or after April 1, 1954.

[1] 20 F. R. 7250.

The amendment made by subsection (b) shall apply only with respect to amounts paid on or after April 1, 1954, for admissions on or after such date.

PAR. 3. Section 101.1, as amended by Treasury Decision 6007, is further amended by adding at the end thereof a new paragraph to read as follows:

The reduction in rates provided by section 201 of the Excise Tax Reduction Act of 1954 is generally effective with respect to amounts paid for admissions on and after April 1, 1954. In the case of a season ticket or subscription the reduction is effective only if all the admissions under the season ticket or subscription can occur only on or after April 1, 1954, and in the case of the permanent use of a box or seat or a lease for the use of such box or seat, only if all the performances or exhibitions at which the box or seat is used or reserved by or for the lessee or holder can occur only on or after such date. The reduction with respect to the tax imposed on sales outside the box office is effective only with respect to amounts paid on or after April 1, 1954, for admissions on or after such date. For special provisions relating to payment, credit, or refund of the admissions tax in cases of amounts collected prior to April 1, 1954, at the rate in effect prior to such date, for admissions on or after such date, see section 101.43a.

PAR. 4. Immediately preceding section 1704 of the Internal Revenue Code of 1939, which immediately precedes section 101.2, there is inserted the following:

SEC. 201. TAX ON ADMISSIONS [EXCISE TAX REDUCTION ACT OF 1954, APPROVED MARCH 31, 1954].

* * * * * * *

(d) SINGLE OR SEASON TICKETS AND SUBSCRIPTIONS.—For reduction in rate of tax on admission by single or season ticket or subscription, see section 504(a).

(e) RATE TO APPLY TO MAJOR FRACTIONS.—Section 1700(a)(1) (relating to rate of tax on single or season tickets and subscriptions) is hereby amended by striking out "fraction" and inserting in lieu thereof "major fraction".

(f) EXEMPTION OF ADMISSIONS OF FIFTY CENTS OR LESS.—Section 1700(a)(1) (relating to rate of tax on single or season tickets and subscriptions) is hereby amended by striking out the second sentence thereof and inserting in lieu thereof the following: "No tax shall be imposed under this paragraph on the amount paid for admission—

"(A) if the amount paid for admission is 50 cents or less, or

"(B) in the case of a season ticket or subscription, if the amount which would be charged to the holder or subscriber for a single admission is 50 cents or less."

(g) ADMISSIONS TO CERTAIN RACE TRACKS.—

(1) Section 1700(a) (relating to rate of tax on single or season tickets and subscriptions) is hereby amended by adding at the end thereof the following:

"(3) CERTAIN RACE TRACKS.—In lieu of the tax imposed under paragraph (1), a tax of 1 cent for each 5 cents or major fraction thereof of the amount paid for admission to any place (including admission by season ticket or subscription) if the principal amusement or recreation offered with respect to such admission is horse or dog racing at a race track. The tax imposed under this paragraph shall be paid by the person paying for such admission."

* * * * * * *

SEC. 203. EFFECTIVE DATE OF TITLE II [EXCISE TAX REDUCTION ACT OF 1954, APPROVED MARCH 31, 1954].

The amendments made by section 201 * * * shall apply only with respect to amounts paid for admissions on or after April 1, 1954. In addition, such amendments shall apply—

(1) in the case of any season ticket or subscription, only if all the admissions under such ticket or subscription can occur only on or after April 1, 1954; * * *

* * * * * * *

SEC. 504. TECHNICAL AMENDMENTS [EXCISE TAX REDUCTION ACT OF 1954, APPROVED MARCH 31, 1954].

(a) TERMINATION OF TAX RATES UNDER SECTION 1650.—Section 1650 (relating to war tax rates of certain miscellaneous taxes) is hereby amended by inserting after "beginning with the effective date of title III of the Revenue Act of 1943" the following: "and ending March 31, 1954,".

* * * * * * *

SEC. 505. EFFECTIVE DATES [EXCISE TAX REDUCTION ACT OF 1954, APPROVED MARCH 31, 1954].

* * * * * * *

(c) The amendment made by section 504(a) shall apply—

(1) insofar as it affects the rate of the tax imposed by section 1700(a)(1) of the Internal Revenue Code, with respect to amounts paid for admissions on or after April 1, 1954, but, in the case of any season ticket or subscription, only if all the admissions under such ticket or subscription can occur only on or after April 1, 1954;

* * * * * * *

PAR. 5. The seventh paragraph of section 101.2 (26 CFR 101.2(g)), as amended by Treasury Decision 5096 [C. B. 1941–2, 260], approved November 1, 1941, is further amended by striking "50 cents" in the first sentence, and inserting in lieu thereof "75 cents".

PAR. 6. Section 101.4, as amended by Treasury Decision 5349 [C. B. 1944, 639], approved March 17, 1944, is further amended as follows:

(A) By striking out the first sentence of the first paragraph (26 CFR 101.4(a)) and inserting in lieu thereof the following:

(a) *General rules.*—The amount paid for admission to any place, including any amount paid for a season ticket or as a subscription, is subject under section 1700(a) of the Code, as amended, to tax at the rates set forth in (b) and (c) of this section.

(B) By striking out the last two sentences of the fourth paragraph (26 CFR 101.4(d)) and inserting in lieu thereof the following:

Thus, if a combination ticket is issued entitling the holder to admission before April 1, 1954, and to the use of a reserved seat for $1.50, using the rate of tax in effect before April 1, 1954, the tax is 30 cents, and the same amount of the tax would be due if separate tickets of admission and for a reserved seat were sold for 75 cents each. In the latter case the tax on the first admission charge of 75 cents is 15 cents and the tax on the additional charge of 75 cents for a reserved seat is 15 cents. The same rule would apply to a combination ticket entitling the holder to admission on or after April 1, 1954, using however, the new rates provided by the Excise Tax Reduction Act of 1954.

(C) By striking out the sixth paragraph (26 CFR 101.4(f)) and inserting in lieu thereof the following:

(b) *Admissions before April 1, 1954.*—(1) The rate of tax applicable to amounts paid for admission before April 1, 1954, to any place is 1 cent for each 5 cents or major fraction thereof (except that no tax is due on the amount paid for the admission of a child under 12 years of age if the amount paid is less than 10 cents). For special provisions relating to payment, credit, or refund of the admissions tax in cases of amounts collected prior to April 1, 1954, at the rate in effect prior to such date, for admissions on or after such date, see section 101.43a.

(2) The following table sets forth the amount of tax applicable to certain admission charges when the rate of tax is 1 cent for each 5 cents or major fraction thereof:

Admission charges	*Tax*
$0.01 to $0.02	$0.00
0.03 to 0.07	0.01
0.08 to 0.12	0.02
0.13 to 0.17	0.03
0.18 to 0.22	0.04
0.23 to 0.27	0.05
0.28 to 0.32	0.06
0.33 to 0.37	0.07
0.38 to 0.42	0.08
0.43 to 0.47	0.09
0.48 to 0.52	0.10

The tax on all other admission charges where the rate of tax is 1 cent for each 5 cents or major fraction thereof shall be computed in a manner corresponding to that set forth in the foregoing table.

(c) *Admissions on or after April 1, 1954.*—(1) *Places other than horse or dog race tracks.*—Any amount paid for admission on or after April 1, 1954, to any place (other than to a place at which the principal amusement or recreation is horse or dog racing at a race track, for treatment of which see (2), below), including any amount paid for a season ticket or subscription, is subject to tax at the rate of 1 cent for each 10 cents or major fraction thereof, determined under the following rules:

(i) For the purposes of the regulations in this part, 5 cents is not considered a major fraction of 10 cents.

(ii) If the amount paid for a single admission is 50 cents or less, the amount so paid is exempt from tax. In the case of a season ticket or subscription, the amount paid therefor is exempt from tax only if the amount which would be charged to the holder or subscriber for each single admission covered by the season ticket or subscription is 50 cents or less. Thus, for example, if A pays $2.50 for a season ticket or subscription which entitles him to admission to 6 performances and if the amount which would be charged A for each single admission to these performances is 50 cents or less, then the entire amount paid for the season ticket or subscription is exempt from tax. However, if A pays $3 for a season ticket or subscription which entitles him to admission to 6 performances and if the amount which would be charged A for each single admission to these performances is more than 50 cents, then the entire amount paid for the season ticket or subscription is taxable. Further, if A pays $3 for a season ticket or subscription which entitles him to admission to 6 performances and if the amount which would be charged A for each single admission to 5 of these performances is 50 cents or less and for a single admission to the sixth performance is more than 50 cents, then the entire amount paid for the season ticket or subscription is taxable.

(iii) The following table sets forth the amount of tax applicable to certain admission charges when the rate of tax is 1 cent for each 10 cents or major fraction thereof:

Admission charges	*Tax*
$0.01 to $0.50	$0.00
0.51 to 0.55	0.05
0.56 to 0.65	0.06
0.66 to 0.75	0.07
0.76 to 0.85	0.08
0.86 to 0.95	0.09
0.96 to 1.05	0.10
1.06 to 1.15	0.11
1.16 to 1.25	0.12

The tax on all other admission charges where the rate of tax is 1 cent for each 10 cents or major fraction thereof shall be computed in a manner corresponding to that set forth in the foregoing table.

(2) *Places at which the principal amusement or recreation is horse or dog racing.*—Any amount paid for admission on or after April 1, 1954, to any place including any amount paid for a season ticket or subscription, if the principal amusement or recreation offered with respect to such admission is horse or dog racing at a race track, is subject to tax at the rate of 1 cent for each 5 cents or major fraction thereof. For computation of tax at this rate see the table in paragraph (b) of this section.

PAR. 7. Section 101.5, as amended by Treasury Decision 6007, is further amended by striking out the last sentence of paragraph (a) and inserting in lieu thereof the following:

A child under 12 years of age admitted prior to April 1, 1954, for less than 10 cents is not liable for tax. A charge of 50 cents or less for an admission on or after April 1, 1954, to certain places is tax free (see section 101.4 (c) (1)).

PAR. 8. Immediately preceding section 101.7 there is inserted the following:

SEC. 201. TAX ON ADMISSIONS [EXCISE TAX REDUCTION ACT OF 1954, APPROVED MARCH 31, 1954].

(a) PERMANENT USE OR LEASE OF BOXES OR SEATS.—Section 1700 (b) (1) (relating to tax on permanent use or lease of boxes or seats), is hereby amended by striking out "11 per centum" and inserting in lieu thereof "10 per centum".

* * * * * * *

(g) ADMISSIONS TO CERTAIN RACE TRACKS.—

* * * * * * *

(2) Section 1700(b) (relating to rate of tax on permanent use or lease of boxes or seats) is hereby amended—

(A) by striking out "paragraph (1) of subsection (a)" and inserting in lieu thereof "paragraph (1) or (3) of subsection (a)"; and

(B) by inserting after "per centum" the following: "(20 per centum if paragraph (3) of subsection (a) would otherwise apply)".

* * * * * * *

SEC. 203. EFFECTIVE DATE OF TITLE II [EXCISE TAX REDUCTION ACT OF 1954, APPROVED MARCH 31, 1954].

The amendments made by section 201 * * * shall apply only with respect to amounts paid for admissions on or after April 1, 1954. In addition, such amendments shall apply—

* * * * * * *

(2) in the case of the permanent use of a box or seat or a lease for the use of such box or seat, only if all the performances or exhibitions at which the box or seat is used or reserved by or for the lessee or holder can occur only on or after April 1, 1954.

* * * * * * *

SEC. 504. TECHNICAL AMENDMENTS [EXCISE TAX REDUCTION ACT OF 1954, APPROVED MARCH 31, 1954].

(a) TERMINATION OF TAX RATES UNDER SECTION 1650.—Section 1650 (relating to war tax rates of certain miscellaneous taxes) is hereby amended by inserting after "beginning with the effective date of title III of the Revenue Act of 1943" the following: "and ending March 31, 1954,".

* * * * * * *

SEC. 505. EFFECTIVE DATES [EXCISE TAX REDUCTION ACT OF 1954, APPROVED MARCH 31, 1954].

* * * * * * *

(c) The amendment made by section 504(a) shall apply—

* * * * * * *

(2) insofar as it affects the rates of the taxes imposed by subsections (b) * * * of section 1700 of the Internal Revenue Code, as though the rates listed under the heading "Old Rate" in the table in section 1650 of such Code were the rates established by the amendments made by title II of this Act;

* * * * * * *

PAR. 9. Section 101.8, as amended by Treasury Decision 5349, is further amended as follows:

(A) So much of the section as precedes the examples is amended to read as follows:

SEC. 101.8. BASIS, RATE, AND COMPUTATION OF TAX.—(a) *General rules.*—In the case of a person having the permanent use or a lease for the use of a box or a seat in any opera house or other place of amusement the tax imposed by section 1700(a) (1) or (3) on "the amount paid for admission to any place" does not apply. Instead, the provisions quoted above impose a tax on the right to the use of the box or seat equivalent to a percentage of the total amount that would be realized by the sale, at the established price, of the right to occupy a similar box or seat for each performance or exhibition during the period for which such box or seat is reserved. For applicable percentage rates of tax, see (b) of this section. In other words, the tax is based not on the amount, if any, *actually paid* for the particular box or seat, but on the *amount that would be paid, at the established price, for admission to all performances given*, not merely those attended, if payments were made for each performance separately. The tax is not on the *actual use* of the box or seat, but on the *most extensive possible use.* Note that the rate of the tax here is a percentage rate and is not "1 cent for each 10 cents or major fraction thereof"; or "1 cent for each 5 cents or major fraction thereof", as the case may be, as under section 1700(a) (1) or (3). In the case of a box, if there is no comparable box for the use of which on single occasions admission charges are made, the tax is to be computed by determining the amount for which a single box seat in the same part of the house is sold, multiplying that amount by the number of seats in the box, and calculating the tax at the applicable percentage rate. If there is no box located in a similar position, the tax is to be computed by determining the amount for which a single seat in the same part of the house is sold, multiplying that amount by the number of seats in the box, and calculating the tax accordingly. The following examples (based upon a tax rate of 20 percent) will illustrate the application of the general rules of this section:

(B) By inserting at the end thereof the following new paragraph:

(b) *Rate of tax on permanent use or lease of boxes or seats.*—The rates of tax applicable to the permanent use, or lease for the use, of a box or seat in any opera house or other place of amusement, are as follows:

Period of use	*Rate*
July 1, 1940 to March 31, 1944, inclusive	11 percent
April 1, 1944 to March 31, 1954, inclusive	20 percent
On or after April 1, 1954	
(1) Horse and dog race tracks	20 percent
(2) All other places	10 percent

The reduced rate of 10 percent for admission to "all other places" applies only in those cases where all the performances or exhibitions at which the box or seat is used or reserved by or for the lessee or holder can occur only on or after April 1, 1954, regardless of the time payment is made for the permanent use or lease of the box or seat. For special provisions relating to payment, credit, or refund of the admissions tax in cases where the tax was collected prior to April 1, 1954, at the 20 percent rate and all the performances or exhibitions can occur only on or after April 1, 1954, see section 101.43a.

PAR. 10. Immediately preceding section 101.9 there is inserted the following:

SEC. 201. TAX ON ADMISSIONS [EXCISE TAX REDUCTION ACT OF 1954, APPROVED MARCH 31, 1954].

* * * * * * *

(b) SALES OUTSIDE BOX OFFICE.—Section 1700(c)(1) (relating to tax on sales outside box office) is hereby amended by striking out "11 per centum" and inserting in lieu thereof "10 per centum".

* * * * * * *

(g) ADMISSIONS TO CERTAIN RACE TRACKS—

* * * * * * *

(3) Section 1700(c) (relating to rate of tax on sales outside box office) is hereby amended—

(A) by striking out "paragraph (1) of subsection (a)" and inserting in lieu thereof "paragraph (1) or (3) of subsection (a)"; and

(B) by inserting after "per centum" the following: "(20 per centum if paragraph (3) of subsection (a) applies)".

* * * * * * *

SEC. 203. EFFECTIVE DATE OF TITLE II [EXCISE TAX REDUCTION ACT OF 1954, APPROVED MARCH 31, 1954].

* * * The amendment made by subsection (b) [201(b)] shall apply only with respect to amounts paid on or after April 1, 1954, for admission on or after such date.

SEC. 504. TECHNICAL AMENDMENTS [EXCISE TAX REDUCTION ACT OF 1954, APPROVED MARCH 31, 1954].

(a) TERMINATION OF TAX RATES UNDER SECTION 1650.—Section 1650 (relating to war tax rates of certain miscellaneous taxes) is hereby amended by inserting after "beginning with the effective date of title III of the Revenue Act of 1943" the following: "and ending March 31, 1954".

* * * * * * *

SEC. 505. EFFECTIVE DATES [EXCISE TAX REDUCTION ACT OF 1954, APPROVED MARCH 31, 1954].

* * * * * * *

(c) The amendment made by section 504(a) shall apply—

* * * * * * *

(2) insofar as it affects the rates of the taxes imposed by subsections * * * (c) * * * of section 1700 of the Internal Revenue Code, as though the rates listed under the heading "Old Rate" in the table in section 1650 of such Code were the rates established by the amendments made by title II of this Act;

* * * * * * *

PAR. 11. Section 101.11, as amended by Treasury Decision 5349, is further amended as follows:

(A) By inserting immediately preceding the first sentence of the first paragraph thereof "(a) *General rules.*".

(B) By striking out the second sentence of the first paragraph (26 CFR 101.11(a)) and inserting in lieu thereof the following:

The tax is determined by applying the appropriate percentage to the amount by which the selling price exceeds the sum of the regular or established price and the tax thereon (see section 101.4). The appropriate percentages are: 20 percent, with respect to (1) an amount paid before April 1, 1954, for admission at any time, (2) an amount paid after March 31, 1954, for admission before April 1, 1954, (3) an amount paid on or after April 1, 1954, for admission on or after such date to a place if the principal amusement or recreation offered with respect to such admission is horse or dog racing at a race track; 10 percent, with respect to an amount paid on or after April 1, 1954, for admission on or after such date to any place of amusement other than a place where the principal amusement or recreation offered with respect to such admission is horse or dog racing at a race track.

(C) By changing the second paragraph thereof (26 CFR 101.11(b)) to read as follows:

In determining the amount of the excess charge, the amount of any tax imposed under section 1700(a)(1) or (3) is always added to the regular or established price and the sum so obtained is subtracted from the selling price. The remainder represents the excess charge, and the applicable percentage rate of tax applies to that amount. Thus, by way of illustration, if a ticket broker sells for $6.00 a ticket or card of admission to a theater the regular or established price of which is $4.00, plus the applicable admission tax (80 cents or 40 cents, as the case may be), the excess charge and the tax due thereon are determined as follows:

	Sale by broker before April 1, 1954	*Sale by broker on or after April 1, 1954, for admissions on or after such date*
Established price	$4.00	$4.00
Admission tax (1 cent for each 5 cents)	.80	----------
Admission tax (1 cent for each 10 cents)	----------	.40
Total	4.80	4.40
Sale price	$6.00	$6.00
Difference, representing taxable excess charge	1.20	1.60
Tax due at 20 percent	.24	----------
Tax due at 10 percent	----------	.16

(D) By inserting "or (3)" immediately following "1700(a)(1)" at the end of the first sentence of the sixth paragraph thereof (26 CFR 101.11(f)).

(E) By inserting immediately following the sixth paragraph thereof (26 CFR 101.11(f)) and immediately preceding the first example, the following new paragraph:

The following examples (based upon a tax rate of 20 percent of the excess charge) will illustrate the application of this section:

PAR. 12. Section 101.12, as amended by Treasury Decision 5349, is further amended by inserting after the words "40 cents" in the parenthetical phrase of the first sentence of the example the following: ", based on the rate of 1 cent for each 5 cents or major fraction thereof", and by adding at the end of the example the following new sentence:

If in this example the broker resold the ticket on or after April 1, 1954, his liability for the tax on the excess charge over the established price would be 5 cents (that is, 10 percent of the 50 cents excess).

PAR. 13. Immediately preceding section 101.13 there is inserted the following:

SEC. 201. TAX ON ADMISSIONS [EXCISE TAX REDUCTION ACT OF 1954, APPROVED MARCH 31, 1954].

* * * * * * *

(c) CABARETS, ROOF GARDENS, ETC.—The first sentence of section 1700(e)(1) (relating to tax on cabarets, roof gardens, etc.) is hereby amended to read as follows: "A tax equivalent to 20 per centum of all amounts paid for admission, refreshment, service, or merchandise, at any roof garden, cabaret, or other similar place furnishing a public performance for profit, by or for any patron or guest who is entitled to be present during any portion of such performance."

* * * * * * *

(g) ADMISSIONS TO CERTAIN RACE TRACKS.—

* * * * * * *

(4) The last sentence of section 1700(e)(1) (relating to tax on cabarets, roof gardens, etc.) is hereby amended by striking out "subsection (a) (1)" and inserting in lieu thereof "paragraph (1) or (3) of subsection (a)".

* * * * * * *

SEC. 203. EFFECTIVE DATE OF TITLE II [EXCISE TAX REDUCTION ACT OF 1954, APPROVED MARCH 31, 1954].

The amendments made by section 201 * * * shall apply only with respect to amounts paid for admissions on or after April 1, 1954. * * *

* * * * * * *

SEC. 504. TECHNICAL AMENDMENTS [EXCISE TAX REDUCTION ACT OF 1954, APPROVED MARCH 31, 1954].

(a) TERMINATION OF TAX RATES UNDER SECTION 1650.—Section 1650 (relating to war tax rates of certain miscellaneous taxes) is hereby amended by inserting after "beginning with the effective date of title III of the Revenue Act of 1943" the following: "and ending March 31, 1954,".

* * * * * * *

SEC. 505. EFFECTIVE DATES [EXCISE TAX REDUCTION ACT OF 1954, APPROVED MARCH 31, 1954].

* * * * * * *

(c) The amendment made by section 504(a) shall apply—

* * * * * * *

(2) insofar as it affects the rates of the taxes imposed by subsections * * * (e) of section 1700 of the Internal Revenue Code, as though the rates listed under the heading "Old Rate" in the table in section 1650 of such Code were the rates established by the amendments made by title II of this Act;

* * * * * * *

PAR. 14. Section 101.13, as amended by Treasury Decision 5385 [C. B. 1944, 637], approved June 30, 1944, is further amended by inserting in the last sentence of the section "or (3)" immediately following "(a)(1)".

PAR. 15. Immediately preceding section 101.15 there is inserted the following:

SEC. 201. TAX ON ADMISSIONS [EXCISE TAX REDUCTION ACT OF 1954, APPROVED MARCH 31, 1954].

* * * * * * *

(h) CERTAIN ATHLETIC GAMES FOR BENEFIT OF HOSPITALS FOR CRIPPLED CHILDREN.—Section 1701 (a)(2) (relating to nonexempt admissions) is hereby amended by striking out "between two elementary or secondary schools" and inserting in lieu thereof the following: "between teams composed of students from elementary or secondary schools".

(i) EXEMPTION OF SCHOOL OR COLLEGE ATHLETIC EVENTS.—Section 1701 (a)(2) (relating to nonexempt admissions) is hereby amended by adding at the end thereof the following new sentence: "Clauses (A) and (B) shall not apply in the case of any athletic event between educational institutions held during the regular athletic season for such event, if the proceeds therefrom inure exclusively to the benefit of such institutions."

(j) HISTORIC SITES, MUSEUMS, AND PLANETARIUMS.—Section 1701 (e)(2) (relating to exemption from admissions tax of historic sites) is hereby amended to read as follows:

"(2) HISTORIC SITES, MUSEUMS, AND PLANETARIUMS.—Any admission to an historic site, house, or shrine, to a museum of history, art, or science, to a planetarium, or to any exhibition in connection with any of the foregoing, operated—

"(A) by any State or political subdivision thereof or by the United States or any agency or instrumentality thereof—if the proceeds therefrom inure exclusively to the benefit of the State, political subdivision, United States, agency, or instrumentality, or

"(B) by any society or organization not organized for profit—if no part of the net earnings thereof inures to the benefit of any private stockholder or individual.

For purposes of subparagraph (A), the term 'State' includes Alaska, Hawaii, and the District of Columbia."

(k) CERTAIN AMATEUR THEATER PERFORMANCES.—Section 1701 (relating to exemptions from the admissions tax) is hereby amended—

(1) by striking out the period at the end of subsection (e) and inserting in lieu thereof "; or "; and

(2) by adding at the end thereof a new subsection as follows:

"(f) CERTAIN AMATEUR THEATER PERFORMANCES.—Any admission to an amateur performance presented and performed by a civic or community theater group or organization—if no part of the net earnings thereof inures to the benefit of any private stockholder or individual."

SEC. 203. EFFECTIVE DATE OF TITLE II [EXCISE TAX REDUCTION ACT OF 1954, APPROVED MARCH 31, 1954].

The amendments made by section 201 (other than subsection (b) thereof) shall apply only with respect to amounts paid for admissions on or after April 1, 1954. In addition, such amendments shall apply—

(1) in the case of any season ticket or subscription, only if all the admissions under such ticket or subscription can occur only on or after April 1, 1954; and

(2) in the case of the permanent use of a box or seat or a lease for the use of such box or seat, only if all the performances or exhibitions at which the box or seat is used or reserved by or for the lessee or holder can occur only on or after April 1, 1954.

The amendment made by subsection (b) shall apply only with respect to amounts paid on or after April 1, 1954, for admissions on or after such date.

PAR. 16. Section 101.15, as amended by Treasury Decision 6007, is further amended as follows:

(A) By amending paragraph (c) to read as follows:

(c) *Nonexempt admissions.*—The exemptions provided by section 1701(a)(1) in the case of events held for the benefit of the organizations specified therein (paragraph (b) (2) through (8) of this section) do not apply with respect to admissions to:

(1) *Athletic games or exhibitions.*—(i) *Prior to April 1, 1954.*—Any athletic game or exhibition held before April 1, 1954, unless the proceeds inure exclusively to the benefit of an elementary or secondary school; or unless, in the case of an athletic game between two elementary or secondary schools the entire gross proceeds from such game inure to the benefit of a hospital for crippled children. (See sec. 101.15(d)(6)(i).)

(ii) *On and after April 1, 1954.*—Except as provided in paragraph (f), any athletic game or exhibition held on or after April 1, 1954, unless—

(*a*) The proceeds inure exclusively to the benefit of an elementary or secondary school; or

(*b*) In the case of an athletic game between two teams composed of students from elementary or secondary schools, the entire gross proceeds from such game inure to the benefit of a hospital for crippled children; or

(*c*) In the case of any athletic game or exhibition between educational institutions held during the regular athletic season for such event, the proceeds from such game or exhibition inure exclusively to the benefit of such participating institutions. Admissions to any athletic game or exhibition between educational institutions held other than during the regular season schedule for such athletic activity, such as a postseason game or exhibition, is not exempt from tax under this subdivision. (See sec. 101.15(d)(6)(ii).)

(2) *Wrestling matches, prize fights, etc.*—(i) *Prior to April 1, 1954.*—Any wrestling match, prize fight, or boxing, sparring, or other pugilistic match or exhibition, held before April 1, 1954, irrespective of the status of the participants, the character of the organization sponsoring the event, or to whom the admission proceeds are payable.

(ii) *On and after April 1, 1954.*—Except as provided in paragraph (f), any wrestling match, prize fight, or boxing, sparring, or other pugilistic match or exhibition, held on or after April 1, 1954, irrespective of the status of the participants, the character of the organization sponsoring the event, or to whom the admission proceeds are payable, except that such event held between educational institutions during the regular athletic season for such event shall be exempt from tax if the proceeds therefrom inure exclusively to the benefit of the participating institutions. This exemption shall not apply to any such event held other than during the regular season schedule for such athletic activity. (See sec. 101.15(d)(7).)

(3) *Carnivals, rodeos, or circuses.*—Any carnival, rodeo, or circus in which any professional performer or operator participates for compensation. It is immaterial whether the professional performer or operator is paid for his services from the admission proceeds or from some other source.

(4) *Motion picture exhibitions.*—Any motion picture exhibition.

(B) By amending paragraph (d)(5) to read as follows:

(5) *Historic sites, etc.*—(i) *Prior to April 1, 1954.*—Admissions prior to April 1, 1954, to historic sites, houses, and shrines, and museums conducted in connection therewith, maintained and operated by a society or organization devoted to the preservation and maintenance of such historic sites, houses, shrines, and museums are exempt from tax, if no part of the net earnings thereof inures to the benefit of any private stockholder or individual. This exemption applies regardless of the disposition made of the proceeds from the admissions. Historic museums not maintained in connection with historic sites, houses, or shrines are not entitled to exemption with respect to admissions thereto.

(ii) *On and after April 1, 1954.*—Except as provided in paragraph (f), admissions on or after April 1, 1954, to an historic site, house, or shrine, to a museum of history, art, or science, or to a planetarium, or to any exhibition in connection with any of the foregoing, is exempt from tax if:

(*a*) Operated by any State (including Alaska, Hawaii, and the District of Columbia) or any political subdivision thereof, or by the United States or any of its agencies or instrumentalities, provided that the proceeds derived therefrom inure to the benefit of such State, political subdivision, the United States, or its agency or instrumentality, or

(*b*) Operated by any society or organization not organized for profit provided that no part of the net earnings thereof inure to the benefit of any private stockholder or individual.

(C) By amending paragraph (d)(6) to read as follows:

(6) *Athletic events.*—(i) *Prior to April 1, 1954.*—Admissions to any athletic game or exhibition held before April 1, 1954, the proceeds of which inure exclusively to the benefit of an elementary or secondary school are exempt from tax. Admissions to any athletic game or exhibition held before April 1, 1954, between two elementary or secondary schools are exempt from tax, if the entire gross proceeds from such game inure to the benefit of a hospital for crippled children. For purposes of this exemption, the term "secondary school" includes any high school, or the equivalent thereof, through grade twelve.

(ii) *On and after April 1, 1954.*—Except as provided in paragraph (f), admissions to—

(*a*) Any athletic game or exhibition held on or after April 1, 1954, the proceeds of which inure exclusively to the benefit of an elementary or secondary school, or

(*b*) Any athletic event or exhibition held on or after April 1, 1954, between teams composed of students from elementary or secondary schools, if the entire gross proceeds from such game inure to the benefit of a hospital for crippled children, or

(*c*) Any athletic event or exhibition between educational institutions held on or after April 1, 1954, and during the regular season schedule for that particular type of athletic activity, if the proceeds from such event inure exclusively to the benefit of the participating institutions.

are exempt from tax. For purposes of this exemption, the term "secondary school" includes any high school or the equivalent thereof through grade twelve.

(D) By adding at the end of paragraph (d) the following new subparagraphs:

(7) *Wrestling matches, prize fights, etc.*—Except as provided in paragraph (f), admissions to any wrestling match, prize fight, or boxing, sparring, or other pugilistic match or exhibition between educational institutions held on or after April 1, 1954, and during the regular season schedule for that particular type of athletic activity are exempt from tax, if the proceeds from such event inure exclusively to the benefit of the participating institutions.

(8) *Amateur theater performances.*—Except as provided in paragraph (f), admissions on or after April 1, 1954, to any amateur theater performance presented and performed by a civic or community group or organization devoted to the presentation of amateur theatricals are exempt from tax, if no part of the net earnings of such group or organization inures to the benefit of any individual or private stockholder. Within the meaning of this section, an amateur theater performance occurs when none of the performers having a part therein receive any compensation for their participation.

(E) By redesignating paragraph (f) thereof as paragraph (g).

(F) By adding after paragraph (e) the following new paragraph:

(f) *Effective date of certain exemptions under the Excise Tax Reduction Act of 1954 in the case of season tickets, etc.*—The exemptions added to section 1701 by subsections (h), (i), (j), and (k) of section 201 of the Excise Tax Reduction Act of 1954 shall apply, in the case of a season ticket, subscription, permanent use of a box or seat, or lease for the use of such box or seat, only if all the admissions under such ticket or subscription, or all the performance or exhibitions at which the box or seat is used or reserved by or for the lessee or holder, can occur only on or after April 1, 1954. In the case of sales outside the box office, such exemptions shall apply only with respect to amounts paid on or after April 1, 1954, for admissions on or after such date.

PAR. 17. Section 101.18, as amended by Treasury Decision 5611 [C. B. 1948–1, 137], approved March 16, 1948, is further amended as follows:

(A) By changing the first table in example (1) to read as follows:

Established price	$1.00
Tax paid	.10
Total	1.10

(B) By changing the second table appearing in example (1) to read follows:

Sold by John Jones,
27 West St., New York City.

Sale price	$1.50
Tax paid	.10
Total sale price	1.60

(C) By Changing the table appearing in example (2) to read as follows:

Sold by Geo. Nelson,
505 West 122 St., New York City.

Sale price	$2.00
Tax paid	.10
Total sale price	2.10

PAR. 18. Section 101.21, as amended by Treasury Decision 5349, is further amended to read as follows:

SEC. 101.21. SIGNS TO BE POSTED.—In the case of every place, admission to which is subject to tax, the proprietor or manager must keep conspicuously posted at the outer entrance and near the box office one or more signs accurately stating each of the prices of admission, and in the case of each such price the tax due and the sum total of the admission price and the tax.

Example. The following is an example of such a sign for use on and after April 1, 1954:

	Admission	*Tax*	*Total*
Box seats	$4. 00	$0. 40	$4. 40
Orchestra	3. 50	0. 35	3. 85
Mezzanine	2. 50	0. 25	2. 75
Balcony	2. 00	0. 20	2. 20
Gallery (except last 4 rows)	1. 00	0. 10	1. 10
Gallery (last 4 rows)	. 50	none	0. 50

PAR. 19. Immediately preceding section 101.22 there is inserted the following:

SEC. 202. TAX ON DUES [EXCISE TAX REDUCTION ACT OF 1954, APPROVED MARCH 31, 1954].

(a) DUES OR MEMBERSHIP FEES.—Section 1710(a)(1) relating to tax on dues or membership fees) is hereby amended by striking out "11 per centum" and inserting in lieu thereof "20 per centum".

(b) INITIATION FEES.—Section 1710(a)(2) (relating to tax on initiation fees) is hereby amended by striking out "11 per centum" and inserting in lieu thereof "20 per centum".

SEC. 504. TECHNICAL AMENDMENTS [EXCISE TAX REDUCTION ACT OF 1954, APPROVED MARCH 31, 1954].

(a) TERMINATION OF TAX RATES UNDER SECTION 1650.—Section 1650 (relating to war tax rates of certain miscellaneous taxes) is hereby amended by inserting after "beginning with the effective date of title III of the Revenue Act of 1943" the following: "and ending March 31, 1954,".

* * * * * * *

PAR. 20. Section 101.31 is amended by adding at the end of the fourth paragraph thereof the following new sentence:

For special provisions relating to payment of the admissions tax collected prior to April 1, 1954, at the rate in effect prior to such date, for admissions on or after such date, see section 101.43a.

PAR. 21. Immediately preceding section 101.41 there is inserted the following:

SEC. 506. SPECIAL CREDIT OR REFUND OF * * * ADMISSIONS TAXES [EXCISE TAX REDUCTION ACT OF 1954, APPROVED MARCH 31, 1954].

Notwithstanding any other provision of law, in any case in which tax has been collected prior to April 1, 1954, at the rate in effect (without regard to the amendments made by this Act) prior to April 1, 1954, * * * for admissions (referred to in section 201, other than subsections (b), (c), and (g) thereof, of this Act) on or after April 1, 1954, the person who collected the tax shall pay the same over to the United States; but credit or refund (without interest) of the tax collected in excess of that applicable (by reason of the amendments made by this Act) on or after April 1, 1954, shall be allowed to the person who collected the tax as if such credit or refund were a credit or refund under the applicable provision of the Internal Revenue Code, but only to the extent that, * * * prior to the event to which the right to admission relates, he has repaid the amount of such excess to the person from whom he collected the tax, or has obtained the consent of such person to the allowance of the credit or refund. * * *

PAR. 22. Immediately following section 101.43 there is inserted the following new section:

SEC. 101.43a. SPECIAL PROVISIONS RELATING TO PAYMENT, CREDIT, AND REFUND UNDER SECTION 506 OF THE EXCISE TAX REDUCTION ACT OF 1954.—(a) *Requirement to pay over tax collected at the old rate.*—Section 506 of the Excise Tax Reduction Act of 1954 requires every person to pay over to the United States any tax on admissions referred to in section 1700 (a) (1) or (b) collected by him prior to April 1, 1954, at the rate in effect prior to such date, for admissions on or after such date. See paragraph (b) of this section for rules relating to the credit or refund of the excess collection of such taxes.

(b) *Credit or refund.*—(1) *In general.*—Section 506 of the Excise Tax Reduction Act of 1954 provides that a credit or refund shall be allowed (as if such credit or refund were a credit or refund under the applicable provisions of the Internal Revenue Code) to any person who, prior to April 1, 1954, collected any tax on admissions referred to in section 1700 (a) (1) or (b), at the rate in effect prior to such date, for admissions on or after such date.

(2) *Amount.*—The amount to be credited or refunded is the excess of the tax collected at the rate in effect prior to April 1, 1954, over the tax at the rate in effect on and after such date. A claim for refund may be filed on Form 843 for the amount of such excess, or credit for such amount may be taken against the tax shown to be due on a subsequent return. The claim for refund should be filed with the District Director for the internal revenue district in which the amount claimed was paid.

(3) *Conditions precedent.*—The credit or refund will be allowed only if all the following conditions are met:

(i) The tax has been collected at the rate in effect prior to April 1, 1954;

(ii) Such tax actually has been paid over to the United States by the person claiming the credit or refund; and

(iii) Prior to the event to which the right to admission relates, such person either has repaid the amount of such excess to the person from whom he collected the tax or has obtained the written consent of such person to the allowance of the credit or refund of such amount.

(4) *Evidence required.*—In order to obtain a credit or refund under section 506 of the Excise Tax Reduction Act of 1954 and this section, the claimant must have satisfactory evidence to substantiate his right to such credit or refund, such as a signed, dated statement from the ticket purchaser showing his name and address and the fact that such purchaser has obtained a refund of the excess tax or has consented to the allowance of the credit or refund of such excess tax to the claimant.

(5) *Interest.*—No interest shall be allowed with respect to any amount of tax refunded or credited under the provisions of this section.

(This Treasury Decision is issued under the authority contained in section 3791 of the Internal Revenue Code of 1939 (53 Stat. 467; 26 U. S. C. 3791).)

O. GORDON DELK,
Acting Commissioner of Internal Revenue.

Approved September 26, 1955.

H. CHAPMAN ROSE,
Acting Secretary of the Treasury.

(Filed by the Division of the Federal Register September 28, 1955, 8:52 a. m.)

Rev. Rul. 55-527

Clarification of Revenue Ruling 175, C. B. 1953-2, 327, with respect to the application of the tax on admissions, imposed by section 1700 of the Internal Revenue Code of 1939, to amounts paid to commercial beach clubs for "membership fees" and for the rental of cabins and cabanas, and to amounts paid to ocean front hotels for the rental of cabins and cabanas maintained by the hotels.

Clarification of Revenue Ruling 175, C. B. 1953-2, 327, has been requested with respect to the application of the tax on admissions,

imposed by section 1700 of the Internal Revenue Code of 1939, to amounts paid to commercial beach clubs as "membership fees" and for the rental of cabins and cabanas, and to amounts paid to ocean front hotels for the rental of cabins and cabanas maintained by such hotels.

The beach clubs are owned and operated by private enterprises. In each case the club property includes a bathing beach on the ocean front. Located on the property are cabins, cabanas, and facilities for dining, dancing and other entertainment. Admission to the clubs and use of their facilities is limited to those designated as "members" and to their guests. "Members" are those persons who have paid "membership fees" for which they receive membership cards entitling them and a limited number of guests to enter the club property for the season and to use the beach, surf and other facilities. The "members," however, have no voice in the management of the enterprise nor do they have any of the usual privileges granted to members of a membership club, as contemplated by section 1710 of the Code, relating to the tax on dues and initiation fees.

The hotels are located on the ocean front and, in addition to their principal business of renting rooms, also maintain cabins and cabanas which they rent to their patrons and to others. No club or membership organization exists. Hotel patrons usually are not required to rent a cabin or cabana as a condition to admission to the swimming pool or other facilities, but may do so for their own convenience. Other persons, however, must rent a cabin or cabana in order to be admitted to such facilities.

Revenue Ruling 175, *supra*, holds that where a seasonal lease of a cabin or cabana from a club, which does not qualify as a social, athletic, or sporting club or organization within the meaning of section 1710 of the Code, entitles the lessee and his family to admission to the club grounds and to use the facilities maintained by the club, the charges made for the lease of the cabin or cabana, as well as daily charges for guests, constitute charges for the right of admission and, as such, are subject to the tax on admissions imposed by section 1700(a) of the Code.

The principles laid down in Revenue Ruling 175, *supra*, to the effect that charges made by a commercial beach club for the seasonal lease of cabins and cabanas to gain admission to a bathing beach area and to the use of the facilities constitute charges for admission, apply to any charge which must be paid in order to gain admission. Thus, where a person can secure the right of admission to the premises of the beach club and the use of the facilities only by payment of the fee designated as a "membership fee," payment of such a fee is, in fact, payment for admission to the club premises and use of the facilities, and is subject to the admissions tax. Likewise, where, in addition to the "membership fee," the rental of a cabin or cabana is required in order to be entitled to use of the beach facilities, the amount paid for the rental of the cabin or cabana is also a payment for admission and is subject to the admissions tax.

If, however, the member of such a club is not required to rent a cabin or cabana in order to be entitled to the use of the beach and swimming facilities, but can secure the right to use these facilities upon payment of the membership fee alone, then the amount paid for

the cabin or cabana is considered a payment for service and not for admission and, therefore, is not subject to the admissions tax.

The same general principles apply in a case where oceanfront hotels maintain cabins and cabanas which they rent to their patrons and to others. If the hotel patron is not required to rent a cabin or cabana in order to be entitled to use of the hotel beach and swimming facilities, but does so for his own convenience, the amount paid for the rental of the cabin or cabana is not a payment for admission and therefore is not subject to the admissions tax. But, if the hotel patron is not admitted to the hotel beach and swimming facilities unless he rents a cabin or cabana, the amount paid as rental is subject to the admissions tax. Likewise, the amounts paid by persons other than patrons for rental of the cabins and cabanas maintained by the hotel are subject to the admissions tax, since the rental of the cabin or cabana entitles those persons to admission to the hotel beach and swimming facilities. The tax applies whether the rental is on a daily, weekly, monthly, or yearly basis.

Application of the tax to the amount paid for a number of single tickets, one valid for admission to each game of the season. See Rev. Rul. 55–719, page 459.

SECTION 1701.—EXEMPTIONS FROM TAX

REGULATIONS 43, SECTION 101.15: Exemptions from tax. Rev. Rul. 55–575

> Welfare funds maintained and operated by the Armed Forces of the United States do not qualify as charitable organizations within the meaning of section 1701(a)(1)(A)(iii) of the Internal Revenue Code of 1939 and, therefore, are not entitled to the benefit of the exemption provided by that section with respect to charges for admissions, the proceeds of which inure to such funds.

There is no provision of law which would exempt admission charges from tax merely because the affair to which admission is obtained may be conducted or sponsored by an instrumentality of the United States. However, the question has been presented as to whether welfare funds, maintained and operated by the Armed Forces of the United States in the manner described below, might qualify as charitable organizations for the purpose of the exemption from admissions tax provided by section 1701(a)(1)(A)(iii) of the Internal Revenue Code of 1939.

The welfare funds are created for the purpose of raising revenue, by means of charges for admission to entertainments and contributions from the general public, to complement the benefits supplied by appropriated monies from the United States for use in improving living conditions of armed forces personnel stationed at United States bases, camps, etc. These nonappropriated funds are established in accordance with regulations of the military departments of the United States, and their supervision and operation are responsibilities of those departments. They are not separate entities but are among the many funds maintained and operated by the military departments. As such, they are considered wholly-owned instrumentalities of the United

States and all properties acquired by them are titled in the United States and become attached to Government owned realty. See Revenue Ruling 54–556, C. B. 1954–2, 369.

Under the provisions of section 1701(a)(1)(A)(iii) of the Code, exemption is granted with respect to admissions, all the proceeds of which inure to the benefit of certain charitable organizations operating on a nonprofit basis. In order for an organization to be entitled to the exemption under the provisions of that section, it must meet certain requirements. The law provides that for the exemption to apply an organization must be organized and operated exclusively for charitable purposes, exempt under section 101(6) of the Code, and supported, in whole or in part, by funds contributed by the United States or any State or political subdivision thereof or primarily supported by contributions from the general public.

It is held that since these nonappropriated welfare funds maintained and operated by the Armed Forces of the United States are not separate entities organized and operated exclusively for charitable purposes, they do not qualify as charitable organizations within the meaning of section 1701(a)(1)(A)(iii) of the Code. Accordingly, all admissions to affairs, the proceeds of which inure to these funds, are subject to the tax on admissions imposed by section 1700 of the Code.

Rev. Rul. 55–684

Applicability of the exemption from admissions tax, provided by section 1701(a) of the Internal Revenue Code of 1939, to charges for admissions to a theatre or other place to view a televised showing of an event taking place simultaneously at a different location.

Advice has been requested concerning the applicability of the exemption from admissions tax, provided by section 1701(a) of the Internal Revenue Code of 1939, to charges for admission to a theatre or other place to view a televised showing of an event taking place simultaneously at a different location.

In the instant case a charitable organization which qualifies for exemption from admissions tax under section 1701(a)(1)(A)(iii) of the Code leased a theatre for use in presenting televised showings of prize fights directs from the ringside by means of closed-circuit transmission facilities. All of the proceeds from the charges for admissions inured to the charitable organization.

Section 1701(a)(1)(A) of the Code provides for exemption from admissions tax where the proceeds from the admissions inure exclusively to certain religious, educational, charitable or other organizations operating on a nonprofit basis except where the charges are for admissions to certain nonexempt affairs specified in section 1701(a)(2) of the Code. Such nonexempt affairs include wrestling matches, prize fights, or boxing, sparring, or other pugilistic matches or exhibitions. Motion picture exhibitions are also included among such nonexempt affairs.

The Internal Revenue Service has concluded that a live televised show or performance comes within the field of graphic arts since it loses its live characteristics and becomes an animated graphic presentation. For example, the action of the moving images participating

in a prize fight as reflected on a screen is not in and of itself a prize fight, but rather it is a graphic reproduction of a prize fight.

A motion picture exhibition also comes within the field of graphic arts, and a television action reflected on a screen is very similar to the action in a motion picture exhibition. Yet, the almost instantaneous reproduction of the original action in graphic form of a televised event or show and the electronic devices and methods of transmission distinguish it from a motion picture exhibition.

It is held that admissions to a theatre or other place to view a televised showing of an event taking place simultaneously at a different location do not come within the category of nonexempt admissions as contained in section 1701(a)(2) of the Code, even though the event in itself is one of those specifically excluded from exemption by that section, and it is shown on a screen similar to a motion picture screen. Accordingly, charges for admission to live televised showings of affairs or events, whether of opera, drama, sporting events, prize fights or notable public events are not subject to the admissions tax if the proceeds from the admission charges inure exclusively to an organization which qualifies for exemption from the tax.

SUBCHAPTER B.—DUES

SECTION 1710.—TAX

Application of the statutory period of limitation to powers of attorney executed by members of a club in support of a refund claim filed for them for dues tax. See Rev. Rul. 55–602, page 650.

SECTION 1712.—DEFINITIONS

REGULATIONS 43, SECTION 101.22: Meaning of dues or membership fees. (Also Section 101.28.) — Rev. Rul. 55–576

Pursuant to a plan to raise funds for a building program, members of a club, which qualifies as a social, athletic, or sporting club or organization within the meaning of section 1710 of the Internal Revenue Code of 1939, entered into an agreement with the club to advance specified amounts to the club in the form of loans. Although the club expects all members, regardless of their class of membership, to participate in this program, the agreement provides that whether or not a member advances any funds under the loan arrangement in no way affects the enjoyment of membership rights and privileges in the club. Under the agreement the club guarantees repayment to the members of the amounts advanced. *Held*, advances made to a club pursuant to such an agreement are considered to be voluntary loans and do not constitute assessments within the meaning of section 1712(a) of the Code. Accordingly, such advances are not subject to the tax on dues or membership fees imposed by section 1710(a)(1) of the 1939 Code. Furthermore, since the enjoyment of membership rights and privileges

in the club by persons who are already members is in no way affected by the making of such loans or the refusal to make such a loan, the loans are not considered to be made as a condition precedent to membership and do not constitute initiation fees within the meaning of section 1712(b) of the 1939 Code. Therefore, the advances are not subject to the tax on initiation fees imposed by section 1710(a)(2) of the Code. If, however, such advances are required of new members or of members electing to acquire a new or different membership as a condition precedent to membership, the amounts thereof are clearly initiation fees within the meaning of section 1712(b) of the Code and subject to the tax imposed by section 1710(a)(2) of the Code.

Rev. Rul. 55-533

Applicability of tax, as imposed upon dues and initiation fees by section 1710 of the Internal Revenue Code of 1939, to certain assessments or contributions paid to a social, athletic or sporting club or organization, when such payments are fixed in prorated or uniform allocations on the basis of membership privileges or the class of membership held.

Subsequent to the decision of the United States Court of Claims in the case of *Century Country Club* v. *United States*, 116 Fed. Supp. 727, reconsideration has been given to the question of applicability of tax, as imposed upon dues and initiation fees by section 1710 of the Internal Revenue Code of 1939, to certain assessments or contributions paid to a social, athletic or sporting club or organization by its members, when such payments are fixed in prorated or uniform allocations on the basis of membership privileges or the class of membership held.

Section 1710 of the Code imposes a tax upon amounts paid as dues or membership fees to any social, athletic or sporting club or organization, if the dues or fees of an active resident annual member are in excess of $10 per year. Section 1712 defines the term "dues" to include any assessment, irrespective of the purpose for which made.

Such a club or organization being an association of individuals joined together for a common cause, it follows that the individual members have undertaken to share the necessary expenses in pursuit of the club's purposes and activities. If by reason of any contingency, recurring or special, the fixed annual membership fees are not sufficient to meet all costs of operating the club, it is a common practice for the club to levy assessments against its members, either by action of its board of directors or by action of the membership.

It has been the opinion of the Internal Revenue Service that such assessments, when fixed in prorated or uniform allocations on the basis of membership privileges or the class of membership held, were "dues" as defined in section 1712 of the Code. However, it has been contended that if, by reason of State law or otherwise, the club is without legal authority to enforce the collection of such assessments, any payments made thereon are in the nature of "contributions" and not taxable. Several court decisions upheld this contention and the weight of those decisions prompted the issuance of rulings and the allowance of claims based upon nontaxable treatment of such payments.

In the more recent Century Country Club case, the plaintiff contended that under the applicable State statute a membership corporation has only those powers conferred by its charter or certificate of incorporation, and that since the certificate of plaintiff did not confer the power to levy such assessments they were not legally enforceable and therefore not taxable. The court held that it did not regard this position as tenable and stated that if this position were correct neither dues nor assessments would have been enforceable, since the certificate does not specifically authorize either, in which event there would have been no way to finance the operation of the club or to accomplish its objects. The court stated that it was the clear intention of Congress as expressed in the legislative enactment that a tax should apply to transactions of this kind where the assessments were levied and collected for the general purposes and operations of the club.

In view of the decision in the Century Country Club case, it is now held that where, for the purpose of carrying on the objectives of a social, athletic or sporting club, its members are subjected to assessments or are requested to contribute amounts fixed in prorated or uniform allocations on the basis of membership privileges or the class of membership held, any amounts so paid constitute "dues" within the meaning of section 1712 of the Code and are subject to the tax imposed by section 1710, regardless of whether the club has the authority to enforce the collection of such an obligation.

Since many clubs, relying upon the earlier court decisions and the consequent rulings of the Service, failed to collect the tax from their members on such assessments or contributions, it has been concluded that under the authority contained in section 3791(b) of the 1939 Code and section 7805(b) of the 1954 Code, the ruling set forth herein will not be applied retroactively with respect to such amounts which were paid by members prior to August 22, 1955, except that any tax which has been paid on such amounts will not be refunded.

REGULATIONS 43, SECTION 101.28: Initiation fees.

Voluntary loans made to a club by its members. See Rev. Rul. 55-576, page 641.

CHAPTER 11—DOCUMENTS, OTHER INSTRUMENTS, AND PLAYING CARDS

SUBCHAPTER A.—RATE AND PAYMENT OF TAX

SECTION 1802.—CAPITAL STOCK (AND SIMILAR INTERESTS)

REGULATIONS 71, SECTION 113.33: Sales and transfers subject to tax. Rev. Rul. 55-685

Where a testator, a resident of Hawaii, leaves shares of stock to two or more persons "in equal shares" (or other equivalent expression),

documentary stamp tax is applicable to such transfer since, under the law of the Territory of Hawaii, title to personal property vests directly in the beneficiaries as tenants in common and not in the personal representative of the decedent. The subsequent split-up of the shares of stock between or among the several beneficiaries individually will be another transfer to which the stamp tax also will apply.

Rev. Rul. 55-686

Applicability of the documentary stamp tax, imposed by Section 1802(b) of the Internal Revenue Code of 1939, to the transfer of capital stock pursuant to the will of a decedent who had been domiciled in a community property state.

Advice has been requested concerning the application of the documentary stamp tax, imposed by section 1802 (b) of the Internal Revenue Code of 1939, when shares of stock are transferred under the following-described circumstances.

A resident of California, a community property state, died testate in 1952, and was survived by his widow who qualified as the executrix of his estate. In the corpus of the estate were 12,000 shares of no par value common stock which were registered in the name of the decedent. This stock had been acquired in 1908 or thereafter (but prior to July 29, 1927) entirely out of community earnings of the husband and wife. The decedent bequeathed to his wife one-half of all shares of stock which he should own at the date of his death, and the residue of his property was bequeathed to a trustee to hold, manage, and control in accordance with prescribed instructions.

Section 1802 (b) of the Code imposes a stamp tax on all sales and transfers of legal title to any shares or certificates of corporate stock, including transfers of rights to receive such stock.

Section 113.33 of Regulations 71 provides that transfers of stock by an administrator or executor to a distributee or legatee and the transfer of stock to or by trustees are subject to tax.

Effective July 29, 1927, section 161a was added to the Civil Code of California providing that the respective interests of the husband and wife in community property during continuance of the marriage relationship are present, existing and equal interests under management and control of the husband. Until adoption of this section, the wife had no vested interest in community property. Since the community property in this case was acquired prior to July 29, 1927, the wife did not have a vested one-half undivided interest in such community property. However, since the Superior Court of the State of the decedent held the property of the estate to be community property, the wife became entitled to receive one-half of the stock by inheritance. She also received one-half of the remaining shares by testamentary disposition. The balance of the shares (3,000) were bequeathed by the testator to his testamentary trustee.

Accordingly, it is held that the transfer of 9,000 shares direct from the name of the decedent to the name of the widow is subject to the transfer tax as imposed by section 1802 (b) of the Code, and the transfer of the remaining 3,000 shares to the testamentary trustee is also subject to the transfer tax.

Rev. Rul. 55-687

Applicability of the documentary stamp tax, imposed by section 1802(b) of the Internal Revenue Code of 1939, to the transfer of shares of stock of a testator in accordance with testamentary provisions and applicable State law.

Advice has been requested whether one or two taxable transfers are involved where a decedent left his property, including shares of stock, to his wife for life and at her death the residue of the estate to go to his son and daughter.

Section 1802(b) of the Internal Revenue Code of 1939 provides that the documentary stamp tax, with certain exemptions not here material, is applicable to all sales or transfers of legal title to any shares or certificates of capital stock.

Section 1802(c) of the Code provides that no tax shall be imposed upon the delivery or transfer from a decedent to his executor or administrator.

Section 113.33 of Regulations 71 provides that the following are taxable transactions: (a) transfers by gift, (b) transfers by an administrator or executor to a distributee or legatee, (c) transfers to or by trustees, (d) transfers from persons holding legal title as tenants in common, as joint tenants, or as tenants by the entirety, to the same persons separately to effect a partition.

Since the laws in the various States are not uniform with respect to the passage of title to decedents' property, the following tax consequences may occur in the factual situations stated herein:

A decedent left his estate, including shares of stock, to his wife for life with the right to use the income and as much of the principal as may be necessary for her comfort and support, and at her death, the residue of the estate to go to his son and daughter. The executor did not actually make a physical transfer of the stock to the name of the life tenant but held the stock in the name of the decedent until the death of the life tenant and then transferred the stock to the children.

Where State law provides that title to personal property of a testator passes to his personal representative, a transfer tax is not incurred upon the passing of title to stock from the name of the decedent to the name of his personal representative, as such transfer is specifically exempt under section 1802(c) of the Code. Where a life estate is interposed and the personal representative continues to hold the legal title of the stock until final distribution thereof to the remaindermen, the estate not being closed prior to such distribution, the transfer of the stock to the remaindermen will incur transfer tax imposed by section 1802(b) of the Code. Where shares are transferred to the remaindermen as tenants in common and subsequently a division or split-up is effected, a tax is also incurred on the transfer to the several tenants, individually, of their respective shares.

Where State law provides that title to personal property of a testator passes directly to his legatees, title to shares of stock bequeathed to the testator's son and daughter in equal shares shall vest immediately upon the death of the testator in his son and daughter as tenants in common. This passage of title is subject to the stock transfer tax. The subsequent division of the property is also subject to a transfer tax as it involves a transfer of title to the stock from the beneficiaries as tenants in common to themselves individually. If the testator be-

queathed specific shares or a specific number of shares to his son and daughter individually, one transfer tax is incurred on the transfer to the respective heirs of the shares to which they are entitled.

Where a testator did not leave his property to his heirs but left it in trust for the benefit of his widow with a direction in the testamentary trust that upon the death of the life beneficiary the corpus of the trust should be distributed to his children, the title of the property passed upon the death of the testator to either his personal representative or the trustee, depending on State law. This passage of title from the decedent, or from his personal representative, to the trustee is subject to the stock transfer tax as provided in section 113.33 of Regulations 71. The subsequent transfer of the stock by the trustee to the decedent's children, is also subject to the transfer tax.

CHAPTER 19.—RETAILERS' EXCISE TAXES

REGULATIONS 51, SECTIONS 320.0, 320.2, 320.10, 320.38, 320.42, 320.51, 320.61

The above sections have been amended to reflect changes required by the Excise Tax Reduction Act of 1954. See T. D. 6139, page 674.

SECTION 2400.—TAX ON JEWELRY, ETC.

REGULATIONS 51, SECTION 320.33: Articles made of, or ornamented, mounted or fitted with, precious metals or imitations thereof. Rev. Rul. 55-548

> Inlays, such as initials or game scenes, which are set and tooled into steel surfaces of guns belonging to sportsmen or gun collectors, constitute articles subject to the retailers' excise tax under section 2400 of the Internal Revenue Code of 1939 when made of, or ornamented, mounted or fitted with, precious metals or imitations thereof.

Advice has been requested whether the retailers' excise tax applies to 24K gold inlays which a gun engraver sets and tools into steel surfaces of guns belonging to sportsmen or gun collectors. The inlays, which are produced from gold furnished by the gun engraver, may include the initials of the owner of the gun or game scenes, such as pheasants, ducks and dogs.

Section 2400 of the Internal Revenue Code of 1939 imposes a tax on the sale at retail of articles made of, or ornamented, mounted or fitted with, precious metals or imitations thereof.

According to the provisions of section 320.33 of Regulations 51 the term "precious metals" includes platinum, gold, silver, and other metals of similar or greater value. The term "imitations thereof" includes alloys of precious metals and platings of such metals which are one one-hundred-thousandth of an inch or more in thickness. See S. T. 935, C. B. 1948-2, 192.

It is held that inlays, such as initials or game scenes, constitute taxable articles under section 2400 of the Code, when made of, or ornamented, mounted or fitted with, gold or other precious metals or

imitations thereof. Under the circumstances in the instant case the tax is applicable to the total charge made by the gun engraver to his customers for the gold inlays, including any labor charge for producing them.

Rev. Rul. 55-588

Determination of amounts subject to retailers' excise tax on sales of wooden gavels and sterling silver bands to be fitted thereon.

Advice has been requested concerning the amounts subject to the retailers' excise tax, imposed by section 2400 of the Internal Revenue Code of 1939, on sales of wooden gavels and sterling silver bands to be fitted thereon.

A retailer who sells plain wooden gavels also sells different styles of sterling silver bands which may be affixed to the gavels. A customer may purchase a gavel and select a silver band which he desires to have attached and engraved in a specified manner. The retailer's sales invoice lists separately the selling price of the gavel, the selling price of the silver band, and the charge for the engraving.

The tax imposed by section 2400 of the Code is applicable, among other things, to the sales at retail of articles ornamented, mounted or fitted with, precious metals or imitations thereof. The term "precious metals" includes platinum, gold, silver, and other metals of similar or greater value. The term "imitations thereof" includes platings and alloys of such metals.

A wooden gavel, as such, is not subject to the tax. But a wooden gavel having one or more bands of silver attached, whether for ornamentation or for a utilitarian purpose, is considered to be taxable as an article ornamented, mounted, or fitted with a precious metal. The tax attaches to the full price for which a gavel so ornamented is sold at retail.

A silver band is, of course, taxable as an article made of a precious metal. Where a retailer sells a wooden gavel and at the same time makes a separate sale to the same customer of a silver band to be attached to the gavel, the tax applies only to the sale of the silver band, even though the attachment of the band to the gavel may be made by the retailer. Charges for engraving any taxable article may be excluded from the tax base provided they are shown separately on the invoice furnished the customer or otherwise established by the records of the retailer.

Regulations 51, Section 320.74: Returned goods; price adjustment. Rev. Rul. 55-562

Application of the retail sales tax on jewelry, etc., imposed by section 2400 of the Internal Revenue Code of 1939, to sales involving trade-in transactions.

Advice has been requested concerning the method of computing the retail sales tax on jewelry, etc., imposed by section 2400 of the Internal Revenue Code of 1939, where sales involve trade-in transactions.

A retail jewelry company sells its merchandise on credit. In many instances the purchasers sign conditional or installment sales contracts providing that title to the merchandise covered remains in the jewelry

company until the purchase price has been paid in full. In the case of diamond sales, the purchaser may return such merchandise at any time and be allowed a credit for the full amount of the original purchase price against the price of a more expensive diamond. In some cases the purchaser may return the diamond after payment in full of the purchase price. In other cases the purchaser may return the diamond after he has paid only a part of such price. Where the purchaser offers in trade a diamond purchased from some other merchant, an allowance is made which is in the general range of allowances fixed for articles purchased originally from the company. As part of a sales promotion program, the company, from time to time, also advertises watches for sale at a listed retail price with the further stipulation that the customer will be allowed a fixed amount for any old watch in trade as a credit on the purchase price of a new watch. The suppliers of the watches participate in this program by making watches available to be sold at the price so reduced. The allowances made by the company for the old watches turned in bear no relationship to the value of such watches, are not determined by any process of bargaining between the parties and have no real significance in fixing the amounts paid for the new watches.

Section 2400 of the Code provides that a tax shall be imposed upon all articles commonly or commercially known as jewelry, whether real or imitation; pearls, precious and semi-precious stones, and imitations thereof; and watches and clocks and cases and movements therefor.

Section 2407(a) of the Code provides that a credit or refund of tax may be allowed with respect to an article, when the price on which the tax was based is readjusted by reason of return or repossession of the article, in the amount of that part of the tax proportionate to the part of the price which is refunded or credited.

Section 320.74 of Regulations 51 provides that a credit or refund of tax is not allowable with respect to an article returned as a "trade-in" in the purchase of another article. In such case, there is no adjustment, within the meaning of section 2407(a) of the Code, of the price at which the first article was sold.

Where title to a diamond article is still in the retailer, as under conditional or installment sales contracts and chattel mortgages, because payment of the purchase price has not been completed, there is a readjustment of the price upon which the tax was based when such article is returned in the purchase of a larger diamond. This constitutes a substitution of a new contract which extinguishes the old contract and creates a new obligation to pay, measured by the purchase price of the larger diamond less any amounts already paid. Such a transaction cannot be regarded as a trade-in as that term is used in section 320.74 of Regulations 51, since the customer cannot trade in something which is not his, nor can the retailer accept in trade something he already owns. Full credit or refund may be allowed in this kind of transaction based upon the allowance made for the article turned in.

Where payment of the purchase price has been completed and title to the article is in the customer, a contrary result follows. In such case the amount allowed for the article accepted as a "trade-in" is not an adjustment, within the meaning of section 2407(a) of the Code, of the price at which the first article was sold. In "trade-in"

transactions of this type the full amount of the tax due upon the sale of the second article is payable without any allowance or offset for the tax paid on the sale of the first article.

The conclusion that refund or credit is not allowable in cases where title to the article has passed to the customer applies whether the first diamond was purchased from the jewelry company or from some other merchant. In either case the sale of the second article is a separate and distinct transaction in which the first article is merely applied in part payment of the purchase price.

The watch transactions are of a different character. As customers are given a uniform allowance without regard to condition, the allowances made do not reflect the actual values of the old watches turned in. What is described as an allowance constitutes, in effect, a trade discount in arriving at the price for which the watches are sold. In transactions of this type the tax is based upon the net sales price.

CHAPTER 25.—FIREARMS

SUBCHAPTER A.—PISTOLS AND REVOLVERS

SECTION 2700(a).—TAX: RATE

REGULATIONS 47, SECTION 302.1.

The above Regulations have been amended to reflect changes required by the Excise Tax Reduction Act of 1954. See T. D. 6139, page 674.

CHAPTER 27.—OCCUPATIONAL TAXES

SUBCHAPTER A.—SPECIAL PROVISIONS

PART IX—COIN-OPERATED AMUSEMENT AND GAMING DEVICES

REGULATIONS 59, SECTION 323.0

The above Regulations have been amended to reflect changes required by the Excise Tax Reduction Act of 1954. See T. D. 6139, page 674.

SECTION 3267.—TAX ON COIN-OPERATED AMUSEMENT AND GAMING DEVICES

REGULATIONS 59, SECTION 323.1: Meaning of terms.

Applicability of the tax on coin-operated amusement devices, imposed by section 3267 of the Internal Revenue Code of 1939, to coin-operated athletic type machines. See Rev. Rul. 55-649, page 473.

CHAPTER 27A.—WAGERING TAXES

SUBCHAPTER A.—TAX ON WAGERS

SECTION 3285.—TAX

REGULATIONS 132, SECTION 325.25: When tax attaches.

Application of the tax on wagers in the case of punchboards with prizes of merchandise, cash, or free plays. See Rev. Rul. 55–754 page 471.

REGULATIONS 132, SECTION 325.26: Rate and computation of tax.

Computation of tax on wagers in the case of punchboards with prizes of merchandise, cash, or free plays. See Rev. Rul. 55–754, page 471.

CHAPTER 28.—PROVISIONS COMMON TO MISCELLANEOUS TAXES

SUBCHAPTER A.—GENERAL PROVISIONS

PART I.—STAMPS, MARKS, AND BRANDS

SECTION 3304.—REDEMPTION OF STAMPS

For continued application of limitations on redemptions under the appropriate sections of the Internal Revenue Code of 1939. See Rev. Rul. 55–708, page 478.

PART II.—ASSESSMENT, COLLECTION, AND REFUND

SECTION 3313.—PERIOD OF LIMITATION UPON REFUNDS AND CREDITS

REGULATIONS 43, SECTION 101.42: Abatement or refund of erroneous or illegal assessments or collections. (Also Section 1710.) Rev. Rul. 55–602

A claim filed by a club or organization on behalf of its members for refund of amounts erroneously collected as dues tax, imposed by section 1710 of the Internal Revenue Code of 1939, is allowable only to the extent of the amount included in the claim for which powers of attorney are filed in support thereof within the statutory period of limitation prescribed by section 3313 of the Code.

Advice has been requested whether powers of attorney, executed by members of an organization authorizing the organization to make

claim on their behalf for refund of dues tax erroneously collected and paid by the organization, are required to be filed within the statutory period of limitation prescribed by section 3313 of the Internal Revenue Code of 1939.

In the instant case, an organization which does not qualify as a social, athletic, or sporting club or organization within the meaning of section 1710 of the Code erroneously collected from its members tax imposed by that section. The organization filed a claim in behalf of its members within the statutory period of limitation for refund of the amount of tax erroneously collected from all of its members. The claim was supported by powers of attorney executed by only a portion of the membership of the organization. Subsequent to the expiration of the statutory period of limitation, the organization filed powers of attorney executed by those members who had not previously authorized it to file claims in their behalf.

Section 1710 of the Code imposes a tax on amounts paid as dues and initiation fees to any social, athletic, or sporting club or organization. Under that section, the tax shall be paid by the person paying such dues and fees.

In accordance with the provisions of section 3313 of the Code, a claim for refund of any internal revenue tax alleged to have been erroneously or illegally collected must be presented to the Commissioner within four years next after payment of the tax.

Section 101.42 of Regulations 43 provides that a club may file a claim in behalf of its members for refund of tax on dues and initiation fees which has been erroneously or illegally collected and paid over to the Government. That section stipulates certain conditions which must be met in connection with a claim filed by the club. One of the conditions is that the claim must be accompanied by a power of attorney executed by each person in whose behalf the claim is filed authorizing the club to act as his agent.

The rationale underlying this regulation is that the member and not the club is the actual taxpayer and that only a taxpayer or a person duly authorized by him can execute a valid claim for refund. The claim filed by a club in behalf of its members, properly supported by powers of attorney, is in essence a claim filed by each individual member. While for the sake of convenience the Internal Revenue Service permits the execution of a single document by the club rather than separate documents by each member, this does not change the essential character of the document as the aggregate of the individual actions of the members.

Once these basic facts are recognized, it becomes apparent that unless or until the member authorizes the club to act for him through the execution of a power of attorney there can be no valid claim filed in his behalf. In order for the claim to be filed within the statutory period of limitation, it follows that the power of attorney must also have been executed and filed within that period. Where a claim filed by a club is defective by reason of not being accompanied by powers of attorney the date of receipt by the District Director of Internal Revenue of any powers of attorney subsequently filed, rather than the date the claim was filed, determines whether the claim or any part thereof has been filed within the statutory period of limitation prescribed by section 3313 of the Code.

Under the circumstances in the instant case the claim filed by the organization in behalf of its members may be allowed to the extent of the amount included in the claim for which powers of attorney were filed in support thereof within the statutory period of limitation. No refund may be made with respect to that portion of the claim in support of which powers of attorney were not filed within the statutory period of limitation.

Rev. Rul. 55-488

Pursuant to the limitations upon refunds and credits provided by section 3313 of the Internal Revenue Code of 1939 a credit for overpayment of tax is not allowable when claimed on Form 720, Quarterly Federal Excise Tax Return, filed more than 4 years after the date overpayment was made, even though such return includes a period which falls within 4 years of the date of the overpayment.

Advice has been requested concerning the application of the period of limitations upon refunds and credits prescribed by section 3313 of the Internal Revenue Code of 1939 to a credit for overpayment of tax claimed on Form 720, Quarterly Federal Excise Tax Return, filed more than 4 years after the date of the overpayment, where a portion of the period covered by the quarterly return is within 4 years of the overpayment date.

Pursuant to the provisions of section 3313 of the Code all claims for refunding or crediting of excise tax alleged to have been overpaid must be presented to the Commissioner within 4 years next after payment of the tax.

In view of the provisions of section 3313 of the Code it is held that a credit for overpayment of excise tax is not allowable when claimed on a quarterly return filed more than 4 years after the date overpayment was made, even though such return includes a period which falls within 4 years of the date of the overpayment. However, the fact that a credit is not allowable under such circumstances, due to the incidence of the filing date of the quarterly return falling beyond the 4-year limitation period, does not preclude the filing of a claim, Form 843, for refund of the overpayment at any time within the 4-year period of limitation.

For continued application of limitations on refunds under the appropriate sections of the Internal Revenue Code of 1939. See Rev. Rul. 55-708, page 478.

CHAPTER 29.—MANUFACTURERS' EXCISE AND IMPORT TAXES

SUBCHAPTER A.—MANUFACTURERS' EXCISE TAXES

REGULATIONS 46, SECTIONS 316.0, 316.2, 316.9, 316.51, 316.56, 316.74, 316.111, 316.122, 316.181, 316.199, 316.204

The above sections have been amended to reflect changes required by the Excise Tax Reduction Act of 1954. See T. D. 6139, page 674.

SECTION 3403.—TAX ON AUTOMOBILES, ETC.

REGULATIONS 46, SECTION 316.50: Scope of tax. Rev. Rul. 55-450

A trailer used for the dispensing of popcorn and designed to be transported on the highways, is equipped with a special drop-down axle, a retractable third wheel, a trailer hitch, and a specially designed counter and storage space. Special equipment includes a corn popping machine, a butter dispenser, a bottle gas tank, a water system, and an electrical power generator. *Held*, since such trailer is primarily designed and adapted for the transportation of property over the highways it is subject to the manufacturers' excise tax imposed by section 3403(a) of the Internal Revenue Code of 1939. It is not considered to be a house trailer which is exempt under section 3403(b). Compare Rev. Rul. 100, C. B. 1953-1, 461. No tax under section 3403 of the Code will attach to that part of the selling price of the complete unit reasonably attributable to the corn popping machine, butter dispenser, bottle gas tank, water system, and electrical power generator, if such part is billed separately on the invoice to the customer or can be otherwise established by adequate records.

REGULATIONS 46, SECTION 316.51: Rates of tax. T. D. 6143 [1]
(Also Section 3415, Section 316.2.)

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER C, PART 316.—EXCISE TAXES ON SALES BY THE MANUFACTURER

Regulations 46 (1940 edition) amended to conform to the Tax Rate Extension Act of 1955.

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

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

In order to conform Regulations 46 (1940 edition) (26 CFR (1939) part 316) to the Tax Rate Extension Act of 1955 (Public Law 18, 84th Cong.) [C. B. 1955-1, 619], approved March 30, 1955, such regulations, as prescribed and made applicable to the Internal Revenue Code of 1954 by Treasury Decision 6091 [C. B. 1954-2, 47], signed August 16, 1954, are amended as follows:

PARAGRAPH 1. Immediately preceding section 316.2 there is inserted the following:

> SEC. 7851. APPLICABILITY OF REVENUE LAWS [INTERNAL REVENUE CODE OF 1954].
>
> (a) GENERAL RULES.—Except as otherwise provided in any section of this title—
>
> * * * * * * *
>
> (4) SUBTITLE D.—Subtitle D [incl. chapter 32, relating to manufacturers excise taxes] of this title shall take effect on January 1, 1955. Subtitles B and C of the Internal Revenue Code of 1939 (except chapters * * * 28 * * * of such Code) are hereby repealed effective January 1, 1955. * * *
>
> * * * * * * *

[1] 20 F. R. 6576.

PAR. 2. Section 316.2, as amended by Treasury Decision 6139 page 674 of this Bulletin, approved August 23, 1955, is further amended by adding at the end thereof the following new paragraph (26 CFR 316.2 (k)):

The applicable provisions of the Internal Revenue Code of 1939, as amended, were superseded as of January 1, 1955, by the corresponding provisions of the Internal Revenue Code of 1954. The applicable provisions of the 1954 Code have been amended by the Tax Rate Extension Act of 1955, approved March 30, 1955. The Tax Rate Extension Act of 1955 continues until April 1, 1956, the rates of tax on chassis and bodies for trucks and other automobiles, and parts and accessories therefor, which rates were increased by section 481 (a), (b), and (c) of the Revenue Act of 1951.

PAR. 3. Immediately preceding section 316.51 there is inserted the following:

SEC. 4061. IMPOSITION OF TAX [INTERNAL REVENUE CODE OF 1954].

(a) AUTOMOBILES.—There is hereby imposed upon the following articles (including in each case parts or accessories therefor sold on or in connection therewith or with the sale thereof) sold by the manufacturer producer, or importer a tax equivalent to the specified percent of the price for which so sold:

(1) Articles taxable at 8 percent, except that on and after April 1, 1955, the rate shall be 5 percent—

Automobile truck chassis.
Automobile truck bodies.
Automobile bus chassis.
Automobile bus bodies.
Truck and bus trailer and semitrailer chassis.
Truck and bus trailer and semitrailer bodies.
Tractors of the kind chiefly used for highway transportation in combination with a trailer or semitrailer.

A sale of an automobile truck, bus, truck or bus trailer or semitrailer shall, for the purpose of this paragraph, be considered to be a sale of the chassis and of the body.

(2) Articles taxable at 10 percent except that on and after April 1, 1955, the rate shall be 7 percent—

Automobile chassis and bodies other than those taxable under paragraph (1).
Chassis and bodies for trailers and semitrailers (other than house trailers) suitable for use in connection with passenger automobiles.
Motorcycles.

A sale of an automobile, trailer, or semitrailer shall, for the purposes of this paragraph, be considered to be a sale of the chassis and of the body.

* * * * * * *

SEC. 3. ONE-YEAR EXTENSION OF CERTAIN EXCISE TAX RATES [TAX RATE EXTENSION ACT OF 1955, APPROVED MARCH 30, 1955].

(a) EXTENSION OF RATES.—The following provisions of the Internal Revenue Code of 1954 are hereby amended by striking out "April 1, 1955" each place it appears and inserting in lieu thereof "April 1, 1956"—

* * * * * * *

(2) section 4061 (relating to motor vehicles);

* * * * * * *

PAR 4. Paragraphs (a) and (b) of section 316.51, as amended by Treasury Decision 6139, are further amended to read as follows:

(a) Automobile truck chassis and bodies; highway tractors; automobile bus chassis and bodies; automobile truck and bus trailer and semitrailer chassis and bodies:

October 1, 1941, to October 31, 1951, inclusive	5 percent
November 1, 1951, to March 31, 1956, inclusive	8 percent
On and after April 1, 1956	5 percent

(b) Other automobile chassis and bodies; other automobile trailer and semitrailer chassis and bodies; motorcycles:

October 1, 1941, to October 31, 1951, inclusive	7 percent
November 1, 1951, to March 31, 1956, inclusive	10 percent
On and after April 1, 1956	7 percent

PAR. 5. Immediately preceding section 316.55 there is inserted the following:

SEC. 4061. IMPOSITION OF TAX [INTERNAL REVENUE CODE] OF 1954].

* * * * * * *

(b) PARTS AND ACCESSORIES.—There is hereby imposed upon parts or accessories (other than tires and inner tubes and other than automobile radio and television receiving sets) for any of the articles enumerated in subsection (a) sold by the manufacturer, producer, or importer a tax equivalent to 8 percent of the price for which so sold, except that on and after April 1 1955, the rate shall be 5 percent.

SEC. 3. ONE-YEAR EXTENSION OF CERTAIN EXCISE TAX RATES [TAX RATE EXTENSION ACT OF 1955, APPROVED MARCH 30, 1955].

(a) EXTENSION OF RATES.—The following provisions of the Internal Revenue Code of 1954 are hereby amended by striking out "April 1, 1955" each place it appears and inserting in lieu thereof "April 1, 1956"—

* * * * * * *

(2) section 4061 (relating to motor vehicles);

* * * * * * *

PAR. 6. Section 316.56, as amended by Treasury Decision 6139, is further amended to read as follows:

SEC. 316.56. RATES OF TAX.—The tax is payable by the manufacturer on the sale price of the articles listed at the rates specified below:

Automobile parts and accessories:

October 1, 1941, to October 31, 1951, inclusive	5 percent
November 1, 1951, to March 31, 1956, inclusive	8 percent
On and after April 1, 1956	5 percent

In each case the taxable sale price shall be determined in accordance with the provisions of section 316.8 to 316.15, inclusive.

Because this Treasury Decision amends the regulations merely by incorporating the extension in the rates of the manufacturers excise taxes on certain motor vehicles and parts or accessories therefor which was made by the Tax Rate Extension Act of 1955, it is found unnecessary to issue this Treasury Decision with notice and public procedure thereon under section 4(a) of the Administrative Procedure Act, approved June 11, 1946, or subject to the effective date limitation of section 4(c) of said Act.

This Treasury Decision shall be effective on March 30, 1955.

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

O. GORDON DELK,
Acting Commissioner of Internal Revenue.

Approved: September 1, 1955.

A. N. OVERBY,
Acting Secretary of the Treasury.

(Filed by the Division of the Federal Register September 7, 1955, 8:49 a. m.)

SECTION 3404.—TAX ON RADIO RECEIVING SETS, TELEVISION RECEIVING SETS, PHONOGRAPHS, PHONOGRAPH RECORDS, AND MUSICAL INSTRUMENTS

REGULATIONS 46, SECTION 316.61: Radio, Television, phonograph components.

Taxability of the sale, by the manufacturer, producer, or importer, of a phonograph mechanism which includes, among other components, a motor, pick-up arm and turntable, but does not include a pick-up cartridge. See Rev. Rul. 55–624, page 456.

SECTION 3405.—TAX ON MECHANICAL REFRIGERATORS, QUICK-FREEZE UNITS, AND SELF-CONTAINED AIR-CONDITIONING UNITS

REGULATIONS 46, SECTION 316.70: Refrigerators, etc.

Application of the manufacturers' excise tax to quick-freeze units of the household type. See Rev. Rul. 55–432, page 455.

SECTION 3406.—EXCISE TAXES IMPOSED BY THE REVENUE ACT OF 1941

REGULATIONS 46, SECTION 316.110: Scope of tax.

Basis for determining whether a gas water heater is of the household type and subject to manufacturers' excise tax. See Rev. Rul 55–645, page 455.

REGULATIONS 46, SECTION 316.180: Scope of tax. Rev. Rul. 55–761

Section 3406(a) (10) of the Internal Revenue Code of 1939 imposes a tax on the sale by the manufacturer, producer, or importer of electric light bulbs and tubes. Section 316.180 of Regulations 46 defines an electric light bulb or tube as any device designed for the diffusion of artificial light for illuminative or decorative purposes through the use of electricity. *Held*, electric bulbs or tubes which are primarily designed for blueprinting, photoprinting, or other photocopying applications in which the ultraviolet radiation furnished by the bulbs or tubes is essential are not electric light bulbs or tubes within the meaning of the law and regulations and accordingly are not subject to tax.

Application of the manufacturers' excise tax to the fair market price of a taxable article used by the manufacturer thereof as a component in the production of a nontaxable installation. See Rev. Rul. 55–735, page 455.

SECTION 3415.—EFFECTIVE DATE OF SUBCHAPTER

REGULATIONS 46, SECTION 316.2: Effective period.

Regulations 46 are amended to reflect changes required by the Tax Rate Extension Act of 1955. See T. D. 6143, page 653.

SECTION 3416.—FLOOR STOCKS REFUND ON REFRIGERATORS, QUICK-FREEZE UNITS, AND ELECTRIC, GAS, AND OIL HOUSEHOLD APPLIANCES

REGULATIONS 46, SECTION 316.204a: Credits or refunds of tax on floor stocks of electric light bulbs, refrigerators, and appliances.

Regulations 46 amended. See T. D. 6141, page 621.

SUBCHAPTER C.—GENERAL ADMINISTRATIVE PROVISIONS

SECTION 3443.—CREDITS AND REFUNDS

REGULATIONS 46, SECTION 316.204: Credits and refunds. Rev. Rul. 55–763

A manufacturer of television picture tubes sells quantities of tubes to a manufacturer of television receiving sets both (1) free of the manufacturers excise tax for use as original equipment in television receiving sets and (2) subject to the tax for resale to distributors and dealers for use as replacement parts. If the original-equipment tubes become defective within the tube manufacturer's warranty period, they are replaced by distributors and dealers from their stocks of tax-paid tubes. The defective tubes are then returned to the tube manufacturer, who gives the television set manufacturer a rebate or credit against the selling price of the tax-paid tubes used as replacements under the warranty provisions. *Held*, such a rebate or credit allowed against the selling price of a tax-paid replacement tube constitutes an adjustment within the purview of section 3443(a)(2) of the Internal Revenue Code of 1939 to the extent that the rebate or credit does not exceed the selling price of the replacement tube. Accordingly, a refund or credit of the manufacturers excise tax may be allowed to the tube manufacturer proportionate to the adjustment in the selling price of the tax-paid tube.

SECTION 3444.—USE BY MANUFACTURER, PRODUCER, OR IMPORTER

REGULATIONS 46, SECTION 316.7: Tax on use by manufacturer, producer, or importer.

Applicability of the manufacturers' excise tax to the use of a taxable article in the manufacture of a nontaxable installation. See Rev. Rul. 55–735, page 455.

CHAPTER 30.—TRANSPORTATION AND COMMUNICATION

REGULATIONS 42, SECTIONS 130.0, 130.10, 130.14, 130.30, 130.33, 130.36, 130.38, 130.39, 130.41, 130.50, 130.52, 130.55, 130.57, 130.74, 130.78a

The above sections have been amended to reflect changes required by the Excise Tax Reduction Act of 1954. See T. D. 6139, page 674.

SUBCHAPTER B.—TELEGRAPH, TELEPHONE, RADIO, AND CABLE FACILITIES

SECTION 3465.—IMPOSITION AND RATE OF TAX

REGULATIONS 42, SECTION 130.38: Rate and application of tax. Rev. Rul. 55-710

Applicability of the tax on leased wires, and wire and equipment service to charges made by a company in connection with the furnishing of a music program service.

Advice has been requested concerning the application of the tax on leased wire service, and wire and equipment service, imposed by sections 3465(a)(2)(A) and 3465(a)(2)(B) of the Internal Revenue Code of 1939, to charges made by a company in connection with a music program service furnished to subscribers.

The company, for the purpose of testing its equipment prior to inaugurating a music program service, leased from the telephone company lines running from its central studio to the places of business of three prospective subscribers. No charge was made by the company for music program service furnished by it during the test period. Since the expiration of the test period, a monthly charge is made by the company to all subscribers to its service.

Section 3465(a)(2)(A) of the Code imposes a tax on the amounts paid for leased wire, teletypewriter, or talking circuit special service, but not including an amount paid for such a service used exclusively in rendering a wire and equipment service taxable under section 3465(a)(2)(B) of the Code.

Section 130.38 of Regulations 42 provides that musical programs rendered over channels between a point of origin and the subscriber's premises constitute a wire and equipment service, and the total amount paid by subscribers for such service, including charges for equipment, instruments and other apparatus, and installation charges, is taxable under section 3465(a)(2)(B) of the Code. The tax is to be paid by the person paying for such services or facilities and is collectible by the person furnishing such services.

Under the circumstances described, all charges made by the company to its subscribers for the music program service, including any charges for equipment and the installation thereof, are subject to tax on wire and equipment service imposed by section 3465(a)(2)(B) of the Code. The company is not liable for tax under section 3465(a)(2)(A) on amounts paid by it to the telephone company for

the lease of wires, or other equipment used in furnishing the taxable music program service to subscribers. However, the company is liable for tax under that section on the amount paid by it to the telephone company for the lease of wires during the test period.

REGULATIONS 42, SECTION 130.40: Scope of tax.

Taxability of charges for radio telephone dispatch service. See Rev. Rul. 55-646, page 459.

SUBCHAPTER C.—TRANSPORTATION OF PERSONS

SECTION 3469.—TAX ON TRANSPORTATION OF PERSONS, ETC.

REGULATIONS 42, SECTION 130.51: Scope of tax.

Applicability of the tax on the transportation of persons to tickets sold aboard a ship, while it is still within "United States" waters en route to Canada, for transportation of the passengers by bus between points in Canada. See Rev. Rul. 55-647, page 460.

REGULATIONS 42, SECTION 130.52: Rate and application of tax. Rev. Rul. 55-507

> The tax on the transportation of persons does not apply to amounts paid by a passenger to a carrier for two separate and distinct transportation movements, where neither of the fares exceeds 35 cents.

Advice has been requested whether the tax on the transportation of persons, imposed by section 3469 of the Internal Revenue Code of 1939, applies to separate payments made for transportation under the following circumstances.

In the instant case a carrier operates buses for transporting passengers between city *X* and city *Y* and between city *Y* and city *Z*. Regular hourly bus service is maintained between city *X* and city *Y* for which a fare of 25 cents is paid by each passenger. The service between city *Y* and city *Z* is limited to two trips daily for which smaller buses are used and for which a fare of 35 cents is paid by each passenger. The carrier does not sell tickets for through transportation from city *X* to city *Z*. All passengers of the bus running between city *X* and city *Y* must leave the vehicle at city *Y* regardless of their intended ultimate destination. The carrier does not know which of the passengers leaving the bus at city *Y* intend to continue on to city *Z*. Likewise, the carrier does not know which of the passengers of the smaller bus running between city *Y* and city *Z* have been transported on the other bus.

Section 3469(a) of the Code imposes a tax upon the amounts paid for the transportation of persons by rail, motor vehicle, water, or air.

Under the provisions of section 3469(b) of the Code the tax does not apply to amounts paid for transportation which do not exceed 35 cents.

Pursuant to the provisions of section 130.52 of Regulations 42, the tax on the transportation of persons is to be measured by the total amount paid, whether paid at one time or collected at intervals during the course of continuous transportation, as in the case of a carrier operating under the zone system.

It is held that, under the circumstances in the instant case, the transportation by bus of a passenger from city *X* to city *Y* and the subsequent transportation of that passenger in another bus from city *Y* to city *Z* are separate and distinct transportation movements and do not constitute continuous transportation within the meaning of section 130.52 of the Regulations. Accordingly, amounts paid by a passenger for the transportation movements described are regarded as payments of separate fares. Since neither of the separate fares exceeds 35 cents, payments thereof are not subject to tax on the transportation of persons imposed by section 3469 of the Code. Compare Revenue Ruling 54–182, C. B. 1954–1, 266, which holds that separate amounts paid, in connection with a one-way trip, for local transportation in one city and for transfer and through transportation to a neighboring city, constitute amounts paid for continuous transportation.

Rev. Rul. 55–762

Under a time payment plan for the sale of tickets for the transportation of persons, the time payment differential, which is the amount paid in excess of the established cash fare, is not considered to be a part of the amount paid for transportation, where it is confined to or representative of the added expense incurred by the carrier in selling tickets on the time payment plan.

Advice has been requested whether the tax on the transportation of persons, imposed by section 3469 (a) of the Internal Revenue Code of 1939, applies to a time payment differential which is paid in excess of the established cash fare under a time payment plan for the sale of tickets.

A carrier sells tickets on a deferred payment basis in accordance with a tariff published and filed with the appropriate regulatory agency. Under the terms and conditions of the tariff, the applicant for transportation must make a cash down payment of not less than ten percent of the applicable cash fare for the journey. He must execute a negotiable note, payable in equal monthly installments, for the unpaid balance plus a time payment differential. This time payment differential, which is separately defined and determined in the tariff, is a variable amount dependent upon the amount of the unpaid balance and the number of monthly installments in which the note is payable. For example, if the cash fare for a particular journey is $100, the applicant for transportation on the time payment plan must make a down payment of not less than $10. If he desires to pay the balance in three equal monthly installments and makes the minimum down payment of $10, he must execute a negotiable note covering the unpaid balance, or $90, plus the time payment differential determined from the tariff, which is $3, thus making a total of $93.

On the other hand, if he should desire to pay the note in ten monthly installments, the time payment differential determined from the tariff would be $9, making a total of $99.

A financial institution has agreed to discount each note on a basis which will yield to the carrier a net amount equal to the applicable fare determined without regard to the time payment plan.

Under these circumstances, the time payment differential is directly attributable to the fact that payment is to be made in installments instead of in cash and it is confined to or representative of the added expense incurred by the carrier in selling tickets on the time payment plan. Accordingly, it is held that the time payment differential is not a part of the amount paid for the transportation of persons within the meaning of section 3469(a) of the Code. The carrier is not required to collect the tax on such time payment differential, provided it is shown separately from the transportation charges in the carrier's records. However, the tax applicable to the established cash fare for a particular journey must be collected from the applicant at the time the carrier receives the cash down payment and the negotiable note covering the balance.

REGULATIONS 42, SECTION 130.58: Motor vehicles with seating capacity of less than ten. Rev. Rul. 55-565

> Amounts paid for transportation furnished by motor vehicles having a seating capacity of less than 10 adult passengers, including the driver, where the vehicles are operated over irregular routes without a fixed schedule and without fixed pickup and discharge points, are not subject to the tax on the transportation of persons, imposed by section 3469(a) of the Internal Revenue Code of 1939, since such vehicles are not operated on an established line.

The Internal Revenue Service has been asked whether the tax on the transportation of persons, imposed by section 3469 of the Internal Revenue Code of 1939, applies to amounts paid for transportation that is furnished in the following manner.

A corporation, which holds a certificate of public convenience and necessity issued by the Interstate Commerce Commission, transports passengers and their baggage approximately two hundred miles, in a door-to-door service, from a metropolitan commercial zone consisting of 16 cities and towns to a resort area where several hundred hotels cater to persons desiring to vacation in that vicinity. This service is known as a "call-and-demand" service and is operated over irregular routes with no fixed schedule. It provides transportation from the door of a passenger's home, which might be located in any of the 16 cities and towns in the above-mentioned metropolitan commercial zone, to the door of the hotel of the passenger's choosing in the resort area, with the same procedure in the reverse direction.

This service is limited to the transportation of not more than six passengers in any one vehicle, not including the driver thereof, and not including children under 10 years of age who do not occupy a seat or seats. There is no central place for pickup and discharge of passengers at either the origin or destination points, or at any place enroute. The trips, which involve travel in two or three states, do not follow a specific route, and the one chosen depends upon the road,

the weather, or other conditions at the time the trips are made. If passengers request service over a particular route, and such requests are reasonable, the carrier will comply with the passengers' requests. The carrier is not required to follow a regular schedule, but is obligated to provide service only at such time as there is a demand.

Section 3469(a) of the Code imposes a tax upon the amount paid for the transportation of persons by rail, motor vehicle, water, or air. Such tax applies to transportation by motor vehicles having a passenger seating capacity of less than 10 adult passengers, including the driver, only when such vehicle is operated on an established line. Section 130.58 of Regulations 42 provides in part that the term "operated on an established line" means operated with some degree of regularity between definite points.

Since in the instant case the carrier does not operate its motor vehicles from pick-up and discharge points established by it but, upon call, picks up and delivers passengers at any place designated by them within the limits of the areas specified in its certificate of public convenience and necessity, it is held that the vehicles are not operated on an established line within the meaning of section 3469(a) of the Code. Therefore, if each vehicle has a seating capacity of less than 10 adult passengers, including the driver, amounts paid for such transportation are not subject to the tax.

REGULATIONS 42, SECTION 130.61: Transportation and facilities furnished to the United States, to States, or political subdivisions thereof. Rev. Rul. 55-487

Payments for transportation of persons made by the California Association of the Future Farmers of America and its local chapters are payments for transportation furnished to a State or political subdivision thereof within the meaning of section 3469(f)(1) of the Internal Revenue Code of 1939, and are exempt from the tax on the transportation of persons. That exemption also applies to payments for transportation made by any other State or Territory Future Farmers of America Association and its local chapters if its activities constitute an integral part of the State (or Territorial) Vocational Education program under conditions substantially similar to those in the State of California. There is no exemption which would apply to payments for transportation made by the National Organization of Future Farmers of America or by an association organized in a possession of the United States.

Advice has been requested whether the exemption provided by section 3469(f)(1) of the Internal Revenue Code of 1939 applies to payments for transportation of persons made by the California Association of the Future Farmers of America and its local chapters. Advice also has been requested whether that exemption extends to payments for transportation made by any other State or Territory Future Farmers of America Association and its local chapters, to such payments made by the National Organization, or to such payments made by an association organized in a possession of the United States.

The Future Farmers of America is a nonprofit national organization of, by, and for boys studying vocational agriculture in public schools under the provisions of the national vocational education acts.

It is composed of chartered state associations which, in turn, are made up of local chapters situated in schools having departments of vocational agriculture. The Future Farmers of America on a national level is legally constituted through an Act of Congress incorporating it as a part of the national program of education and the program of the organization is administered under the direction of the public school systems of the various States and the Federal Office of Education in the Department of Health, Education and Welfare.

In the case of the California Association of the Future Farmers of America, the administration of its activities of a state-wide nature is the responsibility of the State Bureau of Agricultural Education. The State Advisor, who is also the State Supervisor of Agricultural Education, handles all the funds of the state organization and the expenditure of funds in connection with the activities of the Association.

Administration of each local chapter of the California Association is vested in the public school system in which the local chapter is located. The governing board of any school district may authorize any organization composed entirely of pupils attending the schools of the district to maintain such activities as may be approved by the governing board. Each Future Farmers of America chapter in California is required to be established as a student organization using the name of the school. Therefore, the funds of each local chapter in California are under the control of the local board of trustees of the school district. The teacher of vocational agriculture is the chapter advisor.

Section 3469 of the Code imposes a tax upon the amount paid for the transportation of persons by rail, motor vehicle, water or air, except in cases specifically exempt by the Code. Under the provisions of section 3469(f)(1) of the Code, the tax does not apply to the payment for transportation or facilities furnished to any State, Territory of the United States, or political subdivision thereof, or the District of Columbia.

It is held that payments for transportation of persons made by the California Association of Future Farmers of America and its local chapters are payments for transportation furnished to a State or political subdivision thereof within the meaning of section 3469(f)(1) of the Code and, therefore, such payments are exempt from the tax on transportation of persons. Such exemption likewise extends to payments for transportation furnished to any other State or Territory Future Farmers of America Association and its local chapters if its activities constitute an integral part of the State (or Territorial) Vocational Education program under conditions substantially similar to those in the State of California. The right to the exemption in all cases must be established by the use of Form 731, Exemption Certificate, which must be modified to show that the exemption is claimed on behalf of the state association or local chapter involved.

Payments for transportation of persons made by the National Organization of Future Farmers of America are not exempt from tax since they do not come within the scope of the exemption provided by section 3469(f)(1) of the Code and since the statute contains no provision for the exemption of amounts paid for transportation by other nonprofit educational organizations, as such. Furthermore, since the

statute contains no provision for the exemption from tax of payments made for transportation furnished to a possession of the United States, there is no basis on which exemption may be granted to a Future Farmers of America association organized in a possession of the United States.

REGULATIONS 42, SECTION 130.64: Transportation outside the northern portion of the Western Hemisphere. Rev. Rul. 55-451

Application of the tax on the transportation of persons, imposed by section 3469 of the Internal Revenue Code of 1939, to an amount paid in the United States for a ticket for transportation to a point within the northern portion of the Western Hemisphere, where such ticket is issued in conjunction with another ticket in making a through journey to a point outside of the northern portion of the Western Hemisphere.

Advice has been requested concerning the application of the tax on the transportation of persons, imposed by section 3469 of the Internal Revenue Code of 1939, to an amount paid in the United States for a separate ticket issued for transportation to a point within the northern portion of the Western Hemisphere, where such ticket is issued in conjunction with another ticket in making a through journey to a point outside the northern portion of the Western Hemisphere.

In the instant case a traveler purchased from a travel agency in the United States transportation to Caracas, Venezuela, a point of destination outside of the northern portion of the Western Hemisphere, as defined in section 3469(a) of the Code. The travel agency issued two separate tickets which collectively covered the entire journey. The first covered transportation from the point of origin of the journey in the United States to the Dutch West Indies, a point within the northern portion of the Western Hemisphere. The second covered transportation from the Dutch West Indies to the point of destination of the journey outside the northern portion of the Western Hemisphere. No stop was made between the point of origin of the journey in the United States and the Dutch West Indies.

Section 3469(a) of the Code, which imposes a tax on amounts paid for the transportation of persons, provides that the tax shall not apply with respect to transportation any part of which is outside the northern portion of the Western Hemisphere, except with respect to any part of such transportation which is from any port or station within the United States, Canada, or Mexico to any other port or station within the United States, Canada, or Mexico.

It is held that the term "transportation" as used in the exemption provision of section 3469(a) of the Code, relating to travel any part of which is outside the northern portion of the Western Hemisphere, means the journey of the traveler, rather than the individual contracts or authorizations for transportation which collectively cover the entire journey. Since, under the circumstances described, (1) the journey of the traveler is to Caracas, Venezuela, a point of destination outside the northern portion of the Western Hemisphere, (2) the separate ticket for transportation to the Dutch West Indies is issued in conjunction with another ticket in making a through

journey to the point outside the northern portion of the Western Hemisphere, and (3) there were no intermediate stops in the United States, Canada, or Mexico, the tax does not apply to the amount paid by the traveler for any portion of the transportation. However, in order to establish the exempt character of such a journey, all of the separate tickets or orders issued to cover the journey must be appropriately inscribed to show that they are issued for use by the traveler in making one continuous journey to or from a point outside the northern portion of the Western Hemisphere.

REGULATIONS 42, SECTION 130.72: Returns. Rev. Rul. 55-534

Where the transportation of persons involves the services of two or more carriers, the tax imposed by section 3469 of the Internal Revenue Code of 1939 applies only to the payments made by, or on behalf of, the passengers for the complete transportation service. The tax does not apply to payments made by the carriers between themselves in settlement of their charges for their respective services.

The Internal Revenue Service has been requested to state its position with respect to the application of the tax on transportation of persons, imposed by section 3469 of the Internal Revenue Code of 1939, to payments made by one carrier to another under the following circumstances.

In the instant case, *X* carrier contracts to transport the passengers in its own facilities from point of origin to their destination. Due to mechanical failure, the transportation movement is interrupted and *X* carrier is then obligated to have the passengers transported to their ultimate destination through the facilities of *Y* carrier. The persons being transported in this case are traveling on United States Government transportation requests.

Section 3469 of the Code imposes a tax upon amounts paid for the transportation of persons by rail, motor vehicle, water, or air. The tax is payable by the person making the payment subject to tax and is collectible by the person receiving such payment. Payments for the transportation of persons furnished to the United States upon United State Government transportation requests are exempt from the tax. (See authorization of the Secretary of the Treasury, dated June 20, 1947, C. B. 1947-2, 211, and Mim. 6194, C. B. 1947-2, 210.)

It is held that where the transportation of persons involves the services of two or more carriers, the tax applies only to the payments made by, or on behalf of, the passengers for the complete transportation service. The tax does not apply to payments made by the carriers between themselves in settlement of their charges for their respective services, even though the payments made to the initial carrier by or for the passengers may have been exempt from the tax. The initial carrier should in such cases furnish to the other carrier or carriers a certification that (a) the tax has been collected with respect to the amounts paid by or for the passengers for the complete transportation service, or (b) the payments made by or for the passengers were exempt from the tax. Such a certification by the initial

carrier constitutes authority to the other carrier or carriers not to collect the tax.

Accordingly, in the instant case, the tax does not apply to the amounts paid by *X* carrier to *Y* carrier for transporting the passengers to their ultimate destination. At the time *X* carrier makes settlement with *Y* carrier for the services *Y* carrier performed, *X* carrier should certify that the passengers were traveling on United States Government transportation requests and that the payments for such transportation were therefore exempt.

SUBCHAPTER E.—TRANSPORTATION OF PROPERTY

SECTION 3475.—TRANSPORTATION OF PROPERTY

REGULATIONS 113, SECTION 143.1: Meaning of terms.

Application of the tax on transportation of property to charges by a carrier for cleaning and disinfecting cars used for transportation of livestock. See Rev. Rul. 55-614, page 462.

Application of the tax to payments to a mutual cartage association by its members to cover the expense of operating its trucks in transporting the members' merchandise.
See Rev. Rul. 55-751, page 465.

REGULATIONS 113, SECTION 143.13: Application of tax. Rev. Rul. 55-563

A freight forwarder picked up a shipment at the point of origin for transportation to point *X*, but erroneously loaded it on a car destined to point *Y*. The shipment was returned by the carrier from point *Y*, at the freight forwarder's expense, to the distribution point nearest the correct destination, and from that point was transported to the consignee. *Held*, the amount paid by the freight forwarder to the carrier for the back haul transportation of the astray shipment is considered to be a settlement between carriers as contemplated by M. T. 14, C. B. 1943, 1161, which holds that the tax on transportation of property, imposed by section 3475 of the Internal Revenue Code of 1939, does not apply to payments made by carriers between themselves in settlement of their charges for their respective services. Accordingly, the amount paid by the freight forwarder to the carrier, for the back haul transportation of the astray shipment to the distribution point, is not subject to the tax. However, at the time the transportation charges are paid to the carrier by the freight forwarder, the freight forwarder should certify on the appropriate shipping papers that the tax on the charge made by it to the shipper or the consignee for transportation of the property from the point of origin to the correct destination has been or will be collected by it.

Rev. Rul. 55-564

A payment made by an insurance company in settlement of a claim filed by a moving and storage company to cover reimbursement for expenses incurred by the storage company in moving stored goods from a fire-damaged warehouse to another warehouse operated by it, in order to protect the goods from loss or damage, is not a payment for transportation of property within the meaning of section 3475 of the Internal Revenue Code of 1939.

The Internal Revenue Service has been requested to state its position with respect to the application of the tax on transportation of property, imposed by section 3475 of the Internal Revenue Code of 1939, to a payment made under the following described circumstances by an insurance company in settlement of a claim filed by a moving and storage company.

In the case presented, a fire at a moving and storage company's warehouse damaged not only some of the goods stored therein, but also damaged the building to the extent that it was inadvisable to use it for continued storage of goods. In order to protect the goods from loss or damage they were moved from the fire-damaged warehouse to another warehouse operated by the storage company. In moving the goods the storage company used its own vans and drivers at its own expense. The policy covering the goods stored in the warehouse contains a clause which provides that, in the event of loss or damage, the assured shall protect the property from any other or further loss or damage, and that all reasonable expenses incurred in saving or preserving the property shall be the basis of a claim.

Section 3475 of the Code imposes a tax upon the amount paid for the transportation of property by rail, motor vehicle, water, or air from one point in the United States to another. The tax applies only to amounts paid to a person engaged in the business of transporting property for hire. Such tax is payable by the person making the taxable transportation payment and is collectible by the person receiving such payment.

It is held that the payment made by the insurance company under the circumstances is not a payment for transportation of property within the meaning of section 3475 of the Code, but is in the nature of an indemnity which is not subject to the tax. Accordingly, the storage company is not required to collect the tax on the payment made by the insurance company in settlement of the claim.

Rev. Rul. 55-577

Application of the tax on the transportation of property, imposed by section 3475 of the Internal Revenue Code of 1939, to an amount paid to a railroad by the owner of tank cars as an adjustment of the mileage allowance previously paid by the railroad for the use of the tank cars.

Advice has been requested concerning the application of the tax on the transportation of property, imposed by section 3475 of the Internal Revenue Code of 1939, to an amount paid to a railroad by the owner of tank cars as an adjustment of the mileage allowance previously paid by the railroad for the use of the tank cars.

An item of the applicable tariff, designated "Payment of Mileage", provides for payment by the railroad to car owners on a mileage basis for the use of tank cars for loaded and empty movements. Another item of the tariff, designated "Equalization of Mileage on Tank Cars," provides, in general, that where the aggregate empty mileage of tank cars bearing any of the reporting marks assigned to any one person or company exceeds the aggregate loaded mileage on the lines of certain participating railroads, such excess must be paid for by the person or company to whom the reporting marks are assigned, either by an equivalent loaded mileage, or at applicable mileage rates named in certain tariffs, without minimum, plus an amount equivalent to the mileage allowance that has been paid by the railroads on such excess empty mileage. The "payment by the railroad" referred to in the item of the tariff designated "Payment of Mileage", is the "mileage allowance" referred to in the item of the tariff designated "Equalization of Mileage on Tank Cars." The following is illustrative of the adjustment.

Tank cars owned by a company were used by a railroad during a specified yearly period. In such period these cars were transported under load for an aggregate distance of 2,000 miles and transported empty for an aggregate distance of 3,000 miles. The railroad paid the company at the rate of 4 cents per mile for each use of a car whether loaded or empty, or $200. At the end of the agreed yearly period the railroad reclaims from the company and is paid by it the amount paid for so much of the empty mileage as is in excess of the loaded mileage, which in this illustration is 1,000 miles (3,000 minus 2,000), or $40, and in addition makes a charge at the applicable tariff rate for moving the empty cars a distance of 1,000 miles. The mileage adjustment charge and the transportation charge are shown separately in the billing.

It is held that the part of the amount paid to the railroad under the item of the tariff designated Equalization of Mileage on Tank Cars, which is equivalent to the mileage allowance that has been paid previously by the railroad on the excess empty mileage, represents an adjustment of the mileage allowance rather than a payment for transportation of the empty cars. Accordingly, in the above illustration, the amount of $40 reclaimed by the railroad and paid to it by the owner of the tank cars is not subject to tax on the transportation of property. The tax will apply, however, to the additional charges made by the railroad at the applicable tariff rates, on the movement of the empty tank cars.

Rev. Rul. 55-632

The allowance made by a vendor to a carrier for the transportation of property purchased by the carrier for its own use and transported by such carrier over its own lines from point of origin or from a junction to destination, is not subject to the tax on the transportation of property imposed by section 3475 of the Internal Revenue Code of 1939, provided title to the property vests in the purchasing carrier at the time the property reaches its lines. In such a case the freight allowance made by the vendor to the purchasing carrier constitutes an

adjustment in the purchase price of the property rather than a payment for the transportation of the property. Thus, where the property purchased is transported entirely over the lines of the purchasing carrier and such carrier holds title to the property, no liability for transportation tax is incurred. However, where the property is transported by a connecting carrier from the point of origin to a junction point on the lines of the purchasing carrier, the purchasing carrier is liable for payment of the tax on the amount it pays to the connecting carrier for transporting the property to the junction point.

Revenue Ruling 284, C. B. 1953–2, 436, which holds that amounts paid or allowed to a carrier for transporting property purchased for its own use are subject to the tax on the transportation of property, applies only in cases where the purchasing carrier does not hold title to the property at the time such carrier transports the property over its own lines.

Applicability of the tax on the transportation of property to the services performed by a trucking exchange in bringing together shippers who have cargos to be transported and truckers who have requested assistance in obtaining loads to transport. See Rev. Rul. 55–501, page 469.

Hauling of waste oil from storage tanks and spraying it on lease roads located on the same lease as the storage tanks. See Rev. Rul. 55–599, page 461.

Applicability of tax on transportation of property to towing of disabled automobiles. M. T. 10, C. B. 1943, 1160, modified. See Rev. Rul. 55–753, page 468.

REGULATIONS 113, SECTION 143.32: Export shipments not requiring exemption certificate. Rev. Rul. 55–688

> Where a car containing both export and domestic shipments is consigned to a point outside the United States on a through carload rate with stopoff instructions on the bill of lading for partial unloading at a point in the United States, the tax on the transportation of property does not apply to the amount paid for the transportation of the portion of the carload shipment delivered to the consignee outside of the United States.

The Internal Revenue Service has received numerous inquiries relative to the application of the tax on the transportation of property, imposed by section 3475 of the Internal Revenue Code of 1939, to charges paid for the transportation of a carload shipment consigned to a point outside the United States on a through carload rate with stopoff instructions on the bill of lading for partial unloading at a point in the United States.

Section 3475 of the Code imposes a tax upon the amount paid for the transportation of property by rail, motor vehicle, water, or air from one point in the United States to another. Section 143.30 of Regulations 113 provides that the tax will not apply to an amount

paid for the transportation of property in course of exportation to a foreign destination, or shipment to a possession of the United States, in accordance with the applicable requirements of the regulations. In accordance with section 143.32 of the regulations, an amount paid for the transportation of property shipped direct from a point within the United States to a point outside the United States under a through bill of lading, a through export bill of lading, or a domestic bill of lading showing the name of the foreign consignee and the ultimate foreign destination, will be treated as exempt from the transportation tax without further evidence of actual exportation.

It is held that where a car containing both export and domestic shipments is consigned to a point outside the United States on a through carload rate with stopoff instructions on the bill of lading for partial unloading at a point in the United States, the tax on the transportation of property does not apply to the amount paid for the transportation of the portion of the carload shipment delivered to the consignee outside the United States. However, the tax does apply to the amount paid for the transportation of that portion of the carload shipment which is unloaded at the stopoff point in the United States, including any additional amount paid for the stopoff privilege.

With respect to shipments of the kind described above, it is understood that the charges for the transportation of those portions which are delivered to consignees outside the United States as a rule are not shown separately, on the shipping papers. Where the charges are not shown separately the tax is collectible by the carrier on the total transportation charges. However, where the shipping papers indicate the portion of the carload that is being delivered to the consignee outside the United States, then, even though the charges are not shown separately, the carrier may allocate the charges on the basis of the weights of the respective portions and collect the tax only on the portion of the shipment unloaded at the stopoff point in the United States.

If the carrier collects the tax on the total transportation charges, the payor may file Form 843, Claim, for refund with the proper District Director of Internal Revenue and attach thereto the original receipt issued by the carrier showing payment of the tax on the carload shipment involved and documentary evidence establishing the charges allocable to the shipment delivered to the consignee outside the United States.

In a case where a shipment intended for export and a shipment to a domestic destination move on the same bill of lading, but not on one of the bills of lading described in section 143.32 of the regulations, the carrier may likewise allocate the transportation charges on the basis of the weights of the respective portions and collect the tax only on the domestic portion of the shipment, provided (1) the person paying the transportation charges files with the carrier Form 1363, Export Exemption Certificate, covering the transportation charges allocable to the portion of the shipment intended for export, and (2) obtains proof of exportation as required by section 143.34 of the regulations. Where, with respect to such a shipment, the carrier does not allocate the transportation charges but collects the tax

on the total transportation charges, the payor is likewise privileged to file Form 843, Claim, for refund and attach thereto, in addition to the receipt issued by the carrier and evidence establishing the charges allocable to the shipment intended for export, a description of documentary evidence in his possession showing that such shipment was actually exported.

REGULATIONS 113, SECTION 143.33: Export shipments requiring exemption certificate. Rev. Rul. 55-725

Where an export shipment is made on a domestic bill of lading which does not show both the name of the foreign consignee and the ultimate foreign destination and Form 1363, Export Exemption Certificate, is not filed with the carrier by the person paying the transportation charges, the tax on the transportation of property is properly collectible by the carrier, and may not be refunded by the carrier. However, the person who paid the tax to the carrier may file a claim for refund of the tax with his local District Director of Internal Revenue.

Advice has been requested whether tax on the transportation of property, imposed by section 3475 of the Internal Revenue Code of 1939, which has been paid by a shipper under the following circumstances may be refunded by the carrier.

In the instant case, a shipper paid transportation charges and tax with respect to a shipment of property intended for export. The shipment was made on a domestic bill of lading which did not show both the name of the foreign consignee and the ultimate foreign destination. Form 1363, Export Exemption Certificate, was not filed with the carrier at the time payment was made of the transportation charges. After the exportation of the property, the shipper filed with the carrier an export exemption certificate and requested refund of the tax paid.

In accordance with the provisions of section 143.32 of Regulations 113, an amount paid for the transportation of property shipped direct from a point within the United States to a point outside the United States under a through bill of lading, a through export bill of lading, or a domestic bill of lading showing the name of the foreign consignee and the ultimate foreign destination will be treated as exempt from the transportation tax, without further evidence of actual exportation. However, in accordance with the provisions of section 143.33 of the regulations, an amount paid for an export shipment not made on one of the bills of lading described above will be exempt from tax, provided (1) the shipment is covered by a Form 1363, Export Exemption Certificate, and (2) proof of exportation is obtained as required by section 143.34 of the regulations.

A carrier may make a refund of tax collected and take credit therefor on a subsequent return in a case where it makes refund of the payment on which it collected the tax, or where the collection of the tax was clearly erroneous as in the case of tax collected on an export shipment made on one of the bills of lading not requiring an export exemption certificate. However, where an export shipment is not made on such a bill of lading and the person paying the transportation charges

pays the tax to the carrier instead of furnishing the carrier an export exemption certificate, the tax is considered to have been properly collected by the carrier and the carrier may not make refund of such tax. In such a case, the person who paid the tax to the carrier may file Form 843, claim for refund thereof with his local District Director of Internal Revenue.

Accordingly, since in the instant case the domestic bill of lading did not show both the name of the foreign consignee and the ultimate foreign destination and an export exemption certificate was not filed by the shipper at the time he paid the transportation charges, the tax was properly collected by the carrier and may not be refunded by the carrier to the shipper. However, the shipper, as hereinbefore stated, may file claim for refund of the tax paid.

CHAPTER 31.—DOCUMENTS AND OTHER INSTRUMENTS

SECTION 3482.—CONVEYANCES

REGULATIONS 71, SECTION 113.82: Rate and computation of tax. Rev. Rul. 55–578

For documentary stamp tax purposes, a conveyance by a mortgagor of his entire interest in mortgaged real estate to the mortgagee, who becomes the owner of the fee simple title, removes or extinguishes the lien of the mortgage held by the mortgagee. It is immaterial that the conveyance is made to the mortgagee by an assignee of the mortgagor who has not assumed liability for the outstanding indebtedness to the mortgagee. Therefore, the unpaid balance on the mortgage cannot be excluded in the computation of the documentary stamp tax imposed by section 3482 of the Internal Revenue Code of 1939.

CHAPTER 37.—ABATEMENTS, CREDITS AND REFUNDS

SECTION 3770.—AUTHORITY TO MAKE ABATEMENTS, CREDITS, AND REFUNDS

Computation of interest when overpayments of tax are credited to additional tax. See Rev. Rul. 55–485, page 499.

SECTION 3771.—INTEREST ON OVERPAYMENTS

Claims for additional interest on refunds resulting from delay in delivery or error in refund check. See Rev. Rul. 55–477, page 498.

Computation of interest when overpayments of tax are credited to additional tax. See Rev. Rul. 55–485, page 499.

CHAPTER 38.—MISCELLANEOUS PROVISIONS

SECTION 3801.—MITIGATION OF EFFECT OF LIMITATION AND OTHER PROVISIONS IN INCOME TAX CASES

REGULATIONS 118, SECTION 39.3801(a)(1)-1: Rev. Rul. 55-738
Purpose and scope of section 3801.

The adjustments under section 3801 of the Internal Revenue Code of 1939, correcting the effect of an error in a taxable year which is otherwise barred by the statute of limitations, are permissible (except in cases described in paragraphs (b) (6) and (7) of section 3801, as amended by section 211 of the Technical Changes Act of 1953) only if there is adopted in a determination meeting the requirements of that section a position maintained by the opposing party which is inconsistent with the erroneous treatment. Accordingly, the provisions of section 3801 are not applicable where a taxpayer who erroneously reported an item of income in his return for one year sought to correct the error by voluntarily reporting the same income in an amended return for the immediately succeeding taxable year and paid the tax and penalty thereon after the statute of limitations had expired for both years. Moreover, in such case, no determination as provided in section 3801(a) of the 1939 Code was made or could be made after the statutory period for both years had expired.

SECTION 3806(b).—MITIGATION OF EFFECT OF RENEGOTIATION OF WAR CONTRACTS OR DISALLOWANCE OF REIMBURSEMENT: CREDIT AGAINST REPAYMENT ON ACCOUNT OF RENEGOTIATION OR ALLOWANCE

Rev. Rul. 55-474

In determining the amount of a tax credit under section 3806(b) of the Internal Revenue Code of 1939, since assessed taxes are in most cases paid prior to the allowance by the renegotiating agency of the tax credit, although the tax payment may be made subsequent to the computation of such credit by the Internal Revenue Service, it is the policy to use the *assessed* tax in the computation of the credit, in order to avoid the delay in the settlement of the net repayment due the renegotiating agency, which would result if such computation were not made until the assessed taxes were paid in full. Where, however, the Service has knowledge of an outstanding assessment the payment of which is in doubt, the computation of the credit by the Internal Revenue Service is made on the basis of taxes *paid* and the amount of the credit, furnished to the renegotiating agency which allows the tax credit, is limited to the extent of the *overpayment* of tax. In any event, if outstanding taxes are not later paid and the tax credit based on *assessment* (rather than *payment*) has already been finally allowed by the renegotiating agency, the tax credit allowed, to the extent it exceeds the allowable credit based upon taxes *paid*, will be reassessed as a deficiency. See *Baltimore Foundry and Machine Corporation* v. *Commissioner*, 7 T. C. 998.

EXCISE TAX REDUCTION ACT OF 1954

SECTIONS 101, *ET SEQ.*

(Regulations 42, Section 130.0;
Regulations 46, Section 316.0;
Regulations 47, Article 1;
Regulations 51, Section 320.0;
Regulations 59, Section 323.0.)

T. D. 6139[1]

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER C, PARTS 130, 316, 302, 320, AND 323

Regulations 42, 46, 47, 51, and 59 amended to conform to certain provisions of the Excise Tax Reduction Act of 1954.

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

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

In order to conform the following regulations to the Excise Tax Reduction Act of 1954 (Public Law 324, 83d Cong.) [C. B. 1954–1, 343], approved March 31, 1954:

Regulations 42 (1942 edition) (26 CFR, part 130), relating to the taxes imposed under the provisions of chapters 12 and 30 of the Internal Revenue Code of 1939;

Regulations 46 (1940 edition) (26 CFR, part 316), relating to the taxes imposed under the provisions of subchapter A of chapter 29 of the Internal Revenue Code of 1939 (except section 3404(f), as added by section 601(c) of the Excise Tax Reduction Act of 1954, relating to floor stocks refunds on automobiles);

Regulations 47 (1928 edition) (26 CFR, part 302), as prescribed and made applicable to the Internal Revenue Code of 1939 by Treasury Decision 4885 [C. B. 1939–1 (part 1), 396], approved February 11, 1939 (26 CFR, Cum. Supp., note, p. 5876), relating to the taxes imposed under the provisions of subchapter A of chapter 25 of the Internal Revenue Code of 1939;

Regulations 51 (1941 edition) (26 CFR, part 320), relating to the taxes imposed under the provisions of chapters 9A and 19 of the Internal Revenue Code of 1939; and

Regulations 59 (1941 edition) (26 CFR, part 323), relating to the taxes imposed under the provisions of parts IX and X of subchapter A of chapter 27 of the Internal Revenue Code of 1939;

such regulations are amended as follows:

REGULATIONS 42

PARAGRAPH 1. Section 130.0, as amended by Treasury Decision 5994 [C. B. 1953–1, 405], approved February 24, 1953, is further amended as follows:

(A) By changing paragraph (a) to read as follows:

(a) On the use of safe deposit boxes, imposed by chapter 12 of the Internal Revenue Code of 1939, as amended by section 532 of the Revenue Act of 1941 and section 501 of the Excise Tax Reduction Act of 1954.

[1] 20 F. R. 6283.

(B) By striking out in paragraph (c) the words

"and sections 491 and 492 of the Revenue Act of 1951" and inserting in lieu thereof the following: "sections 491 and 492 of the Revenue Act of 1951, and sections 401, 402, 504(a), and 505(c) (3) and (4) of the Excise Tax Reduction Act of 1954".

(C) By striking out in paragraph (d) the words

"and sections 493 and 494 of the Revenue Act of 1951" and inserting in lieu thereof the following: "sections 493 and 494 of the Revenue Act of 1951, and sections 503, 504(a), and 505(c) (5) of the Excise Tax Reduction Act of 1954".

(D) By changing the last paragraph of the section to read as follows:

The statutory references are to the Internal Revenue Code of 1939 (53 Stat., part I) unless otherwise stated.

PAR. 2. Immediately preceding section 130.10 there is inserted the following:

SEC. 501. TAX ON SAFE DEPOSIT BOXES [EXCISE TAX REDUCTION ACT OF 1954, APPROVED MARCH 31, 1954].

Section 1850(a) (relating to tax on the use of safe deposit boxes) is hereby amended by striking out "20 per centum" and inserting in lieu thereof "10 per centum".

SEC. 505. EFFECTIVE DATES [EXCISE TAX REDUCTION ACT OF 1954, APPROVED MARCH 31, 1954].

* * * * * * *

(b) The amendment made by section 501 shall apply only with respect to amounts paid on or after April 1, 1954.

* * * * * * *

PAR. 3. Section 130.10 is amended by adding at the end thereof the following new sentence:

The rate of tax was decreased from 20 percent to 10 percent, effective April 1, 1954, by an amendment to section 1850 (a) made by section 501 of the Excise Tax Reduction Act of 1954.

PAR. 4. The first two paragraphs of section 130.14 (26 CFR 130.14 (a) and (b)) are amended to read as follows:

SEC. 130.14. RATE AND COMPUTATION OF TAX.—The tax is imposed at the rates specified for the following periods:

Period	*Rate*
(a) Amounts collected from October 1, 1941 to March 31, 1954, inclusive	20 percent
(b) Amounts collected on or after April 1, 1954	10 percent

The tax is measured strictly by the amount collected for the use of the safe deposit box without regard to the period for which the payment is made. Thus, the tax at the rate of 20 percent applies to the amount collected prior to April 1, 1954, even though such amount represents a payment, whether in whole or in part, for use of a safe deposit box on and after April 1, 1954.

PAR. 5. Immediately preceding section 130.30 there is inserted the following:

SEC. 401. TAX ON TELEGRAPH, TELEPHONE, RADIO, AND CABLE FACILITIES [EXCISE TAX REDUCTION ACT OF 1954, APPROVED MARCH 31, 1954].

(a) TELEPHONE MESSAGES, ETC.—Section 3465(a)(1)(A) (relating to tax on telephone messages, etc.) is hereby amended by striking out "20 per centum" and inserting in lieu thereof "10 per centum."

(b) TELEGRAPH, CABLE, AND RADIO DISPATCHES.—Section 3465(a)(1) (B) (relating to tax on telegraph, cable, and radio dispatches or mes-

sages) is hereby amended by striking out "15 per centum of the amount so paid, except that in the case of each international telegraph, cable, or radio dispatch or message the rate shall be 10 per centum" and inserting in lieu thereof the following: "10 per centum of the amount so paid."

* * * * * * *

SEC. 402. EFFECTIVE DATE OF TITLE IV [EXCISE TAX REDUCTION ACT OF 1954, APPROVED MARCH 31, 1954].

(a) IN GENERAL.—Subject to the provisions of subsection (b), the amendments made by section 401 shall apply with respect to amounts paid on or after April 1, 1954, for services rendered on or after such date.

(b) AMOUNTS PAID PURSUANT TO BILLS RENDERED.—The amendments made by section 401 shall not apply with respect to amounts paid pursuant to bills rendered before April 1, 1954. In the case of amounts paid pursuant to bills rendered on or after such date for services for which no previous bill was rendered, such amendments shall apply except with respect to such services as were rendered more than 2 months before such date. In the case of services rendered more than 2 months before such date the provisions of sections 1650 and 3465 of the Internal Revenue Code in effect at the time such services were rendered shall apply to the amounts paid for such services.

* * * * * * *

SEC. 504. TECHNICAL AMENDMENTS [EXCISE TAX REDUCTION ACT OF 1954, APPROVED MARCH 31, 1954].

(a) TERMINATION OF TAX RATES UNDER SECTION 1650.—Section 1650 (relating to war tax rates of certain miscellaneous taxes) is hereby amended by inserting after "beginning with the effective date of title III of the Revenue Act of 1943" the following: "and ending March 31, 1954,".

* * * * * * *

SEC. 505. EFFECTIVE DATES [EXCISE TAX REDUCTION ACT OF 1954, APPROVED MARCH 31, 1954].

* * * * * * *

(c) The amendment made by section 504(a) shall apply—

* * * * * * *

(3) Insofar as it affects the rates of the taxes imposed by subsections (a)(1)(A) * * * of section 3465 of the Internal Revenue Code, as though the rates listed under the heading "Old Rate" in the table in section 1650 of such Code were the rates established by the amendments made by section 401 of this Act;

* * * * * * *

PAR. 6. Section 130.30, as amended by Treasury Decision 5994, is further amended by adding at the end thereof the following new paragraph (26 CFR, 130.30(c)):

The reduction in rates provided by sections 401 (a) and (b) and 504(a) of the Excise Tax Reduction Act of 1954 is effective on and after April 1, 1954, and generally applies to amounts paid on and after that date for services rendered on and after that date. The reduction in rates shall not apply to amounts paid as the result of bills rendered before April 1, 1954. However, such reduction in rates shall apply to amounts paid as the result of bills rendered on and after April 1, 1954, where no previous bill was rendered except that where the services were rendered before February 1, 1954, the rates in effect at the time such services were rendered shall apply to the amounts paid for such services.

PAR. 7. Section 130.33, as amended by Treasury Decision 5994, is further amended as follows:

(A) By changing the first paragraph thereof (26 CFR 130.33(a)-(1)) to read as follows:

SEC. 130.33 RATE AND APPLICATION OF TAX—(a) *Telephone and radio telephone messages, and conversations.*—In the case of each telephone or radio telephone message or conversation where the charge is more than 24 cents, the amount paid is subject to tax at the rates specified for the following periods:

Period	Rate
(1) On and after April 1, 1954	10 percent
(2) April 1, 1944 to March 31, 1954, inclusive	25 percent
(3) November 1, 1942, to March 31, 1944, inclusive	20 percent
(4) Prior to November 1, 1942	5 cents for each 50 cents or fraction thereof

(B) By changing paragraph (b)(2) (26 CFR 130.33(b)(2)) to read as follows:

(2) *Domestic messages.*—In the case of each domestic telegraph, cable, or radio dispatch or message, the amount paid therefor is subject to tax at the rates specified for the following periods:

Period	Rate
(i) On and after April 1, 1954	10 percent
(ii) November 1, 1951 to March 31, 1954, inclusive	15 percent
(iii) April 1, 1944 to October 31, 1951, inclusive	25 percent
(iv) November 1, 1942 to March 31, 1944, inclusive	15 percent
(v) Prior to November 1, 1942	10 percent

PAR. 8. Immediately preceding section 130.36 there is inserted the following:

SEC. 401. TAX ON TELEGRAPH, TELEPHONE, RADIO, AND CABLE FACILITIES [EXCISE TAX REDUCTION ACT OF 1954, APPROVED MARCH 31, 1954].

* * * * * * *

(c) LEASED WIRE SERVICE.—Section 3465(a)(2)(A) (relating to tax on leased wire service, etc.) is hereby amended by striking out "15 per centum" and inserting in lieu thereof "10 per centum".

(d) WIRE AND EQUIPMENT SERVICE.—Section 3465(a)(2)(B) (relating to tax on wire and equipment service) is hereby amended to read as follows:

"(B) A tax equivalent to 8 per centum of the amount paid for any wire and equipment service (including stock quotation and information services, burglar alarm or fire alarm service, and all other similar services, but not including service described subparagraph (A))."

* * * * * * *

SEC. 402. EFFECTIVE DATE OF TITLE IV [EXCISE TAX REDUCTION ACT OF 1954, APPROVED MARCH 31, 1954].

(a) IN GENERAL.—Subject to the provisions of subsection (b), the amendments made by section 401 shall apply with respect to amounts paid on or after April 1, 1954, for services rendered on or after such date.

(b) AMOUNTS PAID PURSUANT TO BILLS RENDERED.—The amendments made by section 401 shall not apply with respect to amount paid pursuant to bills rendered before April 1, 1954. In the case of amounts paid pursuant to bills rendered on or after such date for services for which no previous bill was rendered, such amendments shall apply except with respect to such services as were rendered more than 2 months before such date. In the case of services rendered more than 2 months before such date the provisions of sections 1650 and 3465 of the Internal Revenue Code in effect at the time such services were rendered shall apply to the amounts paid for such services.

* * * * * * *

SEC. 504. TECHNICAL AMENDMENTS [EXCISE TAX REDUCTION ACT OF 1954, APPROVED MARCH 31, 1954].

(a) TERMINATION OF TAX RATES UNDER SECTION 1650.—Section 1650 (relating to war tax rates of certain miscellaneous taxes) is hereby amended by inserting after "beginning with the effective date of title III of the Revenue Act of 1943" the following: "and ending March 31, 1954,".

* * * * * * *

SEC. 505. EFFECTIVE DATES [EXCISE TAX REDUCTION ACT OF 1954, APPROVED MARCH 31, 1954].

* * * * * * *

(c) The amendment made by section 504(a) shall apply—

* * * * * * *

(3) insofar as it affects the rates of the taxes imposed by subsections * * * (a)(2)(A), and (a)(2)(B) of section 3465 of the Internal Revenue Code, as though the rates listed under the heading "Old Rate" in the table in section 1650 of such Code were the rates established by the amendments made by section 401 of this Act;

* * * * * * *

PAR. 9. Section 130.36, as amended by Treasury Decision 5559 [C. B. 1947-1, 160], approved April 18, 1947, is further amended by adding at the end thereof the following new paragraph (26 CFR 130.36(c)):

The reduction in rates provided by sections 401 (c) and (d) and 504(a) of the Excise Tax Reduction Act of 1954 is effective on and after April 1, 1954, and generally applies to amounts paid on and after that date for services rendered on and after that date. The reduction in rates shall not apply to amounts paid as the result of bills rendered before April 1, 1954. However, such reduction in rates shall apply to amounts paid as the result of bills rendered on and after April 1, 1954, where no previous bill was rendered except that where the services were rendered before February 1, 1954, the rates in effect at the time such services were rendered shall apply to the amounts paid for such services.

PAR. 10. Section 130.38, as amended by Treasury Decision 5559, is further amended by changing the first paragraph thereof (26 CFR 130.38(a)(1)) to read as follows:

SEC. 130.38. RATE AND APPLICATION OF TAX—(a) *Leased wire, teletypewriter, or talking circuit special service.*—In the case of leased wire, teletypewriter, or talking circuit special service, the amount paid therefor is subject to tax at the rates specified for the following periods:

Period	*Rate*
(1) On and after April 1, 1954	10 percent
(2) April 1, 1944, to March 31, 1954, inclusive	25 percent
(3) November 1, 1942, to March 31, 1944, inclusive	15 percent
(4) Prior to November 1, 1942	10 percent

PAR. 11. Immediately preceding section 130.39 there is inserted the following:

SEC. 401. TAX ON TELEGRAPH, TELEPHONE, RADIO, AND CABLE FACILITIES [EXCISE TAX REDUCTION ACT OF 1954, APPROVED MARCH 31, 1954].

* * * * * * *

(e) LOCAL TELEPHONE SERVICE.—For reduction in rate of tax on local telephone service, see section 504(a).

SEC. 402. EFFECTIVE DATE OF TITLE IV [EXCISE TAX REDUCTION ACT OF 1954, APPROVED MARCH 31, 1954].

(a) IN GENERAL.—Subject to the provisions of subsection (b), the amendments made by section 401 shall apply with respect to amounts paid on or after April 1, 1954, for services rendered on or after such date.

(b) AMOUNTS PAID PURSUANT TO BILLS RENDERED.—The amendments made by section 401 shall not apply with respect to amounts paid pursuant to bills rendered before April 1, 1954. In the case of amounts paid pursuant to bills rendered on or after such date for services for which no previous bills was rendered, such amendments shall apply except with respect to such services as were rendered more than 2 months before such date. In the case of services rendered more than 2 months before such date the provisions of sections 1650 and 3465, of the Internal Revenue Code in effect at the time such services were rendered shall apply to the amounts paid for such services.

* * * * * * *

SEC. 504. TECHNICAL AMENDMENTS [EXCISE TAX REDUCTION ACT OF 1954, APPROVED MARCH 31, 1954].

(a) TERMINATION OF TAX RATES UNDER SECTION 1650.—Section 1650 (relating to war tax rates of certain miscellaneous taxes) is hereby amended by inserting after "beginning with the effective date of title III of the Revenue Act of 1943" the following: "and ending March 31, 1954,".

* * * * * * *

SEC. 505. EFFECTIVE DATES [EXCISE TAX REDUCTION ACT OF 1954, APPROVED MARCH 31, 1954].

* * * * * * *

(c) The amendment made by section 504 (a) shall apply—

* * * * * * *

(4) insofar as it affects the rate of the tax imposed by section 3465(a)(3) of the Internal Revenue Code, as though such amendment were an amendment made by section 401 of this Act; * * *

* * * * * * *

PAR. 12. Section 130.39, as amended by Treasury Decision 5559, is further amended by adding at the end thereof the following new paragraph (26 CFR 130.39(c)):

The reduction in rates provided by sections 401(e) and 504(a) of the Excise Tax Reduction Act of 1954 is effective on and after April 1, 1954, and generally applies to amounts paid on and after that date for services rendered on and after that date. The reduction in rates shall not apply to amounts paid as the result of bills rendered before April 1, 1954. However, such reduction in rates shall apply to amounts paid as the result of bills rendered on and after April 1, 1954, where no previous bill was rendered except that where the services were rendered before February 1, 1954, the rates in effect at the time such services were rendered shall apply to the amounts paid for such services.

PAR. 13. The first paragraph of section 130.41, as amended by Treasury Decision 5559 (26 CFR 130.41(a)), is further amended to read as follows:

SEC. 130.41. RATE AND APPLICATION OF TAX.—The tax is imposed at the rates specified for the following periods based upon the amount paid by any subscriber for local telephone service or any other telephone service which is not subject to the provisions of sections 3465(a) (1) or (2) of the Code, as amended (see sections 130.30 to 130.38):

Period	*Rate*
(a) On and after April 1, 1954	10 percent
(b) April 1, 1944 to March 31, 1954, inclusive	15 percent
(c) November 1, 1942 to March 31, 1944, inclusive	10 percent
(d) Prior to November 1, 1942	6 percent

PAR. 14. Immediately preceding section 130.50 there is inserted the following:

SEC. 503. TAX ON TRANSPORTATION OF PERSONS, ETC. [EXCISE TAX REDUCTION ACT OF 1954, APPROVED MARCH 31, 1954].

For reduction in rate of taxes on the transportation of persons and on seats, berths, etc., see section 504(a).

SEC. 504. TECHNICAL AMENDMENTS [EXCISE TAX REDUCTION ACT OF 1954, APPROVED MARCH 31, 1954].

(a) TERMINATION OF TAX RATES UNDER SECTION 1650.—Section 1650 (relating to war tax rates of certain miscellaneous taxes) is hereby amended by inserting after "beginning with the effective date of title III of the Revenue Act of 1943" the following: "and ending March 31, 1954,".

* * * * * * *

SEC. 505. EFFECTIVE DATES [EXCISE TAX REDUCTION ACT OF 1954, APPROVED MARCH 31, 1954].

* * * * * * *

(c) The amendment made by section 504(a) shall apply—

* * * * * * *

(5) insofar as it affects the rates of the taxes imposed by section 3469 of the Internal Revenue Code, with respect to amounts paid for or in connection with transportation which begins on or after April 1, 1954.

PAR. 15. Section 130.50, as amended by Treasury Decision 5559, is further amended by adding at the end thereof the following new paragraph:

The reduction in rate provided by sections 503 and 504(a) of the Excise Tax Reduction Act of 1954 is applicable to amounts paid for the transportation of persons which begins on or after April 1, 1954. Amounts paid on or after April 1, 1954, for transportation beginning before April 1, 1954, are subject to tax at the rate in effect prior to that date. A person selling transportation tickets, who, prior to April 1, 1954, collects tax at the rate in effect prior to such date for transportation which begins on or after April 1, 1954, must pay over the tax so collected to the United States. For rules governing the filing of a claim for refund or credit of the excess tax collected prior to April 1, 1954, in the case where, prior to the time that the post April 1, 1954 transportation begins, the carrier or his agent has either refunded the excess to his purchaser or obtained his consent to the allowance of the refund or credit, see the provisions of section 130.78a.

PAR. 16. The first paragraph of section 130.52, as amended by Treasury Decision 5559 (26 CFR 130.52(a)), is further amended to read as follows:

SEC. 130.52. RATE AND APPLICATION OF TAX.—The tax is imposed on the amount of the taxable payment for transportation at the rates specified for the following periods:

	Period	*Rate*
(a)	On and after April 1, 1954	10 percent
(b)	April 1, 1944 to March 31, 1954, inclusive	15 percent
(c)	November 1, 1942 to March 31, 1944, inclusive	10 percent
(d)	Prior to November 1, 1942	5 percent

PAR. 17. Immediately preceding section 130.55 there is inserted the following:

SEC. 503. TAX ON TRANSPORTATION OF PERSONS, ETC. [EXCISE TAX REDUCTION ACT OF 1954, APPROVED MARCH 31, 1954].

For reduction in rate of taxes on the transportation of persons and on seats, berths, etc., see section 504(a).

SEC. 504. TECHNICAL AMENDMENTS [EXCISE TAX REDUCTION ACT OF 1954, APPROVED MARCH 31, 1954].

(a) TERMINATION OF TAX RATES UNDER SECTION 1650.—Section 1650 (relating to war tax rates of certain miscellaneous taxes) is hereby amended by inserting after "beginning with the effective date of title III of the Revenue Act of 1943" the following: "and ending March 31, 1954,".

* * * * * * *

SEC. 505. EFFECTIVE DATES [EXCISE TAX REDUCTION ACT OF 1954, APPROVED MARCH 31, 1954].

* * * * * * *

(c) The amendment made by section 504(a) shall apply—

* * * * * * *

(5) insofar as it affects the rates of the taxes imposed by section 3469 of the Internal Revenue Code, with respect to amounts paid for or in connection with transportation which begins on or after April 1, 1954.

PAR. 18. Section 130.55, as amended by Treasury Decision 5559, is further amended by adding at the end thereof the following new paragraph:

The reduction in rate provided by sections 503 and 504(a) of the Excise Tax Reduction Act of 1954 is applicable to amounts paid for seating or sleeping accommodations to be used in connection with transportation which begins on or after April 1, 1954. Amounts paid on and after April 1, 1954, for such accommodations in connection with transportation which begins before April 1, 1954, are subject to tax at the rate in effect prior to that date. A person selling seating or sleeping accommodations, who, prior to April 1, 1954, collects tax at the rate in effect prior to that date for such accommodations to be used in connection with transportation which begins on or after such date, must pay over the tax so collected to the United States. For rules governing the filing of a claim for refund or credit of the excess tax collected prior to April 1, 1954, in the case where, prior to the time that the post April 1, 1954 transportation begins, the carrier or his agent has either refunded the excess to his purchaser or obtained his consent to the allowance of the refund or credit, see the provisions of section 130.78a.

PAR. 19. The first paragraph of section 130.57, as amended by Treasury Decision 5559 (26 CFR 130.57(a)), is further amended to read as follows:

SEC. 130.57 RATE AND APPLICATION OF TAX.—The tax is imposed on the amount of the taxable payment for seating or sleeping accommodations at the rates specified for the following periods:

	Period	*Rate*
(a)	On and after April 1, 1954	10 percent
(b)	April 1, 1944 to March 31, 1954, inclusive	15 percent
(c)	November 1, 1942 to March 31, 1944, inclusive	10 percent
(d)	Prior to November 1, 1942	5 percent

PAR. 20. Section 130.74 is amended by adding at the end thereof the following new sentence:

A person selling transportation tickets (or seating or sleeping accommodations) who, prior to April 1, 1954, collects tax at the 15 percent rate on the amount of the taxable payment for transportation (or for such accommodations in connection with transportation) which begins on or after April 1, 1954, shall pay over the tax so collected to the United States.

PAR. 21. Immediately following section 130.78 there is inserted the following:

SEC. 506. SPECIAL CREDIT OR REFUND OF TRANSPORTATION * * * TAXES [EXCISE TAX REDUCTION ACT OF 1954, APPROVED MARCH 31, 1954.]

Notwithstanding any other provision of law, in any case in which tax has been collected prior to April 1, 1954, at the rate in effect (without regard to the amendments made by this Act) prior to April 1, 1954, for or in connection with the transportation of persons which begins on or after April 1, 1954, * * * the person who collected the tax shall pay the same over to the United States; but credit or refund (without interest) of the tax collected in excess of that applicable (by reason of the amendments made by this Act) on or after April 1, 1954, shall be allowed to the person who collected the tax as if such credit or refund were a credit or refund under the applicable provision of the Internal Revenue Code, but only to the extent that, prior to the time such transportation has begun * * *, he has repaid the amount of such excess to the person from whom he collected the tax, or has obtained the consent of such person to the allowance of the credit or refund. For the purpose of this Act, transportation shall not be considered to have begun on or after April 1, 1954, if any part of the transportation paid for (or for which payment has been obligated) commenced before April 1, 1954.

SEC. 130.78a. CREDIT OR REFUND PROVIDED BY SECTION 506 OF THE EXCISE TAX REDUCTION ACT OF 1954—(a) *In general.*—Section 506 of the Excise Tax Reduction Act of 1954 provides that a credit or refund shall be allowed (as if such credit or refund were a credit or refund under the applicable provisions of the Internal Revenue Code) to any person who, prior to April 1, 1954, collected tax at the 15 percent rate on amounts paid for the transportation of persons (including seating or sleeping accommodations) to begin on or after April 1, 1954.

(b) *Amount.*—The amount to be credited or refunded is the excess of the tax collected at the old rate of 15 percent over the tax at the new rate of 10 percent. A claim for refund may be filed on Form 843 for the amount of such excess, or credit for such amount may be taken against the tax shown to be due on a subsequent return. The claim for refund should be filed with the district director for the internal revenue district in which the amount claimed was paid.

(c) *Conditions precedent.*—The credit or refund will be allowed only if all the following conditions are met:

(1) The tax has been collected at the 15 percent rate;

(2) Such tax actually has been paid over to the United States by the person claiming the refund or credit; and

(3) Prior to the time the transportation has begun, such person either (i) has reimbursed the purchaser of the transportation, etc., for the amount representing the difference between the tax computed at the rate of 15 percent and the tax which would have been paid at the 10 percent rate, or (ii) has obtained the written consent of the purchaser to the allowance of the credit or refund of such amount.

(d) *Evidence required.*—In order to obtain a refund or credit under section 506 of the Excise Tax Reduction Act of 1954 and this section, the claimant must have satisfactory evidence to substantiate his right to such refund or credit, such as a signed, dated statement from the ticket purchaser showing his name and address and the fact that such purchaser has obtained a refund of the excess tax or has consented to the allowance of the refund or credit of such excess tax to the claimant. The refund or credit may not be allowed if any part of the transportation paid for, or for which payment has been obligated, commenced before April 1, 1954. Thus, in the case of a round-trip ticket, if the transportation from the point of origin commenced before April 1, 1954, no refund or credit may be allowed of any part of the tax collected on the amount paid for such ticket even though the return portion of the ticket is not used until after that date.

(e) *Interest.*—No interest shall be allowed with respect to any amount of tax refunded or credited under the provisions of this section.

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PAR. 22. Section 316.0, as amended by Treasury Decision 6029 [C. B. 1953-2, 404], approved July 8, 1953, is further amended by changing the last paragraph thereof to read as follows:

The statutory references are to the Internal Revenue Code of 1939 (53 Stat., part 1) unless otherwise stated.

PAR. 23. Immediately preceding section 316.2 there is inserted the following:

SEC. 505. EFFECTIVE DATES [EXCISE TAX REDUCTION ACT OF 1954, APPROVED MARCH 31, 1954].

(a) The amendments made by * * * title III [secs. 301-306] * * *, and the amendment made by section 504(a) insofar as it affects * * * the rate of the manufacturers' excise tax imposed by section 3406(a)(10) of such Code, shall apply only with respect to articles sold on or after April 1, 1954. * * *

* * * * * * *

PAR. 24. Section 316.2, as amended by Treasury Decision 6029, is further amended by adding at the end thereof the following new paragraph (26 CFR 316.2(j)):

The Excise Tax Reduction Act of 1954, effective April 1, 1954, provides for the reduction in the rates of tax on sporting goods (as originally provided under

section 484 of the Revenue Act of 1951), photographic apparatus, electric light bulbs and tubes, mechanical pencils, fountain and ball-point pens, mechanical lighters for cigarettes, cigars, and pipes, refrigerators, quick-freeze units, and electric, gas, and oil household appliances. The Act also continues until April 1, 1955, the rates of tax on chassis and bodies for trucks and other automobiles, and parts and accessories therefor, which rates were increased by section 481 (a), (b), and (c) of the Revenue Act of 1951. The Act further provides the rule to be used to determine the rate of tax to be applied to payments made on or after April 1, 1954, for articles leased, sold on an installment contract, sold on a conditional sale contract, or sold on a chattel mortgage arrangement providing for payments in installments, where such lease, contract, etc., was entered into prior to April 1, 1954.

PAR. 25. Immediately preceding section 316.8 there is inserted the following:

SEC. 505. EFFECTIVE DATES [EXCISE TAX REDUCTION ACT OF 1954, APPROVED MARCH 31, 1954].

(a) The amendments made by * * * title III [secs 301–306] * * *, and the amendment made by section 504(a) insofar as it affects * * * the rate of the manufacturers' excise tax imposed by section 3406(a)(10) of such Code, shall apply only with respect to articles sold on or after April 1, 1954. For the purpose of the preceding sentence, an article shall not be considered sold before April 1, 1954, unless possession or right to possession passes to the purchaser before such date. In the case of—

(1) a lease,

(2) a contract for the sale of an article wherein it is provided that the price shall be paid by installments and title to the article sold does not pass until a future date notwithstanding partial payment by installments,

(3) a conditional sale, or

(4) a chattel mortgage arrangement wherein it is provided that the sales price shall be paid in installments,

entered into before April 1, 1954, payments made on or after April 1, 1954, shall, for purposes of this subsection, be considered as payments made with respect to articles sold on or after April 1, 1954.

* * * * * * *

PAR. 26. Section 316.9, as amended by Treasury Decision 5348, [C. B. 1944, 613] approved March 15, 1944, is further amended by adding at the end thereof the following new paragraph (26 CFR 316.9(g)):

The following rules shall apply in the case of articles with respect to which the rate of tax was reduced by the Excise Tax Reduction Act of 1954:

(1) If an article is sold prior to April 1, 1954, it shall be subject to tax at the rate in effect prior to such date.

(2) An article shall be considered sold prior to April 1, 1954, if possession or right to possession passes to the purchaser prior to that date. Thus, in the case of a transaction in which the vendor retains possession and the vendee has no right to possession until after March 31, 1954, the rate of tax in effect on or after Apirl 1, 1954, shall apply to the entire sale price of the article, irrespective of whether any portion of the sale price was received by the vendor prior to, on, or after April 1, 1954. Where the vendor retains possession merely for the convenience of the vendee and the vendee is entitled to possession at any time before Apirl 1, 1954, the rate in effect prior to such date shall apply to the price for which the article is sold.

(3) Where an article, prior to Apirl 1, 1954, is (i) leased, (ii) sold under an installment contract, (iii) sold on a conditional sale contract, or (iv) sold on a chattel mortgage arrangement providing for installment payments, the tax rate in effect prior to April 1, 1954, shall apply to all payments made prior to April 1, 1954, and the tax rate in effect on or after April 1, 1954, shall apply to all payments made on or after that date.

PAR. 27. Immediately preceding section 316.51 there is inserted the following:

SEC. 601. ONE-YEAR EXTENSION OF CERTAIN EXCISE TAX RATES [EXCISE TAX REDUCTION ACT OF 1954, APPROVED MARCH 31, 1954].

(a) EXTENSION OF RATES.—The following provisions are hereby amended by striking out "April 1, 1954" each place it appears and inserting in lieu thereof "April 1, 1955".

* * * * * * *

(8) Section 3403 (relating to tax on automobiles, etc.).

* * * * * * *

PAR. 28. Paragraphs (a) and (b) of section 316.51, as amended by Treasury Decision 6029, are further amended to read as follows:

(a) Automobile truck chassis and bodies; highway tractors; automobile bus chassis and bodies; automobile truck and bus trailer and semitrailer chassis and bodies:

October 1, 1941 to October 31, 1951, inclusive	5 percent
November 1, 1951 to March 31, 1955, inclusive	8 percent
On and after April 1, 1955	5 percent

(b) Other automobile chassis and bodies; other automobile trailer and semitrailer chassis and bodies; motorcycles:

October 1, 1941 to October 31, 1951, inclusive	7 percent
November 1, 1951 to March 31, 1955, inclusive	10 percent
On and after April 1, 1955	7 percent

PAR. 29. Immediately preceding section 316.55 there is inserted the following:

SEC. 601. ONE-YEAR EXTENSION OF CERTAIN EXCISE TAX RATES [EXCISE TAX REDUCTION ACT OF 1954, APPROVED MARCH 31, 1954].

(a) EXTENSION OF RATES.—The following provisions are hereby amended by striking out "April 1, 1954" each place it appears and inserting in lieu thereof "April 1, 1955":

* * * * * * *

(8) Section 3403 (relating to tax on automobiles, etc.).

* * * * * * *

PAR. 30. Section 316.56, as amended by Treasury Decision 6029, is further amended to read as follows:

SEC. 316.56. RATES OF TAX.—The tax is payable by the manufacturer on the sale price of the articles listed at the rates specified below:

Automobile parts and accessories:

October 1, 1941 to October 31, 1951, inclusive	5 percent
November 1, 1951 to March 31, 1955, inclusive	8 percent
On and after April 1, 1955	5 percent

In each case the taxable sale price shall be determined in accordance with the provisions of sections 316.8 to 316.15, inclusive.

PAR. 31. Immediately preceding section 316.70 there is inserted the following:

SEC. 305. REDUCTION OF TAX ON REFRIGERATORS AND QUICK-FREEZE UNITS * * * [EXCISE TAX REDUCTION ACT OF 1954, APPROVED MARCH 31, 1954].

(a) REDUCTION OF TAX.—Section 3405 (relating to manufacturers' excise tax on refrigerators, quick-freeze units, and self-contained air-conditioning units) is hereby amended by striking out "10 per centum"

and inserting in lieu thereof the following: "5 per centum (10 per centum in the case of articles subject to tax under subsection (c))"; * * *.

* * * * * * *

SEC. 505. EFFECTIVE DATES [EXCISE TAX REDUCTION ACT OF 1954, APPROVED MARCH 31, 1954].

(a) The amendments made by * * * title III [inc. sec. 305(a)] * * * shall apply only with respect to articles sold on or after April 1, 1954. * * *

* * * * * * *

PAR. 32. Section 316.74, as amended by Treasury Decision 5854, [C. B. 1951-2, 205], approved September 13, 1951, is further amended to read as follows:

SEC. 316.74. RATES OF TAX.—The tax is payable by the manufacturer on the sale price of the articles listed at the rates specified below:

(a) Refrigerators, etc., and refrigerating apparatus:
October 1, 1941 to October 31, 1942, inclusive ..... 10 percent
(b) Household type refrigerators and refrigerating apparatus:
November 1, 1942 to October 31, 1950, inclusive ..... 10 percent
(c) Household type refrigerators, household type units for the quick freezing or frozen storage of foods, and refrigerating and freezing apparatus:
November 1, 1950 to March 31, 1954, inclusive ..... 10 percent
On and after April 1, 1954 ..... 5 percent
(d) Self-contained air-conditioning units ..... 10 percent

In each case the taxable sale price shall be determined in accordance with the provisions of sections 316.8 to 316.15, inclusive.

PAR. 33. Immediately preceding section 316.90 there is inserted the following:

SEC. 301. EXCISE TAXES IMPOSED BY THE REVENUE ACT OF 1941 [EXCISE TAX REDUCTION ACT OF 1954, APPROVED MARCH 31, 1954].

(a) TAX ON SPORTING GOODS.—Section 3406(a)(1) (relating to manufacturers' excise tax on sporting goods) is hereby amended by striking out "15 per centum, except that on and after April 1, 1954, the rate shall be 10 per centum;".

* * * * * * *

SEC. 505. EFFECTIVE DATES [EXCISE TAX REDUCTION ACT OF 1954, APPROVED MARCH 31, 1954].

(a) The amendments made by * * * title III [inc. sec. 301 (a)] * * * shall apply only with respect to articles sold on or after April 1, 1954. * * *

* * * * * * *

PAR. 34. Immediately preceding section 316.110 there is inserted the following:

SEC. 305. REDUCTION OF TAX * * * ON ELECTRIC, GAS, AND OIL HOUSEHOLD APPLIANCES [EXCISE TAX REDUCTION ACT OF 1954, APPROVED MARCH 31, 1954].

(a) REDUCTION OF TAX.—* * * section 3406(a)(3) (relating to manufacturers' excise tax on electric, gas, and oil appliances) is hereby amended by striking out "10 per centum" and inserting in lieu thereof "5 per centum".

* * * * * * *

SEC. 505. EFFECTIVE DATES [EXCISE TAX REDUCTION ACT OF 1954, APPROVED MARCH 31, 1954].

(a) The amendments made by * * * title III [inc. sec. 305(a)] * * * shall apply only with respect to articles sold on or after April 1, 1954. * * *

* * * * * * *

PAR. 35. Section 316.111, as added by Treasury Decision 5099 [C. B. 1941–2, 267], approved November 28, 1941, is amended to read as follows:

SEC. 316.111. RATES OF TAX.—The tax is payable by the manufacturer on the sale price of the articles listed at the rates specified below:

(a) Electric direct motor-driven fans and air circulators and electric, gas, or oil appliances:

October 1, 1941 to October 31, 1951, inclusive ..... 10 percent

(b) Electric direct motor-driven fans and air circulators (not of the industrial type) and household type electric, gas, or oil appliances:

November 1, 1951 to March 31, 1954, inclusive ..... 10 percent
On and after April 1, 1954 ..... 5 percent

In each case the taxable sale price shall be determined in accordance with the provisions of sections 316.8 to 316.15, inclusive.

PAR. 36. Immediately preceding section 316.120 there is inserted the following:

SEC. 301. EXCISE TAXES IMPOSED BY THE REVENUE ACT OF 1941 [EXCISE TAX REDUCTION ACT OF 1954, APPROVED MARCH 31, 1954].

* * * * * * *

(b) TAX ON PHOTOGRAPHIC APPARATUS.—Section 3406(a)(4) (relating to manufacturers' excise tax on photographic apparatus) is hereby amended by striking out "20 per centum" and inserting in lieu thereof "10 per centum".

* * * * * * *

SEC. 505. EFFECTIVE DATES [EXCISE TAX REDUCTION ACT OF 1954, APPROVED MARCH 31, 1954].

(a) The amendments made by * * * title III [inc. sec. 301 (b)] * * * shall apply only with respect to articles sold on or after April 1, 1954. * * *

* * * * * * *

PAR. 37. Paragraphs (a) and (b) of section 316.122, as amended by Treasury Decision 6029, are further amended to read as follows:

(a) Cameras and lenses:

October 1, 1941 to October 31, 1942, inclusive ..... 10 percent
November 1, 1942 to October 31, 1951, inclusive ..... 25 percent
November 1, 1951 to March 31, 1954, inclusive ..... 20 percent
On and after April 1, 1954 ..... 10 percent

(b) Unexposed photographic film in rolls (except X-ray film):

October 1, 1941 to October 31, 1942, inclusive ..... 10 percent
November 1, 1942 to October 31, 1951, inclusive ..... 15 percent
November 1, 1951 to March 31, 1954, inclusive ..... 20 percent
On and after April 1, 1954 ..... 10 percent

PAR. 38. Immediately preceding section 316.180 there is inserted the following:

SEC. 301. EXCISE TAXES IMPOSED BY THE REVENUE ACT OF 1941 [EXCISE TAX REDUCTION ACT OF 1954, APPROVED MARCH 31, 1954].

* * * * * * *

(c) TAX ON ELECTRIC LIGHT BULBS AND TUBES.—Section 3406(a) (10) (relating to manufacturers' excise tax on electric light bulbs and tubes) is hereby amended to read as follows:

"(10) Electric light bulbs and tubes.—Electric light bulbs and tubes, not including articles taxable under any other provision of this subchapter, 10 per centum."

SEC. 504. TECHNICAL AMENDMENTS [EXCISE TAX REDUCTION ACT OF 1954, APPROVED MARCH 31, 1954].

(a) TERMINATION OF TAX RATES UNDER SECTION 1650.—Section 1650 (relating to war tax rates of certain miscellaneous taxes) is hereby amended by inserting after "beginning with the effective date of title III of the Revenue Act of 1943" the following: "and ending March 31, 1954,".

* * * * * * *

SEC. 505. EFFECTIVE DATES [EXCISE TAX REDUCTION ACT OF 1954, APPROVED MARCH 31, 1954].

(a) The amendments made by * * * title III [inc. sec. 301(c)] * * *, and the amendment made by section 504(a) insofar as it affects * * * the rate of the manufacturers' excise tax imposed by section 3406(a) (10) of such Code, shall apply only with respect to articles sold on or after April 1, 1954. * * *

* * * * * * *

PAR. 39. Section 316.181, as amended by Treasury Decision 5563 [C. B. 1947-1,156], approved May 16, 1947, is further amended to read as follows:

SEC. 316.181. RATES OF TAX.—The tax is payable by the manufacturer on the sale price of the articles listed at the rates specified below:

Electric light bulbs and tubes:

October 1, 1941 to March 31, 1944, inclusive	5 percent
April 1, 1944 to March 31, 1954, inclusive	20 percent
On and after April 1, 1954	10 percent

In each case the taxable sale price shall be determined in accordance with the provisions of sections 316.8 to 316.15, inclusive.

PAR. 40. Immediately preceding section 316.196 there is inserted the following:

SEC. 302. TAX ON MECHANICAL PENCILS, FOUNTAIN AND BALLPOINT PENS, AND MECHANICAL LIGHTERS FOR CIGARETTES, CIGARS, AND PIPES [EXCISE TAX REDUCTION ACT OF 1954, APPROVED MARCH 31, 1954].

Section 3408(a) (relating to tax on mechanical pencils, fountain and ball-point pens, and mechanical lighters for cigarettes, cigars, and pipes) is hereby amended by striking out "15 per centum" and inserting in lieu thereof "10 per centum".

SEC. 505. EFFECTIVE DATES [EXCISE TAX REDUCTION ACT OF 1954, APPROVED MARCH 31, 1954].

(a) The amendments made by * * * title III [inc. sec. 302] * * * shall apply only with respect to articles sold on or after April 1, 1954. * * *

* * * * * * *

PAR. 41. Section 316.199, as added by Treasury Decision 6029, is amended to read as follows:

SEC. 316.199. RATES OF TAX.—The tax is payable by the manufacturer on the sale price of the articles listed at the rates specified below:

Mechanical pencils, fountain and ball-point pens, and mechanical lighters for cigarettes, cigars, and pipes:

November 1, 1951 to March 31, 1954, inclusive	15 percent
On and after April 1, 1954	10 percent

In each case the taxable sale price shall be determined in accordance with the provisions of sections 316.8 to 316.15, inclusive.

PAR. 42. Section 316.204, as amended by Treasury Decision 6029, is further amended by adding at the end thereof the following new paragraph (26 CFR 316.204(r)):

Claims for refund or credit with respect to returned sales, sales for export, sales to States, etc., and sales for exempt uses, authorized under section 3443 (a) of the Code, asserted with respect to articles taxable under section 3405 (a) or (b) or 3406(a) (3) or (10) sold prior to April 1, 1954, shall be based on the rate of tax in effect on or after April 1, 1954; except that where proper evidence is submitted to show that such articles were not covered by a claim for refund or credit provided for under the provisions of section 316.204a, relating to claims for refund or credit of tax on floor stocks, the claim for refund or credit filed pursuant to section 316.204 shall be based on the rate of tax in effect prior to April 1, 1954.

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PAR. 43. Immediately preceding article 1 (26 CFR 302.1) there is inserted the following:

SEC. 502. TAX ON PISTOLS AND REVOLVERS [EXCISE TAX REDUCTION ACT OF 1954, APPROVED MARCH 31, 1954].

Section 2700(a) (relating to tax on pistols and revolvers) is hereby amended by striking out "11 per centum" and inserting in lieu thereof "10 per centum".

SEC. 505. EFFECTIVE DATES [EXCISE TAX REDUCTION ACT OF 1954, APPROVED MARCH 31, 1954].

(a) The amendments made by * * * section 502 * * * shall apply only with respect to articles sold on or after April 1, 1954. For the purposes of the preceding sentence, an article shall not be considered sold before April 1, 1954, unless possession or right to possession passes to the purchaser before such date. In the case of—

(1) a lease,

(2) a contract for the sale of an article wherein it is provided that the price shall be paid by installments and title to the article sold does not pass until a future date notwithstanding partial payment by installments,

(3) a conditional sale, or

(4) a chattel mortgage arrangement wherein it is provided that the sales price shall be paid in installments,

entered into before April 1, 1954, payments made on or after April 1, 1954, shall, for purposes of this subsection, be considered as payments made with respect to articles sold on or after April 1, 1954.

* * * * * * *

PAR. 44. Article 1 (26 CFR 302.1), as amended by Treasury Decision 5083 [C. B. 1941–2, 293], approved October 3, 1941, is further amended to read as follows:

ARTICLE 1. *Rates of tax.*—The tax is payable by the manufacturer on the sale price of the articles listed at the rates specified below:

Pistols and revolvers:	
Prior to July 1, 1940	10 percent
July 1, 1940 to March 31, 1954, inclusive	11 percent
On and after April 1, 1954	10 percent

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PAR. 45. Section 320.0 is amended by adding at the end thereof the following new paragraph:

The statutory references are to the Internal Revenue Code of 1939 (53 Stat., Part 1) unless otherwise stated.

PAR. 46. Immediately preceding section 320.2 there is inserted the following:

SEC. 505. EFFECTIVE DATES [EXCISE TAX REDUCTION ACT OF 1954, APPROVED MARCH 31, 1954].

(a) The amendments made by title I [secs. 101–102], * * *, and the amendment made by section 504(a) insofar as it affects the rates of the retailers' excise taxes imposed by sections 2400, 2401, and 2402 of the Internal Revenue Code * * *, shall apply only with respect to articles sold on or after April 1, 1954. * * *

* * * * * * *

PAR. 47. Section 320.2, as amended by Treasury Decision 5922 [C. B. 1952–2, 257], approved July 28, 1952, is further amended by adding at the end thereof the following new paragraph (26 CFR 320.2(c)):

The Excise Tax Reduction Act of 1954, effective April 1, 1954, provides for the reduction in the rates of tax on jewelry, furs, toilet preparations, and luggage. The Act further provides the rule to be used to determine the rate of tax to be applied to payments made on or after April 1, 1954, for articles leased, sold on an installment contract, sold on a conditional sale contract, or sold on a chattel mortgage arrangement providing for payments in installments, where such lease, contract, etc., was entered into prior to April 1, 1954.

PAR. 48. Immediately preceding section 320.10 there is inserted the following:

SEC. 505. EFFECTIVE DATES [EXCISE TAX REDUCTION ACT OF 1954, APPROVED MARCH 31, 1954].

(a) The amendments made by title I [secs. 101–102] * * *, and the amendment made by section 504(a) insofar as it affects the rates of the retailers' excise taxes imposed by sections 2400, 2401, and 2402 of the Internal Revenue Code * * *, shall apply only with respect to articles sold on or after April 1, 1954. For the purposes of the preceding sentence, an article shall not be considered sold before April 1, 1954, unless possession or right to possession passes to the purchaser before such date. In the case of —

(1) a lease,

(2) a contract for the sale of an article wherein it is provided that the price shall be paid by installments and title to the article sold does not pass until a future date notwithstanding partial payment by installment,

(3) a conditional sale, or

(4) a chattel mortgage arrangement wherein it is provided that the sales price shall be paid in installments,

entered into before April 1, 1954, payments made on or after April 1, 1954, shall, for the purposes of this subsection, be considered as payments made with respect to articles sold on or after April 1, 1954.

* * * * * * *

PAR. 49. Section 320.10, as amended by Treasury Decision 5353 [C. B. 1944, 597], approved March 31, 1944, is further amended by adding at the end thereof the following new paragraph (26 CFR 320.10(f)):

The following rules shall apply in the case of articles with respect to which the rate of tax was reduced by the Excise Tax Reduction Act of 1954:

(1) If an article is sold prior to April 1, 1954, it shall be subject to tax at the rate in effect prior to such date.

(2) An article shall be considered sold prior to April 1, 1954, if possession or right to possession passes to the purchaser prior to that date. Thus, in the case of a transaction in which the vendor retains possession and the vendee has no right to possession until after March 31, 1954; the rate of tax in effect on or after April 1, 1954, shall apply to the entire sale price of

the article, irrespective of whether any portion of the sale price was received by the vendor prior to, on, or after April 1, 1954. Where the vendor retains possession merely for the convenience of the vendee and the vendee is entitled to possession at any time before April 1, 1954, the rate in effect prior to such date shall apply to the price for which the article is sold.

(3) Where an article, prior to April 1, 1954, is (i) leased, (ii) sold under an installment contract (iii) sold on a conditional sale contract, or (iv) sold on a chattel mortgage arrangement providing for installment payments, the tax rate in effect prior to April 1, 1954, shall apply to all payments made prior to April 1, 1954, and the tax rate in effect on or after April 1, 1954, shall apply to all payments made on or after that date.

PAR. 50. Immediately preceding section 320.30 there is inserted the following:

SEC. 102. RETAILERS' EXCISE TAXES ON JEWELRY * * * [EXCISE TAX REDUCTION ACT OF 1954, APPROVED MARCH 31, 1954].

For reduction in rate of retailers' excise taxes on jewelry * * *, see section 504(a).

SEC. 504. TECHNICAL AMENDMENTS [EXCISE TAX REDUCTION ACT OF 1954, APPROVED MARCH 31, 1954].

(a) TERMINATION OF TAX RATES UNDER SECTION 1650.—Section 1650 (relating to war tax rates of certain miscellaneous taxes) is hereby amended by inserting after "beginning with the effective date of title III of the Revenue Act of 1943" the following: "and ending March 31, 1954,".

* * * * * * *

SEC. 505. EFFECTIVE DATES [EXCISE TAX REDUCTION ACT OF 1954, APPROVED MARCH 31, 1954].

(a) The amendments made by title I [inc. sec. 102] * * *, and the amendment made by section 504(a) insofar as it affects the rates of the retailers' excise taxes imposed by sections 2400 * * * of the Internal Revenue Code * * *, shall apply only with respect to articles sold on or after April 1, 1954. * * *

* * * * * * *

PAR. 51. Section 320.38, as amended by Treasury Decision 5558 [C. B. 1947-1, 157], approved April 11, 1947, is further amended to read as follows:

SEC. 320.38. RATES OF TAX.—The tax is payable by the retailer based upon the price for which the taxable article is sold by him at the rates specified below:

(a) October 1, 1941 to March 31, 1944, inclusive	
All articles	10 percent
(b) April 1, 1944 to March 31, 1954, inclusive	
Watches selling at retail for $65 or less	10 percent
Alarm clocks selling at retail for $5 or less	10 percent
All other articles	20 percent
(c) On and after April 1, 1954	
All articles	10 percent

The price for which an article is sold shall be determined in accordance with the provisions of sections 320.5 to 320.10, inclusive, and section 320.74.

PAR. 52. Immediately preceding section 320.40 there is inserted the following:

SEC. 102. RETAILERS' EXCISE TAXES ON * * * FURS * * * [EXCISE TAX REDUCTION ACT OF 1954, APPROVED MARCH 31, 1954].

For reduction in rate of retailers' excise taxes on * * * furs * * *, see section 504(a).

SEC. 504. TECHNICAL AMENDMENTS [EXCISE TAX REDUCTION ACT OF 1954, APPROVED MARCH 31, 1954].

(a) TERMINATION OF TAX RATES UNDER SECTION 1650.—Section 1650 (relating to war tax rates of certain miscellaneous taxes) is hereby amended by inserting after "beginning with the effective date of title III of the Revenue Act of 1943" the following: "and ending March 31, 1954,".

* * * * * * *

SEC. 505. EFFECTIVE DATES [EXCISE TAX REDUCTION ACT OF 1954, APPROVED MARCH 31, 1954].

(a) The amendments made by title I [inc. sec. 102] * * *, and the amendment made by section 504(a) insofar as it affects the rates of the retailers' excise taxes imposed by sections * * * 2401 * * * of the Internal Revenue Code * * *, shall apply only with respect to articles sold on or after April 1, 1954. * * *

* * * * * * *

PAR. 53. Section 320.42, as amended by Treasury Decision 5558, is further amended to read as follows:

SEC. 320.42. RATES OF TAX.—The tax is payable by the retailer based upon the price for which the taxable article is sold by him at the rates specified below:

October 1, 1941 to March 31, 1944, inclusive	10 percent
April 1, 1944 to March 31, 1954, inclusive	20 percent
On and after April 1, 1954	10 percent

The price for which an article is sold shall be determined in accordance with the provisions of sections 320.5 to 320.10, inclusive, and section 320.74.

PAR. 54. Immediately preceding section 320.50 there is inserted the following:

SEC. 102. RETAILERS' EXCISE TAXES ON * * * TOILET PREPARATIONS [EXCISE TAX REDUCTION ACT OF 1954, APPROVED MARCH 31, 1954].

For reduction in rate of retailers' excise taxes on * * * toilet preparations, see section 504(a).

SEC. 504. TECHNICAL AMENDMENTS [EXCISE TAX REDUCTION ACT OF 1954, APPROVED MARCH 31, 1954].

(a) TERMINATION OF TAX RATES UNDER SECTION 1650.—Section 1650 (relating to war tax rates of certain miscellaneous taxes) is hereby amended by inserting after "beginning with the effective date of title III of the Revenue Act of 1943" the following: "and ending March 31, 1954,".

* * * * * * *

SEC. 505. EFFECTIVE DATES [EXCISE TAX REDUCTION ACT OF 1954, APPROVED MARCH 31, 1954].

(a) The amendments made by title I [inc. sec. 102] * * *, and the amendment made by section 504(a) insofar as it affects the rates of the retailers' excise taxes imposed by sections * * * 2402 of the Internal Revenue Code * * *, shall apply only with respect to articles sold on or after April 1, 1954. * * *

* * * * * * *

PAR. 55. Section 320.51, as amended by Treasury Decision 5558, is further amended to read as follows:

SEC. 320.51. RATES OF TAX.—The tax is payable by the retailer based upon the price for which the taxable article is sold by him at the rates specified below:

October 1, 1941 to March 31, 1944, inclusive	10 percent
April 1, 1944 to March 31, 1954, inclusive	20 percent
On and after April 1, 1954	10 percent

The price for which an article is sold shall be determined in accordance with the provisions of sections 320.5 to 320.10, inclusive, and section 320.74.

PAR. 56. Immediately preceding section 320.60 there is inserted the following:

SEC. 101. RETAILERS' EXCISE TAX ON LUGGAGE, ETC. [EXCISE TAX REDUCTION ACT OF 1954, APPROVED MARCH 31, 1954.].

Section 1651(a) (relating to retailers' excise tax on luggage, etc.) is hereby amended by striking out "20 per centum" and inserting in lieu thereof "10 per centum".

SEC. 505. EFFECTIVE DATES [EXCISE TAX REDUCTION ACT OF 1954, APPROVED MARCH 31, 1954].

(a) The amendments made by title I [inc. sec. 101] * * * shall apply only with respect to articles sold on or after April 1, 1954, * * *

* * * * * * *

PAR. 57. The first paragraph of section 320.61, as added by Treasury Decision 5353 (26 CFR 320.61(a)), is amended to read as follows:

SEC. 320.61. RATES OF TAX.—The tax is payable by the retailer based upon the price for which the taxable articles is sold by him at the rates specified below:

April 1, 1944 to March 31, 1954, inclusive ..... 20 percent
On and after April 1, 1954 ..... 10 percent

The price for which an article is sold shall be determined in accordance with the provisions of sections 320.5 to 320.10, inclusive, and section 320.74.

REGULATIONS 59

PAR. 58. Section 323.0, as amended by Treasury Decision 5827 [C. B. 1951-1, 142], approved January 16, 1951, is further amended by changing the last paragraph to read as follows:

The statutory references are to the Internal Revenue Code of 1939 (53 Stat., part 1) unless otherwise stated.

PAR. 59. Immediately preceding section 323.30 there is inserted the following:

SEC. 504. TECHNICAL AMENDMENTS [EXCISE TAX REDUCTION ACT OF 1954, APPROVED MARCH 31, 1954].

(a) TERMINATION OF TAX RATES UNDER SECTION 1650.—Section 1650 (relating to war tax rates of certain miscellaneous taxes) is hereby amended by inserting after "beginning with the effective date of title III of the Revenue Act of 1943" the following: "and ending March 31, 1954,".

* * * * * * *

(d) BOWLING ALLEYS AND BILLIARD AND POOL TABLES.—The first sentence of section 3268(a) (relating to tax on bowling alleys, and billiard and pool tables) is hereby amended to read as follows: "Every person who operates a bowling alley, billiard room, or pool room shall pay a special tax of $20 per year for each bowling alley, billiard table, or pool table."

Because this Treasury Decision amends the several regulations merely by incorporating the reduction in the rates of certain excise taxes made by the Excise Tax Reduction Act of 1954 and by making certain other related changes of a technical nature, it is found unnecessary to issue this Treasury Decision with notice and public procedure thereon under section 4(a) of the Administrative Procedure Act, approved June 11, 1946, or subject to the effective date limitation of section 4(c) of said Act.

This Treasury Decision shall be effective on April 1, 1954.

(This Treasury Decision is issued pursuant to the authority contained in sections 1855, 2410, 3450, 3472, and 3791 of the Internal Revenue Code of 1939 (53 Stat. 206, 419, 423, 467, 722, and 55 Stat. 720; 26 U. S. C. 1855, 2410, 3450, 3472, and 3791).)

O. GORDON DELK,
Acting Commissioner of Internal Revenue.

Approved: August 23, 1955.

DAVID W. KENDALL,
Acting Secretary of the Treasury.

(Filed with the Division of the Federal Register August 26, 1955, 8:47 a. m.)

FEDERAL FIREARMS ACT

SECTION 1

Classification of a device designed for submarine spear fishing but capable of chambering and firing .22 caliber rimfire ammunition. See Rev. Rul. 55-569, page 483.

Classification of a burglar alarm device consisting of a metal cylinder hinged in the middle to chamber a 20 gauge shotgun shell after the portion of the shell containing the lead charge has been cut off. See Rev. Rul. 55-699, page 481.

PART III

ALCOHOL TAX RULINGS AND DECISIONS

SUBPART A.—RULINGS AND DECISIONS UNDER THE INTERNATIONAL REVENUE CODE OF 1954

Rulings and decisions published in Part III, Subpart A, of the Internal Revenue Bulletin are based on the application of provisions of the Internal Revenue Code of 1954 and, unless otherwise noted therein, are published without consideration as to any application of the provisions of the Internal Revenue Code of 1939, the Federal Alcohol Administration Act, or related public laws.

SUBTITLE E.—ALCOHOL TOBACCO AND CERTAIN OTHER EXCISE TAXES

CHAPTER 51.—DISTILLED SPIRITS, WINES, AND BEER

SUBCHAPTER A.—GALLONAGE AND OCCUPATIONAL TAXES

PART I.—GALLONAGE TAXES

SUBPART A.—DISTILLED SPIRITS

SECTION 5008.—STRIP STAMPS FOR DISTILLED SPIRITS

26 CFR 225.1038: Original overprinting of stamps. Rev. Rul. 55–509

As stated in Revenue Ruling 54–543, C. B. 1954–2, 444, a distiller may show his real name and a trade name in equal prominence on labels of distilled spirits where the spirits were produced and warehoused by him under such trade name. *Held*, that where spirits are produced and warehoused under a trade name, *i. e.*, the barrels are marked only with the trade name and are to be bottled in bond under labels stating the actual bona fide name of the distiller and the trade name, as provided in Revenue Ruling 54–453, *supra*, both such names should be shown on the bottled in bond strip stamp consistent with the labeling of the spirits.

SECTION 5011.—ABATEMENT, REMISSION, REFUND AND ALLOWANCE FOR LOSS OR DESTRUCTION OF DISTILLED SPIRITS

26 CFR 225.480: Taxable losses. Rev. Rul. 55-739

Revenue Ruling 54-290, C. B. 1954-2, 469, provides that where an application for voluntary destruction of distilled spirits in an internal revenue bonded warehouse is timely filed before the expiration of the eight-year storage period, but the necessary steps to effect the destruction thereof cannot be completed within such period, the spirits may continue to remain in the warehouse temporarily pending final action on the application. While that Revenue Ruling was issued under the Internal Revenue Code of 1939, the principles expressed therein, respecting the timely filing of applications to destroy spirits and the taxability of spirits remaining in a warehouse at the expiration of the eight-year storage period are of equal application under the Internal Revenue Code of 1954. However, the 1954 Code does not require the spirits to be unfit for beverage purposes in order to be eligible for destruction. Section 5011(b) thereof provides that a distiller, warehouseman, or other person responsible for the tax imposed by Chapter 51 with respect to any distilled spirits in bond, may voluntarily destroy such spirits, but only if such destruction is under such supervision and under such regulations as the Secretary or his delegate may prescribe.

If spirits are not withdrawn upon payment of the tax, or as otherwise provided, within eight years from the date of original entry, the tax becomes due and payable on the basis of the regauge for tax determination, without further loss allowance. This obligation upon the warehouseman cannot be altered by reason of his inability to collect the tax from the owner, or to acquire title to abandoned spirits prior to the eight-year force-out. If a warehouseman intends to file an application for destruction, it is necessary that such application be filed prior to the expiration of the eighth anniversary of storage. Such application would be timely filed and would enable the warehouseman to hold the spirits temporarily, if necessary, in order to complete arrangements for the destruction of the spirits.

The filing of a timely application will not preclude taxpayment and withdrawal of the spirits covered by the application if, before destruction is actually effected, it is desired to taxpay and withdraw the spirits. However, failure to effect destruction of spirits covered by a timely application within a reasonable time after expiration of the eight-year period will result in assessment of tax on the spirits and the consequent loss of the privilege of voluntary destruction without payment of tax.

SUBPART C.—WINES

SECTION 5042.—EXEMPTION FROM TAX

26 CFR 240.540: Registered producer. Rev. Rul. 55-489

Section 5387 of the Internal Revenue Code of 1954 provides in part that wine made from agricultural products other than the juice

of fruit shall be made in accordance with good commercial practice as may by regulations be prescribed. The Wine Regulations specifically provide that grain, cereals, malts, or molasses may not be used on bonded wine cellar premises and that alcoholic products made with these materials are not wines. *Held*, barley is not a suitable agricultural product for use in the production of wine. Accordingly, wine may not be produced therefrom for family use under the exemption from tax provided by section 5042 of the Code.

SUBPART D.—BEER

SECTION 5053.—EXEMPTIONS

26 CFR 245.291: Reciprocating foreign countries.

Federal Republic of Germany added to list of reciprocating foreign countries. See Rev. Rul. 55–741, page 702.

SUBPART E.—GENERAL PROVISIONS

SECTION 5062.—REFUND AND DRAWBACK IN CASE OF EXPORTATION

26 CFR 252.4: Reciprocating foreign countries.

Federal Republic of Germany added to list of reciprocating foreign countries. See Rev. Rul. 55–741, page 702.

SUBPART D.—WHOLESALE DEALERS

SECTION 5111.—IMPOSITION AND RATE OF TAX

26 CFR 194.23: Single sale. Rev. Rul. 55–634

A wholesale liquor dealer engaged in the business of selling distilled spirits or distilled spirits and wine in wholesale quantities, who terminates his business at the end of a fiscal year, may in the next fiscal year dispose of his stock in one parcel, or in parcels embracing his entire stock, without incurring additional special tax liability for the latter year, since under such circumstances he is not regarded as continuing in the business of a wholesale liquor dealer. If such dealer is also engaged in the sale of beer and continued selling beer in wholesale quantities, he must, effective July 1, pay special tax as a wholesale dealer in beer. Likewise, if such dealer discontinued the sale of beer but continued the sale of either distilled spirits or wine, or both, he would be required to pay special tax as a wholesale dealer in liquors.

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SECTION 5113.—EXEMPTIONS

26 CFR 240.341 Exemption of proprietor. Rev. Rul. 55-510

Upon the death of a winemaker who was the sole owner of a bonded wine cellar and who sold wine only of his own production, his widow operating as executrix, would not be liable for the special tax as a wholesale or retail liquor dealer by reason of the sale of wine produced by her deceased husband. She would, however, be liable for the special tax if, when the estate is closed, she operates the wine cellar as an individual owner and sells wine produced by her former husband unless the wine has been so blended or treated as to be considered wine of her own production.

The Internal Revenue Service has been requested to advise whether liability for the special tax as a wholesale and/or retail liquor dealer would be incurred by a widow who sells wine produced by her deceased husband if (1) she operates the bonded wine cellar as the executrix of her husband's estate, and (2) she later operates the bonded wine cellar as an individual owner.

A winemaker, the sole owner of a bonded wine cellar, sold wine only of his own production and therefore was exempt from special tax as a wholesale and retail liquor dealer under section 5113(c) of the Internal Revenue Code of 1954 and section 240.341 of the Wine Regulations. Upon the death of the winemaker, his widow, as executrix (or administratrix) of his estate engaged in the sale of wine produced by her deceased husband. After the estate was closed, the widow operated the wine cellar as an individual owner.

Upon the death of a winemaker who sold wine only of his own production, his widow, who is appointed executrix (or administratrix) of his estate and engages in the sale of wine produced by her deceased husband only, incurs no special tax liability as a wholesale or retail liquor dealer by reason of the sale of such wine. The widow in her official capacity as the executrix is recognized as the personal representative of the deceased and, as such, is not liable for the special tax because of the sale of wine produced by the deceased.

After the estate is closed, the widow, operating the bonded wine cellar as an individual owner, is liable for the special tax for the sale of the wine unless it has been so blended or treated as to be considered wine of her own production within the purview of section 240.341 of the Wine Regulations.

SECTION 5116.—SIGN REQUIRED ON PREMISES

26 CFR 194.236: By wholesale dealers in liquors.

Requirements with respect to the posting of a sign outside the business premises of a wholesale liquor dealer. See T. D. 6151, page 713.

SUBPART E.—RETAIL DEALERS

SECTION 5124.—RECORDS

26 CFR 194.229: General requirements for retail dealers.

Requirements relative to the keeping of records by retail dealers covering the receipt of distilled spirits, wines, or beer. See T. D 6151, page 713.

SUBPART F.—NONBEVERAGE DOMESTIC DRAWBACK CLAIMANTS

SECTION 5132.—REGISTRATION AND REGULATION

Rev. Rul. 55–512

Nonbeverage manufacturers who produce vanilla extract are not authorized under sections 5131 to 5134, inclusive, of the Internal Revenue Code of 1954, to traffic in residue such as spent vanilla beans containing alcohol upon which drawback of tax has been allowed. *Held*, spent vanilla beans may not be sold by nonbeverage manufacturers except where all alcohol has been removed or unless such spent vanilla beans have been treated with a substance which will prevent the recovery of any alcohol. To accomplish this, the exhausted beans must be dried to the extent that all alcohol has been evaporated before removal from the nonbeverage premises or they must be treated with kerosene sufficiently to prevent any residual alcohol from being recovered therefrom.

Except in the event of sale as provided above, spent vanilla beans must be destroyed by burning by the nonbeverage manufacturer or must be removed from the premises of the nonbeverage manufacturer for destruction by the sanitation department of the city or municipality. In all instances where exhausted vanilla beans are so removed, the nonbeverage manufacturer must first treat the spent beans with kerosene to the extent that it will be impossible to recover any of the alcohol therefrom.

SUBPART G.—GENERAL PROVISIONS

SECTION 5144.—PROVISIONS RELATING TO LIABILITY FOR OCCUPATIONAL TAXES

26 CFR 245.174: Each place of business taxable. Rev. Rul. 55–549

Under section 5144 of the Internal Revenue Code of 1954 and section 245.174 of the Beer Regulations, liability for special tax is incurred by a brewer at each place of business where he carries on any occupation subject to such tax. However, those sections provide that "place of business" means the entire office, plant or area of the business in any one location under the same proprietorship, and passageways, streets, railways, rail crossings, waterways, or partitions dividing the premises shall not be deemed sufficient separation to

require additional special tax, if the various divisions of the premises are otherwise contiguous. *Held*, the premises for which only one special tax liability is incurred may include an area beyond the bonded premises if such premises and area are not divided or separated otherwise than is recognized in the law and regulations. Therefore, a brewer is not required to submit Form 27–C, Notice By Brewer, to extend the brewery premises to include contiguous areas where beer is sold in order to obtain advantage of the provisions of section 5144 of the Code and section 245.174 of the Beer Regulations.

SUBCHAPTER B.—DISTILLERIES

PART II.—OPERATION

SECTION 5193.—DRAWING, GAUGING, AND MARKING OF DISTILLED SPIRITS

26 CFR 220.544: General. Rev. Rul. 55–740
(Also 225.610.)
(Also Part III–C, Federal Alcohol Administration Act, Section 5(e); FAA Regulations No. 5, Section 21.)

A product produced from neutral spirits at a registered distillery and subjected to the treatment prescribed for the manufacture of vodka, but packaged in reused whisky barrels, may not be designated or labeled as vodka. See Revenue Ruling 55–552, page 735 of this Bulletin which provides that a product having a light golden color from storage in wooden containers may not be labeled as vodka since it would not be without distinctive character. A product so produced and treated should, upon packaging in the distillery, be branded "neutral spirits—grain," followed by the phrase "subjected to vodka process." The product would then, upon bottling, be eligible for labeling as a specialty with a fanciful name and statement of composition.

26 CFR 225.610: Marking and branding packages of distilled spirits.

Branding of spirits subjected to the vodka treatment but packaged in wooden containers. See Rev. Rul. 55–740, page 700.

SECTION 5194.—TRANSFER OF SPIRITS AT REGISTERED DISTILLERIES

26 CFR 230.180: Notice, Form 230. Rev. Rul. 55–594
(Also 235.685.)
(Also Part III–C, Federal Alcohol Administration Act, Section 5(e); FAA Regulations No. 5, Section 21.)

Taxpaid vodka received at a taxpaid bottling house or at a rectifying plant may be reclassified and labeled as grain neutral spirits if the vodka was produced from grain neutral spirits at a registered distillery.

Advice has been requested whether taxpaid vodka distilled from grain and bottled at a rectifying plant may be labeled as grain neutral spirits.

Revenue Ruling 54–493, C. B. 1954–2, 472, provides that vodka produced from grain at 190 degrees of proof and otherwise eligible for classification as "Neutral Spirits—Grain" may be so reclassified prior to taxpayment and withdrawal from an internal revenue bonded warehouse.

Section 21, class 1(a), of Regulations No. 5, defines vodka as neutral spirits distilled from any material at or above 190 degrees of proof and further subjected to one of the refining processes specified therein. Therefore, under the standards of identity, such spirits are neutral spirits. Accordingly, they may be so labeled for bottling as neutral spirits and for use in blended whisky. However, neutral spirits which have not been subjected to one of the refining processes specified in section 21, class 1(a), would not be entitled to the designation vodka.

Taxpaid vodka received at a taxpaid bottling house or at a rectifying plant may be reclassified as grain neutral spirits and so labeled when bottled, provided the vodka was produced from grain neutral spirits at a registered distillery in accordance with the regulations. This ruling does not apply to vodka produced at a rectifying plant under exemption from the rectification tax.

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26 CFR 235.685: Notice, Form 230.

Reclassification of vodka as grain neutral spirits at a taxpaid bottling house or a rectifying plant. See Rev. Rul. 55–594, page 700.

PART III.—GENERAL PROVISIONS RELATING TO DISTILLERIES AND DISTILLED SPIRITS

SECTION 5212.—PREVENTION AND DETECTION OF FRAUD

26 CFR 182.733: Marking of packages. Rev. Rul. 55–490
(Also 26 CFR 182.735.)

The Industrial Alcohol Regulations do not require that the date of filling be placed on packages of specially denatured alcohol although the filling date appears in the illustration of marks in section 182.735. Accordingly, the filling date need not be stenciled or imprinted on packages of specially denatured alcohol. This ruling applies to packages of specially denatured alcohol only. The filling date must be shown on packages of completely denatured alcohol and proprietary solvents.

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26 CFR 182.735: Illustration of marks.

The filling date need not be stenciled or imprinted on packages of specially denatured alcohol. See Rev. Rul. 55–490, above.

26 CFR 230.190: Mingling of different spirits prohibited. Rev. Rul. 55-663

The proprietor of a taxpaid bottling house may consolidate barrels of homogeneous spirits stored therein into a lesser number of the same barrels for continued aging of such spirits. The procedure set forth in Subpart FF of the Regulations relating to the Rectification of Spirits and Wines should be followed insofar as applicable with respect to the gauging, marking, and stamping of wholesale liquor dealer's packages. All marks and brands on the empty packages should be completely obliterated. See Revenue Ruling 55-399, C. B. 1955-1, 572, with respect to the consolidation at an internal revenue bonded warehouse of packages of homogeneous spirits which were taxpaid at the end of 8 years.

SECTION 5214.—REGULATION OF TRAFFIC IN CONTAINERS OF DISTILLED SPIRITS

26 CFR 175.17: Liquor bottle. Rev. Rul. 55-511

Section 175.17 of the Regulations relating to Traffic in Containers of Distilled Spirits defines a liquor bottle as a container (a vessel of a capacity of not less than ½ pint and not more than 5 wine gallons, designed or intended for use for the sale of distilled spirits for other than industrial use) made of glass, or earthenware, or other suitable material approved by the Director, Alcohol and Tobacco Tax Division. Pursuant thereto, pewter has been approved as a suitable material for the manufacture of liquor bottles.

SUBCHAPTER C.—INTERNAL REVENUE BONDED WAREHOUSES

PART II.—OPERATION

SECTION 5248.—WITHDRAWAL OF SPIRITS WITHOUT PAYMENT OF TAX

26 CFR 182.630b: Reciprocating foreign countries. Rev. Rul. 55-741[1]
(Also 225.861; Sections 5053, 5062, 5362; 245.291, 252.4, 240.691.)

Alcohol, distilled spirits, wine and fermented malt liquor may be withdrawn free of tax or with benefit of drawback for use as supplies on aircraft registered in the Federal Republic of Germany and actually engaged in foreign trade or trade between the United States and its possessions, where trade by foreign aircraft is permitted. Accordingly, Revenue Ruling 54-576, C. B. 1954-2, 472, as modified by Revenue Ruling 55-362, C. B. 1955-1, 577, is further modified to include the Federal Republic of Germany.

As so modified, the Revenue Ruling reads as follows:

Under the provisions of section 309 of the Tariff Act of 1930, as amended (46 Stat. 690, as amended; 19 U. S. C. 1309), and applicable regulations of the Internal Revenue Service, alcohol, distilled spirits, fermented malt liquor and

[1] Revenue Ruling 56-81, I. R. B. 1956-10, 34, added Lebanon to this list of countries.

wine may be withdrawn free of tax or with benefit of drawback for use as supplies on aircraft registered in the following foreign countries and actually engaged in foreign trade or trade between the United States and its possessions, where trade by foreign aircraft is permitted.

Australia	Denmark	Japan
Bahama Islands	Ecuador	The Netherlands
Belgium	France	Norway
Bermuda	Germany, Federal Republic of	Peru
Brazil	Israel	Sweden
Canada	Italy	Switzerland
Costa Rica		United Kingdom

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26 CFR 225.861: Reciprocating foreign countries.

Federal Republic of Germany added to list of reciprocating foreign countries. See Rev. Rul. 55-741, page 702.

SUBCHAPTER D.—RECTIFYING PLANTS

PART II.—OPERATION

SECTION 5281.—REGULATION OF BUSINESS OF RECTIFIER

26 CFR 235.410: Marking processing tanks. Rev. Rul. 55-635

Section 235.410 of the Regulations relating to the Rectification of Spirits and Wines requires that the rectifier attach a copy of Form 122, Rectifier's Notice of Dumping and Rectification, to the processing tank or receptacle in which the spirits covered by the form were deposited. *Held*, in order to avoid damage to, and possible obliteration of the information on the Form 122, rectifiers may mark processing receptacles (barrels) with a tag showing all the pertinent information relative to the contents of the receptacle and reflecting thereon the serial number corresponding to the Form 122 pursuant to which the contents were dumped or rectified. In such case, Form 122 must be maintained on the rectifying premises and must be readily available for reference.

SUBCHAPTER E.—INDUSTRIAL ALCOHOL PLANTS, BONDED WAREHOUSES, DENATURING PLANTS, AND DENATURATION

PART I.—INDUSTRIAL ALCOHOL PLANTS, BONDED WAREHOUSES, AND DENATURING PLANTS

SECTION 5310.—WITHDRAWAL OF ALCOHOL FREE OF TAX

26 CFR 182.661: Hospitals, sanitariums, or clinics. Rev. Rul. 55-664

Section 5310(c) of the Internal Revenue Code of 1954 and section 182.661 of the Industrial Alcohol Regulations provide, in part, that

alcohol may be withdrawn from any industrial alcohol plant or bonded warehouse tax free for use in any hospital or sanitarium, or for the use of any clinic operated for charity and not for profit, including use in the compounding of bona fide medicines for treatment outside of such clinics of patients thereof, but not for sale. Under these sections of the law and regulations, it is held that:

(1) A hospital operated for charity or for profit, using tax-free alcohol, may make a separate charge for medicines compounded on hospital premises with tax-free alcohol for administering to patients on the premises. The sale of such medicines for use off the hospital premises is prohibited.

(2) A clinic operated in conjunction with a hospital may not sell medicines compounded with alcohol withdrawn free of tax for use of its patients off the premises, regardless of whether any payment represents the cost of the medicine, is more or less than cost, or is in the nature of a fee or contribution.

(3) A clinic, not connected with any hospital, operated for charity and not for profit, may charge a fee for medicines compounded with tax-free alcohol when administered inside the clinic and no profit is realized by the clinic from any patient as a result thereof or from any source or in any manner. Such a clinic may not dispense medicines compounded with tax-free alcohol to patients for use off the premises if the clinic accepts a fixed fee or nominal registration or admission fee from the patient. See also in this connection Revenue Ruling 54–464, C. B. 1954–2, 509.

The restrictions contained in this Revenue Ruling are applicable to medicines compounded with tax-free alcohol only. They do not apply to the sale of medicines compounded by hospital pharmacies or clinics with taxpaid alcohol, regardless of whether such alcohol may or may not be subject to drawback. Revenue Ruling 54–464, *supra*, should also be so interpreted.

PART II.—DENATURATION

SECTION 5331.—WITHDRAWAL FROM BOND FREE OF TAX

26 CFR 182.725: Approved containers. Rev. Rul. 55–633

The Regulations relating to Industrial Alcohol do not specify the method to be employed in determining tare of containers to be used for specially denatured alcohol or completely denatured alcohol. *Held*, average tare may be taken of containers intended for use in packaging specially denatured alcohol and completely denatured alcohol provided the average tare is determined by weighing not less than ten percent of the empty packages and in no case less than two packages.

SUBCHAPTER F.—BONDED AND TAXPAID WINE PREMISES

PART I.—ESTABLISHMENT

SECTION 5352.—TAXPAID WINE BOTTLING HOUSE

26 CFR 231.30: General. Rev. Rul. 55-595
(Also Federal Alcohol Administration Act, Section 5 (e); FAA Regulations No. 4, Section 35.)

The Taxpaid Wine Bottling House Regulations do not authorize the operation of a taxpaid wine bottling house under alternating proprietorships. Accordingly, such operations may not be permitted. However, the proprietor of a taxpaid wine bottling house may, upon amendment of his basic permit issued pursuant to the Federal Alcohol Administration Act and of his qualifying documents required by Subpart E of the Taxpaid Wine Bottling House Regulations, bottle wine under trade names. Any such authorized trade name may then be shown on bottle labels and on cases as the name of the proprietor. While the bottler (proprietor) may not use as a trade name the operating name of another dealer and may not qualify a trade name registered by another dealer, arrangements may be made between the bottler and another dealer whereby the bottler would qualify a trade name which would be used only on labels of wine to be sold by such other dealer. The label may show, in addition to such trade name but not in lieu thereof, the name and address of the dealer for whom the wine is bottled or packed, immediately preceded by the words "Bottled for," "Packed for," "Distributed by," or other similar statement, as authorized by section 35 of Regulations No. 4. However, the trade name of the bottler may not be similar to the name of the person or firm for whom bottled (unless they are related in ownership), since an erroneous impression may be created that the companies are related entities when such is in fact not the case.

PART II.—OPERATIONS

SECTION 5361.—BONDED WINE CELLAR OPERATIONS

26 CFR 240.130: Activity on bonded wine cellar premises. Rev. Rul. 55-743
(Also 240.133.)

Taxpaid wine may be received on bonded wine cellar premises from other producers for temporary storage and subsequent sale. Wine so received must be stored in the taxpaid room in accordance with the provisions of section 240.133 of the Wine Regulations.

The provisions of section 240.130 of the regulations preclude the establishment of a taxpaid wine bottling house within a taxpaid room of a bonded wine cellar. However, upon curtailment of the bonded

wine cellar by the exclusion of the taxpaid room therefrom, a portion of the taxpaid premises could be used for the establishment of a taxpaid wine bottling house. If access to such taxpaid wine bottling house is to be made through other commercial premises, including the bonded wine cellar, under the control of the proprietor, specific approval therefor must be obtained from the Assistant Regional Commissioner, Alcohol and Tobacco Tax, pursuant to the provisions of section 231.40 of the Taxpaid Wine Bottling House Regulations and section 240.140 of the Wine Regulations.

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26 CFR 240.133: Storage of taxpaid wine.

Receipt on bonded wine cellar premises of taxpaid wine from other producers for temporary storage and subsequent sale. See Rev. Rul. 55-743, page 705.

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26 CFR 240.351: Production on standard wine premises. (Also 240.481.) Rev. Rul. 55-742

Section 240.482 of the Wine Regulations, which requires the submission of formulas covering the production of other than standard wine, specifically exempts vinegar stock from such requirement. Vinegar stock, whether made with or without the use of sugar, may be produced on standard wine cellar premises or on other than standard wine cellar premises under the provisions of sections 240.351 and 240.481 of the Wine Regulations. However, section 240.352 provides that, in the production of other than standard wine, the aggregate weight of the sugar used before and during fermentation must be less than the weight of the primary wine producing material and that the wine must have a basic character derived from the primary material. Accordingly, unless, the vinegar stock is made with standard wine, it must conform to such limitations. Also, such wine must, at all times, be identified as vinegar stock.

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26 CFR 240.481: Classes of wine and other than standard wine.

Production of vinegar stock on standard wine cellar premises and on other than standard wine cellar premises. See Rev. Rul. 55-742, above.

SECTION 5362.—REMOVALS OF WINE FROM BONDED PREMISES

26 CFR 240.650: General. Rev. Rul. 55-744

Wine may be removed from a bonded wine cellar, free of tax, in accordance with the provisions of sections 240.650 through 240.658, inclusive, for use in a vinegar plant operated under bond in the production of vinegar by the addition of a sufficient quantity of 100 grain

distilled vinegar and water to the wine so that the finished product contains not less than four percent acetic acid. The labeling of such a product would, of course, be subject to applicable State or Federal requirements, including the requirements of the Food and Drug Administration of the Department of Health, Education and Welfare; however, advice has been received from that Administration that a vinegar so produced would not be a "wine vinegar" under its standards and, therefore, may not be labeled as wine vinegar.

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26 CFR 240.691: Reciprocating foreign countries.

Federal Republic of Germany added to list of reciprocating foreign countries. See Rev. Rule 55-741, page 702.

SECTION 5364.—STANDARD WINE PREMISES

26 CFR 231.30: General. Rev. Rul. 55-535

Section 5364 of the Internal Revenue Code of 1954 and section 231.30 of the Taxpaid Wine Bottling House Regulations prohibit the receipt and bottling or packaging of wine, which does not meet the requirements for standard wine, on taxpaid wine bottling house premises used for the bottling or packaging of standard wine. *Held*, although a taxpaid wine bottling house may not be used simultaneously for the bottling and packaging of standard wines and wines other than standard wines, such premises may be operated alternately for these purposes. However, standard and other than standard wines may not be on the taxpaid wine bottling house premises at the same time, *i. e.*, all standard wine must be removed from the premises prior to operation thereof for the bottling of other than standard wine, and vice versa.

SECTION 5367.—RECORDS

26 CFR 240.900: Form 702. Rev. Rul. 55-513
(Also 26 CFR 240.904, 240.908.)

Where an application has been approved by an Assistant Regional Commissioner, Alcohol and Tobacco Tax, authorizing a proprietor to add wine spirits a second time to the same lot of wine not in reserve inventory, the second addition of wine spirits should be reported on Form 275, Application for Release of Wine Spirits and Addition to Wine, Form 2056, Record of Still Wine, and Form 702, Monthly Report of Wine Cellar Operations. The amount of wine to which wine spirits are added and the amount of wine produced by such addition of wine spirits should be shown in the proper spaces on the forms in the same manner as the original addition.

26 CFR 240.904: Form 275 and Form 1520.

For the method of reporting the second addition of wine spirits to the same lot of wine not in the reserve inventory, see Rev. Rul. 55–513, page 707.

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26 CFR 240.908: Form 2056, Record of still wine.

For the method of reporting the second addition of wine spirits to the same lot of wine not in the reserve inventory, see Rev. Rul. 55–513, page 707.

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26 CFR 240.920: Record of taxpaid removals from bond. Rev. Rul. 55–665

The proprietor of a bonded wine cellar marking serial numbers on cases at the time of preparing wine for removal is not required to show in his commercial records the serial number of each case nor the range of serial numbers for each kind (class and type) and tax grade of wine involved. *Held*, the recording on the proprietor's invoices of the first and last serial numbers of cases for each particular shipment of wine is in substantial compliance with the provisions of section 240.920 of the Wine Regulations and will afford identification of the wine removed to the extent contemplated thereby.

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26 CFR 240.921: Taxpaid room record. Rev. Rul. 55–666

Section 240.921 of the Wine Regulations, which prescribes the records to be maintained at a taxpaid room provided by the proprietor of a bonded wine cellar, provides, in part, that where the proprietor keeps copies of invoices or other commercial records covering shipments from the taxpaid room as provided therein, and they are kept in chronological order available for inspection and in such manner that the required information may be readily ascertained therefrom by internal revenue officers, the separate record may show the total quantity of wine shipped each day in lieu of the details of each shipment. *Held*, the provisions of this section relative to the "separate record" maintained at a taxpaid room are applicable to the shipment from such taxpaid room of wines received from outside sources as well as wine received from the proprietor's bonded wine cellar. Therefore, the separate record showing the total quantity of wine shipped each day, in lieu of the details of each shipment, should include wine received from other sources as well as wine received from the proprietor's bonded wine cellar, if the invoices or other commercial records are kept in the manner prescribed.

PART III.—CELLAR TREATMENT AND CLASSIFICATION OF WINE

SECTION 5382.—CELLAR TREATMENT OF NATURAL WINE

26 CFR 240.529.—Materials authorized for treatment of wine. Rev. Rul. 55-603 [1]

The following materials, which are in addition to those specifically authorized by section 240.529 of the Wine Regulations, are considered to be consistent with good commercial practice, and, accordingly, have been approved for use by proprietors of bonded wine cellars in the production, cellar treatment, or finishing of wine, within the general limitations of section 240.524 or more specifically shown herein, or given in the sections referred to:

Material	*Use*	*Reference or limitation*
Aferrin	To remove the iron in wine.	No insoluble residue in excess of one part per million and no soluble residue may remain in the finished wine, and the basic character of the wine may not be changed by such treatment.
Antifoam "A"	To reduce the foam in fermenters.	Section 240.524, 26 CFR.
Calcium carbonate	To reduce the excess natural acids in high acid wines.	Section 240.524, 26 CFR. The natural or fixed acids may not be reduced below five parts per thousand.
Cufex	To remove trace metals from wine.	No insoluble residue in excess of one part per million and no soluble residue may remain in the finished wine, and the basic character of the wine may not be changed by such treatment.
Diatomaceous earths or similar products (which contain active chemical ingredients or which have been so treated that they may alter the character of the wine.)	To clarify wine	Section 240.524, 26 CFR.
Mineral oil	On surface of wine in storage tanks to prevent the access of air to the wine.	None of the oil may be in the finished wine when marketed.
Oak chips (uncharred and untreated.)	To treat wines	Section 240.524, 26 CFR.
Oak chips (charred.)	In treatment of Spanish type blending sherry.	The finished product after addition of oak chips must have the flavor and color of Spanish Type Blending Sherry commonly obtained by storage of sherry wine in properly treated used charred oak whisky barrels.
Pectinol	To clarify wine	One pound per 100 gallons of wine. Section 240.524, 26 CFR.
Sparkolloid	To clarify wine	Two pounds to 1,000 gallons of wine. Section 240.524, 26 CFR.

[1] Modified by Revenue Rulings 56-9, I. R. B. 1956-2, and 56-64, I. R. B. 1956-9, 14.

Proprietors of bonded wine cellars who desire to use any of the above materials must file notice, in triplicate, with the Assistant Regional Commissioner, Alcohol and Tobacco Tax, as prescribed by section 240.530 of the Wine Regulations.

Materials previously approved which are not specifically covered either by the Wine Regulations or by this Revenue Ruling are no longer authorized for use in the production, cellar treatment, or finishing of wine.

Revenue Ruling 25, C. B. 1953–1, 431; Revenue Ruling 54–198, C. B. 1954–1, 303; Revenue Ruling 54–454, C. B. 1954–2, 457; and Revenue Ruling 55–41, C. B. 1955–1,598, are superseded.

SECTION 5383.—AMELIORATION AND SWEETENING LIMITATIONS FOR NATURAL GRAPE WINE

26 CFR 240.360: General. Rev. Rul. 55–536

The addition of dry sugar for the development of alcohol is not authorized, under the Internal Revenue Code of 1954 or the Wine Regulations, in the production of natural wine from grape juice having a low natural sugar content and a natural fixed acid content of five parts per thousand or less. Accordingly, winemakers desiring to develop by fermentation a higher alcohol content in the production of natural wine from such material must add concentrate to grape juice or limit the addition of water to concentrate to such extent that the Brix will not be reduced below 23 degrees. See section 240.353 of the Wine Regulations. See also Revenue Ruling 55–400, C. B. 1955–1, 599, with respect to the use of concentrated juice in conjunction with unconcentrated juice for the development of alcohol in wine.

SECTION 5384.—AMELIORATION AND SWEETENING LIMITATIONS FOR NATURAL FRUIT AND BERRY WINES

26 CFR 240.404: Acids. Rev. Rul. 55–667

Section 240.404 of the Wine Regulations prohibits the use of acid to correct deficiencies where ameliorating material, as authorized in section 240.407, is used in the production of fruit wine. The regulations do not, by reason of the addition of wine spirits, prohibit the use of acid to correct deficiencies in natural wine. Section 240.407 of the regulations permits ameliorating material in the form of pure dry sugar to be added to adjust the juice to a solids content prior to fermentation of not more than 23 degrees Brix in order to produce sufficient alcohol to make an acceptable wine. It also permits the addition of water, or pure dry sugar, or a combination of water and pure dry sugar, for the purpose of reducing the natural fixed acid content to a minimum of five parts per thousand. *Held*, where wine spirits, or dry sugar for amelioration or sweetening, has been added in the production of natural fruit wine, the addition of acid for the purpose of correcting deficiencies may be permitted, provided no water or sugar-water solution was used for amelioration.

SECTION 5386.—SPECIAL NATURAL WINES

26 CFR 240.440: Materials. Rev. Rul. 55-668

Section 5386 of the Internal Revenue Code of 1954 defines special natural wines as "the products made, pursuant to a formula approved under this section, from a base of natural wine (including heavy bodied blending wine) exclusively, with the addition, before, during or after fermentation, of natural herbs, spices, fruit juices, aromatics, essences, and other natural flavorings in such quantities or proportions as to enable such products to be distinguished from any natural wine not so treated, and with or without carbon dioxide naturally or artificially added, and with or without the addition, separately or in combination, of pure dry sugar or a solution of pure dry sugar and water, or caramel." *Held*, the addition of fruit juice, fruit essence, or other fruit flavoring to wine, either for the purpose of simulating a particular kind of natural wine or for the purpose of enhancing the flavor characteristic of a particular kind of natural wine, is not within the contemplation of section 5386 of the Code. Any fruit juice, fruit essence and other natural fruit flavoring material used under this section of the Code must be used in conjunction with other authorized flavoring material in such quantities or proportions that the fruit flavor does not predominate in the finished product.

SUBCHAPTER G.—BREWERIES

PART II.—OPERATIONS

SECTION 5411.—USE OF BREWERY

26 CFR 245.241: Temporary storage of repossessed bottled beer. Rev. Rul. 55-491
(Also Section 5555; 26 CFR 245.354.)

> Keg beer upon which the tax has been determined or paid and which has been repossessed from the purchaser may, as a normal brewery operation, be returned to the brewery for temporary storage pending destruction, use as material, or reconditioning.

Information has been requested concerning the temporary storage and handling at a brewery of keg beer upon which the tax has been determined or paid and which has been repossessed from the purchaser.

Section 245.241 of the Beer Regulations makes provision for the temporary storage of repossessed bottled beer. However, no provision is made in the regulations for the temporary storage of repossessed keg beer.

Although not specifically provided in the regulations, it is held that keg beer which has been repossessed may be returned to the brewery for temporary storage pending destruction, use as material, or reconditioning, as such operation is considered a necessary incident to the brewing business. The procedure prescribed by sections 245.241 and 245.354 of the Beer Regulations should, insofar as applicable, be followed by brewers in connection with the return of such re-

possessed beer. No refund, credit, or remission of tax will be allowed on repossessed keg beer returned to the brewery since there is no authority therefor in the law or regulations. Accordingly, the entries for such returns on Form 103, Brewer's Monthly Report of Operations, and on Form 2051, Record of Brewery Operations, should be followed by the notation, "Not subject to refund, credit, or remission of tax."

Repossessed keg beer returned to the brewery, and reconditioned and sold or resold without reconditioning, is again subject to the tax imposed by law when removed from the brewery.

SECTION 5414.—REMOVALS FROM ONE BREWERY TO ANOTHER BELONGING TO THE SAME BREWER

26 CFR 245.210: General. Rev. Rul. 55-596

Two corporations of the same name but incorporated under the laws of different States constitute two separate and distinct legal entities although the directors of each are substantially the same. Accordingly, breweries operated by two such corporations are not considered as belonging to the "same brewer" for the purpose of transferring beer from one brewery to another under section 5414 of the Internal Revenue Code of 1954 and section 245.210 of the Beer Regulations.

The Internal Revenue Service has been requested to state its position with respect to the application of section 5414 of the Internal Revenue Code of 1954 and section 245.210 of the Beer Regulations, in the case of two breweries of the same corporate name, having substantially the same officers and directors, one being a wholly-owned subsidiary of the other, but which are incorporated in different States.

Section 5414 of the Internal Revenue Code of 1954 provides that beer may be removed from one brewery to another brewery *belonging to the same brewer*, without payment of tax, and may be mingled with the beer of the second brewery. Section 245.9 of the Beer Regulations defines a brewer as a person who brews or produces beer for sale. Section 245.21 defines person as meaning, among other things, a corporation.

In the case of *Moline Properties, Inc.* v. *Commissioner of Internal Revenue*, 319 U. S. 436, Ct. D. 1584, C. B. 1943, 1011, the court said that the doctrine of corporate entity fills a useful purpose in business life. Whether the purpose be to gain an advantage under the law of the State of incorporation or to avoid or to comply with the demands of creditors or to serve the creator's personal or undisclosed convenience, so long as that purpose is the equivalent of business activity or is followed by the carrying on of business by the corporation, the corporation remains a separate taxable entity. In the case of *Schenley Distillers Corporation* v. *United States*, 326 U. S. 432, the court stated that while corporate entities may be disregarded where they are made the implement for avoiding a clear legislative purpose, they will not be disregarded where those in control have deliberately adopted the corporate form in order to secure its advantages and where no violence to the legislative purpose is done by

treating the corporate entity as a separate legal person. One who has created a corporate arrangement, chosen as a means of carrying out his business purposes, does not have the choice of disregarding the corporate entity in order to avoid the obligations which the statute lays upon it for the protection of the public.

In view of the principles stated herein, it is held that two breweries, each of which is operated by a separate corporation incorporated under the laws of different States, may not be considered as being operated by the same brewer for the purpose of transferring beer from one such brewery to the other under section 5414 of the Internal Revenue Code of 1954.

SUBCHAPTER I.—MISCELLANEOUS GENERAL PROVISIONS

SECTION 5555.—RECORDS, STATEMENTS, AND RETURNS

26 CFR 194.210: General requirements as to distilled spirits. T. D. 6151[1]

(Also Sections 5124, 5116; 194.229, 194.236.)

TITLE 26—INTERNAL REVENUE, 1954.—CHAPTER I, SUBCHAPTER E, PART 194.—LIQUOR DEALERS

Part 194 of Title 26 of the Code of Federal Regulations amended to provide for prescribed commercial records of receipt and disposition to be kept in lieu of Record 52, the reports to be rendered thereon, and the discontinuance of Form 52F.

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

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

On August 9, 1955, a notice of proposed rulemaking with respect to the records and reports required of wholesale and retail dealers was published in the Federal Register (20 F. R. 5725). The proposal was based on an extensive study of present requirements for recordkeeping and reporting of transactions in liquors which determined that the interests of the Government may now be served by records and reports based solely on the physical movement of distilled spirits. The purposes of the proposal were to provide for (a) elimination of the requirement for recording and reporting transactions in warehouse receipts covering distilled spirits in bond, (b) elimination of the requirement for recording and reporting third-party transactions, (c) discontinuance of Record 52, (d) keeping of commercial records by receipt of distilled spirits, wines, and beer, by wholesale liquor dealers, (e) keeping of commercial records of disposition of distilled spirits by wholesale liquor dealers, (f) keeping of commercial records of receipt of beer by wholesale and retail beer dealers, and (g) authorization of assistant regional commissioners to waive the submission of reports on Forms 52A and 52B under certain conditions. After

[1] 20 F. R. 8157.

consideration of all relevant matter presented by interested parties regarding the regulations proposed, the regulations are hereby adopted in the form set forth below:

Paragraph 1. Subpart M is amended to read as follows:

SUBPART M—PRESCRIBED RECORDS AND REPORTS, AND POSTING OF SIGNS

WHOLESALE DEALERS' RECORDS AND REPORTS

§ 194.210 General Requirements as to Distilled Spirits.—Except as provided elsewhere in this subpart, every wholesale dealer shall, daily, prepare commercial records of the physical receipt and disposition of distilled spirits by him, and shall, daily, prepare a recapitulation record showing the total wine gallons of distilled spirits received and disposed of during the day. Every wholesale dealer shall submit on Forms 52A and 52B daily or periodic reports, prepared from his commercial records, of the physical receipt and disposition of distilled spirits by him: *Provided*, That upon application, the assistant regional commissioner may relieve a dealer from the requirement of preparing and submitting such daily or periodic reports on Forms 52A and 52B until otherwise notified, when the assistant regional commissioner finds that such reporting is not necessary to law enforcement or protection of the revenue. Every wholesale dealer who offers bottled distilled spirits for sale shall submit a monthly report on Form 338, showing the total wine gallons of distilled spirits (1) on hand at the beginning of the month, (2) received during the month, (3) disposed of during the month, and (4) remaining on hand at the end of the month.
(68A Stat. 619, 681; 26 U. S. C. 5114, 5555)

§ 194.211 General Requirements as to Wines and Beer.—Every wholesale liquor dealer who receives wines, or wines and beer, and every wholesale beer dealer, shall keep at his place of business a complete record of all wines and beer received, showing (1) the quantities thereof, (2) from whom received, and (3) the receiving dates. Such record, which must be kept for a period of not less than two years as prescribed in § 194.234, may consist of all purchase invoices or bills covering wines and beer received or, at the option of the dealer, a book record containing all of the required information. Wholesale dealers are not required to prepare or submit reports to assistant regional commissioners of transactions relating to wines and beer.
(68A Stat. 681; 26 U. S. C. 5555)

§ 194.212 Dealers Selling Distilled Spirits in Retail Quantities Only.—A dealer who sells wines or beer, or both, in wholesale quantities, and who sells distilled spirits in retail quantities only, is not required to maintain the records or submit the reports prescribed in § 194.210, but is required to keep records of distilled spirits, wines and beer received, as prescribed in §§ 194.211 and 194.229.
(68A Stat. 619, 681; 26 U. S. C. 5114, 5555)

§ 194.213 Dealers Not Selling Distilled Spirits.—Wholesale liquor dealers who sell wines and beer only, and wholesale beer dealers are not required to maintain the records or submit the reports prescribed in § 194.210, but are required to keep records of wines and beer received, as prescribed in §194.211.
(68A Stat. 619, 681; 26 U. S. C. 5114, 5555)

§ 194.214 RECORDS TO BE KEPT BY STATES.—The provisions of this subpart relative to the maintenance of records and the submission of reports, shall not apply to States and political subdivisions thereof and liquor stores operated by such entities that maintain and make available for inspection by internal revenue officers such records as will enable such officers to verify receipts of wines and beer and to trace readily all distilled spirits received and disposed of by them: *Provided*, That such States and political subdivisions thereof, and the liquor stores operated by them, shall, on request of the assistant regional commissioner, furnish such transcripts, summaries, and copies of their records as he shall require.
(68A Stat. 619, 681; 26 U. S. C. 5114, 5555)

§ 194.215 PROPRIETORS.—The proprietor of an industrial alcohol plant or industrial alcohol bonded warehouse shall keep records and render reports in his capacity as a wholesale dealer in liquors in accordance with Part 182 of this chapter. The proprietor of a registered distillery shall keep records and render reports in his capacity as a wholesale dealer in liquors in accordance with Part 220 of this chapter. The proprietor of a fruit distillery shall keep records and render reports in his capacity as a wholesale dealer in liquors in accordance with Part 221 of this chapter. The proprietor of an internal revenue bonded warehouse shall keep records and render reports in his capacity as a wholesale dealer in liquors in accordance with Part 225 of this chapter. The proprietor of a taxpaid bottling house who (1) does not maintain wholesale liquor dealer premises, or (2) does maintain a wholesale liquor dealer room which is contiguous to the taxpaid bottling house and is used exclusively for products bottled at such taxpaid bottling house, shall keep records and render reports in his capacity as a wholesale dealer in liquors in accordance with Part 230 of this chapter. The proprietor of a rectifying plant who (1) does not maintain wholesale liquor dealer premises, or (2) does maintain wholesale liquor dealer premises which are contiguous to the rectifying plant and are used exclusively for products bottled at such rectifying plant, shall keep records and render reports in his capacity as a wholesale dealer in liquors in accordance with Part 235 of this chapter.
(68A Stat. 619, 637, 652; 26 U. S. C. 5114, 5197, 5282)

§ 194.216 RECORDS OF RECEIPT.—Every wholesale liquor dealer, upon the physical receipt of each individual lot or shipment of distilled spirits, shall prepare a commercial record of receipt which shall show (1) name and address of consignor, (2) date of receipt, (3) brand name, (4) name of producer or bottler, (5) kind of spirits, except that this may be omitted if the dealer keeps available for inspection a separate list or record identifying "kind" with the brand name, (6) quantity actually received (showing number of packages, if any, and number of cases by size of bottle, and explaining any shortage, breakage, leakage, or other difference from the quantity shown on the commercial papers covering the shipment), and (7) serial numbers of packages and cases unless, such serial numbers are available on the consignor's invoice or attachments thereto. Additional information desired by the wholesale dealer may also be shown. All information required to be shown on records of receipt shall be entered on such records by the close of the business day next suc-

ceeding that on which the spirits are received. Where the wholesale dealer so defers the preparation of such records, he shall keep memorandum records, prepared at the time the spirits are received, which shall show the data needed to prepare the prescribed records of receipt. Records of receipt may be prepared by entering each individual lot of distilled spirits either (1) on an individual looseleaf "Record of Receipt", preprinted as prescribed in § 194.219, (2) in chronological order on records prepared by tabulating or other mechanical office equipment, if such records are preprinted as prescribed in § 194.219, or (3) in chronological order in a bound record book, provided all pages of such book are numbered as prescribed in § 194.219. The dealer may elect to use any one of the above types of record, but may not change from one type to another without prior approval from the assistant regional commissioner. All entries, with the exception of those prescribed for returned merchandise, must be supported by corresponding invoices of the consignor. Credit memorandums conforming to the requirements of § 194.219 may, if desired, be used in lieu of individual looseleaf "Records of Receipt" to show the receipt of returned merchandise. Variations in the format or in the methods of preparation may be authorized, as provided in § 194.220.

(68A Stat. 619; 26 U. S. C. 5114)

§ 194.217 Records of Disposition.—Every wholesale dealer shall prepare a commercial record covering the physical disposition of each individual lot of distilled spirits, which shall show (1) name and address of consignee, (2) date of disposition, (3) kind of spirits, except that this may be omitted if the dealer keeps available for inspection a separate list or record identifying "kind" with the brand name, (4) brand name, (5) number of packages, if any, and number of cases by size of bottle, and (6) serial numbers of the cases or packages, unless such serial numbers are shown on commercial papers attached thereto. Additional information desired by the dealer may also be shown. Records of disposition shall be prepared by entering each individual lot of distilled spirits either (1) on an individual looseleaf "Record of Disposition", preprinted as prescribed in § 194.219, (2) in chronological order on records prepared by tabulating or other mechanical office equipment, if such records are preprinted as prescribed in § 194.219, or (3) in chronological order in a bound record book, provided all pages of such book are numbered as prescribed in § 194.219. The completed order forms of the dealer, or exact copies of his invoices of sale, will be acceptable as "Records of Disposition" if such documents provide all of the required information, and are preprinted as prescribed in § 194.219. The dealer may elect to use any one of the above types of record, but may not change from one type to another without prior approval from the assistant regional commissioner. Entries on records of disposition must be completed by the close of the business day next succeeeding that on which the spirits are removed. Where the dealer so defers the preparation of such records he shall keep memorandum records, prepared at the time the spirits are sent out, or prior thereto, which shall show the data needed to prepare the prescribed records. Each record of disposition must be supported by a corresponding delivery receipt (which may be executed on a copy of the "Record of Disposition") fully describing the spirits

and signed by the consignee or his agent, or by a copy of a bill of lading indicating delivery of the spirits to a common carrier. Documents supporting records of disposition shall have noted thereon the serial number of the corresponding "Record of Disposition", or the page number of the machine record or record book, as the case may be. Variations in the format or in the methods of preparation may be authorized, as provided in § 194.220.
(68A Stat. 619; 26 U. S. C. 5114)

§ 194.218 CANCELLED OR CORRECTED RECORDS.—Entries in record books shall not be erased or obliterated, nor shall whole or partial pages be removed from such books. Correction or deletion of any entry in a record or report shall be accomplished by drawing a line through such entry, and making appropriate correction, explanation, or reference on the same page or sheet. Where a looseleaf "Record of Receipt" or "Record of Disposition" is voided for any reason, all copies thereof shall be marked "Cancelled" and be filed as prescribed in § 194.232; if a new record is prepared in lieu thereof, the serial number of the new record shall be noted on all copies of the cancelled record. Where items entered on a "Record of Disposition" are deleted for reasons such as the refusal of the merchandise by the consignee, or the inability of the wholesale dealer to supply such merchandise, appropriate explanations shall be made on all copies of the record.
(68A Stat. 619; 26 U. S. C. 5114)

§ 194.219 FORMAT OF RECORDS OF RECEIPT AND DISPOSITION.—Each individual "Record of Receipt" and "Record of Disposition", each credit memorandum used for recording the receipt of returned distilled spirits, and each sheet, or page used in tabulating or other mechanical office equipment for recording the receipt or disposition of distilled spirits must be preprinted with the name and address of the wholesale liquor dealer. Each such record, sheet, or page shall also bear a preprinted serial number, beginning with number 1 and, before repeating, continuing in numerical sequence to a number high enough to preclude the duplication of a serial number in such group within a period of six months: *Provided*, That upon application, the assistant regional commissioner may authorize a wholesale dealer to affix serial numbers in consecutive order during the preparation or processing of the prescribed commercial records, or authorize the serial numbering of such records beginning with some number other than 1, or authorize the repetition of blocks of serial numbers within a lesser period than six months, where the assistant regional commissioner finds that the dealer's accounting system will afford an effective measure of control and such variation will not be likely to lend itself to the falsification of records. Each serially numbered form or sheet must be accounted for by the dealer. If a bound record book is used for recording receipts and dispositions, all of the pages of such book must be numbered in unbroken sequence.
(68A Stat. 619; 26 U. S. C. 5114)

§ 194.220 VARIATIONS IN FORMAT, OR PREPARATION, OF RECORDS.—The Director, Alcohol and Tobacco Tax Division, may approve variations in the format of records of receipt and disposition, or in the methods of preparing such records, where it is shown that variations from the requirements are necessary in order to use tabulating equipment, business machines, or existing accounting systems, and will not

(1) unduly hinder the effective administration of this part, (2) jeopardize the revenue, or (3) be contrary to any provision of law. A dealer who proposes to employ format or methods other than as provided in this part shall submit a letter-head application so to do, in triplicate, to the assistant regional commissioner. Such application shall describe the proposed variations and set forth the need therefor. The assistant regional commissioner will determine the need for the variations, and whether approval thereof would unduly hinder the effective administration of this part or result in jeopardy to the revenue. The assistant regional commissioner will forward two copies of the application to the Director, Alcohol and Tobacco Tax Division, together with a report of his findings and his recommendation. Variations in format or methods shall not be employed until approval is received from the Director.

§ 194.221 RECAPITULATION RECORDS.—Every wholesale liquor dealer shall, daily, prepare a recapitulation record showing, in wine gallons, the total quantities of distilled spirits received and disposed of during the day. At the end of each month he shall prepare grand totals of all receipts and dispositions during the month. The work sheets from which totals are obtained shall be retained for a period of 2 years.

DAILY AND MONTHLY REPORTS

§ 194.222 WHOLESALE LIQUOR DEALER'S MONTHLY REPORT, FORM 338.—Every wholesale liquor dealer who is required to keep the records prescribed in § 194.210 shall file with the assistant regional commissioner a monthly report, on Form 338, of the total quantities of bottled distilled spirits received and disposed of during the month, not later than the 10th day of the month succeeding that for which rendered.

(68A Stat. 619; 26 U. S. C. 5114)

§ 194.223 NO TRANSACTIONS DURING MONTH.—If there were no receipts or disposals of distilled spirits by a wholesale liquor dealer during a month, Form 338 must be prepared and forwarded to the assistant regional commissioner, showing the quantity on hand the first day of the month and the quantity on hand the last day of the month and marked "No transactions during month." Wholesale liquor dealers maintaining records in the simplified manner prescribed by § 194.230 should show on Form 338 that no distilled spirits were on hand the first day and the last day of the month.

(68A Stat. 619; 26 U. S. C. 5114)

§ 194.224 DISCONTINUANCE OF BUSINESS.—When a wholesale liquor dealer discontinues business as such, he shall render Form 338, covering transactions for the month in which business is discontinued, and mark such report "Final."

(68A Stat. 619; 26 U. S. C. 5114)

§ 194.225 DAILY REPORTS, FORMS 52A AND 52B.—Except as otherwise provided in this subpart, every wholesale liquor dealer shall prepare and submit, daily, a report on Form 52A of all distilled spirits received by him, and on Form 52B of all distilled spirits disposed of by him. The reports shall be filed with the assistant regional commissioner by delivering or mailing them to such officer on the date the transactions entered therein occur: *Provided*, That in any case in

which the assistant regional commissioner shall direct, the reports shall be so filed with the supervisor in charge instead of with the assistant regional commissioner. Each report shall bear the following declaration signed by the person or officer authorized to execute Form 338:

> I declare under the penalties of perjury that this report, consisting of — pages, has been examined by me and to the best of my knowledge and belief is a true, correct, and complete report of all the transactions which occurred during the period covered thereby, and each entry therein is correct.

If in any case the assistant regional commissioner shall so authorize, the reports, in lieu of being filed daily, may be filed for such periods and at such times as he may deem necessary in the interest of the Government, or the reports may be waived as provided in § 194.210.
(68A Stat. 619, 749; 26 U. S. C. 5114, 6065)

§ 194.226 Entries on Forms 52A and 52B.—Where more than one shipment of distilled spirits is received from the same consignor during any month, there will be reported on Form 52A for the first shipment received, the name and address of such consignor, followed by the registry number (preceded by appropriate identifying symbols) and the State of the consignor's plant or warehouse (for example, IRBW–4–Ky.) or, in the case of shipments received from wholesale liquor dealers or importers, the permit number of the consignor (for example, 3–I–1234). For the remaining shipments received from such consignor during the month, there may be reported in the column designated "Name" such registry number or permit number, as the case may be, and the name and address of the consignor may be omitted. Likewise, where more than one shipment of distilled spirits is sent to the same consignee during any month, there will be reported on Form 52B for the first shipment made the name and address of such consignee followed by the registry number or permit number of the consignee. For the remaining shipments made to such consignee during the month, there may be reported in the column designated "Name" such registry number or permit number, as the case may be, and the name and address of the consignee may be omitted. Where the consignor or consignee is a retail dealer in liquors, the name and address must be reported on Form 52A or 52B for each shipment received or sent.
(68A Stat. 619; 26 U. S. C. 5114)

§ 194.227 Entry of Miscellaneous Items.—Wholesale liquor dealers may report on Form 52B as one item the total quantity of different kinds of spirits made up from broken cases disposed of to the same person on the same day, provided such total quantity is not in excess of 10 gallons. The entry of such items shall be stated as "Miscellaneous" or "Misc." and shall show the date, the name and address of the person to whom sold, and the quantity.
(68A Stat. 619; 26 U. S. C. 5114)

§ 194.228 Serial Numbers of Cases.—Serial numbers of cases of distilled spirits received, or disposed of, shall be reported on Forms 52A or 52B unless the omission of such case serial numbers is specifically authorized by the assistant regional commissioner.
(68A Stat. 619; 26 U. S. C. 5114)

RETAIL DEALERS RECORDS AND REPORTS

§ 194.229 General Requirements for Retail Dealers.—Each retail dealer in liquors and each retail dealer in beer shall keep at his place of business a complete record of all distilled spirits, wines, or beer received, showing (1) the quantities thereof, (2) from whom received, and (3) the receiving dates. Such record, which must be kept for a period of not less than two years as prescribed in § 194.234, may consist of all purchase invoices or bills covering distilled spirits, wines, and beer received or, at the option of the dealer, a book record containing all of the required information. Retail dealers who do not maintain a wholesale department are not required to prepare and submit reports of purchases and sales to assistant regional commissioners.
(68A Stat. 622, 681; 26 U. S. C. 5124, 5555)

§ 194.230 Requirements Where Wholesale Department Is Kept.—A liquor dealer engaged in the business of selling primarily at retail, who at the same premises also makes occasional sales of distilled spirits in quantities of 5 wine gallons or more in his capacity as a wholesale liquor dealer, shall keep the records prescribed in § 194.229 for all retail dealers. In addition, as prescribed by § 194.217, he shall prepare commercial records of disposition on all distilled spirits transferred into and sold from his wholesale department, and shall prepare recapitulation records of such spirits, as prescribed by § 194.221. The monthly report of Form 338, prescribed in § 194.222, must be submitted even if there have been no transactions in the wholesale department. Unless the dealer is relieved from such requirement, daily or periodic reports on Forms 52A and 52B shall be submitted by him on all the distilled spirits transferred from the retail department, as prescribed by §§ 194.210 and 195.225. As used in this subpart, the term "selling primarily at retail" shall mean that sales at retail must normally represent at least 90 percent of the volume of distilled spirits sold during a month. Where a liquor dealer is engaged in such business, all distilled spirits at the premises may be considered as having been received in the retail department. When a sale of 5 wine gallons or more is made, the distilled spirits involved in the transaction shall be considered as having been transferred to the wholesale department at the time of sale. The wholesale department need not be maintained in a separate room or be partitioned off from the retail department, but sales at wholesale must be made in a part of the premises designated as the wholesale department.
(68A Stat. 619; 26 U. S. C. 5114.)

§ 194.231 Requirements When Wholesale Liquor Dealer Maintains a Retail Department.—A wholesale liquor dealer who sells distilled spirits in wholesale quantities, and at the same premises maintains a separate retail department where distilled spirits are sold in retail quantities, shall keep the records and render the reports prescribed by § 194.210 on all distilled spirits received and disposed of in his capacity as a wholesale dealer. When distilled spirits are transferred from the wholesale department to the retail department, a commercial record showing such disposition shall be prepared as prescribed by § 194.217. Where it is necessary in the filling of a wholesale order to transfer distilled spirits from the retail department to the wholesale department, a commercial record showing such receipt in the wholesale department shall be prepared as prescribed in

§ 194.216, and the entire sale entered on a record of disposition in the same manner as any other disposition from the wholesale department. The provisions of this subpart relating to submission of reports on Forms 52A and 52B are applicable to all transfers between wholesale and retail departments. The retail department need not be maintained in a separate room, or be partitioned off from the wholesale department, but the retail department must in fact be separate from the wholesale department. Where a wholesale dealer does not maintain a separate retail department, all distilled spirits received and disposed of must be accounted for on records of receipt and disposition regardless of the quantities involved.
(68A Stat. 619; 26 U. S. C. 5114)

FILES OF RECORDS AND REPORTS

§ 194.232 Manner of Filing Looseleaf Records of Receipt and Disposition.—One legible copy of (1) each "Record of Receipt", (2) each credit memorandum used for the purpose of recording the receipt of returned merchandise, and (3) each "Record of Disposition", shall be marked or stamped as "Government File Copy", and shall be filed chronologically, and in numerical sequence within each date, in looseleaf binders or books. Where the chronological filing of such records disarranges their numerical sequence to such an extent that the sequence of numbers cannot be readily traced, a control record shall be maintained by the wholesale liquor dealer, which shall key the numerical sequence of the records to their respective dates. Government file copies shall be filed not later than the close of the business day next succeeding that on which the transaction occurred. Separate files shall be maintained for "Records of Receipt", for credit memorandums used to record receipt of returned merchandise, and for "Records of Disposition". Supporting documents such as consignors' invoices, delivery receipts, and bills of lading, or exact copies thereof, may be filed in accordance with the wholesaler's customary practice. Documents supporting records of disposition shall have noted thereon the identifying serial numbers of the records of disposition to which they refer, as required by § 194.217.
(68A Stat. 619; 26 U. S. C. 5114)

§ 194.233 Place of Filing.—Prescribed records of receipt and disposition and file copies of Forms 52A, 52B, 338, and the recapitulation records required by § 194.221, shall be maintained in chronological order in separate files at the premises where the distilled spirits are received and sent out: *Provided*, That upon application, the assistant regional commissioner may authorize the files, or any individual file, to be maintained at other premises under control of the same dealer, if he finds that such maintenance will not delay the timely filing of any document, or cause undue inconvenience to internal revenue officers desiring to examine such files.
(68A Stat. 619; 26 U. S. C. 5114)

PERIOD OF RETENTION

§ 194.234 Retention of Records and Files.—All records prescribed by this part, documents or copies of documents supporting such records, and file copies of reports submitted, shall be preserved for a period of not less than 2 years, and during such period shall be available, during business hours, for inspection and the taking of

abstracts therefrom by internal revenue officers. Any records, or copies thereof, containing any of the information required by this part to be prepared, wherever kept, shall also be made available for such inspection and the taking of abstracts therefrom.
(68A Stat. 619, 681; 26 U. S. C. 5114, 5555)

PROCUREMENT OF REPORT FORMS

§ 194.235 FORMS TO BE PROVIDED BY USERS AT OWN EXPENSE.—Forms 52A, 52B and 338 will be provided by users at their own expense, but must be in the form prescribed by the Director, Alcohol and Tobacco Tax Division: *Provided*, That, with the approval of the Director, Alcohol and Tobacco Tax Division, they may be modified to adapt their use to tabulating or other mechanical equipment. Application for permission to modify such forms shall be filed in the manner prescribed in § 194.220.

POSTING OF SIGNS

§ 194.236 BY WHOLESALE DEALERS IN LIQUORS.—Every person engaged in business as a wholesale dealer in liquors shall place and keep conspicuously on the outside of his place of business a sign exhibiting in plain, durable, and legible letters the name, or firm of the dealer and the words "Wholesale Liquor Dealer." In those states where the definition of wholesale liquor dealer differs from the definition given in § 194.29, the words "Wholesale Liquor Dealer under Federal Law" may be used. In the case of a wholesale liquor dealer who procures and posts a special tax stamp designated "Wholesale Dealer in Wines", or "Wholesale Dealer in Wines and Beer", the requirements of this section will be met by the posting of a sign of the character prescribed herein, but with words conforming to the designation of the special tax stamp.
(68A Stat. 620; 26 U. S. C. 5116)

§ 194.237 BY OTHERS THAN WHOLESALE LIQUOR DEALERS.—Internal revenue laws do not require the posting of signs by retail dealers in liquors, retail dealers in beer, or wholesale dealers in beer.

Inasmuch as this Treasury decision, except sections 194.211, 194.212, 194.213, 194.229, and 194.234, relieves restriction, it is hereby found that it is unnecessary to issue this Treasury decision subject to the effective date limitation of section 4 (c) of the Administrative Procedure Act (60 Stat. 238; 5 U. S. C. 1003 (c)). Accordingly, this Treasury decision shall be effective on October 1, 1955, except sections 194.211, 194.212, 194.213, 194.229, and 194.234, which, to the extent that they relate to dealers in beer and wine, shall be effective on the first day of the first month which begins not less than 30 days after the date of publication in the Federal Register.

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

T. COLEMAN ANDREWS,
Commissioner of Internal Revenue.

Approved: October 26, 1955.

H. CHAPMAN ROSE,
Acting Secretary of the Treasury.

(Published in the Federal Register October 29, 1955)

26 CFR 230.200: Completion of bottling. Rev. Rul. 55–492

Section 230.200 of the Regulations relating to the Bottling of Tax-paid Spirits read in part, "When the contents of a bottling tank are not completely bottled at the close of the day the bottler shall enter in his certificate on the copy of Form 230 attached to the bottling tank the total quantity bottled that day from such tank, giving all the information required by the form." *Held*, since section 230.200 of the regulations does not specifically require the bottler to make the entries on Form 230, Description and Gauge of Spirits or Wines for Bottling without Rectification, at the close of the day on which the tank is not completely emptied, the required entries in such cases may be made immediately on the morning of the following day when it is not practicable to make them at the close of the day.

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26 CFR 245.354: Brewer's application to dispose of unsalable or returned beer.

For the procedure with respect to the return of repossessed keg beer, see Rev. Rul. 55–491, page 711.

CHAPTER 80.—GENERAL RULES

SUBCHAPTER A.—APPLICATION OF INTERNAL REVENUE LAWS

SECTION 7805.—RULES AND REGULATIONS

26 CFR 170.68: Execution and filing of claim. T. D. 6144[1]

TITLE 26—INTERNAL REVENUE 1954.—CHAPTER I. SUBCHAPTER E, PART 170.—MISCELLANEOUS REGULATIONS RELATING TO LIQUOR

Regulations providing for refund of internal revenue taxes and customs duties paid on distilled spirits and wines lost, rendered unmarketable, or condemned by health authorities as a result of the hurricanes of 1954.

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

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

Public Law 363, Eighty-fourth Congress, First Session, page 766, of this Bulletin, reads as follows:

"Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That the Secretary of the Treasury is authorized and directed to make refund, or allow credit in the case of a distiller, winemaker, or rectifier if he so elects, in the amount of the internal revenue tax and customs duties paid on distilled spirits and wines previously withdrawn, and lost or rendered unmarketable or condemned by a duly authorized health official of the United States or of a State by reason of the hurricanes of 1954 while such spirits or wines were in the possession of (1) the person originally paying such tax, or such tax and duty, on such spirits or wines, (2) rectifier

[1] 20 F. R. 6549.

for rectification or for bottling, or which have been used in the process of rectification, under Government supervision as provided by law and regulations, or (3) a wholesale or retail liquor dealer, all hereinafter referred to as the possessor or possessors. The refunds and credits authorized by this Act may be made to (1) any of the possessors, except a retail liquor dealer, or (2) to any distiller, winemaker, rectifier, importer, or wholesale liquor dealer who replaced for the possessor the full equivalent of the distilled spirits or wines so lost or rendered unmarketable or condemned, without compensation, renumeration, payment, or credit of any kind in respect of the tax, or tax and duty, on such spirits or wines. A claim for the amount of such tax, or such tax and duty, shall be filed with the Secretary of the Treasury within ninety days from the date of enactment of this Act. The claimant shall furnish proof to the Secretary's satisfaction that (1) the internal revenue tax on such spirits or wines, or the tax and duty if imported, was fully paid, (2) such spirits or wines were lost or rendered unmarketable or condemned by a duly authorized health official of the United States or of a State, (3) the claimant was not indemnified by any valid claim of insurance or otherwise against loss of the tax, or tax and duty, paid on the spirits or wines, and (4) in those cases where applicable, that the claimant has had replaced for the possessor the full equivalent of the spirits or wines so lost or rendered unmarketable or condemned, without compensation remuneration, payment, or credit of any kind in respect of the tax, or tax and duty, on such spirits or wines.

"(b) When the Secretary, pursuant to this Act, makes refund, or allows credit, in the amount of the tax, or tax and duty, on spirits or wines rendered unmarketable or condemned by a duly authorized health official, such spirits or wines shall be destroyed under the supervision of the Secretary or his delegate, unless such spirits or wines were, prior to the enactment of this Act, destroyed under the supervision or observation of the Secretary or his delegate.

"(c) Where credit is allowed to a distiller, winemaker, or rectifier for the internal revenue tax previously paid as aforesaid, the Secretary is authorized and directed to provide for the issuance of stamps to cover the tax on distilled spirits or wines subsequently withdrawn or rectified to the extent of the credit so allowed.

"(d) The Secretary is authorized to prescribe such rules and regulations as may be necessary to carry out the provisions of this Act."

Pursuant to the above provisions of law, the following new subpart is added at the end of subpart C of part 170 of chapter 26 of the Code of Federal Regulations:

SUBPART D.—REFUND OF TAX AND DUTY PAID ON DISTILLED SPIRITS AND WINES LOST AS A RESULT OF THE HURRICANES OF 1954

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SUBPART D.—REFUND OF TAX AND DUTY PAID ON DISTILLED SPIRITS AND WINES LOST AS A RESULT OF THE HURRICANES OF 1954

§ 170.50. SCOPE OF REGULATIONS IN THIS SUBPART.—The regulations in this subpart prescribe the procedural and substantive requirements necessary to implement Public Law 363, Eighty-fourth Congress, First Session, concerning the refund of tax, or tax and customs duty, on distilled spirits and wines lost, rendered unmarketable, or condemned by health authorities as a result of the hurricanes of 1954.

DEFINITIONS

§ 170.51. MEANING OF TERMS.—When used in this subpart, where not otherwise distinctly expressed or manifestly incompatible with the intent thereof, terms shall have the meanings ascribed in §§ 170.52–170.65.

§ 170.52. ASSISTANT REGIONAL COMMISSIONER.—"Assistant Regional Commissioner" shall mean the Assistant Regional Commissioner, Alcohol and Tobacco Tax, who is responsible to, and functions under the direction and supervision of, the Regional Commissioner of Internal Revenue.

§ 170.53. CLAIMANT.—"Claimant" shall mean the person to whom the refund may be made, as provided in § 170.67, and in the case where the spirits and wines are to be replaced, such person or persons and the possessor shall join in the claim or claims.

§ 170.54. COMMISSIONER.—"Commissioner" shall mean the Commissioner of Internal Revenue.

§ 170.55. COMMISSIONER OF CUSTOMS.—"Commissioner of Customs" shall mean the Commissioner of Customs, Bureau of Customs, Treasury Department, Washington, D. C.

§ 170.56. DISTILLED SPIRITS OR SPIRITS.—"Distilled spirits" or "spirits" shall include alcohol and spirits commonly known as whisky, brandy, rum, gin, etc., on which tax has been paid at the distilled spirits rate, and rectified spirits.

§ 170.57. FULL EQUIVALENT.—"Full equivalent" shall mean a quantity of spirits, in tax gallons, or a quantity of wine, in wine gallons, equal to the quantity lost, rendered unmarketable, or condemned.

§ 170.58. HEALTH AUTHORITY.—"Health authority" shall mean any health official having authority to authorize the condemnation of spirits and wines.

§ 170.59. INCLUDES AND INCLUDING.—"Includes" and "including" shall not be deemed to exclude things other than those enumerated which are in the same general class.

§ 170.60. INCLUSIVE LANGUAGE.—Words in the plural form shall include the singular and vice versa, and words in the masculine gender shall include the feminine as well as trusts, estates, partnerships, associations, companies, and corporations.

§ 170.61. PERSON ORIGINALLY PAYING TAX OR TAX AND DUTY.—The "person originally paying tax or tax and duty" shall include proprietors of industrial alcohol plants or bonded warehouses, proprietors of internal revenue bonded warehouses, distillers, winemakers (including proprietors of bonded wineries or wine storerooms), rectifiers, and importers.

§ 170.62. POSSESSOR OR POSSESSORS.—"Possessor" or "possessors" shall mean the person or persons in whose possession the spirits or wines were held at the time they were lost, rendered unmarketable, or condemned, as specified in § 170.66.

§ 170.63. REGIONAL COMMISSIONER.—"Regional Commissioner" shall mean the Regional Commissioner of Internal Revenue in each of the internal revenue regions.

§ 170.64. TAX.—"Tax," with respect to unrectified distilled spirits, shall mean the internal revenue distilled spirits tax paid thereon; with respect to rectified spirits, "tax" shall include the distilled spirits tax paid, the rectification tax paid, if any, the cordial tax paid, if any, and the wine tax paid, if any; with respect to wines, "tax" shall mean the internal revenue tax paid thereon.

§ 170.65. WINES.—"Wines" shall include all still wines, effervescent wines, and flavored wines.

PAYMENT OF REFUNDS

§ 170.66. PERSONS BY WHOM REFUNDS ARE PAYABLE.—Assistant Regional Commissioners are authorized and directed to allow refund of the internal revenue taxes, and the Commissioner of Customs is authorized and directed to allow refund of the customs duties, paid on distilled spirits and wines previously withdrawn and lost, or rendered unmarketable, or condemned by health authorities, by reason of the hurricanes of 1954, while such spirits or wines were in the possession of (a) the person originally paying such tax, or such tax and duty, on such spirits and wines, (b) a rectifier for rectification or for bottling, or which have been used in the process of rectification, under Government supervision as provided by law and regulations, or (c) a wholesale or retail liquor dealer.

§170.67. PERSONS TO WHOM REFUNDS MAY BE MADE.—Under the provisions of the law, the refund of the tax, or of the tax and duty if the spirits or wines were imported, may be made to:

(a) any of the possessors referred to in § 170.66 except a retail liquor dealer, or

(b) any distiller, winemaker, rectifier, importer, or wholesale liquor dealer who has replaced for the possessor the full equivalent of the distilled spirits or wines which were lost, rendered unmarketable, or condemned by health authorities: *Provided*, That such replacement was made without compensation, remuneration, payment, or credit of any kind in respect of the tax, or tax and duty, on such spirits or wines.

CLAIMS PROCEDURE

§ 170.68. Execution and Filing of Claim.—A claim for refund of tax or customs duty shall be executed on Form 843 (Internal Revenue) in accordance with such instructions thereon as are applicable, and must be filed with the Assistant Regional Commissioner of the internal revenue region in which the spirits or wines were lost, rendered unmarketable, or condemned, within 90 days from August 11, 1955, the date of enactment of Public Law 363. Any claim for refund under this subpart filed after the 90-day period specified above, will be rejected in full and no refund of tax or duty made.

§ 170.69. Return of Claim for Completion or Correction.—The regulations in this subpart contemplate that claims will be filed (a) where the spirits or wines have been replaced before the filing of the claim; and (b) where the completion of the claim is to await determination, as provided in § 170.74, as to the quantity of spirits or wines lost or rendered unmarketable or condemned, and the quantity replaced for the possessor. In the event of (b), the claim will be returned to the claimant, on completion of such determination, for the insertion of the necessary data. Claims will also be returned which are otherwise defective in any respect.

§ 170.70. Separation of Imported and Domestic Spirits; Separate Claims for Tax and Duty.—If a claim for refund of internal revenue tax involves both domestic and imported spirits or wines, the quantity of each must be shown separately in the claim. A separate claim will be required in respect of refund of the customs duty on the imported spirits or wines.

§ 170.71.—Claimant to Furnish Proof of Loss, Unmarketability, or Condemnation.—The claimant shall furnish proof to the satisfaction of the Assistant Regional Commissioner that:

(a) the internal revenue tax on such spirits or wines, or the tax and duty if imported, was fully paid;

(b) such spirits or wines were lost, rendered unmarketable, or condemned by a duly authorized health authority, by reason of damage sustained as a result of one or more of the hurricanes of 1954;

(c) the claimant (including the possessor if other than the claimant) was not indemnified by any valid claim of insurance or otherwise against loss of the tax, or tax and duty, paid on the spirits or wines; and

(d) in those instances where applicable, that the claimant has replaced for the possessor the full equivalent of the spirits or wines so lost, rendered unmarketable, or condemned, without compensation, remuneration, payment, or credit of any kind in respect of the tax, or tax and duty, on such spirits or wines.

§ 170.72. SUPPORTING EVIDENCE.—The claimant shall support his claim with such evidence as he is able to submit, including inventories, statements, invoices, bills, records, stamps, labels, formulae, etc., relating to the quantity of taxpaid spirits and wines on hand at the time of the hurricane or hurricanes and averred to have been lost, rendered unmarketable, or condemned as a result thereof.

§ 170.73. SUPPORTING STATEMENT.—In an instance of replacement of spirits or wines for a possessor, the claimant shall attest in his claim that he, as a distiller, winemaker (including a proprietor of a bonded winery or wine storeroom), rectifier, importer, or wholesale liquor dealer, as the case may be, replaced for the possessor the full equivalent of the distilled spirits or wines which were lost, rendered unmarketable, or condemned, as the result of a hurricane, without compensation, remuneration, payment, or credit of any kind, in respect of the tax or duty on such spirits or wines, and further that neither the claimant nor the possessor was indemnified by any valid claim of insurance or otherwise against the loss of the tax, or tax and duty, paid on the spirits or wines so lost, rendered unmarketable, or condemned.

§ 170.74. REPLACEMENT.—The replacement of spirits or wines for a possessor and the completion by the claimant of the claim may be delayed until a reasonable determination has been made by the Assistant Regional Commissioner as to the quantity of spirits or wines lost, rendered unmarketable, or condemned, by reason of a hurricane, as provided in § 170.75. The findings of the Assistant Regional Commissioner in this respect may be made available to the claimant and the possessor. The claim shall be fully completed with respect to evidence of replacement before being further processed by the Assistant Regional Commissioner as provided by § 170.75. Nothing in this section is to be construed as extending the 90-day period provided by law and this subpart for the original filing of claims for refund of tax or duty.

§ 170.75. ACTION BY ASSISTANT REGIONAL COMMISSIONER.—The Assistant Regional Commissioner will date-stamp and examine each claim filed for refund of internal revenue tax or customs duty under this subpart and will cause such investigation to be made as may be necessary to establish the validity of the claim. On conclusion of his examination and investigation, the Assistant Regional Commissioner will, in the case of a claim for refund of internal revenue taxes, determine his action on the claim, respecting the quantity of spirits and wines found to have been lost, rendered unmarketable, or condemned, and include, where applicable, his conclusion as to whether the full equivalent of the spirits and wines have been replaced; the claim will then be processed by him in accordance with existing procedures. Claims involving refund of customs duty will be forwarded with a copy of the report of investigation and a copy of a summary statement by the Assistant Regional Commissioner (setting out his conclusions respecting quantities involved, replacements, etc.) to the Commissioner of Customs.

DESTRUCTION OF SPIRITS AND WINES

§ 170.76. SUPERVISION.—When refund is made in the amount of the tax, or tax and duty, on spirits and wines rendered unmarketable or condemned as provided in this subpart, such liquors shall be destroyed by suitable means under the supervision of an internal revenue officer who will be assigned for that purpose by the Assistant Regional Commissioner. The Bureau of Customs will notify the Assistant Regional Commissioner as to refunds of customs duty granted in respect of unmarketable or condemned spirits and wines.

PENALTIES

§ 170.77. PENALTIES.—It is an offense punishable by fine and imprisonment for anyone to make or cause to be made any false or fraudulent claim upon the United States, or to make any false or fraudulent statements or representations in support of any claim, or to falsely or fraudulently execute any documents required by the provisions of the internal revenue laws, or any regulations made in pursuance thereof.

This Treasury Decision shall be effective on publication in the Federal Register.

Compliance with the public rulemaking and effective date requirements of section 4 (a) and (c) of the Administrative Procedure Act (60 Stat. 238; 5 U. S. C. 1003) is impracticable and contrary to the public interest in connection with the issuance of this Treasury Decision because of the 90-day time limitation for filing the refund claims.

(This Treasury Decision is issued under the authority contained in Public Law 363, 84th Congress, 1st session.)

PAUL K. WEBSTER,
Acting Commissioner of Internal Revenue.
RALPH KELLY,
Commissioner of Customs.

Approved September 2, 1955.

A. N. OVERBY,
Acting Secretary of the Treasury.

(Published in the Federal Register September 7, 1955)

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26 CFR 194.23: Single sale. Rev. Rul. 55-689

Section 194.23 of the Regulations relating to Liquor Dealers provides that a single sale, unattended by circumstances showing the one making the sale to be engaged in business, does not create special tax liability. *Held*, a nonbeverage manufacturer who discontinues business may sell his entire stock of distilled spirits on hand in a single sale without incurring liability for special tax as a liquor dealer. It is also held that a nonbeverage manufacturer who discontinues business may return the distilled spirits on hand to the person or company from whom purchased, provided both parties are agreeable, or he

may destroy the distilled spirits or give them to a hospital, clinic, or charitable institution. All packages must have the stamps intact at all times, as evidence of taxpayment, until they are completely emptied.

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26 CFR 225.534: Limitation on number, size, and use of samples of distilled spirits other than brandy or wine spirits. Rev. Rul. 55-493

The removal of samples of distilled spirits, other than brandy or wine spirits, from containers in an internal revenue bonded warehouse in excess of the limitations contained in section 225.534 of the Regulations relating to the Warehousing of Distilled Spirits for organoleptic examination and laboratory analysis, and the removal of samples for any other purpose, regardless of size or number, may be authorized by the Assistant Regional Commissioner, Alcohol and Tobacco Tax. Samples so removed must be taxpaid.

Advice has been requested regarding an interpretation of section 225.534 of the Regulations relating to the Warehousing of Distilled Spirits with respect to the authority vested in Assistant Regional Commissioners, Alcohol and Tobacco Tax, for approving applications for the removal of samples of distilled spirits other than brandy or wine spirits from containers in an internal revenue bonded warehouse.

Under the provisions of section 225.534 of the regulations, the storekeeper-gauger may authorize the removal from a sample package or other container of not in excess of one-half pint for organoleptic examination and not in excess of one pint free of tax for laboratory analysis in a period of six months. Where a one-pint sample is found to be insufficient for laboratory analysis, the storekeeper-gauger may, upon receipt of a statement from the warehouseman showing the necessity for an additional quantity, authorize the removal of an additional quantity free of tax from the sample container, not in excess of one pint. In such case, the samples may be regarded collectively as a single sample. The storekeeper-gauger may also authorize, upon a showing by the warehouseman of a need therefor, the removal of additional quantities subject to the payment of tax where the taxfree withdrawals are insufficient for laboratory analysis.

Samples in excess of the specified limitations, or samples for any other purpose, such as quality approval under section 225.535 of the regulations, regardless of size or number, may be authorized by the Assistant Regional Commissioner, Alcohol and Tobacco Tax, and will be subject to the payment of tax pursuant to Form 1615, Taxable Samples of Distilled Spirits.

The size and number of taxpaid samples must be restricted to the minimum necessary for the purpose for which intended.

SUBPART B.—RULINGS AND DECISIONS UNDER THE INTERNAL REVENUE CODE OF 1939

No rulings or decisions under the Internal Revenue Code of 1939 were published in the Bulletin from July 1, 1955 to December 1, 1955.

SUBPART C.—RULINGS AND DECISIONS UNDER THE FEDERAL ALCOHOL ADMINISTRATION ACT OR RELATED LAWS

Rulings and decisions published in Part III, Subpart C, of the Internal Revenue Bulletin are based on the application of provisions of the Federal Alcohol Administration Act or other related laws and, unless otherwise noted therein, are published without consideration as to any application of the provisions of the Internal Revenue Code of 1954 or the Internal Revenue Code of 1939.

FEDERAL ALCOHOL ADMINISTRATION ACT

SECTION 5(b).—UNFAIR COMPETITION AND UNLAWFUL PRACTICES: TIED HOUSE

FAA REGULATIONS No. 6, SECTION 6.27: Rev. Rul. 55-568
Consumer advertising specialties.

> An arrangement for distributing book matches bearing an advertisement of a distiller's product, whereby part of the cost of the matches would be borne by the retailer and the balance by the distiller and/or a wholesaler, would be in violation of the Federal Alcohol Administration Act if it resulted in inducing the retailer to purchase the products of the distiller or wholesaler concerned to the partial or complete exclusion of distilled spirits sold or offered for sale by other persons in interstate commerce.

The Internal Revenue Service has been requested to advise whether a violation of the Federal Alcohol Administration Act might result by reason of a retailer's paying a part of the cost of book matches bearing a distiller's advertising in the manner indicated herein.

A distiller wishes to distribute book matches bearing material advertising a brand of his whisky. The retailer would absorb 50 percent of the cost of the matches with the remaining 50 percent paid by the distiller and the wholesaler, or by the wholesaler.

Section 5(b)(4) of the Federal Alcohol Administration Act provides, among other things, that it shall be unlawful for a distiller or wholesaler, directly or indirectly or through an affiliate, to induce a retailer to purchase the products of such distiller or wholesaler to the exclusion in whole or in part of distilled spirits sold or offered for sale by other persons in interstate commerce, under the conditions outlined in that section, by paying or crediting the retailer for any advertising, display, or distribution service.

Section 5(b)(3) of the Act prohibits the similar inducement of the retailer by furnishing, giving, renting, lending, or selling to the retailer any signs, supplies, services, money, or other thing of value, subject to such exceptions as may by regulations be prescribed. Section 6.27 of Regulations No. 6 permits a distiller or wholesaler to furnish, give, or sell consumer advertising specialties, such as matches bearing the distiller's or wholesaler's advertising, to retailers for unconditional distribution by them to the general public provided the retailers are not paid or credited in any manner for such distribution service. The regulations contain no exceptions which would operate to permit a distiller or wholesaler to share the cost of producing and disseminating advertising material.

If the proposed methods of distributing book matches bearing an advertisement of the distiller's product result in inducing the retailer to purchase the products of the distiller or wholesaler contributing to the cost of the matches to the partial or complete exclusion of distilled spirits sold or offered for sale by other persons in interstate commerce, violations of the Act would ensue.

Rev. Rul. 55-551

Payments to retailers operating taverns or bars, by a producer, wholesaler, or importer, of the cost of "free drinks" to consumers would result in violations of the Federal Alcohol Administration Act if such payments resulted in inducement and exclusion.

Advice has been requested whether a producer, wholesaler, or importer of distilled spirits or wine may pay a retailer operating a tavern or bar for certain "free drinks."

In the instant case, a producer of distilled spirits desires to run a newspaper advertisement covering one of his brands of spirits, with a consumer mail-in blank as a part of such advertisement. This mail-in blank would contain spaces for the consumer to insert his name and address and the name and address of his favorite tavern or bar. The blank would then be mailed by the consumer to the producer, who in turn would mail a card to the consumer entitling him to one free drink of the brand of distilled spirits advertised at the tavern or bar named by him. The retailer would be compensated for the cost of the drink by the producer.

Section 5(b)(3) of the Federal Alcohol Administration Act prohibits a manufacturer, importer, or wholesaler of alcoholic beverages from inducing a retailer to purchase his products to the exclusion in whole or in part of similar products of other persons sold or offered for sale in interstate commerce, under the conditions stated therein, by furnishing, giving, renting, lending, or selling to the retailer any equipment, fixtures, signs, supplies, money, services, or other thing of value.

It is held that payments to retailers operating taverns or bars by a producer, wholesaler, or importer, of the cost of the free drinks would constitute the furnishing of a service or other thing of value to the retailer within the meaning of Section 5(b)(3) of the Act. Accordingly, if such payments result in the proscribed "inducement" and "exclusion," violations of the Act would ensue.

Rev. Rul. 55-567

The sale by an industry member to a retailer, for resale to consumers, of wrought iron cradles, bearing advertising matter, for use in holding gallon bottles, would not fall within any of the exceptions to the statute set forth in Regulations No. 6. If such sales result in the proscribed "inducement" and "exclusion," violations of the Federal Alcohol Administration Act would ensue.

Advice has been requested whether the sale of wrought iron pouring cradles for gallon bottles to retailers by a wholesaler would result in a violation of the Federal Alcohol Administration Act. The cra-

dles contain advertising matter and are to be resold by the retailer to consumers.

Section 5(b)(3) of the Federal Alcohol Administration Act, among other things, makes it unlawful for a producer, wholesaler, or importer of alcoholic beverages, directly or indirectly, to induce a retailer to purchase his products to the exclusion in whole or in part of similar products sold or offered for sale by other persons in interstate commerce, under the conditions outlined therein, by furnishing, giving, renting, lending, or selling to the retailer, any equipment, supplies, services, or other thing of value, subject to such exceptions as may by regulations be prescribed.

The furnishing of the cradles in the manner indicated would fall within the coverage of section 5(b)(3) of the Act and would not fall within any of the exceptions to the statute set forth in Regulations No. 6.

If retailers are induced to purchase alcoholic beverages to the partial or complete exclusion of alcoholic beverages sold or offered for sale by other persons in interstate or foreign commerce as a result of the sale of the cradles, violations of the Act would ensue. However, if the cradles are sold at their full value to off-premise retailers only and such sales are not conditioned, directly or indirectly, on the purchase of alcoholic beverages, the sale thereof would not appear likely to result in the proscribed "inducement" and "exclusion."

SECTION 5(e).—UNFAIR COMPETITION AND UNLAWFUL PRACTICES: LABELING

FAA REGULATIONS No. 4, SECTION 21: The standards of identity. (Also section 34.) — Rev. Rul. 55-553

Wine made from a variety of blackberry known as the olallie berry may be labeled as "Blackberry Wine of the Olallie variety."

FAA REGULATIONS No. 4, SECTION 23: Grape type designations. (Also Section 24.) — Rev. Rul. 55-537

The designation "Light Sweet Tokay" may, if properly modified as shown below, be used on a light sweet wine similar in other respects to Tokay dessert wine but having an alcoholic content of less than 14 percent by volume. Accordingly, Revenue Ruling 54-511, C. B. 1954-2,584, which lists the types of wine which may be designated as "Tokay," is amended to read as follows:

The designation "Tokay" qualified by an appropriate appellation of origin may be properly used on the following types of wine produced in the United States:

> On a dessert wine which possesses the taste, aroma, and other characteristics generally attributed to this product.

On a wine deriving its predominant taste, aroma, and characteristics, and at least 51 percent of its volume, from Tokay grapes.

On a light wine possessing the taste, aroma, and other characteristics generally attributed to Tokay wine made in Hungary.

In addition, the designation "Light Sweet Tokay" qualified by an appropriate appellation of origin may be properly used on a light sweet wine similar to Tokay dessert wine except that it has an alcoholic content of less than 14 percent by volume. However, in order to avoid confusion which may be caused by the use of the word "Tokay" on many different types of wine, the designation must be followed by a statement "A light wine similar in flavor to American (or California, New York, etc.) Tokay," in readily legible printing. Further, if a name of a state is used in the subsidiary statement, the wine on which the label is to be used must have been produced in such state. Thus, a light sweet wine made in New York, but with an alcoholic content of less than 14 percent by volume, may be designated "New York Light Sweet Tokay," if followed by the statement "A light wine similar in flavor to New York Tokay."

FAA REGULATIONS No. 4, SECTION 24: Generic, semigeneric, and nongeneric designations of geographic significance.

Types of wine which may be designated as "Tokay" and as "Light Sweet Tokay." See Rev. Rul. 55–537, page 733.

FAA REGULATIONS No. 4, SECTION 34: Class and type.

For the labeling of wine made from a variety of blackberry known as the olallie berry. See Rev. Rul. 55–553, page 733.

FAA REGULATIONS No. 4, SECTION 35: Name and address.

Bottling of wine at a taxpaid wine bottling house under a trade name for exclusive use by another dealer. See Rev. Rul. 55–595, page 705.

FAA REGULATIONS No. 4, SECTION 39: Prohibited practices. Rev. Rul. 55–618

Wine labels may not bear the phrases "Altar Style," "Altar Type," "Kosher Style," or "Kosher Type," since the use thereof is considered misleading.

Advice has been requested whether wine labels may bear phrases such as "Altar Style," "Altar Type," "Kosher Style," or "Kosher Type."

Section 30 of Regulations No. 4 provides in part that containers of wine, or any labels on such containers, or any individual covering,

carton, or other wrapper of such container, or any written, printed, graphic, or other matter accompanying such container to the consumer shall not contain any statement that, irrespective of falsity, directly or by ambiguity, omission, or inference, or by the addition of irrelavant, scientific, or technical matter, tends to create a misleading impression.

The Internal Revenue Service has held for many years that where a label for wine contains the words "altar wine," the wine so labeled may be sold only to ministers of the gospel, priests, or religious organizations for sacramental use. When labels bearing such statements are received for approval, the Form 1649, Certificate of Label Approval under the Federal Alcohol Administration Act, is issued with the qualifying statement that "this certificate covers the attached label only if the wine bottled thereunder will be sold to ministers of the gospel, priests, or religious organizations for sacramental use exclusively and will not be sold for beverage use to the consuming public."

It is held that, although altar wines, labeled as such, are not offered for sale to the general public, the use of the phrases "Altar Style" or "Altar Type" would be misleading to persons or organizations qualified to purchase altar wines. It is further held that the use of the phrases "Kosher Style" or "Kosher Type" on non-koshered wines would be misleading to the consuming public. Accordingly, the foregoing phrases may not be used under such circumstances.

FAA Regulations No. 5, Section 21: The standards of identity. Rev. Rul. 55–552

A product having a light golden color from storage in wooden containers may not be labeled as vodka since it would not be "without distinctive character."

Advice has been requested whether grain neutral spirits, which have obtained a light golden color from storage in wood and which are treated with carbon, may be labeled as vodka if, when bottled, the distillate retains all or part of the light golden color.

Section 21, class 1(a) of Regulations No. 5 defines vodka as neutral spirits distilled from any material at or above 190 degrees of proof, reduced to not more than 110 nor less than 80 degrees of proof, and after such reduction in proof treated by one of the three methods set forth therein so that the resulting product would be without distinctive character, aroma, or taste. That section requires that the distillate, after treatment, be stored only in metal, porcelain, or glass containers or paraffin lined tanks.

It is held that a product with a "light golden" color would not conform to the above definition. Accordingly, such a product may not be labeled as vodka.

Reclassification of vodka as grain neutral spirits at a taxpaid bottling house or a rectifying plant. See Rev. Rul. 55–594, page 700.

Labeling of spirits subjected to the vodka treatment but packaged in wooden containers, upon bottling. See Rev. Rul. 55–740, page 700.

FAA REGULATIONS NO. 5, SECTION 36: Alcoholic content. Rev. Rul. 55-494

Products, such as Rock and Rye, when packaged with fresh fruit or other like materials may drop somewhat in proof between the time they are bottled and the time they are sold to the consumer purchaser due to the absorption of alcohol by the fresh fruit or other like materials in the bottle. *Held*, the statement "___ Proof" may be construed by the consumer as relating to the proof at the time of purchase of the product and therefore would result in deception in those cases where the proof has diminished after bottling. Accordingly, labels on bottles of such products should have the proof shown thereon as "Bottled at __ Proof," rather than merely as "__ Proof."

Rev. Rul. 55-712

Odd-size containers for beer are acceptable to the Internal Revenue Service. Accordingly, standards of fill under the Federal Alcohol Administration Act are not needed.

A request was received, submitted on behalf of a substantial number of brewers, asking that a public hearing be held to consider the adoption of standards of fill for malt beverages, pursuant to the authority contained in section 5(e) of the Federal Alcohol Administration Act.

Section 5(e) of the Act, among other things, prohibits any brewer, wholesaler or importer, directly or indirectly, from introducing into interstate or foreign commerce any malt beverages which are not bottled, packaged and labeled in conformity with regulations prescribed by the Secretary after notice and hearing "with respect to packaging, marking, branding and labeling and size and fill of container," as will prohibit deception of the consumer with respect to such product or the quantity thereof. This provision is, however, applicable only to the extent that the state into which the malt beverages are shipped imposes similar requirements.

After careful consideration, it was deemed advisable to hold a hearing to consider the adoption of standards of fill for malt beverages. Accordingly, a notice of hearing to be held on June 1, 1955, was published in the Federal Register on May 7, 1955 (20 F. R. 3113). Also, an announcement with respect thereto was contained in Internal Revenue Bulletin 1955-20, 28.

Following such hearing, it has been concluded that the establishment of standards of fill for malt beverages is not warranted at this time. Accordingly, the requirements with respect to the new odd-size containers contained in Revenue Ruling 55-131, C. B. 1955-1, 614, are hereby continued.

PART IV

LEGISLATION AND TREATIES

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PART IV

LEGISLATION AND TREATIES

SUBPART A.—LEGISLATION

DIGEST OF PUBLIC LAWS ENACTED DURING THE FIRST SESSION OF THE EIGHTY-FOURTH CONGRESS WHICH PERTAIN TO INTERNAL REVENUE MATTERS

The following public laws pertaining to internal revenue matters were enacted during the first session of the Eighty-fourth Congress:

Number of public law	Date approved	Number of public law	Date approved
1	Jan. 20, 1955	319	Aug. 9, 1955
9	Mar. 2, 1955	321	Aug. 9, 1955
18	Mar. 30, 1955	323	Aug. 9, 1955
66	June 8, 1955	333	Aug. 9, 1955
74	June 15, 1955	354	Aug. 11, 1955
91	June 21, 1955	355	Aug. 11, 1955
196	Aug. 1, 1955	363	Aug. 11, 1955
216	Aug. 3, 1955	366	Aug. 11, 1955
285	Aug. 9, 1955	367	Aug. 11, 1955
299	Aug. 9, 1955	370	Aug. 11, 1955
303	Aug. 9, 1955	379	Aug. 12, 1955
306	Aug. 9, 1955	383	Aug. 12, 1955
310	Aug. 9, 1955	384	Aug. 12, 1955
317	Aug 9, 1955	385	Aug. 12, 1955

Following is a list of the 1954 Code sections and the 1939 Code sections which were amended or added by these public laws along with a brief explanation of the amendment; also, explanations of the provisions of the public laws which do not specifically amend a Code section but which do pertain to revenue matters. The statements explaining the Code sections and the amendments are not intended as interpretations but are intended merely to indicate the general nature or effect of the provisions involved.

AMENDMENTS TO THE 1954 CODE

SECTIONS AFFECTED:

11(b)

821(a)(1)(A)

821(b)(1). *Extension of corporate normal-tax rate.*—Public Law 18, C. B. 1955–1, 619, amends these sections to extend the corporate normal-tax rate of 30 percent for an additional year to April 1, 1956.

SECTIONS AFFECTED—Continued

37(f). *Retirement income tax credit for members of the Armed Forces.*—Section 37 provides for an income tax credit with respect to "retirement income." In the case of an individual under 65 years of age, the term "retirement income" includes only income from pensions and annuities under a public retirement system as defined in section 37(f). Section 37(f) excepts from the definition of a "public retirement system" a fund or system established by the United States for members of the Armed Forces. Public Law 299 amends section 37(f) to remove this exception so that Armed Forces retirees under 65 years of age may be entitled to a retirement income credit with respect to the pensions they receive under the Armed Forces retirement system. This amendment is applicable to taxable years beginning after December 31, 1954.

152(b)(3). *Exemption for certain dependents in the Republic of the Philippines.*—This section provides that the term "dependent" does not include any individual who is not a citizen of the United States unless such individual is a resident of the United States, of a country contiguous to the United States, of the Canal Zone, or of the Republic of Panama. However, the section does not exclude from the definition of "dependent" any child of the taxpayer born to him, or legally adopted by him, in the Philippine Islands before July 5, 1946, if the child is a resident of the Philippines and the taxpayer was a member of the United States Armed Forces at the time the child was born or legally adopted. Public Law 333 amends this section to permit the taxpayer to claim as a dependent a child born to him or legally adopted by him prior to January 1, 1956, rather than July 5, 1946. This amendment is effective for taxable years beginning after December 31, 1953, and ending after August 16, 1954. For description of a collateral amendment made by Public Law 333 to the 1939 Code, see the statement made under section 25(b)(3), 1939 Code.

452

462

381(c). *Prepaid income and reserves for estimated expenses.*—Public Law 74, page 748 of this Bulletin, repealed retroactively section 452 and 462 which permitted taxpayers to adopt certain methods of accounting for prepaid income and estimated expenses. Although taxpayers must pay any increase in tax resulting from the repeal of these sections, the savings provisions of Public Law 74 give them an additional period of time in which to make payment thereof and grant them relief, under certain circumstances, from payment of interest on such increase. The amendment to section 381(c) is a technical amendment. It strikes paragraph (7), of such section, relating to carryover of prepaid income in certain corporate acquisitions.

534. *Burden of proof.*—Under the provisions of this section, in deficiency cases before the Tax Court where it is proposed to assert the accumulated earnings tax, the burden of proving

SECTIONS AFFECTED—Continued

that all or any part of an accumulation of earnings and profits is in excess of reasonable needs of the business is, under certain conditions, on the Secretary or his delegate. This "burden of proof rule" is applicable only to taxable years subject to the provisions of the 1954 Code. Under the 1939 Code, the taxpayer had the burden of proof as to the reasonableness of the accumulation. Public Law 367 amends this section to make the "burden of proof rule" also applicable to taxable years under the 1939 Code, in the case of proceedings tried on the merits after August 11, 1955, where a deficiency is proposed in the surtax on corporations improperly accumulating surplus.

542(a)(2). *Definition of personal holding company.*—This section provides for treatment as "individuals" of certain charitable foundations or trusts in applying the stock ownership test for personal holding companies. Public Law 385 makes section 542(a)(2) inapplicable to long-established charitable foundations meeting certain conditions so that they may retain the tax status under which they have operated for many years. The conditions which must be met are as follows: (1) The foundation must have been organized or created before July 1, 1950; (2) at all times on or after July 1, 1950, through the close of the taxable year such foundation must own all of the common stock and at least 80 percent of the total number of shares of all other classes of stock of the corporation; and (3) such foundation must not be denied exemption under section 504 or such trust must not be denied the unlimited charitable deduction under section 681(c). The amendment to section 542(a)(2) applies only with respect to taxable years. The conditions which must be met are as follows: (1)

1233. *Arbitrage operations in securities.* Under section 1233(b)(2) the holding period of securities acquired for investment purposes is considered as starting on the date of the closing of a short sale of substantially identical securities. Public Law 385 adds a new subsection (f) which provides that when a short sale entered into as part of an arbitrage operation is closed and the rules of subsection (b)(2) become applicable, these rules are to apply first to the substantially identical assets acquired for arbitrage operations held on the day the short sale is made. The rules of subsection (b)(2) are to apply to other substantially identical assets only to the extent that the quantity sold short exceeds the substantially identical assets held for arbitrage operations. The amendment of section 1233 applies only with respect to taxable years ending after August 12, 1955, and only in the case of a short sale of property made by the taxpayer after August 12, 1955.

1304. *Tax treatment of income received from patent infringement suits.*—Public Law 366 adds a new section 1304 to the 1954 Code and renumbers former section 1304 as section 1305. The new section provides that the tax attributable to inclusion in gross income of an amount which represents compen-

SECTIONS AFFECTED—Continued

satory damages received or accrued as a result of a judgment for infringement of a United States patent shall not be greater than the aggregate of the increases in taxes which would have resulted if such amount had been included in gross income in equal installments for each month during which the infringement occurred. This amendment is applicable to taxable years ending after August 11, 1955, but only with respect to amounts received or accrued after that date as the result of awards made after that date.

1342. *Recovery of substantial amount held by another under claim of right.*—Public Law 384 adds to the 1954 Code a new section, section 1342, which is complementary to existing section 1341 relating to computation of tax where taxpayer restores to another a substantial amount which he had held under a claim of right. The new section deals with a situation where a taxpayer recovers an item which he had taken as a deduction in a prior year or years because it appeared that another person held an unrestricted right to such item as a result of a court decision in a patent infringement suit. If the recovered item amounts to $3,000, or more, the new section provides that the tax for the year of recovery shall be the lesser of: (1) the tax computed by including the recovered item in the income of the recovery year; or (2) the tax computed by excluding the recovered item from the recovery year's income and adding to the tax so computed the increase in tax (including interest) of the prior year(s) resulting from the restoration of the deduction(s) claimed in the prior year(s). In order for section 1342 to apply, the recovery must be due to the reversal of the court decision on the ground that such decision was induced by fraud or undue influence. Section 1342 is applicable to taxable years beginning after December 31, 1954.

3401. *Withholding of income tax on remuneration paid to a United States citizen for services performed in a United States possession.*—Public Law 321 amends this section to provide that an employer (other than the United States Government) need not withhold income tax on remuneration paid to a United States citizen for services performed in a possession of the United States if the employer is required by the law of the possession to withhold income tax on the remuneration. Under the law prior to this amendment, the wages of a United States citizen employed in a possession of the United States were, under certain circumstances, reduced by withholding for both the income tax of the possession and the Federal income tax. This amendment is effective on August 9, 1955, the date of enactment of Public Law 321.

3402. *Noncash remuneration to retail commission salesmen.*—Public Law 306 amends this section to provide that an employer shall not be required to withhold and deduct taxes on noncash remuneration paid to a retail salesman where such salesman is ordinarily paid for his services by way of

SECTIONS AFFECTED—Continued

cash commissions. However, the employer must file such information with respect to the noncash remuneration as may be required by regulations. This amendment is applicable to remuneration paid after August 9, 1955, the date of enactment of Public Law 306.

4041(c), 4061
4081, 5001(a)(1)
5001(a)(3)
5022, 5041(b)
5051(a), 5063
5134(a)(3)
5701(c)(1)
5707(a), 5707(b)
6412(a), 6412(b)
Sec. 497, Rev.

Act of 1951. *Extension of certain excise tax rates.*—Public Law 18, C. B. 1955–1, 619, amends these sections to postpone until April 1, 1956, the excise tax rate reductions on the following taxable articles which were to become effective on April 1, 1955: Automobiles, trucks, motorcycles, etc., and parts and accessories therefor; gasoline; diesel fuel; cigarettes; distilled spirits generally; imported perfumes containing distilled spirits; still wines; sparkling wines; liqueurs and cordials; and fermented malt liquors.

4061(a)(2). *Repeal of excise tax on motorcycles.*—Public Law 379 amends this section to repeal the excise tax on motorcycles. The repeal is effective as of September 1, 1955. There is no provision for a floor stocks refund of credit with respect to tax paid on inventories of motorcycles held for sale on September 1, 1955 by dealers.

4063(b)
4112, 4113
4218(a)(1)
and (b)
4220
6416(b)(3)(A)
and (B). *Automotive parts or accessories, refrigerator components, radio and television components, and camera lenses.*—Presently, radio and television components and camera lenses are subject to the manufacturers' excise tax if sold to a manufacturer for incorporation in an article not subject to such tax. Automobile parts and accessories and refrigerator components may be sold tax-free if sold to a manufacturer for incorporation in other articles, whether or not such other articles are taxable. However, if such parts or accessories are sold on a tax-paid basis, no credit or refund may be claimed if they are used in the manufacture of nontaxable articles. Public Law 367 amends these sections to provide a single rule for all these articles so that none of them are taxable if sold to a manufacturer for incorporation in other articles, regardless of whether such other articles are taxable. The amendment to section 6416(b)(3)(B) provides a credit

SECTIONS AFFECTED—Continued

or refund of any tax paid on these articles to a manufacturer who purchased and used them in the manufacture of, or as component parts of, any article. The amendments take effect on September 1, 1955, except that the amendment to section 6416(b)(3)(B) applies to articles used by the manufacturer on or after September 1, 1955.

4091, 4092

6416(b)(2). *Excise tax on cutting oils.*—Section 4091 imposes a tax of 6 cents a gallon on lubricating oils sold except that the tax is not to exceed 10 percent of the selling price in the case of cutting oils. Public Law 355 amends section 4091 to provide that the tax on cutting oils shall be 3 cents a gallon and on other lubricating oils, 6 cents a gallon. It also transfers the definition of cutting oils from section 4091 to section 4092 and defines them as oils *sold for use* in cutting and machining operations on metals rather than as oils *used* primarily in cutting and machining operations. Public Law 355 adds to section 6416(b)(2) a new subparagraph (I) providing for a credit or refund not to exceed 3 cents a gallon in the case of lubricating oil on which a tax of 6 cents a gallon was paid if the lubricating oil was used or resold as cutting oil after the effective date of Public Law 355. The amendments made by Public Law 355 take effect on October 1, 1955.

4141, 4143

6416(b)(2)(G). *Radio and television receiving sets and component parts.*—Public Law 367 amends section 4141 to provide that the tax on radio and television receiving sets, automobile radio or television receiving sets, phonographs, and combinations of any of these, shall apply only to articles of the entertainment type. The tax on radio and television components and on phonograph records will continue to apply whether or not the articles are of the entertainment type. The special exemption in section 4143 and the special credit or refund in section 6416(b)(2)(G) for communication, detection, and navigation receivers sold to the United States Government are repealed. The amendment to section 4141 and the repeal of section 4143 take effect on September 1, 1955. The repeal of section 6416(b)(2)(G) applies only with respect to articles sold by the manufacturer, producer, or importer on or after September 1, 1955.

4216

4217. *Manufacturers' excise tax on leases of certain automobile utility trailers.*—Under the provisions of these sections, if a manufacturer leases articles subject to a manufacturers' excise tax, such tax applies to the amount of each lease payment on the same basis as if it were a sale. Frequently, the total rental payments will exceed the price at which the manufacturer would sell the article, thus resulting in a greater tax on the leased article than would have been applicable if the article had been sold. Public Law 317 amends these sections to provide that the maximum tax imposed on

SECTIONS AFFECTED—Continued

the leasing of certain automobile trailers, or semitrailers, is to be an amount equal to the applicable tax rate multiplied by the fair market value of the trailer at the time of the initial lease. The taxpayer is given the option to pay the tax in full at the time of the initial lease or to spread the tax payments over the period of the lease payments. The amendments made by Public Law 317 become effective September 1, 1955. For the purpose of applying this amendment to articles leased before September 1, 1955, the fair market value of an article is considered to be the fair market value as of such date and any lease existing on such date, or if there is none, the first lease entered into after such date is considered an initial lease.

4233(a). *Athletic events for benefit of United States Olympic Association.*—Public Law 354 amends this section to exempt from the admissions tax admissions to athletic events conducted by the United States Olympic Association, or authorized in advance by such association to be conducted for its benefit, if all the proceeds of the admissions inure exclusively to the benefit of such association. This amendment is effective with respect to amounts paid on or after September 1, 1955, for admissions on or after such date.

7237. *Penalties for narcotics violations.*—Public Law 1, C. B. 1955–1, 619, amends this section to correct a technical error in the drafting of the 1954 Code. The amendment makes the penalties provided by this section applicable to offenses described in any subpart of part I of subchapter A of chapter 39, for which no specific penalty is otherwise provided, instead of just to offenses described in subpart C as provided prior to the amendment. The effective date of this amendment is January 20, 1955.

7443(c). *Salaries of Tax Court Judges.*—Public Law 9 amends this section by increasing the salaries of Tax Court judges from $15,000 to $22,500. This amendment took effect on March 1, 1955.

AMENDMENTS TO THE 1939 CODE

SECTIONS AFFECTED:

25(b)(3). *Exemption for certain dependents in the Republic of the Philippines.*—This section defines "dependent" for purposes of the income tax exemption for dependents. Among other things, the section provides that the term "dependent" does not include any individual who is a citizen or subject of a foreign country unless such individual is a resident of the United States or of a country contiguous to the United States. Public Law 333 amends section 25(b)(3) so that this provision will not exclude from the definition of "dependent" any child of the taxpayer born to him, or legally adopted by him, in the Philippine Islands, if the child is a resident of the Philippines and the taxpayer was a member of the United States Armed Forces at the time the child was

SECTIONS AFFECTED—Continued

born or legally adopted. The amendment is effective for all taxable years beginning after December 31, 1946, to which the Internal Revenue Code of 1939 applies. However, the amendment does not open up years with respect to which the statute of limitations has run. For description of a collateral amendment made by Public Law 333 to the 1954 Code, see the statement made under section 152(b)(3), 1954 Code.

112(n)(8). *Sale of residence by members of the Armed Forces.*—Under the provisions of section 112(n) gain on the sale of a taxpayer's principal residence is not recognized, if the taxpayer purchases a new residence within one year or constructs a residence within 18 months of the date of sale, except to the extent that the sales price of the old residence exceeds the "purchase price" of the new residence. Both sections 112(n)(8) of the 1939 Code and section 1034(h) of the 1954 Code provide that the running of the replacement period shall be suspended during any period that the taxpayer or his spouse is on extended active duty with the Armed Forces after the date of the sale of the old residence except that in no case shall the replacement period as suspended extend beyond four years after the date of sale of the old residence. Section 112(n)(8), however, suspends the running of this replacement period only until January 1, 1954. Section 1034(h) of the 1954 Code removes this date limitation altogether and provides in lieu thereof a limitation that the suspension of the running of the replacement period will be applicable only during any period in which individuals are liable for induction in the Armed Forces. The provisions of the 1939 Code are applicable to sales of residences made before January 1, 1954, and those of the 1954 Code are applicable to sales made after December 31, 1953. Public Law 384 amends section 112(n)(8) of the 1939 Code to strike out the January 1, 1954 limitation and replace it with the "induction period" limitation provided in section 1034(h) of the 1954 Code. This amendment takes effect as of December 31, 1953.

3416(a)(2). *Claim for 1954 floor stocks refund or credit on refrigerators, quick-freeze units, etc.*—Under the provisions of this section, a claim for the floor stocks refund or credit on certain household appliances authorized by the Excise Tax Reduction Act of 1954 must be filed before August 1, 1954. Public Law 303, page 24, this Bulletin, amends this section to extend the time for filing such a claim. The amendment makes October 10, 1955, the last day for filing a claim for refund or credit under this section.

AMENDMENTS TO REVENUE ACTS

Section 223
Revenue Act
of 1950. *Use of corporation property by shareholders in case of personal holding companies.*—Section 502(f) of the 1939 Code

provides that amounts received by a corporation as compensation for the use of, or the right to use, property of the corporation constitutes personal holding company income if 25 percent or more of the value of its outstanding stock is owned by an individual entitled to use of the property. Section 223 of the Revenue Act of 1950 provides that section 502(f) shall not apply to rents received during taxable years ending after December 31, 1945, and before January 1, 1950, for use by the lessee of property of the corporation in the operation of a bona fide commercial, industrial, or mining enterprise. Public Law 370 amends section 223 of the Revenue Act of 1950 to extend its application to taxable years ending before January 1, 1954, rather than January 1, 1950.

Section 345
Revenue Act
of 1951. *Abatement of tax on certain trusts for members of the Armed Forces dying in service.*—Section 345 of the Revenue Act of 1951 provided for the allowance of a deduction with respect to certain income accumulated by a trust for a beneficiary for any period beginning on or after December 7, 1941, and ending before January 1, 1948, if the beneficiary died on or after December 7, 1941, and before January 1, 1948, while in active service as a member of the Armed Forces during such period. The deduction is allowable in the year or years in which the income was accumulated. While section 345 was actually a retroactive provision, it only provided relief for cases where the statutory period of limitation had not expired. Public Law 310 provides that refund or credit of an overpayment resulting from application of section 345 which is barred by statute on the date of its enactment, August 9, 1955, shall nevertheless be allowed if claim therefor is filed within one year after the date of enactment. Public Law 310 is not applicable, however, where refund or credit is prevented by the provisions of section 3760 or 3761 of the 1939 Code or section 7121 or 7122 of the 1954 Code relating to closing agreements and compromises.

MISCELLANEOUS PROVISIONS RELATING TO INTERNAL REVENUE MATTERS

Public Law 66, page 747 of this Bulletin. Continues until the close of June 30, 1956, the suspension of duties and import taxes on metal scrap.

Public Law 91, page 749 of this Bulletin. Continues until the close of June 30, 1958, the suspension of certain import taxes on copper.

Public Law 196. Authorizes the President to enter into an agreement with the President of the Philippines revising the Philippine Trade Act of 1946. The tax provisions of the revised agreement between the United States and the Philippines are identical to the provisions of the Philippine Trade Act of 1946 except for deletion of the prohibition against imposition of an export tax by either country upon products which it exports to the other.

Public Law 216, page 754 of this Bulletin. Extends the Renegotiation Act of 1951 for two years to December 31, 1956. It directs the

Joint Committee on Internal Revenue Taxation to make a study as to the necessity of extending the Act beyond December 31, 1956, and to make a report of the results of such study to the Congress not later than May 31, 1956.

Public Law 285. Amends the International Claims Settlement Act of 1949 to authorize the vesting of blocked assets owned by the Governments of Bulgaria, Hungary, and Rumania, or by any national thereof, in officers or agencies of the United States Government for the purpose of settling certain claims of American nationals against such governments and the subsequent liquidation of the blocked assets. With respect to Federal taxes, the law provides that the vesting of the property shall not render inapplicable any Federal tax; that the administering agency shall pay any tax incident to the property to the same extent, as nearly as is practicable, as though the property had not been vested; that the manner of computing Federal taxes, including the applicability in such computation of credits, deductions, and exemptions to which the former owner is or would be entitled, shall be in accordance with regulations prescribed by the Secretary of the Treasury; that the statute of limitations on assessment, collection, refund, or credit of Federal taxes shall be suspended with respect to the vested property while vested and for six months thereafter; and that the property vested shall not be subject to lien, attachment, or garnishment except as provided in Public Law 285.

Public Law 319. Amends title V of the Agricultural Act of 1949, providing for the Mexican farm labor program, to extend such program for three and one-half years to June 30, 1959. Under the provisions of section 3121(b)(1)(C) of the 1954 Code, wages paid for service performed by foreign agricultural workers under contracts entered into in accordance with title V of the Agricultural Act of 1949, as amended, are not subject to FICA taxes.

Public Law 323. Provides for the purchase by the heads of Governmental departments and independent establishments of blanket, position schedule, or other type of surety bonds covering civilian officers and employees and military personnel of such departments required by law or administrative ruling to be bonded. This general rule provided by Public Law 323 applicable to the various departments of the Government supersedes the specific authorization given the Secretary in section 7803(c) of the 1954 Code to purchase blanket or schedule bonds covering employees of the Internal Revenue Service. However, any bond obtained by the Secretary under section 7803(c), the term of which will expire after the enactment date of Public Law 323, may be continued in force until the expiration of such term. The amendments made by Public Law 323 take effect on January 1, 1956.

Public Law 363. Authorizes and directs the Secretary of the Treasury to allow a refund or credit to a distiller, winemaker, or rectifier in the amount of tax or duty paid on distilled spirits and wines lost or rendered unmarketable by reason of the hurricanes of 1954. A claim for the amount of the tax must be filed with the Secretary within ninety days from the August 11 enactment date. These

refund provisions are applicable only with respect to spirits and wines which were in the possession of the person originally paying the tax, the rectifier, or a wholesale or retail liquor dealer at the time they were lost.

Public Law 383. Amends the Railroad Retirement Act of 1937 and the Railroad Unemployment Insurance Act to restore retroactively the exemption of railroad-retirement and railroad unemployment-insurance benefits against attachment or other legal process in connection with the collection of Federal taxes. This exemption had been eliminated when the Internal Revenue Code of 1954 was enacted.

PUBLIC LAW 9, EIGHTY-FOURTH CONGRESS
[CHAPTER 9, FIRST SESSION]
H. R. 3828

An Act To adjust the salaries of judges of United States courts, United States attorneys, Members of Congress, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United Statts of America in Congress assembled, That

* * * * * * *

(h) Section 7443(c) of the Internal Revenue Code of 1954, relating to judges of the Tax Court of the United States, is amended to read as follows:

"(c) Salary: Each judge shall receive salary at the rate of $22,500 per annum, to be paid in monthly installments."

* * * * * * *

SEC. 5. The provisions of this Act shall take effect on March 1, 1955.

Approved March 2, 1955.

PUBLIC LAW 66, EIGHTY-FOURTH CONGRESS
[CHAPTER 135, FIRST SESSION]
H. R. 5223

An Act to continue until the close of June 30, 1956, the suspension of duties and import taxes on metal scrap, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That the first sentence of section 2 of the Act of September 30, 1950 (Public Law 869, Eighty-first Congress) [C. B. 1950–2, 253], is hereby amended by striking out "June 30, 1955" and inserting in lieu thereof "June 30, 1956": *Provided*, That this Act shall not apply to lead scrap or zinc scrap.

SEC. 2. The amendment made by the first section of this Act shall not be construed to affect in any way the application of Public Law 38, Eighty-second Congress [C. B. 1951–1, 184], to copper scrap.

Approved June 8, 1955.

PUBLIC LAW 74, EIGHTY-FOURTH CONGRESS
[CHAPTER 143, FIRST SESSION]
H. R. 4725 [1]

An Act To repeal sections 452 and 462 of the Internal Revenue Code of 1954.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. REPEAL OF SECTIONS 452 AND 462.

(a) PREPAID INCOME.—Section 452 of the Internal Revenue Code of 1954 is hereby repealed.

(b) RESERVES FOR ESTIMATED EXPENSES, ETC.—Section 462 of the Internal Revenue Code of 1954 is hereby repealed.

SEC. 2. TECHNICAL AMENDMENTS.

The following provisions of the Internal Revenue Code of 1954 are hereby amended as follows:

(1) Subsection (c) of section 381 is amended by striking out paragraph (7) (relating to carryover of prepaid income in certain corporate acquisitions).

(2) The table of sections for subpart B of part II of subchapter E of chapter 1 (relating to taxable year for which items of gross income included) is amended by striking out

"Sec. 452. Prepaid income."

(3) The table of sections for subpart C of such part II (relating to taxable year for which deductions are taken) is amended by striking out—

"Sec. 462. Reserves for estimated expenses, etc."

SEC. 3. EFFECTIVE DATE.

The amendments made by this Act shall apply with respect to taxable years beginning after December 31, 1953, and ending after August 16, 1954.

SEC. 4. SAVING PROVISIONS.

(a) FILING OF STATEMENT.—If—

(1) the amount of any tax required to be paid for any taxable year ending on or before the date of the enactment of this Act is increased by reason of the enactment of this Act, and

(2) the last date prescribed for payment of such tax (or any installment thereof) is before December 15, 1955,

then the taxpayer shall, on or before December 15, 1955, file a statement which shows the increase in the amount of such tax required to be paid by reason of the enactment of this Act.

(b) FORM AND EFFECT OF STATEMENT.—

(1) FORM OF STATEMENT, ETC.—The statement required by subsection (a) shall be filed at the place fixed for filing the return. Such statement shall be in such form, and shall include such information necessary or appropriate to show the increase in the amount of the tax required to be paid for the taxable year by reason of the enactment of this Act, as the Secretary of the Treasury or his delegate shall by regulations prescribe.

(2) TREATMENT AS AMOUNT SHOWN ON RETURN.—The amount shown on a statement filed under subsection (a) as the increase in the amount of the tax required to be paid for the taxable year by reason of the enactment of this Act shall, for all purposes of the internal revenue laws, be treated as tax shown on the return. Notwithstanding the preceding sentence, that portion of the amount of increase in tax for any taxable year which is attributable to a decrease (by reason of the enactment of this Act) in the net operating loss for a succeeding taxable year shall not be treated as tax shown on the return.

(3) WAIVER OF INTEREST IN CASE OF PAYMENT ON OR BEFORE DECEMBER 15, 1955.—If the taxpayer, on or before December 15, 1955, files the statement referred to in subsection (a) and pays in full that portion of the amount

[1] House Report, page 852; Senate Report, page 858.

shown thereon for which the last date prescribed for payment is before December 15, 1955, then for purposes of computing interest (other than interest on overpayments) such portion shall be treated as having been paid on the last date prescribed for payment. This paragraph shall not apply if the amount shown on the statement as the increase in the amount of the tax required to be paid for the taxable year by reason of the enactment of this Act is greater than the actual increase unless the taxpayer establishes, to the satisfaction of the Secretary of the Treasury or his delegate, that his computation of the greater amount was based upon a reasonable interpretation and application of sections 452 and 462 of the Internal Revenue Code of 1954, as those sections existed before the enactment of this Act.

(c) SPECIAL RULES.—

(1) INTEREST FOR PERIOD BEFORE ENACTMENT.—Interest shall not be imposed on the amount of any increase in tax resulting from the enactment of this Act for any period before the day after the date of the enactment of this Act.

(2) ESTIMATED TAX.—Any addition to the tax under section 294 (d) of the Internal Revenue Code of 1939 shall be computed as if this Act had not been enacted. In the case of any installment for which the last date prescribed for payment is before December 15, 1955, any addition to the tax under section 6654 of the Internal Revenue Code of 1954 shall be computed as if this Act had not been enacted.

(3) TREATMENT OF CERTAIN PAYMENTS WHICH TAXPAYER IS REQUIRED TO MAKE.—If—

(A) the taxpayer is required to make a payment (or an additional payment) to another person by reason of the enactment of this Act, and

(B) the Internal Revenue Code of 1954 prescribes a period, which expires after the close of the taxable year, within which the taxpayer must make such payment (or additional payment) if the amount thereof is to be taken into account (as a deduction or otherwise) in computing taxable income for such taxable year,

then, subject to such regulations as the Secretary of the Treasury or his delegate may prescribe, if such payment (or additional payment) is made on or before December 15, 1955, it shall be treated as having been made within the period prescribed by such Code.

(4) TREATMENT OF CERTAIN DIVIDENDS.—Subject to such regulations as the Secretary of the Treasury or his delegate may prescribe, for purposes of section 561 (a) (1) of the Internal Revenue Code of 1954, dividends paid after the 15th day of the third month following the close of the taxable year and on or before December 15, 1955, may be treated as having been paid on the last day of the taxable year, but only to the extent (A) that such dividends are attributable to an increase in taxable income for the taxable year resulting from the enactment of this Act, and (B) elected by the taxpayer.

(5) DETERMINATION OF DATE PRESCRIBED.—For purposes of this section, the determination of the last date prescribed for payment or for filing a return shall be made without regard to any extension of time therefor and without regard to any provision of this section.

(6) REGULATIONS.—For requirement that the Secretary of the Treasury or his delegate shall prescribe all rules and regulations as may be necessary by reason of the enactment of this Act, see section 7805(a) of the Internal Revenue Code of 1954.

Approved June 15, 1955.

PUBLIC LAW 91, EIGHTY-FOURTH CONGRESS
[CHAPTER 174, FIRST SESSION]
H. R. 5695

An Act To continue until the close of June 30, 1958, the suspension of certain import taxes on copper.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That the Act entitled "An Act to suspend certain import taxes on copper", approved

SECTIONS AFFECTED—Continued

May 22, 1951 (Public Law 38, Eighty-second Congress) [C. B. 1951–1, 184], as amended [C. B. 1954–2, 595], is hereby further amended by striking out "June 30, 1955" and inserting in lieu thereof "June 30, 1958".

Approved June 21, 1955.

PUBLIC LAW 196, EIGHTY-FOURTH CONGRESS
[CHAPTER 438, FIRST SESSION]
H. R. 6059

An Act relating to revisions of the executive agreement concerning trade and related matters entered into by the President of the United States and the President of the Philippines on July 4, 1946.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

TITLE I.—SHORT TITLE AND DEFINITION

SECTION 1. SHORT TITLE.

This Act may be cited as the "Philippine Trade Agreement Revision Act of 1955".

SEC. 2 REVISED AGREEMENT DEFINED.

For purposes of this Act, the term "revised agreement" means the executive agreement concerning trade and related matters entered into by the President of the United States and the President of the Philippines on July 4, 1946, as such executive agreement is revised pursuant to the authority contained in section 201 of this Act.

TITLE II.—REVISION OF TRADE AGREEMENT WITH THE REPUBLIC OF THE PHILIPPINES

SEC. 201. AUTHORITY TO REVISE THE 1946 AGREEMENT.

In order to make revisions proposed by the delegations of the Governments of the United States of America and of the Republic of the Philippines in the "Final Act of Negotiations Relative to Revision of the 1946 Trade Agreement Between the United States of America and the Republic of the Philippines" signed at Washington, December 15, 1954, as corrected, the President of the United States is hereby authorized to enter into an agreement with the President of the Philippines revising the executive agreement concerning trade and related matters entered into by the President of the United States and the President of the Philippines on July 4, 1946, so that such executive agreement as so revised, will read as follows:

AGREEMENT BETWEEN THE UNITED STATES OF AMERICA AND THE REPUBLIC OF THE PHILIPPINES CONCERNING TRADE AND RELATED MATTERS DURING A TRANSITIONAL PERIOD FOLLOWING THE INSTITUTION OF PHILIPPINE INDEPENDENCE, SIGNED AT MANILA ON JULY 4, 1946, AS REVISED

The President of the United States of America and the President of the Republic of the Philippines, mindful of the close economic ties between the people of the United States and the people of the Philippines during many years of intimate political relations, and desiring to enter into an agreement in keeping with their long friendship, which will be mutually beneficial to the two peoples and will strengthen the economy of the Philippines so as to enable that Republic to contribute more effectively to the peace and prosperity of the free world, have agreed to the following Articles:

* * * * * * *

ARTICLE IV

1. With respect to articles which are products of the United States coming into the Philippines, or with respect to articles manufactured in the Philippines wholly or in part from such articles, no internal tax shall be—

(a) Collected or paid in an amount in excess of the internal tax imposed with respect to like articles which are the product of the Philippines, or collected or paid in any amount if the internal tax is not imposed with respect to such like articles;

(b) Collected or paid in an amount in excess of the internal tax imposed with respect to like articles which are the product of any other foreign country, or collected or paid in any amount if the internal tax is not imposed with respect to such like articles.

Where an internal tax is imposed with respect to an article which is the product of a foreign country to compensate for an internal tax imposed (1) with respect to a like article which is the product of the Philippines, or (2) with respect to materials used in the production of a like article which is the product of the Philippines, if the amount of the internal tax which is collected and paid with respect to the article which is the product of the United States is not in excess of that permitted by Paragraph 1(b) of Article IV such collection and payment shall not be regarded as in violation of the first sentence of this Paragraph.

2. With respect to articles which are products of the Philippines coming into the United States, or with respect to articles manufactured in the United States wholly or in part from such articles, no internal tax shall be—

(a) Collected or paid in an amount in excess of the internal tax imposed with respect to like articles which are the product of the United States, or collected or paid in any amount if the internal tax is not imposed with respect to such like articles;

(b) Collected or paid in an amount in excess of the internal tax imposed with respect to like articles which are the product of any other foreign country, or collected or paid in any amount if the internal tax is not imposed with respect to such like articles.

Where an internal tax is imposed with respect to an article which is the product of a foreign country to compensate for an internal tax imposed (1) with respect to a like article which is the product of the United States, or (2) with respect to materials used in the production of a like article which is the product of the United States, if the amount of the internal tax which is collected and paid with respect to the article which is the product of the Philippines is not in excess of that permitted by Paragraph 2(b) of Article IV such collection and payment shall not be regarded as in violation of the first sentence of this Paragraph. This Paragraph shall not apply to the taxes imposed under Sections 4591, 4812, or 4831 of the Internal Revenue Code of the United States which are set forth in part as Annexes IV, V, and VI of this Agreement.

3. No processing tax or other internal tax shall be imposed or collected in the United States or in the Philippines with respect to articles coming into such country for the official use of the Government of the Philippines or of the United States, respectively, or any department or agency thereof.

4. No processing tax or other internal tax shall be imposed or collected in the United States with respect to manila (abaca) fiber not dressed or manufactured in any manner.

5. The United States will not reduce the preference of two cents per pound provided in Section 4513 of the Internal Revenue Code of the United States (relating to processing taxes on coconut oil, etc.), which is set forth as Annex VII to this Agreement, with respect to articles 'wholly the production of the Philippine Islands' or articles 'produced wholly from materials the growth or production of the Philippine Islands'; except that it may suspend the provisions of Section 4511(b) of the Internal Revenue Code of the United States during any period as to which the President of the United States, after consultation with the President of the Philippines, finds that adequate supplies of neither copra nor coconut oil, the product of the Philippines, are readily available for processing in the United States.

* * * * * * *

ARTICLE XI

1. This Agreement shall have no effect after July 3, 1974. It may be terminated by either the United States or the Philippines at any time, upon not less

than five years' written notice. If the President of the United States or the President of the Philippines determines and proclaims that the other country has adopted or applied measures or practices which would operate to nullify or impair any right or obligation provided for in this Agreement, then the Agreement may be terminated upon not less than six months' written notice.

2. The revisions of this Agreement authorized by the Congress of the United States and the Congress of the Philippines in 1955 shall enter into force on January 1, 1956.

PROTOCOL TO ACCOMPANY THE AGREEMENT BETWEEN THE UNITED STATES OF AMERICA AND THE REPUBLIC OF THE PHILIPPINES CONCERNING TRADE AND RELATED MATTERS DURING A TRANSITIONAL PERIOD FOLLOWING THE INSTITUTION OF PHILIPPINE INDEPENDENCE, SIGNED AT MANILA ON JULY 4, 1946, AS REVISED

The undersigned duly empowered Plenipotentiaries have agreed to the following Protocol to the Agreement between the United States of America and the Republic of the Philippines concerning trade and related matters during a transitional period following the institution of Philippine Independence, signed at Manila on July 4, 1946, as revised, which shall constitute an integral part of the Agreement:

1. For the purpose of the Agreement—

(a) The term "person" includes partnerships, corporations, and associations.

(b) The term "United States" means the United States of America and, when used in a geographical sense, means the States, the District of Columbia, the Territories of Alaska and Hawaii, and Puerto Rico.

(c) The term "Philippines" means the Republic of the Philippines and, when used in a geographical sense, means the territories of the Republic of the Philippines, whether a particular act in question took place, or a particular situation in question existed, within such territories before or after the institution of the Republic of the Philippines. As used herein the territories of the Republic of the Philippines comprise all the territories specified in Section 1 of Article I of the Constitution of the Philippines which is set forth as Annex X to this Agreement.

(d) The term "ordinary customs duty" means a customs duty based on the article as such (whether or not such duty is also based in any manner on the use, value, or method of production of the article, or on the amount of like articles imported, or on any other factor); but does not include—

* * * * * * *

(5) The tax imposed by Section 4581 of the Internal Revenue Code of the United States, which is set forth as Annex VIII to this Agreement, with respect to an article, merchandise, or combination, ten per centum or more of the quantity by weight of which consists of, or is derived directly or indirectly from, one or more of the oils, fatty acids, or salts specified in Section 4511 of such Code which is set forth as Annex VII to this Agreement; or the tax imposed by Section 4501(b) of such Code which is set forth as Annex IX to this Agreement.

(e) The term "United States article" means an article which is the product of the United States, unless, in the case of an article produced with the use of materials imported into the United States from any foreign country (except the Philippines) the aggregate value of such imported materials at the time of importation into the United States was more than twenty per centum of the value of the article imported into the Philippines, the value of such article to be determined in accordance with, and as of the time provided by, the customs laws of the Philippines in effect at the time of importation of such article. As used in this Subparagraph the term "value", when used in reference to a material imported into the United States, includes the value of the material ascertained under the customs laws of the United States in effect at the time of importation into the United States, and, if not included in such value, the cost of bringing the material to the United States, but does not include the cost of landing it at the port of importation, or customs duties collected in the United States. For the purposes of this Subparagraph any imported material, used in the production of an article in the United States, shall be considered as having been used in the production of an article subsequently produced in the United States, which is the product of a chain of production in the United States in the course of which an article, which is the product of one stage of the chain, is

used by its producer or another person, in a subsequent stage of the chain, as a material in the production of another article. It is understood that "United States articles" do not lose their status as such, for the purpose of Philippine tariff preferences, by reason of being imported into the Philippines from a country other than the United States or from an insular possession of the United States or by way of or via such a country or insular possession.

* * * * * * *

(i) The term "internal tax" includes an internal fee, charge, or exaction, and includes—

(1) The tax imposed by Section 4581 of the Internal Revenue Code of the United States which is set forth as Annex VIII to this Agreement, with respect to an article, merchandise, or combination, ten per centum or more of the quantity by weight of which consists of, or is derived directly or indirectly from, one or more of the oils, fatty acids, or salts specified in Section 4511 of such Code which is set forth as Annex VII to this Agreement; and the tax imposed by Section 4501(b) of such Code which is set forth as Annex IX to this Agreement; and

(2) Any other tax, fee, charge, or exaction, imposed on or in connection with importation unless the law of the country imposing it designates or imposes it as a customs duty or contains a provision to the effect that it shall be treated as a duty imposed under the customs laws.

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3. For the purposes of Paragraphs 1 and 2 of Article IV, any material, used in the production of an article, shall be considered as having been used in the production of an article subsequently produced, which is the product of a chain of production in the course of which an article, which is the product of one stage of the chain, is used by its producer or another person, in a subsequent stage of the chain, as a material in the production of another article.

4. The terms "includes" and "including" when used in a definition contained in this Agreement shall not be deemed to exclude other things otherwise within the meaning of the term defined.

SEC. 202. MODIFICATION OF TEXT OF REVISED AGREEMENT.

The test of the revised agreement which is set forth in section 201 may be modified before the agreement authorized by such section is signed, but only—

(1) to the extent necessary (A) to correct errors, (B) to correct references to laws, or (C) to reflect action taken by the Republic of the Philippines with respect to article V of such agreement; or

(2) if such modifications are merely changes of style.

TITLE III.—MISCELLANEOUS

SEC. 301. PROCLAMATION; EFFECTIVE DATE OF TITLE.

(a) PROCLAMATION.—If the agreement authorized by section 201 has been entered into before January 1, 1956, the President of the United States shall so proclaim, and the revised agreement shall be effective in the United States in accordance with its terms.

(b) EFFECTIVE DATE OF TITLE.—The provisions of this title (other than this section) shall take effect on January 1, 1956, but only if the President of the United States has made the proclamation referred to in subsection (a).

SEC. 302. PHILIPPINE TRADE ACT OF 1946.

The Philippine Trade Act of 1946 (except section 506(a) relating to termination of payments into Philippine Treasury, and except amendments and repeals made by such Act) shall not apply during such time as the revised agreement is in effect.

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SEC. 304. SUSPENSION OF 2 CENTS PER POUND ADDITIONAL PROCESSING TAX ON COCONUT OIL.

The authority contained in paragraph 5 of article IV of the revised agreement to suspend the provisions of section 4511(b) of the Internal Revenue Code of 1954 may be exercised by the President by proclamation.

SEC. 305. TRADE AGREEMENT WITH THE REPUBLIC OF THE PHILIPPINES.

Until July 4, 1974, no trade agreement shall be entered into with the Republic of the Philippines under section 350, as amended, of the Tariff Act of 1930

which is inconsistent with this Act or with the revised agreement, unless, prior to such time, the revised agreement has been terminated.

* * * * * * *

SEC. 307. ADMINISTRATION OF REVISED AGREEMENT.

The provisions of articles I, II, III, and IV of the revised agreement which are in effect in the United States which relate to customs or internal revenue matters shall be administered as parts of the customs and internal revenue laws of the United States.

SEC. 308. TECHNICAL AMENDMENT.

Section 9 of the Act of March 2, 1917, as amended (48 U. S. C., sec. 734), is hereby amended by inserting after "the Philippine Trade Act of 1946" the following: "or the Philippine Trade Agreement Revision Act of 1955".

Approved August 1, 1955.

PUBLIC LAW 216, EIGHTY-FOURTH CONGRESS
[CHAPTER 499, FIRST SESSION]
H. R. 4904

An Act to extend the Renegotiation Act of 1951 for 2 years [1]

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That subsection (a) of section 102 of the Renegotiation Act of 1951 (50 U. S. C., App., section 1212(a)) is hereby amended by striking out "December 31, 1954" and inserting in lieu thereof "December 31, 1956".

SEC. 2. (a) Subsection (d) of section 102 of the Renegotiation Act of 1951 (50 U. S. C., App., section 1212(d)) is hereby amended by inserting after "title" each place it appears "or would be subject to this title except for the provisions of section 106(a)(8)".

(b) The amendments made by subsection (a) shall apply to contracts with the Departments and subcontracts only to the extent of the amounts received or accrued by a contractor or subcontractor after December 31, 1953.

SEC. 3. (a) Section 106(a)(8) of such Act (50 U. S. C., App., section 1216(a)(8)) is hereby amended as follows:

(1) By inserting after "a standard commercial article" in the first sentence thereof "or a standard commercial service";

(2) By inserting after "such article" each place it appears in the first and second sentences thereof "or such service";

(3) By striking out "and" at the end of subparagraph (C);

(4) By redesignating subparagraph (D) to be subparagraph (G); and

(5) By inserting after subparagraph (C) the following:

(D) the term "service" means any processing or other operation performed by chemical, electrical, physical, or mechanical methods directly on materials owned by another person;

(E) the term "standard commercial service" means a service which is customarily performed by more than two persons for general civilian industrial or commercial requirements, or is reasonably comparable with a service so performed;

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[1] For excerpts from the Renegotiation Act of 1951, see C. B. 1951-1, 180.

(F) the term "reasonably comparable" means of the same or a similar kind, performed with the same or similar materials, and having the same or a similar result, without necessarily involving identical operations; and.

(b) The amendments made by subsection (a) shall apply to contracts with the Departments and subcontracts only to the extent of the amounts received or accrued by a contractor or subcontractor after December 31, 1953.

SEC. 4. (a) Section 106(a) of such Act (50 U. S. C., App., section 1216(a)) is hereby amended—

(1) by striking out the period at the end of paragraph (8) and inserting in lieu thereof "; or"; and

(2) by adding at the end thereof a new paragraph as follows:

(9) any contract, awarded as a result of competitive bidding, for the construction of any building, structure, improvement, or facility, other than a contract for the construction of housing financed with a mortgage or mortgages insured under the provisions of title VIII of the National Housing Act, as now or hereafter amended.

(b) The amendments made by subsection (a) shall apply only to contracts with the Departments made after December 31, 1954.

SEC. 5. (a) Section 106(c) (2) of such Act (50 U. S. C., App., section 1216(c)(2)) is hereby amended to read as follows:

(2) DEFINITIONS.—For the purpose of this subsection, the term "durable productive equipment" means machinery, tools, or other productive equipment, which has an average useful life of more than five years.

(b) The amendment made by subsection (a) shall apply only with respect to fiscal years (as defined in section 103(h) of the Renegotiation Act of 1951) ending on or after June 30, 1953.

SEC. 6. (a) The Joint Committee on Internal Revenue Taxation, or any duly authorized subcommittee thereof, is hereby authorized and directed to make a complete study in order to determine—

(1) whether there is any necessity of extending the Renegotiation Act of 1951 beyond December 31, 1956; and

(2) if any such further extension is found necessary, the extent to which renegotiation of Government contracts should apply after such date.

(b) The Joint Committee shall, not later than May 31, 1956, report to the Senate and the House of Representatives the results of the study conducted pursuant to this section, together with such recommendations as it deems necessary or desirable.

(c) For the purpose of making the study and report required by this section, the Joint Committee, and the Chief of Staff of the Joint Committee, may exercise any of the powers conferred upon the Joint Committee and the Chief of Staff of the Joint Committee by sections 8021 and 8023 of the Internal Revenue Code of 1954. The provisions of section 8023(b) of such Code shall apply to requests made under the authority of this subsection to the same extent as in the case of other requests made under the authority of section 8023(a) of such Code.

Approved August 3, 1955.

PUBLIC LAW 285, EIGHTY-FOURTH CONGRESS
[CHAPTER 645, FIRST SESSION]
H. R. 6382 [2]

An Act To amend the International Claims Settlement Act of 1949, as amended, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That the International Claims Settlement Act of 1949, as amended, is further amended by inserting after the first section thereof the following: "TITLE I".

SEC. 2. The word "Act", wherever it appears in title I in reference to the International Claims Settlement Act of 1949, is amended to read "title".

SEC. 3. The International Claims Settlement Act of 1949, as amended, is further amended by adding at the end thereof the following:

TITLE II

VESTING AND LIQUIDATION OF BULGARIAN, HUNGARIAN, AND RUMANIAN PROPERTY

SEC. 201. As used in this title the term—

(1) "Person" means a natural person, partnership, association, other unincorporated body, corporation, or body politic.

(2) "Property" means any property, right, or interest.

(3) "Treaty of peace", with respect to a country, means the treaty of peace with that country signed at Paris, France, February 10, 1947, which came into force between that country and the United States on September 15, 1947.

SEC. 202. (a) In accordance with article 25 of the treaty of peace with Bulgaria, article 29 of the treaty of peace with Hungary, and article 27 of the treaty of peace with Rumania, any property which was blocked in accordance with Executive Order 8389 of April 10, 1940, as amended, and remains blocked on the effective date of this title, and which, as of September 15, 1947, was owned directly or indirectly by Bulgaria, Hungary, and Rumania or by any national thereof as defined in such Executive order, shall vest in such officer or agency as the President may from time to time designate and shall vest when, as, and upon such terms as the President or his designee shall direct. Such property shall be sold or otherwise liquidated as expeditiously as possible after vesting under such rules and regulations as the President or his designee may prescribe. The net proceeds remaining upon completion of the administration and liquidation thereof, including the adjudication of any suits or claims with respect thereto under sections 207 and 208, shall be covered into the Treasury. Notwithstanding the preceding provisions of this subsection, any such property determined by the President or his designee to be owned directly by a natural person shall not be vested under this subsection but shall remain blocked subject to release when, as, and upon such terms as the President or his designee may prescribe. If, at any time within one year from the date of the vesting of any property under this subsection, the President or his designee shall determine that it was directly owned at the date of vesting by a natural person, then the President or his designee shall divest such property and restore it to its blocked status prior to vesting, subject to release when, as, and upon such terms as the President or his designee may prescribe, or if such property has been liquidated, shall divest the net proceeds thereof and carry them in blocked accounts with the Treasury, bearing no interest, in the name of the owner thereof at the date of vesting, subject to release when, as, and upon such terms as the President or his designee may prescribe.

(b) The net proceeds of any property which was vested in the Alien Property Custodian or the Attorney General after December 17, 1941, pursuant to the Trading With the Enemy Act, as amended, and which at the date of vesting was owned directly or indirectly by Bulgaria, Hungary, or Rumania, or any national thereof, shall after completion of the administration, liquidation, and

[2] House Report, page 878; Senate Report, page 880.

disposition of such property pursuant to such Act, including the adjudication of any suits or claims with respect thereto under such Act, be covered into the Treasury, except that the net proceeds of any such property which the President or his designee shall determine was directly owned by a natural person at the date of vesting shall be divested by the President or such officer or agency as he may designate and carried in blocked accounts with the Treasury, bearing no interest, in the name of the owner thereof at the date of vesting, subject to release when, as, and upon such terms as the President or his designee may prescribe.

(c) The determination under this section that any vested property was not directly owned by a natural person at the date of vesting shall be within the sole discretion of the President or his designee and shall not be subject to review by any court.

(d) The President or his designee may require any person to furnish, in the form of reports or otherwise, complete information, including information with regard to past transactions, relative to any property blocked under Executive Order 8389 of April 10, 1940, as amended, or as may be otherwise necessary to enforce the provisions of this section; and the President or his designee may require of any person the production of any books of account, records, contracts, letters, memoranda, or other papers relative to such property or as may be otherwise necessary to enforce the provisions of this section.

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SEC. 212. (a) The vesting in any officer or agency designated by the President under this title of any property or the receipt by such designee of any earnings, increment, or proceeds thereof shall not render inapplicable any Federal, State, Territorial, or local tax for any period before or after such vesting.

(b) The officer or agency designated by the President under this title shall, notwithstanding the filing of any claim or the institution of any suit under this title, pay any tax incident to any such property, or the earnings, increment, or proceeds thereof, at the earliest time appearing to him to be not contrary to the interest of the United States. The former owner shall not be liable for any such tax accruing while such property, earnings, increment, or proceeds are held by such designee, unless they are returned pursuant to this title without payment of such tax by the designee. Every such tax shall be paid by the designee to the same extent, as nearly as may be deemed practicable, as though the property had not been vested, and shall be paid only out of the property, or earnings, increment, or proceeds thereof, to which they are incident or out of other property acquired from the same former owner, or earnings, increment, or proceeds thereof. No tax liability may be enforced from any property or the earnings, increment, or proceeds thereof while held by the designee except with his consent. Where any property is transferred, otherwise than pursuant to section 207(a) or 207(b) hereof, the designee may transfer the property free and clear of any tax, except to the extent of any lien for a tax existing and perfected at the date of vesting, and the proceeds of such transfer shall, for tax purposes, replace the property in the hands of the designee.

(c) Subject to the provisions of subsection (b) of this section, the manner of computing any Federal taxes, including without limitation by reason of this enumeration, the applicability in such computation of credits, deductions, and exemptions to which the former owner is or would be entitled, and the time and manner of any payment of such taxes and the extent of any compliance by the designee with provisions of Federal law and regulations applicable with respect to Federal taxes, shall be in accordance with regulations prescribed by the Secretary of the Treasury to effectuate this section. Statutes of limitations on assessments, collection, refunds, or credit of Federal taxes shall be suspended with respect to any vested property or the earnings, increment, or proceeds thereof, while vested and for six months thereafter; but no interest shall be paid upon any refund with respect to any period during which the statute of limitations is so suspended.

(d) The word "tax" as used in this section shall include, without limitation by reason of this enumeration, any property, income, excess-profits, war-profits, excise, estate, and employment tax, import duty, and special assessment; and also any interest, penalty, additional amount, or addition thereto not arising from any act, omission, neglect, failure, or delay on the part of the designee.

SEC. 213. Prior to covering the net proceeds of liquidation of any property into the Treasury pursuant to section 202(a), the designee of the President under this title shall determine—

(1) the amount of his administrative expenses attributable to the performance of his functions under this title with respect to such property and the proceeds thereof. The amount so determined, together with an amount not exceeding that expended or incurred for the conservation, preservation, or maintenance of such property and the proceeds thereof, and for taxes in respect of same, shall be deducted and retained by the designee from the proceeds otherwise covered into the Treasury; and

(2) that the time for the institution of a suit under section 207(a), for the filing of a notice of claim under section 207(b), and for the filing of debt claims under section 208 has elapsed.

The determinations of the designee under this section shall be final and conclusive.

SEC. 214. No property conveyed, transferred, assigned, delivered, or paid to the designee of the President under this title, or the net proceeds thereof, shall be liable to lien, attachment, garnishment, trustee process, or execution, or subject to any order or decree of any court, except as provided in this title.

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Approved August 9, 1955.

PUBLIC LAW 299, EIGHTY-FOURTH CONGRESS
[CHAPTER 659, FIRST SESSION]
H. R. 291[3]

An Act To extend the retirement income tax credit to members of the Armed Forces.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That section 37(f) of the Internal Revenue Code of 1954 is hereby amended by striking out the following: "; except that such term does not include a fund or system established by the United States for members of the Armed Forces of the United States".

SEC. 2. The amendment made by this Act shall be applicable to taxable years beginning after December 31, 1954.

Approved August 9, 1955.

PUBLIC LAW 303, EIGHTY-FOURTH CONGRESS
[CHAPTER 663, FIRST SESSION]
H. R. 3712

An Act To extend the period during which claims for floor stocks refunds may be filed with respect to certain manufacturers' excise taxes which were reduced by the Excise Tax Reduction Act of 1954.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That section 3416(a)(2) of the Internal Revenue Code of 1939 (relating to period for filing claims for certain floor stocks refunds) is hereby amended by striking out "before August 1, 1954" and inserting in lieu thereof "on or before the sixtieth day after the date of the enactment of H. R. 3712, Eighty-fourth Congress".

Approved August 9, 1955.

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[3] House Report, page 841; Senate Report, page 842.

PUBLIC LAW 306, EIGHTY-FOURTH CONGRESS
[CHAPTER 666, FIRST SESSION]
H. R. 542 [4]

An Act To amend the Internal Revenue Code.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That the terms used in this Act shall have the same meaning as when used in the Internal Revenue Code.

SEC. 2. COLLECTION OF INCOME TAX AT SOURCE ON WAGES

Section 3402 of the Internal Revenue Code is hereby amended as follows:

(a) By inserting "(except as provided in subsection (j))" immediately after the words "shall deduct and withhold upon such wages" in subsection (a) thereof; and

(b) By adding at the end thereof the following new subsection:

(j) NONCASH REMUNERATION TO RETAIL COMMISSION SALESMAN.—In the case of remuneration paid in any medium other than cash for services performed by an individual as a retail saleman for a person, where the service performed by such individual for such person is ordinarily performed for remuneration solely by way of cash commission an employer shall not be required to deduct or withhold any tax under this subchapter with respect to such remuneration, provided that such employer files with the Secretary or his delegate such information with respect to such remuneration as the Secretary or his delegate may by regulation prescribe.

SEC. 3. EFFECTIVE DATE.

The amendment made by section 2 shall be applicable only with respect to remuneration paid after the date of enactment of this Act.

Approved August 9, 1955.

PUBLIC LAW 310, EIGHTY-FOURTH CONGRESS
[CHAPTER 670, FIRST SESSION]
H. R. 2619 [5]

An Act To amend section 345 of the Revenue Act of 1951.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That if refund or credit of an overpayment resulting from the application of section 345 of the Revenue Act of 1951 (relating to abatement of tax on certain trusts for members of Armed Forces dying in service) is prevented on the date of the enactment of this Act by the operation of any law or rule of law (other than section 3760 of the Internal Revenue Code of 1939 or section 7121 of the Internal Revenue Code of 1954, relating to closing agreements, and other than section 3761 of the Internal Revenue Code of 1939 or section 7122 of the Internal Revenue Code of 1954, relating to compromises), refund or credit of such overpayment may, nevertheless, be made or allowed if claim therefor is filed within one year after the date of enactment of this Act. No interest shall be allowed or paid on any overpayment if refund or credit of such overpayment would not be allowable but for this Act.

Approved August 9, 1955.

[4] House Report, page 843; Senate Report, page 843.
[5] House Report, page 846; Senate Report, page 846.

PUBLIC LAW 317, EIGHTY-FOURTH CONGRESS
[CHAPTER 677, FIRST SESSION]
H. R. 3437 [6]

An Act To amend the Internal Revenue Code of 1954 to provide for a maximum manufacturers' excise tax on the leases of certain automobile utility trailers.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That section 4216 (c) (1) of the Internal Revenue Code of 1954 is amended by inserting after "lease" the following: "(other than a lease to which subsection (d) applies)".

SEC. 2. Section 4216 of the Internal Revenue Code of 1954 is amended by adding at the end thereof the following:

(d) LEASES OF CERTAIN TRAILERS.—In the case of any lease of a trailer or semitrailer taxable under section 4061(a) and suitable for use in connection with passenger automobiles, there shall be paid, at the election of the taxpayer—

(1) upon the initial lease a tax at the applicable rate specified in section 4061(a) based upon the fair market value on the date of such lease, or

(2) upon each lease payment with respect to such trailer or semitrailer, a percentage of such payment equal to the rate of tax which would be imposed upon the sale of such trailer or semitrailer, until the total of the tax payments under such lease and any prior lease equals the total tax. In any case where a trailer or semitrailer which has been leased is sold before the total tax has been paid, the tax payable on such sale shall be the difference between the tax paid on the lease payments and the total tax. For purposes of this paragraph, the term 'total tax' means the tax computed, at the rate in effect on the date of the initial lease, on the fair market value on the date of such lease. However, in the case where a trailer or semitrailer which has been leased is sold before the total tax has been paid, the total tax shall not exceed a tax computed, at the rate in effect on the date of the initial lease, on the amount received on such sale (determined without regard to section 4216(b)) plus the total of the payments received by the lessor under any lease of such trailer or semitrailer.

SEC. 3. Section 4217 of the Internal Revenue Code of 1954 is amended by adding at the end thereof a new sentence as follows: "This section shall not apply to the lease of an article upon which the tax has been paid in the manner provided in section 4216(d)(1) or the total tax has been paid in the manner provided in section 4216(d)(2)."

SEC. 4. The amendments made by subsection (a) shall take effect on the first day of the first month which begins more than 10 days after the date of the enactment of this Act. In the application of section 4216(d) of the Internal Revenue Code of 1954 (as added by this Act) to any article which has been leased before the effective date specified in the preceding sentence, under regulations prescribed by the Secretary of the Treasury or his delegate—

(1) the fair market value of such article shall be the fair market value determined as of such effective date;

(2) only payments under a lease received on or after such effective date shall be considered in determining when the total tax (as defined in such section 4216(d)) has been paid;

(3) any lease existing on such effective date, or if there is none, the first lease entered into after such effective date, shall be considered an initial lease (except that fair market value shall be determined as provided in paragraph (1) of this sentence); and

[6] House Report, page 847; Senate Report, page 848.

(4) any lease existing on such effective date shall be considered as having been entered into on such date.

Approved August 9, 1955.

PUBLIC LAW 319, EIGHTY-FOURTH CONGRESS
[CHAPTER 679, FIRST SESSION]
H. R. 3822

An Act To amend title V of the Agricultural Act of 1949, as amended

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That section 509 of the Agricultural Act of 1949, as amended, is amended by striking out "December 31, 1955" and inserting "June 30, 1959".

SEC. 2. Subsection 3 of section 502 of such Act, as amended, is amended by inserting before the period at the end thereof the following: ": *Provided, however*, That if the employer can establish to the satisfaction of the Secretary of Labor that the employer has provided or paid to the worker the cost of return transportation and subsistence from the place of employment to the appropriate reception center, the Secretary under such regulations as he may prescribe may relieve the employer of his obligation to the United States under this subsection."

SEC. 3. Section 503 of such Act, as amended, is amended by adding at the end thereof the following:

"In carrying out the provisions of (1) and (2) of this section, provision shall be made for consultation with agricultural employers and workers for the purpose of obtaining facts relevant to the supply of domestic farm workers and the wages paid such workers engaged in similar employment. Information with respect to certifications under (1) and (2) shall be posted in the appropriate local public employment offices and such other public places as the Secretary may require."

Approved August 9, 1955.

PUBLIC LAW 321, EIGHTY-FOURTH CONGRESS
[CHAPTER 681, FIRST SESSION]
H. R. 4394 [7]

An Act To amend section 3401 of the Internal Revenue Code of 1954.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That subdivision (a) of section 3401 of the Internal Revenue Code of 1954 is amended to read as follows:

SEC. 3401. DEFINITIONS.

(a) WAGES.—For purposes of this chapter, the term "wages" means all remuneration (other than fees paid to a public official) for services performed by an employee for his employer, including the cash value of all remuneration paid in any medium other than cash; except that such term shall not include remuneration paid—

(1) for active service as a member of the Armed Forces of the United States performed in a month for which such member is entitled to the benefits of section 112; or

[7] House Report, page 848; Senate Report, page 849.

(2) for agricultural labor (as defined in section 3121(g); or

(3) for domestic service in a private home, local college club, or local chapter of a college fraternity or sorority; or

(4) for service not in the course of the employer's trade or business performed in any calendar quarter by an employee, unless the cash remuneration paid for such service is $50 or more and such service is performed by an individual who is regularly employed by such employer to perform such service. For purposes of this paragraph, an individual shall be deemed to be regularly employed by an employer during a calendar quarter only if—

(A) on each of some 24 days during such quarter such individual performs for such employer for some portion of the day service not in the course of the employer's trade or business; or

(B) such individual was regularly employed (as determined under subparagraph (A)) by such employer in the performance of such service during the preceding calendar quarter; or

(5) for services by a citizen or resident of the United States for a foreign government or an international organization; or

(6) for services performed by a nonresident alien individual, other than—

(A) a resident of a contiguous country who enters and leaves the United States at frequent intervals; or

(B) a resident of Puerto Rico if such services are performed as an employee of the United States or any agency thereof; or

(7) for such services, performed by a nonresident alien individual who is a resident of a contiguous country and who enters and leaves the United States at frequent intervals, as may be designated by regulations prescribed by the Secretary or his delegate; or

(8)(A) for services for an employer (other than the United States or any agency thereof)—

(i) performed by a citizen of the United States if, at the time of the payment of such remuneration, it is reasonable to believe that such remuneration will be excluded from gross income under section 911; or

(ii) performed in a foreign country or in a possession of the United States by such a citizen if, at the time of the payment of such remuneration, the employer is required by the law of any foreign country or possession of the United States to withhold income tax upon such remuneration; or

(B) for services for an employer (other than the United States or any agency thereof) performed by a citizen of the United States within a possession of the United States (other than Puerto Rico), if it is reasonable to believe that at least 80 percent of the remuneration to be paid to the employee by such employer during the calendar year will be for such services; or

(C) for services for an employer (other than the United States or any agency thereof) performed by a citizen of the United States within Puerto Rico, if it is reasonable to believe that during the entire calendar year the employee will be a bona fide resident of Puerto Rico; or

(9) for services performed by a duly ordained, commissioned, or licensed minister of a church in the exercise of his ministry or by a member of a religious order in the exercise of duties required by such order; or

(10)(A) for services performed by an individual under the age of 18 in the delivery or distribution of newspapers or shopping news, not including delivery or distribution to any point for subsequent delivery or distribution; or

(B) for services performed by an individual in, and at the time of, the sale of newspapers or magazines to ultimate consumers, under an arrangement under which the newspapers or magazines are to be sold by him at a fixed price, his compensation being based on the retention of the excess of such price over the amount at which the newspapers or magazines are charged to him, whether or not he is guaranteed a minimum amount of compensation for such services, or is entitled to be credited with the unsold newspapers or magazines turned back; or

(11) for services not in the course of the employer's trade or business, to the extent paid in any medium other than cash; or

(12) to, or on behalf of, an employee or his beneficiary—

(A) from or to a trust described in section 401(a) which is exempt from tax under section 501(a) at the time of such payment unless such

payment is made to an employee of the trust as remuneration for services rendered as such employee and not as a beneficiary of the trust; or

(B) under or to an annuity plan which, at the time of such payment, meets the requirements of section 401(a)(3), (4), (5), and (6).

Approved August 9, 1955.

PUBLIC LAW 323, EIGHTY-FOURTH CONGRESS
[CHAPTER 683, FIRST SESSION]
H. R. 4778

An Act To provide for the purchase of bonds to cover civilian officers and employees and military personnel of the Federal Government.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That section 14 of title 6 of the United States Code is amended to read as follows:

"SEC. 14. PURCHASE OF BONDS TO COVER OFFICERS AND EMPLOYEES OF THE FEDERAL GOVERNMENT

"(a) Subject to subsection (b) of this section, the head of each department and independent establishment in the executive branch of the Federal Government shall obtain, under regulations which shall be promulgated by the Secretary of the Treasury, blanket, position schedule, or other types of surety bonds covering the civilian officers and employees and military personnel of such department or independent establishment who are required by law or administrative ruling to be bonded. The appropriate officials of the legislative and judicial branches of the Federal Government may obtain any or all of such types of surety bonds covering such officers and employees under their respective jurisdictions as such officials may deem appropriate to be bonded. Each bond obtained under this section shall be of the most economical type available for the number and type of personnel to be bonded and shall be conditioned upon the faithful performance of the duties of the individual or individuals so bonded. The bond premium may cover a period not exceeding two years and shall be paid from any funds available for the payment of administrative expenses at the time such premium becomes payable. Whenever any civilian officers or employees or military personnel are covered by a bond under authority of this section, the surety or sureties on any existing bond of any such civilian officers or employees or military personnel shall not be liable for any defaults occurring subsequent to the date of the new coverage. For purposes of this section, the term 'faithful performance of the duties' shall include the proper accounting for all funds or property received by reason of the position or employment of the individual or individuals so bonded and all duties and responsibilities imposed upon such individual or individuals by law or by regulation issued pursuant to law.

"(b) If, in the opinion of the head of the department or independent establishment concerned, the premium cost for any bond procured under this section covering officers or employees in the executive branch of the Federal Government will exceed the rate of $150 per annum, the procurement of such bond shall be made by the head of such department or independent establishment only after advertising a sufficient time previously for proposals for the furnishing of such bond, except that such advertising for proposals shall not be required when the public exigencies require the immediate procurement of such bond.

"(c) The Secretary of the Treasury shall transmit to the Congress, on or before June 30, 1956, a comprehensive report of the operations of the departments and independent establishments under this section. Thereafter, the Secretary of the Treasury shall transmit to the Congress on or before October 1 of each year, beginning with the year 1957, a comprehensive report of such operations during the preceding fiscal year. Such report shall include, among other matters, information, in summary and in detail, with respect to operations under this section, setting forth—

"(1) the number of officers and employees covered by bonds procured under this section,

"(2) the number and types of bonds procured under this section and the individual penal sums thereof,

"(3) the amounts of the premiums paid for bonds procured under this section, and

"(4) such other information as may be necessary to enable the Committee on Post Office and Civil Service of the Senate and the Committee on Post Office and Civil Service of the House of Representatives to determine the results of operations under this section.

The reports submitted by the Secretary of the Treasury under this section shall be delivered to the President of the Senate and to the Speaker of the House of Representatives (or to the Clerk of the House and the Secretary of the Senate, respectively, if the Congress is not in session) on the same day, and shall be referred to the Committee on Post Office and Civil Service of each House."

SEC. 2. The last sentence of section 6 of title 6 of the United States Code is amended to read as follows: "Except with respect to bonds obtained under section 14 of this title, no officer or person having the approval of any bond shall require that such bond shall be furnished by a guaranty company or by any particular guaranty company."

SEC. 3. The analysis of title 6 of the United States Code, immediately preceding section 1 of such title, is amended by striking out the item

"14. Rate of premium on bond; premiums not to be paid by United States."

and inserting in lieu thereof the following:

"14. Purchase of bonds to cover officers and employees of the Federal Government.".

SEC. 4. The amendments made by this Act shall take effect on January 1, 1956.

Approved August 9, 1955.

PUBLIC LAW 333, EIGHTY-FOURTH CONGRESS
[CHAPTER 693, FIRST SESSION]
H. R. 7148 [8]

An Act To amend the Internal Revenue Codes so as to provide a personal exemption with respect to certain dependents in the Republic of the Philippines.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That section 25 (b) (3) of the Internal Revenue Code of 1939 (defining the term "dependent") is hereby amended by inserting after the fourth sentence thereof the following new sentence: "For taxable years beginning after December 31, 1946, the preceding sentence shall not exclude from the definition of 'dependent' any child of the taxpayer born to him, or legally adopted by him, in the Philippine Islands, if (i) the child is a resident of the Republic of the Philippines, and (ii) the taxpayer was a member of the Armed Forces of the United States at the time the child was born to him or legally adopted by him."

SEC. 2. Section 152 (b) (3) of the Internal Revenue Code of 1954 (defining the term "dependent") is hereby amended by striking out "July 5, 1946" and inserting in lieu thereof "January 1, 1956".

SEC. 3. (a) The amendment made by the first section of this Act shall apply with respect to taxable years beginning after December 31, 1946, to which the Internal Revenue Code of 1939 applies.

[8] House Report, page 888; Senate Report, page 888.

(b) The amendment made by section 2 of this Act shall apply with respect to taxable years beginning after December 31, 1953, and ending after August 16, 1954.

Approved August 9, 1955.

PUBLIC LAW 354, EIGHTY-FOURTH CONGRESS
[CHAPTER 792, FIRST SESSION]
H. R. 7095 [9]

An Act To provide that the tax on admissions shall not apply to certain athletic events held for the benefit of the United States Olympic Association.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That section 4233(a) of the Internal Revenue Code of 1954 (relating to exemptions from the admissions tax) is hereby amended by adding at the end thereof the following new paragraph:

"(10) ATHLETIC EVENTS FOR BENEFIT OF UNITED STATES OLYMPIC ASSOCIATION.—Any admissions to an athletic event, if (A) such event is conducted by the United States Olympic Association, or the conduct of such event for the benefit of such association is authorized in advance by such association, and (B) all the proceeds of the admissions inure exclusively to the benefit of such association."

SEC. 2. The amendment made by the first section of this Act shall apply only with respect to amounts paid on or after the first day of the first month which begins more than 10 days after the date of the enactment of this Act for admission on or after such first day.

Approved August 11, 1955.

PUBLIC LAW 355, EIGHTY-FOURTH CONGRESS
CHAPTER 793, FIRST SESSION
H. R. 4581 [10]

An Act To amend the Internal Revenue Code of 1954 with respect to the tax on cutting oils.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That (a) section 4091 of the Internal Revenue Code of 1954 is amended to read as follows:

"SEC. 4091. IMPOSITION OF TAX.

"There is hereby imposed upon the following articles sold in the United States by the manufacturer or producer a tax at the following rates, to be paid by the manufacturer or producer:

"(1) cutting oils, 3 cents a gallon; and

"(2) other lubricating oils, 6 cents a gallon."

(b) Section 4092 of the Internal Revenue Code of 1954 is amended to read as follows:

"SEC. 4092. DEFINITIONS.

"(a) CERTAIN VENDEES CONSIDERED AS MANUFACTURERS.—For purposes of this subpart, a vendee who has purchased lubricating oils free of tax under section 4093 shall be considered the manufacturer or producer of such lubricating oils.

[9] House Report, page 886; Senate Report, page 887.

[10] House Report, page 850; Senate Report, page 851.

"(b) CUTTING OILS.—For purposes of this subpart, the term 'cutting oils' means oils sold for use in cutting and machining operation (including forging, drawing, rolling, shearing, punching, and stamping) on metals."

(c) The table of sections to subpart B of part III of subchapter A of chapter 32 of the Internal Revenue Code of 1954 is amended by striking out "Definition of certain vendees as a manufacturer" and inserting in lieu thereof "Definitions".

SEC. 2. Section 6416 (b) (2) of the Internal Revenue Code of 1954 is amended by striking the period at the end of subparagraph (H) and inserting in lieu thereof a semicolon, and by inserting after subparagraph (H) the following new subparagraph:

"(I) In the case of lubricating oils in respect of which tax was paid at the rate of 6 cents a gallon, used or resold for use on or after the effective date of this subparagraph as cutting oils (within the meaning of section 4092 (b)); except that the amount of such overpayment shall not exceed an amount computed at the rate of 3 cents a gallon."

SEC. 3. The amendments made by this Act shall take effect on the first day of the first calendar quarter which begins more than ten days after the date of the enactment of this Act.

Approved August 11, 1955.

PUBLIC LAW 363, EIGHTY-FOURTH CONGRESS
[CHAPTER 801, FIRST SESSION]
H. R. 5249 [11]

An Act To amend the Internal Revenue Code of 1954 to provide for refund or credit of internal revenue taxes and customs duties paid on distilled spirits and wines lost, rendered unmarketable, or condemned by health authorities as a result of the hurricanes of 1954.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That the Secretary of the Treasury is authorized and directed to make refund, or allow credit in the case of a distiller, winemaker, or rectifier if he so elects, in the amount of the internal revenue tax and customs duties paid on distilled spirits and wines previously withdrawn, and lost or rendered unmarketable or condemned by a duly authorized health official of the United States or of a State by reason of the hurricanes of 1954 while such spirits or wines were in the possession of (1) the person originally paying such tax, or such tax and duty, on such spirits or wines, (2) rectifier for rectification or for bottling, or which have been used in the process of rectification, under Government supervision as provided by law and regulations, or (3) a wholesale or retail liquor dealer, all hereinafter referred to as the possessor or possessors. The refunds and credits authorized by this Act may be made to (1) any of the possessors, except a retail liquor dealer, or (2) to any distiller, winemaker, rectifier, importer, or wholesale liquor dealer who replaced for the possessor the full equivalent of the distilled spirits or wines so lost or rendered unmarketable or condemned, without compensation, remuneration, payment, or credit of any kind in respect of the tax, or tax and duty, on such spirits or wines. A claim for the amount of such tax, or such tax and duty, shall be filed with the Secretary of the Treasury within ninety days from the date of enactment of this Act. The claimant shall furnish proof to the

[11] House Report, page 868; Senate Report, page 869.

Secretary's satisfaction that (1) the internal revenue tax on such spirits or wines, or the tax and duty if imported, was fully paid, (2) such spirits or wines were lost or rendered unmarketable or condemned by a duly authorized health official of the United States or of a State, (3) the claimant was not indemnified by any valid claim of insurance or otherwise against loss of the tax, or tax and duty, paid on the spirits or wines, and (4) in those cases where applicable, that the claimant has had replaced for the possessor the full equivalent of the spirits or wines so lost or rendered unmarketable or condemned, without compensation, remuneration, payment, or credit of any kind in respect of the tax, or tax and duty, on such spirits or wines.

(b) When the Secretary, pursuant to this Act, makes refund, or allows credit, in the amount of the tax, or tax and duty, on spirits or wines rendered unmarketable or condemned by a duly authorized health official, such spirits or wines shall be destroyed under the supervision of the Secretary or his delegate, unless such spirits or wines were, prior to the enactment of this Act, destroyed under the supervision or observation of the Secretary or his delegate.

(c) Where credit is allowed to a distiller, winemaker, or rectifier for the internal revenue tax previously paid as aforesaid, the Secretary is authorized and directed to provide for the issuance of stamps to cover the tax on distilled spirits or wines subsequently withdrawn or rectified to the extent of the credit so allowed.

(d) The Secretary is authorized to prescribe such rules and regulations as may be necessary to carry out the provisions of this Act.

Approved August 11, 1955.

PUBLIC LAW 366, EIGHTY-FOURTH CONGRESS
[CHAPTER 804, FIRST SESSION]
H. R. 7300 [12]

An Act To amend the Internal Revenue Code of 1954 with respect to the tax treatment of income received from patent infringement suits.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That (a) part I of subchapter Q of chapter 1 of the Internal Revenue Code of 1954 is hereby amended by renumbering section 1304 as section 1305, and by inserting after section 1303 the following new section:

"SEC. 1304. COMPENSATORY DAMAGES FOR PATENT INFRINGEMENT.

"If an amount representing compensatory damages is received or accrued by a taxpayer during a taxable year as the result of an award in a civil action for infringement of a patent issued by the United States, then the tax attributable to the inclusion of such amount in gross income for the taxable year shall not be greater than the aggregate of the increases in taxes which would have resulted if such amount had been included in gross income in equal installments for each month during which such infringement occurred."

(b) The table of sections for such part I is hereby amended by striking out

"Sec. 1304. Rules applicable to this part."

and inserting in lieu thereof the following:

"Sec. 1304. Compensatory damages for patent infringement.

"Sec. 1305. Rules applicable to this part."

[12] House Report, page 889; Senate Report, page 890.

SEC. 2. The amendments made by the first section of this Act shall apply with respect to taxable years ending after the date of the enactment of this Act, but only with respect to amounts received or accrued after such date as the result of awards made after such date.

Approved August 11, 1955.

PUBLIC LAW 367, EIGHTY FOURTH CONGRESS CHAPTER 805, FIRST SESSION H. R. 7024 [13]

An Act To remove the manufacturers' excise tax from the sales of certain component parts for use in other manufactured articles, to confine to entertainment-type equipment the tax on radio and television apparatus, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That chapters 32 and 65 of the Internal Revenue Code of 1954 are amended as follows:

(a) Section 4218(a)(1) of the Internal Revenue Code of 1954 is amended by inserting after "section 4141" the following: "and other than an automobile part or accessory taxable under section 4061(b), a refrigerator component taxable under section 4111, a radio or television component taxable under section 4141, or a camera lens taxable under section 4171)".

(b) Section 4218(b) of the Internal Revenue Code of 1954 is amended to read as follows:

"(b) EXCEPTION.—This section shall not apply with respect to the use by the manufacturer, producer, or importer of an automobile part or accessory taxable under section 4061(b), a refrigerator component taxable under section 4111, a radio or television component taxable under section 4141, or a camera lens taxable under section 4171, if such part, accessory, component, or lens is used by him as material in the manufacture or production of, or as a component part of, any article."

(c) The first two sentences of section 4220 of the Internal Revenue Code of 1954 are amended to read as follows:

"Under regulations prescribed by the Secretary or his delegate, no tax under this chapter shall be imposed with respect to the sale of—

"(1) any article (other than an automobile part or accessory taxable under section 4061(b), a refrigerator component taxable under section 4111, a radio or television component taxable under section 4141, or a camera lens taxable under section 4171)—

"(A) for use by the vendee as material in the manufacture or production of, or as a component part of, an article enumerated in this chapter; or

"(B) for resale by the vendee for such use by his vendee, if such article is in due course so resold; or

"(2) an automobile part or accessory taxable under section 4061(b), a refrigerator component taxable under section 4111, a radio or television component taxable under section 4141, or a camera lens taxable under section 4171—

"(A) for use by the vendee as material in the manufacture or production of, or as a component part of, any article; or

"(B) for resale by the vendee for such use by his vendee, if such article is in due course so resold.

For purposes of this chapter, the manufacturer or producer to whom an article is sold under paragraph (1)(A) or (2)(A) or resold under paragraph (1)(B) or (2)(B) shall be considered the manufacturer or producer of such article."

(d) Section 4113 of the Internal Revenue Code of 1954 is hereby repealed.

(e) Section 4112 of the Internal Revenue Code of 1954 is amended—

(A) by striking out the heading to such section and inserting in lieu thereof the following:

"SEC. 4112. DEFINITION OF REFRIGERATOR COMPONENTS.";

(B) by striking out "(a) REFRIGERATOR COMPONENTS.—"; and

(C) by striking out subsection (b) thereof.

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[13] House Report, page 881; Senate Report, age 884.

(f) The table of sections to part I of subchapter B of chapter 32 of the Internal Revenue Code of 1954 is amended—

(A) by striking out "Definitions" and inserting in lieu thereof "Definition of refrigerator components"; and

(B) by striking out "Sec. 4113. Exemptions for manufacturers.".

(g) Section 4063(b) of the Internal Revenue Code of 1954 is amended—

(A) by striking out "or parts or accessories" in the first sentence thereof; and

(B) by striking out ", or parts or accessories" in the second sentence thereof.

(h) Section 6416(b)(3)(A) of the Internal Revenue Code of 1954 is amended by inserting after "section 4141" the following: "and other than an automobile part or accessory taxable under section 4061 (b), a refrigerator component taxable under section 4111, a radio or television component taxable under section 4141, or a camera lens taxable under section 4171".

(i) Section 6416(b)(3) of the Internal Revenue Code of 1954 is amended by changing subparagraph (B) thereof to read as follows:

"(B) An automobile part or accessory taxable under section 4061(b), a refrigerator component taxable under section 4111, a radio or television component taxable under section 4141, or a camera lens taxable under section 4171, purchased by a manufacturer or producer and used by him as material in the manufacture of, production of, or as a component part of, any article."

SEC. 2. RADIO AND TELEVISION RECEIVING SETS AND COMPONENT PARTS.—(a) Section 4141 of the Internal Revenue Code of 1954 is amended by inserting at the end thereof a new sentence as follows: "Except in the case of radio and television components and phonograph records, the tax imposed by this section shall apply only to articles of the entertainment type.".

(b) Sections 4143 and 6416(b)(2)(G) of the Internal Revenue Code of 1954 are hereby repealed.

(c) The table of sections to Part I of subchapter C of chapter 32 of the Internal Revenue Code of 1954 is amended by striking out

"Sec. 4143. Exemptions for sales to United States.".

SEC. 3. EFFECTIVE DATE.—The amendments made by the first section and section 2 of this Act shall take effect on the first day of the first month which begins more than ten days after the date of the enactment of this Act. Notwithstanding the preceding sentence—

(1) the repeal of section 6416(b)(2)(G) of the Internal Revenue Code of 1954 shall apply only with respect to articles sold by the manufacturer, producer, or importer on or after the first day of the first month which begins more than 10 days after the date of the enactment of this Act, and

(2) section 6416(b)(3)(B) of the Internal Revenue Code of 1954, as amended by subsection (i) of the first section of this Act, shall apply with respect to articles used on or after such first day by the manufacturer or producer as material in the manufacture of, production of, or as a component part of, another article.

SEC. 4. Subsection (e) of section 534 of the Internal Revenue Code of 1954 (relating to burden of proof in certain proceedings relating to imposition of accumulated earnings tax) is hereby amended to read as follows:

"(e) APPLICATION OF SECTION.—

"(1) Notwithstanding any other provision of law, this section shall apply with respect to taxable years to which this subchapter applies and (except as provided in paragraph (2)) to taxable years to which the corresponding provisions of prior revenue laws apply.

"(2) In the case of a notice of deficiency for a taxable year to which this subchapter does not apply, this section shall apply only in the case of pro-

ceedings tried on the merits after the date of the enactment of this paragraph."

SEC. 5. Subsection (b) of section 534 of such Code (relating to notification by Secretary) is hereby amended by adding at the end thereof the following new sentence: "In the case of a notice of deficiency to which subsection (e)(2) applies and which is mailed on or before the 30th day after the date of the enactment of this sentence, the notification referred to in the preceding sentence may be mailed at any time on or before such 30th day."

Approved August 11, 1955.

PUBLIC LAW 370, EIGHTY-FOURTH CONGRESS
[CHAPTER 808, FIRST SESSION]
H. R. 2553 [14]

An Act To amend section 223 of the Revenue Act of 1950, relating to the use of corporation property by a shareholder.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That section 223 of the Revenue Act of 1950 (relating to use of corporation property by a shareholder) is hereby amended by striking out "January 1, 1950" and inserting in lieu thereof "January 1, 1954".

SEC. 2. No interest shall be allowed or paid on any overpayment resulting from the amendment made by the first section of this Act.

Approved August 11, 1955.

PUBLIC LAW 379, EIGHTY-FOURTH CONGRESS
[CHAPTER 865, FIRST SESSION]
H. R. 5647 [15]

An Act To repeal the manufacturers excise tax on motorcycles.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That section 4061 (a)(2) of the Internal Revenue Code of 1954 (relating to tax on certain motor vehicles) is hereby amended by striking out "Motorcycles".

SEC. 2. The amendment made by the first section of this Act shall apply only with respect to articles sold on or after the first day of the first month which begins more than ten days after the date of the enactment of this Act.

Approved August 12, 1955.

PUBLIC LAW 383, EIGHTY-FOURTH CONGRESS
[CHAPTER 869, FIRST SESSION]
H. R. 4744 [16]

An Act To amend the Railroad Retirement Act of 1937, as amended, and the Railroad Unemployment Insurance Act.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That, effective with

[14] House Report, page 844; Senate Report, page 845.
[15] House Report, page 870; Senate Report, page 871.
[16] House Report, page 865; Senate Report, page 867.

respect to annuities accruing in months following the month of enactment hereof, section 2(e) of the Railroad Retirement Act of 1937, as amended, is amended by striking out "than $40" and inserting in lieu thereof the following: ", with respect to any month, than an amount equal to the maximum amount which could be paid to anyone, with respect to such month, as a wife's insurance benefit under section 202 (b) of the Social Security Act as amended from time to time".

SEC. 2. Effective with respect to annuities accruing in months following the month of enactment hereof, section 5(g)(2) of the Railroad Retirement Act of 1937, as amended, is amended by striking out the second sentence thereof.

SEC. 3. Effective as of January 1, 1955, section 5(l)(9) of the Railroad Retirement Act of 1937, as amended, is amended by striking out the language between "(ii)" and "(B)" and inserting in lieu thereof the following: "if such compensation for any calendar year before 1955 is less than $3,600 or for any calendar year after 1954 is less than $4,200 and the average monthly remuneration computed on compensation alone is less than $350 and the employee has earned in such calendar year 'wages' as defined in paragraph (6) hereof, such wages, in an amount not to exceed the difference between the compensation for such year and $3,600 for years before 1955 and $4,200 for years after 1954, by".

SEC. 4. Effective as of the dates of their original enactment, section 12 of the Railroad Retirement Act of 1937, as amended, and section 2 (e) of the Railroad Unemployment Insurance Act, are each amended by striking out "No" and inserting in lieu thereof "Notwithstanding any other law of the United States, or of any State, Territory, or the District of Columbia, no".

SEC. 5. Section 10(b)4 of the Railroad Retirement Act of 1937, as amended, is amended by inserting immediately after the first sentence thereof the following sentence: "All positions to which such individuals are appointed, except one administrative assistant to each member of the Board, shall be in and under the competitive civil service and shall not be removed or excepted therefrom."

SEC. 6. The second paragraph of section 12(l) of the Railroad Unemployment Insurance Act is amended by inserting immediately before the first colon therein the following: ": *Provided*, That all positions to which such persons are appointed, except one administrative assistant to each member of the Board, shall be in and under the competitive civil service and shall not be removed or excepted therefrom".

Approved August 12, 1955.

PUBLIC LAW 384, EIGHTY-FOURTH CONGRESS
[CHAPTER 870, FIRST SESSION]
H. R. 257 [17]

An Act To amend section 112(n)(8) of the Internal Revenue Code of 1939, relating to the suspension of certain periods of limitation while the taxpayer is on extended active duty with the Armed Forces, and to amend the Internal Revenue Code of 1954 with respect to tax treatment where the taxpayer recovers amounts held by another under claim of right.

[17] House Report, page 839; Senate Report, page 840.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That section 112 (n)(8) of the Internal Revenue Code of 1939 (relating to the suspension of certain periods of limitation while the taxpayer is on extended active duty with the Armed Forces) is hereby amended by striking out "and before January 1, 1954, except that any such period" and inserting in lieu thereof the following: "and during an induction period (as defined in section 112(c)(5) of the Internal Revenue Code of 1954), except that any such period of time".

SEC. 2. The amendment made by the first section of this Act shall take effect as of December 31, 1953.

SEC. 3. The Internal Revenue Code of 1954 is amended by adding a new section to chapter 1 of subtitle A immediately following section 1341 to read as follows:

"SEC. 1342. COMPUTATION OF TAX WHERE TAXPAYER RECOVERS SUBSTANTIAL AMOUNT HELD BY ANOTHER UNDER CLAIM OF RIGHT.

"(a) GENERAL RULE.—If—

"(1) an item was deducted from gross income for a prior taxable year (or years) because it appeared that another person held an unrestricted right to such item as a result of a court decision in a patent infringement suit (whether or not the taxpayer is a party to such suit); and

"(2) gross income is increased for the taxable year because it was established after the close of such prior taxable year (or years) that such other person did not have an unrestricted right to such item or to a portion of such item because of the subsequent reversal of such court decision on the ground that such decision was induced by fraud or undue influence; and

"(3) the amount of such increase in gross income exceeds $3,000, then the tax imposed by this chapter for the taxable year shall be the lesser of the following:

"(4) the tax for the taxable year computed with the gross income so increased; or

"(5) an amount equal to—

"(A) the tax for the taxable year computed without such increase in gross income, plus

"(B) the increase in tax (including interest) under this chapter (or the corresponding provisions of prior revenue laws) for the prior taxable year (or years) which would result solely from the elimination of such item (or portion thereof) as a deduction from gross income for such prior taxable year (or years).

"(b) SPECIAL RULE.—For purposes of subsection (a)(5)(B) interest shall be computed from the due date of the return for such prior taxable year to the due date of the return for the taxable year."

SEC. 4. The amendment made by section 3 of this Act shall apply with respect to taxable years beginning after December 31, 1954.

Approved August 12, 1955.

PUBLIC LAW 385, EIGHTY-FOURTH CONGRESS
[CHAPTER 871, FIRST SESSION]
H. R. 6263 [18]

An Act To amend section 1233 and section 542(a)(2) of the Internal Revenue Code of 1954.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That section 1233

[18] House Report, page 871; Senate Report, page 874.

of the Internal Revenue Code of 1954 is amended by adding at the end thereof a new subsection as follows:

"(f) ARBITRAGE OPERATIONS IN SECURITIES.—In the case of a short sale which had been entered into as an arbitrage operation, to which sale the rule of subsection (b)(2) would apply except as otherwise provided in this subsection—

"(1) subsection (b)(2) shall apply first to substantially identical assets acquired for arbitrage operations held at the close of business on the day such sale is made, and only to the extent that the quantity sold short exceeds the substantially identical assets acquired for arbitrage operations held at the close of business on the day such sale is made, shall the holding period of any other such identical assets held by the taxpayer be affected;

"(2) in the event that assets acquired for arbitrage operations are disposed of in such manner as to create a net short position in assets acquired for arbitrage operations, such net short position shall be deemed to constitute a short sale made on that day;

"(3) for the purpose of paragraphs (1) and (2) of this subsection the taxpayer will be deemed as of the close of any business day to hold property which he is or will be entitled to receive or acquire by virtue of any other asset acquired for arbitrage operations or by virtue of any contract he has entered into in an arbitrage operation; and

"(4) for the purpose of this subsection arbitrage operations are transactions involving the purchase and sale of assets for the purpose of profiting from a current difference between the price of the asset purchased and the price of the asset sold, and in which the asset purchased, if not identical to the asset sold, is such that by virtue thereof the taxpayer is, or will be entitled to acquire assets identical to the assets sold. Such operations must be clearly identified by the taxpayer in his records as arbitrage operations on the day of the transaction or as soon thereafter as may be practicable. Assets acquired for arbitrage operations will include stocks and securities and the right to acquire stocks and securities."

SEC. 2. The amendment made by the first section of this Act shall apply only with respect to taxable years ending after the date of the enactment of this Act and only in the case of a short sale of property made by the taxpayer after such date.

SEC. 3. Section 452(a)(2)[19] of the Internal Revenue Code of 1954 (defining the term "personal holding company") is hereby amended by adding at the end thereof the following new sentence: "The preceding sentence shall not apply in the case of an organization or trust organized or created before July 1, 1950, if at all times on or after July 1, 1950, and before the close of the taxable year such organization or trust has owned all of the common stock and at least 80 percent of the total number of shares of all other classes of stock of the corporation, but only if such organization or trust is not denied exemption under section 504 or an unlimited charitable deduction is not denied under section 681(c) and, for this purpose—

"(A) all income of the corporation which is available for distribution as dividends to its shareholders at the close of any taxable year shall be deemed to have been distributed at the close of such year whether or not any portion of such income was in fact distributed; and

"(B) section 504(a)(1) and section 681(c)(1) shall also not apply to income attributable to property of a decedent dying before January 1, 1951, which was transferred during his lifetime to a trust or property that was transferred under his will to such trust."

SEC. 4. The amendment made by section 3 of this Act shall apply only with respect to taxable years beginning after December 31, 1954.

Approved August 12, 1955.

[19] This section reference is apparently intended for section 542(a)(2).

SUBPART B.—TAX CONVENTIONS

UNITED STATES-BELGIUM INCOME TAX CONVENTION

(Also Part I, Section 894) Rev. Rul. 55-617

A Belgian corporation, which constitutes a Belgian enterprise and markets its goods in the United States but which has no permanent establishment in the United States, is exempt from United States income tax with respect to its industrial and commercial profits from sources within the United States even though it is, by reason of such marketing, engaged in trade or business within the United States.

Advice has been requested whether the industrial and commercial profits derived by a Belgian corporation from the sale of its manufactured products in the United States are subject to United States income tax. The corporation does extensive business in the United States through the medium of a commission agent and thus is engaged in trade or business within the United States as defined by section 871(c) of the Internal Revenue Code of 1954. However, the corporation has no permanent establishment in the United States.

Section 894 of the Internal Revenue Code of 1954 provides as follows:

> Income of any kind, to the extent required by any treaty obligation of the United States, shall not be included in gross income and shall be exempt from taxation under this subtitle.

Article III of the United States–Belgium Income Tax Convention, C. B. 1954–2, 626, provides in part as follows:

> (1) An enterprise of one of the contracting States is not subject to taxation by the other contracting State in respect of its industrial and commercial profits except in respect of such profits allocable to its permanent establishment in such other State.

Article II(1) (f) of the cited convention provides in part as follows:

> (f) The term "permanent establishment", when used with respect to an enterprise of one of the contracting States, means * * *. An enterprise of one of the contracting States shall not be deemed to have a permanent establishment in the other contracting State merely because it carries on business dealings in such other contracting State through a bona fide commission agent or broker acting in the ordinary course of his business as such. * * *

Article III(1) of the cited convention clearly provides that a Belgian enterprise is exempt from United States tax on its industrial and commercial profits from sources within the United States except in respect of such profits allocable to its permanent establishment in the United States. Section 894 of the Internal Revenue Code recognizes such exemption. One of the main purposes of Article III is to facilitate international commerce through exemption from tax, in the State from which industrial and commercial profits are derived, of the business income of an enterprise of the contracting State carrying on its business through a commission agent, as in the instant case.

Accordingly, it is held that a Belgian corporation constituting a Belgian enterprise, selling all or some of its products in the United States through the medium of a commission agent acting in the ordi-

nary course of his business as such, and having no permanent establishment in the United States, is exempt, under the provisions of Article III of the United States–Belgium income tax convention, from United States tax with respect to its industrial and commercial profits so derived from sources within the United States, notwithstanding that such corporation is engaged in trade or business within the United States.

UNITED STATES—FRANCE INCOME TAX CONVENTION

T. D. 5499, SECTION 7.420: Compensation for labor or personal services.
(Also Part I, Section 871.)

Rev. Rul. 55–508

Compensation received by a French citizen, who is in the United States on an exchange visitor's visa to perform professional services as a research assistant at a university in the United States, is exempt from Federal income tax under the provisions of article 10 of the income tax convention between the United States and France.

Advice has been requested whether compensation received by a French citizen, who is in the United States on an exchange visitor's visa to perform professional services as a research assistant at a university, is exempt from Federal income tax under the provisions of article 10 of the income tax convention between the United States and France. Provisions of that convention were made a part of Treasury Decision 5499, published in C. B. 1946–1, 134.

Under the provisions of section 7.420(b) of Treasury Decision 5499, *supra*, a resident of France, who is a nonresident alien and who is present in the United States during any part of the taxable year rendering professional services, such as medical, legal, engineering, and scientific services, is not subject to United States tax with respect to his compensation for such services unless he has an office or other fixed place in the United States during the taxable year.

When read in connection with the first sentence of article 10 of the United States-France income tax convention (which provides that income from the exercise of a liberal profession shall be taxable only in the State in which the professional activity is exercised and that there is such exercise only when such activity has a fixed center), section 7.420(b) of T. D. 5499 indicates that the term "fixed center" referred to in article 10 relates to an office or fixed place of business maintained by the professional individual on his own account, or on the account of his foreign employer. It does not refer to a previously established United States firm, organization, or educational institution where services are performed by a French professional individual who has not severed his connections with his French employer.

In view of the above, it is held that compensation received by a French citizen, who is in the United States on an exchange visitor's visa to perform professional services as a research assistant at a university, is exempt from Federal income tax under the provisions of article 10 of the income tax convention between the United States and France.

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UNITED STATES-JAPAN INCOME TAX CONVENTION

(Also Part I, Section 861) Rev. Rul. 55-472

The limitation of $3,000 paid for personal services, as provided in article IX(b) of the United States-Japan income tax convention, applies equally to compensation paid in dollars or in yen. In the determination of the amount paid for personal services or the amount of tax to be paid, the currency shall be converted at the current official dollar rate of exchange in effect at the time the payment is made.

The advice of the Internal Revenue Service has been requested as to its interpretation of the limitation appearing in article IX(b) of the income tax convention between the United States and Japan,[1] specifically, whether the limitation of the exemption to $3,000 paid for personal services applies equally to compensation paid in United States dollars or Japanese yen.

Article IX of the United States-Japan income tax convention provides that:

An individual resident of one of the contracting States shall be exempt from the tax of the other contracting State upon compensation for labor or personal services (including the practice of liberal professions) performed in such other State in any taxable year if such resident is temporarily present in such other State:

(a) for a period or periods not exceeding a total of 180 days during such taxable year and his compensation is received for such labor or personal services performed as an officer or employee of a resident or corporation or other entity of the former State, or

(b) for a period or periods not exceeding a total of 90 days during such taxable year and his compensation received for such labor or personal services does not exceed 3,000 United States dollars, or the equivalent sum in yen as computed at the official basic rate of exchange in effect at the time such compensation is paid.

To insure consistency in administrative practice by both countries, it is specified that the current official rate of exchange be used as a measure of dollar equivalent when compensation is paid in yen. Hence, a Japanese performing services in this country who is paid in yen or an American performing services in Japan who is paid in yen would be regarded as receiving an amount in dollars equal to that procurable at the official rate when the yen were received although in fact either may have or could have converted the yen to dollars at a different rate. The designation of the official rate as a measure of yen value in dollars is intended not to create any difference in treatment because of the medium of payment but merely to insure uniformity in computation of dollar equivalent for purposes of applying the $3,000 ceiling fixed for the exemption.

Accordingly, the limitation for tax exemption of $3,000 paid for personal services, as provided in article IX(b) of the United States-Japan income tax convention, applies equally to compensation paid in dollars or in yen. In the determination of the amount paid for personal services, the currency shall be converted at the current official dollar rate of exchange in effect at the time the payment is made.

[1] Cumulative Bulletin 1955-1, 654.

UNITED STATES—NETHERLANDS INCOME TAX CONVENTION

(Also Part I, Sections 1441, 1442.) T. D. 6153 [1]

TITLE 26—INTERNAL REVENUE, 1954.—CHAPTER I, SUBCHAPTER G, PART 505.—NETHERLANDS, SUBPART.—NETHERLANDS ANTILLES

Release of excess tax withheld and exemption from, or reduction in rate of, withholding of tax at source in the case of residents of the Netherlands Antilles and of Netherlands Antilles corporations, as affected by the extension to the Netherlands Antilles of the income tax convention of April 29, 1948, between the United States and the Netherlands.

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

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

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§ 505.201 INTRODUCTORY.—(a) *Pertinent provisions.*—The income tax convention of April 29, 1948 [C. B. 1950–1, 92], between the United States and the Netherlands, as supplemented by the protocol of June 15, 1955, between such Governments, was extended to the Netherlands Antilles subject to the limitations expressed in the notification of June 24, 1952, given by the Government of the Netherlands in accordance with Article XXVII of the convention. The convention as so extended to the Netherlands Antilles, hereinafter referred to as the convention, provides in part as follows, effective on and after January 1, 1955. For that purpose all references in the convention to the Netherlands or to one or the other Contracting State, as the case may be, shall be construed to refer to the Netherlands Antilles.

ARTICLE I

(1) The taxes which are the subject of the present Convention are:
(a) In the case of the United States: the Federal income taxes.
(b) In the case of the Netherlands:
(i) For the application of the provisions of the Convention other than Article XX, the income tax and the Netherlands taxes credited against it, the corporation tax and the Netherlands taxes credited against it, * * * and the tax on fees of directors and managers of corporations; and
(ii) For the application of Articles XX to XXVIII inclusive (except Articles XXIV and XXVII), the capital accretions tax and the extraordinary capital tax.

(2) The present Convention shall apply also to any other taxes of a substantially similar character imposed by either Contracting State subsequently to the

[1] 20 F. R. 9151.

date of signature of the present Convention, or, by the government of any overseas part of the Kingdom (in the case of the Netherlands) or overseas territory (in the case of the United States) to which the present Convention is extended under Article XXVII, subsequently to the date of the notification of extension.

(3) In the event of appreciable changes in the fiscal laws of either of the Contracting States the competent authorities of the Contracting States will consult together.

ARTICLE II

(1) In the present Convention, unless the context otherwise requires:

(a) The term "United States" means the United States of America, and when used in a geographical sense means the States, the Territories of Alaska and of Hawaii, and the District of Columbia.

(b) The term "Netherlands" means only the Kingdom of the Netherlands in Europe.

(c) The term "United States corporation" means a corporation, association or other organization or juridical entity created in the United States or under the laws of the United States or of any State or territory of the United States.

(d) The term "Netherlands corporation" means a corporation, association or other organization or juridical entity created in the Netherlands or under the laws of the Netherlands.

(e) The term "corporation of one Contracting State" and "corporation of the other Contracting State" means a United States corporation or a Netherlands corporation, as the context requires.

(f) The term "United States enterprise" means an industrial or commercial enterprise or undertaking carried on in the United States by a citizen or resident of the United States or by a United States corporation.

(g) The term "Netherlands enterprise" means an industrial or commercial enterprise or undertaking carried on in the Netherlands by a citizen or resident of the Netherlands or by a Netherlands corporation.

(h) The terms "enterprise of one of the Contracting States" and "enterprise of the other Contracting State" mean a United States enterprise or a Netherlands enterprise, as the context requires.

(i) The term "permanent establishment", when used with respect to an enterprise of one of the Contracting States, means a branch, factory, or other fixed place of business, but does not include an agency unless the agent has, and habitually exercises, a general authority to negotiate and conclude contracts on behalf of such enterprise or has a stock of merchandise from which he regularly fills orders on behalf of such enterprise. An enterprise of one of the Contracting States shall not be deemed to have a permanent establishment in the other Contracting State merely because it carries on business dealings in such other Contracting State through a *bona fide* commission agent, broker or custodian acting in the ordinary course of his business as such. The fact that an enterprise of one of the Contracting States maintains in the other Contracting State a fixed place of business exclusively for the purchase of goods or merchandise shall not of itself constitute such fixed place of business a permanent establishment of such enterprise. When a corporation of one Contracting State has a subsidiary corporation which is a corporation of the other Contracting State or which is engaged in trade or business in such other Contracting State, such subsidiary corporation shall not, merely because of that fact, be deemed to be a permanent establishment of its parent corporation.

(j) The term "competent authority" or "competent authorities" means, in the case of the United States, the Commissioner of Internal Revenue or his duly authorized representative; in the case of the Netherlands, the Directeur-Generaal der Belastingen or his duly authorized representative; and, in the case of any part or territory to which provisions of the present Convention are extended under Article XXVII, the competent authority for the administration in such part or territory of the taxes to which such provisions apply.

(2) In the application of the provisions of the present Convention by either of the Contracting States, any term which is not defined in the present Convention shall, unless the context otherwise requires, have the meaning which that term has under the laws of such Contracting States relating to the taxes which are the subject of the present Convention.

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ARTICLE V

Income of whatever nature derived from real property and interest from mortgages secured by real property shall be taxable only in the Contracting State in which the real property is situated.

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ARTICLE VII

(1) The rate of United States tax on dividends derived from a United States corporation by a resident or corporation of the Netherlands not engaged in trade or business in the United States through a permanent establishment shall not exceed 15 percent: Provided that such rate of tax shall not exceed 5 percent if such Netherlands corporation controls, directly or indirectly, at least 95 percent of the entire voting power in the corporation paying the dividend, and not more than 25 percent of the gross income of such paying corporation is derived from interest and dividends, other than interest and dividends from its own subsidiary corporation. Such reduction of the rate to 5 percent shall not apply if the relationship of the two corporations has been arranged or is maintained primarily with the intention of securing such reduced rate.

(2) Dividends derived from sources within the Netherlands by a resident or corporation of the United States not engaged in trade or business in the Netherlands through a permanent establishment shall be exempt from Netherlands tax.

(3) Either of the Contracting States may terminate this Article, by giving written notice of termination to the other Contracting State through diplomatic channels, on or before the thirtieth day of June in any year after the first year for which the present Convention becomes effective. In such event this Article shall cease to be effective on and after the first day of January in the year next following that in which such notice is given.

ARTICLE VIII

(1) Interest (on bonds, securities, notes, debentures, or on any other form of indebtedness), other than interest referred to in Article V of the present Convention, derived from sources within the United States by a resident or corporation of the Netherlands not engaged in trade or business in the United States through a permanent establishment, shall be exempt from United States tax; but such exemption shall not apply to such interest paid by a United States corporation to a Netherlands corporation controlling, directly or indirectly, more than 50 percent of the entire voting power in the paying corporation.

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ARTICLE IX

Royalties for the right to use copyrights, patents, designs, secret processes and formulae, trade marks, and other analogous property, and royalties, including rentals, in respect of motion picture films or for the use of industrial, commercial or scientific equipment, derived from sources within one of the Contracting States by a resident or corporation of the other Contracting State not engaged in trade or business in the former State through a permanent establishment, shall be exempt from tax imposed by the former State.

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ARTICLE XII

Dividends and interest paid by a Netherlands corporation shall be exempt from United States tax except where the recipient is a citizen, resident, or corporation of the United States.

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ARTICLE XV

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(2) Private pensions and life annuities derived from within one of the Contracting States and paid to individuals in the other Contracting State shall be exempt from taxation in the former State.

(3) The term "pensions" as used in this Article means periodic payments made in consideration for services rendered or by way of compensation for injuries received.

(4) The term "life annuities" as used in this Article means a stated sum payable periodically at stated times during life, or during a specified number of years, under an obligation to make the payments in return for adequate and full consideration in money or money's worth.

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ARTICLE XXI

The competent authorities of the Contracting States shall exchange such information (being information which such authorities have in proper order at their disposal) as is necessary for carrying out the provisions of the present Convention or for the prevention of fraud or the administration of statutory provisions against legal avoidance in relation to the taxes which are the subject of the present Convention. Any information so exchanged shall be treated as secret and shall not be disclosed to any person other than those concerned with the assessment and collection of the taxes which are the subject of the present Convention. No information as aforesaid shall be exchanged which would disclose any trade, business, industrial or professional secret or trade process.

ARTICLE XXII

(1) The Contracting States undertake to lend assistance and support to each other in the collection of the taxes which are the subject of the present Convention, together with interest, costs, and additions to the taxes and fines not being of a penal character.

(2) In the case of applications for enforcement of taxes, revenue claims of each of the Contracting States which have been finally determined may be accepted for enforcement by the other Contracting State and collected in that State in accordance with the laws applicable to the enforcement and collection of its own taxes. The State to which application is made shall not be required to enforce executory measures for which there is no provision in the law of the State making the application.

(3) Any application shall be accompanied by documents establishing that under the laws of the State making the application the taxes have been finally determined.

(4) The assistance provided for in this Article shall not be accorded with respect to the citizens, corporations, or other entities of the State to which application is made, except as is necessary to insure that the exemption or reduced rate of tax granted under the convention to such citizens, corporations or other entities shall not be enjoyed by persons not entitled to such benefits.

ARTICLE XXIII

(1) In no case shall the provisions of Article XXI and XXII be construed so as to impose upon either of the Contracting States the obligation

(a) To carry out administrative measures at variance with the regulations and practice of either Contracting State, or

(b) To supply particulars which are not procurable under its own legislation or that of the State making application.

(2) The State to which application is made for information or assistance shall comply as soon as possible with the request addressed to it. Nevertheless, such State may refuse to comply with the request for reasons of public policy or if compliance would involve violation of a trade, business, industrial or professional secret or trade process. In such case it shall inform, as soon as possible, the State making the application.

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ARTICLE XXV

(1) The provisions of the present Convention shall not be construed to restrict in any manner any exemption, deduction, credit or other allowance accorded by the laws of one of the Contracting States in the determination of the tax imposed by such State.

(2) Should any difficulty or doubt arise as to the interpretation or application of the present Convention, the competent authorities of the Contracting States shall undertake to settle the question by mutual agreement.

(3) The citizens or subjects of one of the Contracting States shall not, while resident in the other Contracting State, be subjected therein to other or more

burdensome taxes than are the citizens or subjects of such other Contracting State residing in its territory. The term "citizens" or "subjects" as used in this Article includes all legal persons, partnerships and associations deriving their status from, or created or organized under the laws in force in, the respective Contracting States. In this Article the word "taxes" means taxes of every kind or description whether national, federal, state, provincial or municipal.

ARTICLE XXVI

(1) The authorities of each of the Contracting States, in accordance with the practices of that State, may prescribe regulations necessary to carry out the provisions of the present Convention.

(2) With respect to the provisions of the present Convention relating to exchange of information and mutual assistance in the collection of taxes, the competent authorities may, by common agreement, prescribe rules concerning matters of procedure, forms of application and replies thereto, conversion of currency, disposition of amounts collected, minimum amounts subject to collection, and related matters.

ARTICLE XXVII

(1) Either of the Contracting States may, at the time of exchange of instruments of ratification or thereafter while the present Convention continues in force, by a written notification of extension given to the other Contracting State through diplomatic channels, declare the desire of the government of any overseas part of the Kingdom (in the case of the Netherlands) or overseas territory (in the case of the United States), which imposes taxes substantially similar in character to those which are the subject of the present Convention, that the operation of the present Convention, either in whole or as to such provisions thereof as may be deemed to have special application, shall extend to such part or territory.

(2) In the event that a notification is given by one of the Contracting States in accordance with paragraph (1) of this Article, the present Convention, or such provisions thereof as may be specified in the notification, shall apply to any part or territory named in such notification on and after the first day of January [immediately preceding] the date of a written communication through diplomatic channels addressed to such Contracting State by the other Contracting State, after such action by the latter State as may be necessary in accordance with its own procedures, stating that such notification is accepted in respect of such part or territory. In the absence of such acceptance, none of the provisions of the present Convention shall apply to such part or territory.

(3) At any time after the expiration of one year from the effective date of an extension made by virtue of paragraphs (1) and (2) of this Article, either of the Contracting States may, by a written notice of termination given to the other Contracting State through diplomatic channels, terminate the application of the present Convention to any part or territory to which the Convention, or any of its provisions, has been extended. In that case, the present Convention, or the provisions thereof specified in the notice of termination, shall cease to be applicable to the part or territory named in such notice of termination on and after the first day of January following the expiration of a period of six months after the date of such notice; provided, however, that this shall not affect the continued application of the Convention, or any of the provisions thereof, to the United States, to the Netherlands, or to any part or territory (not named in the notice of termination) to which the Convention, or such provision thereof, applies.

(4) For the application of the present Convention in relation to any part or territory to which it is extended by notification given by the United States or the Netherlands, references to "the United States" or to "the Netherlands" or to one or the other Contracting State, as the case may be, shall be construed to refer to such part or territory.

* * * * * * *

(b) *Definitions.*—(1) *In general.*—Any term defined in the convention or this Treasury decision shall have the meaning so assigned to it; any term not so defined shall, unless the context otherwise requires, have the meaning which such term has under the internal revenue laws of the United States.

(2) *Antilles.*—As used in this Treasury decision, the term "Antilles" means the Netherlands Antilles which, when used in a geographical sense, includes only the following islands off the coast of Venezuela: Aruba, Bonaire, Curacao, Saba, St. Eustalius, and St. Martin (Netherlands part). The term does not include Dutch Guiana (Surinam).

§ 505.202 DIVIDENDS.—(a) *Paid by Antilles corporation.*—Dividends paid on or after January 1,1955, by an Antilles corporation are exempt from United States tax under the provisions of Article XII of the convention if the recipient is not a citizen, resident, or corporation of the United States. Dividends so paid are not subject to the withholding of United States tax at source.

(b) *Derived from domestic corportion.*—(1) *Rate of 15 percent.*—The rate of United States tax upon dividends (other than dividends falling within the scope of paragraph (c) (1) of this section) derived from a domestic corporation on or after January 1, 1955, by a nonresident alien individual who is a resident of the Antilles, or by an Antilles corporation, shall not exceed 15 percent under the provisions of Article VII of the convention if such alien or corporation at no time during the taxable year in which such dividends are derived has engaged in trade or business within the United States through a permanent establishment situated therein.

(2) *Personal services.*—If a nonresident alien individual who is a resident of the Antilles performs personal services within the United States during the taxable year, but has at no time during such year a permanent establishment in the United States, he is entitled to the reduced rate of tax prescribed by subparagraph (1) of this paragraph, even though under the provisions of section 871(c) of the Internal Revenue Code of 1954 he has engaged in trade or business within the United States during such year by reason of his having performed personal services therein.

(c) *Derived from a domestic subsidiary.*—(1) *Rate of 5 percent.*—Under the proviso of Article VII (1) of the convention, dividends derived from a domestic corporation on or after January 1, 1955, by an Antilles corporation which controls, directly or indirectly, at the time the dividend is paid 95 percent or more of the entire voting power in the corporation paying the dividend are subject to United States tax at a rate not in excess of 5 percent if (i) not more than 25 percent of the gross income of the paying corporation for the three-year period immediately preceding the taxable year in which the dividend is paid consists of dividends and interest (other than dividends and interest received by such paying corporation from its own subsidiary corporations, if any), (ii) the relationship between the paying corporation and the Antilles corporation has not been arranged or maintained primarily with the intention of securing the reduced rate of 5 percent, and (iii) the Antilles corporation at no time during the taxable year in which such dividends are derived has engaged in trade or business within the United States through a permanent establishment situated therein.

(2) *Information to be filed with Commissioner.*—Any domestic corporation which claims or contemplates claiming that dividends paid or to be paid by it are subject to a rate not in excess of 5 percent shall file the following information with the Commissioner of Internal

Revenue as soon as practicable: (i) the date and place of its organization; (ii) the number of outstanding shares of stock of the domestic corporation having voting power and the voting power thereof; (iii) the person or persons beneficially owning such stock of the domestic corporation and their relationship to the Antilles corporation; (iv) the amounts by years (for the three-year period immediately preceding the taxable year in which the dividend is paid) of the gross income of the domestic corporation, of the interest and dividends included in such gross income, and of the interest and dividends received by the domestic corporation from its own subsidiary corporations, if any; and (v) the relationship between the domestic corporation and the Antilles corporation deriving the dividend.

(3) *Notification by Commissioner.*—As soon as practicable after such information is filed, the Commissioner will determine whether the dividends concerned fall within the scope of the proviso of Article VII(1) of the convention and will notify the domestic corporation of his determination. If the dividends fall within the scope of the proviso, this notification may also authorize the release, pursuant to § 505.208(a)(2), of excess tax withheld from the dividends concerned.

(d) *Effect of address in the Antilles.*—For the purpose of paragraph (e)(1) of this section, every nonresident alien (including a nonresident alien individual, fiduciary, and partnership) whose address is in the Antilles shall be deemed by United States withholding agents to be a nonresident alien individual who is a resident of the Antilles not engaged in trade or business within the United States through a permanent establishment situated therein; and every foreign corporation whose address is in the Antilles shall be deemed by such withholding agents to be an Antilles corporation not engaged in trade or business within the United States through a permanent establishment situated therein.

(e) *Withholding of United States tax from dividends.*—(1) *Rate of 15 percent.*—Withholding at source, as required under the internal revenue laws, in the case of dividends (other than dividends falling within the scope of subparagraph (2) of this paragraph) derived from a domestic corporation by nonresident aliens (including a nonresident alien individual, fiduciary, and partnership) and by foreign corporations, having addresses in the Antilles, shall be at the rate of 15 percent in every case except that in which, prior to the date of payment of such dividends, the Commissioner of Internal Revenue has notified the withholding agent that the reduced rate of withholding shall not apply. This provision is based upon the assumption that the payee of the dividend is the actual owner of the capital stock from which the dividend is derived. As to action by a recipient who is not the owner of the dividend, see § 505.203.

(2) *Rate of 5 percent.*—If, in accordance with paragraph (c)(3) of this section, the Commissioner of Internal Revenue has notified the domestic corporation that the dividends fall within the scope of the proviso of Article VII(1) of the convention, the reduced withholding rate of 5 percent, to the extent withholding of United States tax is required, shall apply to any dividends subsequently paid by such corporation and derived by the Antilles corporation, unless the stock ownership of the domestic corporation, or the character of its income,

materially changes; or unless the Commissioner determines that the relationship between the two corporations concerned is being maintained primarily with the intention of securing the reduced rate of tax. In such instance, if such change in stock ownership or character of income occurs, the domestic corporation shall promptly notify the Commissioner of the then existing facts with respect thereto. The continued application of the rate not in excess of 5 percent is also dependent upon the continued fulfillment of paragraph (c)(1)(iii) of this section.

(3) *Evidence of tax withheld.*—The rate at which United States tax has been withheld from any dividend paid at any time after the expiration of the thirtieth day after the date on which this Treasury decision is published in the Federal Register to any person whose address is in the Antilles at the time the dividend is paid shall be shown either in writing or by appropriate stamp on the check, draft, or other evidence of payment, or on an accompanying statement.

§ 505.203 Dividends Received by Addressee Not Actual Owner.—(a) *Additional tax to be withheld.*—(1) *Nominee or representative.*—The recipient in the Antilles of any dividend from which United States tax at the reduced rate of 15 percent has been withheld at source pursuant to § 505.202(e)(1), who is a nominee or representative through whom the dividend is received by a person other than one described in § 505.202(b) as being entitled to the reduced rate, shall withhold an additional amount of United States tax equivalent to the United States tax which would have been withheld if the convention had not been in effect (30 percent as of the date of approval of this Treasury decision) minus the 15 percent which has been withheld at the source.

(2) *Fiduciary or partnership.*—A fiduciary or a partnership with an address in the Antilles which receives, otherwise than as a nominee or representative, a dividend from which United States tax at the reduced rate of 15 percent has been withheld at source pursuant to § 505.202(e)(1) shall withhold an additional amount of United States tax from the portion of the dividend included in the gross income from sources within the United States of any beneficiary or partner, as the case may be, who is not entitled to the reduced rate of tax in accordance with § 505.202(b). The amount of the additional tax is to be calculated in the same manner as under subparagraph (1) of this paragraph.

(3) *Released amounts of tax.*—If any amount of United States tax is released pursuant to § 505.208(a)(1) by the withholding agent in the United States with respect to a dividend paid to such a person (nominee, representative, fiduciary, or partnership) with an address in the Antilles, the latter shall withhold from such released amount any additional amount of United States tax, otherwise required to be withheld from the dividend by the provisions of subparagraphs (1) and (2) of this paragraph, in the same manner as if at the time of payment of the dividend United States tax at the rate of only 15 percent had been withheld at source therefrom.

(b) *Returns filed by Antilles withholding agents.*—The amounts withheld pursuant to paragraph (a) of this section by any withholding agent in the Antilles shall be deposited, without converting the

amounts into United States dollars, with the Administrateur van Financien of the Netherlands Antilles on or before the 15th day after the close of the quarter of the calendar year in which the withholding in the Antilles occurs. The withholding agent making the deposit shall render therewith such appropriate Antilles form as may be prescribed by the Administrateur van Financien. The amounts so deposited should be remitted by the Administrateur van Financien by draft in United States dollars to the District Director of Internal Revenue, Baltimore 2, Maryland, U. S. A., on or before the end of the calendar month in which the deposit is made, and should be accompanied by such Antilles form as may be required to be rendered by the withholding agent in the Antilles in connection with the deposit.

§ 505.204 *Interest.*—(a) *Paid by Antilles corporation.*—Interest paid on or after January 1, 1955, by an Antilles corporation is exempt from United States tax under the provisions of Article XII of the convention if the recipient is not a citizen, resident, or corporation of the United States. Interest so paid is not subject to the withholding of United States tax at source.

(b) *Received from domestic payers.*—Interest on bonds, securities, notes, debentures, or on any other form of indebtedness, which is paid by a person other than an Antilles corporation and which is derived from sources within the United States on or after January 1, 1955, by a nonresident alien individual who is a resident of the Antilles, or by an Antilles corporation, is exempt from United States tax under the provisions of Article VIII(1) of the convention if the alien or corporation at no time during the taxable year in which the interest is derived has engaged in trade or business within the United States through a permanent establishment situated therein. This paragraph applies to interest on obligations of the United States and instrumentalities thereof. It does not apply to interest from mortgage notes (not including bonds) secured by real property or to the interest falling within the scope of paragraph (c) of this section.

(c) *Paid by domestic subsidiary.*—Under the exception contained in Article VIII(1) of the convention, any interest derived from sources within the United States and paid by a domestic corporation to an Antilles corporation is not exempt from United States tax if the Antilles corporation controls, directly or indirectly, at the time the interest is paid more than 50 percent of the entire voting power of all classes of stock of the domestic corporation. The exemption from United States tax granted by Article VIII(1) of the convention does not apply in such instance.

(d) *Exemption from withholding of United States tax.*—(1) *Coupon bond interest.*—(i) *Form to use.*—To avoid withholding of United States tax at source in the case of coupon bond interest to which paragraph (b) of this section applies, the nonresident alien who is a resident of the Antilles, or the Antilles corporation, shall for each issue of bonds file Form 1001–NA in duplicate when presenting the interest coupons for payment. This form shall be signed by the owner of the interest, trustee, or agent and shall show the name and address of the obligor, the name and address of the owner of the interest, and the amount of the interest. It shall contain a statement

(*a*) that the owner is a resident of the Antilles, or is an Antilles corporation, (*b*) that the owner is not engaged in trade or business within the United States through a permanent establishment situated therein, and, in the case of interest paid by a domestic corporation to an Antilles corporation, (*c*) that the owner does not control, directly or indirectly, more than 50 percent of the entire voting power of all classes of stock of the United States domestic corporation. If there is uncertainty as to the degree of stock ownership, see paragraph (e) of this section.

(ii) *Exemption applicable only to owner.*—The exemption from United States tax contemplated by Article VIII(1) of the convention, insofar as it concerns coupon bond interest, is applicable only to the owner of the interest. The person presenting the coupon or on whose behalf it is presented shall, for the purpose of the exemption from tax, be deemed to be the owner of the interest only if he is, at the time the coupon is presented for payment, the owner of the bond from which the coupon has been detached. If the person presenting the coupon or on whose behalf it is presented is not the owner of the bond, Form 1001, and not Form 1001–NA, shall be executed.

(iii) *Disposition of form.*—The original and duplicate of Form 1001–NA shall be forwarded by the withholding agent to the District Director of Internal Revenue, Audit Division, Alien Returns Section, Baltimore 2, Maryland, with the quarterly return on Form 1012. Form 1001–NA need not be listed on Form 1012.

(2) *Interest on noncoupon bonds.*—(i) *Notification by letter.*—To avoid withholding of United States tax at source in the case of noncoupon bond interest to which paragraph (b) of this section applies, the nonresident alien who is a resident of the Antilles, or the Antilles corporation, shall notify the withholding agent by letter in duplicate that the interest is exempt from United States tax under the provisions of Article VIII(1) of the convention. The letter of notification shall be signed by the owner of the interest, trustee, or agent and shall show the name and address of the obligor and the name and address of the owner of the interest. It shall contain a statement (*a*) that the owner is neither a citizen nor a resident of the United States but is a resident of the Antilles, or, in the case of a corporation, that the owner is an Antilles corporation, (*b*) that the owner has at no time during the current taxable year engaged in trade or business within the United States through a permanent establishment situated therein, and, in the case of interest paid by a domestic corporation to an Antilles corporation, (*c*) that the owner does not control, directly or indirectly, more than 50 percent of the entire voting power of all classes of stock of the United States domestic corporation. If there is uncertainty as to the degree of stock ownership, see paragraph (e) of this section.

(ii) *Use of letter for release of tax.*—If the letter is also to be used as authorization for the release, pursuant to § 505.208(a) (5) and (6), of excess tax withheld from interest, it shall also contain a statement (*a*) that, at the time when the interest was derived from which the excess tax was withheld, the owner was neither a citizen nor a resident of the United States but was a resident of the Antilles, or, in the case of a corporation, the owner was an Antilles corporation, (*b*) that the owner at no time during the taxable year in which the interest

was derived was engaged in trade or business within the United States through a permanent establishment situated therein, and, in the case of interest paid by a domestic corporation to an Antilles corporation, (*c*) that the owner did not control, directly or indirectly, at the time when the interest was paid, more than 50 percent of the entire voting power of all classes of stock of the United States domestic corporation.

(iii) *Manner of filing letter.*—The letter of notification, which shall constitute authorization for the payment of the interest without withholding of United States tax at source, shall be filed with the withholding agent for each successive three-calendar-year period during which the interest is paid. For this purpose, the first period shall commence with the beginning of the calendar year in which the interest is first paid on or after January 1, 1955. Each letter filed with any withholding agent shall be filed not later than 20 days preceding the date of the first payment within each successive period, or, if that is not possible because of special circumstances, as soon as possible after such first payment. Once a letter has been filed in respect of any three-calendar-year period, no additional letter need be filed in respect thereto unless the Commissioner of Internal Revenue notifies the withholding agent that an additional letter shall be filed by the taxpayer. If, after filing a letter of notification, the taxpayer ceases to be eligible for the exemption from United States tax granted by Article VIII(1) of the convention, he shall promptly notify the withholding agent by letter in duplicate. When any change occurs in the ownership of the interest as recorded on the books of the payer, the exemption from withholding of United States tax shall no longer apply unless the new owner of record is entitled to and does properly file a letter of notification with the withholding agent.

(iv) *Disposition of letter.*—Each letter of notification, or the duplicate thereof, shall be immediately forwarded by the withholding agent to the District Director of Internal Revenue, Audit Division, Alien Returns Section, Baltimore 2, Maryland.

(e) *Interest paid by domestic subsidiary where degree of stock ownership is uncertain.*—(1) *Request for ruling in case of anticipated payments.*—If an Antilles corporation anticipates the receipt of interest from a domestic corporation and the relationship existing between the Antilles corporation and the domestic corporation is such as to render uncertain whether, by reason of the exception contained in Article VIII (1) of the convention, the exemption will apply, the Antilles corporation shall not file Form 1001–NA or the letter of notification prescribed by paragraph (d) of this section unless it has, prior to such filing, applied for and received from the Commissioner of Internal Revenue, Washington 25, D. C., a determination that it does not control, directly or indirectly, more than 50 percent of the entire voting power in the paying corporation. The application to the Commissioner shall contain a full statement of all the facts pertinent to a determination of the question.

(2) *Notification of taxpayer.*—As soon as practicable after the application has been filed, the Commissioner of Internal Revenue will determine whether the Antilles corporation has such control of the domestic corporation as to render the exemption granted by Article VIII (1) of the convention inapplicable to interest paid by the domestic corporation to the Antilles corporation and shall notify the Antilles

corporation of his determination. The Antilles corporation shall forthwith file with the domestic corporation a copy of the Commissioner's letter of notification.

(3) *Period during which determination is effective.*—A determination of the Commissioner that the Antilles corporation does not have such control of the domestic corporation as to render the exemption granted by Article VIII (1) of the convention inapplicable will apply until such time as the stock ownership of the domestic corporation has changed to the extent that interest to be received from the domestic corporation by the Antilles corporation is no longer exempt from United States tax under that article. If such a change in stock ownership occurs, the Antilles corporation shall promptly notify both the Commissioner of Internal Revenue and the domestic corporation.

(4) *Exemption from withholding of United States tax.*—If the Commissioner's determination is that the Antilles corporation does not control, directly or indirectly, more than 50 percent of the entire voting power of all classes of stock of the domestic corporation, the Antilles corporation may thereafter avoid withholding of tax at the source with respect to subsequent payments of interest by complying with the provisions of paragraph (d) of this section, that is, by submitting Form 1001–NA in the case of coupon bond interest, or the letter of notification in the case of interest on noncoupon bonds.

(5) *Prior payments.*—If an Antilles corporation has received on or after January 1, 1955, interest from a domestic corporation and the relationship existing between the Antilles corporation and the domestic corporation was at the time the interest was paid such as to render uncertain whether, by reason of the exception contained in Article VIII (1) of the convention, the interest was exempt from United States tax, the Antilles corporation shall apply to the Commissioner of Internal Revenue for a determination as to the degree of control at the time the interest was paid. If the Commissioner's determination is that at such time the degree of control was such as to permit the application of the exemption granted by Article VIII (1) of the convention, his letter of notification may, subject to the provisions of § 505.208 (a) (5), authorize the release of excess tax withheld from the exempt interest.

§ 505.205 PATENT AND COPYRIGHT ROYALTIES.—(a) *Exemption from tax.*—Royalties for the right to use copyrights, patents, designs, secret processes and formulae, trade marks, and other analogous property, and royalties and rentals in respect of motion picture films or for the use of industrial, commercial, or scientific equipment, which are derived from sources within the United Sates on or after January 1, 1955, by a nonresident alien individual who is a resident of the Antilles, or by an Antilles corporation, are exempt from United States tax under the provisions of Article IX of the convention if such alien or corporation at no time during the taxable year in which such income is derived has engaged in trade or business within the United States through a permanent establishment situated therein.

(b) *Exemption from withholding of United States tax.*—(1) *Notification by letter.*—To avoid withholding of United Sates tax at source in the case of the items of income to which this section applies, the nonresident alien who is a resident of the Antilles, or the Antilles corporation, shall notify the withholding agent by letter in duplicate

that the income is exempt from the United States tax under the provisions of Article IX of the convention.

(2) *Manner of filing letter.*—The provisions of § 505.204(d)(2) (other than those pertaining to the degree of control of voting power) relating to the execution, filing, effective period, and disposition of the letter of notification prescribed therein, including its use for the release of excess tax withheld, are equally applicable with respect to the income falling within the scope of this section.

§ 505.206 PRIVATE PENSIONS AND LIFE ANNUITIES.—(a) *Exemption from tax.*—Private pensions and life annuities, as defined in paragraph (c) of this section, derived from sources within the United States on or after January 1, 1955, and paid to a nonresident alien individual who is a resident of the Antilles are exempt from United States tax under the provisions of Article XV (2) of the convention.

(b) *Exemption from withholding of United States tax.*—(1) *Notification by letter.*—To avoid withholding of United States tax at source in the case of the items of income to which this section applies, the nonresident alien individual who is a resident of the Antilles shall notify the withholding agent by letter in duplicate that the income is exempt from United States tax under the provisions of Article XV (2) of the convention. The letter of notification shall be signed by the owner of the income, shall show the name and address of both the payer and the owner of the income, and shall contain a statement that the owner, an individual, is neither a citizen nor a resident of the United States but is a resident of the Antilles.

(2) *Use of letter for release of tax.*—If the letter is also to be used as authorization for the release, pursuant to § 505.208(a)(6), of excess tax withheld from such items of income, it shall also contain a statement that the owner was, at the time when the income was derived from which the excess tax was withheld, neither a citizen nor a resident of the United States but was a resident of the Antilles.

(3) *Manner of filing letter.*—The letter of notification shall constitute authorization for the payment of such items of income without withholding of United States tax at source unless the Commissioner of Internal Revenue subsequently notifies the withholding agent that the tax shall be withheld with respect to payments of such items of income made after receipt of such notice. If, after filing a letter of notification, the owner of the income ceases to be eligible for the exemption from United States tax granted by the convention in respect to such income, he shall promptly notify the withholding agent by letter in duplicate. When any change occurs in the ownership of the income as recorded on the books of the payer, the exemption from withholding of United States tax shall no longer apply unless the new owner of record is entitled to and does properly file a letter of notification with the withholding agent.

(4) *Disposition of letter.*—Each letter of notification, or the duplicate thereof, shall be immediately forwarded by the withholding agent to the District Director of Internal Revenue, Audit Division, Alien Returns Section, Baltimore 2, Maryland.

(c) *Definitions.*—As used in this section, the term "pensions" means periodic payments made in consideration for services rendered or by way of compensation for injuries received, and the term "life annuities" means a stated sum payable periodically at stated times during

life, or during a specified number of years, under an obligation to make the payments in return for adequate and full consideration in money or money's worth. Neither term includes retired pay or pensions paid by the United States or by any State or Territory of the United States.

§ 505.207 Beneficiaries of a Domestic Estate or Trust.—(a) *Entitled to benefits of convention.*—If he otherwise satisfies the requirements of the respective articles concerned, a nonresident alien individual who is a resident of the Antilles and who is a beneficiary of a domestic estate or trust shall be entitled to the exemption from, or reduction in the rate of, United States tax granted by Articles VII, VIII, IX, and XII of the convention with respect to dividends, interest, and patent royalties and other like amounts, to the extent that (1) any amount paid, credited, or required to be distributed by such estate or trust to such beneficiary is deemed to consist of such items, and (2) such items would, without regard to the convention, be includible in his gross income.

(b) *Withholding of United States tax.*—In order to be entitled in such instance to the exemption from, or reduction in rate of, withholding of United States tax the beneficiary must otherwise satisfy such requirements and shall, where applicable, execute and submit to the fiduciary of the estate or trust in the United States the appropriate letter of notification prescribed in §§ 505.204(d)(2) and 505.205(b).

(c) *Amounts otherwise includible in gross income of beneficiary.*—For the determination of amounts which, without regard to the convention, are includible in the gross income of the beneficiary, see subchapter J or chapter 1 of the Internal Revenue Code of 1954, and the regulations thereunder.

§ 505.208 Release of Excess Tax Withheld at Source.—(a) *Amounts to be released.*—(1) *Dividends derived from domestic corporation.*—If United States tax has been withheld at the statutory rate on or after January 1, 1955, from dividends described in § 505.202(b) and derived from a domestic corporation by a nonresident alien (including a nonresident alien individual, fiduciary, and partnership) or by a foreign corporation, whose address at the time of payment was in the Antilles, the withholding agent shall release and pay over to the person from whom the tax was withheld an amount which is equal to the difference between the tax so withheld and the tax required to be withheld pursuant to § 505.202(e)(1).

(2) *Dividends derived from a domestic subsidiary.*—If United States tax has been withheld at the statutory rate on or after January 1, 1955, from dividends which fall within the scope of the proviso of Article VII(1) of the convention, the withholding agent shall, if so authorized in accordance with § 505.202(c)(3), release and pay over to the corporation from which the tax was withheld an amount which is equal to the difference between the tax so withheld and the tax required to be withheld pursuant to § 505.202(e)(2).

(3) *Dividends and interest paid by Antilles corporation.*—If United States tax has been withheld at the statutory rate on or after January 1, 1955, from dividends and interest paid by an Antilles corporation to a recipient other than a citizen, resident, or corporation of

the United States, the withholding agent shall release and pay over to the person from whom the tax was withheld an amount which is equal to the tax so withhheld.

(4) *Coupon bond interest.*—(i) *Substitute form.*—In the case of every taxpayer who furnishes to the withholding agent Form 1001–NA clearly marked "Substitute" and executed in accordance with § 505.204(d) (1) (i), where United States tax has been withheld at the statutory rate on or after January 1, 1955, from coupon bond interest, the withholding agent shall release (except as provided in subparagraphs (3) and (5) of this paragraph) and pay over to the person from whom the tax was withheld an amount which is equal to the tax so withheld, if the taxpayer also attaches to such form a letter in duplicate, signed by the owner, trustee, or agent and containing the following:

(*a*) The name and address of the obligor;

(*b*) The name and address of the owner of the interest from which the excess tax was withheld;

(*c*) A statement that, at the time when the interest was derived from which the excess tax was withheld, the owner was neither a citizen nor a resident of the United States but was a resident of the Antilles, or, in the case of a corporation, the owner was an Antilles corporation;

(*d*) A statement that the owner at no time during the taxable year in which the interest was derived was engaged in trade or business within the United States through a permanent establishment situated therein; and

(*e*) In the case of interest paid by a domestic corporation to an Antilles corporation, a statement that the owner did not control, directly or indirectly, at the time when the interest was paid, more than 50 percent of the entire voting power of all classes of stock of the United States domestic corporation.

One such substitute form shall be filed in duplicate with respect to each issue of bonds and will serve with respect to that issue to replace all Forms 1001 previously filed by the taxpayer in the calendar year in which the excess tax was withheld and with respect to which such excess is released.

(ii) *Disposition of form.*—The original and duplicate of substitute Form 1001–NA (and letter) shall be forwarded by the withholding agent to the District Director of Internal Revenue, Audit Division, Alien Returns Section, Baltimore 2, Maryland, with the quarterly return on Form 1012. Substitute Form 1001–NA need not be listed on Form 1012.

(5) *Interest paid where degree of stock ownership is determined.*—If United States tax has been withheld at the statutory rate on or after January 1, 1955, from interest paid by a domestic corporation to an Antilles corporation, and if the relationship existing between the Antilles corporation and the domestic corporation was, at the time the interest was paid, such as to render uncertain whether, by reason of the exception contained in Article VIII (1) of the convention, the interest was exempt from United States tax, the withholding agent shall release and pay over to the Antilles corporation an amount which is equal to the tax so withheld, provided that the Antilles corporation (i) furnishes to the domestic corporation a copy

of the Commissioner's authorization of release prescribed in § 505.204(e)(5) and (ii) files the letter of notification prescribed in § 505.204(d)(2)(ii), or the substitute Form 1001-NA prescribed in subparagraph (4) of this paragraph, whichever is applicable.

(6) *Interest on noncoupon bonds, royalties, private pensions, and life annuities.*—If a taxpayer furnishes to the withholding agent the authorization of release prescribed in §§ 505.204(d)(2)(ii), 505.205(b)(2), or 505.206(b)(2) and United States tax has been withheld at the statutory rate on or after January 1, 1955, from the interest, copyright royalties or other like amounts, private pensions, or life annuities in respect of which such authorization is prescribed, the withholding agent shall release (except as provided in subparagraph (5) of this paragraph) any pay over to the person from whom the tax was withheld an amount which is equal to the tax so withheld.

(b) *Amounts not to be released.*—The provisions of this section do not apply to excess tax withheld at source which has been paid by the withholding agent to the district director of internal revenue.

(c) *Statutory rate.*—As used in this section, the term "statutory rate" means the rate prescribed by chapter 3 of the Internal Revenue Code of 1954 and the regulations thereunder, as though the convention had not come into effect.

§ 505.209 Information To Be Furnished in Ordinary Course.—(a) *Documents to the Antilles.*—In compliance with the provisions of Article XXI of the convention, the Commissioner of Internal Revenue will transmit to the Administrateur van Financien of the Netherlands Antilles, as soon as practicable after the close of the calendar year 1955 and of each subsequent calendar year during which the convention is in effect, the following information relating to such preceding calendar year:

(1) The duplicate copy of each available Form 1042 Supplement filed pursuant to paragraph (b) of this section; and

(2) The duplicate copy of each available ownership certificate, Form 1001-NA, filed pursuant to § 505.204(d)(1), and substitute Form 1001-NA, filed pursuant to § 505.208(a)(4) and (5), in connection with coupon bond interest.

(b) *Information return by withholding agent.*—(1) *Form to use.*—To facilitate compliance with Article XXI of the convention, every United States withholding agent shall make and file in duplicate with the District Director of Internal Revenue, Baltimore 2, Maryland, an information return on Form 1042 Supplement, with respect to persons having addresses in the Antilles, which shall be filed for the calendar year 1956 and subsequent calendar years. This return shall be filed simultaneously with Form 1042.

(2) *Information to be given.*—There shall be reported on such Form 1042 Supplement all items of fixed or determinable annual or periodical income (and amounts described in section 402(a)(2), section 631(b) and (c), and section 1235 of the Internal Revenue Code of 1954, which are considered to be gains from the sale or exchange of capital assets) derived from sources within the United States and paid to nonresident aliens (including nonresident alien individuals, fiduciaries, and partnerships) and to nonresident foreign corporations, whose addresses at the time of payment were in the Antilles, including such items of income upon which, in accordance with this Treasury

decision, no withholding of United States tax is required; except that any of such items which constitutes interest in respect of which Form 1001–NA or substitute Form 1001–NA has been filed in duplicate with the withholding agent is not required to be reported on such Form 1042 Supplement.

§ 505.210 *Effective Date.*—(a) *Payments on or after January 1, 1955.*—In order to give the convention effective application at the earliest practicable date, the exemptions from, and reductions in the rate of, withholding of United States tax at source granted by this Treasury decision are hereby made effective beginning January 1, 1955, contingent upon compliance with the applicable provisions hereof.

(b) *Taxable years beginning in 1954 and ending in 1955.*—If, in the case of a taxable year beginning in 1954 and ending in 1955, a taxpayer is not engaged in trade or business in the United States through a permanent establishment at any time during that part of the taxable year which follows December 31, 1954, then he shall, for purposes of this Treasury decision, be deemed not to have been engaged in trade or business within the United States at any time during the taxable year through a permanent establishment situated therein.

Because it is necessary to bring into effect at the earliest practicable date the rules of this Treasury decision respecting release of excess tax withheld, and exemption from, or reduction in the rate of, withholding of tax, it is hereby found that it is impracticable to issue this Treasury decision with notice and public procedure thereon under section 4(a) of the Administrative Procedure Act, approved June 11, 1946, or subject to the effective date limitation of section 4(c) of that Act.

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

O. Gordon Delk,
Acting Commissioner of Internal Revenue.

Approved December 5, 1955.

H. Chapman Rose,
Acting Secretary of the Treasury.

(Filed by the Division of the Federal Register December 8, 1955, 8:45 a. m.)

UNITED STATES–KINGDOM OF NORWAY INCOME TAX CONVENTION

T. D. 6150 [1]

TITLE 26—INTERNAL REVENUE, 1954.—CHAPTER I, SUBCHAPTER G, PART 510.—NORWAY

General regulations under the income tax convention between the United States and the Kingdom of Norway, proclaimed by the President of the United States on December 13, 1951, subject to the protocol of exchange signed on December 11, 1951.

[1] 20 F. R. 7595.

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

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

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510.109 Patent and copyright royalties and film rentals.
510.110 Real property income and natural resource royalties.
510.111 Compensation for labor or personal services.
510.112 Government wages, salaries, and pensions.
510.113 Private pensions and life annuities.
510.114 Visiting professors or teachers.
510.115 Students or apprentices.
510.116 Credit against United States tax for Norwegian tax.
510.117 Exchange of information.
510.118 Double taxation claims.
510.119 Beneficiaries of an estate or trust.
510.120 Norwegian partnerships.

AUTHORITY: Sections 510.101 to 510.120, inclusive, are issued under the authority contained in 68A Stat. 917 (26 U. S. C. 7805) and in Article XXI, 2 UST[1] 2332.

On June 16, 1955, notice of proposed rulemaking regarding the general regulations under the income tax convention between the United States and the Kingdom of Norway, proclaimed by the President of the United States on December 13, 1951, was published in the Federal Register (20 F. R. 4219). No objections to the regulations proposed having been received during the 30-day period prescribed in the notice, the regulations set forth below are hereby adopted:

§ 510.101. INTRODUCTORY.—The income tax convention between the United States and the Kingdom of Norway, signed June 13, 1949, and proclaimed by the President of the United States on December 13, 1951, subject to the understanding expressed in the protocol of exchange, hereinafter referred to as the convention, provides as follows, effective for taxable years beginning on or after January 1, 1951:

ARTICLE I

(1) The taxes referred to in this Convention are:
(a) In the case of the United States of America:
The Federal income tax, including surtaxes.
(b) In the case of Norway:
The national and the communal income taxes, including the old age pension tax, the war pension tax, the tax on bank deposits and the seamen's tax.
(2) The present Convention shall also apply to any other income taxes of a substantially similar character imposed by either contracting State subsequently to the date of signature of the present Convention.

ARTICLE II

(1) As used in this Convention:
(a) The term "United States" means the United States of America, and when used in a geographical sense includes only the States, the Territories of Alaska and Hawaii, and the District of Columbia.

[1] UST—United States Treaties and Other International Agreements.

(b) The term "Norway" means the Kingdom of Norway; the provisions of the Convention shall not, however, extend to Svalbard and Jan Mayen, nor do they apply to the Norwegian dependencies outside Europe.

(c) The term "permanent establishment" means a branch office, factory, workshop, warehouse or other fixed place of business, but does not include the casual and temporary use of merely storage facilities, nor does it include an agency unless the agent has and exercises a general authority to negotiate and conclude contracts on behalf of an enterprise or has a stock of merchandise from which he regularly fills orders on its behalf. An enterprise of one of the contracting States shall not be deemed to have a permanent establishment in the other State merely because it carries on business dealings in such other State through a *bona fide* commission agent, broker or custodian acting in the ordinary course of his business as such. The fact that an enterprise of one of the contracting States maintains in the other State a fixed place of business exclusively for the purchase of goods or merchandise shall not of itself constitute such fixed place of business a permanent establishment of such enterprise. The fact that a corporation of one contracting State has a subsidiary corporation which is a corporation of the other State or which is engaged in trade or business in the other State shall not of itself constitute that subsidiary corporation a permanent establishment of its parent corporation.

(d) The term "enterprise of one of the contracting States" means, as the case may be, "United States enterprise" or "Norwegian enterprise".

(e) The term "enterprise" includes every form of undertaking whether carried on by an individual, partnership, corporation, or any other entity.

(f) The term "United States enterprise" means an enterprise carried on in the United States by a resident of the United States or by a United States corporation or other entity; the term "United States corporation or other entity" means a partnership, corporation or other entity created or organized in the United States or under the law of the United States or of any State or Territory of the United States.

(g) The term "Norwegian enterprise" means an enterprise carried on in Norway by a resident of Norway or by a Norwegian corporation or other entity; the term "Norwegian corporation or other entity" means a partnership, corporation or other entity created or organized in Norway or under Norwegian laws.

(h) The term "competent authorities" means, in the case of the United States, the Commissioner of Internal Revenue or his authorized representative; and in the case of Norway, the Ministry of Finance and Customs.

(2) In the application of the provisions of the present Convention by one of the contracting States any term not otherwise defined shall, unless the context otherwise requires, have the meaning which such term has under its own tax laws.

ARTICLE III

(1) An enterprise of one of the contracting States shall not be subject to taxation in the other contracting State in respect of its industrial and commercial profits unless it is engaged in trade or business in such other State through a permanent establishment situated therein. If it is so engaged such other State may impose its tax upon such profits of the enterprise from sources within such other State.

(2) In determining the industrial or commercial profits from sources within the territory of one of the contracting States of an enterprise of the other contracting State, no profits shall be deemed to arise from the mere purchase of goods or merchandise within the territory of the former contracting State by such enterprise.

(3) Where an enterprise of one of the contracting States is engaged in trade or business in the territory of the other contracting State through a permanent establishment situated therein, there shall be attributed to such permanent establishment the industrial or commercial profits which it might be expected to derive if it were an independent enterprise engaged in the same or similar activities under the same or similar conditions and dealing at arm's length with the enterprise of which it is a permanent establishment and the profits so attributed shall, subject to the law of such other contracting State, be deemed to be income from sources within the territory of such other contracting State.

(4) The competent authorities of the two contracting States may lay down rules by agreement for the apportionment of industrial and commercial profits.

ARTICLE IV

Where an enterprise of one of the contracting States, by reason of its participation in the management or the financial structure of an enterprise of the other contracting State, makes with or imposes on the latter, in their commercial or financial relations, conditions different from those which would be made with an independent enterprise, any profits which would normally have accrued to one of the enterprises, but by reason of those conditions have not so accrued, may be included in the profits of that enterprise and taxed accordingly.

ARTICLE V

(1) Income which an enterprise of one of the contracting States derives from the operation of ships or aircraft shall be exempt from taxation in the other contracting State.

(2) The provisions of this Article shall be deemed to suspend the arrangement between the United States and Norway providing for relief from double income taxation on shipping profits, effected by exchanges of notes dated November 26, 1924, January 23, 1925, and March 24, 1925.

ARTICLE VI

Interest on bonds, securities, notes, debentures, or on any other form of indebtedness derived from sources within one of the contracting States by a resident or corporation or other entity of the other contracting State not having a permanent establishment in the former State shall be exempt from taxation in such former Sate.

ARTICLE VII

Royalties and other amounts derived, as consideration for the right to use copyrights, artistic and scientific works, patents, designs, secret processes and formulas, trade-marks and other like property (including rentals and like payments in respect of motion picture films), from sources within one of the contracting States by a resident or corporation or other entity of the other contracting State not having a permanent establishment in the former State shall be exempt from taxation in such former State: Provided, That each of the contracting States reserves the right according to the principles of Article IV to deny a deduction to the payor thereof for such royalty or any portion thereof as is not considered by the revenue authorities of such State to be reasonable consideration for the right to use the property referred to in this Article.

ARTICLE VIII

(1) Income from real property (not including interest derived from mortgages and bonds secured by real property) and royalties in respect of the operation of mines, quarries, or other natural resources, shall be taxable only in the contracting State in which such property, mines, quarries, or other natural resources are situated.

(2) A resident or corporation of one of the contracting States deriving any such income from sources within the other contracting State may, for any taxable year, elect to be subject to the tax of such other contracting State, on a net basis, as if such resident or corporation were engaged in trade or business within such other contracting State through a permanent establishment therein during such taxable year.

ARTICLE IX

Gains derived from the sale or exchange of real property shall be taxable only in the contracting State in which such property is situated.

ARTICLE X

(1) A resident of Norway shall be exempt from United States tax upon compensation for labor or personal services (including the practice of the liberal and artistic professions) if he is temporarily present in the United States for a period or periods not exceeding a total of 183 days during the taxable year and either of the following conditions is met:

(a) his compensation is received for labor or personal services performed as an employee, or under contract with, a resident, or corporation or other entity of Norway, or

(b) his compensation received for labor or personal services does not exceed $10,000.

(2) The provisions of paragraph (1) of this Article shall apply *mutatis mutandis*, to a resident of the United States with respect to compensation for such labor or personal services performed in Norway.

(3) The provisions of paragraphs (1) and (2) of this Article shall have application to directors' fees representing reasonable compensation for services rendered whether or not the recipient of such fees has been present at any time during the taxable year in the contracting State from which payment of such fees has been made.

(4) The provisions of this Article shall have no application to the income to which Article XI (1) relates.

ARTICLE XI

(1) (a) Wages, salaries and similar compensation, and pensions paid by the United States or by the political subdivisions or territories thereof to an individual (other than a Norwegian citizen who is not also a citizen of the United States) shall be exempt from Norwegian tax.

(b) Wages, salaries and similar compensation, and pensions paid either directly by, or from funds or institutions created by, Norway or Norwegian communities or counties (fylker) to an individual (other than a United States citizen who is not also a citizen of Norway) shall be exempt from United States tax.

(2) Private pensions and life annuities derived from within one of the contracting States and paid to individuals residing in the other contracting State shall be exempt from taxation in the former State.

(3) The term "pensions", as used in this Article, means periodic payments made in consideration for services rendered or by way of compensation for injuries received.

(4) The term "life annuities" as used in this Article means a stated sum payable periodically at stated times during life, or during a specified number of years, under an obligation to make the payments in return for adequate and full consideration in money or moneys' worth.

ARTICLE XII

A professor or teacher, a resident of one of the contracting States, who temporarily visits the other contracting State for the purpose of teaching for a period not exceeding two years at a university, college, school or other educational institution in the other contracting State, shall be exempted in such other contracting State from tax on his remuneration for such teaching for such period.

ARTICLE XIII

A student or apprentice, a resident of one of the contracting States, who temporarily visits the other contracting State exclusively for the purposes of study or for acquiring business or technical experience shall not be taxable in the latter State in respect of remittances received by him from abroad for the purposes of his maintenance or studies.

ARTICLE XIV

(1) It is agreed that double taxation shall be avoided in the following manner:

(a) The United States in determining its taxes specified in Article I of this Convention in the case of its citizens, residents or corporations may, regardless of any other provision of this Convention, include in the basis upon which such taxes are imposed all items of income taxable under the revenue laws of the United States as if this Convention had not come into effect. The United States shall, however, subject to the provisions of section 131, Internal Revenue Code, as in effect on the date of the entry into force of this Convention, deduct from its taxes the amount of Norwegian taxes specified in Article I of this Convention.

(b) Norway in determining its taxes specified in Article I of this Convention in the case of its residents or corporations may, regardless of any other provision of this Convention, include in the basis upon which such taxes are imposed all items of income taxable under the revenue laws of Norway as if the Convention had not come into effect. Norway shall, however, deduct from the taxes so calculated that portion of such tax liability which the taxpayer's income from sources in the United States (not exempt from United States tax under this Convention) bears to his entire income. The competent authority of Norway may, however, decide that the deduction shall not exceed the United States tax on income taxable in the United States.

(2) The provisions of this Article shall not be construed to deny the exemptions from United States tax or Norwegian tax, as the case may be, granted by Article XI (1) of this Convention.

ARTICLE XV

With a view to the more effective imposition of the taxes to which the present Convention relates, each of the contracting States undertakes, subject to reciprocity, to furnish such information in the matter of taxation, which the authorities of the State concerned have at their disposal or are in a position to obtain under their own law, as may be of use to the authorities of the other State in the assessment of the taxes in question and to lend assistance in the service of documents in connection therewith. Any information so exchanged shall be treated as secret and shall only be disclosed to persons (including a court) concerned with the assessment, determination and collection of the taxes which are the subject of the present Convention, or the determination of appeals in relation thereto. No information shall be exchanged which would disclose a trade, business, industrial or professional secret. Information and correspondence relating to the subject matter of this Article shall be exchanged between the competent authorities of the contracting States in the ordinary course or on request.

ARTICLE XVI

In accordance with the preceding Article and insofar as may be found to be practicable, the competent authorities of each contracting State shall forward to the competent authorities of the other contracting State as soon as practicable after the close of each calendar year the following information relating to such calendar year:

The names and addresses of all addressees within such other State deriving from sources within the former State dividends, interest, royalties, pensions, annuities, wages, salaries, rents, or other fixed or determinable annual or periodical income, showing the amount of such income with respect to each addressee.

ARTICLE XVII

(1) The contracting States undertake to lend assistance and support to each other in the collection of the taxes which are the subject of the present Convention, together with interest, costs, and additions to the taxes.

(2) In the case of applications for enforcement of taxes, revenue claims of each of the contracting States which have been finally determined may be accepted for enforcement by the other contracting State and may be collected in that State in accordance with the laws applicable to the enforcement and collection of its own taxes.

(3) Any application shall include a certification that under the laws of the State making the application the taxes have been finally determined.

(4) The assistance provided for in this Article shall not be accorded with respect to the citizens, corporations, or other entities of the State to which application is made.

ARTICLE XVIII

The State to which application is made for information or assistance shall comply as soon as possible with the request addressed to it except that such State may refuse to comply with the request for reasons of public policy or if compliance would involve violation of a trade, business, industrial or professional secret.

ARTICLE XIX

Where a taxpayer shows proof that the action of the revenue authorities of the contracting States has resulted, or will result, in double taxation contrary to the provisions of the present Convention, he shall be entitled to lodge a claim with the State of which he is a citizen or, if he is not a citizen of either of the contracting States, with the State of which he is a resident, or, if the taxpayer is a corporation or other entity, with the State in which it is created or organized. Should the claim be upheld, the competent authority of such State shall undertake to come to an agreement with the competent authority of the other State with a view to equitable avoidance of the double taxation in question.

ARTICLE XX

(1) The provisions of this Convention shall not be construed to deny or affect in any manner the right of diplomatic and consular officers to other or additional exemptions now enjoyed or which may hereafter be granted to such officers.

(2) The provisions of the present Convention shall not be construed to restrict in any manner any exemption, deduction, credit or other allowance now or hereafter accorded by the laws of one of the contracting States in the determination of the tax imposed by such State.

(3) Should any difficulty or doubt arise as to the interpretation or application of the present Convention, or its relationship to Conventions between one of the contracting States and any other State, the competent authorities of the contracting States may settle the question by mutual agreement.

ARTICLE XXI

(1) The competent authorities of the two contracting States may prescribe regulations necessary to carry into effect the present Convention within the respective States. With respect to the provisions of this Convention relating to exchange of information, service of documents, and mutual assistance in the collection of taxes, such authorities may, by common agreement, prescribe rules concerning matters of procedure, forms of application and replies thereto, conversion of currency, disposition of amounts collected, costs of collection, minimum amounts subject to collection and related matters.

(2) The competent authorities of the two contracting States may communicate with each other directly for the purpose of giving effect to the provisions of this Convention.

ARTICLE XXII

(1) The present Convention shall be ratified and the instruments of ratification shall be exchanged at Washington as soon as possible. It shall have effect for the taxable years beginning on or after the first day of January of the year in which such exchange takes place.

(2) The present Convention shall continue effective for a period of five years and indefinitely after that period, but may be terminated by either of the contracting States at the end of the five-year period or at any time thereafter, provided that at least six months' prior notice of termination has been given and, in such event, the present Convention shall cease to be effective for the taxable years beginning on or after the first day of January next following the expiration of the six-month period.

DONE at Washington, in duplicate, in the English and Norwegian languages, the two texts having equal authenticity, this thirteenth day of June, 1949.

For the President of the United States of America:

[SEAL] JAMES E. WEBB

For his Majesty the King of Norway:

[SEAL] WILHELM MUNTHE MORGENSTIERNE

PROCLAMATION OF THE PRESIDENT OF THE UNITED STATES DATED DECEMBER 13, 1951.

* * * * * * *

AND WHEREAS the Senate of the United States of America, by their resolution of September 17, 1951, two-thirds of the Senators present concurring therein, did advise and consent to the ratification of the aforesaid convention subject to an understanding as follows:

"It is understood that the application of Article XVII of the convention shall be confined and limited as granting authority to each Contracting State to collect only such taxes imposed by the other Contracting State as will insure that the exemption or reduced rate of tax granted under the present convention by such other State, shall not be enjoyed by persons not entitled to such benefits.";

And whereas the text of the aforesaid understanding was communicated by the Government of the United States of America to the Government of the Kingdom of Norway and the aforesaid understanding was accepted by the Government of the Kingdom of Norway;

And whereas the aforesaid convention was duly ratified by the President of the United States of America on November 26, 1951, in pursuance of the aforesaid advice and consent of the Senate and subject to the aforesaid understanding, and the aforesaid convention was duly ratified on the part of the Kingdom of Norway;

And whereas the respective instruments of ratification of the aforesaid convention were duly exchanged at Washington on December 11, 1951, and a protocol of exchange was signed at that place and on that date by the respective Plenipotentiaries of the United States of America and the Kingdom of Norway, the said protocol containing a statement that it is understood by the two Governments that, upon entry into force of the aforesaid convention in accordance with its provisions, Article XVII thereof shall be applied in accordance with the aforesaid understanding;

And whereas it is provided in Article XXII of the aforesaid convention that the convention shall have effect for the taxable years beginning on or after the first day of January of the year in which the exchange of instruments of ratification takes place;

Now, therefore, be it known that I, HARRY S. TRUMAN, President of the United States of America, do hereby proclaim and make public the aforesaid convention to the end that the said convention and each and every article and clause thereof, subject to the aforesaid understanding, may be observed and fulfilled with good faith by the United States of America and by the citizens of the United States of America and all other persons subject to the jurisdiction thereof.

* * * * * * *

§ 510.102 APPLICABLE PROVISIONS OF LAW—(a) *General.* The Internal Revenue Code of 1954 provides in part as follows:

SUBTITLE A—INCOME TAXES

* * * * * * *

SEC. 894. INCOME EXEMPT UNDER TREATY.

Income of any kind, to the extent required by any treaty obligation of the United States, shall not be included in gross income and shall be exempt from taxation under this subtitle.

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SUBTITLE F—PROCEDURE AND ADMINISTRATION

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SEC. 7805. RULES AND REGULATIONS.

(a) AUTHORIZATION.—Except where such authority is expressly given by this title to any person other than an officer or employee of the Treasury Department, the Secretary or his delegate shall prescribe all needful rules and regulations for the enforcement of this title, including all rules and regulations as may be necessary by reason of any alteration of law in relation to internal revenue.

(b) RETROACTIVITY OF REGULATIONS OR RULINGS.—The Secretary or his delegate may prescribe the extent, if any, to which any ruling or regulation, relating to the internal revenue laws, shall be applied without retroactive effect.

* * * * * * *

(b) *Internal Revenue Code of 1939.* Any reference in this Treasury decision to any provision of the Internal Revenue Code of 1954 shall, where applicable, be deemed also to refer to the corresponding provision of the Internal Revenue Code of 1939.

(c) *Effective date of regulations.*—Pursuant to sections 894 and 7805 of the Internal Revenue Code of 1954, Article XXI of the convention, and other provisions of the internal revenue laws, this Treasury decision, which is designated as §§ 510.101 through 510.120 of Chapter 1, Title 26, Code of Federal Regulations, is hereby prescribed effective for taxable years beginning on or after January 1, 1951. All regulations inconsistent herewith are modified accordingly.

§ 510.103 SCOPE OF THE CONVENTION—(a) *Purpose of convention.* The primary purposes of the convention, to be accomplished on a reciprocal basis, are to avoid double taxation upon certain items of income derived from sources within one country by residents or corporations or other entities of the other country and to provide for administrative cooperation between the competent tax authorities of the two countries looking to the avoidance of double taxation and the prevention of fiscal evasion.

(b) *Exemption from United States tax.*—The following items of income from sources within the United States are exempt from United States tax for taxable years beginning on or after January 1, 1951, subject to the respective articles of the convention:

(1) Industrial and commercial profits of a Norwegian enterprise having no permanent establishment in the United States (Article III);

(2) Income derived by a Norwegian enterprise from the operation of ships or aircraft (Article V);

(3) Interest derived by a nonresident alien who is a resident of Norway, or by a Norwegian corporation or other entity, if such alien, corporation, or other entity has no permanent establishment in the United States (Article VI);

(4) Patent and copyright royalties, and other like amounts, including motion picture film rentals, derived by a nonresident alien who is a resident of Norway, or by a Norwegian corporation or other entity, if such alien, corporation, or other entity has no permanent establishment in the United States (Article VII);

(5) Compensation, subject to certain limitations, for personal services performed in the United States by a nonresident alien individual who is a resident of Norway (Article X);

(6) Compensation and pensions paid by Norway to an alien individual, and to a citizen of Norway who is also a citizen of the United States, including such items as are from sources without the United States (Article XI);

(7) Private pensions and life annuities paid to a nonresident alien individual who is a resident of Norway (Article XI); and

(8) Remuneration derived from certain teaching in the United States by a professor or teacher who is a nonresident alien residing in Norway (Article XII).

(c) *Students or apprentices.*—Remittances received from abroad for the purpose of maintenance or studies by a student or apprentice, a nonresident alien residing in Norway, who is temporarily present in the United States under specified circumstances are also exempt from United States tax (Article XIII).

(d) *Withholding regulations.*—For regulations pertaining to the release or refund of excess tax withheld, and to exemption from withholding of United States tax at source, in the case of interest, patent and copyright royalties, film rentals, private pensions, and life annuities, received from sources within the United States by a nonresident alien who is a resident of Norway, or by a Norwegian corporation or other entity, see Treasury Decision 5956 [C. B. 1953–1, 228], approved December 9, 1952 [26 CFR (1939) 7.100 through 7.109].

(e) *United States citizens, residents, and corporations.*—(1) Any citizen of Norway who is a resident of the United States is liable to United States tax as though the convention had not come into effect; however, such alien resident of the United States is entitled to the foreign tax credit in accordance with Article XIV of the convention and is also entitled to the benefits of Article XI(1) and ArticleXX.

(2) A citizen of the United States, even though resident in Norway, or a domestic corporation, even though engaged in trade or business in Norway through a permanent establishment situated therein, is also liable to United States tax as though the convention had not come into effect but is entitled to the foreign tax credit and, to the extent applicable, to the benefits of Article XI(1).

(f) *Other provisions applicable to Norwegian residents and corporations.*—Except as otherwise expressly provided by the convention, the United States tax liability of a nonresident alien who is a resident of Norway, or of a Norwegian corporation or other entity, is determined in accordance with the provisions of the Internal Revenue Code of 1954 relating to nonresident alien individuals and foreign corporations.

§ 510.104 DEFINITIONS—(a) *General.*—Any term defined in the convention or this Treasury decision shall have the meaning so assigned to it; any term not so defined shall, unless the context otherwise requires, having the meaning which such term has under the internal revenue laws of the United States.

(b) *Specific terms.*—As used in this Treasury decision—

(1) *United States tax.*—The term "United States tax" means the Federal income tax, including surtaxes, of the United States and any other income tax of a substantially similar character imposed by the United States after June 13, 1949.

(2) *Norwegian tax.*—The term "Norwegian tax" means the national and the communal income taxes of Norway, including the old age pension tax, the war pension tax, the tax on bank deposits and the seamen's tax, and any other income tax of a substantially similar character imposed by Norway after June 13, 1949.

(3) *United States.*—The term "United States" means the United States of America; and, when used in a geographical sense, includes only the States, the Territories of Alaska and Hawaii, and the District of Columbia.

(4) *Norway.*—The term "Norway" means the Kingdom of Norway, but does not include Svalbard, Jan Mayen, or the Norwegian dependencies outside Europe.

(5) *Permanent establishment*—(i) *Fixed place of business.*—The term "permanent establishment" means a branch office, factory, workshop, warehouse, or other fixed place of business, but does not include the casual and temporary use of merely storage facilities. It implies the active conduct of a business enterprise. The mere ownership, for example, of timberlands or a warehouse in the United States by a Norwegian enterprise does not mean that such enterprise, in the absence of any business activity therein, has a permanent establishment in the United States. The fact that a Norwegian enterprise maintains in the United States an office or other fixed place of business used exclusively for the purchase for such enterprise of goods or merchandise shall not of itself constitute such fixed place of business a permanent establishment of such enterprise.

(ii) *Subsidiary corporation.*—The fact that a Norwegian corporation has a domestic subsidiary corporation, or a foreign subsidiary corporation which is engaged in trade or business in the United States through a permanent establishment situated therein, does not of itself constitute either subsidiary corporation the United States permanent establishment of the Norwegian parent corporation.

(iii) *Agency.*—A Norwegian enterprise which has an agency in the United States does not thereby have a permanent establishment in the United States, unless the agent has and exercises a general authority to negotiate and conclude contracts on behalf of such enterprise or unless he has a stock of merchandise from which he regularly fills orders on its behalf. If the enterprise has an agent in the United States who has power to contract on its behalf, but only at fixed prices and under conditions determined by such principal, it does not thereby necessarily have a permanent establishment in the United States. The mere fact that an agent of a Norwegian enterprise—assuming he has no general authority to negotiate and conclude contracts on behalf of his principal—maintains samples, or occasionally fills orders from incidental stocks of goods maintained, in the United States does not of itself mean that such enterprise has a permanent establishment in the United States. The mere fact that salesmen, employees of a Norwegian enterprise, promote the sale of their employer's products in the United States or that a Norwegian enterprise transacts business in the United States by means of mail order activities does not mean that such enterprise has a permanent establishment in the United States. A Norwegian enterprise shall not be deemed to have a permanent establishment in the United States merely because it carries on business dealings in the United States through a bona fide commission agent, broker, or custodian, acting in the ordinary course of his business as such.

(6) *Enterprise.*—The term "enterprise" means any commercial or industrial undertaking carried on by any person, for example, by an individual, partnership or corporation. It includes such

activities as manufacturing, merchandising, mining, processing, banking, and insuring. It does not include the rendition of personal services. Hence, a nonresident alien individual who is a resident of Norway and who performs personal services is not, merely by reason of such services, engaged in a Norwegian enterprise within the meaning of the convention; consequently, his liability to United States tax is not determined under Article III of the convention, if he has not otherwise carried on a Norwegian enterprise.

(7) *Norwegian enterprise.*—The term "Norwegian enterprise" means an enterprise carried on in Norway by a nonresident alien individual who is a resident of Norway, or by a Norwegian corporation or other entity. Thus, an enterprise carried on wholly outside Norway by a Norwegian corporation is not a Norwegian enterprise within the meaning of the convention.

(8) *Norwegian corporation or other entity.*—The term "Norwegian corporation or other entity" means a partnership, corporation, or other entity created or organized in Norway or under Norwegian laws.

(9) *United States enterprise.*—The term "United States enterprise" means an enterprise carried on in the United States by an individual who is a resident of the United States or by a United States corporation or other entity.

(10) *United States corporation or other entity.*—The term "United States corporation or other entity" means a partnership, corporation, or other entity created or organized in the United States or under the law of the United States or of any State or Territory of the United States.

(11) *Industrial and commercial profits.*—The term "industrial and commercial profits" means profits arising from industrial, commercial, mercantile, manufacturing, and like activities of an enterprise. It does not include dividends, interest, rents, royalties, or other mere investment income, or remuneration for personal services. In determining the industrial and commercial profits from sources within the United States of a Norwegian enterprise, no profits shall be deemed to arise from the mere purchase of goods or merchandise within the United States by such enterprise.

(12) *Commissioner.*—The term "Commissioner" means the Commissioner of Internal Revenue or his authorized representative.

(13) *Ministry of Finance and Customs.*—The term "Ministry of Finance and Customs" means the Ministry of Finance and Customs (Finans- og Tolldepartementet) of Norway.

§ 510.105 Industrial and Commercial Profits.—(a) *General.*—(1) Article III of the convention adopts the principle that an enterprise of one of the contracting States shall not be taxable by the other contracting State upon its industrial and commercial profits unless it is engaged in trade or business in the latter State through a permanent establishment situated therein. Accordingly, a Norwegian enterprise is subject to United States tax upon its industrial and commercial profits, to the extent of such profits from sources within the United States, only if it is engaged in trade or business in the United States at

some time during the taxable year through a permanent establishment situated therein.

(2) From the standpoint of the United States tax the article has application only to a Norwegian enterprise and its industrial and commercial profits from sources within the United States. Thus, a nonresident alien individual who is a citizen of Norway, or a Norwegian corporation or other entity, carrying on an enterprise which is not Norwegian, is subject to tax on such income of such enterprise pursuant to section 871(c) or section 882(a), Internal Revenue Code of 1954, if such alien, corporation, or other entity has engaged in trade or business in the United States at any time during the taxable year, even though it has not had a permanent establishment therein at any time within such year.

(b) *No United States permanent establishment.*—A Norwegian enterprise is not subject to United States tax upon its industrial and commercial profits from sources within the United States, nor shall such profits be included in gross income, if such enterprise at no time during the taxable year in which such profits are derived has engaged in trade or business in the United States through a permanent establishment situated therein. For example, if during the taxable year an enterprise carried on in Norway by a nonresident alien individual who is a resident of Norway, or by a Norwegian corporation, were to sell merchandise, such as textiles, furs, or canned fish products, in the United States through a bona fide commission agent or broker in the United States acting in the ordinary course of his business as such agent or broker, the profits arising from such sale would not be included in gross income and would be exempt from United States tax under Article III of the convention. Similarly, if during the taxable year such enterprise were to secure orders in the United States for such merchandise through its sales agents whose sole function in the United States is sales promotion, the orders being transmitted to Norway for acceptance, then the profits arising from such sales would not be included in gross income and would be exempt from United States tax.

(c) *United States permanent establishment*—(1) *General.*—A Norwegian enterprise is subject to United States tax upon its industrial and commercial profits from sources within the United States to the same extent as are nonresident aliens or foreign corporations which are subject to tax pursuant to section 871(c) or section 882(a), Internal Revenue Code of 1954, if such enterprise at any time during the taxable year in which such profits are derived has engaged in trade or business in the United States through a permanent establishment situated therein. If it is so engaged, it is subject to United States tax upon its entire income from sources within the United States except to the extent otherwise exempt from United States tax.

(2) *Allocation of profits.*—In the determination of the income taxable to such enterprise for purposes of the United States tax, all industrial and commercial profits from sources within the United States shall be deemed to be allocable to the permanent establishment in the United States. Hence, if a Norwegian enterprise which has a permanent establishment in the United States at some time during the taxable year were to sell in the United States, through a bona fide commission agent therein acting in the ordinary course of his

business as such, merchandise which has been produced in Norway, the profits arising from such sale would be allocable to the permanent establishment to the extent they are derived from sources within the United States, even though the sale is made independently of the permanent establishment.

(d) *Independent basis.*—The industrial and commercial profits of the permanent establishment in the United States shall be determined as if the establishment were an independent enterprise engaged in the same or similar activities under the same or similar conditions and dealing at arm's length, or on an independent basis, with the enterprise of which it is a permanent establishment. Any such profits so attributed to such permanent establishment shall, subject to the provisions of the Internal Revenue Code of 1954, be deemed to be income from sources within the United States.

§ 510.106 CONTROL OF A UNITED STATES ENTERPRISE BY A NORWEGIAN ENTERPRISE.—In effect, Article IV of the convention provides that, if a Norwegian enterprise by reason of its control of a United States enterprise imposes on the latter enterprise conditions different from those which would result from normal business relations between independent enterprises, the accounts between the enterprises shall be adjusted in order to ascertain the true taxable income of each enterprise. The purpose is to place the controlled United States enterprise on a tax parity with an uncontrolled United States enterprise by determining, according to the standard of an uncontrolled enterprise, the true taxable income from the property and business of the controlled enterprise. The basic objective of the article is that, if the accounting records do not truly reflect the taxable income from the property and business of the United States enterprise, the Commissioner shall intervene and, by making such distribution, apportionments, or allocations as he may deem necessary of gross income, deductions, credits, or allowances, or of any item or element affecting taxable income, between the United States enterprise and the Norwegian enterprise by which it is controlled or directed, shall determine the true taxable income of the United States enterprise. The provisions of section 482 of the Internal Revenue Code of 1954, and the regulations thereunder, shall, insofar as applicable, be followed in the determination of the taxable income of the United States enterprise.

§ 510.107 INCOME FROM OPERATION OF SHIPS OR AIRCRAFT—(a) *Exempt from tax.*—Under Article V of the convention so much of the income from sources within the United States of a Norwegian enterprise as consists of earnings derived from the operation of ships or aircraft, whether or not they are documented or registered in or under the laws of Norway, shall not be included in gross income and shall be exempt from United States tax, even though at some time during the taxable year such enterprise has engaged in trade or business in the United States through a permanent establishment situated therein.

(b) *Prior arrangement suspended.*—The provisions of Article V shall be deemed to suspend the arrangement between the United States and Norway providing for relief from double income taxation on shipping profits, effected by exchanges of notes dated November 26, 1924, January 23, 1925, and March 24, 1925 [Executive Agreement

Series, No. 15; 47 Stat. 2617]. Accordingly, while the provisions of Article V are in effect, no exemption from United States tax shall be accorded pursuant to, or by reason of, any agreement effected by the exchange of such notes. This paragraph shall not be construed, however, to restrict any exemption which, without reference to an exchange of notes, is accorded by section 872(b) and section 883 of the Internal Revenue Code of 1954. See Article XX(2) of the convention.

§ 510.108 INTEREST. (a) Interest on bonds, securities, notes, debentures, or on any other form of indebtedness, including interest on obligations of the United States, interest on obligations of instrumentalities of the United States, and interest on mortgages and bonds secured by real property, which is derived from sources within the United States by a nonresident alien individual who is a resident of Norway, or by a Norwegian corporation or other entity, shall not be included in gross income and shall be exempt from United States tax under the provisions of Article VI of the convention if such alien, corporation, or other entity at no time during the taxable year in which such interest is derived has a permanent establishment in the United States.

(b) If, for example, a nonresident alien individual who is a resident of Norway performs personal services within the United States during the taxable year, but has at no time during such year a permanent establishment within the United States, he is entitled to the exemption from United States tax with respect to interest derived in that year from United States sources, as provided in Article VI of the convention, even though under the provisions of section 871 (c) of the Internal Revenue Code of 1954 he has engaged in trade or business within the United States during such year by reason of his having performed personal services therein.

§ 510.109 PATENT AND COPYRIGHT ROYALTIES AND FILM RENTALS—(a) *General.*—Royalties, and other amounts, representing consideration for the right to use copyrights, artistic and scientific works, patents, designs, secret processes and formulas, trade-marks, and other like property, including rentals and like payments in respect of motion picture films, which are derived from sources within the United States by a nonresident alien individual who is a resident of Norway, or by a Norwegian corporation or other entity, shall not be included in gross income and shall be exempt from United States tax under the provisions of Article VII of the convention if such alien, corporation, or other entity at no time during the taxable year in which such items of income are derived has a permanent establishment in the United States.

(b) *Items not deductible.*—Under the provisions of Article VII the United States reserves the right, according to the principles of Article IV and § 510.106, to deny a deduction to the payer thereof for such royalties and other like amounts, or any portion thereof, as is considered by the Commissioner not to be reasonable consideration for the right to use the property involved.

§ 510.110 REAL PROPERTY INCOME AND NATURAL RESOURCE ROYALTIES—(a) *General.*—Income of whatever nature derived by a nonresident alien who is a resident of Norway, or by a Norwegian corporation or other entity, from real property situated in the United

States, including gains derived from the sale or exchange of such property, rentals from such property, and royalties in respect of the operation of mines, quarries, timber, or other natural resources situated in the United States, is not exempt from United States tax by the convention. Such items of income are subject to taxation under the provisions of the Internal Revenue Code of 1954 generally applicable to the taxation of nonresident alien individuals and foreign corporations. See Articles VIII(1) and IX of the convention. Interest derived from mortgages and bonds secured by real property does not constitute income from real property for purposes of this section but is subject to the provisions applicable to interest generally. See § 510.108.

(b) *Net basis*—(1) *General.* Notwithstanding the provisions of paragraph (a) of this section, a nonresident alien who is a resident of Norway, or a Norwegian corporation, who during the taxable year derives from sources within the United States any income from real property as described in such paragraph may elect for such taxable year to be subject to United States tax on a net basis as though such alien or corporation were engaged in trade or business in the United States during such year through a permanent establishment situated therein. See Article VIII(2) of the convention.

(2) *Manner of electing.*—Such nonresident alien (including an individual, fiduciary, and member of a partnership) shall signify his election to be subject to the tax on such a basis by filing Form 1040B clearly marked at the top of the first page thereof as follows: "Return of Resident of Norway Electing to File on a Net Basis Pursuant to Article VIII of Norwegian Income Tax Convention." Such corporation shall signify its election to be subject to tax on such a basis by filing Form 1120 clearly marked at the top of the first page thereof as follows: "Return of Norwegian Corporation Electing to File on a Net Basis Pursuant to Article VIII of Norwegian Income Tax Convention". The election so signified shall be irrevocable for the taxable year for which such election is made. All income from sources within the United States, including gains from the sale or exchange of capital assets or of other property, shall be disclosed on the return so filed. See sections 871 and 882 of the Internal Revenue Code of 1954 and the regulations thereunder.

§ 510.111 Compensation for Labor or Personal Services—(a) *Exemption from tax.*—Under Article X of the convention compensation received by a nonresident alien individual who is a resident of Norway for labor or personal services, including the practice of the liberal and artistic professions, performed in the United States shall not be included in gross income and shall be exempt from United States tax in either of the following situations:

(1) *Norwegian employer.*—Where such individual is temporarily present in the United States for a period or periods not exceeding in the aggregate a total of 183 days during a taxable year beginning on or after January 1, 1951, any compensation received by him (irrespective of when received, if received in taxable years beginning on or after January 1, 1951) for such labor or personal services performed in the United States during such year as an employee of, or under contract with, a nonresident alien (including a nonresident alien individual and fiduciary) who is a resident of Norway, or a Norwegian

corporation or other entity, whether or not such alien, corporation, or other entity is engaged in trade or business within the United States, shall not be included in gross income and shall be exempt from United States tax.

(2) *Other employers.*—Where such individual is temporarily present in the United States for a period or periods not exceeding in the aggregate a total of 183 days during a taxable year beginning on or after January 1, 1951, any compensation received by him (irrespective of when received, if received in taxable years beginning on or after January 1, 1951) for such labor or personal services performed in the United States during such year shall not be included in gross income and shall be exempt from United States tax if such compensation does not exceed $10,000 in the aggregate. Thus, if a nonresident alien individual who is a resident of Norway performs personal services in the United States during the taxable year as an employee of a domestic corporation for which he receives compensation of $15,000 in the aggregate, none of such compensation shall be exempt from United States tax even though such individual is present in the United States during such year for a period or periods not exceeding a total of 183 days, since the aggregate compensation received is in excess of $10,000.

(b) *Definitions.*—For purposes of this section, the term "compensation for labor or personal services" shall include, but shall not be limited to, the compensation, profits, emoluments, or other remuneration of public entertainers, such as, stage, motion picture, television, or radio artists, musicians, and athletes. It shall also include directors' fees representing reasonable compensation for services rendered, whether or not the recipient of such fees has been present at any time during the taxable year in the contracting State from which payment of such fees has been made. For the allocation or segregation as between sources within, and sources without, the United States in the case of compensation for labor or personal services, see sections 861 through 864, Internal Revenue Code of 1954, and the regulations thereunder.

(c) *Exception.* The provisions of this section have no application to the income to which Article XI (1) of the convention relates.

§ 510.112. GOVERNMENT WAGES, SALARIES, AND PENSIONS—(a) *General.*—Under Article XI of the convention any wage, salary, or similar compensation, or any pension, paid directly by the Government of Norway or by Norwegian communities or counties (fylker), or paid from funds or institutions created by such Government, communities, or counties, to any alien individual (whether or not a resident of the United States) or to any individual who occupies the dual status of a citizen of the United States and a citizen of Norway shall not be included in gross income and shall be exempt from United States tax, even though at some time during the taxable year such individual has engaged in trade or business in the United States through a permanent establishment situated therein.

(b) *Definition.*—As used in this section, the term "pensions" means periodic payments made, in consideration for services rendered or by way of compensation for injuries received. Under Article XIV(2) of the convention the exclusion from gross income, and exemption

from United States tax, provided by this section shall not be denied despite the provisions of Article XIV. See § 510.116.

(c) *Cross reference.*—For the taxation generally of compensation of alien employees of foreign governments and the consequences of executing and filing the waiver provided for in section 247 (b) of the Immigration and Nationality Act, see section 893 of the Internal Revenue Code of 1954 and the regulations thereunder.

§ 510.113 Private Pensions and Life Annuities—(a) *General.*—Private pensions and life annuities derived from sources within the United States and paid to a non-resident alien individual who is a resident of Norway shall not be included in gross income and shall be exempt from United States tax, in accordance with Article XI of the convention, even though at some time during the taxable year in which such items of income are derived such individual has engaged in trade or business in the United States through a permanent establishment situated therein.

(b) *Definitions.*—As used in this section, the term "pensions" means periodic payments made in consideration for services rendered or by way of compensation for injuries received; and the term "life annuities" means a stated sum payable periodically at stated times during life, or during a specified number of years, under an obligation to make the payments in return for adequate and full consideration in money or money's worth.

§ 510.114 Visiting Professors or Teachers—(a) *General.*—Pursuant to Article XII of the convention a professor or teacher, a nonresident alien who is a resident of Norway, who temporarily visits the United States for the purpose of teaching for a period not exceeding two years at any university, college, school, or other educational institution situated within the United States shall, for a period not exceeding two years from the date of his initial arrival in the United States, be exempt from United States tax with respect to his remuneration earned in taxable years beginning on or after January 1, 1951, for such teaching during such period not in excess of two years.

(b) *More than two years.* The exemption granted by Article XII is applicable to remuneration earned during such part of the individual's visit as does not exceed two years from the date of arrival even though the total period of his presence in the United States may extend beyond two years, provided that during such entire period he may be considered to be temporarily visiting the United States.

(c) *Residence.*—Such exemption shall not apply to the remuneration of an alien who is a resident of the United States or who is not a resident of Norway.

(d) *Nonresidence presumed.*—An individual who otherwise qualifies for the exemption from United States tax granted by Article XII shall, for a period of not more than two years immediately succeeding the date of his arrival within the United States for the purpose of such teaching, be deemed to have the tax status of a nonresident alien in the absence of proof of his intention to remain indefinitely in the United States. See section 871 of the Internal Revenue Code of 1954 and the regulations thereunder.

§ 510.115 Students or Apprentices—(a) *General.*—Under Article XIII of the convention a student or apprentice, a nonresident alien who is a resident of Norway, who temporarily visits the United

States exclusively for the purposes of study or for acquiring business or technical experience shall not include in gross income, and shall be exempt from United States tax with respect to, amounts derived by him in taxable years beginning on or after January 1, 1951, and received during such years from without the United States as remittances for the purposes of his maintenance or studies.

(b) *Residence.*—The exemption shall not apply to remittances received by an alien who is a resident of the United States or who is not a resident of Norway.

§ 510.116 CREDIT AGAINST UNITED STATES TAX FOR NORWEGIAN TAX—(a) *General*—(1) *Taxable as though no convention.*—Notwithstanding any other provision of the convention the United States, in determining the United States tax of a citizen or resident of the United States, or of a domestic corporation, may, under Article XIV(1)(a) of the convention, include in the basis upon which such tax is imposed all items of income taxable under the revenue laws of the United States, as though the convention had not come into effect. For example, despite the exemption from United States tax granted by Article VI of the convention with respect to interest derived from sources within the United States by a resident of Norway, such interest shall be included in gross income and is subject to United States tax when so derived by a resident of Norway who is a citizen of the United States, even though such resident has no permanent establishment in the United States.

(2) *Exception.*—Notwithstanding the provisions of subparagraph (1) of this paragraph, the exclusion from gross income, and exemption from United States tax, granted by Article XI(1) of the convention with respect to wages, salaries, and similar compensation, and pensions, paid by Norway or Norwegian communities or counties shall not be denied. See Article XIV(2) of the convention.

(b) *Application of credit.*—For the purpose of mitigating double taxation Article XIV(1)(a) of the convention provides that a citizen or resident of the United States, or a domestic corporation, deriving income from sources within Norway shall be allowed a credit against the United States tax for the amount of Norwegian tax paid or accrued during the taxable year. This credit shall be made in accordance with the provisions of section 131 of the Internal Revenue Code of 1939 as in effect on December 11, 1951, but subject to the provisions of Article XX(2) of the convention.

§ 510.117 EXCHANGE OF INFORMATION—(a) *General.*—(1) By Article XV of the convention the United States and Norway adopt the principle of exchange of such information as may be of use for carrying out the provisions of the convention, preventing fraud, or detecting practices which are aimed at the reduction of the revenues of either country, but not including information which would be contrary to public policy or which would disclose any trade, business, industrial, or professional secret.

(2) The information and correspondence relative to exchange of information may be transmitted directly by the Commissioner to the Ministry of Finance and Customs.

(b) *Return of information by withholding agents.*—(1) To facilitate compliance with Article XVI of the convention, every United States withholding agent shall make and file in duplicate with the

District Director of Internal Revenue, Baltimore 2, Maryland, an information return on Form 1042 Supplement, with respect to Norwegian addressees, which shall be filed for the calendar year 1955 and subsequent calendar years. This return shall be filed simultaneously with Form 1042.

(2) There shall be reported on such Form 1042 Supplement all items of fixed or determinable annual or periodical income (and amounts described in section 402(a)(2), section 631 (b) and (c), and section 1235 of the Internal Revenue Code of 1954, which are considered to be gains from the sale or exchange of capital assets) derived from sources within the United States and paid to nonresident aliens (including nonresident alien individuals, fiduciaries, and partnerships) and to nonresident foreign corporations, whose addresses at the time of payment were in Norway, including such items of income upon which, in accordance with the withholding regulations under the convention, no withholding of United States tax is required; except that any of such items which constitute interest in respect of which Form 1001–NO or substitute Form 1001–NO has been filed in duplicate with the withholding agent is not required to be reported on such Form 1042 Supplement.

(c) *Information to be furnished in ordinary course.*—In compliance with the provisions of Article XVI of the convention the Commissioner will transmit to the Ministry of Finance and Customs, as soon as practicable after the close of the calendar year 1955 and of each subsequent calendar year during which the convention is in effect, the following information relating to such preceding calendar year:

(1) The duplicate copy of each available Form 1042 Supplement filed pursuant to paragraph (b) of this section; and

(2) The duplicate copy of each available ownership certificate, Form 1001–NO, and substitute Form 1001–NO, filed pursuant to the withholding regulations under the convention, in connection with coupon bond interest.

(d) *Information in specific cases.*—Under the provisions and limitations of Articles XV and XVIII of the convention and upon request of the Ministry of Finance and Customs, the Commissioner shall furnish to the Ministry information available to, or obtainable by, the Commissioner relative to the tax liability of any person under the revenue laws of Norway in any case in which such information is necessary to the administration of the provisions of the convention or of statutory provisions against tax avoidance. or in which such information is necessary for the prevention of fraud.

§ 510.118 Double Taxation Claims—(a) *General.*—Under Article XIX of the convention, where the taxpayer shows proof that the action of the revenue authorities of the United States or Norway has resulted, or will result, in double taxation contrary to the provisions of the convention, he is entitled to lodge a claim with the country of which he is a citizen; or, if he is not a citizen of either country, with the country of which he is a resident; or, if the taxpayer is a corporation or other entity, with the country in which it is created or organized. The article provides that, should the claim be upheld, the competent authority of the country with which the claim is lodged shall undertake to come to an agreement with the competent authority

of the other country with a view to equitable avoidance of the double taxation in question.

(b) *Manner of filing claim.*—Such a claim on behalf of a United States citizen, corporation, or other entity, or on behalf of a resident of the United States who is not a Norwegian citizen, shall be filed with the Commissioner. The claim shall be set up in the form of a letter addressed to "The Commissioner of Internal Revenue, Washington 25, D. C." and shall show fully all facts and law on the basis of which the claimant alleges that such double taxation has resulted or will result. If the Commissioner determines that there is an appropriate basis for the claim under the convention, he shall take up the matter with the Ministry of Finance and Customs with a view to arranging an agreement of the character contemplated by Article XIX.

§ 510.119 BENEFICIARIES OF AN ESTATE OR TRUST—(a) *Qualified beneficiary.*—If he otherwise satisfies the requirements of the respective articles concerned, a nonresident alien who is a resident of Norway and who is a beneficiary of an estate or trust shall be entitled to the exemption from United States tax granted by Articles VI and VII of the convention with respect to interest, and patent royalties and other like amounts, to the extent that (1) any amount paid, credited, or required to be distributed by such estate or trust to such beneficiary is deemed to consist of such items and (2) such items would, without regard to the convention, be includible in his gross income.

(b) *Amounts otherwise includible in gross income of beneficiary.*—For the determination of amounts which, without regard to the convention, are includible in the gross income of the beneficiary, see subchapter J of chapter 1 of the Internal Revenue Code of 1954, and the regulations thereunder.

§ 510.120 NORWEGIAN PARTNERSHIPS—(a) *General.*—Whether an individual, corporation, or other entity, a member of a partnership created or organized in Norway or under Norwegian laws, is subject to United States tax upon such person's distributive share of the income of such partnership depends upon both the status of the partnership and the status of such member.

(b) *Citizen partner.*—A citizen or resident of the United States, or a domestic corporation, is subject to United States tax upon such person's distributive share of the income of such partnership as though the convention had not come into effect, but subject to the provisions of § 510.116; even though other members, by reason of benefits granted by the convention, are not subject to United States tax upon their distributive share of such income.

(c) *Noncitizen partner.*—In any case in which income is derived from sources within the United States by a partnership created in Norway or under Norwegian laws, any member of such partnership who has a permanent establishment in the United States or who is either a nonresident alien not a resident of Norway or is a foreign corporation which is not Norwegian is not entitled, with respect to such member's distributive share of such income, to any benefit granted by the convention solely to nonresident aliens residing in Norway, or to Norwegian corporations or other entities, having no permanent establishment in the United States. Conversely, any member of such

partnership who individually complies with the requirements for obtaining any such benefit will be entitled thereto with respect to such member's distributive share of such income. A member of a Norwegian partnership which has a permanent establishment in the United States shall likewise be considered to have a permanent establishment in the United States.

O. GORDON DELK,
Acting Commissioner of Internal Revenue.

Approved October 6, 1955.

H. CHAPMAN ROSE,
Acting Secretary of the Treasury.

(Filed by the Division of the Federal Register October 11, 1955, 8:48 a. m.)

UNITED STATES–SWISS CONFEDERATION INCOME TAX CONVENTION

T. D. 6149 [1]

TITLE 26—INTERNAL REVENUE, 1954.—CHAPTER I, SUBCHAPTER G, PART 509.—THE SWISS CONFEDERATION

General regulations under the income tax convention between the United States and the Swiss Confederation, proclaimed by the President of the United States on October 1, 1951, subject to the protocol of exchange signed on September 27, 1951.

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

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

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AUTHORITY: Sections 509.101 to 509.122, inclusive, are issued under the authority contained in 68A Stat. 917 (26 U. S. C. 7805) and in Article XIX, 2 UST [2] 1762.

[1] 20 F. R. 7587.

[2] UST—United States Treaties and Other International Agreements.

On June 16, 1955, notice of proposed rulemaking regarding the general regulations under the income tax convention between the United States and the Swiss Confederation, proclaimed by the President of the United States on October 1, 1951, was published in the Federal Register (20 F. R. 4211). No comments regarding the regulations proposed were received during the 30-day period prescribed in such notice, and the regulations set forth below are hereby adopted:

§ 509.101. INTRODUCTORY.—The income tax convention between the United States and the Swiss Confederation, signed May 24, 1951, and proclaimed by the President of the United States on October 1, 1951, subject to the understanding expressed in the protocol of exchange, hereinafter referred to as the convention, provides as follows, effective for taxable years beginning on or after January 1, 1951:

ARTICLE I

(1) The taxes referred to in this convention are:

(a) In the case of the United States of America: The Federal income taxes, including surtaxes and excess profits taxes.

(b) In the case of The Swiss Confederation: The federal, cantonal and communal taxes on income (total income, earned income, income from property, industrial and commercial profits, etc.).

(2) The present convention shall also apply to any other income or profits tax of a substantially similar character imposed by either contracting State subsequently to the date of signature of the present convention.

ARTICLE II

(1) As used in this convention:

(a) The term "United States" means the United States of America, and when used in a geographical sense means the States, the Territories of Alaska and Hawaii, and the District of Columbia.

(b) The term "Switzerland" means The Swiss Confederation.

(c) The term "permanent establishment" means a branch, office, factory, workshop, warehouse or other fixed place of business, but does not include the casual and temporary use of merely storage facilities, nor does it include an agency unless the agent has and habitually exercises a general authority to negotiate and conclude contracts on behalf of an enterprise or has a stock of merchandise from which he regularly fills orders on its behalf. An enterprise of one of the contracting States shall not be deemed to have a permanent establishment in the other State merely because it carries on business dealings in such other State through a commission agent, broker or custodian or other independent agent acting in the ordinary course of his business as such. The fact that an enterprise of one of the contracting States maintains in the other State a fixed place of business exclusively for the purchase of goods or merchandise shall not of itself constitute such fixed place of business a permanent establishment of such enterprise. The fact that a corporation of one contracting State has a subsidiary corporation which is a corporation of the other State or which is engaged in trade or business in the other State shall not of itself constitute that subsidiary corporation a permanent establishment of its parent corporation. The maintenance within the territory of one of the contracting States by an enterprise of the other contracting State of a warehouse for convenience of delivery and not for purposes of display shall not of itself constitute a permanent establishment within that territory even though offers of purchase have been obtained by an agent of the enterprise in that territory and transmitted by him to the enterprise for acceptance.

(d) The term "enterprise of one of the contracting States" means, as the case may be, "United States enterprise" or "Swiss enterprise".

(e) The term "United States enterprise" means an industrial or commercial enterprise or undertaking carried on in the United States by a resident (including an individual, fiduciary and partnership) of the United

States or by a United States corporation or other entity; the term "United States corporation or other entity" means a corporation or other entity created or organized under the law of the United States or of any State or Territory of the United States.

(f) The term "Swiss enterprise" means an industrial or commercial enterprise or undertaking carried on in Switzerland by an individual resident in Switzerland or by a Swiss corporation or other entity; the term "Swiss corporation or other entity" means a corporation or institution or foundation having juridical personality, or a partnership (association "en nom collectif" or "en commandite"), or other association without juridical personality, created or organized under Swiss laws.

(g) The term "competent authorities" means, in the case of the United States, the Commissioner of Internal Revenue as authorized by the Secretary of the Treasury; and in the case of Switzerland, the Director of the Federal Tax Administration as authorized by the Federal Department of Finances and Customs.

(h) The term "industrial or commercial profits" includes manufacturing, mercantile, mining, financial and insurance profits, but does not include income in the form of dividends, interest, rents or royalties, or remuneration for personal services: Provided, however, that such excepted items of income shall, subject to the provisions of this Convention, be taxed separately or together with industrial or commercial profits in accordance with the laws of the contracting States.

(2) In the application of the provisions of the present Convention by one of the contracting States any term not otherwise defined shall, unless the context otherwise requires, have the meaning which such term has under its own tax laws.

ARTICLE III

(1) (a) A Swiss enterprise shall not be subject to taxation by the United States in respect of its industrial and commercial profits unless it is engaged in trade or business in the United States through a permanent establishment situated therein. If it is so engaged the United States may impose its tax upon the entire income of such enterprise from sources within the United States.

(b) A United States enterprise shall not be subject to taxation by Switzerland in respect of its industrial and commercial profits except as to such profits allocable to its permanent establishment situated in Switzerland.

(2) No account shall be taken in determining the tax in one of the contracting States of the mere purchase of merchandise therein by an enterprise of the other State.

(3) Where an enterprise of one of the contracting States is engaged in trade or business in the territory of the other contracting State through a permanent establishment situated therein, there shall be attributed to such permanent establishment the industrial or commercial profits which it might be expected to derive if it were an independent enterprise engaged in the same or similar activities under the same or similar conditions and dealing at arm's length with the enterprise of which it is a permanent establishment.

(4) In the determination of the industrial or commercial profits of the permanent establishment there shall be allowed as deductions all expenses which are reasonably applicable to the permanent establishment, including executive and general administrative expenses so applicable.

(5) The competent authorities of the two contracting States may lay down rules by agreement for the apportionment of industrial and commercial profits.

ARTICLE IV

Where an enterprise of one of the contracting States, by reason of its participation in the management or the financial structure of an enterprise of the other contracting State, makes with or imposes on the latter, in their commercial or financial relations, conditions different from those which would be made with an independent enterprise, any profits which would normally have accrued to one of the enterprises, but by reason of those conditions have not so accrued, may be included in the profits of that enterprise and taxed accordingly.

ARTICLE V

Income which an enterprise of one of the contracting States derives from the operation of ships or aircraft registered in that State shall be taxable only in the State in which such ships or aircraft are registered.

ARTICLE VI

(1) The rate of tax imposed by one of the contracting States upon dividends derived from sources within such State by a resident or corporation or other entity of the other contracting State not having a permanent establishment in the former State shall not exceed 15 percent: Provided, however, that this paragraph shall have no application to Swiss tax in the case of dividends derived from Switzerland by a Swiss citizen (who is not also a citizen of the United States) resident in the United States.

(2) It is agreed, however, that such rate of tax shall not exceed five percent if the shareholder is a corporation controlling, directly or indirectly, at least 95 percent of the entire voting power in the corporation paying the dividend, and if not more than 25 percent of the gross income of such paying corporation is derived from interest and dividends, other than interest and dividends received from its own subsidiary corporations. Such reduction of the rate to five percent shall not apply if the relationship of the two corporations has been arranged or is maintained primarily with the intention of securing such reduced rate.

(3) Switzerland may collect its tax without regard to paragraphs (1) and (2) of this Article but will make refund of the tax so collected in excess of the tax computed at the reduced rates provided in such paragraphs.

ARTICLE VII

(1) The rate of tax imposed by one of the contracting States on interest on bonds, securities, notes, debentures or on any other form of indebtedness (including mortgages or bonds secured by real property) derived from sources within such contracting State by a resident or corporation or other entity of the other contracting State not having a permanent establishment in the former State shall not exceed five percent: Provided, however, that this paragraph shall have no application to Swiss tax in the case of interest derived from Switzerland by a Swiss citizen (who is not also a citizen of the United States) resident in the United States.

(2) Switzerland may collect its tax without regard to paragraph (1) of this Article but will make refund of the tax so collected in excess of the tax computed at the reduced rate provided in such paragraph.

ARTICLE VIII

Royalties and other amounts derived, as consideration for the right to use copyrights, artistic and scientific works, patents, designs, plans, secret processes and formulae, trade-marks, and other like property and rights (including rentals and like payments in respect to motion picture films or for the use of industrial, commercial or scientific equipment), from sources within one of the contracting States by a resident or corporation or other entity of the other contracting State not having a permanent establishment in the former State shall be exempt from taxation in such former State.

ARTICLE IX

(1) Income from real property (including gains derived from the sale or exchange of such property but not including interest from mortgages or bonds secured by real property) and royalties in respect of the operation of mines, quarries, or other natural resources, shall be taxable only in the contracting State in which such property, mines, quarries, or other natural resources are situated.

(2) A resident or corporation or other entity of one of the contracting States deriving any such income from such property within the other contracting State may, for any taxable year, elect to be subject to the tax of such other contracting State, on a net basis, as if such resident or corporation or entity were engaged in trade or business within such other contracting State through a permanent establishment therein during such taxable year.

ARTICLE X

(1) An individual resident of Switzerland shall be exempt from United States tax upon compensation for labor or personal services performed in the United States (including the practice of the liberal professions and rendition of services as director) if he is temporarily present in the United States for a period or

periods not exceeding a total of 183 days during the taxable year and either of the following conditions is met:

(a) his compensation is received for such labor or personal services performed as an employee of, or under contract with, a resident or corporation or other entity of Switzerland, or

(b) his compensation received for such labor or personal services does not exceed $10,000.

(2) The provisions of paragraph (1) of this Article shall apply *mutatis mutandis*, to an individual resident of the United States with respect to compensation for such labor or personal services performed in Switzerland.

(3) The provisions of this Article shall have no application to the income to which Article XI (1) relates.

(4) The provisions of paragraph (1) (a) of this Article shall not apply to the compensation, profits, emoluments or other remuneration of public entertainers such as stage, motion picture or radio artists, musicians and athletes.

ARTICLE XI

(1) (a) Wages, salaries and similar compensation, and pensions paid by the United States or by the political subdivisions or territories thereof to an individual (other than a Swiss citizen who is not also a citizen of the United States) shall be exempt from Swiss tax.

(b) Wages, salaries and similar compenstation and pensions paid by Switzerland and by any agency or instrumentality thereof or by any political subdivisions or other public authorities thereof to an individual (other than a United States citizen who is not also a citizen of Switzerland) shall be exempt from United States tax.

(2) Private pensions and life annuities derived from within one of the contracting States and paid to individuals residing in the other contracting State shall be exempt from taxation in the former State.

(3) The term "pensions", as used in this Article, means periodic payments made in consideration for services rendered or by way of compensation for injuries received.

(4) The term "life annuities" as used in this Article, means a stated sum payable periodically at stated times during life, or during a specified number of years, under an obligation to make the payments in return for adequate and full consideration in money or money's worth.

ARTICLE XII

A professor or teacher, a resident of one of the contracting States, who temporarily visits the other contracting State for the purpose of teaching for a period not exceeding two years at a university, college, school or other educational institution in the other contracting State, shall be exempted in such other contracting State from tax on his remuneration for such teaching for such period.

ARTICLE XIII

A student or apprentice, a resident of one of the contracting States, who temporarily visits the other contracting State exclusively for the purposes of study or for acquiring business or technical experience shall not be taxable in the latter State in respect of remittances received by him from abroad for the purposes of his maintenance or studies.

ARTICLE XIV

(1) Dividends and interest paid by a corporation other than a United States domestic corporation shall be exempt from United States tax where the recipient is a nonresident alien as to the United States resident in Switzerland or a Swiss corporation, not having a permanent establishment in the United States.

(2) Dividends and interest paid by a corporation other than a Swiss corporation shall be exempt from Swiss tax where the recipient is a resident or corporation of the United States, not having a permanent establishment in Switzerland.

ARTICLE XV

(1) It is agreed that double taxation shall be avoided in the following manner:

(a) The United States in determining its taxes specified in Article I of this Convention in the case of its citizens, residents or corporations may,

regardless of any other provision of this Convention, include in the basis upon which such taxes are imposed all items of income taxable under the revenue laws of the United States as if this Convention had not come into effect. The United States shall, however, subject to the provisions of section 131, Internal Revenue Code, as in effect on the date of the entry into force of this Convention, deduct from its taxes the amount of Swiss taxes specified in Article I of this Convention. It is agreed that by virtue of the provisions of subparagraph (b) of this paragraph, Switzerland satisfies the similar credit requirement set forth in section 131 (a) (3), Internal Revenue Code.

(b) Switzerland, in determining its taxes specified in Article I of this Convention in the case of its residents, corporations or other entities, shall exclude from the basis upon which such taxes are imposed such items of income as are dealt with in this Convention, derived from the United States and not exempt from, and not entitled to the reduced rate of, United States tax under this Convention; but in the case of a citizen of the United States resident in Switzerland there shall be excluded all items of income derived from the United States. Switzerland, however, reserves the right to take into account in the determination of the rate of its taxes also the income excluded as provided in this paragraph.

(2) The provisions of this Article shall not be construed to deny the exemptions from United States tax or Swiss tax, as the case may be, granted by Article XI (1) of this Convention.

ARTICLE XVI

(1) The competent authorities of the contracting States shall exchange such information (being information available under the respective taxation laws of the contracting States) as is necessary for carrying out the provisions of the present Convention or for the prevention of fraud or the like in relation to the taxes which are the subject of the present Convention. Any information so exchanged shall be treated as secret and shall not be disclosed to any person other than those concerned with the assessment and collection of the taxes which are the subject of the present Convention. No information shall be exchanged which would disclose any trade, business, industrial or professional secret or any trade process.

(2) Each of the contracting States may collect such taxes imposed by the other contracting State as though such taxes were the taxes of the former State as will ensure that the exemption or reduced rate of tax granted under Articles VI, VII, VIII and XI (2) of the present Convention by such other State shall not be enjoyed by persons not entitled to such benefits.

(3) In no case shall the provisions of this Article be construed so as to impose upon either of the contracting States the obligation to carry out administrative measures at variance with the regulations and practice of either contracting State or which would be contrary to its sovereignty, security or public policy or to supply particulars which are not procurable under its own legislation or that of the State making application.

ARTICLE XVII

(1) Where a taxpayer shows proof that the action of the tax authorities of the contracting States has resulted, or will result, in double taxation contrary to the provisions of the present Convention, he shall be entitled to present the facts to the State of which he is a citizen or a resident, or, if the taxpayer is a corporation or other entity, to the State in which it is created or organized. Should the taxpayer's claim be deemed worthy of consideration, the competent authority of such State shall undertake to come to an agreement with the competent authority of the other State with a view to equitable avoidance of the double taxation in question.

(2) Should any difficulty or doubt arise as to the interpretation or application of the present Convention, or its relationship to Conventions between one of the contracting States and any other State, the competent authorities of the contracting States may settle the question by mutual agreement.

ARTICLE XVIII

(1) The provisions of this Convention shall not be construed to deny or affect in any manner the right of diplomatic and consular officers to other or

additional exemptions now enjoyed or which may hereafter be granted to such officers.

(2) The provisions of the present Convention shall not be construed to restrict in any manner any exemption, deduction, credit or other allowance now or hereafter accorded by the laws of one of the contracting States in the determination of the tax imposed by such State.

(3) The citizens of one of the contracting States shall not, while resident in the other contracting State, be subjected therein to other or more burdensome taxes than are the citizens of such other contracting State residing in its territory. The term "citizens" as used in this Article includes all legal persons, partnerships and associations created or organized under the laws in force in the respective contracting States. In this Article the word "taxes" means taxes of every kind or description, whether Federal, State, cantonal, municipal or communal.

ARTICLE XIX

(1) The competent authorities of the two contracting States may prescribe regulations necessary to carry into effect the present Convention within the respective States.

(2) The competent authorities of the two contracting States may communicate with each other directly for the purpose of giving effect to the provisions of this Convention.

ARTICLE XX

The present Convention shall be ratified and the instruments of ratification shall be exchanged at Berne as soon as possible. It shall have effect for the taxable years beginning on or after the first day of January of the year in which such exchange takes place: Provided, however, that if such exchange takes place on or after October 1 of such year, Article VI (except paragraph (2) thereof) and Article VII of the Convention shall have effect only for taxable years beginning on or after the first day of January of the year immediately following the year in which such exchange takes place.

(2) The present Convention shall continue effective for a period of five years beginning with the calendar year in which the exchange of the instruments of ratification takes place and indefinitely after that period, but may be terminated by either of the contracting States at the end of the five-year period or at any time thereafter, provided that at least six months' prior notice of termination has been given and, in such event, the present Convention shall cease to be effective for the taxable years beginning on or after the first day of January next following the expiration of the six-month period.

DONE at Washington, in duplicate, in the English and German languages, the two texts having equal authenticity, this 24th day of May, 1951.

For the President of the United States of America:

DEAN ACHESON [SEAL]

For the Swiss Federal Council:

CHARLES BRUGGMANN [SEAL]

PROCLAMATION BY THE PRESIDENT OF THE UNITED STATES DATED OCTOBER 1, 1951

* * * * * * *

AND WHEREAS the Senate of the United States of America, by their resolution of September 17, 1951, two-thirds of the Senators present concurring therein, did advise and consent to the ratification of the aforesaid convention, subject to a reservation, as follows:

> "The Government of the United States of America does not accept paragraph (4) of Article X of the Convention, relating to the profits or remuneration of public entertainers."

And whereas the text of the aforesaid reservation was communicated by the Government of the United States of America to the Government of the Swiss Confederation and the aforesaid reservation was accepted by the Government of the Swiss Confederation;

And whereas the aforesaid convention was duly ratified by the President of the United States of America on September 20, 1951, in pursuance of the aforesaid advice and consent of the Senate and subject to the aforesaid reservation, and the aforesaid convention was duly ratified on the part of the Swiss Confederation;

And whereas the respective instruments of ratification of the aforesaid convention were duly exchanged at Bern on September 27, 1951, and a protocol of exchange of instruments of ratification, in the English and French languages, was signed at that place and on that date by the respective Plenipotentiaries of the United States of America and the Swiss Confederation, the said protocol containing a statement that it is understood by the two Governments that the convention aforesaid, upon entry into force in accordance with its provisions, is modified in accordance with the aforesaid reservation, so that, in effect, paragraph (4) of Article X of the convention is deemed to be deleted;

And whereas, so far as appertains to an exchange of instruments of ratification prior to October 1 of any year, it is provided in Article XX of the aforesaid convention that upon the exchange of instruments of ratification the convention shall have effect for the taxable years beginning or [sic] or after the first day of January of the year in which such exchange takes place;

Now, therefore, be it known that I, Harry S. Truman, President of the United States of America, do hereby proclaim and make public the aforesaid convention to the end that the said convention and each and every article and clause thereof, subject to the aforesaid reservation, may be observed and fulfilled with good faith by the United States of America and by the citizens of the United States of America and all other persons subject to the jurisdiction thereof.

* * * * * * *

§ 509.102 APPLICABLE PROVISIONS OF LAW—(a) *General.*—The Internal Revenue Code of 1954 provides in part as follows:

SUBTITLE A—INCOME TAXES

* * * * * * *

SEC. 894. INCOME EXEMPT UNDER TREATY.

Income of any kind, to the extent required by any treaty obligation of the United States, shall not be included in gross income and shall be exempt from taxation under this subtitle.

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SUBTITLE F—PROCEDURE AND ADMINISTRATION

* * * * * * *

SEC. 7805. RULES AND REGULATIONS

(a) *Authorization.*—Except where such authority is expressly given by this title to any person other than an officer or employee of the Treasury Department, the Secretary or his delegate shall prescribe all needful rules and regulations for the enforcement of this title, including all rules and regulations as may be necessary by reason of any alteration of law in relation to internal revenue.

(b) *Retroactivity of regulations or rulings.*—The Secretary or his delegate may prescribe the extent, if any, to which any ruling or regulation, relating to the internal revenue laws, shall be applied without retroactive effect.

* * * * * * *

(b) *Internal Revenue Code of 1939.*—Any reference in this Treasury decision to any provision of the Internal Revenue Code of 1954 shall, where applicable, be deemed also to refer to the corresponding provision of the Internal Revenue Code of 1939.

(c) *Effective date of regulations.*—Pursuant to sections 894 and 7805 of the Internal Revenue Code of 1954, Article XIX of the convention, and other provisions of the internal revenue laws, this Treasury decision, which is designated as 26 CFR 509.101 through 509.122, is hereby prescribed effective for taxable years beginning on or after January 1, 1951. All regulations inconsistent herewith are modified accordingly.

§ 509.103 SCOPE OF THE CONVENTION—(a) *Purposes of convention.*—The primary purposes of the convention, to be accomplished on a reciprocal basis, are to avoid double taxation upon certain items of income derived from sources in one country by residents or corporations or other entities of the other country and to provide for administrative cooperation between the competent tax authorities of the two countries looking to the avoidance of double taxation and the prevention of fiscal evasion.

(b) *Exemption from United States tax.* The following items of income from sources within the United States are exempt from United States tax for taxable years beginning on or after January 1, 1951, subject to the respective articles of the convention:

(1) Industrial and commercial profits of a Swiss enterprise having no permanent establishment in the United States (Article III);

(2) Income derived by a Swiss enterprise from the operation of ships or aircraft registered in Switzerland (Article V);

(3) Patent and copyright royalties, and other like amounts, including motion picture film rentals, derived by a nonresident alien who is a resident of Switzerland, or by a Swiss corporation or other entity, if such alien, corporation, or other entity has no permanent establishment in the United States (Article VIII);

(4) Compensation, subject to certain limitations, for personal services performed in the United States by a nonresident alien individual who is a resident of Switzerland (Article X);

(5) Compensation and pensions paid by Switzerland to an alien individual, and to a citizen of Switzerland who is also a citizen of the United States, including such items as are from sources without the United States (Article XI);

(6) Private pensions and life annuities paid to a nonresident alien individual who is a resident of Switzerland (Article XI);

(7) Remuneration derived from certain teaching in the United States by a professor or teacher who is a nonresident alien residing in Switzerland (Article XII); and

(8) Dividends and interest paid by a foreign corporation to a nonresident alien who is a resident of Switzerland, or to a Swiss corporation, if such alien or corporation has no permanent establishment in the United States (Article XIV).

(c) *Students or apprentices.*—Remittances received from abroad for the purpose of maintenance or studies by a student or apprentice, a nonresident alien residing in Switzerland, who is temporarily present in the United States under specified circumstances are also exempt from United States tax (Article XIII).

(d) *Reduced rates of United States tax.*—Dividends and interest derived from sources within the United States by a nonresident alien who is a resident of Switzerland, or by a Swiss corporation or other entity, are subject to United States tax at reduced rates, if such alien, corporation, or other entity has no permanent establishment in the United States (Articles VI and VII).

(e) *Withholding regulations.*—For regulations pertaining to the release of excess tax withheld, and to exemption from, or reduction in the rate of, withholding of United States tax at source, in the case of dividends, interest, patent and copyright royalties, film rentals, private

pensions, and life annuities, received from sources within the United States by a nonresident alien who is a resident of Switzerland, or by a Swiss corporation or other entity, see Treasury Decision 5867 (C. B. 1951–2, 75), approved November 21, 1951 [26 CFR (1939) 7.300 through 7.309].

(f) *United States citizens, residents, and corporations.*—(1) Any citizen of Switzerland who is a resident of the United States is liable to United States tax as though the convention had not come into effect; however, such alien resident of the United States is entitled to the foreign tax credit in accordance with Article XV and is also entitled to the benefits of Article XI (1) and Article XVIII.

(2) A citizen of the United States, even though resident in Switzerland, or a domestic corporation, even though engaged in trade or business in Switzerland through a permanent establishment situated therein, is also liable to United States tax as though the convention had not come into effect but is entitled to the foreign tax credit and, to the extent applicable, to the benefits of Article XI (1).

(g) *Other provisions applicable to Swiss residents and corporations.*—Except as otherwise expressly provided by the convention, the United States tax liability of a nonresident alien who is a resident of Switzerland, or of a Swiss corporation or other entity, is determined in accordance with the provisions of the Internal Revenue Code of 1954 relating to nonresident alien individuals and foreign corporations.

§ 509.104 DEFINITIONS—(a) *General.*—Any term defined in the convention or this Treasury decision shall have the meaning so assigned to it; any term not so defined shall, unless the context otherwise requires, have the meaning which such term has under the internal revenue laws of the United States.

(b) *Specific terms.*—As used in this Treasury decision—

(1) *United States tax.*—The term "United States tax" means the Federal income taxes, including surtaxes and excess profits taxes, and any other income or profits tax of a substantially similar character imposed by the United States after May 24, 1951.

(2) *Swiss tax.*—The term "Swiss tax" means the federal, cantonal, and communal taxes on income—that is, on total income, earned income, income from property, industrial and commercial profits, etc.—and any other income or profits tax of a substantially similar character imposed by Switzerland after May 24, 1951.

(3) *United States.*—The term "United States" means the United States of America; and, when used in a geographical sense, means the States, the Territories of Alaska and Hawaii, and the District of Columbia.

(4) *Switzerland.*—The term "Switzerland" means the Swiss Confederation.

(5) *Permanent establishment*—(i) *Fixed place of business.*—The term "permanent establishment" means an office, factory, workshop, warehouse, branch, or other fixed place of business, but does not include the casual and temporary use of merely storage facilities. It implies the active conduct of a business enterprise. The mere ownership, for example, of timberlands or a warehouse in the United States by a Swiss enterprise does not mean that such enterprise, in the absence of any business activity

therein, has a permanent establishment in the United States. Moreover, the maintenance within the United States by a Swiss enterprise of a warehouse for convenience of delivery, and not for purposes of display, does not of itself constitute a permanent establishment in the United States, even though offers of purchase have been obtained by an agent therein of the Swiss enterprise and transmitted by him to the Swiss enterprise for acceptance. The fact that a Swiss enterprise maintains in the United States an office or other fixed place of business used exclusively for the purchase for such enterprise of goods or merchandise shall not of itself constitute such fixed place of business a permanent establishment of such enterprise.

(ii) *Subsidiary corporation.*—The fact that a Swiss corporation has a domestic subsidiary corporation, or a foreign subsidiary corporation which is engaged in trade or business in the United States through a permanent establishment situated therein, does not of itself constitute either subsidiary corporation the United States permanent establishment of the Swiss parent corporation.

(iii) *Agency.*—A Swiss enterprise which has an agency in the United States does not thereby have a permanent establishment in the United States, unless the agent has, and habitually exercises, a general authority to negotiate and conclude contracts on behalf of such enterprise or unless he has a stock of merchandise from which he regularly fills orders on its behalf. If the enterprise has an agent in the United States who has power to contract on its behalf, but only at fixed prices and under conditions determined by such principal, it does not thereby necessarily have a permanent establishment in the United States. The mere fact that an agent of a Swiss enterprise—assuming he has no general authority to negotiate and conclude contracts on behalf of his principal—maintains samples, or occasionally fills orders from incidental stocks of goods maintained, in the United States does not of itself mean that such enterprise has a permanent establishment in the United States. The mere fact that salesmen, employees of a Swiss enterprise, promote the sale of their employer's products in the United States or that a Swiss enterprise transacts business in the United States by means of mail order activities does not mean that such enterprise has a permanent establishment in the United States. A Swiss enterprise shall not be deemed to have a permanent establishment in the United States merely because it carries on business dealings in the United States through a commission agent, broker, custodian, or other independent agent, acting in the ordinary course of his business as such.

(6) *Enterprise.*—The term "enterprise" means any commercial or industrial enterprise or undertaking carried on by any person, for example, by an individual, partnership, or corporation. It includes such activities as manufacturing, merchandising, mining, processing, banking, and insuring. It does not include the rendition of personal services. Hence, a nonresident alien individual who is a resident of Switzerland and who performs personal services is not, merely by reason of such services, engaged in a Swiss enterprise within the meaning of the conven-

tion; consequently, his liability to United States tax is not determined under Article III of the convention, if he has not otherwise carried on a Swiss enterprise.

(7) *Swiss enterprise.*—The term "Swiss enterprise" means an enterprise carried on in Switzerland by a nonresident alien individual who is a resident of Switzerland, or by a Swiss corporation or other entity. Thus, an enterprise carried on wholly outside Switzerland by a Swiss corporation is not a Swiss enterprise within the meaning of the convention.

(8) *Swiss corporation or other entity.*—The term "Swiss corporation or other entity" means a corporation or institution or foundation having juridical personality, or a partnership (association "en nom collectif" or "en commandite"), or other association without juridical personality, created or organized under Swiss laws.

(9) *United States enterprise.*—The term "United States enterprise" means an enterprise carried on in the United States by a resident of the United States (including an individual, fiduciary, and partnership) or by a United States corporation or other entity.

(10) *United States corporation or other entity.*—The term "United States corporation or other entity" means a corporation or other entity created or organized under the law of the United States or of any State or Territory of the United States.

(11) *Industrial and commercial profits.*—The term "industrial and commercial profits" means profits arising from industrial, commercial, mercantile, manufacturing, and like activities of an enterprise, including mining, financial, and insurance profits. It does not include income in the form of dividends, interest, rents, royalties, or remuneration for personal services. In determining the industrial and commercial profits from sources within the United States of a Swiss enterprise, no profits shall be deemed to arise from the mere purchase of goods or merchandise within the United States by such enterprise. Moreover, in determining such profits of the United States permanent establishment of such enterprise, there shall be allowed as deductions all expenses which are reasonably applicable to the permanent establishment, including executive and general administrative expenses so applicable. See sections 861 through 864, Internal Revenue Code of 1954, and the regulations thereunder.

(12) *Commissioner.*—The term "Commissioner" means the Commissioner of Internal Revenue or his authorized representative.

(13) *Director of the Federal Tax Administration.*—The term "Director of the Federal Tax Administration" means the Director of the Federal Tax Administration (Direktor der eidgenoessischen Steuerverwaltung) of Switzerland.

§ 509.105 Industrial and Commercaal Profits—(a) General.—(1) Article III of the convention adopts the principle that an enterprise of one of the contracting States shall not be taxable by the other contracting State upon its industrial and commercial profits unless it is engaged in trade or business in the latter State through a perma-

nent establishment situated therein. Accordingly, a Swiss enterprise is subject to United States tax upon its industrial and commercial profits, to the extent of such profits from sources within the United States, only if it is engaged in trade or business in the United States at some time during the taxable year through a permanent establishment situated therein.

(2) From the standpoint of the United States tax the article has application only to a Swiss enterprise and its industrial and commercial profits from sources within the United States. Thus, a nonresident alien individual who is a citizen of Switzerland, or a Swiss corporation or other entity, carrying on an enterprise which is not Swiss, is subject to tax on such income of such enterprise pursuant to section 871 (c) or section 882 (a), Internal Revenue Code of 1954, if such alien, corporation, or other entity has engaged in trade or business in the United States at any time during the taxable year, even though it has not had a permanent establishment therein at any time within such year.

(b) *No United States permanent establishment.*—A Swiss enterprise is not subject to United States tax upon its industrial and commercial profits from sources within the United States, nor shall such profits be included in gross income, if it has not at any time during the taxable year engaged in trade or business in the United States through a permanent establishment situated therein. For example, if during the taxable year an enterprise carried on in Switzerland by a nonresident alien individual who is a resident of Switzerland, or by a Swiss corporation, were to sell merchandise, such as watches, dairy products, or liqueurs, in the United States through a commission agent or broker in the United States acting in the ordinary course of his business as such agent or broker, the profits arising from such sale would not be included in gross income and would be exempt from United States tax under Article III of the convention. Similarly, if during the taxable year such enterprise were to secure orders in the United States for such merchandise through its sales agents whose sole function in the United States is sales promotion, the orders being transmitted to Switzerland for acceptance, then the profits arising from such sales would not be included in gross income and would be exempt from United States tax.

(c) *United States permanent establishment*—(1) *General.*—A Swiss enterprise is subject to United States tax upon its industrial and commercial profits from sources within the United States to the same extent as are nonresident aliens or foreign corporations which are subject to tax pursuant to section 871 (c) or section 882 (a), Internal Revenue Code of 1954, if such enterprise has at any time during the taxable year engaged in trade or business in the United States through a permanent establishment situated therein. If it is so engaged, it is subject to United States tax upon its entire income from sources within the United States except to the extent otherwise exempt from United States tax.

(2) *Allocation of profits.*—In the determination of the income taxable to such enterprise for purposes of the United States tax, all industrial and commercial profits from sources within the United States shall be deemed to be allocable to the permanent establishment in the United States. Hence, if a Swiss enterprise which has a permanent

establishment in the United States at some time during the taxable year were to sell in the United States, through a commission agent therein acting in the ordinary course of his business as such, merchandise which has been produced in Switzerland, the profits arising from such sale would be allocable to the permanent establishment to the extent they are derived from sources within the United States, even though the sale is made independently of the permanent establishment.

(3) *Independent basis.*—The industrial and commercial profits of the permanent establishment in the United States shall be determined as if the establishment were an independent enterprise engaged in the same or similar activities under the same or similar conditions and dealing at arm's length, or on an independent basis, with the enterprise of which it is a permanent establishment.

§ 509.106 CONTROL OF A UNITED STATES ENTERPRISE BY A SWISS ENTERPRISE.—In effect, Article IV of the convention provides that, if a Swiss enterprise by reason of its control of a United States enterprise imposes on the latter enterprise conditions different from those which would result from normal business relations between independent enterprises, the accounts between the enterprises shall be adjusted in order to ascertain the true taxable income of each enterprise. The purpose is to place the controlled United States enterprise on a tax parity with an uncontrolled United States enterprise by determining, according to the standard of an uncontrolled enterprise, the true taxable income from the property and business of the controlled enterprise. The basic objective of the article is that, if the accounting records do not truly reflect the taxable income from the property and business of the United States enterprise, the Commissioner shall intervene and, by making such distributions, apportionments, or allocations as he may deem necessary of gross income, deductions, credits, or allowances, or of any item or element affecting taxable income, between the United States enterprise and the Swiss enterprise by which it is controlled or directed, shall determine the true taxable income of the United States enterprise. The provisions of section 482 of the Internal Revenue Code of 1954, and the regulations thereunder, shall, insofar as applicable, be followed in the determination of the taxable income of the United States enterprise.

§ 509.107 INCOME FROM OPERATION OF SHIPS OR AIRCRAFT.—Under Article V of the convention so much of the income from sources within the United States of a Swiss enterprise as consists of earnings derived from the operation of ships or aircraft documented or registered in Switzerland shall not be included in gross income and shall be exempt from United States tax, even though at some time during the taxable year such enterprise has engaged in trade or business in the United States through a permanent establishment situated therein.

§ 509.108 DIVIDENDS—(a) *General.*—(1) The rate of United States tax imposed by the Internal Revenue Code of 1954 upon dividends derived from sources within the United States by a nonresident alien individual who is a resident of Switzerland, or by a Swiss corporation or other entity, shall not exceed 15 percent under the provisions of Article VI of the convention, if such alien, corporation, or other entity at no time during the taxable year in which such dividends are derived has a permanent establishment in the United States.

(2) If, for example, a nonresident alien individual who is a resident of Switzerland performs personal services within the United States during the taxable year, but has at no time during such year a permanent establishment within the United States, he is entitled to the reduced rate of tax with respect to dividends derived in that year from United States sources, as provided in Article VI of the convention, even though under the provisions of section 871(c) of the Internal Revenue Code of 1954 he has engaged in trade or business within the United States during such year by reason of his having performed personal services therein.

(b) *Dividends paid by related corporation.*—The rate of United States tax imposed by the Internal Revenue Code of 1954 upon dividends derived from sources within the United States by a Swiss corporation shall not exceed 5 percent under the provisions of Article VI (2) of the convention if—

(1) The Swiss corporation is a shareholder which controls, directly or indirectly, at the time the dividend is paid 95 percent or more of the entire voting power in the corporation paying the dividend;

(2) Not more than 25 percent of the gross income of the paying corporation for the three-year period immediately preceding the taxable year in which the dividend is paid consists of dividends and interest (other than dividends and interest received by such paying corporation from its own subsidiary corporations, if any);

(3) The relationship between the paying corporation and the Swiss corporation has not been arranged or maintained primarily with the intention of securing the reduced rate of 5 percent; and

(4) The Swiss corporation at no time during the taxable year in which such dividends are derived has a permanent establishment in the United States.

§ 509.109 Interest.—The rate of United States tax imposed by the Internal Revenue Code of 1954 upon interest on bonds, securities, notes, debentures, or on any other form of indebtedness, including interest on obligations of the United States, obligations of instrumentalities of the United States, and mortgages and bonds secured by real property, which is derived from sources within the United States by a nonresident alien individual who is a resident of Switzerland, or by a Swiss corporation or other entity, shall not exceed 5 percent under the provisions of Article VII of the convention, if such alien, corporation, or other entity at no time during the taxable year in which such interest is derived has a permanent establishment in the United States.

§ 509.110 Patent and Copyright Royalties and Film Rentals.—Royalties and other amounts representing consideration for the right to use copyrights, artistic and scientific works, patents, designs, plans, secret processes and formulae, trade-marks, and other like property and rights, including rentals and like payments in respect to motion picture films or for the use of industrial, commercial, or scientific equipment, which are derived from sources within the United States by a nonresident alien individual who is a resident of Switzerland, or

by a Swiss corporation or other entity, are exempt from United States tax under the provisions of Article VIII of the convention if such alien, corporation, or other entity at no time during the taxable year in which such items of income are derived has a permanent establishment in the United States.

§ 509.111 Real Property Income and Natural Resource Royalties—(a) *General.*—Income of whatever nature derived by a nonresident alien who is a resident of Switzerland, or by a Swiss corporation or other entity, from real property situated in the United States, including gains derived from the sale or exchange of such property, rentals from such property, and royalties in respect of the operation of mines, quarries, or other natural resources situated in the United States, is not exempt from United States tax by the convention. Such items of income are subject to taxation under the provisions of the Internal Revenue Code of 1954 generally applicable to the taxation of nonresident alien individuals and foreign corporations. See Article IX of the convention. Interest derived from mortgages and bonds secured by real property does not constitute income from real property for purposes of this section but is subject to the provisions applicable to interest generally. See § 509.109.

(b) *Net basis*—(1) *General.*—Notwithstanding the provisions of paragraph (a) of this section, a nonresident alien who is a resident of Switzerland, or a Swiss corporation or other entity, who during the taxable year derives from sources within the United States any income from real property as described in such paragraph may elect for such taxable year to be subject to United States tax on a net basis as though such alien, corporation, or other entity were engaged in trade or business in the United States during such year through a permanent establishment situated therein.

(2) *Manner of electing.*—Such nonresident alien (including an individual, fiduciary, and member of a partnership) shall signify his election to be subject to tax on such a basis by filing Form 1040B clearly marked at the top of the first page thereof as follows: "Return of Resident of Switzerland Electing to File on a Net Basis Pursuant to Article IX of Swiss Income Tax Convention". Such corporation shall signify its election to be subject to tax on such a basis by filing Form 1120 clearly marked at the top of the first page thereof as follows: "Return of Swiss Corporation Electing to File on a Net Basis Pursuant to Article IX of Swiss Income Tax Convention". The election so signified shall be irrevocable for the taxable year for which such election is made. All income from sources within the United States, including gains from the sale or exchange of capital assets or of other property, shall be disclosed on the return so filed. See sections 871 and 882 of the Internal Revenue Code of 1954 and the regulations thereunder.

§ 509.112 Compensation for Labor or Personal Services—(a) *Exemptionfrom tax.*—Under Article X of the convention compensation received by a nonresident alien individual who is a resident of Switzerland for labor or personal services, including the practice of the liberal professions and the rendition of services as a director, performed in the United States shall not be included in gross income and shall be exempt from United States tax in either of the following situations:

(1) *Swiss employer.*—Where such individual is temporarily present in the United States for a period not exceeding in the aggregate a total of 183 days during a taxable year beginning on or after January 1, 1951, any compensation received by him (irrespective of when received, if received in taxable years beginning on or after January 1, 1951) for such labor or personal services performed in the United States during such year as an employee of, or under contract with, a nonresident alien (including a nonresident alien individual and fiduciary) who is a resident of Switzerland, or a Swiss corporation or other entity, whether or not such alien, corporation, or other entity is engaged in trade or business within the United States, shall not be included in gross income and shall be exempt from United States tax.

(2) *Other employers.*—Where such individual is temporarily present in the United States for a period or periods not exceeding in the aggregate a total of 183 days during a taxable year beginning on or after January 1, 1951, any compensation received by him (irrespective of when received, if received in taxable years beginning on or after January 1, 1951) for such labor or personal services performed in the United States during such year shall not be included in gross income and shall be exempt from United States tax if such compensation does not exceed $10,000 in the aggregate. Thus, if a nonresident alien individual who is a resident of Switzerland performs personal services in the United States during the taxable year as an employee of a domestic corporation for which he receives compensation of $15,000 in the aggregate, none of such compensation shall be exempt from United States tax even though such individual is present in the United States during such year for a period or periods not exceeding a total of 183 days, since the aggregate compensation received is in excess of $10,000.

(b) *Definitions.*—For purposes of this section, the term "compensation for labor or personal services" shall include, but shall not be limited to, the compensation, profits, emoluments, or other remuneration of public entertainers, such as, stage, motion picture, television, or radio artists, musicians, and athletes. For the allocation or segregation as between sources within, and sources without, the United States in the case of compensation for labor or personal services, see sections 861 through 864, Internal Revenue Code of 1954, and the regulations thereunder.

(c) *Exception.*—The provisions of this section have no application to the income to which Article XI (1) of the convention relates.

§ 509.113 GOVERNMENT WAGES, SALARIES, AND PENSIONS—(a) *General.*—Under Article XI of the convention any wage, salary, or similar compensation, or any pension, paid by Switzerland or any agency or instrumentality thereof, or by any political subdivisions or other public authorities of Switzerland, to any alien individual (whether or not a resident of the United States) or to any individual who occupies the dual status of a citizen of the United States and a citizen of Switzerland shall not be included in gross income and shall be exempt from United States tax, even though at some time during the taxable year such individual has engaged in trade or business in

the United States through a permanent establishment situated therein.

(b) *Definition.*—As used in this section, the term "pensions" means periodic payments made in consideration for services rendered or by way of compensation for injuries received. Under Article XV (2) of the convention the exclusion from gross income, and exemption from United States tax, provided by this section shall not be denied despite the provisions of Article XV. See § 509.118.

(c) *Cross reference.*—For the taxation generally of compensation of alien employees of foreign governments and the consequences of executing and filing the waiver provided for in section 247 (b) of the Immigration and Nationality Act, see section 893 of the Internal Revenue Code of 1954 and the regulations thereunder.

§ 509.114 Private Pensions and Life Annuities—(a) *General.*—Private pensions and life annuities derived from sources within the United States and paid to a nonresident alien individual who is a resident of Switzerland shall not be included in gross income and shall be exempt from United States tax, in accordance with Article XI of the convention, even though at some time during the taxable year such individual has engaged in trade or business in the United States through a permanent establishment situated therein.

(b) *Definitions.*—As used in this section, the term "pensions" means periodic payments made in consideration for services rendered or by way of compensation for injuries received; and the term "life annuities" means a stated sum payable periodically at stated times during life, or during a specified number of years, under an obligation to make the payments in return for adequate and full consideration in money or money's worth.

§ 509.115 Visiting Professors or Teachers—(a) *General.*—Pursuant to Article XII of the convention, a professor or teacher, a nonresident alien who is a resident of Switzerland, who temporarily visits the United States for the purpose of teaching for a period not exceeding two years at any university, college, school, or other educational institution situated within the United States shall, for a period not exceeding two years from the date of his initial arrival in the United States, be exempt from United States tax with respect to his remuneration earned in taxable years beginning on or after January 1, 1951, for such teaching during such period not in excess of two years.

(b) *More than two years.*—The exemption granted by Article XII is applicable to remuneration earned during such part of the individual's visit as does not exceed two years from the date of arrival even though the total period of his presence in the United States may extend beyond two years, provided that during such entire period he may be considered to be temporarily visiting the United States.

(c) *Residence.*—Such exemption shall not apply to the remuneration of an alien who is a resident of the United States or who is not a resident of Switzerland.

(d) *Nonresidence presumed.*—An individual who otherwise qualifies for the exemption from United States tax granted by Article XII shall, for a period of not more than two years immediately succeeding the date of his arrival within the United States for the purpose of such teaching, be deemed to have the tax status of a nonresident alien in the absence of proof of his intention to remain indefinitely in the United States. See section 871 of the Internal Revenue Code of 1954 and the regulations thereunder.

§ 509.116 STUDENTS OR APPRENTICES—(a) *General.*—Under Article XIII of the convention, a student or apprentice, a nonresident alien who is a resident of Switzerland, who temporarily visits the United States exclusively for the purposes of study or for acquiring business or technical experience shall not include in gross income, and shall be exempt from United States tax with respect to, amounts derived by him in taxable years beginning on or after January 1, 1951, and received during such years from without the United States as remittances for the purposes of his maintenance or studies.

(b) *Residence.*—The exemption shall not apply to remittances received by an alien who is a resident of the United States or who is not a resident of Switzerland.

§ 509.117 DIVIDENDS AND INTEREST PAID BY A FOREIGN CORPORATION—(a) *General*—(1) *Dividends.*—A dividend paid by a foreign corporation constitutes, in whole or in part, income from sources within the United States and is subject to tax by the United States when received by a nonresident alien individual or other foreign corporation, if 50 percent or more of the gross income of the paying corporation for the statutory period was derived from sources within the United States. See section 861 (a) (2) (B), section 872 (a), and section 882 (b), Internal Revenue Code of 1954; and the regulations thereunder.

(2) *Interest.*—Interest on bonds, notes, and other interest-bearing obligations of resident foreign corporations constitutes, in its entirety, income from sources within the United States and is subject to tax by the United States when received by a nonresident alien individual or other foreign corporation, if 20 percent or more of the gross income of the paying corporation for the statutory period was derived from sources within the United States. See section 861 (a) (1) (B), section 872 (a), and section 882 (b), Internal Revenue Code of 1954; and the regulations thereunder.

(b) *Exemption from United States tax.*—Notwithstanding the provisions of paragraph (a) of this section, Article XIV (1) of the convention provides that dividends and interest paid by any foreign corporation and derived by a nonresident alien who is a resident of Switzerland, or by a Swiss corporation, shall not be included in gross income and shall be exempt from United States tax if such alien or corporation at no time during the taxable year in which such items of income are derived has a permanent establishment in the United States. The exemption so provided shall apply even though the corporation paying the dividends or interest is a resident foreign corporation at the time of payment and without regard to the percentage of its gross income from sources within the United States.

§ 509.118 CREDIT AGAINST UNITED STATES TAX FOR SWISS TAX—(a) *General*—(1) *Taxable as though no convention.*—Notwithstanding any other provision of the convention the United States, in determining the United States tax of a citizen or resident of the United States, or of a domestic corporation, may, under Article XV (1) (a) of the convention, include in the basis upon which such tax is imposed all items of income taxable under the revenue laws of the United States, as though the convention had not come into effect. For example, despite the exemption from United States tax granted by Article VIII of the convention with respect to a copyright royalty,

derived from sources within the United States by a resident of Switzerland, such royalty shall be included in gross income and is subject to United States tax when so derived by a resident of Switzerland who is a citizen of the United States, even though such resident has no permanent establishment in the United States.

(2) *Exception.*—Notwithstanding the provisions of subparagraph (1) of this paragraph, the exclusion from gross income, and exemption from United States tax, granted by Article XI (1) of the convention with respect to wages, salaries, and similar compensation, and pensions, paid by Switzerland or any agency or instrumentality thereof, or by any political subdivisions or other public authorities of Switzerland, shall not be denied. See Article XV (2) of the convention.

(b) *Application of credit*—(1) *General.*—For the purpose of mitigating double taxation, Article XV (1) (a) of the convention provides that a citizen or resident of the United States, or a domestic corporation, deriving income from sources within Switzerland shall be allowed a credit against the United States tax for the amount of Swiss tax paid or accrued during the taxable year. This credit shall be made in accordance with the provisions of section 131 of the Internal Revenue Code of 1939 as in effect on September 27, 1951, but subject to the provisions of Article XVIII (2) of the convention.

(2) *Similar credit requirement.* (i) Article XV (1) (a) further provides that, by virtue of the provisions of Article XV (1) (b) of the convention, relating to the exclusion from basis for computing the Swiss tax, Switzerland satisfies the similar credit requirement set forth in section 901 (b) (3), Internal Revenue Code of 1954, relating to alien residents of the United States, etc.

(ii) This provision of Article XV (1) (a) shall be taken to mean that, solely by reason of the exclusion granted by it under Article XV (1) (b) and without reference to concessions otherwise made by such country, Switzerland satisfies the similar credit requirement only with respect to taxes paid to Switzerland, and not with respect to taxes paid to another foreign country. Nothing in this subdivision shall be construed, however, to prevent Switzerland from otherwise satisfying the similar credit requirement, in accordance with section 901 of the Internal Revenue Code of 1954 and the regulations thereunder, with respect to taxes paid to another foreign country. Thus, if pursuant to a convention between Switzerland and another foreign country, Switzerland were to exempt from its income taxes the income received from sources within such other foreign country by a United States citizen residing in Switzerland, then Switzerland would, in accordance with such regulations under section 901, satisfy the similar credit requirement of section 901 (b) (3) with respect to income taxes paid to such other country by a Swiss citizen residing in the United States.

§ 509.119 Exchange of Information—(a) *General.*—(1) By Article XVI of the convention the United States and Switzerland adopt the principle of exchange of such information as is necessary for carrying out the provisions of the convention, preventing fraud, or detecting practices which are aimed at the reduction of the revenues of either country, but not including information which would be contrary to public policy or which would disclose any trade, business, industrial, or professional secret or any trade process.

(2) The information and correspondence relative to exchange of information may be transmitted directly by the Commissioner to the Director of the Federal Tax Administration.

(b) *Return of information by withholding agents.*—(1) To facilitate compliance with Article XVI of the convention, every United States withholding agent shall make and file in duplicate with the District Director of Internal Revenue, Baltimore 2, Maryland, an information return on Form 1042 Supplement, with respect to persons having addresses in Switzerland, which shall be filed for the calendar year 1955 and subsequent calendar years. This return shall be filed simultaneously with Form 1042.

(2) There shall be reported on such Form 1042 Supplement all items of fixed or determinable annual or periodical income (and amounts described in section 402 (a) (2), section 631 (b) and (c), and section 1235 of the Internal Revenue Code of 1954, which are considered to be gains from the sale or exchange of capital assets) derived from sources within the United States and paid to nonresident aliens (including nonresident alien individuals, fiduciaries, and partnerships) and to nonresident foreign corporations, whose addresses at the time of payment were in Switzerland, including such items of income upon which, in accordance with the withholding regulations under the convention, no withholding of United States tax is required; except that any of such items which constitute interest in respect of which Form 1001–S or substitute Form 1001–S has been filed in duplicate with the withholding agent is not required to be reported on such Form 1042 Supplement.

(c) *Information to be furnished in ordinary course.*—In compliance with the provisions of Article XVI of the convention the Commissioner will transmit to the Director of the Federal Tax Administration, as soon as practicable after the close of the calendar year 1955 and of each subsequent calendar year during which the convention is in effect, the following information relating to such preceding calendar year:

(1) The duplicate copy of each available Form 1042 Supplement filed pursuant to paragraph (b) of this section; and

(2) The duplicate copy of each available ownership certificate, Form 1001–S, and substitute Form 1001–S, filed pursuant to the withholding regulations under the convention, in connection with coupon bond interest.

(d) *Information in specific cases.*—Under the provisions and limitations of Article XVI of the convention and upon request of the Director of the Federal Tax Administration, the Commissioner shall furnish to the Director information available to, or obtainable by, the Commissioner relative to the tax liability of any person under the revenue laws of Switzerland in any case in which such information is necessary for carrying out the provisions of the convention or for the prevention of fraud or the like in relation to the taxes which are the subject of the convention.

§ 509.120 Double Taxation Claims—(a) *General.*—Under Article XVII of the convention, where the taxpayer shows proof that the action of the tax authorities of the United States or Switzerland has resulted, or will result, in double taxation contrary to the provisions of the convention, he is entitled to present the facts to the country of

which he is a citizen; or, if he is not a citizen of either country, to the country of which he is a resident; or, if the taxpayer is a corporation or other entity, to the country in which it is created or organized. The article provides that, should the taxpayer's claim be deemed worthy of consideration, the competent authority of the country to which the facts are presented shall undertake to come to an agreement with the competent authority of the other country with a view to equitable avoidance of the double taxation in question.

(b) *Manner of filing claim.*—Such a claim on behalf of a United States citizen, corporation, or other entity, or on behalf of a resident of the United States who is not a Swiss citizen, shall be filed with the Commissioner. The claim shall be set up in the form of a letter addressed to "The Commissioner of Internal Revenue, Washington 25, D. C." and shall show fully all facts and law on the basis of which the claimant alleges that such double taxation has resulted or will result. If the Commissioner determines that there is an appropriate basis for the claim under the convention, he shall take up the matter with the Director of the Federal Tax Administration with a view to arranging an agreement of the character contemplated by Article XVII.

§ 509.121 Beneficiaries of an Estate or Trust—(a) *Qualified beneficiary.*—If he otherwise satisfies the requirements of the respective articles concerned, a nonresident alien who is a resident of Switzerland and who is a beneficiary of an estate or trust shall be entitled to the exemption from, or reduction in the rate of, United States tax granted by Articles VI, VII, VIII, and XIV of the convention with respect to dividends, interest, and royalties and other like amounts, to the extent that (1) any amount paid, credited, or required to be distributed by such estate or trust to such beneficiary is deemed to consist of such items and (2) such items would, without regard to the convention, be includible in his gross income.

(b) *Amounts otherwise includible in gross income of beneficiary.*—For the determination of amounts which, without regard to the convention, are includible in the gross income of the beneficiary, see subchapter J of chapter 1 of the Internal Revenue Code of 1954, and the regulations thereunder.

§ 509.122 Swiss Partnerships—(a) *General.*—Whether an individual, corporation, or other entity, a member of a partnership created or organized under Swiss laws, is subject to United States tax upon such person's distributive share of the income of such partnership depends upon both the status of the partnership and the status of such member.

(b) *Citizen partner.*—A citizen or resident of the United States, or a domestic corporation, is subject to the United States tax upon such person's distributive share of the income of such partnership as though the convention had not come into effect, but subject to the provisions of § 509.118; even though other members, by reason of benefits granted by the convention, are not subject to United States tax upon their distributive share of such income.

(c) *Noncitizen partner.*—In any case in which income is derived from sources within the United States by a partnership created or organized under Swiss laws, any member of such partnership who has a permanent establishment in the United States or who is either a non-

resident alien not a resident of Switzerland or is a foreign corporation which is not Swiss is not entitled, with respect to such member's distributive share of such income, to any benefit granted by the convention solely to nonresident aliens residing in Switzerland, or to Swiss corporations or other entities, having no permanent establishment in the United States. Conversely, any member of such partnership who individually complies with the requirements for obtaining any such benefit will be entitled thereto with respect to such member's distributive share of such income. A member of a Swiss partnership which has a permanent establishment in the United States shall likewise be considered to have a permanent establishment in the United States.

O. GORDON DELK,
Acting Commissioner of Internal Revenue.

Approved October 6, 1955.

H. CHAPMAN ROSE,
Acting Secretary of the Treasury.

(Filed by the Division of the Federal Register October 11, 1955, 8:48 a. m.)

UNITED STATES–UNITED KINGDOM ESTATE TAX CONVENTION

T. D. 5565, C. B. 1947–1, 125, SECTION 82.104: Rev. Rul. 55–701
Situs of property.

In the application of the United States–United Kingdom Estate Tax Convention, a partner's share in a copartnership is situated where the partnership business is carried on.

Advice has been requested concerning the situs, under the estate tax convention between the United States and the United Kingdom, Treasury Decision 5565, C. B. 1947–1, 125, of a share in a partnership conducting a business in the United States.

At the time of death, the decedent was a British subject domiciled in England and a partner in a copartnership organized in and doing business in the State of New York.

In resolving this question, three possible positions are considered: (1) that his interest constitutes a debt and, consequently, under the terms of Article III(2)(c) of the treaty is situated at the place of decedent's domicile; (2) that the situs of his interest is where the individual items of the partnership assets are located; and (3) that the situs of a partner's interest is where the business is carried on.

Article III(2)(c) of the treaty provides that debts, other than the forms of indebtedness for which specific provision is otherwise made in the treaty, shall be deemed situated at the place where the decedent was domiciled at the time of death. This is not a situs rule in the true sense, but constitutes a special exemption from taxation based on situs of property in the taxing jurisdiction. This special exemption is directed to investments predominantly characterized by the debtor-creditor relationship and there was no intention to encompass in this special exemption proprietary interests such as characterize a share of stock or a partnership interest.

Although on dissolution of a partnership a partner is entitled to share in what would remain of the partnership assets after its liabilities are satisfied, and such interest constitutes a chose in action, this does not adequately describe the interest for estate tax purposes. Under the Federal estate tax statute (section 2033 of the Internal Revenue Code of 1954), such property is subjected to tax under the clause reading "the gross estate shall include the value of all property (except real property situated outside of the United States) to the extent of any interest therein of the decedent at the time of his death." A partnership interest at the time of a partner's death is not in the nature of a debt although it may accrue as a debt after death.

Paragraph (2) of Article III of the treaty provides in effect that as to any property not falling within the specific situs rules of the article situs shall be determined, in the case of a deceased domiciliary of the United Kingdom, by the law in the United States, and, in the case of a deceased domiciliary of the United States, by the law in the United Kingdom. No specific situs rule is provided in this article for a partnership interest.

The second possible position heretofore mentioned (consideration of the individual items of the partnership assets) has some support in State court decisions, notably a decision by the Supreme Court of Montana, *In re Perry's Estate*, 192 P. 2d 532, 121 Mont. 280. However, this decision does not have the support of the weight of authority and cannot be regarded as the Federal rule.

In the decision of the United States Supreme Court, *Blodgett, Tax Commissioner of State of Connecticut* v. *Silberman et al.*, 277 U. S. 1, it was held that for the purpose of the application of an inheritance tax by the State of Connecticut a deceased partner's interest constitutes intangible personal property. In the Blodgett case the decedent was domiciled in Connecticut and a partner of a New York partnership. A considerable portion of the partnership assets consisted of real estate located in New York. Under the law, the Connecticut inheritance tax was not applicable to real estate located outside Connecticut and the question at issue was whether the decedent's interest was intangible property as a share of the partnership or whether a portion of it consisted of real estate located in New York. Although this decision does not directly hold that the situs of a partnership interest is where the partnership business is carried on, it is inherent in the decision that the situs of the partnership interest is not to be determined by the location of the underlying assets of the partnership.

In *Salomon Bros. & Hutzler* v. *Pedrick*, 105 Fed. Supp. 210, the United States District Court for the Southern District of New York, commenting upon the nature of a partner's interest in a partnership, said: "It also seems abundantly clear that under the New York statute, the individual partner has no fractional right in specific partnership property which he alone can assign. He is incapable of making an individual transfer of a fractional interest in each security held by the firm. * * * The law in New York is settled that a partner is not the owner of a fractional or undivided interest in each partnership asset." The New York partnership law is stated to follow the Uniform Partnership Act. The court said it is clear that "the rights of each individual partner in specific partnership assets, referred to in

the statute as 'tenant in partnership' fall short of what would ordinarily be regarded as individual ownership even of an undivided interest in specific assets."

In *Commissioner of Stamp Duties* v. *Salting* (1907), A. C. 449, it was held that for the purpose of the New South Wales death duty situs is where the business was carried on at the time of the deceased partner's death. In this case the deceased partner was domiciled in England but was a partner in the business of graziers and sheep farmers carried on in the State of New South Wales. It was held that the New South Wales tax was properly applicable on the basis of situs of property in that State. This is the leading case directly in point on the subject, establishes the British position, and is to be given weight in establishing our position.

In view of the foregoing, it is held that in the application of the United States-United Kingdom Estate Tax Convention the situs of a partnership interest is where the business is carried on.

SUBPART C.—COMMITTEE REPORTS

[H. R. 257]
SALE OF RESIDENCE BY MEMBERS OF THE ARMED FORCES

[House of Representatives Report No. 1352, Eighty-fourth Congress, First Session]

[July 23, 1955]

Mr. BYRNES of Wisconsin, from the Committee on Ways and Means, submitted the following report [To accompany H. R. 257]:

The Committee on Ways and Means, to whom was referred the bill (H. R. 257) to amend section 112 (n) (8) of the Internal Revenue Code of 1939 to provide that in certain cases of a sale or exchange of a taxpayer's residence, certain periods of limitation shall not run against the taxpayer while he is on extended active duty in the Armed Forces, having considered the same, report favorably thereon without amendment and recommend that the bill do pass.

PURPOSE OF BILL

The purpose of this bill is to remove an unintentional discrimination against those in the Armed Forces of the United States who sold or exchanged their residences prior to January 1, 1954. For such persons, but not for those who have sold such residences since that time, the suspension of the time restrictions for replacing of the residences without tax consequences ended as of December 31, 1953. This bill provides that the replacement period under the 1939 code, as is presently provided under the 1954 code, is to be available to those on active duty with the Armed Forces during a period when an induction law is in effect but not more than 4 years.

REASONS FOR BILL

Under both the 1939 code and the 1954 code, the recognition of capital gain on the sale of a taxpayer's principal residence is postponed in most cases, provided the proceeds of the sale are used to acquire a new residence within 1 year or to construct a residence within 18 months. In the case of qualifying sales the basis of the old residence is carried over to the new residence.

In the case of members of the Armed Forces both the 1939 and 1954 codes (sec. 112(n)(8) of the 1939 code and sec. 1034(h) of the 1954 code) provide that the replacement period will not if the taxpayer or his spouse is on extended active duty after the sale of the old residence. However, in no case is the replacement period postponed for more than 4 years after the date of sale of the old residence.

The 1939 code, however, suspended the running of this replacement period only until January 1, 1954. The 1954 code, in view of the continuance of the draft and the recall of reserves to active duty, removed this January 1, 1954, date altogether and provided instead for the postponement of the running of the replacement period during any period in which individuals are liable for induction into the Armed Forces. The requirement that the period of suspension is not extended beyond 4 years from the date of sale of the old residence is retained.

The nonrecognition of gain under section 1034(a) of the 1954 code applies only to sales of residences after December 31, 1953. But the 1939 code continues to apply to cases where the sale of a residence occurred prior to January 1, 1954, and for such cases the January 1, 1954, cutoff date continues to apply. As a result those who, while on extended active duty, sold their residences prior to January 1, 1954, are denied the privilege of postponing the running of the replacement period beyond December 31, 1953, while those who sold their residences after December 31, 1953, may postpone the running of this period for as much as 4 years if they remain on active duty that long.

EXPLANATION OF BILL

The bill removes the discrimination against those who sold their residences prior to January 1, 1954, by striking out, in section 112(n) (8) of the 1939 code, the

reference to before January 1, 1954, and inserting in its place "* * * during an induction period * * *." This conforms the 1939 code with the 1954 code in this respect. The effect of the amendment for those members of the Armed Forces of the United States who sold their residences prior to 1954 is to postpone the running of the replacement prior for as much as 4 years if they are on active duty in the Armed Forces for such period.

The amendment to the 1939 code made by this bill is effective as of December 31, 1953, or just before the end of the period for the suspension of the running of the replacement period.

The revenue effect of this bill is expected to be negligible.

This bill has been reported unanimously by your committee.

CHANGES IN EXISTING LAW[1]

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[H. R. 257]
SALE OF RESIDENCE BY MEMBERS OF THE ARMED FORCES

[Senate Report No. 1254, Eighty-fourth Congress, First Session, Calendar No. 1271]

[July 29, 1955]

Mr. BYRD, from the Committee on Finance, submitted the following report [To accompany H. R. 257]:

The Committee on Finance, to whom was referred the bill (H. R. 257) to amend section 112(n)(8) of the Internal Revenue Code of 1939 to provide that in certain cases of a sale or exchange of a taxpayer's residence, certain periods of limitation shall not run against the taxpayer while he is on extended active duty in the Armed Forces, having considered the same, report favorably thereon with amendments and recommend that the bill do pass.

SECTION 1

Section 1 of the bill removes an unintentional discrimination against those in the Armed Forces of the United States who sold or exchanged their residences prior to January 1, 1954. For such persons, but not for those who have sold such residences since that time, the suspension of the time restrictions for replacing of the residences without tax consequences ended as of December 31, 1953. This bill provides that the replacement period under the 1939 code, as is presently provided under the 1954 code, is to be available to those on active duty with the Armed Forces during a period when an induction law is in effect but not more than 4 years.

REASONS FOR SECTION 1

Under both the 1939 code and the 1954 code, the recognition of capital gain on the sale of a taxpayer's principal residence is postponed in most cases, provided the proceeds of the sale are used to acquire a new residence within 1 year or to construct a residence within 18 months. In the case of qualifying sales the basis of the old residence is carried over to the new residence.

In the case of members of the Armed Forces both the 1939 and 1954 codes (sec. 112(n)(8) of the 1939 code and sec. 1034(h) of the 1954 code) provide that the replacement period will not if the taxpayer or his spouse is on extended active duty after the sale of the old residence. However, in no case is the replacement period postponed for more than 4 years after the date of sale of the old residence.

The 1939 code, however, suspended the running of this replacement period only until January 1, 1954. The 1954 code, in view of the continuance of the draft and the recall of Reserves to active duty, removed this January 1, 1954, date altogether and provided instead for the postponement of the running of the replacement period during any period in which individuals are liable for induction into the Armed Forces. The requirement that the period of suspension is not extended beyond 4 years from the date of sale of the old residence is retained.

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[1] Not reproduced.

The nonrecognition of gain under section 1034(a) of the 1954 code applies only to sales of residences after December 31, 1953. But the 1939 code continues to apply to cases where the sale of a residence occurred prior to January 1, 1954, and for such cases the January 1, 1954, cutoff date continues to apply. As a result those who, while on extended active duty, sold their residences prior to January 1, 1954, are denied the privilege of postponing the running of the replacement period beyond December 31, 1953, while those who sold their residences after December 31, 1953, may postpone the running of this period for as much as 4 years if they remain on active duty that long.

SECTION 2

Section 2 of the bill adds a new section to the 1954 code which is complementary to section 1341 of the 1954 code.

Section 1341 deals with the situation where a taxpayer mistakenly includes an item in his gross income of a prior year(s), and in a later year is required to restore the money or property which gave rise to the item of income in the prior year. Where the restored item amounts to $3,000, or more, section 1341 allows the taxpayer the option of: (1) deducting the restored amount in the tax year it is restored to a third party; or (2) computing the tax for the restoration year without deducting the amount restored, and then lowering the tax of the taxable (restoration) year by the amount of decrease in tax caused by excluding the restored item(s) from the income of the earlier year(s) in which reported.

The proposed bill would give a similar option to a taxpayer who, mistakenly thinking a third party had a claim of right to money or property, takes a deduction for the item(s) in an earlier year(s). In the tax year taxpayer recovers the item(s) previously deducted.

Where the recovered item amounts to $3,000, or more, the proposed bill would allow the taxpayer, in computing the tax for the tax year (recovery year), the option of: (1) including the recovered item in the income of the tax year; or (2) excluding the amount from the tax year's income and adding the amount of tax caused by putting the item(s) back in the prior year(s).

However, section 2 is limited to situations where an item was deducted from gross income for a prior taxable year (or years) because it appeared that another person held an unrestricted right to such item as a result of a court decision in a patent infringement case suit (whether or not the taxpayer is a party to such suit) which court decision was later reversed on the ground that such decision was induced by fraud or undue influence. Interest will be computed on the increase in tax resulting solely from the elimination of such item as a deduction for the prior taxable year. This section applies with respect to taxable years after December 31, 1954.

CHANGES IN EXISTING LAW[1]

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[H. R. 291]
RETIREMENT INCOME TAX CREDIT FOR ARMED FORCES

[House of Representatives Report No. 1288, Eighty-fourth Congress, First Session]

[July 20, 1955]

Mr. Cooper, from the Committee on Ways and Means, submitted the following report [To accompany H. R. 291]:

The Committee on Ways and Means, to whom was referred the bill (H. R. 291) to extend the retirement income-tax credit to members of the Armed Forces, having considered the same, report favorably thereon with an amendment and recommended that the bill as amended do pass.

The amendment is as follows:

Page 1, line 10, strike out "1953" and insert "1954".

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[1] Not reproduced.

PURPOSE

H. R. 291 would allow retired members of the Armed Forces who have not attained age 65 to qualify for the retirement income tax credit allowed under section 37 of the Internal Revenue Code of 1954 in the same manner as other persons who retire under a public retirement system.

GENERAL STATEMENT

The Internal Revenue Code of 1954 (Public Law 591, 83d Cong.) provided a new tax credit for retirement income. This retirement income tax credit as enacted by the House (H. R. 8300, 83d Cong.) was limited to individuals who had attained the age of 65. The Senate amended the House version of this provision to provide that persons who retire under a "public retirement system" may qualify for the credit without regard to whether or not they had attained the age of 65. In defining the term "public retirement system" the Senate specifically excluded a retirement fund or system established by the United States for members of the Armed Forces of the United States. Because the subject of eliminating the age requirement for eligibility for the retirement credit with respect to military personnel was not germane to the conference, the amendment was accepted by the conferees.

Your committee's bill would remove the discrimination existing under present law against members of the Armed Forces by allowing them to claim the retirement income tax credit under the same circumstances and to the same extent as retired civil servants and others under a public retirement system. This provision will be of benefit to those persons who upon retirement from the Armed Forces do not obtain other employment. This provision is not likely to benefit a retired person who obtains other employment, since the amount of retirement income on which the credit is computed each year cannot exceed $1,200 less the amount of any earned income in excess of $900. Thus, for persons who retire and then secure another job the retirement income tax credit would be reduced, dollar for dollar, for earnings over $900. For persons who receive $2,100 or more per year in earned income there would be no retirement income tax credit allowed.

Your committee has adopted an amendment to H. R. 291 so that the bill would apply only with respect to taxable years beginning after December 31, 1954.

The Department of Defense has recommended this legislation to the Congress. Your committee is unanimous in urging the enactment of H. R. 291, as amended.

It is estimated that the enactment of this bill will result in a loss of revenue of $6 million.

CHANGES IN EXISTING LAW[1]

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[H. R. 291]
RETIREMENT INCOME TAX CREDIT FOR ARMED FORCES

[Senate Report No. 1142. Eighty-fourth Congress, First Session, Calendar No. 1154]

[July 26, 1955]

Mr. Byrd, from the Committee on Finance, submitted the following report [To accompany H. R. 291]:

The Committee on Finance, to whom was referred the bill (H. R. 291) to extend the retirement income-tax credit to members of the Armed Forces, having considered the same, report favorably thereon without amendment and recommend that the bill do pass.

By virtue of this act, the Committee on Finance accepts the report of the Committee on Ways and Means, which is as follows:

[See House Report No. 1288, page 841 of this Bulletin.]

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[1] Not reproduced.

[H. R. 542]
INCOME TAX WITHHELD ON NONCASH REMUNERATION TO RETAIL COMMISSION SALESMEN

[House of Representatives Report 1289, Eighty-fourth Congress, First Session]

[July 20, 1955]

Mr. Keogh, from the Committee on Ways and Means, submitted the following report [To accompany H. R. 542]:

The Committee on Ways and Means, to whom was referred the bill (H. R. 542) to amend the Internal Revenue Code, having considered the same, report favorably thereon with an amendment and recommend that the bill do pass.

The amendment is as follows:

Page 2, strike out lines 12, 13, and 14, and insert:

Secretary or his delegate such information with respect to such remuneration as the Secretary or his delegate may by regulation prescribe.

PURPOSE

This bill amends section 3402 of the Internal Revenue Code of 1954 by adding a new subsection which exempts from the withholding tax provisions certain noncash remuneration paid to retail commission salesmen.

GENERAL STATEMENT

Under present law, the term "wages" for purposes of the withholding tax on wages includes remuneration for services performed by an employee, including the cash value of remuneration includible in gross income paid in any medium other than cash. However, there are exemptions from such withholding for certain types of taxable wages, such as wages paid agricultural laborers, ministers, etc.

The bill provides that when an employee is paid in a medium other than cash for services performed by him as a retail commission salesman, the remuneration will not be subjected to withholding if the individual is ordinarily compensated solely by way of cash commissions. It is required, under the bill as reported, that the employer in such cases file with the Secretary of the Treasury or his delegate any information with respect to the noncash remuneration that may be required under regulations prescribed by the Secretary of the Treasury or his delegate.

Employers who pay their retail salesmen on a commission basis frequently offer noncash prizes to salesmen who exceed their quotas or who achieve outstanding sales records and so on. The stimulus to sales promotion which is provided by these noncash prizes may be substantially lessened if the employer is required to withhold from the employee's wages to the extent of the fair market value of these prizes. The bill, therefore, exempts this noncash remuneration from the withholding tax. It does not, however, affect the taxability to the retail commission salesman of the noncash remuneration.

The bill is effective with respect to remuneration paid after the date of enactment of this bill.

No revenue loss is expected to result from the enactment of this bill.

CHANGES IN EXISTING LAW [1]

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[H. R. 542]
INCOME TAX WITHHELD ON NONCASH REMUNERATION TO RETAIL COMMISSION SALESMEN

[Senate Report No. 1143, Eighty-fourth Congress, First Session, Calendar No. 1155]

[July 26, 1955]

Mr. Byrd, from the Committee on Finance, submitted the following report [To accompany H. R. 542]:

[1] Not reproduced.

The Committee on Finance, to whom was referred the bill (H. R. 542) to amend the Internal Revenue Code, having considered the same, report favorably thereon without amendment and recommend that the bill do pass.

By virtue of this act, the Committee on Finance accepts the report of the Committee on Ways and Means, which is as follows:

[See House Report No. 1289, page 843 of this Bulletin.]

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CHANGES IN EXISTING LAW[1]

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[H. R. 2553]
AMENDMENT OF SECTION 223 OF THE REVENUE ACT OF 1950

[House of Representatives Report No. 1353, Eighty fourth Congress, First Session]

[July 23, 1955]

Mr. Boggs, from the Committee on Ways and Means, submitted the following report [to accompany H. R. 2553]:

The Committee on Ways and Means, to whom was referred the bill (H. R. 2553) to amend section 502(f) of the Internal Revenue Code of 1939, as amended by section 223 of the Revenue Act of 1950, relating to the use of corporation property by a shareholder, having considered the same, report favorably thereon with amendments and recommend that the bill as amended do pass:

The amendments are as follows:

Strike out all after the enacting clause and insert the following:

That section 223 of the Revenue Act of 1950 (relating to use of corporation property by a shareholder) is hereby amended by striking out "January 1, 1950" and inserting in lieu thereof "January 1, 1954".

SEC. 2. No interest shall be allowed or paid on any overpayment resulting from the amendment made by the first section of this Act.

Amend the title so as to read:

A bill to amend section 223 of the Revenue Act of 1950, relating to the use of corporation property by a shareholder.

PURPOSE OF BILL

H. R. 2553 qualifies the application of section 502(f) of the Internal Revenue Code of 1939 to provide that personal holding company income is not to include rents received during taxable years ending after December 31, 1945, and before January 1, 1954, if the rents are for the use of property of a corporation where the lessee uses the property in the operation of a bona fide commercial, industrial, or mining enterprise. The same treatment was provided for the years 1946 through 1949 and somewhat similar treatment is provided for 1954 and subsequent years by the Internal Revenue Code of 1954.

REASONS FOR BILL

Both the 1939 and 1954 codes provide that if a closely held corporation receives most of its income from such sources as dividends, interest, certain rents, and royalties, indicating that the company is being used as an "incorporated pocketbook," it is designated for tax purposes as a personal holding company. Generally, such a company, in addition to paying the regular corporate income taxes, is subject to an additional penalty tax at the rate of 75 percent or 85 percent on its undistributed income.

Included in personal holding company income under section 502(f) of the 1939 code (sec. 543(a)(6) of the 1954 code) are amounts received for the use of the corporation's property where 25 percent or more of the stock of the corporation is held by the individual renting the corporate property. However, the Revenue Act of 1950 provided an exception to this rule for taxable years ending after 1945 and before 1950. The exception provided that personal holding com-

[1] Not reproduced.

pany income, despite this 25-percent rule, was not to include property leased by a corporation to an individual if he used the property in the operation of a bona fide commercial, industrial, or mining enterprise. The Senate Finance Committee's report on the Revenue Act of 1950 indicated that this exception to the general 25-percent rule was provided because—

> * * * through a set of fortuitous circumstances, corporations have become closely held and also have rented most of their assets for use in the operation of businesses to the individuals holding the stock of the companies. Thus, unwittingly the corporations have become personal holding companies and subject to the penalty tax.

This same problem was recognized in the Internal Revenue Code of 1954 with respect to taxable years beginning after December 31, 1953, and ending after August 16, 1954. In this case, however, the exception to the 25-percent rule is expressed in somewhat different terms. For 1954 and subsequent years the 25-percent rule with respect to use of corporate property by a shareholder is to apply only to a corporation which has personal holding company income, wholly apart from rents or other compensation for the use of property, in excess of 10 percent of its gross income. The report of your committee on the Internal Revenue Code of 1954 indicates that this amendment is designed to take care of hardship cases which frequently arise where a corporation rents property to its principal stockholders. Your committee's report on the 1954 code states:

> In the absence of appreciable amounts of other investment income, rental income received from shareholders does not constitute a tax avoidance problem.

As a result of the 1950 and 1954 actions an anomalous situation is presented whereby the rental of property by a company to its principal stockholders is permitted in certain cases with respect to the years 1946 through 1949 and for 1954 and subsequent years, but, is classified as personal holding company income for the years 1950 through 1953.

EXPLANATION OF BILL

This bill removed this anomaly situation by providing that for the years ending after December 31, 1945, and before January 1, 1954, section 502(f) of the 1939 code (which is the subsection providing that compensation for the use of corporate property by a shareholder holding 25 percent or more of the stock of the corporation is to be classified as personal holding company income) is not to apply with respect to rents received for the use by the stockholder in the operation of a bona fide commercial, industrial, or mining enterprise of the property of the corporation.

It is estimated that any revenue loss resulting from the enactment of this bill will be negligible.

This bill has been reported unanimously by your committee.

CHANGES IN EXISTING LAW[1]

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[H. R. 2553]
AMENDMENT OF SECTION 223 OF THE REVENUE ACT OF 1950

[Senate Report No. 1242, Eighty-fourth Congress, First Session. Calendar No. 1259.]

[July 29, 1955]

Mr. Byrd, from the Committee on Finance, submitted to the following report [to accompany H. R. 2553]:

The Committee on Finance, to whom was referred the bill (H. R. 2553) to amend section 502(f) of the Internal Revenue Code of 1939, as amended by section 223 of the Revenue Act of 1950, relating to the use of corporation property by a shareholder, having considered the same, report favorably thereon without amendment and recommend that the bill do pass.

[1] Not reproduced.

By virtue of this act, the Committee on Finance accepts the report of the Committee on Ways and Means.

[See House Report No. 1353, page 844 of this Bulletin.]

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CHANGES IN EXISTING LAW[1]

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[H. R. 2619]
AMENDMENT OF SECTION 345 OF THE REVENUE ACT OF 1951

[House of Representatives Report No. 1438, Eighty-fourth Congress, First Session]

[July 26, 1955]

Mr. Cooper, from the Committee on Ways and Means, submitted the following report [To accompany H. R. 2619]:

The Committee on Ways and Means, to whom was referred the bill (H. R. 2619) to amend section 345 of the Revenue Act of 1951, having considered the same, report favorably thereon without amendment and recommend that the bill do pass.

PURPOSE OF BILL

This bill provides that if a credit or refund under section 345 of the Revenue Act of 1951 of the tax on the income of certain trusts was barred by operation of law or rule of law (other than a closing agreement or compromise), credit or refund is nevertheless to be allowed if the claim is filed within 1 year of the date of enactment of this bill. No interest is to be allowed or paid on such refunds or credits. The trusts referred to are those where the income had been accumulated for the benefit of servicemen killed on active duty during the period December 7, 1941, to January 1, 1948.

REASONS FOR BILL

Section 345 of the Revenue Act of 1951 provided for a credit or refund of the tax paid on the income of trusts where the income had been accumulated for a member of the military or naval forces of the United States or of one of the other United Nations if the serviceman died in active service in the period December 7, 1941, to January 1, 1948.

No relief was provided in the 1951 act, however, for cases where refunds or credits were barred by the expiration of the period of limitations, by prior court decisions, or for other similar reasons. Your committee is of the opinion that this failure was an oversight, and it believes that it is only equitable to extend treatment equivalent to that provided in section 345 of the Revenue Act of 1951 to cases where refunds or credits were barred by operation of law or rule of law (other than closing agreements or compromises).

It is believed that the revenue loss resulting from the enactment of this bill will be negligible.

This bill has been reported unanimously by your committee.

[H. R. 2619]
AMENDMENT OF SECTION 345 OF THE REVENUE ACT OF 1951

[Senate Report No. 1243, Eighty-fourth Congress, First Session. Calendar No. 1260]

[July 29, 1955]

Mr. Byrd, from the Committee on Finance, submitted the following [To accompany H. R. 2619]:

The Committee on Finance, to whom was referred the bill (H. R. 2619) to amend section 345 of the Revenue Act of 1951, having considered the same,

[1] Not reproduced.

report favorably thereon without amendment and recommend that the bill do pass.

By virtue of this act, the Committee on Finance accepts the report of the Committee on Ways and Means, which is as follows:

[See House Report No. 1438, page 846 of this Bulletin.]

[H. R. 3437]
MANUFACTURERS' EXCISE TAX ON THE LEASES OF CERTAIN AUTOMOBILE UTILITY TRAILERS

[House of Representatives Report No. 1290, Eighty-fourth Congress, First Session]

[July 20, 1955]

Mr. Ikard, from the Committee on Ways and Means, submitted the following report [To accompany H. R. 3437]:

The Committee on Ways and Means, to whom was referred the bill (H. R. 3437) to amend the Internal Revenue Code of 1954 to provide for a maximum manufacturers' excise tax on the leases of certain automobile utility trailers, having considered the same, report favorably thereon with amendments and recommend that the bill as amended do pass.

The amendments are as follows:

Page 2, line 5, strike out "price" and insert "value".

Page 2, line 18, strike out "price" and insert "value".

Page 3, line 10, after the period insert:

In the application of section 4216 (d) of the Internal Revenue Code of 1954 (as added by this Act) to any article which has been leased before the effective date specified in the preceding sentence, under regulations prescribed by the Secretary of the Treasury or his delegate—

(1) the fair market value of such article shall be the fair market value determined as of such effective date;

(2) only payments under a lease received on or after such effective date shall be considered in determining when the total tax (as defined in such section 4216 (d)) has been paid;

(3) any lease existing on such effective date, or if there is none, the first lease entered into after such effective date, shall be considered an initial lease (except that fair market value shall be determined as provided in paragraph (1) of this sentence); and

(4) any lease existing on such effective date shall be considered as having been entered into on such date.

GENERAL STATEMENT

Section 4217 of the 1954 code provides that—

* * * the lease of an article (including any renewal or any extension of a lease or any subsequent lease of such article) by the manufacturer, producer, or importer shall be considered a taxable sale of such article.

Under this provision, if a manufacturer leases articles subject to a manufacturers' excise tax, the manufacturers' tax will apply to the amount of each lease payment on the same basis as if it were a sale.

This bill modifies the rule described above by adding a new subsection (d) to section 4216, relating to the definition of price, providing that the maximum tax imposed on the leasing of certain automobile trailers, or semitrailers, is to be an amount equal to the applicable tax rate (10 percent or 8 percent at the present time) multiplied by the fair market value of the trailer at the time of the initial lease. The taxpayer is given the option under the new subsection (d) to pay the tax in full at the time of the initial lease or to spread the taxpayments over the period of the lease payments. Under the latter option the tax payable with respect to each lease payment is to be an amount equal to the applicable tax rate multiplied by the amount of each lease payment until the total amount collected in this manner equals the maximum tax described above. Thereafter the lease payments are to be free of tax.

The new subsection (d) provides that the treatment described above is to be available for trailers or semitrailers suitable for use with passenger automobiles whether the trailers are subject to the 8-percent tax on trucks and similar items, or to the 10-percent tax on passenger automobiles, etc.

At the present time manufacturers of utility trailers who also maintain a rental business are discriminated against, relative to businesses which carry on either, but not both, of these activities. Frequently the sum of the rental payments received on a utility trailer substantially exceeds the price at which a manufacturer would sell such a trailer, since each such rental payment includes not only a pro rata portion of the cost of the trailer but also a share of the expenses of maintaining the rental business as well. Thus, the tax payable by the manufacturer who leases utility trailers is likely to be substantially greater than the tax of the manufacturer who sells these trailers. Moreover, a competitor who may lease the trailers but does not manufacture them pays no excise tax at all.

Provision is made under the new subsection (d) for cases where a trailer is sold after having been leased for a period of time, but not long enough for the payment of the full tax. In such cases it is provided that the tax payable at the time of the sale is to be the difference between the tax already paid, and the maximum tax described above. However, in such cases the tax is not to exceed the applicable tax rate (at the time of the initial lease) multiplied by the actual sales price of the trailer.

The committee amendment also makes provision for articles which have been leased prior to the effective date of the bill. In such a case the bill, as amended, provides that the lease is to be considered a new lease as of the effective date of the bill and that taxes paid on prior lease payments are to be ignored in applying this provision. If no lease is in effect on the date of enactment of the bill the taxpayer is to consider the first lease made after that date as the initial lease.

This bill is to be effective on the first day of the first month beginning more than 10 days after the date of its enactment.

It is estimated that the revenue loss involved in this provision will be negligible.

CHANGES IN EXISTING LAW [1]

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[H. R. 3437]
MANUFACTURERS' EXCISE TAX ON THE LEASES OF CERTAIN AUTOMOBILE UTILITY TRAILERS

[Senate Report No. 1144, Eighty-fourth Congress, First Session, Calendar No. 1156]

[July 26, 1955]

Mr. Byrd, from the Committee on Finance, submitted the following report [To accompany H. R. 3437]:

The Committee on Finance, to whom was referred the bill (H. R. 3437) to amend the Internal Revenue Code of 1954 to provide for a maximum manufacturers' excise tax on the leases of certain automobile utility trailers, having considered the same, report favorably thereon without amendment and recommend that the bill do pass.

By virtue of this act, the Committee on Finance accepts the report of the Committee on Ways and Means, which is as follows:

[See House Report No. 1290, page 847 of this Bulletin.]

[H. R. 4394]
AMENDMENT OF SECTION 3401 OF THE INTERNAL REVENUE CODE OF 1954

[House of Representatives Report No. 1354, Eighty-fourth Congress, First Session]

[July 23, 1955]

Mr. Keogh, from the Committee of Ways and Means, submitted the following report [To accompany H. R. 4394]:

[1] Not reproduced.

The Committee on Ways and Means, to whom was referred the bill (H. R. 4394) to amend section 3401 of the Internal Revenue Code of 1954, having considered the same, report favorably thereon with an amendment and recommend that the bill as amended do pass.

The amendment is as follows:

Page 4, line 6, strike out "such" and insert: "any".

PURPOSE OF BILL

This bill amends section 3401 of the Internal Revenue Code of 1954 to provide that there is to be no withholding of United States income tax on remuneration paid for services performed in a possession of the United States by a United States citizen if the employer is required by the law of the possession to withhold income tax on the remuneration.

REASONS FOR BILL

Under present law the wages of a United States citizen employed in Puerto Rico or a possession of the United States may under certain circumstances be reduced by withholding for the income tax of Puerto Rico or the possession as well as for the Federal income tax. This is true even though eventually the foreign tax credit in these cases usually relieves the taxpayer of most or all of the Federal income tax liability. This has presented especially serious problems in the case of Puerto Rico although the problem also exists to a lesser extent in the case of the Virgin Islands and Guam. As a result of this double withholding, potential employees are reluctant to take jobs in Puerto Rico or the possessions. Moreover, the Internal Revenue Code already relieves United States citizens who perform services in a foreign country (for an employer other than the United States) from the withholding of the Federal income tax where withholding of a foreign income tax is provided.

EXPLANATION OF BILL

This bill in section 3401(a)(8)(A)(ii) provides that an employer (other than the United States Government) need not withhold income tax with respect to services performed in a possession of the United States (which for this purpose includes Puerto Rico) if the employer is required by the law of the possession to withhold income tax on such remuneration. This is the same treatment as is presently provided in the case of services performed in a foreign country.

A committee amendment makes a technical correction to prevent an unintended change in prior law.

It is not believed that there will be any revenue loss resulting from the enactment of this bill.

Your committee has reported this bill unanimously.

CHANGES IN EXISTING LAW[1]

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[H. R. 4394]
AMENDING SECTION 3401 OF THE INTERNAL REVENUE CODE OF 1954

[Senate Report No. 1244, Eighty-fourth Congress, First Session. Calendar No. 1261]

[July 29, 1955]

Mr. Byrd, from the Committee on Finance, submitted the following report [to accompany H. R. 4394]:

The Committee on Finance to whom was referred the bill (H. R. 4394) to amend section 3401 of the Internal Revenue Code of 1954, having considered the same, report favorably thereon without amendment and recommend that the bill do pass.

[1] Not reproduced.

By virtue of this act, the Committee on Finance accepts the report of the Committee on Ways and Means, which is as follows:

[See House Report No. 1354, page 848 of this Bulletin.]

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CHANGES IN EXISTING LAW[1]

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[H. R. 4581]

EXCISE TAX ON CUTTING OILS

[House of Representatives Report No. 1490, Eighty-fourth Congress, first session]

[July 27, 1955]

Mr. SIMPSON of Pennsylvania, from the Committee on Ways and Means, submitted the following report [To accompany H. R. 4581]:

The Committee on Ways and Means, to whom was referred the bill (H. R. 4581) to amend section 4091 of the Internal Revenue Code of 1954 (relating to imposition of tax on lubricating oils), and to amend section 6416 (b) of the Internal Revenue Code of 1954 (relating to overpayments of tax), having considered the same, report favorably thereon with amendments and recommend that the bill as amended do pass.

The amendments are as follows:

Strike out all after the enacting clause and insert the following:

That (a) section 4091 of the Internal Revenue Code of 1954 is amended to read as follows:

SEC. 4091. IMPOSITION OF TAX

"There is hereby imposed upon the following articles sold in the United States by the manufacturer or producer a tax at the following rates, to be paid by the manufacturer or producer:

"(1) cutting oils, 3 cents a gallon; and

"(2) other lubricating oils, 6 cents a gallon."

(b) Section 4092 of the Internal Revenue Code of 1954 is amended to read as follows:

"SEC. 4092. DEFINITIONS.

"(a) CERTAIN VENDEES CONSIDERED AS MANUFACTURERS.—For purposes of this subpart, a vendee who has purchased lubricating oils free of tax under section 4093 shall be considered the manufacturer or producer of such lubricating oils.

"(b) CUTTING OILS.—For purposes of this subpart, the term 'cutting oils' means oils sold for use in cutting and machining operations (including forging, drawing, rolling, shearing, punching, and stamping) on metals."

(c) The table of sections to subpart B of part III of subchapter A of chapter 32 of the Internal Revenue Code of 1954 is amended by striking out "Definition of certain vendees as a manufacturer" and inserting in lieu thereof "Definitions".

SEC. 2. Section 6416 (b) (2) of the Internal Revenue Code of 1954 is amended by striking the period at the end of subparagraph (H) and inserting in lieu thereof a semicolon, and by inserting after subparagraph (H) the following new subparagraph:

"(I) In the case of lubricating oils in respect of which tax was paid at the rate of 6 cents a gallon, used or resold for use on or after the effective date of this subparagraph as cutting oils (within the meaning of section 4092(b)); except that the amount of such overpayment shall not exceed an amount computed at the rate of 3 cents a gallon."

SEC. 3. The amendments made by this Act shall take effect on the first day of the first calendar quarter which begins more than ten days after the date of the enactment of this Act.

Amend the title so as to read:

A bill to amend the Internal Revenue Code of 1954 with respect to the tax on cutting oils.

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[1] Not reproduced.

PURPOSE OF BILL

This bill, as reported, revises the application of the lubricating oils excise tax in the case of cutting oils to provide that the tax on such oils is to be 3 cents per gallon. Under present law the tax on cutting oils is 6 cents per gallon but not more than 10 percent of the manufacturer's price. The bill also provides that the term "cutting oils" is to mean oils "sold for use in" cutting and machining operations (including forging, drawing, rolling, shearing, punching, and stamping) on metals, rather than oils "used primarily" in such operations and "known commercially as" cutting oils. This bill is to take effect on the first day of the first calendar quarter beginning more than 10 days after the enactment of this bill.

REASONS FOR BILL

In the Excise Tax Reduction Act of 1954 Congress reduced most ad valorem excise taxes to a 10-percent rate. In addition, that act provided that in the case of certain excises levied on a specific basis, the tax otherwise imposed was not to exceed 10 percent of the manufacturer's price. In the case of the tax on lubricating oil, it was provided that oils used for cutting and machining operations on metals and known commercially as cutting oil were to be subject to a limitation of this type.

The tax of 3 cents a gallon provided by the bill is expected to result in a tax which will average about the same as the tax of 10 percent of the manufacturers' price. The specific gallonage tax, rather than an ad valorem tax, is preferred in the case of cutting and other lubricating oils because the industry is accustomed to this type of tax and because this provides a uniform tax irrespective of whether the manufacturer sells at the wholesale or retail level.

The industry has also had difficulty with the definition of "cutting oils" placed in the Internal Revenue Code by the Excise Tax Reduction Act of 1954. This act provided that cutting oils meant oils "used primarily in" cutting and machining operations on metals and "known commercially as" cutting oils. However, there is no uniform agreement as to what oil is "used primarily in" and "known commercially as" cutting oils, since various lubricating oils are used for such purposes. For that reason this bill provides instead that the term "cutting oils" means oils "sold for use in" such operations.

The bill also adds a new subparagraph (I) to section 6416 (b) (2) of the 1954 code providing for credits or refunds in the case of lubricating oils used or resold for use as cutting oils. The credit or refund is to be available with respect to oil on which a 6 cents per gallon tax was paid, which was used or resold as cutting oil after the effective date of this bill. The credit or refund is not to exceed an amount computed at the rate of 3 cents a gallon.

This bill is to take effect on the first day of the first calendar quarter which begins more than 10 days after the enactment of this bill.

It is estimated that the revenue effect of this bill will be negligible.

This bill has been reported unanimously by your committee.

CHANGES IN EXISTING LAW[1]

* * * * * * *

[H. R. 4581]
EXCISE TAX ON CUTTING OILS

[Senate Report No. 1260, Eighty-fourth Congress, first session, Calendar No. 1277]

[July 29, 1955]

Mr. BYRD, from the Committee on Finance, submitted the following report [To accompany H. R. 4581]:

The Committee on Finance, to whom was referred the bill (H. R. 4581) to amend the Internal Revenue Code of 1954 with respect to the tax on cutting oils, having considered the same, report favorably thereon without amendment and recommended that the bill do pass.

[1] Not reproduced.

By virtue of this act, the Committee on Finance accepts the report of the Committee on Ways and Means, which is as follows:

[See House Report No. 1490, page 850 of this Bulletin.]

* * * * * * *

CHANGES IN EXISTING LAW

In the opinion of the Senate it is necessary in order to expedite the business of the Senate to dispense with the requirement of subsection 4 of rule XXIX of the Standing Rules of the Senate.

[H. R. 4725]
REPEAL OF SECTIONS 452 and 462 OF THE INTERNAL REVENUE CODE OF 1954

[House of Representatives Report No. 293, Eighty-Fourth Congress, First Session]

[March 22, 1955]

Mr. COOPER, from the Committee on Ways and Means, submitted the following report [to accompany H. R. 4725]:

The Committee on Ways and Means, to whom was referred the bill (H. R. 4725) to repeal sections 452 and 462 of the Internal Revenue Code of 1954, having considered the same, report favorably thereon with an amendment and recommend that the bill as amended do pass.

The amendment is as follows:

Page 2, after line 14, insert:

SEC. 4. SAVING PROVISIONS.

(a) FILING OF STATEMENT.—If—

(1) the amount of any tax required to be paid for any taxable year is increased by reason of the enactment of this Act, and

(2) the last date prescribed for payment of such tax (or any installment thereof) is before September 15, 1955,

then the taxpayer shall, on or before September 15, 1955, file a statement which shows the increase in the amount of such tax required to be paid by reason of the enactment of this Act.

(b) FORM AND EFFECT OF STATEMENT.—

(1) FORM OF STATEMENT, ETC.—The statement required by subsection (a) shall be filed at the place fixed for filing the return. Such statement shall be in such form, and shall include such information necessary or appropriate to show the increase in the amount of the tax required to be paid for the taxable year by reason of the enactment of this Act, as the Secretary of the Treasury or his delegate shall by regulations prescribe.

(2) TREATMENT AS AMOUNT SHOWN ON RETURN.—The amount shown on a statement filed under subsection (a) as the increase in the amount of the tax required to be paid for the taxable year by reason of the enactment of this Act shall for all purposes of the internal revenue laws be treated as tax shown on the return.

(3) WAIVER OF INTEREST IN CASE OF PAYMENT ON OR BEFORE SEPTEMBER 15, 1955.—If the taxpayer, on or before September 15, 1955, files the statement referred to in subsection (a) and pays in full that portion of the amount shown thereon for which the last date prescribed for payment is before September 15, 1955, then for purposes of computing interest (other than interest on overpayments) such portion shall be treated as having been paid on the last date prescribed for payment. This paragraph shall not apply if the amount shown on the statement as the increase in the amount of the tax required to be paid for the taxable year by reason of the enactment of this act is greater than the actual increase unless the taxpayer establishes, to the satisfaction of the Secretary of the Treasury or his delegate, that his computation of the greater amount was based upon a reasonable interpretation and application of sections 452 and 462 of the Internal Revenue Code of 1954, as those sections existed before the enactment of this act.

(c) SPECIAL RULES.—

(1) INTEREST FOR PERIOD BEFORE ENACTMENT.—Interest shall not be imposed on the amount of any increase in tax resulting from the enactment of this Act for any period before the day after the date of the enactment of this Act.

(2) ESTIMATED TAX.—Any addition to the tax under section 294 (d) of the Internal Revenue Code of 1939 shall be computed as if this Act had not been enacted. In the case of any installment for which the last date prescribed for payment is before September 15, 1955, any addition to the tax under section 6654 of the Internal Revenue Code of 1954 shall be computed as if this Act had not been enacted.

(3) TREATMENT OF CERTAIN PAYMENTS WHICH TAXPAYER IS REQUIRED TO MAKE.—If—

(A) the taxpayer is required to make a payment (or an additional payment) to another person by reason of the enactment of this Act, and

(B) the Internal Revenue Code of 1954 prescribes a period, which expires after the close of the taxable year, within which the taxpayer must make such payment (or additional payment) if the amount thereof is to be taken into account (as a deduction or otherwise) in computing taxable income for such taxable year,

then, subject to such regulations as the Secretary of the Treasury or his delegate may prescribe, if such payment (or additional payment) is made on or before September 15, 1955, it shall be treated as having been made within the period prescribed by such Code.

(4) DETERMINATION OF DATE PRESCRIBED.—For purposes of this section, the determination of the last date prescribed for payment or for filing a return shall be made without regard to any extension of time therefor and without regard to any provision of this section.

(5) REGULATIONS.—For requirement that the Secretary of the Treasury or his delegate shall prescribe all rules and regulations as may be necessary by reason of the enactment of this Act, see section 7805 (a) of the Internal Revenue Code of 1954.

SUMMARY OF PROVISIONS

Section 1 of the bill repeals sections 452 and 462 of the Internal Revenue Code of 1954, relating to prepaid income and reserves for estimated expenses, respectively.

Section 2 contains technical conforming amendments.

Section 3 provides that the amendments made by this bill are to apply to taxable years beginning after December 31, 1953, and ending after the date of enactment of the 1954 Code.

The committee amendment adds a new section 4 which contains certain saving provisions designed to place, insofar as possible, taxpayers who elected the benefits of sections 452 and 462 in the same position they would have been in had these sections never been enacted.

GENERAL STATEMENT

Your committee for some time has been concerned as to the effect of these provisions on the revenue. The Secretary of the Treasury, after reviewing the provisions in connection with proposed regulations, has also expressed concern as to their revenue effects and has requested their repeal as shown by the following letter addressed to the chairman of the committee:

THE SECRETARY OF THE TREASURY,
Washington, March 7, 1955.

HON. JERE COOPER,
Chairman, Committee on Ways and Means,
House of Representatives, Washington, D. C.

MY DEAR MR. CHAIRMAN: This supplements my letter of March 3 concerning the operation of the two new accounting provisions covering deferred income and reserves for estimated expenses (secs. 452 and 462 of the Internal Revenue Code of 1954). Our studies now have proceeded far enough to indicate clearly that many taxpayers are planning to use these provisions to defer income and create deductions in excess of anything contemplated at the time they were proposed.

The objective of these sections was simply to conform tax bookkeeping with business bookkeeping. They never were intended to cover innumerable items some taxpayers apparently intend to claim. If permitted to remain in the law, they will cause a greater loss in revenue than estimated and cause considerable litigation. We are not able to adequately correct this by regulation. Accordingly, I recommend that the two provisions cited above immediately be repealed retroactively to their original effective dates.

Our report and recommendations on various other technical corrections in the 1954 Code will be ready soon.

Sincerely yours,

G. M. HUMPHREY,
Secretary of the Treasury.

Upon receipt of this letter, the chairman of your committee and the ranking minority member of your committee introduced companion bills to accomplish the repeal of sections 452 and 462 of the Internal Revenue Code of 1954. Your committee also scheduled hearings on one of these bills, H. R. 4725, and invited the Secretary of the Treasury as the first witness. Three additional days were devoted to the hearing of testimony from taxpayers and interested parties who would be affected by repeal of the two sections. In addition taxpayers were invited to submit statements which could be incorporated in the record of the hearings.

Your committee has given careful consideration to the statements made by the witnesses at the hearings. Your committee is in accord with the general principle that tax accounting should be brought into harmony with generally accepted principles of business accounting since the latter generally reflect more accurately the timing of receipt of income and of incurring of expenses. However, your committee is concerned about the very large revenue loss which it now appears is involved in the transition period in which taxpayers adopt reserves for estimated expenses or elect to defer prepaid income. Last year when these provisions were enacted it was estimated by the Treasury Department that the total revenue loss involved in all of the accounting provisions was $47 million. From incomplete information now available it appears that the loss from these two provisions alone may well exceed $1 billion. Your committee believes that this is a loss which the Nation can ill afford at this time.

The protests which have been made by numerous taxpayers to the proposed regulations under these sections and data received from other sources indicate that these sections are being interpreted as extending far beyond the operation contemplated at the time of their adoption. The result will undoubtedly be protracted and costly litigation. Moreover, the Treasury is of the opinion that the serious deficiencies that exist in the provisions cannot be corrected by administrative action.

In view of the testimony received from taxpayers by your committee and the recognized desirability of conforming tax accounting to business accounting, your committee has instructed the staff of the Treasury Department and the staff of the Joint Committee on Internal Revenue Taxation to make studies of these accounting problems in an effort to provide conformance of tax and business accounting without the transitional revenue loss. It has further requested each staff to report any suggested solutions to the committee as soon as feasible.

Pending these studies, however, it is believed that the prompt enactment of this bill is necessary to guard against the unintended and unexpected revenue loss. Proposals have been advanced that the income-deferring provisions of section 452 should be retained in the law even though the estimated expense provisions of section 462 are repealed. It is contended that the revenue loss from section 452 is relatively insignificant in relation to the loss involved in section 462. Your committee has given careful consideration to the possibility of such action. It has been advised by the Treasury, however, that if section 452 is not repealed at the same time section 462 is repealed, a number of taxpayers who have reported a greatly reduced tax liability by electing the benefits of section 462 would be able to accomplish the same result by electing to defer income under section 452. For example, under section 462 it is possible to set up a reserve for estimated expenses attributable to fulfilling obligations of servicing and repairs under a product guaranty. If section 462 only were repealed, it would be possible for taxpayers, simply by changing the form of the transaction, to defer under section 452 that portion of income from the sale of the product

which is attributable to the liability for future servicing and repairs under the guaranty. It is, therefore, deemed necessary to repeal section 452 as well as section 462.

The prompt enactment of this bill will mitigate the serious inconveniences and the expense that may be occasioned to taxpayers who have filed or are about to file their returns or have made various commitments in reliance upon sections 452 and 462. In addition, your committee has added an amendment to the bill designed to alleviate the inconvenience to taxpayers of the repeal of these sections. This amendment will have the effect of relieving taxpayers of any interest which would otherwise be imposed by reason of the increase in tax resulting from this bill if taxpayers file a statement and pay the portion of the increased tax which is due on or before September 15, 1955. Under the amendment additions to tax will not be imposed with respect to the increase in tax resulting from the enactment of this bill if the required statement is filed on or before that date. It is also recognized that the repeal of sections 452 and 462 from the time that they became effective in the 1954 Code will have the result of increasing the taxable income in the first year of change. As a result, the amendment also provides that the time for qualifying for any deductions which are affected by such increase will be extended to September 15, 1955. For example, if contributions to a pension and profit-sharing trust are geared to taxable income, the period during which allowable contributions may be paid by an accrual basis taxpayer is extended to September 15.

Your committee in repealing sections 452 and 462 does not intend to disturb prior law as it affected permissible accrual accounting provisions for tax purposes, including the treatment of prepaid newspaper subscriptions. On the question of accrual of vacation pay, the Treasury has indicated to the committee that the provisions of its rulings under the 1939 Code which permitted accrual of vacation pay under specified conditions will not be revoked for any taxable year ending prior to January 1, 1956. These assurances are confirmed in the following letter from the Secretary of the Treasury:

WASHINGTON, *March 22, 1955.*

Hon. JERE COOPER,
Chairman, Committee on Ways and Means,
House of Representatives, Washington, D. C.

MY DEAR MR. CHAIRMAN: This letter will confirm the statements made to you today by Treasury representatives.

I assure your committee that if H. R. 4725 as reported out by your committee is enacted, as I earnestly hope it will be, the Treasury Department will apply revenue ruling 54–608 (relating to the accrual of vacation pay) only to taxable years ending after December 31, 1955.

Furthermore, the Treasury Department will not consider the repeal of section 452 as any indication of congressional intent as to the proper treatment of prepaid subscriptions and other items of prepaid income, either under prior law or under other provisions of the 1954 code. In other words, the repeal of section 452 will not be considered by the Department as either the acceptance or the rejection by Congress of the decision in *Beacon Publishing Co.* v. *Commissioner* (218 F. (2d) 697, C. A. 10, 1955) or any other judicial decisions.

It is my understanding that the foregoing is consistent with the desire of your committee, with which I agree, that the repeal of sections 452 and 462 should operate simply to reestablish the principles of law which would have been applicable if sections 452 and 462 had never been enacted.

Sincerely yours,

G. M. HUMPHREY,
Secretary of the Treasury.

TECHNICAL ANALYSIS OF THE COMMITTEE AMENDMENT

Under the committee amendment to the bill (the text of which appears at the beginning of this report) a new section 4 would be added to the bill. Subsection (a) of this section requires a taxpayer to file a statement on or before September 15, 1955, showing the increase in the tax required to be paid by reason of the repeal of sections 452 and 462 of the Internal Revenue Code of 1954, if the due date for the payment of such increase or any installment thereof is before September 15, 1955. The due date for payment is to be determined without regard to any extension of time granted for payment of the tax (including extensions arising by reason of the provisions of this sec. 4).

Where 1 installment is so payable before September 15, 1955, the full amount of the increase required to be paid for the taxable year shall be shown on the statement, even though the other installment is not due until on or after September 15, 1955. Where the taxpayer is required to file a statement, the increase in tax required to be paid by reason of the repeal of sections 452 and 462 shall be determined by recomputing taxable income for the taxable year and any deductions or credits affected thereby.

The provisions of subsection (a) may be illustrated by the following example. Corporation X files its income-tax return for the calendar year 1954 on March 15, 1955, and elected under section 6152 of the Internal Revenue Code of 1954 to pay the unpaid amount of the tax shown thereon in two equal installments. Such installment payments are due on March 15, 1955, and June 15, 1955, respectively. In determining its tax liability for such year it elected to avail itself of the benefits of sections 452 and 462. Since corporation X's tax liability for the year 1954 is increased by reason of the enactment of the bill, and since the last date prescribed for paying its tax is before September 15, 1955, it is required to submit a statement on or before September 15, 1955, showing such increase in tax.

Subsection (b) of the proposed section 4 contains provisions relating to the form of the statement required by subsection (a), and the effect of filing such statement. Paragraph (1) of subsection (b) provides that the statement shall be filed at the place fixed for filing the taxpayer's tax return for the taxable year to which the statement relates. The statement shall contain the information and computations necessary or appropriate to show the increase in the tax required to be paid as a result of the repeal of sections 452 and 462, and shall be made on a form prescribed by the Secretary or his delegate.

Paragraph (2) of subsection (b) provides that the amount of increase in tax attributable to the enactment of the bill, as shown by the taxpayer on the statement required by subsection (a), shall be treated for all purposes of the internal revenue laws as though it were a tax shown by the taxpayer on his return. This provision insures that all provisions of law applicable to the assessment and collection of the tax shown on the return will apply with respect to the amount shown on such statement. One effect of this paragraph is to preclude the imposition of additions to tax, with respect to such amount, under the pertinent provisions of chapter 68 of the Internal Revenue Code of 1954. Thus, the additions to the tax provided for in section 6653 (relating to additions to the tax for negligence or fraud) will not apply to the amount shown on the statement. Neither this paragraph, nor any other provision of this section, affects any criminal penalty.

Paragraph (3) of subsection (b) prescribes the conditions under which a period of time will be disregarded in computing interest with respect to the increase in tax. If the taxpayer files the statement in accordance with subsection (a) and pays in full that portion of the increase in tax shown thereon which is due before September 15, 1955, then for the purpose of computing interest (other than interest on overpayments) such amount shall be treated as having been paid on the last day prescribed by law for making such payment. The provisions of this paragraph may be illustrated by the following examples:

(1) Corporation X's return for the calendar year 1954 was filed on March 15, 1955, and it paid the tax liability shown thereon in equal installments on March 15, 1955, and June 15, 1955. It filed a statement on September 15, 1955, showing the increase in its tax liability by reason of the repeal of sections 452 and 462 and paid at that time the increase in tax shown thereon. Since the taxpayer has complied with the provisions of paragraph (3), no interest will be imposed with respect to the amount of the payment.

(2) On July 15, 1955, Corporation Y filed its return for a fiscal year ending on April 30, 1955. It elected to pay its tax in two equal installments on July 15, 1955, and October 15, 1955. Corporation Y filed the statement required in subsection (a) on September 15, 1955, and paid with such statement one-half of the increase shown thereon. Since Corporation Y has satisfied the provisions of paragraph (3) no interest will be imposed with respect to the payment made on September 15, 1955. On October 15, 1955, it must pay its second installment of tax, including one-half of the increase in tax shown on the statement. With respect to the installment due on October 15, 1955, including the applicable portion of the increase in tax, interest on any failure to pay the amount due on such date shall be computed under the applicable provisions of the Internal Revenue Code.

The last sentence of paragraph (3) provides that the paragraph shall not apply if the amount shown on the statement as the increase in the amount of the tax required to be paid for the taxable year is (by reason of the enactment of the bill) greater than the actual increase unless the taxpayer establishes, to the satisfaction of the Secretary or his delegate, that his computation of the greater amount was based upon a reasonable interpretation and application of sections 452 and 462 of the Internal Revenue Code of 1954, as those sections existed before the enactment of the bill.

Paragraph (1) of subsection (c) states that interest shall not be imposed with respect to the amount of any increase in tax resulting from the repeal of sections 452 and 462 for any period prior to the day after the date of enactment of the bill. The provisions of this paragraph are applicable notwithstanding any other provisions of section 4.

Paragraph (2) of subsection (c) states the conditions under which additions to the tax will not be imposed with respect to the estimated tax of an individual where additions to the tax would result from the enactment of the bill. Any addition to the tax under section 294(d) of the Internal Revenue Code of 1939, relating to estimated tax, shall be computed without regard to any increase in tax resulting from the enactment of the bill. In the case of any underpayment of estimated tax to which section 6654 of the Internal Revenue Code of 1954 applies, any additions to the tax for installments due before September 15, 1955, shall be computed without regard to any increase in tax resulting from the enactment of the bill. Any additions to the tax with respect to installments due on or after September 15, 1955, shall be imposed in accordance with the applicable provisions of the code.

Paragraph (3) of subsection (c) provides that if—

(A) the taxpayer is required to make a payment (or an additional payment) to another person by reason of the enactment of the bill and

(B) the Internal Revenue Code of 1954 prescribes a period (which expires after the close of the taxable year) within which the taxpayer must make the payment (or additional payment) if the amount thereof is to be taken into account (as a deduction or otherwise) in computing taxable income for such taxable year,

then (subject to regulations and if made on or before September 15, 1955) the payment (or additional payment) shall be treated as having been made within the period prescribed by the 1954 Code. The application of this paragraph may be illustrated by the following examples:

(1) Assume that section 267 of the 1954 Code (relating to losses, expenses, and interest with respect to transactions between related taxpayers) applies to amounts accrued by taxpayer A for salary payable to I. For the taxable year 1954, A is required to pay I a salary equal to 5 percent of A's taxable income for the taxable year. Under existing law (with the application of sec. 462) the amount accrued for the taxable year was $5,000. By reason of paragraph (3) taxpayer A's deduction for 1954 of $1,000 will not be disallowed if that amount is paid on or before September 15, 1955.

(2) Assume that on March 1, 1955, X, a calendar year taxpayer on the accrual basis, makes a payment described in section 404(a)(6) of the 1954 Code (relating to contributions of an employer to an employees' trust) of $10,000 which is accrued for 1954 and is required to be paid on the basis of the amount of the taxable income for that year. The taxpayer filed his return March 15, 1955. By reason of the enactment of the bill taxpayer X's taxable income is increased so that he is required to make an additional payment of $2,000. This payment is made before September 15, 1955. By reason of paragraph (3), this additional payment is deemed to have been made on the last day of 1954.

CHANGES IN EXISTING LAW[1]

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[1] Not reproduced.

[H. R. 4725]
REPEAL OF SECTIONS 452 AND 462 OF THE INTERNAL REVENUE CODE OF 1954

[Senate Report No. 372, Eighty-fourth Congress, First Session, Calendar No. 376]

[May 23 (legislative day, May 2), 1955.]

Mr. Byrd, from the Committee on Finance, submitted the following report [to accompany H. R. 4725]:

The Committee on Finance, to whom was referred the bill (H. R. 4725) to repeal sections 452 and 462 of the Internal Revenue Code of 1954, report favorably thereon with amendments and recommend that the bill as amended do pass.

The amendments are as follows:

1. Under section 4(a) and (b) of the House bill taxpayers have until September 15, 1955, to file a statement showing the increase in tax required to be paid solely by reason of the retroactive repeal of sections 452 and 462 and to pay the increase in tax which is due on or before that date. Your committee has extended this date to December 15, 1955, in all instances.

2. Under section 4(c) of the House bill a taxpayer is given additional time to make timely payments where the payments are required to be made to another person by reason of this bill and the taxpayer was otherwise allowed a period in which to make the payments after the close of its taxable year. An amendment extends this provision, for purposes of the accumulated earnings tax, the personal holding company tax, and the taxation of regulated investment companies, to cover dividends which are paid after the due date of the return (without regard to any extensions) and on or before December 15, 1955. This treatment of dividends is applicable only to the extent that the dividends are attributable to an increase in taxable income resulting from this bill and only if the taxpayer so elects.

3. Two clarifying amendments have been added to the House bill. The first amendment insures that the saving provision applies only to taxable years ending on or before the date of enactment of this bill. The second clarifying amendment provides that an increase in tax, which arises because of the effect of the repeal of sections 452 and 462 on a net operating loss, is not to be treated as tax shown on the return for purposes of the statement required to be filed under section 4(b)(2) of the bill.

PART I. SUMMARY OF BILL

Section 1 of the bill repeals sections 452 and 462 of the Internal Revenue Code of 1954, relating to prepaid income and reserves for estimated expenses, respectively.

Section 2 contains technical conforming amendments.

Section 3 provides that the amendments made by this bill are to apply to taxable years beginning after December 31, 1953, and ending after the date of enactment of the 1954 Code.

Section 4 contains certain provisions designed to place, insofar as possible, taxpayers who elected the benefits of section 452 and section 462 in the same position they would have been in if these sections had not been enacted. The committee amendments to section 4 of the House bill give taxpayers until December 15, 1955, instead of until September 15, 1955, to comply with these provisions. Two additional changes are made by the committee amendments to the House bill which are described below.

PART II. SUMMARY OF SECTIONS 462 AND 452 OF EXISTING LAW

Section 462 of the 1954 Code permits an accrual-basis taxpayer to deduct reasonable additions (in the discretion of the Secretary or his delegate) to reserves for various types of estimated expenses. The expenses placed in such a reserve must be related to income of the current or preceding years and must be of a type the Secretary or his delegate is satisfied can be estimated with reasonable accuracy. The reserves are required to be adjusted each year to reflect the best estimate available and any amount found to be excessive is to be taken into account in such year. A taxpayer, without the consent of the Treasury Department, can elect to establish reserves for estimated expenses for the

first year beginning after December 31, 1953, in which he has such expenses. For subsequent years, however, the consent of the Treasury Department is required.

Section 452 of the 1954 Code permits accrual-basis taxpayers to defer the reporting of advance payments as income until the year, or years, in which, under the taxpayer's regular method of accounting, the income is earned. Where the liability to perform services or supply property does not end within a 5-year period the income must be allocated to the 5-year period unless the Secretary or his delegate consents to a different allocation. In such cases taxpayers, unless they have the consent of the Treasury to do otherwise, are to take the prepayments into account ratably over the period of the taxable year of receipt and the 5 succeeding taxable years. Where a taxpayer dies or where, for any other reason, the liability with respect to the deferred income ceases, prepayments not previously reported as income become taxable at that time. The election provided in this provision is available without consent of the Treasury with respect to advance payments received by a taxpayer in his first taxable year beginning after December 31, 1953, in which he has prepaid income. For subsequent years consent of the Treasury must be obtained. If the election is made the treatment explained above must be applied to all income received in advance, during the year of the election and subsequent years.

PART III. REASONS FOR REPEAL OF SECTIONS 462 AND 452

The President in his state of the Union and budget messages to Congress in January of 1954 requested action on several tax proposals. Among these was one that the Congress act to bring tax accounting more nearly in line with accepted business accounting practice. In this budget message, presented in January 1954, item No. 20 of his tax recommendations was as follows:

> *Accounting definitions.*—Tax accounting should be brought more nearly in line with accepted business accounting by allowing prepaid income to be taxed as it is earned rather than as it is received, and by allowing reserves to be established for known future expenses.

On the basis of this recommendation, the Internal Revenue Code of 1954, as passed by the House, contained section 452, permitting the deferral of prepaid income and section 462, providing for reserves for estimated expenses. The estimate of the revenue expected to be lost as the result of the enactment of sections 452, 462, and certain other accounting provisions, as shown in the House report accompanying the Internal Revenue Code of 1954, was $45 million for the fiscal year 1955. The American Institute of Accountants this year estimated the revenue loss from sections 452 and 462 at $500 million. Others have expressed the view that the revenue loss from these provisions may run to several billion dollars. Your committee believes, however, that these estimates do not give proper recognition to an amendment made to section 462 by your committee last year.

When the bill providing for the Internal Revenue Code of 1954 came before your committee last year, concern was expressed that the revenue loss from sections 452 and 462 might well be above the amount then estimated in the report of the House Committee on Ways and Means. In the hearings held by your committee in 1954 a witness representing the American Institute of Accountants stated:

> The bill makes great strides in the direction of putting business accounting and income-tax accounting on the same wavelength. This is something we have urged upon the Congress for many years. We applaud H. R. 8300 for getting it underway. The transition will bring on some problems, both from a revenue standpoint, as well as the scope of reserves for estimated expenses. For that reason, there is included in our list of recommendations certain cautions and restraints during the gearshifting period (hearings before the Senate Finance Committee on the Internal Revenue Code of 1954, p. 1312).

In the list of recommendations referred to above of the American Institute of Accountants there was the following statement:

> *Recommendation No. 136.*—Section 462(a): To avoid the impact on the revenues in the transitional year where there will be a deduction both for the actual expenses and the estimated expenses, and in order to avoid undue distortion of income, the addition to the reserve should be spread as a deduction over the transitional year and the 2 succeeding years.

It was your committee's awareness of this revenue problem which prompted it to amend section 462 to limit the additions to reserves for estimated expenses to those which could be taken into account in the discretion of the Secretary of the Treasury or his delegate. As amended by the Senate Finance Committee, section 462(a) of the Internal Revenue Code of 1954 reads as follows:

> GENERAL RULE.—In computing taxable income for the taxable year, there shall be taken into account (in the discretion of the Secretary or his delegate) a reasonable addition to each reserve for estimated expenses to which this section applies.

The Senate Finance Committee amendment passed the Senate and was accepted by the House conferees and thus became part of the 1954 Code.

This amendment of the Senate Finance Committe was adopted in lieu of the recommendation of the American Institute of Accountants because it was believed that it provided a more effective control over any unreasonable revenue loss that might develop than the proposal of the accountants.

Frequently it is asserted that section 462 of the 1954 Code provides for a double deduction. This, however, is an incorrect interpretation. As your committee's report last year on the accounting provisions in the Internal Revenue Code of 1954 stated:

> The changes embodied in the House bill and in your committee's bill are designed to bring the income-tax provisions of the law into harmony with generally accepted accounting principles, and *to assure that all items of income and deductions are to be taken into account once, but only once in the computation of taxable income.* [Emphasis supplied.]

Rather than being a problem of double deductions, the problem presented by section 462 is that of the timing of deductions when a taxpayer changes accounting methods. The question is whether in the year a taxpayer shifts to the reserve method he should be entitled to deduct an amount equal to his addition to his reserve (representing expenses attributable to income of the current year but which in large part may not be incurred until subsequent years) and also expenses actually incurred in the year of transition but attributable to income of prior years. Whether these expenses are incurred in the current year or in a subsequent year, they would be allowable deductions under the code at some time even if section 462 were not in the law. It is, therefore, only a question of when the deductions should be allowed which constitutes a problem under this provision.

As indicated above, your committee last year recognized this problem in the timing of deductions where a taxpayer converts to the expense reserve method and believed that its amendment met the problem by giving the Secretary of the Treasury discretion over not only the amount of estimated expense to be added to the reserve for each taxable year but also the kind of items which entered into the estimated reserve. With such limitations in the section, it was the opinion of your committee that any revenue loss which might occur would be well within the limits of last year's estimate. It would appear possible, for example, for the Secretary to require the spreading of the deductions for actual expenses incurred in the year of transition to the reserve method, over an extended period of years, a period which could be much longer than that advocated by the American Institute of Accountants. It apparently is the opinion of the Secretary of the Treasury, however, that the words "in the discretion of the Secretary or his delegate" only limit the amount of the allowable deductions and not the type of items which can be deducted. (See p. 11 of House hearings on secs. 452 and 462.) The Secretary apparently is fearful of exercising the discretion which your committee intended him to have in this matter. He has expressed the view that some taxpayers may contest his decisions and that there may be prolonged litigation before the matter is ultimately decided.

It is because of the Secretary's fears and his desire to have a fresh review of section 462, relating to estimated expenses, and its counterpart section 452, relating to prepaid income, and because of the House action repealing these sections that your committe has reluctantly concluded to report out the House bill repealing these sections from the effective date of their enactment. Since the Secretary has not, by regulations, exercised the discretionary limitations which your committe delegated to him in the law, it is apparent that the loss in revenue under these provisions may be much larger than was anticipated last year.

Your committee does not, however, believe that the repeal of these sections solves the problem presented. I. T. 3956 (1949 C. B., p. 78) which the Secretary of the Treasury in a letter to the chairman of the House Committee on Ways and Means promised to keep in effect through 1955, presents essentially the same problem as to the timing of vacation pay deductions as the present section 462 does generally. Moreover, if this I. T. is withdrawn for 1956, taxpayers who previously have been accruing vacation pay under this and similar rulings will be faced with the possibility of having no deductions for vacation pay in 1956.

The status of prepaid subscription income will also be uncertain as the result of the repeal of section 452. In I. T. 3369 (1940-1 C. B. 46) the Treasury ruled that publishers of periodicals on the accrual basis, who over a period of years for tax purposes had consistently deferred the reporting of prepaid income would be permitted to continue to file their tax returns on this basis. Moreover, one witness appearing before your committee stated that some of the rulings on prepaid subscription income granted in recent years have permitted the taxpayer to defer prepaid subscription income even though the taxpayer had not reported his income for tax purposes in the past on this basis. Another aspect of the uncertainty with respect to subscription income if section 452 is repealed arises from a recent circuit court decision in *Beacon Publishing Company* v. *Commissioner* (C. C. A. 10th, January 3, 1955). The court in this case held that the deferral of prepaid subscription income was in fact proper under the accrual method of accounting. The Secretary of the Treasury in the letter previously referred to which he sent to the chairman of the House Committee on Ways and Means indicated that the repeal of section 452 would not be taken as an indication by the Treasury Department of congressional intent as to the proper treatment of prepaid subscription income under prior law or under other provisions of the 1954 Code. He also indicated that the repeal of section 452 will not be considered by the Department as either acceptance or rejection by Congress of the decision in *Beacon Publishing Company* v. *Commissioner* or in any other judicial decisions. It has come to your committee's attention that the vast majority of publishing concerns having prepaid income are already deferring their income with Treasury approval. It is recommended to the Treasury Department that it modify its published ruling to the end that the remaining publishers may be entitled to defer prepaid subscription income so that they may be placed upon a fair and equitable basis.

Uncertainty will also exist in other areas with the repeal of these two provisions. In *Pacific Grape Products* (C. C. A. 9th, February 10, 1955), for example, the circuit court held that certain freight and shipping expenses incurred after the end of the year could be accrued for tax purposes as of the end of the year. An extension of the principles laid down in this case might well lead the courts in the future to permit the accrual of most estimated expenses which would be covered by section 462 even though this section is repealed.

Your committee desires to make its position clear that it expects to report out legislation dealing with prepaid income and reserves for estimated expenses at an early date. As indicated above, the existing rulings of the Treasury Department and the court decisions dealing with estimated expenses and prepaid income are now in such a state of confusion and uncertainty that in the opinion of your committee legislative action is required on these subjects. In addition, your committee believes that it is essential that the income tax laws be brought into harmony with generally accepted accounting principles. Moreover, your committee believes that the present status, where some taxpayers are able to defer prepaid income while others are not, is inequitable and should not be allowed to continue. In order to eliminate this uncertainty and discrimination, definite rules must be written into the income tax law. For these reasons your committee plans to begin studies in the near future to devise proper substitutes for the sections now being repealed.

Part IV. Description of Section 4 of Bill

Section 4 of the House bill contains the savings provisions which are intended to alleviate to some extent the hardships imposed on taxpayers by the retroactive feature of the bill. Under the House bill this section provided that a taxpayer would be relieved from the payment of any interest which would otherwise be imposed by reason of the increase in tax resulting from the retroactive repeal of sections 452 and 462, if a statement were filed not later than September 15, 1955, and the portion of the increase in tax which is due on or before that date were

paid not later than September 15, 1955. Your committee has extended this date to December 15, 1955.

Under the House bill, additions to tax would not be imposed with respect to the increase in tax resulting from enactment of this bill if the taxpayer filed a statement showing such increase in tax on or before September 15, 1955. Your committee has extended this date to December 15, 1955.

The statement which the taxpayer must file in order to be relieved of interest and additions to tax must be in the form prescribed by the Secretary or his delegate under regulations. The House bill provided that the amount which was shown on the statement as the increase in tax resulting from the repeal of sections 452 and 462 should be treated as "tax shown on the return." This rule should not apply, however, where the increase in tax is to any extent attributable to a decrease in the net operating loss for another year and the decrease in net operating loss arose because of the repeal of sections 452 and 462. Your committee's amendment so provides.

The effect of the retroactive repeal of sections 452 and 462 may, in certain cases, affect payments which the taxpayer is required to make to another person. Under the Internal Revenue Code the taxpayer may have a period of time after the close of the taxable year to make such required payments. The House bill provided that where the taxpayer's payments to another person were payments required by reason of this bill and the taxpayer was otherwise allowed a period in which to make the payments after the close of the taxable year, any payments made on or before September 15, 1955, would be treated as having been timely made. Your committee has extended the period within which such payments may be made to December 15, 1955. Your committee has also provided, for purposes of the accumulated earnings tax, the personal holding company tax, and the taxation of regulated investment companies, that any dividends paid after the 15th day of the third month following the close of the corporation's taxable year and paid on or before December 15, 1955, are to be treated as though they had been paid on the last day of the taxable year to the extent that the dividends are attributable to an increase in taxable income for that year resulting from the repeal of sections 452 and 462. This treatment of dividends paid after the close of the taxable year and on or before December 15, 1955, is applicable only if the taxpayer so elects.

PART V. TECHNICAL ANALYSIS OF THE COMMITTEE BILL

Section 1 of the bill is identical to that of the House bill and repeals sections 452 and 462 of the Internal Revenue Code of 1954, relating to prepaid income and reserves for estimated expenses, respectively.

Section 2 of the bill is identical to that of the House bill and contains conforming amendments.

Section 3 of the bill is identical to that of the House bill and provides that the provisions of the bill are to apply to taxable years beginning after December 31, 1953, and ending after the date of enactment of the code.

Section 4 of the bill corresponds to the same section of the House bill with certain modifications made by committee amendments as hereinafter explained.

Subsection (a) is identical with the same provision of the House bill except that there is changed the date on or before which the statements are required to be filed from September 15, 1955, to December 15, 1955, and there is added a clarifying amendment to indicate that the saving provisions apply only to taxable years ending on or before date of enactment of this bill. Subsection (a) of this section requires a taxpayer to file a statement on or before December 15, 1955, showing the increase in the tax required to be paid by reason of the repeal of sections 452 and 462 of the Internal Revenue Code of 1954, if the due date for the payment of such increase or any installment thereof is before December 15, 1955. If the tax of more than 1 taxable year is increased by reason of the enactment of this bill, separate statements shall be filed for each such year. For example, if a net operating loss is decreased by reason of the enactment of this bill and the net operating loss has been allowed as a carryback to the 2 preceding years, separate statements are required if the net operating loss as decreased results in an increase in tax for such 2 preceding taxable years. The due date for payment is to be determined without regard to any extension of time granted for payment of the tax (including extensions arising by reason of sec. 4 of the bill).

Where one installment is so payable before December 15, 1955, the full amount of the increase required to be paid for the taxable year shall be shown on the

statement, even though another installment is not due until on or after December 15, 1955. Where the taxpayer is required to file a statement, the increase in tax required to be paid by reason of the repeal of sections 452 and 462 shall be determined by recomputing taxable income for the taxable year and any deductions or credits affected thereby.

It is contemplated that the Secretary of the Treasury or his delegate may, under his general regulatory authority under the Internal Revenue Code of 1954, require persons filing certain information returns, such as partnerships, to file a statement similar to that required under subsection (a) in connection with increases in taxable income resulting by reason of the enactment of the bill.

By reason of the enactment of the bill, shareholders of a corporation may be required to file the statement required by subsection (a). This result would follow where an increase in taxable income (or a decrease in a net operating loss) of the corporation results from the repeal of sections 452 and 462 which may require an adjustment in the earnings and profits of the corporation and may affect the taxability of distributions of the corporation.

The provisions of subsection (a) may be illustrated by the following example. Corporation X files its income-tax return for the calendar year 1954 on March 15, 1955, and elects under section 6152 of the Internal Revenue Code of 1954 to pay the unpaid amount of the tax shown thereon in two equal installments. Such installment payments are due on March 15, 1955, and June 15, 1955, respectively. In determining its tax liability for such year it elected to avail itself of the benefits of sections 452 and 462. Since corporation X's tax liability for the year 1954 is increased by reason of the enactment of the bill, and since the last date prescribed for paying its tax is before December 15, 1955, it is required to submit a statement on or before December 15, 1955, showing such increase in tax.

Subsection (b) of section 4 corresponds to the same provision of the House bill, with modifications in paragraphs (2) and (3) thereof by committee amendments. Subsection (b) contains provisions relating to the form of the statement required by subsection (a), and the effect of filing such statement. Paragraph (1) of subsection (b) is identical to that of the House bill and provides that the statement shall be filed at the place fixed for filing the taxpayer's tax return for the taxable year to which the statement relates. The statement shall contain the information and computations necessary or appropriate to show the increase in the tax required to be paid as a result of the repeal of sections 452 and 462, and shall be made on a form prescribed by the Secretary or his delegate.

Paragraph (2) of subsection (b) corresponds to the same provision of the House bill with an amendment. Paragraph (2) provides that the amount of increase in tax attributable to the enactment of the bill, as shown by the taxpayer on the statement required by subsection (a), shall be treated for all purposes of the internal revenue laws as though it were a tax shown by the taxpayer on his return. It is provided, however, that an increase in tax for any taxable year attributable to a decrease (by reason of the enactment of the bill) in the net operating loss for a succeeding taxable year, shall not be treated as tax shown on the return.

Paragraph (2) of subsection (b) insures that all provisions of law applicable to the assessment and collection of the tax shown on the return will apply with respect to the amount shown on such statement. One effect of this paragraph is to preclude the imposition of additions to tax, with respect to such amount, under the pertinent provisions of chapter 68 of the Internal Revenue Code of 1954. Thus, the additions to the tax provided for in section 6653 (relating to additions to the tax for negligence or fraud) will not apply to the amount shown on the statement. Neither this paragraph, nor any other provision of this section, affects any criminal penalty.

Paragraph (3) of subsection (b) is identical to that of the House bill except that the date September 15, 1955, has been changed by amendment to December 15, 1955, in conformity with the change made in subsection (a) of section 4. Paragraph (3) prescribes the conditions under which a period of time will be disregarded in computing interest with respect to the increase in tax. If the taxpayer files the statement in accordance with subsection (a) and pays in full that portion of the increase in tax shown thereon which is due before December 15, 1955, then for the purpose of computing interest (other than interest on overpayments) such amount shall be treated as having been paid on the last day prescribed by law for making such payment.

The provisions of the preceding paragraph may be illustrated as follows:

Corporation X's return for the calendar year 1954 was filed on March 15, 1955, and it paid the tax liability shown thereon in equal installments on March 15, 1955, and June 15, 1955. It filed a statement on December 15, 1955, showing the increase in its tax liability by reason of the repeal of sections 452 and 462 and paid at that time the increase in tax shown thereon. Since the taxpayer has complied with the provisions of paragraph (3), no interest will be imposed with respect to the amount of the payment.

The last sentence of paragraph (3) provides that the paragraph shall not apply if the amount shown on the statement as the increase in the amount of the tax required to be paid for the taxable year is (by reason of the enactment of the bill) greater than the actual increase unless the taxpayer establishes, to the satisfaction of the Secretary or his delegate, that his computation of the greater amount was based upon a reasonable interpretation and aplication of sections 452 and 462 of the Internal Revenue Code of 1954, as those sections existed before the enactment of the bill.

Subsection (c) of section 4 of the bill is identical with that of the House bill with the exception that there is added a new paragraph (4) and the remaining paragraphs have been renumbered. Subsection (c) provides special rules to give effect to the repeal of sections 452 and 462. Paragraph (1) of subsection (c) is identical with that of the House bill and states that interest shall not be imposed with respect to the amount of any increase in tax resulting from the repeal of sections 452 and 462 for any period prior to the day after the date of enactment of the bill. The provisions of this paragraph are applicable notwithstanding any other provisions of section 4.

Paragraph (2) of subsection (c) is identical with that of the House bill and states the conditions under which additions to the tax will not be imposed with respect to the estimated tax of an individual where additions to the tax would result from the enactment of the bill. Any addition to the tax under section 294(d) of the Internal Revenue Code of 1939, relating to estimated tax, shall be computed without regard to any increase in tax resulting from the enactment of the bill. In the case of any underpayment of estimated tax to which section 6654 of the Internal Revenue Code of 1954 applies, any additions to the tax for installments due before December 15, 1955, shall be computed without regard to any increase in tax resulting from the enactment of the bill. Any additions to the tax with respect to installments due on or after December 15, 1955, shall be imposed in accordance with the applicable provisions of the code.

Paragraph (3) of subsection (c) is identical to that of the House bill. Paragraph (3) provides that if—

(A) the taxpayer is required to make a payment (or an additional payment) to another person by reason of the enactment of the bill, and

(B) the Internal Revenue Code of 1954 prescribes a period (which expires after the close of the taxable year) within which the taxpayer must make the payment (or additional payment) if the amount thereof is to be taken into account (as a deduction or otherwise) in computing taxable income for such taxable year,

then (subject to regulations and if made on or before December 15, 1955) the payment (or additional payment) shall be treated as having been made within the period prescribed by the 1954 Code. The application of this paragraph may be illustrated by the following examples:

(1) Assume that section 267 of the 1954 Code (relating to losses, expenses, and interest with respect to transactions between related taxpayers) applies to amounts accrued by taxpayer A for salary payable to I for the calendar year 1954 if remaining unpaid at the close of March 15, 1955. A is required to pay I a salary equal to 5 percent of taxable income for such taxable year. Under existing law (with the application of sec. 462) the amount accrued and paid for the taxable year 1954 was $5,000. By reason of the enactment of the bill taxable income of A is increased so that the proper accrual for 1954 would have been $6,000. Under paragraph (3) taxpayer A would be entitled to an additional deduction for 1954 of $1,000 if that amount is paid on or before December 15, 1955.

(2) Assume that on March 1, 1955, X, a calendar-year taxpayer on the accrual basis, makes a payment described in section 404(a)(6) of the 1954 Code (relating to contributions of an employer to an employees' trust) of $10,000 which is accrued for 1954 and is required to be paid on the basis of the amount of the taxable income for that year. The taxpayer filed his return April 15,

1955. By reason of the enactment of the bill taxpayer X's taxable income is increased so that he is required to make an additional payment of $2,000. This payment is made before December 15, 1955. By reason of paragraph (3), this additional payment is deemed to have been made on the last day of 1954.

There is added a new paragraph (4) to subsection (c) providing for the treatment of certain dividends paid by a corporation. Paragraph (4) provides that, at the election of a corporation, a dividend paid by such corporation to its shareholders on or before December 15, 1955, may be treated, for purposes of section 561(a)(1), as having been paid in the prior taxable year under certain circumstances. This rule applies only to the extent dividends paid are attributable to an increase in the taxable income of the corporation for the taxable year to which such dividends are related back only if such increase results from the enactment of the bill. It applies to those situations where the Internal Revenue Code of 1954 prescribes a period (which expires after the close of the taxable year) within which a dividend paid may be treated as having been paid in the prior taxable year. This paragraph is subject to such regulations as the Secretary of the Treasury or his delegate may prescribe. Paragraph (4) has no application to dividends paid for taxable years which are not subject to the Internal Revenue Code of 1954.

For example, corporation Y, a personal holding company, for its calendar year 1954 dividends to its shareholders on March 14, 1955, in order that it might claim 1954 paid dividends to its shareholders on March 14, 1955, in order that it might claim a deduction for dividends paid provided for by section 561(a)(1) for purposes of computing its personal holding company tax. Corporation Y may elect the treatment provided by paragraph (4) with respect to dividends paid to its shareholders for 1954 for purposes of the personal holding company tax but only if all the requirements of paragraph (4) are met. Other corporations which may be entitled to make the election are regulated investment companies and corporations subject to the accumulated earnings tax.

PART VI. CHANGES IN EXISTING LAW[1]

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[H. R. 4744]
AMENDING THE RAILROAD RETIREMENT ACT OF 1937, AS AMENDED, AND THE RAILROAD UNEMPLOYMENT INSURANCE ACT

[House of Representatives Report No. 1046, Eighty-fourth Congress, first session]

[July 1, 1955]

Mr. Priest, from the Committee on Interstate and Foreign Commerce, submitted the following report [To accompany H. R. 4744]:

The Committee on Interstate and Foreign Commerce, to whom was referred the bill (H. R. 4744) to amend the Railroad Retirement Act of 1937, as amended and the Railroad Unemployment Insurance Act, having considered the same, report favorably thereon with an amendment and recommend that the bill as amended to pass.

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PROVISIONS OF THE BILL

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4. Other provisions

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Section 4 of the reported bill merely reasserts the congressional policy, established with the enactment of the Railroad Retirement Act and the Railroad Unemployment Insurance Act, that benefits payable under these acts shall not be assignable, or be subject to any Federal or State tax, or to garnishment, attachment, or other legal process under any circumstances whatsoever.

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[1] Not reproduced.

NEED FOR LEGISLATION

Your committee has received a large number of letters protesting the inadequacy of spouses' benefits payable under the Railroad Retirement Act as compared to spouses' benefits payable under the Social Security Act. Also, a large number of protests have been received from widows who find their widow's' annuities payable under the Railroad Retirement Act reduced because they had found social security employment and qualified for an old-age benefit under that system. Last year, the Congress passed H. R. 7840, 83d Congress, which repealed a similar restriction on railroad survivor annuities when the survivor was entitled to railroad retirement benefits in his or her own right. Retention of such a restriction in the case where the eligible survivor is entitled to social security benefits can no longer be justified. These inequities will be corrected by enactment of the committee bill.

Further evidence of the need for the legislation is indicated by the fact that 11 Members of the House of Representatives introduced bills identical to the committee bill, H. R. 4744. In addition, there are a number of bills which provide, in part, for the repeal of the dual benefit restriction on widows' annuities.

The need for these and other provisions of the reported bill is discussed below.

* * * * * * *

3. Exemptions from taxation, attachment, etc., of retirement and unemployment insurance benefits

The amendments made by section 4 of the reported bill to section 12 of the Railroad Retirement Act and section 2 (e) of the Railroad Unemployment Insurance Act would preclude the attachment of the benefits payable under these two acts for Federal taxes. The retroactive effective date of the amendments made by section 4 of the reported bill shows continuity of the congressional policy, from the time of the original enactment of these two sections to date, against making such benefits assignable or subject to any tax or to garnishment, attachment, or other legal process under any circumstance whatsoever, and against the anticipation of the payment of such benefits.

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SECTION-BY-SECTION EXPLANATION OF THE COMMITTEE BILL

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Section 4. Restoring and clarifying the exemptions from taxation, attachment, or other legal process of railroad retirement and railroad unemployment insurance benefits

Section 4 of the reported bill would amend section 12 of the Railroad Retirement Act and section 2(e) of the Railroad Unemployment Insurance Act to restore in full the exemption, with respect to the Federal laws, from taxation, attachment, or other legal process of benefits payable under the respective acts, and to make clear that such exemption is effective, as well, contrary to the views of some State authorities, in respect of the laws of several States, the District of Columbia, and the Territories. The amendments made by this section of the bill, being enacted subsequent to the enactment in 1954 of general provisions of the Internal Revenue Code (secs. 6321, 6322, 6331–6334) indirectly removing, with respect to such benefits, the exemption against attachment or other legal process for purposes of tax collection, will again preclude the attachment of benefits under the two sections of the acts above for purposes of collecting Federal taxes. The specification of a retroactive effective date for this section shows continuity of the congressional policy, from the time of the original enactment of these two sections to date, against making such benefits under said two sections assignable, or subject to any tax, garnishment, attachment, or other legal process under any circumstances whatever, and against the anticipation of such benefits.

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CHANGES IN EXISTING LAW[1]

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[H. R. 4744]
AMENDING THE RAILROAD RETIREMENT ACT OF 1937, AS AMENDED, AND THE RAILROAD UNEMPLOYMENT INSURANCE ACT

[Senate Report No. 1040, Eighty-fourth Congress, first session]

[July 20, 1955]

Mr. Kennedy, from the Committee on Labor and Public Welfare, submitted the following report [To accompany H. R. 4744]:

The Committee on Labor and Public Welfare, to whom was referred the bill (H. R. 4744) to amend the Railroad Retirement Act of 1937, as amended, and the Railroad Unemployment Insurance Act, having considered the same, report favorably with the recommendation that it do pass without amendment.

H. R. 4744 as passed by the House of Representatives is a companion bill to S. 1589, introduced by Senator Hill for himself and 28 other Senators and referred to this committee. The House bill was passed on July 5, 1955. The House having acted first, the committee proceeded to consider the House bill and reported it out without amendment.

PURPOSE OF THE BILL

The bill proposes to increase the maximum benefit payable to the wife (or dependent husband) of a railroad retirement annuitant or pensioner to the maximum that would be payable as a wife's benefit under the Social Security Act. It proposes also to strike the restriction on a survivor's annuity against the survivor's receiving the full benefit otherwise payable under both the Railroad Retirement and the Social Security Acts. The bill would reinstate the congressional policy that benefits payable under the Railroad Retirement and Railroad Unemployment Insurance Acts shall not be subject to any Federal or State tax or to garnishment, attachment, or other legal process. In addition, the bill would assure that the personnel of the Railroad Retirement Board appointed under the sections of the acts amended by sections 5 and 6 of the bill would be altogether in and under the competitive civil service and would continue to be. Finally, the bill would provide a technical amendment in connection with the computation of a survivor's benefit.

* * * * * * *

NECESSITY FOR THE BILL

Many complaints have been received by the committee and other Members of the Congress that the benefits payable to wives under the Railroad Retirement Act are less than those payable under the Social Security Act. Also, during the last session of Congress, an amendment to the railroad retirement legislation was enacted which repealed a restriction on railroad survivor annuities requiring that these benefits be reduced by the amount of any railroad retirement benefit derived from the survivor's own employment. Our committee has received since then many requests for the removal of similar restrictions on the right of survivors to obtain full benefits deriving from their own employment covered by the Social Security Act. These inequities should be removed, particularly in the light of the previous actions of the Congress in removing the restriction on dual benefits in the case of other survivors and in the case of railroad retirement annuitants themselves.

The necessity for the various provisions of the bill are discussed in some detail below:

* * * * * * *

Section 4. Restoring the exemption from taxation, attachment, and garnishment of railroad retirement and unemployment insurance benefits

Section 4 of the bill would restore the exemption (eliminated possibly through inadvertence in recent amendments to the Internal Revenue Code) of railroad-retirement and unemployment-insurance benefits against attachment or other process in connection with the collection of Federal taxes. It would also clarify

the exemption against taxation by any State, which certain State authorities have recently questioned.

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SECTIONAL EXPLANATION OF THE COMMITTEE BILL

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Section 4. Reinstating fully and clarifying the exemptions from Federal and State taxation, attachment, or other legal process of railroad retirement and railroad unemployment insurance benefits

Section 4 of the bill would amend section 12 of the Railroad Retirement Act and section 2(e) of the Railroad Unemployment Insurance Act to reinstate completely the exemption, with respect to the Federal laws, from taxation, attachment, or other legal process of the benefits payable under the two acts, and to make clear that this exemption applies also, contrary to the views of some State authorities, with respect to the laws of the several States, the District of Columbia, and the Territories. Since, upon enactment, the amendments made by this section will have been enacted after the enactment in 1954 of the general provisions of the Internal Revenue Code (sections 6321, 6322, 6331-6334), indirectly removing, with respect to these retirement and unemployment insurance benefits, the prior exemption against attachment or other legal process for purposes of tax collection, the amendment will prevent again the attachment of these benefits for purposes of collecting Federal taxes. The section would be effective from the enactment of the original acts and would, thus, demonstrate the continuity of congressional policy from the very beginning against making these benefits subject to any tax, attachment, garnishment, or other legal process under any circumstances whatever, and against the anticipation of such benefits.

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CHANGES IN EXISTING LAW[1]

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[H. R. 5249]

REFUND OF TAX ON DISTILLED SPIRITS AND WINES RENDERED UNMARKETABLE AS RESULT OF HURRICANES OF 1954

[House of Representatives Report No. 1491, Eighty-fourth Congress, First Session]

[July 27, 1955]

Mr. Forand, from the Committee on Ways and Means, submitted the following report [to accompany H. R. 5249]:

The Committee on Ways and Means, to whom was referred the bill (H. R. 5249) to amend the Internal Revenue Code of 1954 to provide for refund or credit of internal revenue taxes and custom duties paid on distilled spirits and wines lost, rendered unmarketable, or condemned by health authorities as a result of the hurricanes of 1954, having considered the same, report favorably thereon without amendment and recommend that the bill do pass.

PURPOSE OF BILL

This bill provides for certain refunds or credits in the case of distillers, wine-makers, or rectifiers for the amount of excise tax and customs duties paid on distilled spirits and wine lost or rendered unmarketable, or condemned by a duly authorized health official, by reason of the 1954 hurricanes.

[1] Not reproduced.

REASONS FOR BILL

Your committee believes that in view of the heavy burden of the tax on alcoholic beverages, it is desirable to provide for refunds of such taxes where heavy losses are sustained in a general emergency by dealers and other persons holding tax-paid stocks of such products. This bill grants relief similar to that provided for spirits destroyed by the 1951 floods by section 498 of the Revenue Act of 1951, except that this bill includes wines and winemakers, and it provides that spirits or wines condemned by a duly authorized health official are within the scope of the provision.

GENERAL STATEMENT

The bill authorizes and directs the Secretary of the Treasury under certain conditions to make refund, or allow credit, to a distiller, winemaker, or rectifier who so elects for the amount of the internal revenue tax and customs duties paid on distilled spirits and wines which are lost or rendered unmarketable or condemned by a duly authorized health official by reason of the 1954 hurricanes. For such refund or credit to be made, the spirits or wines must have been lost, rendered unmarketable, or condemned while in the possession of (1) the original taxpayer, (2) a rectifier, or (3) a wholesale or retail liquor dealer. The refund may be made to any of these persons except a retail liquor dealer. It may also be made to any distiller, winemaker, rectifier, importer, or wholesale liquor dealer who replaced, for the possessor of the spirits or wines (including retailers), the lost, unmarketable, or condemned spirits or wines without compensation for the tax or duty.

The claimant of a credit or refund must furnish proof that (1) the tax and any duty on the beverages have been paid; (2) the beverages were lost, or rendered unmarketable, or condemned by a duly authorized health official of the United States or of a State; (3) the claimant was not indemnified by insurance or otherwise against loss of the tax and any duty; and (4) where applicable, the claimant has replaced for the possessor the equivalent of the spirits or wines lost, rendered unmarketable, or condemned without compensation for the tax and any duty.

When the Secretary of the Treasury makes a refund or allows a credit under this bill for the beverages rendered unmarketable or condemned, the beverages must be destroyed under the supervision of the Secretary or his delegate unless the spirits or wines were destroyed under the supervision or observation of the Secretary or his delegate prior to the enactment of this bill.

The Secretary is authorized to prescribe any rules and regulations as may be necessary to carry out the provisions of this bill. Any claim for refund or credit must be filed with the Secretary within 90 days after enactment of the bill.

Your committee has reported this bill unanimously.

[H. R. 5249]

REFUND OF TAX ON DISTILLED SPIRITS AND WINES RENDERED UNMARKETABLE AS A RESULT OF HURRICANES OF 1954

[Senate Report No. 1262, Eighty-fourth Congress, First Session, Calendar No. 1279]

[July 29, 1955]

Mr. Byrd, from the Committee on Finance, submitted the following report [to accompany H. R. 5249]:

The Committee on Finance, to whom was referred the bill (H. R. 5249) to amend the Internal Revenue Code of 1954 to provide for refund or credit of internal revenue taxes and custom duties paid on distilled spirits and wines lost, rendered unmarketable, or condemned by health authorities as a result of the hurricanes of 1954, having considered the same, report favorably thereon without amendment and recommend that the bill do pass.

By virtue of this act, the Committee on Finance accepts the report of the Committee on Ways and Means, which is as follows:

[See House Report No. 1491, page 868 of this Bulletin.]

[H. R. 5647]
REPEALING THE MANUFACTURERS' EXCISE TAX ON MOTORCYCLES

[House of Representatives Report No. 1440, Eighty-fourth Congress, First Session]

[July 26, 1955]

Mr. Boggs, from the Committee on Ways and Means, submitted the following report [to accompany H. R. 5647]:

The Committee on Ways and Means, to whom was referred the bill (H. R. 5647) to repeal the manufacturers' excise tax on motorcycles, having considered the same, report favorably thereon without amendment and recommend that the bill do pass.

Purpose of Bill

This bill removes motorcycles from the base of the 10 percent manufacturers' excise tax on passenger cars, etc. This is accomplished by striking out the term "motorcycles" in section 4061(a)(2) of the Internal Revenue Code of 1954. This change is to be effective as of the first of the month beginning more than 10 days after the enactment of this bill.

Reasons for Bill

Your committee believes that the repeal of the excise tax on motorcycles is desirable primarily because the industry is a depressed industry, which in the past several years at least has been faced with declining sales. Profits of the three leading manufacturers in the industry (presently accounting for more than 90 percent of domestic sales) show a declining trend since 1947. In that year profits amounted to nearly $3.5 million, in 1948 they had declined to $2.3 million, and by 1950 they had shrunk to approximately $1.4 million. In 1951 the profits of the 3 producers amounted to only $300,000 and since that time they have generally declined until the 3 producers were faced with a loss of slightly over $400,000 in 1954. During this 8-year period when the profits of the entire domestic industry exceeded $1 million in only 3 years, the excise tax payments exceeded a million dollars in all but 2 years of these and even in those 2, the excise payments were only slightly under a million dollars.

Sales of the 3 leading domestic producers shrunk from over $29 million in 1948 to slightly under $16 million in 1954, a decline of 45 percent in the 7-year period. Employment of these three producers also decreased steadily in this period. From a level of about 3,800 workers in 1948, their employment declined to a level of slightly under 1,900 in 1954.

Your committee believes that where there is a general and steady decline in an industry during a period of generally rising profits, it is undesirable to ask the industry to pay special excise taxes. Moreover, the fact that the aggregate amount collected from the motorcycle industry is not large, makes it possible to make this reduction without seriously impairing the revenues.

It is understood that nearly half of the motorcycles purchased are used by individuals seeking an economical means of transportation. Moreover, such use by individuals, coupled with the use made of motorcycles by small commercial businesses, are believed to account for over two-thirds of all purchases.

It is estimated that this bill will decrease revenues by approximately $1.5 million in a full year of operation. This takes into account both domestic production and imports.

This bill has been reported unanimously by your committee.

Changes in Existing Law [1]

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[1] Not reproduced.

[H. R. 5647]
REPEALING THE MANUFACTURERS' EXCISE TAX ON MOTORCYCLES

[Senate Report No. 1245, Eighty-fourth Congress, First Session, Calendar No. 1262]

[July 29, 1955]

Mr. Byrd, from the Committee on Finance, submitted the following report [to accompany H. R. 5647]:

The Committee on Finance to whom was referred the bill (H. R. 5647) to repeal the manufacturers' excise tax on motorcycles, having considered the same, report favorably thereon without amendment and recommend that the bill do pass.

By virtue of this act, the Committee on Finance accepts the report of the Committee on Ways and Means, which is as follows:

[See House Report No. 1440, page 870 of this Bulletin.]

[H. R. 6263]
AMENDING SECTION 1233 OF THE INTERNAL REVENUE CODE OF 1954

[House of Representatives Report No. 1345, Eighty-fourth Congress, First Session]

[July 22, 1955]

Mr. KEAN, from the Committee on Ways and Means, submitted the following report [To accompany H. R. 6263]:

The Committee on Ways and Means, to whom was referred the bill (H. R. 6263) to amend section 1233 of the Internal Revenue Code of 1954 and section 117(1) of the Internal Revenue Code of 1939, having considered the same, report favorably thereon with amendments and recommend that the bill, as amended, do pass.

The amendments are as follows:

Strike out line 10 on page 3 and all that follows through line 10 on page 5 and insert in lieu thereof the following:

SEC. 2. The amendment made by the first section of this Act shall apply only with respect to taxable years ending after the date of the enactment of this Act and only in the case of a short sale of property made by the taxpayer after such date.

Amend the title so as to read:

A bill to amend section 1233 of the Internal Revenue Code of 1954.

GENERAL STATEMENT

This bill amends section 1233 of the Internal Revenue Code of 1954, relating to gains and losses from short sales. It provides a special rule for the application of the new holding-period rule in section 1233 (b) (2) for certain "substantially identical property" in cases where the taxpayer has made what have been held to be short sales in connection with arbitrage operations in securities. As originally introduced, this bill also amended section 117(1) of the Internal Revenue Code of 1939 and would have applied to all transactions after September 23, 1950, the date of the enactment of the Revenue Act of 1950, which added section 117(1) to the 1939 code. Your committee has amended the bill so that it will apply only to taxable years ending after the date of enactment of this bill and only to sales after that date.

PROBLEM PRESENTED

In the Revenue Act of 1950 Congress enacted a special provision relating to short sales to prevent the artificial conversion of short-term gains (taxed as ordinary income) into long-term gains (subject to a maximum rate of 25 percent)

and long-term losses into short-term losses. Prior to the enactment of this provision, it was possible for an investor in stocks to realize a capital gain in less than 6 months and to obtain long-term capital gain tax treatment on it by making a short sale, assuring his gain on his original investment, and then defer closing out the short sale until the original stock had been held more than 6 months. Also, prior to the 1950 act substantially identical property could be acquired after a short sale and used to close the sale with little or no realized gain resulting. Meanwhile, substantially similar property, with a potential gain, acquired before the short sale could be retained with no tax effect even though the taxpayer was not at risk in the market from the time of the short sale until the time of acquiring the stock used to close the sale.

To prevent this type of abuse the Revenue Act of 1950 provided two rules intended to cover the situation where on the date of a short sale the taxpayer had held substantially identical property for not more than 6 months or where such property was acquired after the short sale but before it was closed. First, any gain from the closing of this short sale was considered as a short-term gain (sec. 1233(b)(1) of the 1954 code). Second, the holding period of substantially identical property (with certain exceptions) was considered as starting on the date of the closing of the short sale (sec. 1233(b)(2) of the 1954 code). Where the substantially identical property held exceeded the amount sold short, the special rule relating to the holding period of the substantially identical property applied in the order of the dates of acquisition.

This bill is intended to restrict the application of the rule relating to the holding period of the substantially identical property where the sale is made in arbitrage operations in securities. Revenue Ruling 154 (1953-2 C. B. 173) of the Internal Revenue Service both gives an example of these arbitrage operations and indicates the Service considers them to be short sales. The ruling is as follows:

Certain bonds traded in on the New York Stock Exchange are convertible, at the option of the holder, into common stock of the issuing corporation. The market price of the bonds tends to fluctuate in direct relation to the market price of the stock. At times, however, there is a slight difference in the relative market prices of the bonds and stock. When the price of the bonds is down, in relation to the price of the stock, members of the exchange buy the bonds at the market price and as nearly simultaneously as possible sell the stock into which the bonds are convertible. The bonds purchased are then converted and the stock so received is used to close the sale. These transactions are known as arbitrage operations. Held, sales of stock in the manner described constitute short sales within the purview of section 117(1) of the Internal Revenue Code.

By holding these sales to be short sales the second rule described above is made applicable. Thus, under present law, if the taxpayer acquires securities for investment purposes and during the holding of such securities makes short sales of other but substantially identical securities in arbitrage operations, the application of section 1233(b)(2), as interpreted in the ruling, results in the securities held for investment purposes losing their original holding period. These securities lose their holding period rather than the securities acquired at the time of the short sale, because they were the first acquired, even though held for investment purposes. The result is that the taxpayer may for an indefinite period of time be prevented from establishing a holding period of more than 6 months for the securities held for investment purposes.

Bona fide arbitrage operations in securities do not present opportunities for abuse. The taxpayer who engages in such operations does not thereby convert a short-term gain into a long-term gain. Rather the arbitrager is performing a valuable function by facilitating the self-regulation of the stock market.

EXPLANATION OF BILL

The bill as reported provides that the rules of subsection (b)(2) of section 1233 are not to apply to property not acquired for arbitrage operations if the taxpayer engages in an arbitrage operation under the conditions set forth in the bill.

This bill adds a new subsection (f) to section 1233. The first part of this subsection provides that when a short sale entered into as part of an arbitrage operation is closed and the rules of subsection (b)(2) become applicable, these rules are to apply first to the substantially identical assets acquired for arbitrage operations held on the day the short sale is made. The rules of subsection (b)(2) are to apply to other substantially identical assets only to the extent

that the quantity sold short exceeds the substantially identical assets held for arbitrage operations. In determining the quantity of substantially identical assets held for arbitrage operations on the day the sale is made, all assets acquired on the day of the sale are to be taken into account.

The operation of subsection (f) (1) is illustrated by the following example:

Assume that A buys 100 X bonds on January 2 for purposes other than arbitrage operations and that X bonds are convertible into X stock on the basis of 1 bond for 1 share at the demand of the bondholders. Assume also that on April 2 A sells 100 shares of X stock in a transaction identified and intended to be part of an arbitrage operation and that on the same day he buys 100 bonds of X in a transaction also identified as and intended to be part of an arbitrage operation. A holds no other bonds or stock of X corporation. If the sale on April 2 is a short sale, the 100 X bonds purchased on April 2 for arbitrage operations will have no holding period until the short sale is closed. If the bonds purchased on April 2 are converted into stock and such stock is delivered to close the sale of April 2, the holding period of the bonds purchased January 2 is not to be affected.

Under paragraph (2) of subsection (f) the rules of subsection (b) (2) become applicable at any time assets acquired for arbitrage operations are disposed of in such a manner as to create a net short position in assets acquired for arbitrage operations. To the extent of such net short position the open short sale in the arbitrage operations will be deemed to be short sales made on the date that such net short position is created. For example, in the example above, if on June 1 A sells the 100 X bonds acquired on April 2 (or converts such bonds into stock and sells the stock) without closing the short sale made on April 2 thereby creating a net short position in the arbitrage operations at the close of business on June 1, the short sale made on April 2 would be deemed to be a short sale made on June 1 and such short sale would make the rules of subsection (b) (2) applicable to the 100 X bonds purchased on January 2.

Paragraph (3) of subsection (f) provides that solely for the purpose of applying paragraphs (1) and (2) of subsection (f) and not for the purpose of any other provision of this subtitle, the taxpayer is to be deemed to hold assets for arbitrage operations as of the close of any business day (even though he may not physically hold such assets), if he has the right to receive or acquire such property by virtue of any other asset acquired for arbitrage operations, or by virtue of any contract he has entered into in an arbitrage operation. To illustrate: Taxpayer holds 100 convertible bonds of X. He thereafter contracts to purchase for arbitrage operations 100 convertible bonds of X and on the same day as the purchase makes a short sale for arbitrage operations of the quantity of shares of X that will be received on conversion of 100 bonds of X. At the close of the day the short sale is made the taxpayer has not received the bonds contracted to be purchased. By reason of paragraph (3) the taxpayer will be deemed to hold the bonds contracted to be purchased and there will be no net short position in assets acquired for arbitrage operations. If it were not for paragraph (3), it could be held that taxpayer did not "hold" any substantially identical asset for arbitrage operations at the close of business on the day of the short sale, with the result that the rule of subsection (b) (2) would be applied to the bonds held for investment.

"Arbitrage operations" are defined in subsection (f) (4) as—

transactions involving the purchase and sale of assets for the purpose of profiting from a current difference between the price of the asset purchased and the price of the assets sold, and in which the asset purchased, if not identical to the asset sold, is such that by virtue thereof the taxpayer is, or will be, entitled to acquire assets identical to the assets sold.

Any transaction, to be considered as an arbitrage operation, must be clearly identified by the taxpayer in his records as an arbitrage operation as soon as he is able to do so. This identification must ordinarily be made on the day of the transaction.

Arbitrage operations may involve the right to acquire stocks and securities as well as bonds, preferred stock, and common stock. Thus, arbitrage operations coming under this subsection may include the purchase of convertible preferred stock and the sale of common stock, the purchase of stock rights and the sale of stock to be acquired through the exercise of rights and other situations, as well as the example given in Revenue Ruling 154.

Property acquired in a transaction properly identified as an arbitrage operation is the only property considered to be "acquired for arbitrage operations" under this bill, and all property so acquired is deemed to be an asset acquired for arbitrage operations although the taxpayer may decide after the acquisition of the property to dispose of the property in some manner other than by the completion of the arbitrage operation. For example, if A bought bonds of X corporation and identified the bonds as acquired for arbitrage operations and A intended at the time of acquisition of the bonds to immediately sell stock of X corporation into which the bonds were convertible, the bonds so acquired would continue to be characterized as assets acquired for arbitrage operations although, due to a change in the value of the stock or bonds, the taxpayer decided to sell the bonds outright rather than make a short sale of stock, convert the bonds into stock, and deliver the stock received on the conversion to close the sale.

No inference is to be drawn from the enactment of this provision with respect to Revenue Ruling 154. If, in fact, an arbitrage sale is not a short sale, section 1233 of the Internal Revenue Code of 1954 would not apply, since it is the classifying of these arbitrage sales as short sale which makes the holding period rules of section 1233 applicable.

REVENUE EFFECT

The revenue effect of this bill is believed to be negligible.

This bill was reported unanimously by your committee.

CHANGES IN EXISTING LAW[1]

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[H. R. 6263]
AMENDING SECTION 1233 OF THE INTERNAL REVENUE CODE OF 1954

[Senate Report No. 1255, Eighty-fourth Congress, First Session, Calendar No. 1272]

[July 29, 1955]

Mr. BYRD, from the Committee on Finance, submitted the following report [To accompany H. R. 6263]:

The Committee on Finance, to whom was referred the bill (H. R. 6263) to amend section 1233 of the Internal Revenue Code of 1954, having considered the same, report favorably thereon with amendments and recommend that the bill do pass.

FIRST SECTION

The first section of the bill amends section 1233 of the Internal Revenue Code of 1954 relating to gains and losses from short sales. It provides a special rule for the application of the new holding-period rule in section 1233(b)(2) for certain "substantially identical property" in cases where the taxpayer has made what have been held to be short sales in connection with arbitrage operations in securities. This section will apply only to taxable years ending after the date of enactment of this bill and only to sales after that date.

PROBLEMS DEALT WITH BY FIRST SECTION

In the Revenue Act of 1950 Congress enacted a special provision relating to short sales to prevent the artificial conversion of short-term gains (taxed as ordinary income) into long-term gains (subject to a maximum rate of 25 percent) and long-term losses into short-term losses. Prior to the enactment of this provision, it was possible for an investor in stocks to realize a capital gain in less than 6 months and to obtain long-term capital gain tax treatment on it by making a short sale, assuring his gain on his original investment, and then defer closing out the short sale until the original stock had been held more than 6 months. Also, prior to the 1950 act substantially identical property could be acquired after a short sale and used to close the sale with little or no realized

[1] Not reproduced.

gain resulting. Meanwhile, substantially similar property, with a potential gain, acquired before the short sale could be retained with no tax effect even though the taxpayer was not at risk in the market from the time of the short sale until the time of acquiring the stock used to close the sale.

To prevent this type of abuse the Revenue Act of 1950 provided two rules intended to cover the situation where on the date of a short sale the taxpayer had held substantially identical property for not more than 6 months or where such property was acquired after the short sale but before it was closed. First, any gain from the closing of this short sale was considered as a short-term gain (sec. 1233(b)(1) of the 1954 code). Second, the holding period of substantially identical property (with certain exceptions) was considered as starting on the date of the closing of the short sale (sec. 1233(b)(2) of the 1954 code). Where the substantially identical property held exceeded the amount sold short, the special rule relating to the holding period of the substantially identical property applied in the order of the dates of acquisition.

This section is intended to restrict the application of the rule relating to the holding period of the substantially identical property where the sale is made in arbitrage operations in securities. Revenue Ruling 154 (1953-2 C. B. 173) of the Internal Revenue Service both gives an example of these arbitrage operations and indicates the Service considers them to be short sales. The ruling is as follows:

Certain bonds traded in on the New York Stock Exchange are convertible, at the option of the holder, into common stock of the issuing corporation. The market price of the bonds tends to fluctuate in direct relation to the market price of the stock. At times, however, there is a slight difference in the relative market prices of the bonds and stock. When the price of the bonds is down, in relation to the price of the stock, members of the exchange buy the bonds at the market price and as nearly simultaneously as possible sell the stock into which the bonds are convertible. The bonds purchased are then converted and the stock so received is used to close the sale. These transactions are known as arbitrage operations. Held, sales of stock in the manner described constitute short sales within the purview of section 117(1) of the Internal Revenue Code.

By holding these sales to be short sales the second rule described above is made applicable. Thus, under present law, if the taxpayer acquires securities for investment purposes and during the holding of such securities makes short sales of other but substantially identical securities in arbitrage operations, the application of section 1233(b)(2), as interpreted in the ruling, results in the securities held for investment purposes losing their original holding period. These securities lose their holding period rather than the securities acquired at the time of the short sale, because they were the first acquired, even though held for investment purposes. The result is that the taxpayer may for an indefinite period of time be prevented from establishing a holding period of more than 6 months for the securities held for investment purposes.

Bona fide arbitrage operations in securities do not present opportunities for abuse. The taxpayer who engages in such operations does not thereby convert a short-term gain into a long-term gain. Rather the arbitrager is performing a valuable function by facilitating the self-regulation of the stock market.

EXPLANATION OF FIRST SECTION

The first section of the bill as reported provides that the rules of subsection (b)(2) of section 1233 are not to apply to property not acquired for arbitrage operations if the taxpayer engages in an arbitrage operation under the conditions set forth in the bill.

This bill adds a new subsection (f) to section 1233. The first part of this subsection provides that when a short sale entered into as part of an arbitrage operation is closed and the rules of subsection (b)(2) become applicable, these rules are to apply first to the substantially identical assets acquired for arbitrage operations held on the day the short sale is made. The rules of subsection (b)(2) are to apply to other substantially identical assets only to the extent that the quantity sold short exceeds the substantially identical assets held for arbitrage operations. In determining the quantity of substantially identical assets held for arbitrage operations on the day the sale is made, all assets acquired on the day of the sale are to be taken into account.

The operation of subsection (f)(1) is illustrated by the following example:

Assume that A buys 100 X bonds on January 2 for purposes other than arbitrage operations and that X bonds are convertible into X stock on the basis of 1 bond

for 1 share at the demand of the bondholders. Assume also that on April 2 A sells 100 shares of X stock in a transaction identified and intended to be part of an arbitrage operation and that on the same day he buys 100 bonds of X in a transaction also identified as, and intended to be part of, an arbitrage operation. A holds no other bonds or stock of X corporation. If the sale on April 2 is a short sale, the 100 X bonds purchased on April 2 for arbitrage operations will have no holding period until the short sale is closed. If the bonds purchased on April 2 are converted into stock and such stock is delivered to close the sale of April 2, the holding period of the bonds purchased January 2 is not to be affected.

Under paragraph (2) of subsection (f) the rules of subsection (b) (2) become applicable at any time assets acquired for arbitrage operations are disposed of in such a manner as to create a net short position in assets acquired for arbitrage operations. To the extent of such net short position the open short sale in the arbitrage operations will be deemed to be short sales made on the date that such net short position is created. For example, in the example above, if on June 1 A sells the 100 X bonds acquired on April 2 (or converts such bonds into stock and sells the stock) without closing the short sale made on April 2, thereby creating a net short position in the arbitrage operations at the close of buisness on June 1, the short sale made on April 2 would be deemed to be a short sale made on June 1 and such short sale would make the rules of subsection (b) (2) applicable to the 100 X bonds purchased on January 2.

Paragraph (3) of subsection (f) provides that solely for the purpose of applying paragraphs (1) and (2) of subsection (f) and not for the purpose of determining what property is held by the taxpayer or what constitutes a short sale under any other provision of this subtitle, the taxpayer is to be deemed to hold assets for arbitrage operations as of the close of any business day (even though he may not physically hold such assets), if he has the right to receive or acquire such property by virtue of any other asset acquired for arbitrage operations, or by virtue of any contract he has entered into in an arbitrage operation. To illustrate: Taxpayer holds 100 convertible bonds of X. He thereafter contracts to purchase for arbitrage operations 100 convertible bonds of X and on the same day as the purchase makes a short sale for arbitrage operations of the quantity of shares of X that will be received on conversion of 100 bonds of X. At the close of the day the short sale is made the taxpayer has not received the bonds contracted to be purchased. By reason of paragraph (3) the taxpayer will be deemed to hold the bonds contracted to be purchased and there will be no net short position in assets acquired for arbitrage operations. If it were not for paragraph (3), it could be held that taxpayer did not "hold" any substantially identical asset for arbitrage operations at the close of business on the day of the short sale, with the result that the rule of subsection (b) (2) would be applied to the bonds held for investment.

"Arbitrage operations" are defined in subsection (f) (4) as—

transactions involving the purchase and sale of assets for the purpose of profiting from a current difference between the price of the asset purchased and the price of the assets sold, and in which the asset purchased, if not identical to the asset sold, is such that by virtue thereof the taxpayer is, or will be, entitled to acquire assets identical to the assets sold.

Any transaction, to be considered as an arbitrage operation, must be clearly identified by the taxpayer in his records as an arbitrage operation as soon as he is able to do so. This identification must ordinarily be made on the day of the transaction.

Arbitrage operations may involve the right to acquire stocks and securities, as well as bonds, preferred stock, and common stock. Thus, arbitrage operations coming under this subsection may include the purchase of convertible preferred stock and the sale of common stock, the purchase of stock rights and the sale of stock to be acquired through the exercise of rights and other situations, as well as the example given in Revenue Ruling 154.

Property acquired in a transaction properly identified as an arbitrage operation is the only property considered to be "acquired for arbitrage operations" under this section, and all property so acquired is deemed to be an asset acquired for arbitrage operations although the taxpayer may decide after the acquisition of the property to dispose of the property in some manner other than by the completion of the arbitrage operation. For example, if A bought bonds of X corporation and identified the bonds as acquired for arbitrage operations and A intended at the time of the acquisition of the bonds to immediately sell stock

of X corporation into which the bonds were convertible, the bonds so acquired would continue to be characterized as assets acquired for arbitrage operations although, due to a change in the value of the stock or bonds, the taxpayer decided to sell the bonds outright rather than make a short sale of stock, convert the bonds into stock, and deliver the stock received on the conversion to close the sale.

No inference is to be drawn from the enactment of this provision with respect to Revenue Ruling 154. If, in fact, an arbitrage sale is not a short sale, section 1233 of the Internal Revenue Code of 1954 would not apply, since it is the classifying of these arbitrage sales as short sale which makes the holding period rules of section 1233 applicable.

Your committee amended H. R. 6263 as passed by the House by striking out in line 7 on page 1 the words "the closing of". The problem dealt with in the House bill arises when an arbitrager makes a short sale in an arbitrage operation and it exists whether or not the taxpayer closes the short sale before he disposes of his other securities. The amendment therefore brings the new subsection into operation when the taxpayer makes a short sale in an arbitrage operation rather than at the time he closes the short sale.

SECTION 2

Section 2 makes the provisions of the first section of this bill applicable only to taxable years ending after the date of enactment of this act and only in the case of a short sale of property made by the taxpayer after such date.

SECTION 3

Section 542(a)(2) of the Internal Revenue Code of 1954 (defining the term "personal holding company") provides for treating charitable foundations or trusts as "individuals" in determining the stock ownership test for personal holding companies. This provision was new in the 1954 code and is so broad in its wording as to include investment companies which have been wholly owned by charitable foundations for many years and would thereby for the first time require treatment of such investment companies as personal holding companies.

Certain long-established charitable trusts have, solely for business reasons, owned and controlled certain of their investments through the means of a separately formed investment company. Such company is, of course, subject to payment of the customary Federal income taxes and is used as a matter of convenience in the business-like handling and development of enterprises requiring additional capital from time to time in their expanding activities. If such organizations are to come under the rule for personal holding companies then they would become subject to the penalty tax applicable thereto. This would make it impracticable to conduct their activities on a normal basis involving carefully planned reinvestment to provide required capital to meet the needs of growth situations such as public utilities with resulting expansion of income. The alternative would require dissolution of such investment companies which would deprive the Federal Government of the income tax now being paid by such companies.

Section 3 of the bill, which has been added by your committee, amends this provision of the 1954 code in a limited manner so that certain long-established charitable foundations may retain the tax status under which they have operated for many years.

DETAILED EXPLANATION

Section 3 amends section 542(a)(2) of the Internal Revenue Code of 1954 which deals with certain charitable foundations. Three conditions must be met. The foundation must be organized or created before July 1, 1950. Second, at all times on or after July 1, 1950, through the close of the taxable year such foundation must own all of the common stock and at least 80 percent of the total number of shares of all other classes of stock of the corporation. Thirdly, such foundation must not be denied exemption under section 504 or such trust must not be denied the unlimited charitable deduction under section 681(c) and, for this purpose, the income of the investment company is treated as though distributed to the foundation or trust to the extent of their proportionate interest in income available for distribution as dividends. Also, for purposes of this last condition it is provided that the restrictions in sections 504(a)(1) and 681(c)(1)

of the 1954 code against unreasonable accumulations will not apply to income attributable to property of a decedent dying before January 1, 1951, which was transferred, either to an inter vivos trust during his lifetime or was transferred under his will to such trust.

SECTION 4

Section 4 provides that the amendments made by section 3 of this bill will apply only with respect to taxable years beginning after December 31, 1954.

CHANGES IN EXISTING LAW [1]

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[H. R. 6382]
FOREIGN CLAIMS SETTLEMENT COMMISSION

[House of Representatives Report No. 624, Eighty-fourth Congress, first session]

[May 24, 1955]

Mr. Richards, from the Committee on Foreign Affairs, submitted the following report [To accompany H. R. 6382].

The Committee on Foreign Affairs, to whom was referred the bill (H. R. 6382) to amend the International Claims Settlement Act of 1949, as amended, and for other purposes, having considered the same, report favorably thereon without amendment and recommend that the bill do pass.

* * * * * * *

INTRODUCTION

The main objective of this bill is to enable the Foreign Claims Settlement Commission of the United States to handle certain claims against five governments: Bulgaria, Hungary, Rumania, Italy, and the Union of Soviet Socialist Republics.

The bill does not create a new Government agency. It does not authorize, nor does its implementation depend upon, negotiations with any of these governments. It places no additional burden on the American taxpayer since expenses of administration are to be met from the funds available for distribution to the claimants.

The available assets of these 5 countries from which claims can be paid are approximately $41 million:

Bulgaria, Hungary, and Rumania	$27,000,000
Italy	5,000,000
Russia	9,000,000
Net total available for payment of claims	41,000,000

These funds will be available as follows:

(1) Blocked assets of the three satellite countries are more than $34 million. This total consists of about $27 million of government- and corporate-owned assets and $7 million of assets owned by natural persons. The bill specifically prohibits the vesting of the blocked assets of natural persons, and the $7 million of these assets are to remain blocked subject to future decision as to their disposition, leaving only $27 million of government- and corporation-owned assets to pay claims.

(2) Under the Lombardo Agreement of August 14, 1947, Italy turned over to the United States $5 million for distribution by the United States in full satisfaction of claims against Italy arising out of the war and not otherwise provided for in the peace treaty with Italy.

(3) Pursuant to the Litvinov Assignment of November 16, 1933, the United States has recovered the sum of approximately $9 million which is now available for the payment of claims of United States nationals against the Soviet Union and certain of its nationals.

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[1] Not reproduced.

Following is a statistical breakdown of the claims:

Estimated number of claims, amounts, and funds available

Country	Estimated number of claimants	Estimated total of claims to be filed	Funds available to pay claims
Bulgaria	[1] 4, 000	$125, 000, 000+	$3, 000, 000
Hungary			6, 000, 000
Rumania			25, 000, 000
Italy	1, 000–1, 500	5, 000, 000+	5, 000, 000
Russia	3, 000–3, 500	425, 000, 000	9, 000, 000
Total funds			48, 000, 000
Less assets owned by natural persons			7, 000, 000
Net total available for payment of claims			41, 000, 000

[1] It is estimated that approximately ½ of these claims are for losses arising prior to Sept. 15, 1947.

Before the blocked assets of the three satellite countries can become available for the payment of such claims, the United States must vest (take title to) the assets of these countries in the United States, make cerain initial determinations disposing of prewar debt claims and title claims, liquidate the assets, and turn the net proceeds over to the Treasury Department. When this has been accomplished, a separate and distinct fund will be set up in the Treasury Department for each of the three satellite countries. No vesting or title taking will be needed in the case of Italian and U. S. S. R. assets covered by this bill, since title in those assets already exists in the United States. As in the case of the satellite funds, separate and distinct funds are to be set up in the Treasury for Italy and the U. S. S. R. claims respectively.

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PROVISIONS OF BILL

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TITLE II. VESTING AND LIQUIDATION OF BULGARIAN, HUNGARIAN, AND RUMANIAN PROPERTY

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AUTHORIZATION FOR VESTING (SEC. 202(a))

Subsection (a).—Provides for the vesting of Bulgarian, Hungarian, and Rumanian assets which were directly or indirectly owned by such governments or by any national thereof (other than a natural person) on September 15, 1947, and which remain blocked on the effective date of title II. (September 15, 1947, is the date upon which treaties of peace became effective between such governments and the Government of the United States.) Such assets would vest in such officer or agency as the President may designate for this purpose, presumably the Office of Alien Property in the Department of Justice. This subsection requires liquidation of such assets as expeditiously as possible. Property found to be owned directly by natural persons would not be vested under this subsection but would remain blocked subject to possible future release.

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PAYMENT OF TAXES (SEC. 212)

Provides that all Federal, State, and local taxes otherwise payable shall not be rendered inapplicable by vesting and requires the vesting agency to pay such taxes.

DEDUCTION OF EXPENSES (SEC. 213)

Provides that the vesting agency shall deduct the amount of its administrative expenses applicable to any particular assets prior to transferring them to the Treasury.

VESTED PROPERTY NOT SUBJECT TO LIEN (SEC. 214)

Proscribes postvesting liens, attachments, etc., against vested assets or the proceeds thereof.

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CHANGES IN EXISTING LAW [1]

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[H. R. 6382]
FOREIGN CLAIMS SETTLEMENT COMMISSION

[Senate Report No. 1050, Eighty-fourth Congress, first session. Calendar No. 1063]

[July 20, 1955]

Mr. Green, from the Committee on Foreign Relations, submitted the following report [To accompany H. R. 6382]:

The Committee on Foreign Relations, having had under consideration H. R. 6382, amending the International Claims Settlement Act of 1949, as amended, to provide for the settlement of certain claims of nationals of the United States against Bulgaria, Hungary, Rumania, Italy, and the Soviet Union, report the same to the Senate with a number of amendments and recommend that it do pass.

1. MAIN PURPOSE OF THE BILL

The purpose of the present bill is to establish a claims program for the benefit of American nationals whereby they may obtain at least partial compensation for (1) war damage, nationalization, and prewar governmental debt (bond) claims, against the Governments of Bulgaria, Hungary, and Rumania; (2) claims against the Government of Italy arising out of the war and not otherwise provided for in the Italian peace treaty; and (3) claims against Russian nationals secured by liens on certain assets prior to the Litvinov Assignment, and other claims arising prior to November 16, 1933, against the Soviet Government. To that end the bill authorizes the vesting and liquidation of currently blocked assets of the Governments of Bulgaria, Hungary, and Rumania and of their nationals other than natural persons. Approximately $27 million will be realized from this source. Claims against the Soviet and Italian Governments would be satisfied out of two additional funds consisting, respectively, of aproximately $9 million in assets transferred to the United States under the Litvinov Assignment, and of $5 million made available to this country pursuant to an exchange of notes known as the Lombardo Agreement.

Under this bill, the entire program would be administered by the Foreign Claims Settlement Commission which succeeded to the functions of the International Claims Commission and the War Claims Commission under Reorganization Plan No. 1 of July 1, 1954. This is accomplished by amending the International Claims Settlement Act of 1949, as amended, so as to authorize the Foreign Claims Settlement Commission to adjudicate the various classes of claims described above, and to certify its awards to the Secretary of the Treasury for payment in accordance with the procedure established in the bill. Neither the amounts paid in satisfaction of the claims, nor any expenses incurred in administration of the program would be derived from general appropriations. All awards will be payable exclusively from assets of the countries referred to which are or will become available to the United States for the settlement of these claims. In other words, the funds do not come from the pockets of the taxpayer.

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4. SUMMARY OF PROVISIONS

(a) Vesting and liquidation of assets (title II)

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Section 209 empowers the administering authority to hold hearings, prescribe rules governing the disposition of claims, and issue subpenas, administer oaths,

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[1] Not reproduced.

and examine witnesses. A 1-year statute of limitations is provided for filing suits and claims for return of vested property (section 210). As in other portions of the bill, a 10 percent ceiling is established on attorneys' fees in suits or claims for return of property (section 211). Under section 212, Federal, State, and local taxes otherwise payable are not rendered inapplicable by vesting, and the administering agency is authorized to pay such taxes. The amount of any administrative expenses incurred by the agency in connection with particular assets may be deducted prior to their transfer to the Treasury (section 213). Postvesting liens, attachments, and the like against vested assets or the proceeds thereof are prohibited except as specifically authorized (section 214), and criminal penalties are established for violation of the provisions of title II of the bill (section 215).

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CHANGES IN EXISTING LAW[1]

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[H. R. 7024]

MANUFACTURERS' EXCISE TAX ON CERTAIN COMPONENT PARTS AND ON CERTAIN RADIO AND TELEVISION APPARATUS

[House of Representatives Report No. 1308, Eighty-fourth Congress, First Session]

[July 21, 1955]

Mr. SIMPSON of Pennsylvania, from the Committee on Ways and Means, submitted the following report [To accompany H. R. 7024]:

The Committee on Ways and Means, to whom was referred the bill (H. R. 7024) to remove the manufacturers' excise tax from the sales of certain component parts for use in other manufactured articles, and to confine to entertainment-type equipment the tax on radio and television apparatus, having considered the same, report favorably thereon with amendments and recommend that the bill, as amended, do pass.

The amendments are as follows:

Page 1, line 5, strike out "4216" and insert "4218".

Page 2, line 2, strike out "4171." and insert "4171)".

Page 2, strike out lines 16 to 18, inclusive, and insert:

Under regulations prescribed by the Secretary or his delegate, no tax under this chapter shall be imposed with respect to the sale of—

Page 3, strike out lines 16 to 20, inclusive, and insert:

For purposes of this chapter, the manufacturer or producer to whom an article is sold under paragraph (1) (A) or (2) (A) or resold under paragraph (1) (B) or (2) (B) shall be considered the manufacturer or producer of such article.

Page 4, lines 12 and 13, strike out "4112. Exemptions for Manufacturers." and insert "4113 Exemptions for manufacturers.".

Page 4, line 22, strike out "of" and insert "or".

Page 5, line 4, strike out "4171." and insert "4171".

Page 6, strike out lines 1 to 10, inclusive, and insert:

(b) Sections 4143 and 6416 (b) (2) (G) of the Internal Revenue Code of 1954 are hereby repealed.

Page 6, line 11, strike out "(d)" and insert "(c)".

Page 6, line 17, after "Act." insert:

Notwithstanding the preceding sentence—

(1) the repeal of section 6416 (b) (2) (G) of the Internal Revenue Code of 1954 shall apply only with respect to articles sold by the manfacturer, producer, or importer on or after the first day of the first month which begins more than 10 days after the date of the enactment of this Act, and

(2) section 6416 (b) (3) (B) of the Internal Revenue Code of 1954, as amended by subsection (i) of the first section of this Act, shall apply with

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[1] Not reproduced.

respect to articles used on or after such first day by the manufacturer or producer as material in the manufacture of, production of, or as a component part of, another article.

The committee amendments to the first section of the bill correct clerical and printing errors. The committe amendments to section 2 of the bill strike out a proposed redefinition of the term "radio and television components" and make clerical and conforming changes. The amendment to section 3 is a technical amendment to clarify the application of the effective date.

GENERAL STATEMENT

The first section of this bill would provide that parts, accessories, or components subject to manufacturers' excise taxes may be sold free of tax if the purchaser uses or resells them "as material in the manufacture or production of, or is a component part of," any other articles whether or not these other articles are subject to a manufacturers' excise tax.

Section 2 of this bill provides that the 10-percent excise tax on radios, television sets, phonographs, automobile radio or television sets, and combinations of radio, television or phonograph sets, is to apply only if the article is of the "entertainment type." The bill, as amended by the committee, would make no change in the type of radio or television components which are taxable when sold separately from a set. Thus, under the bill as reported, as well as under present law, the following radio and television components will continue to be subject to tax: chassis, cabinets, tubes, speakers, amplifiers, power-supply units, antennas of the built-in type, and phonograph mechanisms. These components will continue to be subject to tax when sold as repair or replacement parts whether or not the set in which the part is to be used is of the entertainment type.

SALE OF CERTAIN TAXABLE COMPONENT PARTS FOR USE IN OTHER MANUFACTURED ARTICLES

Parts, accessories, or components presently subject to manufacturers' excise tax are automotive parts or accessories, refrigeration components, radio and television components, and camera lenses. Presently radio and television components and camera lenses are taxable if sold to a manufacturer for incorporation in an article not subject to a manufacturers' excise tax, or if sold for resale to such a manufacturer. Refrigerator components, as the result of a special provision in the code, are not taxable if sold for incorporation in, or as components of, refrigeration equipment whether or not such equipment is subject to a manufacturers' excise tax. Under a ruling of the Internal Revenue Service issued in 1932, automotive parts and accessories (other than spark plugs, storage batteries, leaf springs, coils, timers, and tire chains) may be sold free of tax by one manufacturer to another manufacturer even though they are to be used in the manufacture of nontaxable articles. On the other hand, if these parts or accessories are sold on a tax-paid basis, no credit or refund may be claimed if they are used in the manufacture of nontaxable articles.

The first section of this bill would provide a single rule for all of these parts, accessories, or components, exempting them from tax where they are sold for incorporation in other end articles, whether or not these other end articles are taxable. This is accomplished by establishing a new exemption category in section 4220 for these parts, accessories, or components. The new paragraph (2) of this section provides an exemption for automobile parts or accessories, refrigerator components, radio or television components, and camera lenses for use by the purchaser, or for resale by him for use, in the manufacture or production of, or as a component part of, any article. Section 6416(b)(3)(B) is amended to provide a credit or refund for these parts, accessories, or components when purchased by a manufacturer and used by him as material in the manufacture of, production of, or as a component part of, any article. The exemption in present law for refrigerator components sold for use by a manufacturer of refrigerating equipment, or sold to a purchaser for resale to such a manufacturer (secs. 4112(b) and 4113), is repealed as no longer necessary with the general provision provided by this section.

The adoption of a single rule exempting parts, accessories, or components from tax, except where they are sold for repair or replacement use, will provide greater equity and simplify administration and compliance. Providing for tax-free sales where the end products are not taxable also will prevent the indirect taxation of articles which Congress has not considered it desirable to subject to direct excise taxation. Furthermore, where there are tax-free substitute components for use in these nontaxable end articles, the change made by the first section of this bill would remove the discrimination against manufacturers of taxable parts or components. This provision will also have the effect of removing the indirect tax sometimes required to be paid by States and municipalities, or with respect to articles produced for export, where these parts or components are purchased by manufacturers for incorporation in other articles.

RADIO AND TELEVISION SETS OF THE ENTERTAINMENT TYPE

Section 2(a) of this bill would amend section 4141 to provide that the tax on radio and television receiving sets, automobile radio or television receiving sets, phonographs, and combinations of any of these would apply only to articles of the entertainment type. The tax on radio and television components and on phonograph records will continue to apply whether or not the articles are of the entertainment type.

The change described above would make it possible to remove provisions in present law providing a special exemption (sec. 4143) and a special credit or refund (sec. 6416(b)(2)(G)) for communication, detection, and navigation receivers when sold to the United States Government. These receivers, upon the enactment of this bill, will in any case be exempt from tax since they are not of the "entertainment type."

The excise tax on radios, television sets, etc., would be limited under the bill to items of the entertainment type because your committee sees no reason for singling out for excise-tax levy special communication, detection, and navigation equipment used by businesses. This change is in conformance with similar actions taken by Congress in recent years in revising the tax basis of the excises on photographic apparatus and film and electric, gas, and oil appliances. Moreover, this change would considerably ease administrative and compliance problems.

EFFECTIVE DATE

The amendments made by this bill generally are to take effect on the first of the month beginning more than 10 days after the enactment of this bill. The committee amendment to this section makes it clear that there is an overpayment of tax where a communication, detection, or navigation receiver of the type used in commercial, military, or marine installations with respect to which tax has been paid is resold after the effective date to the United States for its exclusive use. The amendment also makes it clear that there is an overpayment of tax where the articles described in section 6416(b)(3)(B) of the Internal Revenue Code of 1954, as amended by the bill, were purchased before the effective date and are used by a manufacturer or producer on or after the effective date as material in the manufacture of, production of, or as a component part of, any article.

REVENUE EFFECT

It is estimated that the combined effect of the changes made by this bill will reduce revenues by approximately $1 million in a full year of operation.

Your committee is unanimous in recommending enactment of H. R. 7024, as amended.

CHANGES IN EXISTING LAW[1]

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[1] Not reproduced.

[H. R. 7024]
REMOVING THE MANUFACTURERS' EXCISE TAX FROM THE SALES OF CERTAIN COMPONENT PARTS FOR USE IN OTHER MANUFACTURED ARTICLES, AND TO CONFINE TO ENTERTAINMENT-TYPE EQUIPMENT THE TAX ON RADIO AND TELEVISION APPARATUS

[Senate Report No. 1162, Eighty-fourth Congress, First Session, Calendar No. 1174]

[July 27, 1955]

Mr. BYRD, from the Committee on Finance, submitted the following report [To accompany H. R. 7024]:

The Committee on Finance, to whom was referred the bill (H. R. 7024) to remove the manufacturers' excise tax from the sales of certain component parts for use in other manufactured articles, and to confine to entertainment-type equipment the tax on radio and television apparatus, having considered the same, report thereon with amendments and recommend that the bill, as amended, do pass.

SECTIONS 1, 2, AND 3. REMOVAL OF MANUFACTURERS' EXCISE TAX FROM CERTAIN ARTICLES

The first section of this bill would provide that parts, accessories, or components subject to manufacturers' excise taxes may be sold free of tax if the purchaser uses or resells them "as material in the manufacture or production of, or is a component part of," any other articles whether or not these other articles are subject to a manufacturers' excise tax.

Section 2 of this bill provides that the 10-percent excise tax on radios, television sets, phonographs, automobile radio or television sets, and combinations of radio, television, or phonograph sets, is to apply only if the article is of the "entertainment type." The bill would make no change in the type of radio or television components which are taxable when sold separately from a set. Thus, under the bill, as well as under present law, the following radio and television components will continue to be subject to tax: chassis, cabinets, tubes, speakers, amplifiers, power-supply units, antennas of the built-in type, and phonograph mechanisms. These components will continue to be subject to tax when sold as repair or replacement parts whether or not the set in which the part is to be used is of the entertainment type.

Parts, accessories, or components presently subject to manufacturers' excise tax are automotive parts or accessories, refrigeration components, radio and television components, and camera lenses. Presently radio and television components and camera lenses are taxable if sold to a manufacturer for incorporation in an article not subject to a manufacturers' excise tax, or if sold for resale to such a manufacturer. Refrigerator components, as the result of a special provision in the code, are not taxable if sold for incorporation in, or as components of, refrigeration equipment whether or not such equipment is subject to a manufacturers' excise tax. Under a ruling of the Internal Revenue Service issued in 1932, automotive parts and accessories (other than spark plugs, storage batteries, leaf springs, coils, timers, and tire chains) may be sold free of tax by one manufacturer to another manufacturer even though they are to be used in the manufacture of nontaxable articles. On the other hand, if these parts or accessories are sold on a tax-paid basis, no credit or refund may be claimed if they are used in the manufacture of nontaxable articles.

The first section of this bill would provide a single rule for all of these parts, accessories, or components, exempting them from tax where they are sold for incorporation in other end articles, whether or not these other end articles are taxable. This is accomplished by establishing a new exemption category in section 4220 for these parts, accessories, or components. Paragraph (2) of this section provides an exemption for automobile parts or accessories, refrigerator components, radio or television components, and camera lenses for use by the purchaser, or for resale by him for use, in the manufacture or production of, or as a component part of, any article. Section 6416(b)(3)(B) is amended to provide a credit or refund for these parts, accessories, or components when purchased by a manufacturer and used by him as material in the manufacture of, production of, or as a component part of, any article. The exemption in present

law for refrigerator components sold for use by a manufacturer of refrigerating equipment, or sold to a purchaser for resale to such a manufacturer (secs. 4112(b) and 4113), is repealed as no longer necessary with the general provision provided by this section.

The adoption of a single rule exempting parts, accessories, or components from tax, except where they are sold for repair or replacement use, will provide greater equity and simplify administration and compliance. Providing for tax-free sales where the end products are not taxable also will prevent the indirect taxation of articles which Congress has not considered it desirable to subject to direct excise taxation. Furthermore, where there are tax-free substitute components for use in these nontaxable end articles, the change made by the first section of this bill would remove the discrimination against manufacturers of taxable parts or components. This provision will also have the effect of removing the indirect tax sometimes required to be paid by States and municipalities, or with respect to articles produced for export, where these parts or components are purchased by manufacturers for incorporation in other articles.

Section 2(a) of this bill would amend section 4141 to provide that the tax on radio and television receiving sets, automobile radio or television receiving sets, phonographs, and combinations of any of these would apply only to articles of the entertainment type. The tax on radio and television components and on phonograph records will continue to apply whether or not the articles are of the entertainment type.

The change described above would make it possible to remove provisions in present law providing a special exemption (sec. 4143) and a special credit or refund (sec. 6416(b)(2)(G)) for communication, detection, and navigation receivers when sold to the United States Government. These receivers, upon the enactment of this bill, will in any case be exempt from tax since they are not of the "entertainment type."

The excise tax on radios, television sets, etc., would be limited under the bill to items of the entertainment type because your committee sees no reason for singling out for excise-tax levy special communication, detection, and navigation equipment used by businesses. This change is in conformance with similar actions taken by Congress in recent years in revising the tax basis of the excises on photographic apparatus and film and electric, gas, and oil appliances. Moreover, this change would considerably ease administrative and compliance problems.

The amendments made by these sections generally are to take effect on the first of the month beginning more than 10 days after the enactment of this bill. The committee amendment to this section makes it clear that there is an overpayment of tax where a communication, detection, or navigation receiver of the type used in commercial, military, or marine installations with respect to which tax has been paid is resold after the effective date to the United States for its exclusive use. The amendment also makes it clear that there is an overpayment of tax where the articles described in section 6416(b)(3)(B) of the Internal Revenue Code of 1954, as amended by the bill, were purchased before the effective date and are used by a manufacturer or producer on or after the effective date as material in the manufacture of, production of, or as a component part of, any article.

It is estimated that the combined effect of the changes made by sections 1, 2, and 3 will reduce revenues by approximately $1 million in a full year of operation.

SECTIONS 4 AND 5. RELATING TO BURDEN OF PROOF IN CERTAIN PROCEEDINGS BEFORE THE TAX COURT

Section 4 of this bill amends the Internal Revenue Code of 1954 to provide that the burden of proof in certain cases involving the accumulated-earnings tax will be on the Government rather than the taxpayer. Under this provision the burden will be on the Government in cases involving taxable years to which the Internal Revenue Code of 1939 applies in the case of proceedings tried on the merits after the date of enactment of this bill if the burden of proof would have been on the Government had the deficiency been such that section 534 of the 1954 Code (as originally enacted) applied.

The relief that this provision will grant to taxpayers can be shown by comparison of the provisions for burden of proof under the 1939 Code as compared with the 1954 Code. Under the 1939 law if the Commissioner of Internal Revenue proposed a deficiency on the ground that the taxpayer had accumulated earnings

and profits in excess of the reasonable needs of the business, the taxpayer had the burden of proof as to the reasonableness of the accumulation. If earnings and profits were accumulated in excess of the reasonable needs of the business, the accumulation was deemed to be for the purposes of tax avoidance unless the taxpayer proved otherwise by the clear preponderance of the evidence.

Under the 1954 Code the taxpayer may, upon receipt of notice of a proposed deficiency with respect to the accumulated earnings tax, file a statement of the grounds (together with sufficient facts to show the basis for the statement) on which the taxpayer relies to establish the reasonableness of the accumulation. If the taxpayer submits such a statement within the proper time, the burden of proof will be upon the Government as to whether the accumulation is in excess of the reasonable needs of the business. If the taxpayer does not file such a statement, it must bear the burden of proof as under prior law. Moreover, if the taxpayer's statement of the grounds relied upon fails to set forth the facts which show the basis thereof, the burden of proof with respect to these grounds must be borne by the taxpayer. If the Secretary or his delegate fails to give the taxpayer notification prior to the issuance of a notice of deficiency, then the Government must bear the burden of proof even though the taxpayer has filed no statement.

The amendment made to section 534 of the 1954 Code by sections 4 and 5 of this bill will apply the provisions of thte 1954 Code to all cases in which the proceedings are tried on the merits after the date of enactment of this bill.

CHANGES IN EXISTING LAW[1]

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[H. R. 7095]
EXEMPTION FROM ADMISSIONS TAX FOR CERTAIN ATHLETIC EVENTS HELD FOR THE BENEFIT OF UNITED STATES OLYMPIC ASSOCIATION

[House of Representatives, Report No. 1496, Eighty-fourth Congress, First Session]

[July 27, 1955]

Mr. Cooper, from the Committee on Ways and Means, submitted the following report [to accompany H. R. 7095]:

The Committee on Ways and Means, to whom was referred the bill (H. R. 7095) to provide that the tax on admissions shall not apply to certain athletic events held for the benefit of the United States Olympic Association, having considered the same, report favorably thereon with an amendment and recommend that the bill as amended do pass.

The amendment is as follows:

Page 1, strike out lines 3 to 10, inclusive, and insert:

That section 4233 (a) of the Internal Revenue Code of 1954 (relating to exemptions from the admissions tax) is hereby amended by adding at the end thereof the following new paragraph:

"(10) ATHLETIC EVENTS FOR BENEFIT OF UNITED STATES OLYMPIC ASSOCIATION.—Any admissions to an athletic event, if (A) such event is conducted by the United States Olympic Association, or the conduct of such event for the benefit of such association is authorized in advance by such association, and (B) all the proceeds of the admissions inure exclusively to the benefit of such association."

PURPOSE OF BILL

This bill provides an exemption from the admissions tax for athletic events sponsored by the United States Olympic Association where all of the proceeds of the admissions inure exclusively to the benefit of the association. This bill is effective as of the first of the month beginning more than 10 days after the enactment of this bill for admissions on or after that day.

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[1] Not reproduced.

REASONS FOR BILL

This bill is intended to make it possible for the United States Olympic Association to raise funds to send athletes to the Olympic and Pan-American games without having the proceeds so received subjected to Federal admissions tax.

EXPLANATION OF BILL

The bill as reported adds a new paragraph to section 4233 (a) of the 1954 code providing that admissions to an athletic game or exhibition, including all of the types of athletic events at the Olympic or Pan-American games, are to be free of the admissions tax under certain conditions. To be free of tax of these events must be conducted by or for the United States Olympic Association. Events conducted for the benefit of the association must have been authorized by the association in advance of the event. Also, all of the proceeds of the admissions must inure exclusively to the benefit of the association, and not to a subordinate organization.

The term "all of the proceeds" means all the net proceeds of the regular admismission charges or excess charges, as the case may be, after payment of actual and reasonable expenses incurred in presenting the event. If the expenses are in excess of what is reasonable and necessary under the circumstances, all the proceeds would not be considered as inuring exclusively to the benefit of the United States Olympic Association. In any case where the amount to be received by any person or organization other than the association for talent, services, or otherwise, is based on a percentage of the net or gross proceeds, the United State Olympic Association before exemption may be allowed must establish that the maximum amount to be received on the percentage basis is a reasonable sum and not more than would ordinarily be received on a flat-rate basis for the same or similar talent or services, and that the contract actually operates to its benefit.

It is estimated that the revenue effect of this bill is negligible.

This bill has been reported unanimously by your committee.

CHANGES IN EXISTING LAW[1]

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[H. R. 7095]

EXEMPTION FROM ADMISSIONS TAX FOR CERTAIN ATHLETIC EVENTS HELD FOR THE BENEFIT OF UNITED STATES OLYMPIC ASSOCIATION

[Senate Report No. 1264, Eighty-fourth Congress, First Session. Calendar No. 1281]

[July 29, 1955]

Mr. Byrd, from the Committee on Finance, submitted the following report [To accompany H. R. 7095]

The Committee on Finance, to whom was referred the bill (H. R. 7095) to provide that the tax on admissions shall not apply to certain athletic events held for the benefit of the United States Olympic Association, having considered the same, report favorably thereon without amendment and recommend that the bill do pass.

By virtue of this act, the Committee on Finance accepts the report of the Committee on Ways and Means, which is as follows:

[See House Report No. 1496, page 886 of this Bulletin.]

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CHANGES IN EXISTING LAW[1]

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[1] Not reproduced.

[H. R. 7148]
INCOME TAX EXEMPTION FOR CERTAIN DEPENDENTS IN THE REPUBLIC OF THE PHILIPPINES

[House of Representatives Report No. 1293, Eighty-fourth Congress, first session]

[July 20, 1955]

Mr. FORAND, from the Committee on Ways and Means, submitted the following report [To accompany H. R. 7148]:

The Committee on Ways and Means, to whom was referred the bill (H. R. 7148) to amend the Internal Revenue Codes so as to provide a personal exemption with respect to certain dependents in the Republic of the Philippines, having considered the same, report favorably thereon without amendment and recommend that the bill do pass.

PURPOSE

This bill amends both the Internal Revenue Code of 1939 and the Internal Revenue Code of 1954 to provide that certain children (including adopted children) of members of the Armed Forces may be claimed as dependents by the taxpayer.

GENERAL STATEMENT

Under section 25 (b) (3) of the 1939 code no exemption for a dependent was allowed if the dependent was a citizen or subject of a foreign country unless he was a resident of the United States or a contiguous country. The 1954 code modified this restriction by providing in section 152 (b) that any child of the taxpayer born to him, or legally adopted by him, in the Philippine Islands before July 5, 1946, may be claimed as a dependent if the child is a resident of the Republic of the Philippines, and if the taxpayer was a member of the Armed Forces of the United States at the time of the birth or adoption of the child.

This bill permits a taxpayer to claim as a dependent under the 1939 code any child born to him, or legally adopted by him, in the Philippine Islands if the child is a resident of the Philippines for the taxable year for which the deduction is claimed and the taxpayer was a member of the Armed Forces of the United States at the time of the birth or adoption of the child. This provision applies to all taxable years beginning after December 31, 1946, to which the Internal Revenue Code of 1939 applies. However, the bill does not open up years with respect to which the statute of limitations has run.

The provision in the 1954 code relating to dependents who are residents of the Republic of the Philippines is also amended by permitting the taxpayer to claim as a dependent a child born to him or legally adopted by him prior to January 1, 1956, rather than July 5, 1946. This amendment applies with respect to taxable years beginning after December 31, 1953, and ending after August 16, 1954.

This provision is designed primarily to be of aid to Filipinos who as members of the United States Armed Forces during World War II became citizens of the United States but whose families continue to reside in the Philippine Islands and have not become United States citizens.

CHANGES IN EXISTING LAW[1]

* * * * * * *

[H. R. 7148]
INCOME TAX EXEMPTION FOR CERTAIN DEPENDENTS IN THE REPUBLIC OF THE PHILIPPINES

[Senate Report No. 1148, Eighty-fourth Congress, first session, Calendar No. 1160]

[July 26, 1955]

Mr. BYRD, from the Committee on Finance, submitted the following report [To acompany H. R. 7148]:

The Committee on Finance, to whom was referred the bill (H. R. 7148) to amend the Internal Revenue Codes so as to provide a personal exemption with

[1] Not reproduced.

respect to certain dependents in the Republic of the Philippines, having considered the same, report favorably thereon without amendment and recommend that the bill do pass.

By virtue of this act, the Committee on Finance accepts the report of the Committee on Ways and Means, which is as follows:

[See House Report No. 1293, page 888 of this Bulletin.]

* * * * * * *

CHANGES IN EXISTING LAW[1]

* * * * * * *

[H. R. 7300]
TAX TREATMENT OF INCOME RECEIVED FROM PATENT INFRINGEMENT SUITS

[House of Representatives Report No. 1357, Eighty-fourth Congress, first session]

[July 23, 1955]

Mr. IKARD, from the Committee on Ways and Means, submitted the following report [To accompany H. R. 7300]:

The Committee on Ways and Means, to whom was referred the bill (H. R. 7300) to amend the Internal Revenue Code of 1954 with respect to the tax treatment of income received from patent infringement suits, having considered the same, report favorably thereon with an amendment and recommend that the bill as amended do pass.

The amendment is as follows:

Strike out all after the enacting clause and insert:

That (a) part I of subchapter Q of chapter 1 of the Internal Revenue Code of 1954 is hereby amended by renumbering section 1304 as section 1305, and by inserting after section 1303 the following new section:

"SEC. 1304. COMPENSATORY DAMAGES FOR PATENT INFRINGEMENT.

"If an amount representing compensatory damages is received or accrued by a taxpayer during a taxable year as the result of an award in a civil action for infringement of a patent issued by the United States, then the tax attributable to the inclusion of such amount in gross income for the taxable year shall not be greater than the aggregate of the increases in taxes which would have resulted if such amount had been included in gross income in equal installments for each month during which such infringement occurred."

(b) The table of sections for such part I is hereby amended by striking out

"Sec. 1304. Rules applicable to this part."

and inserting in lieu thereof the following:

"Sec. 1304. Compensatory damages for patent infringement.
Sec. 1305. Rules applicable to this part."

SEC. 2. The amendments made by the first section of this Act shall apply with respect to taxable years ending after the date of the enactment of this Act, but only with respect to amounts received or accrued after such date as the result of awards made after such date.

PURPOSE OF BILL

This bill, as amended, inserts a new section 1304 in the Internal Revenue Code of 1954. Under this section, a taxpayer who receives or accrues an amount which represents compensatory damages resulting from a judgment for infringement of a patent issued by the United States may spread such amount proportionately over the period in which the infringement occurred if this results in a lesser tax than including the lump sum proceeds in gross income.

REASONS FOR BILL

Under existing law, averaging of certain receipts, such as those from an individual's invention or artistic work, is permitted. In the case of a patent

[1] Not reproduced.

infringement, however, the owner of the patent (or the owner of an undivided interest in the patent) may receive a judicial award for infringement of the patent where the infringement occurred over a period of years. If the taxpayer is required to include the total infringement award in gross income for the year in which the award is made, he may be compelled to pay a substantially increased tax over the tax that he would have had to pay if he had received the equivalent of the compensatory damages during the period in which the infringement occurred. This bill, therefore, permits the taxpayer to readjust his taxes with respect to such compensatory damages.

EXPLANATION OF BILL

The income spreading permitted under the bill is restricted to those instances in which damages are received or accrued in the taxable year as the result of an award in a civil action for infringement of a patent issued by the United States. The amount which may be spread back is limited to that portion of the award which represents *compensatory damages* and *does not include* that portion of the award which represents *increased damages* awarded by the court over and above the amount found adequate to compensate for the infringement. (See U. S. C. title 35, sec. 284.) It also does not include any amount that may be awarded to the taxpayer as attorney's fees, interest, or costs in the judicial action.

In determining the period over which the amount representing compensatory damages may be spread, only those months in which an infringement occurred may be taken into account. Thus, the ceiling on the computation of tax with respect to the amount representing compensatory damages is computed by determining the number of months in which the infringement occurred, dividing the amount by the number of such months and, by including the quotient in gross income for each of such months.

Where the recipient of an infringement award is entitled to capital-gains treatment on the proceeds the averaging permitted under this bill may be applied to the proceeds which are deemed to arise from the sale or exchange of a capital asset held for more than 6 months.

The amendment is effective with respect to taxable years ending after the date of enactment of this bill but only with respect to any amounts which are received or accrued after that date as the results of an award in a civil action made after that date.

Your committee has reported this bill unanimously.

CHANGES IN EXISTING LAW[1]

* * * * * * *

[H. R. 7300]
TAX TREATMENT OF INCOME RECEIVED FROM PATENT INFRINGEMENT SUITS

[Senate Report No. 1249, Eighty-fourth Congress, first session, Calendar No. 1266]

[July 29, 1955]

Mr. BYRD, from the Committee on Finance, submitted the following report [To accompany H. R. 7300]:

The Committee on Finance, to whom was referred the bill (H. R. 7300) to amend the Internal Revenue Code of 1954 with respect to the tax treatment of income received from patent infringement suits, having considered the same, report favorably thereon without amendment and recommend that the bill do pass.

By virtue of this act, the Committee on Finance accepts the report of the Committee on Ways and Means, which is as follows:

[See House Report No. 1357, page 889 this Bulletin.]

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CHANGES IN EXISTING LAW[1]

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[1] Not reproduced.

PART V

ADMINISTRATIVE AND MISCELLANEOUS MATTERS

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PART V

ADMINISTRATIVE AND MISCELLANEOUS MATTERS

T. D. 6138

TITLE 26—INTERNAL REVENUE, 1954

Temporary rules relating to the election to treat two or more separate operating mineral interests as one property under section 614 of the Internal Revenue Code of 1954.

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

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

In order to prescribe temporary rules with respect to the election to treat as one property, two or more separate operating mineral interests which constitute part or all of an operating unit, Treasury Decision 6118 [C. B. 1955–1, 698], approved December 30, 1954, is hereby amended as follows:

Paragraph 14 of Treasury Decision 6118 [C. B. 1955–1, 698] is amended by striking the next to last sentence which begins "Such election, when made," and by inserting in lieu thereof the following:

Such election, when made, shall be effective for all purposes of subtitle A of the Internal Revenue Code of 1954, and shall be binding for all subsequent taxable years, except that the Secretary or his delegate may consent to a different treatment of the interest with respect to which the election was made. If the last day prescribed by law for filing the return for a taxable year for which an election was made (including extensions thereof) falls before the last day of the third month following the month in which the regulations under section 614 are published in the Federal Register, consent is hereby given for the taxpayer to change to a different treatment for such taxable year with respect to the interest to which the election was made, provided, an amended return, reflecting the change in treatment, and including the information required by the regulations under section 614 in the case of a change in election, is filed on or before the last day of such third month with the district director for the district in which the original return was filed. In all other cases, any change to a different treatment of the interest may be made only with the consent of the official of the Service to whom authority to grant such consent is delegated in regulations promulgated under section 614.

Because the election provided in section 614 must be exercised within the time prescribed by law for filing the return which, in many cases, will expire in less than 30 days, it is found impracticable to issue this Treasury Decision with notice and public procedure thereon under section 4(a) of the Administrative Procedure Act, approved June 11, 1946, or subject to the effective date limitation of section 4(c) of that Act.

[1] 20 F. R. 6154.

(This Treasury Decision is issued under the authority contained in sections 446, 614, and 7805 of the Internal Revenue Code of 1954 (68A Stat. 151, 210, and 917; 26 U. S. C. 446, 614, and 7805).)

T. COLEMAN ANDREWS,
Commissioner of Internal Revenue.

Approved August 19, 1955.

A. N. OVERBY,
Acting Secretary of the Treasury.

(Filed by the Division of the Federal Register August 23, 1955, 8:51 a. m.)

COMMISSIONER DELEGATION ORDER NO. 2[2]

(Effective April 20, 1955)

Authority to communicate and consult on tax matters with the finance ministry of Sweden.

Pursuant to authority vested in me as Commissioner of Internal Revenue:

1. There is hereby delegated to the Assistant Commissioner (Technical) and the Director, International Tax Relations Division, the authority to perform the function delegated to the Commissioner of Internal Revenue by Treasury Department Order No. 150–38[3] to communicate and consult on tax matters with the Finance Ministry of Sweden.

2. The exercise of the authority delegated herein to the Director, International Tax Relations Division, shall be subject to the direction and supervision of the Assistant Commissioner (Technical) who shall have authority to revoke or modify all or any part of the authority delegated to the Director, International Tax Relations Division.

3. All other internal management documents or portions thereof, the provisions of which are inconsistent or in conflict with the provisions of this order, are hereby amended or superseded accordingly.

T. COLEMAN ANDREWS,
Commissioner.

COMMISSIONER DELEGATION ORDER NO. 3[4]

(Effective June 1, 1955)

Designation to act as Commissioner of Internal Revenue.

Pursuant to authority vested in me by Treasury Department Order No. 150–2, dated May 15, 1952, and Treasury Department Order No. 129 (Revision No. 2),[5] it is ordered that:

1. The Deputy Commissioner shall perform the duties of Commissioner of Internal Revenue during the absence or disability of the

[2] 20 F. R. 3044.
[3] This document was not published in the Bulletin.
[4] 20 F. R. 3833.
[5] Neither document was published in the Bulletin.

Commissioner of Internal Revenue, when there is a vacancy in that office, or when otherwise designated to act as Commissioner of Internal Revenue; and

2. The Assistant Commissioner (Operations), and the Assistant Commissioner (Technical), in the order named, shall perform the duties of the Commissioner of Internal Revenue during the absence or disability of the Commissioner of Internal Revenue or a vacancy in that office and the absence and disability of the Deputy Commissioner.

This Order supersedes Commissioner Delegation Order No. 1 [6] issued April 10, 1953.

T. COLEMAN ANDREWS,
Commissioner.

COMMISSIONER DELEGATION ORDER NO. 4 [7]

(Effective June 7, 1955)

Delegation of authority to issue summonses and to examine books and records and witnesses.

Pursuant to the authority vested in me as Commissioner of Internal Revenue, it is hereby ordered:

1. The following officers and employees of the Internal Revenue Service are authorizd to exercise the authority provided by section 7602 of the Internal Revenue Code of 1954, including the authority (1) to examine books, papers, records, or other data; (2) to summon persons to appear and produce books, papers, records, or other data and give testimony under oath; and (3) to take testimony under oath of a person concerned:

(a) Assistant Commissioner (Inspection).

(b) Regional Commissioners and District Directors of Internal Revenue.

(c) Assistant Regional Commissioners (Intelligence); Executive Assistants to Assistant Regional Commissioners (Intelligence); Chiefs, Review and Conference Staff, Intelligence Division; and Reviewer Conferees, Intelligence Division.

(d) Assistant Regional Commissioners (Alcohol and Tobacco Tax).

(e) Officers and employees of the respective divisions of the Internal Revenue Service designated as follows:

(1) *Collection Division:* Chiefs of the Collection Division, Chiefs of the Delinquent Accounts and Returns Branches, and Group Supervisors.

(2) *Audit Division:* Chiefs of Divisions and Branches, Group Supervisors, all Internal Revenue Agents, and Estate Tax Examiners.

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[6] Commissioner Delegation Order No. 1 reads as follows: "Pursuant to the authority conferred upon me as Commissioner of Internal Revenue, it is hereby ordered that during the absence or disability of the Commissioner of Internal Revenue, or when otherwise directed, the Deputy Commissioner of Internal Revenue shall perform the functions of the Commissioner. In the performance of such functions, the Deputy Commissioner shall be designated as Acting Commissioner of Internal Revenue."

[7] 20 F. R. 4143.

(3) *Intelligence Division:* Chiefs, Assistant Chiefs, Group Supervisors and all Special Agents.

(4) *Inspection:* Director, Internal Security Division; Assistant Directors, Internal Security Division; Regional Inspectors; and all Inspectors.

The authority to summon persons delegated by this paragraph may not be redelegated.

2. Each of the officers and employees referred to in paragraph 1 of this order may designate any other employee of the Internal Revenue Service as the individual before whom a person summoned pursuant to section 7602 of the Internal Revenue Code of 1954 shall appear. Any such other employee of the Internal Revenue Service, when so designated in a summons, is authorized to take testimony under oath of the person summoned and to receive and examine books, papers, records, or other data produced in compliance with the summons.

3. The Assistant Commissioner (Inspection), each Regional Commissioner and each District Director of Internal Revenue is authorized to redelegate to any employee of the Internal Revenue Service within his jurisdiction the authority provided by section 7602(1) of the Internal Revenue Code of 1954 to examine books, papers, records, or other data.

4. This order supersedes Commissioner's Reorganization Order No. 6 dated May 15, 1952; Com.-Mimeograph Coll. No. 4354, A. T. No. 54, dated July 3, 1935; and instructions 7 and 8 appearing on page 36, Part II, Handbook on Reorganization of Internal Revenue Field Service, August 1952, and amends Bureau Memorandum No. 888 dated June 24, 1952.[8] All other delegations of authority to officers or employees of the Internal Revenue Service and any other internal management documents are superseded to the extent that they are inconsistent with any of the provisions of this order.

O. GORDON DELK,
Acting Commissioner.

COMMISSIONER DELEGATION ORDER NO. 5[9]

(Effective June 9, 1955)

Emergency order of succession and delegation of authority

1. By virtue of the authority vested in me by Treasury Department Order No. 129, Revision No. 2, dated April 22, 1955,[10] the officials in the positions listed below and on a document filed at the Internal Revenue Service emergency relocation site are hereby authorized, in the event of an enemy attack on the continental United States, and the disability of the Commissioner, his absence from the emergency relocation site, or if there is a vacancy in the office, to suceed to the position of Acting Commissioner in the order listed, and are authorized to per-

[8] None of these documents were published in the Bulletin.
[9] 20 F. R. 4227.
[10] This document was not published in the Bulletin.

form the function of Commissioner to insure the continuity of the functions of that office:

Deputy Commissioner
Assistant Commissioner (Operations)
Assistant Commissioner (Technical)
Assistant Commissioner (Inspection)
Assistant Commissioner (Administration)
Assistant Commissioner (Planning)

If none of these officials are available, the first available Regional Commissioner, in the order listed in the document on file at the emergency relocation site, will become Acting Commissioner.

Immediately in the event of an attack on the United States, each Regional Commissioner shall communicate as quickly as possible with the emergency National Office at the relocation site and advise the official in charge of his availability to assume the position of Acting Commissioner. After the lapse of a reasonable time for receipt of communications from the Regional Commissioners, the official in charge of the emergency National Office will advise the available Regional Commissioner highest in the order of succession to report to the emergency National Office at the relocation site to become Acting Commissioner.

If no Regional Commissioner is available, a District Director will become Acting Commissioner in the order indicated in the above-mentioned document on file at the emergency relocation site. District Directors need not contact the emergency National Office.

2. There is hereby delegated to Regional Commissioners and District Directors, or the officials acting in their stead, upon the event of an enemy attack on the continental United States, all authority vested in the Commissioner of Internal Revenue by law or transfer from the Secretary of the Treasury as is necessary to insure the continuous performance of Internal Revenue Service essential functions by those officials in their areas of jurisdiction. This delegation of authority will remain in effect until notice is received that it has been terminated.

T. Coleman Andrews,
Commissioner.

COMMISSIONER DELEGATION ORDER NO. 6 [11]

(Effective June 1, 1955)

Delegation of authority to grant authorizations of agents under section 3504 of the Internal Revenue Code.

Pursuant to the authority vested in me as Commissioner of Internal Revenue, it is directed that:

1. The authority to grant authorizations of agents to perform all acts required of employers under chapters 21, 24, and 25,[12] subtitle C of the Internal Revenue Code of 1954, is delegated to the Assistant

[11] 20 F. R. 4661.
[12] Chapters 21, 24, and 25 relate to and are entitled the Federal Insurance Contributions Act, the Collection of Income Tax at Source on Wages, and General Provisions Relating to Employment Taxes.

Commissioner (Technical) to be exercised in accordance with applicable regulations and procedures.

2. The Assistant Commissioner (Technical) is authorized to redelegate the authority to such subordinates within his jurisdiction as, in his judgment, may be desirable.

T. COLEMAN ANDREWS,
Commissioner.

COMMISSIONER DELEGATION ORDER NO. 7 [13]

(Effective August 23, 1955)

Delegation of authority to grant extensions of time for filing corporation declarations of estimated income tax.

Pursuant to authority vested in me as Commissioner of Internal Revenue, District Directors of Internal Revenue are hereby delegated authority to grant reasonable extensions of time to file corporation declarations of estimated income tax required by section 6016(a) of the Internal Revenue Code of 1954. The authority herein delegated shall be exercised in accordance with applicable regulations and procedures.

T. COLEMAN ANDREWS,
Commissioner.

COMMISSIONER DELEGATION ORDER NO. 8 [13]

(Effective September 7, 1955)

Delegation of authority to sign agreements as to liability for personal holding company tax.

Pursuant to the authority vested in me as Commissioner of Internal Revenue and in accordance with the provisions of paragraphs 12 and 22 of Treasury Decision 6118, I. R. B. 1955–3, 90, approved December 30, 1954, the authority to enter into agreements on Form 2198,[14] pursuant to section 547(c)(3), Internal Revenue Code of 1954, relating to liability for personal holding company tax, is hereby redelegated to the following officers of the Internal Revenue Service:

(a) Associate Chiefs of Regional Appellate Divisions;
(b) Assistant Chiefs of Regional Appellate Divisions; and
(c) Special Assistants to the Chiefs of Regional Appellate Divisions.

T. COLEMAN ANDREWS,
Commissioner.

[13] 20 F. R. 7083.
[14] Form 2198 is entitled "Determination of Liability for Personal Holding Company Tax" and is available from offices of District Directors of Internal Revenue or Assistant Regional Commissioners (Appellate).

Publication of internal practices and procedures affecting rights or duties of taxpayers, or industry regulations, as a new series called Revenue Procedures.

Rev. Rul. 2, C. B. 1953-1, 484, and Rev. Rul. 212, C. B. 1953-2, 449, amended.

SECTION 1. PURPOSE.

The purpose of this Revenue Procedure is to announce the establishment of a new policy of the Internal Revenue Service with respect to the publication of internal practices and procedures for the information of the public, prescribing the form of their publication, and fixing the authority and responsibility for the initiation, coordination and issuance of the prescribed public document.

SEC. 2. SCOPE.

The policy set forth herein shall not apply to (a) interpretations of substantive tax law publishable as Revenue Rulings or (b) the regulations (including Treasury Decisions) prescribed by the Commissioner with the approval of the Secretary pursuant to and for the enforcement of the Internal Revenue Code and related statutes. All other statements of practices, procedure or regulations come within the scope of this Revenue Procedure.

SEC. 3. POLICY.

It shall be the policy to publish for public information all statements of practice and procedure issued primarily for internal use, and, hence, appearing in internal management documents, which affect rights or duties of taxpayers or other members of the public under the Internal Revenue Code and related statutes. This policy, however, is not intended to preclude the publication of a Revenue Procedure (see section 4.01) based on an internal management document which contains information not necessarily affecting rights or duties of the public but which should be a matter of public knowledge.

SEC. 4. FORM OF PUBLICATION.

.01 The publication of internal practices and procedures for public information in accordance with the policy stated above will be in the form of Revenue Procedures (abbreviated as "Rev. Proc.") in the Internal Revenue Bulletin. The contents of such Revenue Procedures will be published in the Federal Register when such publication is required under the Administrative Procedure Act of 1946.

.02 IR-Mimeographs, IR-Circulars and other internal management documents issued hereafter will not be released or distributed to the public as has been the practice in the past. Also the practice of converting IR-Mimeographs and IR-Circulars into Revenue Rulings will be discontinued.

SEC. 5. RESPONSIBILITIES.

.01 The Assistant Commissioners and the Chief Counsel are responsible for determining whether procedures and practices prescribed in internal management documents prepared by their offices should be published as Revenue Procedures and for the initiation and content of such Revenue Procedures.

.02 The Assistant Commissioner (Technical) is responsible for administering the system for the publication of Revenue Procedures and their filing with the Federal Register, except that the filing of

Revenue Procedures on matters pertaining to functions of the Alcohol and Tobacco Tax Division will be the responsibility of the Assistant Commissioner (Operations).

SEC. 6. EFFECT ON THE OTHER DOCUMENTS.

.01 This Revenue Procedure amends Revenue Ruling 2, C. B. 1953-1, 484, and Revenue Ruling 212, C. B. 1953-2, 449.

SEC. 7. EFFECTIVE DATE.

This Revenue Procedure is effective July 13, 1955.

Rev. Proc. 55-2

Centralization of international operating responsibilities to obtain better tax administration abroad.

SECTION 1. PURPOSE.

The purpose of this Revenue Procedure is to announce the establishment of the International Operations Division in the Philadelphia Region, Baltimore District, with headquarters in Washington, D. C.

SEC. 2. ESTABLISHMENT OF INTERNATIONAL OPERATIONS DIVISION.

To provide for the centralization of responsibility for the international operations of the Internal Revenue Service, and to obtain better administration of Service affairs abroad, there has been established, in the Baltimore District of the Philadelphia Region, the International Operations Division, with headquarters in Washington, D. C. The functions and responsibilities assigned to the Division shall be administered and directed by an Assistant District Director (International Operations), who shall have the operating title of "Director of International Operations." The District Director is authorized to delegate to the Director of International Operations all authorities vested in him, to the extent redelegable, to take final action with respect to the performance of the functions of the International Operations Division.

SEC. 3. FUNCTIONS.

.01 The International Operations Division, in general, shall have primary responsibility for the administration of the United States internal revenue laws in all areas of the world outside the continental United States, the territories of Alaska and Hawaii, and the possessions of Puerto Rico, the Virgin Islands, and the Canal Zone.

.02 The functions of the Division include, but are not limited to, the following:

1. The taking of appropriate and necessary action to maintain a satisfactory level of voluntary tax compliance among United States taxpayers residing, located or doing business in the geographical areas assigned; and

2. The audit of returns of nonresident taxpayers, the collection of delinquent accounts of such nonresidents, the administration of section 6316 of the Internal Revenue Code of 1954 concerning the collection of taxes in foreign currencies, the conduct of surveys and investigations concerning delinquency and evasion in the assigned areas, the conduct of military and other taxpayer education and assistance programs abroad, the maintenance of close liaison with the military services concerning Federal tax

matters, the executive direction of Service personnel temporarily detailed or permanently stationed in the assigned areas, and other responsibilities necessary or incident to the proper administration and enforcement of the tax laws with respect to taxpayers residing, located or doing business in the assigned areas of responsibility.

SEC. 4. TRANSFER OF FUNCTIONS.

The functions of the International Operations Division described above are currently being performed in part by other organizational units of the Baltimore District Office, other District Offices, Regional Offices and the National Office. To assure continuity of this work, the organizational components of the Service now performing functions and work assigned herein to the International Operations Division shall continue to perform such functions and work until otherwise instructed.

SEC. 5. TRANSFER OF ORGANIZATIONAL UNITS.

The supervision of the Office of the Treasury Representative (Taxation), Paris, France, shall be transferred from the Lower Manhattan District to the International Operations Division, Baltimore District, effective September 1, 1955.

SEC. 6. EFFECT ON OTHER DOCUMENTS.

This Revenue Procedure amends Commissioner's Reorganization Order No. 15 dated July 1, 1953, C. B. 1953-2,505. Any other internal management documents, the provisions of which are inconsistent or in conflict with the provisions of this Revenue Procedure, are hereby amended or superseded accordingly.

SEC. 7. EFFECTIVE DATE.

This Revenue Procedure is effective August 22, 1955.

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26 CFR 601.104: Collection functions. Rev. Proc. 55-3
(Also Part I; Sections 802, 6081, 6161.)

Life insurance companies taxable under the provisions of section 802 of the Internal Revenue Code of 1954 are granted extensions of time until March 15, 1956, to file declarations and make payments of estimated income tax for the year 1955.

1. Pursuant to the authority contained in sections 6081(a) and 6161(a)(1) of the Internal Revenue Code of 1954, the time for filing Form 1120-ES, Corporation Declaration of Estimated Tax, and for paying the tax due thereon, for the year 1955, is hereby extended to March 15, 1956, in the case of life insurance companies taxable under the provisions of section 802 of the Code.

2. Interest is not imposed on any unpaid estimated income tax whether or not the time for payment of such tax is extended. However, the addition to the tax under section 6655 of the Code for failure to pay the estimated tax would apply to any unpaid amount of estimated tax deferred under this extension of time and determined to be an underpayment by reason of the provisions of such section.

3. Any inquiry relating to this Revenue Procedure should be addressed to the Assistant Commissioner (Operations) for the attention of O:C.

26 CFR SECTION 601.602: Forms and instructions.

Existing 1954 tax forms are to be used by certain taxpayers for reporting self-employment income for fiscal years ending in 1955.

SECTION 1. PURPOSE.

The purpose of this Revenue Procedure is to provide instructions for the adaptation and use of existing 1954 tax forms by taxpayers reporting self-employment income for fiscal years ending in 1955.

SEC. 2. SELF-EMPLOYMENT COVERAGE EXTENDED.

Under the provisions of the Social Security Amendments of 1954, 68 Stat. 1052, C. B. 1954–2, 603, for taxable years ending after December 31, 1954, the $3,600 limitation on self-employment income is increased to $4,200. No proration for taxable years begining in 1954 and ending in 1955 is required. In addition, the self-employment coverage is extended to certain occupational groups not previously covered, including farm operators. These changes are in the form of amendments to section 1402 of the Internal Revenue Code of 1954.

SEC. 3. SPECIAL REPORTING PROCEDURE.

One of these amendments provides for a special reporting procedure for self-employed farm operators on the cash basis. If his gross income from farming is not more than $1,800, he has the option of reporting for self-employment tax purposes either the actual self-employment net earnings or 50 percent of his gross income from farming. If his gross income from farming is more than $1,800 and his actual self-employment net earnings are less than $900, he has the option of reporting for self-employment tax purposes either the actual self-employment net earnings or $900. This amendment appears at the end of section 1402(a) of the Code. Of course, if the net earnings which he intends to report for self-employment tax purposes are less than $400, they are not to be so reported in view of the limitations under section 1402(b) of the Code.

SEC. 4. USE OF EXISTING FORMS.

New tax forms for use by 1955 fiscal year taxpayers (years beginning in 1954 and ending in 1955) who are subject to self-employment tax will not be designed and printed. Therefore, existing 1954 tax forms must be adapted to fit the needs of such persons. Schedule C, Profit (or Loss) From Business or Profession, of Form 1040, U. S. Individual Income Tax Return, should be changed, in the case of all self-employed taxpayers filing a 1955 fiscal year return. The instructions on the reverse side of Schedule C should also be changed. Such changes should be as follows:

Page 3, line 32, change "$3,600" to "$4,200."
Page 3, line 33, change the parenthetical clause to read "If such wages exceed $4,200, enter $4,200."

SEC. 5. REQUIREMENT OF SCHEDULES.

Section 39.22(a)-7(e) of Regulations 118 (applicable under the 1954 Code by virtue of T. D. 6091, C. B. 1954–2, 47) requires each farmer who keeps no records or who keeps only records of cash re-

ceipts and disbursements to fill in and attach Form 1040F, Schedule of Farm Income and Expenses, to his Form 1040. However, farmers on the accrual basis may use either Form 1040F or Schedule C. Form 1040F for 1954 does not provide for the computation of the self-employment tax for farmers on a fiscal year basis and, accordingly, does not have a Schedule C–a, U. S. Report of Self-Employment Income, which is detached by personnel of the Internal Revenue Service and forwarded to the Social Security Administration for their wage records. Therefore, farmers filing Form 1040F with their 1955 fiscal year returns must also complete and file the Computation of Self-Employment Tax, page 3 of Schedule C.

SEC. 6. EXPLANATION OF DIFFERENT AMOUNTS.

The amount of net earnings from farming or the amount determined under the optional method in the case of the farmer reporting on the cash receipts and disbursements basis, as discussed above, which is taken into account in determining the liability for the self-employment tax, should be entered on line 25 of page 3 of Schedule C, Form 1040. Where the amount of net profit from the farming operations so reported on line 25 differs from the net farm profit shown either on line 24 of Schedule C, Form 1040, or line 10 of page one of Form 1040F, the difference should be explained in a statement attached to the return. Such situation is likely to arise in the case where (1) the gross income from farming operations is not more than $1,800, and the taxpayer elects to report 50 percent of his gross farm income as his self-employment net earnings under the first option explained above; (2) the gross income from farming operations is more than $1,800, net farm earnings are less than $900, and the taxpayer elects under the second option discussed above to report $900 as his self-employment net earnings; (3) the taxpayer's computation of gross income from farming operations includes items which are to be excluded from his computation of self-employment net earnings, such as capital gains or losses, certain gains or losses from property other than capital assets, etc.; or (4) other adjustments were made which resulted in a greater or lesser net farm profit than the amount reported as his net earnings from self-employment from farming operations. Whatever the difference, it should be explained in a separate statement attached to the return.

SEC. 7. SHORT PERIODS.

The foregoing provisions are also applicable to self-employed taxpayers filing returns, Form 1040, and supporting schedules, for short periods ending in 1955.

SEC. 8. PERIOD TO WHICH APPLICABLE.

The provisions of this Revenue Procedure are applicable only for taxable periods ending in 1955.

SEC. 9. INQUIRIES.

Inquiries relating to this Revenue Procedure should be addressed to the Assistant Commissioner (Operations), for the attention of O:A:PPr.

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Revision of Form 433 and consolidation of Forms 433A and 433B to be used in connection with offers in compromise.

SECTION 1. PURPOSE.

The purpose of this Revenue Procedure is to provide a revised Form 433 and a new Form 433AB, both entitled, "Statement of Financial Condition and Other Information," to supersede Forms 433A, "Statement of Financial Condition," and 433B, "Statement of Financial Condition."

SEC. 2. BACKGROUND.

.01 Taxpayers are required to file Form 433 with all offers in compromise based on an inability to pay the total liability due the Government, except when Form 433A or 433B may be filed, as set forth in paragraphs .02 and .03 below.

.02 Form 433A is required of taxpayers filing offers in compromise involving alcohol, tobacco, and firearms tax liabilities, or excise tax liabilities, if the amount of the liability is $1,000 or less (exclusive of unassessed penalty and interest).

.03 Form 433B is required of taxpayers with offers in compromise involving unpaid income-withholding and/or employment taxes, including interest and penalty, regardless of the amount of the liability.

SEC. 3. SCOPE.

The provisions of this Revenue Procedure will apply to all offers in compromise filed pursuant to section 7122 of the Internal Revenue Code of 1954 based on an inability of the taxpayer to pay the total amount due the Government.

SEC. 4. FORM 433 (REVISED).

.01 All taxpayers seeking to compromise an unpaid tax liability (including interest and penalty) on the grounds of inability to pay the total amount due will be required to file with the offer in compromise a Form 433 (Revised), regardless of the type of tax involved, if the amount sought to be compromised at the time the offer is filed is $1,000 or more. This form may also be required of taxpayers in cases involving liabilities under $1,000 if, in the judgment of the District Director of Internal Revenue, it is deemed advisable.

.02 Form 433 (Revised) will be required in cases involving interest and/or penalty only (liability $1,000 or more) if the offer is based on the inability of the taxpayer to pay the total liability due.

SEC. 5. FORM 433AB.

Form 433AB will be required in connection with offers in compromise involving unpaid tax liabilities (including interest and penalties) or involving interest and/or penalty only, if the offers are based on inability to pay the total amount due and the amount sought to be compromised at the time the offer is filed is less than $1,000.

SEC. 6. SUPPLY OF FORMS.

The present forms (Forms 433, 433A, and 433B) will continue to be used until the stocks are exhausted at which time the revised forms will be placed in use.

(Also Part I, Section 7602.) Rev. Proc. 55–6

Procedure for the use, issuance and enforcement of one standard form in summoning persons to appear to testify or to produce books and records.

SECTION 1. PURPOSE.

The purpose of this Revenue Procedure is to provide for the use, issuance and enforcement of one standard form of summons in accordance with the provisions of the Internal Revenue Code of 1954.

SEC. 2. BACKGROUND.

Prior to the enactment of the Internal Revenue Code of 1954, different forms and procedures, under separate sections of law, were used by the Collection, Audit, Intelligence, and Alcohol and Tobacco Tax Divisions and by the Inspection Service, in summoning persons to appear to testify or produce books and records. The various provisions of law in the Internal Revenue Code of 1939 relating to the use and enforcement of such summons were consolidated in sections 7602 through 7605 of the Internal Revenue Code of 1954.

SEC. 3. AUTHORITY TO ISSUE SUMMONS.

.01 The authority for the issuance of a summons by the Secretary of the Treasury or his delegate under the Internal Revenue Code of 1954 is set forth in section 7602.

.02 In addition to Regional Commissioners and District Directors of Internal Revenue, the following officers and employees of the respective divisions may issue summonses provided for in section 7602 of the Internal Revenue Code of 1954:

1. *Collection Division.*—Chief of the Collection Division, Chief of the Delinquent Accounts and Returns Branch, and the Group Supervisors;

2. *Audit Division.*—Chiefs of Division and Branches, Group Supervisors, Internal Revenue Agents, and Estate Tax Examiners;

3. *Intelligence Division.*—Assistant Regional Commissioner, Executive Assistant to Assistant Regional Commissioner, Chiefs, Review and Conference Staff, Reviewer Conferees, Chiefs, Assistant Chiefs, Group Supervisors and all Special Agents;

4. *Alcohol and Tobacco Tax Division.*—Assistant Regional Commissioner; and

5. *Inspection.*—Assistant Commissioner (Inspection), Director and Assistant Directors of the Internal Security Division; Regional Inspector; and all Inspectors.

.03 Any officer or employee of the Internal Revenue Service may be designated as the individual before whom a person shall appear in response to a summons, and any officer or employee of the Service who is so designated in the summons may take testimony under oath of the person summoned and may receive books, papers, records or other data produced in response to the summons.

SEC. 4. USE OF SUMMONS.

.01 The summons may be used to compel relevant or material testimony and/or the production of relevant or material books, papers, records or other data for any of the following purposes:

1. Ascertaining the correctness of any return;
2. Making a return where none has been made;
3. Determining the liability of any person for any internal revenue tax;
4. Determining the liability at law or in equity of any transferee or fiduciary of any person in respect of any internal revenue tax; and
5. Collecting any internal revenue tax liability.

.02 The following persons may be summoned under the provisions of section 7602 of the Internal Revenue Code of 1954:

1. Persons liable for the tax;
2. Any officer or employee of such persons;
3. Any person having possession, custody or care of books of account containing entries relating to the business of the person liable for the tax; and
4. Any other person who may be deemed proper by the officer issuing the summons.

.03 When a witness requests that he be served with a summons as evidence of his legal duty to produce records or testify and indicates that he will voluntarily comply therewith, it will be issued for such purpose.

SEC. 5. FORMS USED.

.01 The summons form consists of two pages. The first sheet is designated "Original" (Form 2039), with a certificate of service on the reverse side and the second sheet is designated "Attested Copy" (Form 2039A), with the pertinent sections of the Internal Revenue Code of 1954 on the reverse side. This is the form assembly which will be used by all persons authorized to issue a summons under the provisions of section 7602 of the Internal Revenue Code of 1954. The face of the "Attested Copy" thereof shall be an exact copy of the "Original" except for the words "Attested Copy" and "Original" and the form number.

.02 Section 7605 of the 1954 Code provides that the date and time fixed for appearance in response to a summons shall be such as are reasonable under the circumstances and shall not be less than 10 calendar days from the date of the summons. Although a person summoned may indicate a willingness to comply with the requirements of the summons by testifying, or the delivery of books or records, on a date earlier than that required by statute, the time for his appearance will, nevertheless, be shown on the summons as not less than 10 days from the date of the summons. This will not preclude the person summoned from submitting records for an earlier or immediate examination or the earlier giving of testimony.

SEC. 6. ISSUANCE.

.01 After the summons has been prepared it will be served in accordance with the provisions of section 7603, Internal Revenue Code of 1954. Officers and employees of the Internal Revenue Service authorized to issue a summons or who have authority to investigate

and receive information as to matters relating to the Internal Revenue laws and regulations may serve a summons.

.02 Section 7603 of the Code provides that service shall be made by delivery in hand of an attested copy to the person to whom it is directed or by leaving an attested copy at his last and usual place of abode. The second sheet (Form 2039A) of the form assembly, bearing the words "Attested Copy," will be either handed to the person to whom it is directed or left at his last and usual place of residence either with some person present or in a place where the person summoned will be likely to find the copy.

.03 The original of the summons (Form 2039), after the completion of the certificate of service, will be placed in the administrative file in the office of the issuing division. If the person to whom it is directed neglects or refuses to comply with the requirements of the summons, the original will be used as a basis for enforcing compliance. Furthermore, as provided by section 7603 of the 1954 Code, the certificate of service signed by the person serving the summons shall be evidence of the facts it states on the hearing of an application for the enforcement of the summons.

SEC. 7. ENFORCEMENT OF SUMMONS

.01 The United States district court for the district in which the person, to whom the summons is directed, resides or is found shall have jurisdiction to compel his attendance, testimony or the production of books, papers, records or other data, as detailed in sections 7402(b) and 7604(a), Internal Revenue Code of 1954.

.02 A judge of the district court or a United States commissioner may enforce obedience to the requirements of the summons and may punish such person for his default or disobedience following the procedure set out in section 7604(b) of the Code. This section provides for the enforcement of any summons issued under authority of section 7602 of the Code through the issuance of an attachment, upon proper application, by the judge of the district court or a United States commissioner, directed to some proper officer for the arrest of the person summoned. Upon his arrest, the person summoned will be brought before the district judge or United States commissioner. The judge or United States commissioner shall have power to make such order as he deems proper not inconsistent with the law for punishment of contempts, to enforce obedience to the summons or punish the person for his default or disobedience.

.03 A fine or imprisonment or both are provided by section 7210 of the Code, upon conviction, for neglect to comply with a summons properly issued in accordance with sections 7602, 7603, and 7604(b) of the Code.

(Also Part I, Section 6311.) Rev. Proc. 55-7

Instructions for the payment of internal revenue taxes or stamps by check or money order.

SECTION 1. PURPOSE.

The purpose of this Revenue Procedure is to prescribe instructions with respect to remittances acceptable in payment of taxes and stamps under the Internal Revenue Code of 1954.

SEC. 2. AUTHORITY.

Section 6311 of the 1954 Code authorizes the acceptance of checks or money orders in payment of internal revenue taxes, or in payment for internal revenue stamps, to the extent and under the conditions provided in regulations issued by the Secretary of the Treasury or his delegate.

SEC. 3. DEFINITION OF TERMS.

.01 As used herein, the term "money order" means:

1. A United States postal, bank, express, or telegraph money order;

2. A money order issued by a domestic building and loan association (as defined in section 7701(a)(19) of the Code) or by a similar association incorporated under the laws of a possession of the United States; or

3. A postal money order issued by a country with which the United States maintains direct exchange of money orders on a domestic basis. Such countries presently are: Antigua, The Bahamas, Barbados, Bermuda, British Guiana, British Honduras, British Virgin Islands, Canada, Canal Zone, Cuba, Dominica, Grenada, Jamaica, Montserrat, Nevis, St. Kitts, St. Lucia, St. Vincent, Trinidad and Tobago.

.02 The term "domestic building and loan association," referred to above and as defined in section 7701(a)(19) of the Code, means "a domestic building and loan association, a domestic savings and loan association, and a Federal savings and loan association, substantially all the business of which is confined to making loans to members."

SEC. 4. PAYMENT OF TAXES.

Pursuant to regulations, Treasury Decision 6119, C. B. 1955-1, —, which became effective on January 1, 1955, District Directors of Internal Revenue may accept personal checks, or money orders, drawn on any bank or trust company incorporated under the laws of the United States or under the laws of any State, Territory, or possession of the United States, in payment for internal revenue taxes, provided such checks or money orders are collectible in United States money at par (without any deduction for exchange or other charges). District Directors also may accept such checks or money orders in payment for internal revenue stamps, or for the prepayment of the taxes on wines, to the extent and under the conditions provided in section 5 below.

SEC. 5. PAYMENT FOR INTERNAL REVENUE STAMPS, OR PREPAYMENT OF WINE TAX

.01 District Directors may accept checks and money orders described in section 4—

1. *Except* in payment for internal revenue stamps for:

a. Taxes imposed under subchapter F of chapter 39 (relating to silver bullion),

b. Taxes imposed under chapter 34 (relating to documentary stamps),

c. Taxes on distilled spirits, including rectification tax, imposed under chapter 51,

d. Taxes imposed under chapter 52 (relating to tobacco and manufactures); and

2. *Except* in prepayment of the taxes on wines as authorized by Part 240, Title 26, Code of Federal Regulations.

The District Director shall, except as authorized in subsection .02 below, accept in payment for silver bullion, documentary, distilled spirits (including rectification), or tobacco stamps, or in prepayment of taxes on wines only cash; certified, cashiers' or treasurers' checks drawn on any bank or trust company incorporated under the laws of any State, Territory, or possession of the United States; and money orders described in section 3.

.02 A person desiring to tender personal checks for silver bullion, documentary, distilled spirits (including rectification), or tobacco stamps, or in prepayment of the taxes on wines, should make application in advance to the District Director, giving his name, address, firm name if any, and the approximate value of stamps (or amount of prepayment of taxes on wines) for which it is desired to tender personal checks per week or other period. In the case of silver bullion or documentry stamps, if deemed necessary the applicant may be required to furnish a financial statement as a basis for consideration of such request. In the case of distilled spirits and tobacco stamps, or prepayment of the taxes on wines, personal checks may be accepted in an amount not exceeding the amount of the bond; or, if an applicant wishes to tender personal checks in amounts exceeding his bond, he shall submit a financial statement, and personal checks may be accepted in an amount not exceeding the net worth shown on such statement. (The District Director may require a new financial statement once a year, or more frequently if deemed advisable.) When personal checks are outstanding in the full amount of the bond or net worth, sufficient time should be allowed for the outstanding checks to clear before accepting further personal checks.

.03. When applications pursuant to section 5.02 above are received from companies which operate in more than one district, and which desire to tender personal checks in excess of the bond, for distilled spirits (including rectification), or tobacco stamps, or in prepayment of the taxes on wines, it will be necessary that more detailed information be secured from the applicant. In such cases, the company should be requested to furnish information as to the total amount of personal checks proposed to be tendered during a given period in each district in which the company operates. This will enable each District Director to compare the total proposed purchases in all districts within a specified period with the total net worth of the company. In the case of distilled spirits, the financial statement must show the value of liquor in bond separately from other assets. In considering applications from such distilleries, attention should be given first to all assets exclusive of liquor in bond, and if the check or checks proposed to be tendered during a given period will approach the stated value of such assets, consideration should then be given as to the probable net amount which could be realized on the liquor in bond in event of seizure under levy.

SEC. 6. DISCRETION AS TO ACCEPTANCE OF PERSONAL CHECKS.

.01 Notwithstanding the provisions of section 5 above, the District Director, in his discretion, may refuse to accept any personal check in payment for internal revenue stamps or in prepayment of taxes on

wines; also, checks tendered pursuant to a prior application as prescribed in section 5.02. The District Director may at any time terminate his authorization under section 5.02.

.02 In any case in which a taxpayer delinquent account includes a charge back of a returned check (for which reasonable cause is not established), District Directors are authorized to instruct collection officers to accept only cash; certified, cashiers' or treasurers' checks; or money orders in payment of the balance of such account. This policy should be extended to any other case where it is believed that acceptance of a personal check will delay or jeopardize ultimate collection of the liability.

(Also Part I, Sections 452, 462.) Rev. Proc. 55–8

Manner in which a taxpayer filing an income tax return for a taxable year ending on or before June 15, 1955, may elect to apply the accounting methods provided in sections 452 and 462 of the Internal Revenue Code of 1954.
Revenue Ruling 55–539, page 246 of this Bulletin, amplified.

The Internal Revenue Service desires to clarify the procedure set forth in Revenue Ruling 55–539, page 246 of this Bulletin, with respect to taxpayers whose tax liability is affected by Public Law 74, 69 Stat. 134, I. R. B. 1955–28, 21, repealing sections 452 and 462 of the Internal Revenue Code of 1954.

A taxpayer filing an income tax return on or after June 15, 1955, for a taxable year ending on or before such date, may elect to apply the accounting methods provided in sections 452 and 462 of the Code. The election may be exercised—

(1) By computing the tax liability shown on such return as though the provisions of sections 452 and 462 of the Code had not been repealed. In such a case, the taxpayer must file on or before December 15, 1955, a statement on Form 2175, Statement to be Filed Pursuant to Repeal of Sections 452 and 462 of the Internal Revenue Code of 1954, showing the increase in tax liability resulting from the repeal of sections 452 and 462 of the Code, or

(2) By computing the tax liability without regard to sections 452 and 462 of the Code. In this case, Form 2175 must be filed with the return. However, taxable income and the tax liability computed with the application of sections 452 and 462 of the Code shall be shown on lines 8 and 14, respectively, of Form 2175, in lieu of the amounts otherwise called for on those lines.

However, taxpayers are advised that the waiver of interest provisions in section 4(b)(3) of Public Law 74, *supra*, do not apply unless the taxpayer has reasonably interpreted and applied sections 452 and 462 of the Code. Compliance with the regulations issued under those sections will meet this requirement.

If a taxpayer does not make an election to have the provisions of sections 452 and 462 of the Code apply, he shall not be entitled to the savings provisions of section 4 of Public Law 74, *supra*.

Revenue Ruling 55–539, page 246 of this Bulletin, amplified.

(Also Part I, Section 6016.) Rev. Proc. 55-9

Procedure with respect to the filing of Form 1120ES, Corporation Declaration of Estimated Income Tax, and the payment of the required tax.

SECTION 1. PURPOSE.

The purpose of this Revenue Procedure is to outline the policy of the Internal Revenue Service with respect to corporation declarations of estimated tax required to be filed under the provisions of section 6016 of the Internal Revenue Code of 1954.

SEC. 2. FILING REQUIREMENT.

.01 Section 6016(a) of the Internal Revenue Code provides that for taxable years ending on or after December 31, 1955, a declaration of estimated tax shall be made by every corporation which is subject to taxation under section 11 or 1201(a), or subchapter L of chapter 1 (relating to insurance companies), if its income tax under such sections or such subchapter can reasonably be expected to exceed the sum of $100,000 plus the amount of any estimated credits allowable under part IV of subchapter A of chapter 1.

.02 The term "estimated tax" in the case of a corporation is defined in section 6016(b) of the Code to mean the amount by which the corporation's estimated income tax for the taxable year exceeds the sum of (1) $100,000 and (2) the amount of the corporation's estimated credits against tax. Thus, for example, a corporation which reasonably anticipates its income tax liability for the taxable year to be $105,000 but which does not expect to have any allowable credits has an "estimated tax" of $5,000 (the estimated income tax liability of $105,000 less $100,000, the amount of the exemption).

.03 Under section 6074(a) of the Code, the corporation declaration of estimated tax is required to be filed on or before the fifteenth day of the ninth month of the taxable year. If, however, the requirements necessitating the filing of a declaration are first met after the last day of the eighth month and before the first day of the twelfth month of the taxable year, the declaration must be filed on or before the fifteenth day of the twelfth month of the taxable year.

.04 A declaration filed on or before the fifteenth day of the ninth month of the taxable year may be amended at any time on or before the fifteenth day of the twelfth month of the taxable year.

SEC. 3. PAYMENT OF ESTIMATED TAX.

.01 The amount of the estimated tax required to be paid is a percentage of such tax. The percentage increases from 10 percent for taxable years ending before December 31, 1956, to 50 percent for taxable years ending on or after December 31, 1959, as shown in the following table:

If the taxable year ends—	*The amount required to be paid is the following percentage of the estimated tax:*
On or after December 31, 1955 and before December 31, 1956	10 percent
On or after December 31, 1956 and before December 31, 1957	20 percent
On or after December 31, 1957 and before December 31, 1958	30 percent
On or after December 31, 1958 and before December 31, 1959	40 percent
On or after December 31, 1959	50 percent

.02 The required percentage of the estimated tax is payable in two equal installments. The first installment is due at the time prescribed for filing the declaration. The second installment is due not later than the 15th day of the twelfth month of the taxable year. If, however, the taxpayer is not required to file its declaration as of the fifteenth day of the ninth month of the taxable year but is required to file on or before the fifteenth day of the twelfth month, the amount of the estimated tax required to be paid must be paid in full at the time of filing the declaration.

.03 In the case of an amended declaration, the installment payable on the 15th day of the twelfth month of the taxable year, if any, is increased or decreased, as the case may be, to reflect the increase or decrease in the estimated tax by reason of the amended declaration. For example, a corporation on the calendar year basis filed a declaration on September 15, 1955, reporting an estimated tax in the amount of $20,000. The first installment of $1,000 (5% of $20,000) accompanied the declaration. However, it files an amended declaration on December 15, 1955, and reports an amended estimated tax of $30,000. Since the corporation already has paid $1,000, it must now make a payment of $2,000 computed as follows:

Required amount of estimated tax (10% of $30,000)	$3,000
Amount paid with original estimate (5% of $20,000)	1,000
Balance to accompany amended declaration	$2,000

In the above example, had the amended declaration been filed on December 10, 1955, then only the balance of the first installment ($500) otherwise due on September 15 would have to be paid with the amended declaration, and the second installment would be due on December 15 in the amount of $1,500, without demand.

SEC. 4. DECLARATION FORM.

Form 1120-ES, Corporation Declaration of Estimated Income Tax, is the form to be used by corporations in making the declarations required under the provisions of section 6016(a) of the Code. Form 1120–ES for 1955 was mailed to all corporations which filed corporation income tax returns for the calendar year 1954 and certain fiscal years ending in 1955. Mailings of Form 1120–ES for 1956 and subsequent years will be made only to corporations which file taxable declarations on Form 1120-ES for the preceding year.

SEC. 5. FAILURE TO PAY ESTIMATED TAX.

.01 The addition to tax provided by section 6655 of the Code for failure to comply with the new declaration system with respect to corporations is very similar to that effective in the case of individuals. Such addition is six percent per annum upon the amount of the underpayment, as determined under section 6655(b) of the Code, for the period of the underpayment as determined under section 6655(c) of the Code.

.02 Although no criminal penalties are provided under the Internal Revenue Code for failure to file a corporation declaration of estimated tax, section 7203 of the Code imposes a criminal penalty for willful failure to pay the corporation estimated tax.

SEC. 6. EXTENSIONS OF TIME FOR FILING.

.01 District Directors of Internal Revenue are authorized to grant reasonable extensions of time for filing corporation declarations of estimated income tax on Form 1120-ES and amended declarations on such form and for paying the tax due thereon. District Directors will follow a policy of granting such extensions only if it is shown to their satisfaction that undue hardship, as distinguished from financial inconvenience, would result if payment of the installment due were made on the date prescribed for its payment. Interest is not imposed on any unpaid estimated income tax, whether or not the time for payment of such tax is extended. However, the addition to the tax under section 6655 of the Code for failure to pay the estimated income tax would apply to any unpaid amount of estimated tax deferred under an extension of time and determined to be an underpayment by reason of the provisions of such section, and it would be computed from the original due date, without regard to the deferral.

.02 Applications for extensions of time to file corporation declarations must be in writing and should contain sufficiently complete information to enable District Directors to pass upon the question of undue hardship. In any case in which undue hardship is established, the period of the extension to be granted will depend upon the facts of the case but in no event shall such period exceed three months. Ordinarily, extensions should not be granted for a period of more than one month.

SEC. 7. EFFECTIVE DATE.

This Revenue Procedure is effective August 23, 1955.

Rev. Proc. 55-10

Procedure is established for assigning and stamping Internal Revenue Service serial numbers on firearms which bear no manufacturer's serial numbers.

SECTION 1. PURPOSE.

The purpose of this Revenue Procedure is to establish the procedure for assigning and stamping Internal Revenue Service serial numbers to firearms, bearing no manufacturer's serial numbers, for control purposes and to decentralize such activity to regional offices.

SEC. 2. DELEGATION OF AUTHORITY.

There is hereby delegated to the Assistant Regional Commissioners, Alcohol and Tobacco Tax, subject to the direction and supervision of Regional Commissioners, the authority to perform all functions pertaining to the assignment of Internal Revenue Service serial numbers to firearms and stamping such numbers on the firearms.

SEC. 3. SCOPE.

.01 The provisions of this Revenue Procedure are applicable to all firearms as defined in section 5848 (1) of the Internal Revenue Code of 1954 (National Firearms Act).

.02 Section 5848 (1) of the 1954 Code defines a firearm as "a shotgun or rifle having a barrel of less than 18 inches in length, or any

other weapon, except a pistol or revolver, from which a shot is discharged by an explosive if such weapon is capable of being concealed on the person, or a machine gun, and includes a muffler or silencer for any firearm whether or not such firearm is included within the foregoing definition, but does not include any rifle which is within the foregoing provisions solely by reason of the length of its barrel if the caliber of such rifle is .22 or smaller and if its barrel is 16 inches or more in length."

SEC. 4. PROCEDURE.

Any person possessing such a firearm which has not been registered, whether or not it bears a manufacturer's serial number, should contact the appropriate Assistant Regional Commissioner, Alcohol and Tobacco Tax, for instructions concerning registration. Such officer should also be contacted in the event a firearm bearing no manufacturer's serial number has previously been registered and the person possessing such firearm desires to have an Internal Revenue Service serial number assigned to it.

SEC. 5. EFFECTIVE DATE.

This Revenue Procedure is effective March 18, 1955.

Rev. Proc. 55-11

This Revenue Procedure contains information covering areas where problems or different interpretations of the new regulations relating to manufactured tobacco are considered likely to arise, with respect to permits, inventories, trade name certificates, bonds, factory premises, packages, and records.

SECTION 1. PURPOSE.

The purpose of this Revenue Procedure is to provide certain information as an aid in the uniform and orderly transition from the provisions of Regulations 8, insofar as they relate to manufactured tobacco, to the provisions of the Regulations relating to Manufacturers, Importers, and Dealers in Manufactured Tobacco, published in the Federal Register on July 19, 1955, and effective on that date.

SEC. 2. PERMITS.

Each Assistant Regional Commissioner, Alcohol and Tobacco Tax, will distribute to each qualified manufacturer of tobacco in his region, except as indicated below, an application for permit, Form 2093, with instructions as to the documents required to be furnished with such application. In order for the manufacturer to continue his operations, it will be necessary that the application for permit be made without undue delay. The permit issued to a manufacturer will bear the same number as the revenue number now assigned to the factory of the manufacturer. This procedure does not apply to such persons who carry on the business of a quasi-manufacturer and who, under the Internal Revenue Code of 1954, are defined as dealers in tobacco materials and will make applications for permits as such dealers when Part 280, Title 26, Code of Federal Regulations, relating to such dealers, becomes effective.

SEC. 3. OPENING INVENTORIES.

.01 A manufacturer of tobacco, qualified on July 19, 1955, is not required to make an opening inventory in connection with his application for permit unless a superseding bond is given with such permit application.

.02 An opening inventory made by a fiduciary successor, under section 275.93 of the regulations, will be regarded as the closing inventory of the predecessor.

SEC. 4. TRADE NAME CERTIFICATE.

The refurnishing of a trade name certificate is not intended under section 275.74 of the regulations when the Assistant Regional Commissioner, Alcohol and Tobacco Tax, already possesses such a certificate furnished by the manufacturer in connection with his prior qualification.

SEC. 5. TOBACCO FACTORY AND CIGAR AND CIGARETTE FACTORY IN ONE BUILDING.

Where the premises of an existing tobacco factory, also a cigar and cigarette factory, are located in the same building and such factories are of common ownership, the separation prescribed by section 275.77 (b) may not be required, provided the Assistant Regional Commissioner, Alcohol and Tobacco Tax, is satisfied that the present premises of such factories afford adequate protection to the revenue.

SEC. 6. PACKAGING MATERIALS.

Manufacturers of tobacco may use their existing supplies of packaging materials, prepared under previous regulations, until such supplies are exhausted.

SEC. 7. DUMMY PACKAGES FOR DISPLAY PURPOSES.

A manufacturer of tobacco may use his regular packages, when empty, as dummy packages for display purposes, provided such packages do not have any revenue stamps affixed thereto.

SEC. 8. MANUFACTURED TOBACCO DAMAGED OR WITHDRAWN FROM THE MARKET.

Packages of manufactured tobacco that are damaged or withdrawn from the market by a manufacturer, or his agent, may be assembled, before the detail of a revenue officer is requested, in a suitable place in his factory, if the manufacturer has received the authorization so to do as required by section 275.142 of the regulations.

SEC. 9. RECORD.

.01 The record, Form 2141, required under section 275.132, is in the process of preparation. The initial distribution of this form will be made as soon as it is available. Until this new form is issued, manufacturers shall continue to keep records on Form 74. Such records should be modified in order to make entries of the operations and transactions required under section 275.132 of the regulations to be recorded, namely, all (a) tobacco materials received (except with respect to samples as provided by section 275.148), shipped, and lost or destroyed, (b) manufactured tobacco produced, received, removed, furnished for personal consumption or use by employees, used for

experimental purposes, reduced to material, and lost or destroyed, and (c) stamps received, used, and lost or destroyed.

.02 The preparation of internal revenue tobacco invoices, Form 774, by manufacturers of tobacco with respect to tobacco materials received or shipped will no longer be required, except in connection with the exportation of tobacco materials until new regulations in Part 290, Title 26, Code of Federal Regulations, become effective.

SEC. 10. RESTAMPING PACKAGES.

Manufacturers will not be restricted, under section 275.63, as to the place where the restamping of packages of manufactured tobacco from which the stamps have been lost or destroyed, or where the repacking of such tobacco, may be accomplished. If the manufacturer desires to bring the tobacco back into his factory for such purposes, he may do so, subject to the provisions of sections 275.63 and 275.142 of the regulations.

SEC. 11. TERMINATION OF EXPORT AND SEA STORES BONDS.

Bonds required of manufacturers of tobacco under section 275.75 shall cover all of the operations of the factories of the manufacturers for which the bonds are furnished, including removals and receipts of tobacco materials and manufactured tobacco, as indicated in sections 275.140, 275.141, 275.146, 275.147, 275.155, 275.156, and 275.157. Where the Assistant Regional Commissioner, Alcohol and Tobacco Tax, has determined that the manufacturer's bond meets the standards set forth in section 275.75, and is holding a separate export or sea stores bond, Form 549 or 549–A, furnished for the same factory, he may terminate such separate bonds. The sureties on such bonds shall remain liable in respect of any liability incurred by the manufacturers in connection with export or sea stores removals made under and charged against such bonds until such removals are properly accounted for and cleared.

SEC. 12. INQUIRIES.

Inquiries in regard to this Revenue Procedure should refer to the number thereof and should be directed to the Director, Alcohol and Tobacco Tax Division, marked for the attention of O:AT:T.

SEC. 13. EFFECTIVE DATE.

This Revenue Procedure is effective July 19, 1955.

Rev. Proc. 55–12[1]

Information and instructions are contained herein for the guidance of manufacturers of cigars and cigarettes with respect to permits, amount of bond, cigar and cigarette factory and tobacco factory in one building, records, reports, servicing of vending machines, etc.

SECTION 1. PURPOSE

The purpose of this Revenue Procedure is to provide certain information and instructions as an aid in the uniform and orderly transition from the provisions of Regulations 8 to the provisions of the regulations relating to cigars and cigarettes (Manufacturers, Importers, and Dealers), which became effective on June 25, 1955.

[1] Modified by Revenue Ruling 56–73, I. R. B. 1956–10, 20.

SEC. 2. PERMITS AND OPENING INVENTORIES

Existing manufacturers of cigars and cigarettes, in order to continue the manufacture thereof under the new regulations, must file Form 2093, Application for Permit Under Chapter 52, Internal Revenue Code. The permit issued to a manufacturer pursuant thereto will bear the same number as the factory number now assigned to the manufacturer. An existing manufacturer is not required to make an opening inventory in connection with his application for a permit unless a superseding bond is given with such application.

SEC. 3. TRADE NAME CERTIFICATE

It is not intended, under section 270.84 of the regulations relating to cigars and cigarettes (Manufacturers, Importers, and Dealers), to require the refurnishing of a trade name certificate where the Assistant Regional Commissioner, Alcohol and Tobacco Tax, already possesses such a certificate furnished by the manufacturer.

SEC. 4. AMOUNT OF BOND

With respect to the amount of the bond required of a manufacturer of large cigars under section 270.122 of the regulations, it will be necessary to determine the tax liability on such cigars produced during the base 12 months' period by using the percentage of each class removed taxpaid during the same period. In the case of a manufacturer of large cigars commencing business, it will be necessary for him to estimate the quantity of such cigars of each class which he will produce during the next 12 months.

SEC. 5. CIGAR AND CIGARETTE FACTORY AND TOBACCO FACTORY IN ONE BUILDING

Where one building comprises a cigar and cigarette factory and a tobacco factory, and such factories are of common ownership, the separation prescribed by section 270.87 (b) of the regulations need not be required, provided the Assistant Regional Commissioner, Alcohol and Tobacco Tax, is satisfied that the present premises afford adequate protection to the revenue.

SEC. 6. OPENING INVENTORY BY FIDUCIARY SUCCESSOR

Where an opening inventory is made by a fiduciary successor under section 270.103, such inventory will also be regarded as the closing inventory of the predecessor.

SEC. 7. PACKAGING MATERIALS

Manufacturers of cigars and cigarettes will be permitted to use their existing supplies of packaging materials until such supplies are exhausted.

SEC. 8. DUMMY PACKAGES FOR DISPLAY PURPOSES

A manufacturer of cigars and cigarettes may use his regular packages as dummy packages for display purposes, notwithstanding they bear the mark and, in the case of large cigars, the class designation thereon, provided they do not have any revenue stamps affixed thereto.

SEC. 9. CIGARS AND CIGARETTES DAMAGED OR WITHDRAWN FROM THE MARKET

Packages of cigars and cigarettes that are damaged or withdrawn from the market may be assembled, before the detail of a revenue offi-

cer is requested, in a suitable place in the factory, provided the manufacturer has received the authorization required by section 270.153 of the regulations.

SEC. 10. RECORDS

The records, Forms 2142 and 2143, required under section 270.142 of the regulations, to be kept by manufacturers of cigars and cigarettes, are in the process of preparation. Until these new forms are issued, such manufacturers shall continue to keep records on Parts 1 and 2 of Form 73, appropriately modified to make entries of the operations and transactions required by section 270.142 of the regulations to be recorded. All (a) tobacco materials received (except with respect to samples as provided by section 270.159), shipped, and lost or destroyed, (b) cigars and cigarettes manufactured, received, removed, furnished for personal consumption by employees, used for experimental purposes, reduced to material, and lost or destroyed, and (c) stamps received, used, and lost or destroyed, must be shown. The preparation of internal revenue tobacco invoices, Form 774, by manufacturers of cigars and cigarettes shall be discontinued immediately, except in connection with the importation of tobacco materials until Form 2146, prescribed by section 270.166, becomes available, and except in connection with the exportation of tobacco materials until new regulations with respect thereto become effective.

SEC. 11. REPORTS

The report, Form 2136, required by section 270.143 to be made by manufacturers of cigars and cigarettes, is in the process of preparation. Until the new form is issued, such manufacturers shall continue to make reports monthly on Parts 1 and 2 of Form 72, appropriately modified to show summary entries of operations and transactions required by section 270.143 of the regulations. Such entries include (a) totals of tobacco materials received (except with respect to samples as provided by section 270.159), shipped, used, and lost or destroyed, (b) totals of cigars and cigarettes manufactured, received, removed, furnished for personal consumption by employees, used for experimental purposes, reduced to material, and lost or destroyed, and (c) total values of stamps of each kind and class received, used, lost or destroyed, and inventories of products and stamps as required by the report forms. Daily entries on such reports are no longer required.

SEC. 12. SERVICING VENDING MACHINES

Partially emptied packages of cigars may be removed from vending machines at the time the machines are serviced, and such cigars may be used to make up full packages for insertion into vending machines.

SEC. 13. RESTAMPING PACKAGES

It is not intended, under section 270.73, to restrict the place where the restamping of packages of cigars and cigarettes from which the stamps have been lost or destroyed, or where the repacking of such products, may be accomplished. If a manufacturer of cigars and cigarettes desires to bring such products back into his factory, he may do so, subject to the provisions of sections 270.73 and 270.153 of the regulations.

SEC. 14. CUSTOMS BONDED MANUFACTURING WAREHOUSES, CLASS 6

The manufacture in, and removal of cigars from, customs bonded manufacturing warehouses, class 6, are governed by customs regulations. Cigars manufactured in such warehouses, when removed for consumption in the United States, shall be treated similarly to cigars imported from a foreign country.

SEC. 15. TERMINATION OF EXPORT AND SEA STORES BONDS

It is intended that the bonds required of manufacturers of cigars and cigarettes by section 270.85 of the regulations shall cover all of the operations of the factories of the manufacturers for which the bonds are furnished, including removals and receipts of tobacco materials, cigars, and cigarettes. See sections 270.151, 270.157, 270.158, 270.166, 270.167, and 270.168 of the regulations relating to cigars and cigarettes (Manufacturers, Importers, and Dealers). Where a manufacturer's bond meets the standard set forth in section 270.85 and the Assistant Regional Commissioner is holding a separate export or sea stores bond, Form 549 or 549–A, furnished for the same factory, he is authorized to terminate such separate bonds. However, the sureties on such bonds shall remain liable in respect of any liability incurred by the manufacturers in connection with export or sea stores removals made under and charged against such bonds.

SEC. 16. ADDITIONAL INFORMATION

Correspondence with respect to information contained in this Revenue Procedure or other information in connection with the requirements of the regulations should be addressed to the appropriate Assistant Regional Commissioner, Alcohol and Tobacco Tax Division.

SEC. 17. EFFECTIVE DATE

This Revenue Procedure is effective June 25, 1955.

Rev. Proc. 55-13

Substitutes for Form 1099, U. S. Information Return, will be accepted, subject to certain prescribed conditions, in lieu of the official form.

SECTION 1. PURPOSE

The purpose of this Revenue Procedure is to state the policy of the Internal Revenue Service relating to acceptance of substitutes for Form 1099, U. S. Information Return, for filing purposes in lieu of the official form printed by the Government Printing Office.

SEC. 2. SPECIFICATIONS

Substitutes for Form 1099 may be manufactured with slight variation of format, and used without specific approval of the Internal Revenue Service if the following conditions are met:

.01 COLOR AND QUALITY OF INK AND PAPER: Black ink on white paper, both of quality as good as that used by the Government;

the paper to be of substantially the same weight and texture as that used in the official forms;

.02 TYPOGRAPHY: Type to be not smaller than the corresponding type on the official form, and as nearly as possible of the same font;

.03 FORMAT: Substantially the same as the official form. If, however, the form is to be used to report dividend payments only, and it is desired to eliminate the columns and their headings shown on the official form, the notation "Dividend" or "Dividend Payments" should be conspicuously shown on the form in lieu of such columns and headings; and

.04 DIMENSIONS: The official form is 7⅞ inches by 3½ inches. Substitute forms may vary in width from 7 inches to 8 inches, and in depth from 3⅛ inches to 3⅔ inches.

SEC. 3. PROCEDURE, PROPOSED SUBSTITUTE FORMS

Proposed substitute forms which do not meet the conditions stated above should be forwarded by letter, addressed to the Commissioner of Internal Revenue, Attention: O:C:PF, Washington 25, D. C., for approval.

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26 CFR 601.201: Rulings and determination letters. (Also Part I, Section 1033.) — Rev. Proc. 55-14

Requests, by taxpayers, for rulings on prospective or actual replacement of involuntarily converted property, which are received in the National Office after the taxpayer has filed his return, will be forwarded to the appropriate District Director of Internal Revenue for the necessary consideration, and the taxpayer will be so advised.

Where a taxpayer elects, in his return, to replace involuntarily converted property, the District Director of Internal Revenue is charged with certain responsibilities under the regulations pertaining to section 112(f) of the Internal Revenue Code of 1939 (section 1033 of the 1954 Code).

If no replacement of the involuntarily converted property has been made by the taxpayer after the first year expires (as described in the statute), the taxpayer must apply to the District Director for an extension of time. If the District Director determines there are obstacles which prevent replacement, an extension of time is granted.

If replacement of the property has been made by the taxpayer, the District Director is responsible for determining whether or not the replacement is proper. If the replacement was not proper, or an extension of time is not granted, the District Director will assert a deficiency.

Accordingly, all requests, by taxpayers, for rulings on prospective or actual replacement of involuntarily converted property, which are received in the National Office after the taxpayer has filed his return, will be forwarded to the appropriate District Director of Internal Revenue for the necessary consideration, and the taxpayer will be so advised.

Subject to certain conditions, the Internal Revenue Service will accept substitutes for Form W–2, Withholding Tax Statement—1956, in lieu of the official form printed by the Government Printing Office.

SECTION 1. PURPOSE.

The purpose of this Revenue Procedure is to state the policy of the Internal Revenue Service relating to acceptance of substitutes for Form W–2, Withholding Tax Statement—1956, for filing purposes in lieu of the official form printed by the Government Printing Office.

SEC. 2. SPECIFICATIONS.

.01 Substitutes for Form W–2 may be privately printed with slight variation of format, and used without specific approval of the Internal Revenue Service if the conditions enumerated in section 3 are met.

.02 The official form is designed for mailing in a standard window envelope. This feature will be found desirable in most of the privately printed substitutes.

.03 Copy D is included in the official assembly for the convenience of the employer. Although there is no requirement that privately printed substitute forms include Copy D, employers may find it desirable to make and retain such copy.

SEC. 3. CONDITIONS.

.01 *Arrangement of assembly.*—Except as provided in paragraph .05, the parts in the assembly shall be arranged as follows: Copy A, "For District Director;" Copy B, "To Be Filed With Employee's Tax Return;" Copy C, "For Employee's Records;" Copy D, "For Employer." All references to the various parts shall be to "Copy A," "Copy B," "Copy C," or "Copy D."

.02 *Color and quality of ink and paper.*—Brown ink on white paper, both of quality as good as that used by the Government; the paper to be of substantially the same weight and texture as that used in the official form, which is printed on substance 32-pound white-writing—basis 1,000 sheets, 17 x 22.

.03 *Typography.*—Type to be not smaller than the corresponding type on the official form and as nearly as possible of the same font.

.04 *Format and data.*—The substitute forms must provide the same spaces as the official form for reporting wages paid and taxes withheld. Payroll deductions other than those required to be reported on the form may not be shown on Copies A and B. In any rearrangement of the spaces for wage information, the block headed "SOCIAL SECURITY INFORMATION" must be to the left of or above the block headed "INCOME TAX INFORMATION." No deviation from the instructions on either the front or back of Copies A, B, or C will be permitted.

.05 *Additional copies.*—Additional copies may be prepared for the use of employers in connection with taxes or deductions other than Federal income tax and Federal Insurance Contributions Act taxes. Such additional copies shall not be placed ahead of Copy C in the assembly except that if a copy for a State or local taxing authority

is prepared, it may be placed in the third position in the assembly for better legibility. Forms for delivery to State or local taxing authorities should be clearly labeled to indicate the purpose for which they are intended and should not bear any part of the designation, "Form W-2—U. S. Treasury Department, Internal Revenue Service."

.06 *Dimensions.*—The official form is 8 inches wide by 3½ inches deep, exclusive of a ½ inch snap-stub on the left side of the form. The substitute forms may vary in width from 7 inches to 8 inches, and in depth from 3⅛ inches to 3⅔ inches. The snap feature is not required on substitutes.

.07 *Carbonized forms or "spot carbons."*—Not permissible. Interleaved carbon, if used, to be of good quality to preclude smudging and preferably black.

.08 *Special identification.*—Copy B to show the full-face dots, arranged vertically on the upper right side.

.09 A space at least ½ inch deep to be provided at the top of the block on the lower right side of each form in the assembly, containing instructions to either the employer or the employee.

.10 *The Government Printing Office symbol.*—To be omitted.

.11 Additional wage or tax information for State or local taxing authorities may be shown on Copy C but it must not appear on Copies A and B.

SEC. 4. SUBSTITUTES NOT MEETING ABOVE CONDITIONS.

PROPOSED SUBSTITUTE FORMS WHICH DO NOT MEET THE CONDITIONS STATED ABOVE AND REQUESTS FOR SUBMISSION OF PUNCHED CARD FORMS W-2 SHOULD BE FORWARDED BY LETTER TO THE COMMISSIONER OF INTERNAL REVENUE, ATTENTION O:C:PF, WASHINGTON 25, D. C., FOR APPROVAL.

SEC. 5. REPRODUCTION PROOFS.

Reproduction proofs of the official Form W-2 are available upon the request of any employer who desires to use reproductions of such form. Requests for reproduction proofs should be addressed to the Commissioner of Internal Revenue, Attention A:O:P, Washington 25, D. C.

TITLE 26—INTERNAL REVENUE, 1954.— CHAPTER 1, SUBCHAPTER H, PART 601.— STATEMENT OF PROCEDURAL RULES [1]

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[1] 20 F. R. 4621, except for Subpart C which was published in 20 F. R. 7731.

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AUTHORITY.—§ § 601.101 to 601.702 issued under R. S. 161; 5 U. S. C. 22.

SUBPART A—GENERAL PROCEDURAL RULES

SEC. 601.101. INTRODUCTION.—(*a*) *General.*—The Internal Revenue Service is a branch of the Treasury Department under the immediate direction of the Commissioner of Internal Revenue. The Commissioner has general superintendence of the assessment and collection of all taxes imposed by any law providing internal revenue and also of other functions relating to the administration and enforcement of laws applicable to alcohol and certain firearms which are in addition to those related to taxes. The Internal Revenue Service is the agency by which these functions are performed. Generally, the procedural rules of the Service are based on the Internal Revenue Code of 1939 and the Internal Revenue Code of 1954, and the procedural rules in this part apply to the taxes imposed by both Codes except to the extent specifically stated or where the procedure under one Code is incompatible with the procedure under the other Code. References to sections of the Code are references to the Internal Revenue Code of 1954, unless otherwise expressly indicated.

(b) *Scope.*—This part sets forth the procedural rules of the Internal Revenue Service respecting all taxes administered by the Service, and supersedes the previously published statement (26 CFR (1939) Parts 600 and 601) with respect to such procedural rules. Subpart A provides a descriptive statement of the general course and method by which the Service's functions are channeled and determined, insofar as such functions relate generally to the assessment and collection of internal revenue taxes. Certain provisions special to particular taxes are separately described in subpart D. Conference and practice re-

quirements of the Internal Revenue Service are contained in subpart E. Specific matters not generally involved in the assessment and collection functions are separately described in subpart B. A description of the rule-making functions of the Treasury Department with respect to internal revenue tax matters is contained in subpart F. The procedural rules of the Service with respect to distilled spirits, wine, beer, tobacco, and certain firearms are described in Subpart C of this part. Subpart G relates to matters of official record in the Internal Revenue Service and the extent to which records and documents are subject to publication or open to public inspection. This part does not contain a detailed discussion of the substantive provisions pertaining to any particular tax or the procedures relating thereto, and for such information it is necessary that reference be made to the applicable provisions of law and the regulations promulgated thereunder. The regulations relating to the taxes administered by the Service are contained in titles 26 and 27 of the Code of Federal Regulations.

SEC. 601.102. CLASSIFICATION OF TAXES COLLECTED BY THE INTERNAL REVENUE SERVICE.—(*a*) *Principal divisions.*—Internal revenue taxes fall generally into the following principal divisions:

(1) taxes collected by assessment,

(2) taxes collected by means of revenue stamps.

(*b*) *Assessed taxes.*—Taxes collected principally by assessment fall into the following two main classes:

(1) Taxes within the jurisdiction of the Tax Court of the United States. These include:

(i) income and profits taxes imposed by chapters 1 and 2 of the 1939 Code and taxes imposed by subtitle A of the 1954 Code, relating to income taxes;

(ii) estate taxes imposed by chapter 3 of the 1939 Code and chapter 11 of the 1954 Code;

(iii) gift tax imposed by chapter 4 of the 1939 Code and chapter 12 of the 1954 Code.

(2) Taxes not within the jurisdiction of the Tax Court of the United States. Taxes not imposed by chapter 1, 2, 3, or 4 of the 1939 Code or subtitle A or chapter 11 or 12 of the 1954 Code are within this class, such as:

(i) employment taxes,

(ii) various sales taxes collected by return,

(iii) miscellaneous excise taxes collected by return, and

(iv) miscellaneous excise taxes collected by sale of revenue stamps.

(3) The difference between these two main classes is that only taxes described in subparagraph (1) of this paragraph, i. e., those within the jurisdiction of the Tax Court, may be contested before an independent tribunal prior to payment. Taxes of both classes may be contested by first making payment, filing claim for refund, and then bringing suit to recover if the claim is disallowed or no decision is rendered thereon within six months.

(*c*) *Stamp taxes.*—Taxes collected by means of revenue stamps may in special circumstances be collected by assessment, but references hereinafter to the assessment process do not contemplate taxes ordinarily

collectible by means of stamps, except as specially stated. For provisions special to taxes collected by means of revenue stamps, see section 601.404. Taxes collectible by assessment may be collected by suit without assessment, but this is seldom done.

SEC. 601.103. SUMMARY OF GENERAL TAX PROCEDURE.—(*a*) *Collection procedure.*—The Federal tax system is basically one of self-assessment. Each taxpayer (or person required to collect and pay over the tax) is required to file a prescribed form of return which shows the facts upon which tax liability may be determined and assessed. Generally, the taxpayer must compute the tax due on the return and make payment thereof on or before the due date for filing the return. If the taxpayer fails to pay the tax when due, the District Director of Internal Revenue issues a notice and demands payment within 10 days from the date of the notice. In the case of wage earners and nonresident aliens, the income tax is collected in large part through withholding at the source. Another means of collecting the income tax is through payments on declarations of estimated tax which are required by law to be filed by certain taxpayers whose gross income for the taxable year may be expected to exceed a specified amount. For taxable years ending on or after December 31, 1955, the law requires a declaration of estimated tax by certain corporations. See section 6016 of the Code. Neither withholding nor a declaration of estimated tax relieves a taxpayer from the duty of filing a return otherwise required. Certain excise taxes are collected by the sale of internal revenue stamps.

(*b*) *Examination and determination of tax liability.*—After the returns are filed in the office of the District Director of Internal Revenue, they are sorted, classified, and processed. Many of these returns are selected for examination. If adjustments are proposed with which the taxpayer does not agree, he is ordinarily accorded an opportunity to discuss the proposed adjustments (except with respect to mathematical errors) in an informal conference in the District Director's office. If this informal conference results in agreement on the proposed adjustments, the taxpayer is requested to execute an agreement form. If the tax involved is an income, profits, estate, or gift tax, and if the taxpayer waives restrictions on the assessment and collection of the tax (see sec. 601.105 (*b*)), the deficiency will be immediately assessed.

(*c*) *Disputed liability.*—(1) *General.*—If the informal conference does not result in agreement on the adjustments proposed to be made the taxpayer is given an opportunity to submit a protest in writing, stating under oath the facts on which he relies and the grounds for his contention that the adjustments are not proper. Following review of the protest, the case will be referred to the Appellate Division of the region and the taxpayer may also be accorded a conference in the Appellate Division. The determination of tax liability by the Appellate Division is final insofar as the taxpayer's appellate rights within the Service are concerned.

(2) *Petition to the Tax Court of the United States.*—In the case of income, profits, estate and gift taxes, before a deficiency may be assessed a statutory notice of deficiency (commonly called a "90-day letter") must be sent to the taxypayer by registered mail unless the taxpayer waives this restriction on assessment. The taxpayer may then

file a petition for a redetermination of the proposed deficiency with the Tax Court of the United States within 90 days from the date of the mailing of the statutory notice. If the notice is addressed to a person outside the States of the Union and the District of Columbia, the period within which a petition may be filed in the Tax Court is 150 days in lieu of 90 days. In other words, the taxpayer has the right in respect of these taxes to contest any proposed deficiency before an independent tribunal prior to assessment or payment of the deficiency. Unless the taxpayer waives the restrictions on assessment and collection after the date of the mailing of the statutory notice, no assessment or collection of a deficiency (not including the correction of a mathematical error) may be made in respect of these taxes until the expiration of the applicable period or, if a petition is filed with the Tax Court, until the decision of the Court has become final. If, however, the taxpayer makes a payment with respect to a deficiency, the amount of such payment may be assessed. See, however, section 601.105 (*h*). If the taxpayer fails to file a petition with the Tax Court within the applicable period, the deficiency will be assessed upon the expiration of such period and notice and demand for payment of the amount thereof will be mailed to the taxpayer by the District Director of Internal Revenue. If the taxpayer files a petition with the Tax Court, the entire amount redetermined as the deficiency by a final decision of the Tax Court will be assessed and is payable upon notice and demand from the district director. There are no restrictions on the assessment and collection of the amount of any deficiency determined by the Tax Court, and a petition for review of the Court's decision will not stay the assessment and collection of the deficiency so determined, unless on or before the time the petition for review is filed the taxpayer files with the Tax Court a bond in a sum fixed by the Court not exceeding twice the portion of the deficiency in respect of which the petition for review is filed. No part of an amount determined as a deficiency but disallowed as such by a decision of the Tax Court which has become final may be assessed or collected by levy or by proceeding in court with or without assessment.

(3) *Claims for refund.*—After payment of the tax a taxpayer may, within the applicable period of limitations, contest the assessment by filing with the District Director a claim for refund of all or any part of the amount paid, except with respect to certain taxes determined by the Tax Court, the decision of which has become final. If the claim is allowed, the overpayment of tax and allowable interest thereon will be credited against other liabilities of the taxpayer, or will be refunded to the taxpayer. Generally, if the claim for refund is rejected in whole or in part, the taxpayer is notified of the rejection by registered mail. He may then bring suit in the United States District Court or in the United States Court of Claims for recovery of the tax. Suit may not be commenced before the expiration of 6 months from the date of filing of the claim for refund, unless a decision is rendered thereon within that time, nor after the expiration of 2 years from the date of mailing by registered mail to the taxpayer of a notice of the disallowance of the part of the claim to which the suit relates. Under the 1954 Code, the 2-year period of limitation for bringing suit may be extended for such period as may be agreed upon in a properly executed Form 907. Also, under the 1954 Code, if the taxpayer files a written waiver of the re-

quirement that he be sent a notice of disallowance, the 2-year period for bringing suit begins to run on the date such waiver is filed. See section 6532 (a) of the Code.

SEC. 601.104. COLLECTION FUNCTIONS.—(*a*) *Collection methods.*—(1) *Returns.*—Generally, an internal revenue tax assessment is based upon a return required by law or regulations to be filed by the taxpayer upon which he himself computes the tax in the manner indicated by the return. If a taxpayer fails to make a return it may be made for him by a District Director, revenue agent, or other duly authorized officer or employee. See section 6020 of the Code and the regulations thereunder. Returns must be made on the forms prescribed by the Internal Revenue Service. Forms are obtainable at the principal and branch offices of District Directors of Internal Revenue. District Directors commonly mail forms to persons who they have reason to believe may be required to file returns, but failure to receive a form does not excuse failure to comply with the law or regulations requiring a return. Returns, supplementary returns, statements, or schedules and the time for filing them may sometimes be prescribed by regulations issued under authority of law by the Commissioner with the approval of the Secretary of the Treasury. In the case of certain individual income taxpayers having gross income not exceeding an amount prescribed by law and consisting of income from specified sources, a special form (Form 1040A) is prescribed upon which the taxpayer may set forth the information necessary to a determination of his tax liability, and the District Director will compute the tax due and mail to the taxpayer a notice and demand for payment. A husband and wife may make a single income tax return jointly. Certain affiliated groups of corporations may file consolidated income tax returns. See section 1501 of the Code and the regulations thereunder.

(2) *Withholding of tax at source.*—Withholding at the source of income payments is an important method used in collecting taxes. For example, in the case of wage earners, the income tax is collected in large part through the withholding by employers of taxes on wages paid to their employees. The tax withheld at the source on wages is applied as a credit in payment of the individual's income tax liability for the taxable year. In no case does withholding of the tax relieve an individual from the duty of filing a return otherwise required by law. The chief means of collecting the income tax due from nonresident alien individuals and foreign corporations not engaged in trade or business within the United States is the withholding of the tax by persons paying or remitting the income to the recipients. The tax withheld is allowed as a credit in payment of the tax imposed on such nonresident alien individuals and foreign corporations.

(3) *Declarations of estimated tax.*—Any individual who may reasonably expect to receive gross income for the taxable year from wages or from sources other than wages, in excess of amounts specified by law, is required to file a declaration of estimated income tax. Payments of estimated tax are applied in payment of the tax for the taxable year. A husband and wife may make a single declaration jointly, and the amount of the estimated tax paid on the declaration may be applied in payment of the income tax liability of either spouse in any proportion they may specify. For taxable years ending

on or after December 31, 1955, the law requires a declaration of estimated tax by certain corporations. See section 6016 of the Code.

(4) *Collection by sale of revenue stamps.*—Certain taxes are collected by sale of revenue stamps. These taxes fall into three general classes: documentary stamp taxes, commodity stamp taxes, and occupational stamp taxes. The documentary and commodity stamp taxes are paid by having affixed to the document, memorandum of sale, policy, package, container, etc., in respect to which the tax is imposed, internal revenue stamps in the amount equal to the tax due and by canceling such stamps in the manner prescribed. Payment of occupational taxes is evidenced by posting or displaying a special occupational tax stamp on the premises where the business is operated. In certain situations where it is not practicable to collect the tax by stamp, for example, where the instrument or commodity subject to stamp tax is no longer in existence or for other reasons cannot be stamped or where it is discovered that an occupational stamp tax was due for a prior taxable year, the tax may be collected by assessment. For special provisions applicable to stamp taxes, see section 601.404.

(5) *Collection of tax by another person.*—Certain miscellaneous excise taxes are imposed on the person making the payment for admission, telephone service, transportation, and other facilities or services. Such taxes are required to be collected by the theater, telephone company, railroad, or other person receiving the payment. All taxes collected in this manner are held by the collecting agent in trust for the United States until paid over to the District Director of Internal Revenue. If the person from whom the tax is required to be collected refuses to pay it or if for any reason it is impossible for the collecting agency to collect the tax from such person, the collecting agency is required to report the facts to the District Director of Internal Revenue and the tax will then be collected by direct assessment against the person failing or refusing to pay the tax to the collecting agent. For special provisions applicable to excise taxes collected by another person, see section 601.403.

(*b*) *Extension of time for filing returns.*—Under certain circumstances the Commissioner is authorized to grant a reasonable extension of time for filing a return or declaration. This authority has been delegated to the several District Directors of Internal Revenue. The maximum period for extensions cannot be in excess of 6 months, except in the case of taxpayers who are abroad. With an exception in the case of estate tax returns, written application for extension must be received by the District Director on or before the date prescribed by law for filing the return or declaration. On or before the last date prescribed by law for filing its income tax return, a corporation may obtain an automatic 3-month extension of time for filing the income tax return by filing Form 7004 and paying an estimated amount not less than would be required as the first installment of tax due should the corporation elect to pay the tax in installments. An extension of time for filing a declaration of estimated tax (generally limited to a period of not more than 15 days) automatically extends the time for paying the estimated tax (without interest) for the same period.

(*c*) *Enforcement procedure*—(1) *General.*—Taxes shown to be due on returns, deficiencies in taxes, and additional or delinquent taxes

to be assessed, and penalties, interest and additions to taxes are recorded by the District Director of Internal Revenue as "assessments." Under the law, an assessment is prima facie correct for all purposes, the burden to disprove its correctness being upon the taxpayer. Upon assessment, the District Director is required to effect collection of any amounts which remain due and unpaid after the expiration of 10 days from the date of notice and demand for their payment.

(2) *Levy.*—If a taxpayer neglects or refuses to pay any tax within 10 days after notice and demand for its payment, it is lawful for the District Director to make collection by levy on the taxpayer's property. See section 6331 of the Code. No suit for the purpose of restraining the assessment or collection of an internal-revenue tax may be maintained in any court, except to restrain the assessment or collection of income, estate, or gift taxes during the period within which the assessment or collection of deficiencies in such taxes is prohibited. See section 7421 of the Code. Property taken under authority of any revenue law of the United States is irrepleviable. United States Revised Statutes, sec. 934; 28 U. S. C. 747.

(3) *Liens.*—The United States claim for taxes is a lien on the taxpayer's property. Such lien is not valid as against any mortgagee, pledgee, purchaser, or judgment creditor until notice has been filed by the District Director. Despite such filing, the lien is not valid with respect to certain securities as against any mortgagee, pledgee or purchaser of such securities, for an adequate and full consideration in money or money's worth, who is without notice or knowledge of the existence of such lien. A valid lien generally continues until the liability is satisfied or becomes unenforceable by reason of lapse of time. A certificate of release of lien may be issued upon the taxpayer furnishing proper bond in lieu of the lien, or when the liability is satisfied or becomes unenforceable by reason of lapse of time. The Code also contains additional provisions with respect to liens in the case of estate and gift taxes. For the specific rules with respect to liens, see subchapter C of chapter 64 of the Code and the regulations thereunder.

(4) *Penalties.*—In the case of failure to file a return within the prescribed time, a certain percentage of the amount of tax is, pursuant to statute, added to the tax unless the failure to file the return within the prescribed time is shown to the satisfaction of the District Director to be due to reasonable cause and not to willful neglect. Civil penalties are also imposed for fraudulent returns; in the case of income and gift taxes, for intentional disregard of rules and regulations or negligence; and additions to the tax are imposed for the failure to comply with the requirements of law with respect to the estimated income tax. See chapter 68 of the Code. Criminal penalties are imposed for willful failure to pay, collect, or truthfully account for and pay over tax willfully attempting to evade or defeat tax or the payment thereof, or willful failure to make returns, keep records, supply information, etc. (See chapter 75 of the Code.)

(5) *Informants' rewards.*—Payments to informers are authorized for detecting and bringing to trial and punishment persons guilty of violating the internal revenue laws. See section 7623 of the Code and the regulations thereunder. Claims for rewards should be made

on Form 211. Relevant facts should be stated on the form, which after execution should be forwarded to the District Director of Internal Revenue for the district in which the informer resides, or to the Commissioner of Internal Revenue, Washington 25, D. C.

SEC. 601.105. EXAMINATION OF RETURNS AND CLAIMS FOR REFUND, CREDIT OR ABATEMENT; DETERMINATION OF CORRECT TAX LIABILITY.—(*a*) *Processing of returns.*—When the returns are filed in the office of the District Director of Internal Revenue, they are received by the Collection Division of the office and are checked first for form, execution, and mathematical accuracy. Mathematical errors are corrected and a correction notice of any such error is sent to the taxpayer. Notice and demand is made for the payment of any deficiency so resulting, or refund is made of any overpayment. All returns are then sorted by the Collection Division according to such classifications and subclassifications as are prescribed by the uniform management directives of the Commissioner. The purpose of these classifications is to facilitate prompt processing of returns showing refunds due and returns received with insufficient or no remittance, the selection of returns for audit, and the compilation of income and other statistics.

(*b*) *Examination of returns.*—(1) *General.*—The original examination of income, profits, estate, gift, excise, and employment tax returns is a primary function of internal revenue agents in the Audit Division of the office of each District Director of Internal Revenue. Such internal revenue agents are organized in groups, each of which is under the immediate supervision of a group supervisor designated by the District Director. Revenue agents and collection officers (and such other officers or employees of the Internal Revenue Service as may be designated for this purpose by the Commissioner) are authorized to examine any books, papers, records, or memoranda bearing upon matters required to be included in Federal tax returns and to take testimony relative thereto and to administer oaths. See section 7602 of the Code and the regulations thereunder. There are two general types of audit. These are commonly called "office audit" and "field audit."

(2) *Office audit.*—Certain returns are examined by office audit. Ordinarily these are returns which do not disclose activities involving the conduct of a business. An office audit involves an analysis of the return in the light of the law and the regulations using such evidence as may be available based on returns for previous years, information returns and other records, and the returns of other taxpayers. The original classification of the return usually will have disclosed the need for explanation or supporting evidence. Generally, any questions arising in the office audit are brought to the taxpayer's attention through correspondence with him, and he is asked to supply explanations or copies of supporting evidence by mail. Frequently, however, the examining agent will request the taxpayer to come to the District Director's office for a personal conference and interview. The taxpayer has a right, of course, to bring to the attention of the examing agent any amounts included in his return which are not subject to tax or any deductions which he failed to claim on the return.

(3) *Field audit.*—Certain returns are examined by field audit which involves an examination by an internal revenue agent of the tax-

payer's books and records on the taxpayer's premises. The revenue agent will check the entire return filed by the taxpayer and will examine all books, papers, records, and memoranda dealing with matters required to be included in the return. If the return presents an engineering or appraisal problem (e. g., depreciation or depletion deductions, gains or losses upon the sale or exchange of property, or losses on account of abandonment, exhaustion, or obsolescence), it may, at the discretion of the officer responsible for making the final determination with respect to the tax liability, be investigated by an engineer agent who makes a separate report.

(4) *Conclusion of audit.*—At the conclusion of an office or field audit, the taxpayer is afforded an opportunity to agree with the findings of the examining agent. In the event that the taxpayer does not agree, the examining agent will inform the taxpayer of his right to an informal conference. The examining agent will furnish the taxpayer a brief statement identifying the proposed adjustments as a basis for requesting an informal conference, if desired. Such informal conference will afford the taxpayer an opportunity to discuss orally the proposed adjustments prior to the preparation of the examining agent's report. See paragraph (*c*) of this section for informal conference procedure. On the other hand, if the taxpayer agrees with the proposed changes, he should then execute Form 870, or other appropriate agreement form, which will be tendered to him by the examining agent. If the case involves income, profits, estate, or gift taxes, this agreement is evidenced in the form of a waiver by the taxpayer of restrictions on assessment and collection of the deficiency or an acceptance of a proposed overassessment. If the case involves excise or employment taxes, the agreement is evidenced by the taxpayer's signing a waiver of his right to file a claim for abatement after the assessment of the additional tax or by an acceptance of a proposed overassessment. Even though the taxpayer signs an acceptance of a proposed overassessment, the District Director remains free to assess a deficiency. On the other hand, the taxpayer who has given a waiver may still claim a refund of any part of the deficiency assessed against him and paid by him or any part of the tax originally assessed and paid by him. The taxpayer's acceptance of an agreed overassessment does not prevent his filing a claim and bringing a suit for an additional sum, nor does it preclude the Government from maintaining suit to recover an erroneous refund. As a matter of practice, however, waivers or acceptances ordinarily result in the closing of a case insofar as the Government is concerned.

(*c*) *Informal conference procedure.*—(1) *General.*—If the taxpayer does not agree with the findings of the examining agent, the taxpayer is advised in writing that he may present his objections to such findings at an informal conference in the Audit Division of the District Director's office. The taxpayer is usually granted 10 days from the date of the written notice in which to request an informal conference on the proposed changes. Such request may be made by telephoning or writing to the number or address set forth in such written notice. If the taxpayer fails to request an informal conference within such time or to obtain an extension of time for requesting a conference, the examining agent will proceed with the completion of his report, a copy of which will be mailed to the taxpayer by the

District Director under cover of a "30-day letter" stating the action proposed to be taken. For further procedure in such a case, see paragraph (*d*) of this section. If the case involves an additional or delinquent excise or employment tax and the taxpayer fails to request an informal conference, in lieu of a "30-day letter," the taxpayer will be sent a letter advising that the additional or delinquent tax will be assessed by the District Director and further advising the taxpayer of the alternative courses of action available to him after the assessment. See paragraph (*d*) (2) of this section. In certain excise and employment tax cases, in lieu of enclosing a copy of the examining agent's report, such letter will contain an explanation of the proposed adjustments.

(2) *Scope of informal conference procedure.*—The informal conference procedure described in this paragraph is applicable in the determination of any liability in respect of income, profits, estate, gift, excise, or employment taxes. This procedure, however, is not applicable in the determination of liability for any excise tax imposed by the following provisions of the Code (and the corresponding provisions of the 1939 Code): chapter 35 (relating to wagering); subchapter A of chapter 39 (relating to narcotic drugs and marihuana); subtitle E (relating to alcohol, tobacco, machine guns and certain other firearms); and subchapter D of chapter 78 (relating to certain import taxes) insofar as it relates to alcohol and tobacco. The procedure described in this paragraph does not apply in any case where criminal prosecution is under consideration, or in any case in which, in the discretion of the District Director of Internal Revenue, the Government's interest would be prejudiced thereby. Nor does this procedure preclude the taking of appropriate action where the assessment or collection of the tax is in jeopardy. See paragraph (*h*) of this section.

(3) *Rules governing informal conferences.*—The objective of the informal conference procedure is to give taxpayers greater opportunity to reach an early agreement with respect to disputed items arising from examinations made by internal revenue agents. This procedure affords a means by which such issues may be resolved prior to the preparation of the agent's report and without the necessity of the taxpayer filing a formal protest. The examining agent will be present at the conference. If the taxpayer is represented by an attorney or agent, the rules with respect to their recognition, the filing of powers of attorney, and the filing of fee statements are applicable. For conference and practice requirements, see subpart E. In the conduct of informal conferences, it is the duty of the group supervisor or other officer who may be acting as conferee to conduct the conference in accordance with the objectives of the informal conference procedure and to provide the taxpayer a fair and courteous hearing at which the taxpayer may present his statement of facts and his view of the issues; to make certain that all pertinent facts are included in the record and are considered in arriving at the proposed recommendation; to make certain that the pertinent provisions of the Internal Revenue Code are applied in arriving at the proposed recommendation and that the proposed recommendation is in accord with the interpretations of the Internal Revenue Service as expressed in regulations and rulings; and to explain fully to the taxpayer the con-

clusions reached and the reasons therefor. It is the responsibility of the group supervisor or other designated officer to prepare a conference report with respect to each case on which an informal conference is held. This report, which will set forth briefly and concisely the facts and conclusions reached with respect to each issue, will be made available to the examining officer. In preparing his report the examining officer will give effect to the conference decisions. The examination report and the conference report are subject to review in the Audit Division of the District Director's office. The purpose of this review is to insure uniformity in the application of the provisions of the Code, the regulations and rulings, as well as the general policy of the Service. In the event that an agreement with the taxpayer is reached at the informal conference, the taxpayer will be requested to execute Form 870 or other appropriate agreement form. Any deficiency in tax or additional tax proposed will then be assessed, or any overpayment will be credited or refunded.

(*d*) *Thirty-day letters; protests; claims for abatement*—(1) *General.*—The report of the examining agent, as approved after review, recommends one of four determinations:

(i) acceptance of the return as filed and closing of the case;

(ii) assertion of a given deficiency or additional tax;

(iii) allowance of a given overassessment, with or without a claim for refund, credit, or abatement;

(iv) if a claim for refund, credit, or abatement has been filed and has been found wholly lacking in merit, denial of the claim.

If any one of the last three determinations is made (except a full allowance of a claim in respect of any tax or a proposed additional excise or employment tax), unless the taxpayer has previously agreed with the finding by signing an agreement form as above described in this section, the District Director sends to the taxpayer a preliminary or "30-day letter." This is a form letter which states the determination proposed to be made. Except in certain excise and employment tax cases, it is accompanied by a copy of the examining agent's report explaining the basis of the proposed determination. It suggests to the taxpayer that, if he concurs in the recommendation, he indicate his agreement by executing and returning the enclosed form of waiver or acceptance. The preliminary letter also advises the taxpayer that if he disagrees with the proposed determination, he may file a written protest under oath within 30 days (from the date of the letter) stating the grounds for his disagreement and may have a hearing in the Appellate Division of the region if requested. Failure by the taxpayer to make any response within 30 days will result in the issuance of a statutory notice of deficiency in income, profits, estate and gift tax cases, or other appropriate action, such as the issuance of a certificate of overassessment or the denial of a claim.

(2) *Excise and employment tax cases.*—If the case involves excise or employment taxes and the examination report proposes an additional or delinquent tax, in lieu of a "30-day letter," the taxpayer will be sent a letter advising that the additional or delinquent tax will be assessed by the District Director and that upon receipt of notice and demand for payment of such additional or delinquent tax from the District Director, the taxpayer may pay the assessment and file a claim for refund or credit, or may defer paying the assessment and

instead file a claim for abatement of the assessment. Form 843 is the form prescribed for use in filing such claims. The taxpayer will also be advised that if he wishes the case to be transferred to the Appellate Division of the region he should file with the claim a request in writing for such transfer. If the taxpayer requests consideration by the Appellate Division, he may file with his claim a written protest under oath setting forth the facts upon which he relies and his contentions with respect to the issues involved. If the taxpayer files a claim for abatement of the assessment and a request in writing for transfer of the case to the Appellate Division of the region, but does not file a protest, the Appellate Division may thereafter request the taxpayer to file a protest if the conferee to whom the case is assigned decides that a protest would facilitate disposition of the case. If the taxpayer fails to file a claim for abatement within 10 days from the date of the notice and demand for payment of the assessment, the tax becomes collectible immediately upon expiration of such period.

(3) *Protests.*—If the taxpayer chooses to file a protest against the proposed determination set forth in the "30-day letter," his protest should be filed in the District Director's office and, following review of the protest, the case will be referred to the Appellate Division of the region. The taxpayer will also be accorded a conference in the Appellate Division if he requests it. Protests should be filed in triplicate. No particular form of protest has been prescribed. However, instructions for the preparation of protests are sent with the "30-day letter." For a description of the procedure in the Appellate Division, see section 601.106.

(*e*) *Claims for refund or credit.*—(1) After payment of the tax a taxpayer may contest the assessment by filing a claim for refund or credit for all or any part of the amount paid, except as provided in section 6512 of the Code with respect to certain taxes determined by the Tax Court, the decision of which has become final. A claim for refund or credit is made on Form 843, which is obtainable from the District Director. Generally, the claim, together with appropriate supporting evidence, must be filed in the office of the District Director for the district in which the tax was paid. A claim for refund or credit must be filed within the applicable statutory period of limitation. In the case of individuals a properly executed income tax return may, if the taxpayer elects, operate as a claim for refund or credit of the amount of the overpayment disclosed by such return. If an individual income taxpayer elects to file Form 1040A as a return, such return operates automatically as a claim for refund for the amount of the overpayment shown by the District Director's computation of the tax on the basis of the return.

(2) Claims for refund or credit are investigated and considered by the Audit Division of the District Director's office. The procedure applicable to the determination of correct tax liability upon the basis of a claim for refund or credit filed by the taxpayer is substantially the same as the procedure applicable to the original determination of tax liability upon the basis of a return filed by a taxpayer. The procedure applicable to the review of determinations of overassessments exceeding $100,000 is substantially the same as that applicable to such determinations by the Appellate Division. See section 601.108.

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(3) As to suits for refund, see section 601.103(*c*).

(4) A special procedure is applicable to claims for excess profits tax relief (including credit or refund) under section 722 of the Internal Revenue Code of 1939. See section 601.107 for a description of the applicable procedure.

(5) There is also a special procedure applicable to applications for tentative carryback adjustments under section 6411 of the Code (consult Forms 1045 and 1139).

(*f*) *Interruption of audit and conference procedure.*—The process of field audits and the course of the administrative procedure described in this section and in the following section may be interrupted in some cases by the imminent expiration of the statutory period of limitations for assessment of the tax. In this event the District Director of Internal Revenue or other appropriate officer concerned must dispatch a statutory notice of deficiency (income, profits, estate or gift tax cases) or take other appropriate action with a view to assessment, even though the audit or conferences may then be going forward. In order to avoid interruption of the established procedure (except in estate tax cases), it is suggested to the taxpayer that he execute an agreement on Form 872 (or such other form as may be prescribed for this purpose). To be effective this agreement must be entered into by the taxpayer and the District Director or other appropriate officer concerned prior to the expiration of the time otherwise provided for assessment. Such a consent extends the period for assessment of any deficiency, or any additional or delinquent tax, and extends the period during which the taxpayer may claim a refund or credit to a date 6 months after the agreed time of extension of the assessment period.

(*g*) *Fraud.*—The procedure described in this section does not apply in any case in which criminal prosecution is under consideration. Such procedure does obtain, however, in cases involving the assertion of the civil fraud penalty after the criminal aspects of the case have been closed.

(*h*) *Jeopardy assessments.*—If the District Director believes that the assessment or collection of a tax will be jeopardized by delay, he is authorized and required to assess the tax immediately, together with interest and other additional amounts provided by law, notwithstanding the restrictions on assessment or collection of income, estate, and gift taxes contained in section 6213(a) of the Code. A jeopardy assessment does not deprive the taxpayer of his right to file a petition with the Tax Court. Collection of a tax in jeopardy may be immediately enforced by the District Director upon notice and demand. To stay collection the taxpayer may file with the District Director a bond equal to the amount for which the stay is desired.

SEC. 601.106. APPELLATE FUNCTIONS.—(*a*) *General.*—(1) There is provided in each region an Appellate Division, with office facilities within the region. Subject to the limitations set forth in subparagraphs (2) and (3) of this paragraph, there is vested in certain officers of the Appellate Division of each region, by delegation of authority from the regional commissioner, the exclusive and final authority to represent the Commissioner in the determination of Federal income, profits, estate, or gift tax liability (whether before or after the issuance of a statutory notice of deficiency) and in the determination

of employment or certain Federal excise tax liability in any case originating in the office of any District Director of Internal Revenue situated in the region, in which the taxpayer has protested the determination of liability made by that officer and no agreement has been reached. The Appellate Division has complete jurisdiction of every income, profits, estate, or gift tax case after the issuance of the statutory notice of deficiency, subject to the limitations provided in subparagraph (2) of this paragraph. After the filing of a petition in the Tax Court the Appellate Division continues to have exclusive jurisdiction of the case, subject to the provisions of subparagraph (2) of this paragraph, and to have custody of all administrative files, papers, and documents relating to the case, which, however, are at all times available to the regional counsel for the preparation of appropriate pleadings to the petition and for the defense before the Tax Court of the Commissioner's determination. Subject to the exceptions and limitations set forth in subparagraph (2) of this paragraph, there is also vested in the Appellate Division of the region exclusive authority to settle (i) all cases docketed in the Tax Court of the United States and placed on a calendar for hearing at any place within the territory comprising the region and (ii) all cases originating in the office of any District Director situated within the region which are placed on the Washington, D. C., calendar of the Tax Court, unless the petitioner is then domiciled in the region which includes Washington, D. C. Furthermore, the Appellate Division of the region may retain exclusive authority to settle all cases docketed in the Tax Court which originated in the office of any District Director situated within the territorial jurisdiction of such region which may be placed upon a calendar of the Tax Court for hearing at a place within the territorial jurisdiction of the Appellate Division of an adjoining region.

(2) The authority described in subparagraph (1) of this paragraph does not include the authority to:

(i) make or approve a settlement in any case docketed in the Tax Court, except with the concurrence of regional counsel;

(ii) eliminate the ad valorem fraud or negligence penalty in any case not docketed in the Tax Court, except with the concurrence of regional counsel;

(iii) act in any case in which criminal prosecution has been recommended, unless and until final disposition has been made of the criminal aspects thereof; or

(iv) modify any decision of the Excess Profits Tax Council with respect to any issue arising under the provisions of section 722 of the Internal Revenue Code of 1939, except with the concurrence of the Council.

(3) The authority vested in the Appellate Division does not extend to the determination of liability for any excise tax imposed by the following chapters of the Internal Revenue Code (and the corresponding provisions of the 1939 Code): chapter 35 (relating to wagering); subchapter A of chapter 39 (relating to narcotic drugs and marihuana); subtitle E (relating to alcohol, tobacco, machine guns and certain other firearms); and subchapter D of chapter 78 (relating to certain import taxes) insofar as it relates to alcohol and tobacco.

(*b*) *Initiation of proceedings before the Appellate Division.*—In any case in which the District Director of Internal Revenue has issued a preliminary or "30-day letter" and the taxpayer files a written protest under oath against the proposed determination of tax liability made by the District Director, and in any case in which the taxpayer files a claim for abatement or refund of any excise or employment tax, the taxpayer has the right (and will be so advised by the District Director) of administrative appeal to the Appellate Division of the region. Following review of the protest, the case and its administrative record are referred to the Appellate Division. No taxpayer is required to submit his case to the Appellate Division for consideration. Appeal is at the option of the taxpayer. A request for administrative appeal to the Appellate Division will not be denied because no informal conference was held in the District Director's office. The Appellate Division will not consider before the issuance of a statutory notice of deficiency any case involving a determination of income, profits, estate, or gift tax liability in which no protest has been filed with the District Director. After the issuance by the District Director of a statutory notice of deficiency in such a case, upon the taxpayer's request, the Appellate Division may take up the case for settlement and may grant the taxpayer a hearing thereon. Except in unusual circumstances, however, no hearing in such a case will be granted prior to the filing of a petition in the Tax Court for a redetermination of the deficiency proposed in the statutory notice.

(*c*) *Nature of proceedings before the Appellate Division.*—Proceedings before the Appellate Division are informal. Testimony under oath is not taken, although matters alleged as fact may be required to be submitted in the form of affidavits. Taxpayers may appear in person or by or with a representative duly enrolled to practice before the Treasury Department and whose appearance must be under a proper power of attorney authorizing him to act for the taxpayer. See subpart E. Any material matter of fact not presented to the District Director of Internal Revenue will be subject to reference to the District Director for investigation and report. At any hearing granted by the Appellate Division the District Director will be represented if he so desires, or if the Chief of the Appellate Division of the region, or his authorized representative, deems it advisable; and at any such hearing on a case involving the ad valorem fraud or negligence penalty, the regional counsel will be represented if he so desires.

(*d*) *Disposition and settlement of cases before the Appellate Division*—(1) *Cases not docketed in the Tax Court.*—(i) If after consideration of the case by the Appellate Division of the region a satisfactory settlement of the issues is reached with the taxpayer, he will be requested to sign Form 870–AD or other appropriate agreement form waiving restrictions on the assessment and collection of any deficiency, or to sign an acceptance of any overassessment resulting under the agreed settlement. As an incident to such settlement the taxpayer may also be required to execute an agreement to make prompt payment of the agreed deficiency or additional tax, together with interest due thereon; not to file an offer in compromise in respect of the agreed tax liability; and upon request to execute at any time a

final closing agreement (see sec. 601.202) under the provisions of section 7121 of the Code in respect of the tax liabilities determined upon the basis of the agreed settlement.

(ii) If after consideration of the case by the Appellate Division of the region it is determined that there is a deficiency in income, profits, estate or gift tax, to which the taxpayer does not agree, a statutory notice of deficiency will be prepared and issued by the Appellate Division after consideration by the regional counsel. The case will be retained by the Appellate Division and, in the event a petition is filed with the Tax Court, the case will be referred to the regional counsel for preparation of the answer or other appropriate pleading. In the event that no petition is filed, the case will be transferred to the District Director for appropriate action. In any other unagreed case, the case and its administrative record will be returned to the District Director with directions to take such action with respect to the tax liability determined in the Appellate Division as may be apropriate, such as the issuance of a statutory notice of disallowance of a claim for refund or credit in whole or in part, the preparation of a certificate of overassessment or other appropriate action, or the collection of any additional tax (excise and employment tax cases).

(2) *Cases docketed in the Tax Court.*—(i) If the case under consideration in the Appellate Division is docketed in the Tax Court and agreement is reached with the taxpayer with respect to the issues involved, the disposition of the case is effected by a stipulation of agreed deficiency or overpayment to be filed with the Tax Court and in conformity with which the Court will enter its order.

(ii) If the case under consideration in the Appellate Division is docketed in the Tax Court and the issues remain unsettled after consideration and conference in the Appellate Division, the case will be referred to the regional counsel for the region for defense of the tax liability determined.

(*e*) *Transfer and centralization of cases.*—(1) If a case is docketed in the Tax Court of the United States and is placed on a calendar for hearing at any place within one region, and such case originated in the office of a District Director situated within another region, the Commisisoner has the authority to confer all or any part of the jurisdiction, authority, and duties vested in the Appellate Division of the region in which the case originated upon the Appellate Division of the region within which the place of hearing is located. However, jurisdiction will not be transferred to the Appellate Division of the region which includes Washington, D. C., in any docketed case set for hearing at Washington, D. C., which did not originate within such region, unless the taxpayer's domicile is then situated within such region. Likewise, the Chief Counsel has corresponding authority to transfer the jurisdiction, authority, and duties of the regional counsel for any region to the regional counsel of another region within which the case has been set for hearing before the Tax Court.

(2) Should a regional commissioner determine that it would better serve the interests of the Government, he may, by order in writing, withdraw any case not docketed before the Tax Court from the jurisdiction of the Appellate Division of the region, and provide for its

disposition under his personal direction. Similarly, should the regional commissioner and the regional counsel jointly determine that it would better serve the interests of the Government, they may, by order in writing, withdraw any case docketed before the Tax Court from the jurisdiction of the Appellate Division of the region, and provide for its disposition under their joint direction.

(*f*) *Conference and practice requirements.*—Practice and conference procedure before the Appellate Division is governed by Treasury Department Circular 230, as amended (31 CFR, pts. 10, 12, 13, and 14), and the requirements of subpart E. In addition to such rules but not in modification of them, the following rules are also applicable to practice before the Appellate Division:

(1) RULE I. The Appellate Division conferee shall bear in mind that an exaction by the United States Government, which is not based upon law, statutory or otherwise, is a taking of property without due process of law, in violation of the Fifth Amendment to the United States Constitution. The conferee, in his conclusions of fact or application of the law, shall hew to the law and the recognized standards of legal construction. It shall be the duty of the conferee to determine the correct amount of the tax, with strict impartiality as between the taxpayer and the Government, and without favoritism or discrimination as between taxpayers.

(2) RULE II. In recognition of the difference between abstract theory and practical administration, where substantial uncertainties exist either in law or in fact, or both, as to the correct application of the law to the whole record of a controversy, the Appellate Division will give serious consideration to an offer of settlement of the dispute on a basis which fairly reflects the strength or weakness of the opposing views. However, no settlement will be countenanced based upon nuisance value of the case to either party.

(3) RULE III. Where the Appellate Division conferee recommends acceptance of the taxpayer's proposal of settlement, or, in the absence of a proposal, recommends action favorable to the taxpayer, and said recommendation is disapproved in whole or in part by a reviewing officer in the Appellate Division, the taxpayer shall be so advised by such reviewing officer and upon written request shall be accorded a rehearing before such reviewing officer. The Appellate Division disregards this rule where the interests of the Government would be injured by delay, as for example, a case involving the imminent expiration of the statute of limitations, dissipation of assets, etc.

(4) RULE IV. Where the Chief of the Appellate Division, the Associate Chief, Assistant Chief, or Special Assistant to the Chief, as the case may be, deems it advisable, whether or not upon request of the taxpayer, the District Director of Internal Revenue will be requested to be represented at any Appellate Division conference on the case, in which event such representative (or representatives) will be invited and expected to enter into the discussion and oral argument at the conference on an equal footing with the taxpayer.

(5) RULE V. In order to bring an income, profits, estate or gift tax case before the Appellate Division in pre-statutory notice status, the taxpayer must first file with the District Director of Internal Revenue a written protest setting forth specifically the reason for his refusal to accept the director's findings. The Appellate Division will not assume jurisdiction in an employment or excise tax case prior to the filing of a claim for refund or a claim for abatement.

(6) RULE VI. A taxpayer cannot withhold evidence from the District Director of Internal Revenue and expect to introduce it for the first time before the Appellate Division, at a conference in nondocketed status, without being subject to having the case returned to the District Director for reconsideration. Where newly discovered evidence is submitted for the first time to the Appellate Division, in a case pending in nondocketed status, that office, in the reasonable exercise of its discretion, may transmit same to the District Director for his consideration and comment.

(7) RULE VII. Where the taxpayer has had the benefit of a conference either before the office of the District Director of Internal Revenue or before the Appellate Division, as the case may be, in the prestatutory notice status, or where the opportunity for such a conference was accorded but not availed of, there will be

no conference granted before the Appellate Division in the 90-day status after the mailing of the statutory notice of deficiency, in the absence of unusual circumstances.

(8) RULE VIII. In any case docketed in the Tax Court of the United States on which a conference is being conducted before an Appellate Division conferee, the Regional Counsel is privileged to be represented and to participate in the discussion. In cases not docketed in the Tax Court of the United States on which a conference is being conducted before an Appellate Division conferee, the Regional Counsel or his representative may be requested to attend and to give legal advice in the more difficult cases, or on matters of legal or litigating policy.

(9) RULE IX. A taxpayer may request the reopening or resumption of settlement conferences in a docketed case, before the Associate Chief or the Assistant Chief, as the case may be, in charge of an Appellate Division office, and whenever such request is granted, the conferee who originally heard the case shall ordinarily be present and participate in any conference.

(*g*) *Limitations on the jurisdiction and functions of the Appellate Division.*—(1) *Overassessments of more than $100,000.*—If the Appellate Division of the region determines in any case that there is an overassessment (of taxes, penalties, or interest) exceeding $100,000, such determination is subject to review by the Office of the Chief Counsel. See section 601.108.

(2) *Offers in compromise.*—For jurisdiction of the Appellate Division with respect to offers in compromise of tax liabilities, see section 601.203.

(3) *Closing agreements.*—For jurisdiction of the Appellate Division with respect to closing agreements under section 7121 of the Code relating to any internal revenue tax liability, see section 601.202.

(4) *Bankruptcy and receivership.*—For limitations on the authority and functions of the Appellate Division in bankruptcy and receivership cases, see section 601.109.

SEC. 601.107. EXCESS PROFITS TAX COUNCIL; APPELLATE FUNCTIONS AND PROCEDURES UNDER SECTION 722 OF THE INTERNAL REVENUE CODE OF 1939.—(*a*) *General.*—(1) Subchapter E of chapter 2 of the Internal Revenue Code of 1939 imposed on corporations an excess profits tax based on their "adjusted excess profits net income" as defined in section 711 of such Code. This tax was effective as to taxable years beginning after December 31, 1939, and was repealed by the Revenue Act of 1945, with respect to taxable years beginning after December 31, 1945. Section 722 of the 1939 Code provides that if the taxpayer, pursuant to certain rules and standards in such section, establishes that the tax computed under subchapter E is excessive and discriminatory, relief under limitations contained in section 722 will be granted. The appellate functions of the Excess Profits Tax Council relate to the consideration and the determination of issues arising under section 722.

(2) The rules bearing upon the procedure applicable with respect to section 722 of the 1939 Code are found in Regulations 109 and Regulations 112 (26 CFR, 1938 Ed. and Supps., pt. 35). There has also been published "Bulletin on Section 722 of the Internal Revenue Code," copies of which may be obtained from the Superintendent of Documents, Government Printing Office, Washington 25, D. C. Practice and conference procedure before the Council is also governed by Treasury Department Circular 230 (31 CFR, pt. 10–14), and the requirements of subpart F.

(b) *Procedure.*—(1) To secure excess profits tax relief under section 722 of the 1939 Code an application therefor must be filed within the applicable period of time prescribed by section 322 of such Code.

The application is required to be filed in duplicate on Form 991, copies of which are obtainable at district directors' offices. The regulations promulgated under section 722 (see par. (*a*) (2) of this section) provide that an application must be filed for each year for which the benefits of section 722 are claimed and that only one section 722 application for any year may be filed. Such applications are required to be so framed as to adequately disclose the essential facts and issues involved.

(2) Applications for relief under section 722 are referred for investigation and consideration to section 722 field committees established at the offices of District Directors of Internal Revenue. After completion of investigation and consideration of an application for relief by a section 722 field committee, the taxpayer is afforded opportunity for a conference for the consideration of the committee's findings. After field committee consideration and conference with the taxpayer, the recommendations of the field committee are certified to the Excess Profits Tax Council for review. In the event that the taxpayer and the field committee cannot reach an agreement on the application or where an agreement between the taxpayer and the field committee is not approved by the Council, the taxpayer will be afforded an adequate opportunity to have its case heard before the Council.

(3) Determinations of the Council are subject to appeal to the Tax Court of the United States under the provisions of section 732 of the 1939 Code.

SEC. 601.108. REVIEW OF OVERASSESSMENTS EXCEEDING $100,000.—(*a*) *By Office of Chief Counsel.*—Determinations of overassessments (other than overassessments of alcohol, tobacco, and certain firearms taxes) with respect to any internal revenue tax exceeding $100,000 are subject to review by the Office of the Chief Counsel. If upon review of such a determination by the Office of the Chief Counsel that office questions the proposed overassessments, the taxpayer or his representative will ordinarily, if a legal question is involved, be advised by letter regarding such issue. Such letter will also advise the taxpayer or his representative that upon request a conference will be granted by the Office of the Chief Counsel at which time the taxpayer or his representative may appear and present his views regarding the issue.

(*b*) *Other applicable procedures.*—If agreement is reached with the taxpayer on the issues involved (including agreement with the Office of the Chief Counsel on any issues raised by that office), the taxpayer will be requested to file a letter stating his agreement with any proposed revision of the overassessment and the basis thereof, and also to agree in such letter to execute Form 870 or other appropriate agreement form accepting the revised proposed overassessment and not to file any further claims for refund, credit, or abatement with respect to any tax, penalty, or interest to which such proposed overassessment relates. In addition, the taxpayer may also be requested to execute at any time upon request a final closing agreement under section 7121 of the Code respecting the tax liability to which the proposed overassessment relates.

(*c*) *Certification or rejection of claimed overpayment.*—Section 6405 of the Code provides that no refund or credit of income, profits, estate or gift taxes in excess of $100,000 shall be made until after the

expiration of 30 days from the date upon which a report of the matter is made to the Joint Committee on Internal Revenue Taxation of Congress. After compliance with section 6405, the case will be processed for issuance of a certificate of overassessment, and payment or credit of any overpayment. If the final determination involves a rejection of a claimed overpayment, in whole or in part, a statutory notice of rejection will be sent by registered mail to the taxpayer. See section 6532(a)(1) of the Code.

SEC. 601.109. BANKRUPTCY AND RECEIVERSHIP CASES.—(*a*) *General.*—(1) Upon the adjudication of bankruptcy of any taxpayer in any liquidating proceeding or the approval of a petition of, or against, any taxpayer in any other proceeding under the Bankruptcy Act or the appointment of a receiver for any taxpayer in any receivership proceeding before a court of the United States or of any State or Territory or of the District of Columbia, the assessment of any deficiency in income, profits, estate, or gift taxes (together with all interest, additional amounts, or additions to the tax provided for by law) shall be made immediately. See section 6871 of the Code. In such cases the restrictions imposed by section 6213(a) of the Code upon assessments are not applicable. (In the case of an assignment for the benefit of creditors, the assessment will be made under section 6861, relating to jeopardy assessments. See sec. 601.105(h).) Cases in which immediate assessment will be made include those of taxpayers in receivership or in bankruptcy, agricultural composition, reorganization, arrangement, or wage earner proceedings under chapters I to VII, sections 75, 77, chapters X, XI, XII, and XIII of the Bankruptcy Act. The term "approval of a petition in any other proceeding under the Bankruptcy Act" includes the filing of a petition under section 75 or chapters XI to XIII of the Bankruptcy Act with a court of competent jurisdiction. A fiduciary in any proceeding under the Bankruptcy Act (including a trustee, receiver, debtor in possession, or other person designated by the court as in control of the assets or affairs of a debtor) or a receiver in any receivership proceeding may be required, as provided in regulations prescribed under section 6036 of the Code, to give notice in writing to the District Director of his qualification as such. Failure on the part of such fiduciary in a receivership proceeding or a proceeding under the Bankruptcy Act to give such notice, when required, results in the suspension of the running of the period of limitations on the making of assessments from the date of the institution of the proceeding to the date upon which such notice is received by the District Director, and for an additional 30 days thereafter. However, in no case where the required notice is not given shall the suspension of the running of the period of limitations on assessment exceed 2 years. See section 6872 of the Code.

(2) It is the duty of the District Director, promptly after ascertaining the existence of any outstanding Federal tax liability against a taxpayer in any proceeding under the Bankruptcy Act or receivership proceeding, and in any event within the time limited by appropriate provisions of law or the appropriate orders of the court in which such proceeding is pending, to file a proof of claim covering such liability in the court in which the proceeding is pending. Such a claim is filed whether the unpaid taxes involved have been assessed or not except in cases where departmental instructions direct otherwise. At

the same time claim is filed with the bankruptcy or receivership court, the District Director will send to the taxpayer notice and demand for payment together with a copy of such claim.

(3) After the institution of a railroad reorganization, corporate reorganization, or real property arrangement proceeding under section 77 and chapters X and XII of the Bankruptcy Act, copies of the proof of claim and all other information essential to the protection of the interests of the Government are transmitted to the Chief Counsel in the National Office where the Chief Counsel's legal functions in these proceedings are performed. In connection with strict bankruptcy liquidation proceedings, agricultural composition and extension proceedings, arrangement proceedings and wage earner plan proceedings, under chapters I to VII, section 75 and chapters XI and XIII of the Bankruptcy Act and with respect to receivership proceedings, decedent's estates, assignments for the benefit of creditors and other miscellaneous insolvency proceedings, the District Director retains all of such information until he concludes that legal action or advice of regional counsel is desirable, or necessary, in which event he refers the legal case to regional counsel.

(*b*) *Procedure in office of district director of internal revenue.*—(1) While the District Director is required by section 6871 of the Code to make immediate assessment of any deficiency in income, estate, or gift taxes, such assessment is not made as a jeopardy assessment (see sec. 601.105(*h*)), and the provisions of section 6861 do not apply to any assessment made under section 6871. Therefore, the notice of deficiency provided for in section 6861(*b*) will not be mailed to the taxpayer. Nevertheless, a letter (Form 7900) will be prepared and addressed in the name of the taxpayer, immediately followed by the name of the trustee, receiver, debtor in possession or other person designated by the court in which the bankruptcy or receivership proceeding is pending as in control of the assets or affairs of the debtor. Such letter will state how the deficiency was computed and advise that within 30 days a written protest under oath may be filed with the District Director showing wherein the deficiency is claimed to be incorrect, and that upon request an informal conference will be granted with respect to such deficiency. If, after protest is filed and any informal conference is held, adjustment appears necessary in the deficiency, appropriate action will be taken. Except where the interests of the Government require otherwise, Form 7900 letters are issued by the office of the District Director of Internal Revenue. If at the time of the adjudication of bankruptcy in a liquidating proceeding or the approval of a petition in any other proceeding under the Bankruptcy Act or appointment of a receiver a case was pending before the Tax Court of the United States, the prescribed Form 7900 letter will not advise the addressee of any right to file a protest or to request a conference in the office of the District Director. Protests must be filed in triplicate. In general, the procedure concerning informal conferences described in section 601.105(*c*) is also applicable to an informal conference held after the issuance of a Form 7900 letter, except that the examining agent's report may be prepared prior to such conference.

(2) The immediate assessment required by section 6871 of the Code represents an exception to the usual restrictions on the assess-

ment of Federal income, estate, and gift taxes. Since there are no restrictions on the assessment of Federal excise or employment taxes, immediate assessment of such taxes will be made in any case where section 6871 of the Code would require immediate assessment of income, estate, or gift taxes.

(3) If after such assessment a claim for abatement is filed and such claim is accompanied by a request in writing for a hearing, an informal conference in the office of the District Director of Internal Revenue will be granted. Ordinarily, only one conference will be held unless it develops that additional information can be furnished which has a material bearing upon the tax liability, in which event the conference will be continued to a later date.

(*c*) *Procedure before Appellate Division not applicable.*—A case involving immediate assessment under sectiton 6871 of the Code or an assessment of excise or employment taxes after an adjudication of bankruptcy in a liquidating proceeding or the approval of a petition in any other proceeding under the Bankruptcy Act or the appointment of a receiver will not be referred by the District Director to a field office of the Appellate Division. Therefore, the taxpayer, or the trustee, receiver, or debtor in possession or other person designated by the court as in control of the assets or affairs of the debtor, may not request consideration of the case by the Appellate Division. If at the time of the adjudication of bankruptcy or the approval of a petition or the appointment of a receiver an income, estate, or gift tax case is under consideration by a field office of the Appellate Division, whether before or after issuance of a statutory notice of deficiency, the case will be returned to the District Director for issuance of the Form 7900 letter and filing proof of claim in any proceeding under the Bankruptcy Act or in a receivership proceeding. Excise and employment tax cases pending in the Appellate Division at such time will likewise be returned to the District Director for filing proof of claim in any proceeding under the Bankruptcy Act or in a receivership proceeding. Thereafter, the case will not be transferred by the district director to the Appellate Division unless a petition for redetermination of the deficiency had been filed in the Tax Court prior to the adjudication of bankruptcy in a liquidating proceeding or the approval of a petition in any other proceeding under the Bankruptcy Act or the appointment of a receiver, and the taxpayer or the trustee, receiver, debtor in possession or other person designated by the bankruptcy or receivership court as in control of the debtor's assets or affairs elects to prosecute the proceeding in the Tax Court. A petition for redetermination of a deficiency may not be filed in the Tax Court after the adjudication of bankruptcy or the approval of a petition or the appointment of a receiver. See section 6871 (*b*). However, the Tax Court is not deprived of jurisdiction where the adjudication of bankruptcy or the approval of a petition or the appointment of a receiver occurred subsequent to the filing of the petition. In such a case the jurisdiction of the bankruptcy or receivership court and the Tax Court is concurrent.

(*d*) *Priority of claims.*—Under section 3466 of the Revised Statutes and section 3467 of the Revised Statutes, as amended, and section 64 of the Bankruptcy Act, taxes are entitled to the priority over other claims therein stated and the trustee, receiver, debtor in possession or

other person designated as in control of the assets or affairs of the debtor by the court in which the bankruptcy or receivership proceeding is pending may be held personally liable for failure on his part to protect the priority of the Government respecting taxes of which he has notice. Sections 75 (1), 77(e), 199, 337(2), 455, and 659(6) of the Bankruptcy Act also contain provisions with respect to the rights of the United States relative to priority of payment. Bankruptcy courts have jurisdiction under the Bankruptcy Act to determine all disputes regarding the amount and the validity of tax claims against a bankrupt or debtor in a proceeding under the Bankruptcy Act. A bankruptcy or receivership proceeding or an assignment for the benefit of creditors does not discharge any portion of a claim of the United States for taxes except in the case of a proceeding under section 77 or chapter X of the Bankruptcy Act; and any portion of a claim of the United States for taxes which has been allowed by the court in which the bankruptcy or receivership is pending and which remains unsatisfied after the termination of the proceeding shall be collected with interest in accordance with law.

SUBPART B—RULINGS AND OTHER SPECIFIC MATTERS

SEC. 601.201. RULINGS AND DETERMINATION LETTERS.—(*a*) *General policy and definitions.*—(1) It is the policy of the Internal Revenue Service to answer inquiries of individuals and organizations, whenever appropriate in the interest of sound tax administration, as to their status for tax purposes and as to the tax effects of their acts or transactions, prior to their filing of returns or reports as required by the internal revenue laws. One of the functions of the National Office of the Internal Revenue Service is the issuance of rulings on such matters. District Directors of Internal Revenue are authorized, as hereinafter provided, to issue determination letters within the scope of their functions in answer to taxpayers' inquiries or requests.

(2) The term "ruling" is used to describe a written statement issued by the National Office of the Internal Revenue Service which is an expression of the official interpretation or policy of the Office of the Commissioner of Internal Revenue. Rulings are issued by the Commissioner, or under his authority, and are intended to serve the purpose of establishing principles and policies of the Service in the interpretation and application of substantive tax law. Rulings are issued only by the National Office of the Internal Revenue Service. The Office of the Chief Counsel provides legal services and advice to the Commissioner and his staff in connection with rulings and closing agreements.

(3) The term "determination letter" is used to describe a written statement issued by a District Director of Internal Revenue in response to an inquiry by an individual or an organization, and solely by way of application to the facts involved in a particular inquiry or request of the principles and policies previously established by the National Office. Determination letters are issued only where a determination can be made on the basis of clearly established rules as set forth in the statute, Treasury decisions or regulations, or rulings, opinions or court decisions published in the Internal Revenue Bulletin. Where such a determination cannot be made (such as where the question presented involves a novel issue) or the matter is excluded from the

jurisdiction of a District Director of Internal Revenue by the provisions of this section, a determination letter will not be issued by the District Director.

(*b*) *Rulings issued by the National Office in Washington, D. C.*—(1) In income, profits, estate, and gift tax matters the National Office will exercise jurisdiction with respect to prospective transactions and with respect to completed transactions affecting returns to be filed, except that it will not ordinarily issue rulings to taxpayers or their representatives in connection with returns to be filed if the identical issue is also involved in a return or returns of the taxpayer already filed for a taxable period or periods with respect to which the statutory period of limitation on assessment or refund of tax has not expired.

(2) In employment and excise tax matters the National Office will exercise jurisdiction over requests for rulings received in the National Office whether such requests are received direct from the taxpayers or whether they are received through the office of a District Director of Internal Revenue, except that the National Office will not ordinarily issue a ruling to a taxpayer or his representative if it knows or has reason to believe that the issue is before the District Director in an active examination or audit of the liability of the taxpayer. Likewise, the National Office will not ordinarily take jurisdiction of an issue with respect to future action if it knows or has reason to believe that the identical issue is before the District Director in an active examination or audit of the liability of the taxpaper for a prior period.

(*c*) *Determination letters issued by District Directors of Internal Revenue.*—(1) In income, profits, estate, and gift tax matters District Directors of Internal Revenue are authorized to issue determination letters in response to taxpayers' requests submitted to their offices involving completed transactions only, which affect returns required to be filed in their districts, but only if the question presented is covered specifically by statute, Treasury decision or regulations, or specifically by a ruling, opinion, or court decision published in the Internal Revenue Bulletin. Determination letters will not usually be issued with respect to a question which involves an income, profits, estate, or gift tax return or returns to be filed by the taxpayer if the identical question is involved in a return or returns already filed by the taxpayer. District Directors of Internal Revenue are not authorized to issue determination letters as to the income, profits, estate, or gift tax consequence of prospective or proposed transactions, except as provided in subparagraph (4) of this paragraph.

(2) In employment and excise tax matters District Directors of Internal Revenue are authorized to issue determination letters in response to requests from taxpayers who have filed or who are required to file returns in the district over which they have jurisdiction, but only if the question presented is covered specifically by statute, Treasury decision or regulations, or specifically by a ruling, opinion, or court decision published in the Internal Revenue Bulletin.

(3) Notwithstanding the provisions of subparagraphs (1) and (2) of this paragraph, a District Director of Internal Revenue is not authorized to issue a determination letter in response to an inquiry, although presenting a question covered specifically by statute, regulations, or a ruling, etc., published in the Internal Revenue Bulletin, where (i) it appears that a similar inquiry from the taxpayer has been

directed to the National Office, (ii) the determination letter is requested by an industry, trade association, or similar group, or (iii) the request involves an industry-wide problem. A District Director of Internal Revenue is not authorized to issue a determination letter unless it is clearly indicated that the inquiry is with regard to a taxpayer or taxpayers in the district under the supervision of the District Director who receives the request. Notwithstanding the provisions of subparagraph (2) of this paragraph, the District Director of Internal Revenue is not authorized to issue a determination letter on an employment tax question when the specific question involved has been or is being considered by the National Office of the Social Security Administration, nor on an excise tax question if the request is for a determination of fair market price under sections 4216(b) and 4218 of the Code or for a determination of fair charges under sections 4281 or 4282 of the Code.

(4) District Directors of Internal Revenue are authorized to issue determination letters involving the status of plans and trusts under section 401 of the Code but are restricted to (i) the initial qualification of the plan under section 401 of the Code, and if trusteed, the status for exemption of the trust forming a part of the plan; (ii) amendments to the plan or trust; (iii) curtailment or termination of plan; and (iv) the effect of an investment of trust funds in stock or securities of the employer on the qualification of the plan. Such authority does not include determinations or opinions under section 402, 403, or 404 of the Code. See also paragraph (1) of this section.

(5) District Directors of Internal Revenue are authorized to issue determination letters involving the exempt status of an organization described in sections 501 and 521 of the Code with respect to the filing of returns and the payment of income tax. Such determination letters are restricted to routine determinations in which the application of the law to the facts shown on the exemption application is clear and which do not present an involved or questionable issue. Applications presenting involved or questionable issues will be forwarded by the District Directors of Internal Revenue to the National Office in Washington, D. C., for the issuance of a ruling. See also paragraph (*k*) of this section.

(6) A request received by a District Director of Internal Revenue with respect to a question involved in an income, profits, estate, or gift tax return or returns already filed will, in general, be considered in connection with the examination of the return or returns. However, if response to such inquiry is made prior to an examination or audit, it will not be considered a determination letter but will be considered a tentative finding in any subsequent examination or audit of the return.

(*d*) *Discretionary authority to issue rulings and determination letters.*—(1) Except as provided in subparagraph (2) of this paragraph, the Internal Revenue Service has discretionary authority to issue rulings or determination letters. This discretion will be exercised in the light of all relevant circumstances, including the business or other reasons motivating the transaction, and with a view to issuing rulings or determination letters only to the extent consistent with the proper administration of the internal revenue laws.

(2) Rulings will be made in the National Office on prospective transactions where the law or regulations provide for a determination of the effect of a proposed transaction for tax purposes, as in the case of a transfer coming under the provisions of chapter 5 of the Code, or an exchange coming under the provisions of section 367 of the Code.

(*e*) *Questions on which no ruling or determination letter will be issued.*—In addition to the other situations described in this section, rulings or determination letters ordinarily will not be issued in connection with income, profits, estate, and gift tax matters where the determination requested is primarily one of fact, e. g., (1) market value of property, (2) whether compensation is reasonable in amount, (3) whether a transfer is one in contemplation of death, (4) whether retention of earnings and profits by a corporation is for the purpose of avoiding surtax on its shareholders, or (5) whether a transfer or acquisition is within section 1551 or section 269 of the Code.

(*f*) *Instructions with respect to submission of requests for rulings or determination letters.*—(1) Requests for determination letters and rulings should be submitted in duplicate if more than one issue is presented in the request. Requests relating to prospective transactions should not contain alternative plans. Each request for a determination letter or a ruling on either a prospective transaction or a completed transaction must include the following:

(i) A complete statement of the facts regarding the transaction, including the names and addresses of all interested parties, together with a copy of each contract or other document necessary to present such facts. (Inasmuch as exhibits and documents will be retained in the Service files, original documents should not be furnished.) If the subject matter is a corporate reorganization, distribution, or similar related transaction, there should also be submitted the corporate balance sheet nearest the date of the transaction (the most recent balance sheet if the transaction is prospective).

(ii) A full and precise statement of the business reasons, if any, for the transaction.

(iii) If the taxpayer is contending for a particular determination, an explanation of the ground for such contention, together with a memorandum of relevant authorities.

(2) If the request is with respect to the qualification of an organization described in section 501 or 521 of the Code for exemption from Federal income tax, see paragraph (*k*) of this section. If the request is with respect to the qualification of a plan under section 401 of the Code, see paragraph (*l*) of this section.

(3) A request by or on behalf of a taxpayer must be signed by the taxpayer or his duly authorized representative. (For provisions relating to powers of attorney and enrollment, see subpart E.) Requests with respect to matters on which a ruling is desired from the National Office should be addressed to the Commissioner of Internal Revenue, Washington 25, D. C. Requests with respect to matters on which a determination letter from a District Director of Internal Revenue is desired should be addressed to the office of the District Director in which the tax return of the taxpayer has been filed or is required to be filed. In this connection see paragraphs (*k*) and (*l*) of this section.

(4) It is the practice of the Service to process requests for rulings or determination letters in regular order and as expeditiously as possible. Compliance with a request for consideration of a particular matter ahead of its regular order tends to delay the disposition of other matters. However, requests for processing ahead of the regular order, made in writing and showing clear need for such treatment, will be given consideration as the particular circumstances warrant.

(*g*) *Withdrawal of requests.*—Requests for a ruling or a determination letter may be withdrawn at any time prior to the signing of the letter of reply. The withdrawal of the request, however, will not prevent the National Office from furnishing its views to the District Director in whose office the return has been or will be filed. Neither shall such withdrawal prevent a District Director of Internal Revenue from considering the information submitted in a subsequent audit or examination of the taxpayer's return. Even though a request is withdrawn all correspondence and exhibits shall be retained in the files of the Internal Revenue Service and may not be returned to the taxpayer.

(*h*) *Oral advice to taxpayers.*—It is the policy of the Service not to issue rulings or determination letters upon oral request. For reasons of sound administration, oral opinions or advice given to taxpayers by employees or officers of the Internal Revenue Service are considered as aids to taxpayers only.

(*i*) *Effect of rulings.*—(1) Generally no statement by any official of the Internal Revenue Service, other than a closing agreement under section 7121 of the Code (see sec. 601.202), is final and conclusive upon the Internal Revenue Service. However, see subparagraphs (2), (3), and (4) of this paragraph.

(2) As part of the determination of a taxpayer's liability, District Directors will ascertain whether any ruling previously issued to the taxpayer has been properly applied. Thus, it will be determined whether the representations upon which the ruling was based reflected an accurate statement of the material facts and whether the transaction actually was carried out substantially as proposed.

(3) If, in the course of the determination of the tax liability, it is the view of the District Director that a ruling previously issued to the taxpayer should be modified or revoked, the findings and recommendations of the District Director will be forwarded to the National Office for consideration of the matter prior to further action.

(4) A ruling found to be in error or no longer in accord with the position of the Internal Revenue Service may be modified or revoked. However, it is the general policy of the Internal Revenue Service to limit the revocation or modification of a ruling issued to, or with respect to, a particular taxpayer to a prospective application only, if (i) there has been no misstatement or omission of material facts, (ii) the facts subsequently developed are not materially different from the facts on which the ruling was based, (iii) there has been no change in the applicable law, and (iv) such taxpayer acted in good faith in reliance upon such ruling and a retroactive revocation would be to his detriment.

(5) With respect to rulings published in the Internal Revenue Bulletin, it is the general policy of the Service that taxpayers may rely upon such rulings in determining the rule applicable to their own transactions and need not request a specific ruling applying the prin-

ciples of the published ruling to the facts of the taxpayer's particular case where otherwise applicable. See, however, subparagraph (7) of this paragraph. In the event of revocation or modification of a ruling published in the Internal Revenue Bulletin, it is the general practice of the Service to make such revocation or modification prospective only.

(6) Under the provisions of section 1108(b) of the Revenue Act of 1926, a ruling holding that the sale or lease of a particular article is subject to the manufacturers' excise or the retailers' excise tax must be limited in its retroactive application in any case, where (i) such ruling reverses a prior ruling holding the particular article to be nontaxable, and (ii) the taxpayer in reliance upon such ruling parted with possession or ownership of such article without passing the tax on to his customer.

(7) Since each ruling represents the conclusion of the Service as to the application of the law to the entire state of facts involved, taxpayers and others concerned are cautioned against reaching the same conclusion in other cases unless the facts and circumstances are substantially the same. Furthermore, taxpayers and others concerned should, in this connection, consider the effect of subsequent legislation, regulations, court decisions, and rulings.

(*j*) *Effect of determination letters.*—A determination letter issued by a District Director, in accordance with this section, will be given the same effect upon examination of the return of the taxpayer to whom the determination letter was issued as is described in paragraph (i) of this section, except that reference to the National Office is not necessary where, upon the examination of the return, it is the opinion of the District Director that a conclusion contrary to that expressed in the determination letter is indicated. A District Director of Internal Revenue, however, is not authorized to limit the revocation of a determination letter to a prospective application only, but may refer the matter to the National Office for exercise by the Commissioner, or his delegate, of the authority so to limit the revocation.

(*k*) *Organizations claiming exemption under section 501 or 521 of the Code.*—(1) Any organization claiming exemption under section 501 or 521 of the Code, unless already in receipt of a determination letter or ruling letter from the Internal Revenue Service establishing exemption, is required by Treasury Department regulations to file an application for exemption with the District Director of Internal Revenue for its district. If such application is filed with any office of the Internal Revenue Service other than that prescribed by the regulations, it will, without any action thereon, be forwarded immediately to the appropriate District Director's office.

(2) In view of the statutory requirements for exemption and the administrative responsibilities of the Service in the field of exempt organizations, a determination or ruling on an application for exemption will generally not be made with respect to a newly formed organization until it has actually operated for such a period and to such an extent as to clearly demonstrate a bona fide operation for the purposes specified in the exemption statute. Exceptions to this general rule are stated in subparagraphs (4), (5), and (6) of this paragraph.

(3) Except as otherwise provided in subparagraphs (4), (5), and (6) of this paragraph, an application should not be filed by an organi-

zation until it has had at least 12 months of active operation (not mere existence) for the purposes for which it was created in order to clearly demonstrate by actual operation for such a period that in fact the organization is conducted for purposes within the exemption provisions of the Code.

(4) A tentative determination letter may be issued by a District Director to a newly formed organization with less than 12 months of active operation in a case in which an affirmative showing is made (in or in connection with the exemption application) that the organization is of the community or public type. Tentative rulings will be issued by the National Office upon the same standards. Factors which characterize a community or public organization include responsible public representation on its board of directors or trustees, financial support provided by public contributions, or required reporting to a governmental or public body assuring the organization's adherence to the purposes for which it was formed. Where the facts clearly establish that the organization is of the community or public type, the District Director may issue a tentative determination letter with the requirement that the organization at the termination of its first full year of operation submit a new application, together with complete supporting data as specified in the application form or in the applicable regulations.

(5) The provisions of subparagraph (4) shall not be deemed to limit the authority of a District Director, in cases where the liability of an organization for certain other Federal taxes is dependent on a determination under, or similar to that under, section 501 (such as in the case of certain exemptions under the admissions tax), to make a tentative determination of the status of the organization for purposes of such other taxes, pending and subject to a determination or ruling on the organization's application for exemption under section 501. However, for income tax purposes, unless the exemption application filed under such circumstances by an organization with less than 12 months of active operation makes an affirmative showing that the organization is of the community or public type, it will be returned as incomplete and a determination or ruling as to the status of the organization under section 501 for purposes of income tax will not be made until the organization has had at least 12 months active operation.

(6) Determination letters allowing exemption under section 501(a) of the Code will be issued to State chartered credit unions described in section 501(c)(14) of the Code at any time after their formation if they operate under uniform bylaws approved by the State.

(7) A list of organizations, contributions to which are deductible under section 23(o) and (q) of the 1939 Code (sec. 170 of the 1954 Code), is available for purchase from the Superintendent of Documents, United States Government Printing Office, Washington 25, D. C.

(*l*) *Employees' trusts or plans.*—(1) Determination letters as to the qualification of pension, annuity, profit-sharing, and stock bonus plans under section 401 of the Code are issued if requested by taxpayers. Such determination letters are issued with respect to consummated or proposed transactions relating to the initial qualification of a plan and, if trusteed, the status for exemption of the trust forming a part thereof; amendments to plans and trusts; curtailments and terminations of plans; and the effect on qualification of the plan of an

investment of trust funds in the stock or securities of the employer. Rulings and determination letters under sections 402 and 403 of the Code are issued with respect to the taxability of a beneficiary, the treatment of the beneficiary of a nonexempt trust and the treatment of certain employees' annuities. Rulings and determination letters under section 404 of the Code are issued with respect to the application of pertinent principles of such section.

(2) Requests for determination letters under section 401 of the Code should be filed with the District Director of Internal Revenue having jurisdiction, determined as follows:

(i) In the case of a plan of a single employer, where the principal place of business of such employer is located;

(ii) In the case of a plan of a parent and subsidiary companies, where the principal place of business of the parent company is situated regardless of whether consolidated returns are filed;

(iii) In the case of an industry-wide plan (a plan established in a particular industry by all subscribing employers, some of whom are located within the jurisdiction of more than one District Director's office), where the trustee's principal place of business is located or, if more than one trustee, where the usual place of meeting of the trustees is held;

(iv) In the case of a plan of multiple employers not provided for in the categories set forth in clauses (ii) and (iii) above, where the trustee's principal place of business is located or, if more than one trustee, or if non-trusteed, where the usual place of meeting of the trustees or principal supervisors is held. Such District Director is authorized, subject to review by the National Office, to issue determination letters as to the status of the plans and trusts under section 401 of the Code. All requests for determination letters as to the status of the plan or trust should be accompanied by duplicate statements of all pertinent information. Requests for rulings under sections 402, 403, and 404 of the Code should be submitted to the Commissioner of Internal Revenue, Washington 25, D. C. However, in this connection see paragraph (*c*) of this section with respect to determination letters on these issues.

(3) Treasury Department regulations relating to income taxes set forth the information required to be submitted in connection with certain types of inquiries relating to pension, annuity, profit-sharing, and stock bonus plans.

(*m*) *Conferences.*—A conference requested by a taxpayer in writing at the time his request for a ruling or a determination letter is filed or shortly thereafter will be granted at that stage in the consideration of the case when it will be most helpful. The taxpayer or his representative should not request that the conference be deferred until Internal Revenue Service action (whether or not in accord with the taxpayer's contention) is imminent. More than one conference should not be sought unless the taxpayer has important new matter to present, or unless the problems involved require the consideration of the case by different divisions or offices of the Internal Revenue Service. This conference rule shall apply with respect to any request for a determination letter which is referred to the National Office for a ruling, including paragraph (*k*) (4) of the section. Taxpayers and their

representatives are required to fulfill the conference and practice requirements of the Internal Revenue Service (see subpart E).

SEC. 601.202. CLOSING AGREEMENTS.—(*a*) *General.*—(1) Under section 7121 of the Code and the regulations thereunder the Commissioner, or any officer or employee of the Internal Revenue Service authorized in writing by the Commissioner, may enter into and approve a written agreement with any person relating to the liability of such person (or of the person or estate for whom he acts) in respect of any internal revenue tax for any taxable period. Such agreement, except upon a showing of fraud or malfeasance, or misrepresentation of a material fact, shall be final and conclusive.

(2) Closing agreements under section 7121 of the Code may relate to any taxable period ending prior or subsequent to the date of the agreement. With respect to taxable periods ended prior to the date of the agreement, the matter agreed upon may relate to the total tax liability of the taxpayer or it may relate to one or more separate items affecting the tax liability of the taxpayer. A closing agreement may also be entered into in order to provide a "determination," as defined in section 1313 of the Code, and for the purpose of allowing a deficiency dividend deduction under section 547 of the Code. With respect to taxable periods ending subsequent to the date of the agreement, the matter agreed upon may relate to one or more separate items affecting the tax liability of the taxpayer. A closing agreement with respect to any taxable period ending subsequent to the date of the agreement is subject to any change in or modification of the law enacted subsequent to the date of the agreement and applicable to such taxable period, and each closing agreement shall so recite. Closing agreements may be entered into even though under the agreement the taxpayer is not liable for any tax for the period to which the agreement relates. There may be a series of agreements relating to the tax liability for a single period. A closing agreement may be entered into in any case in which there appears to be an advantage in having the case permanently and conclusively closed, or where good and sufficient reasons are shown by the taxpayer for desiring a closing agreement and it is determined by the Commissioner or his representatives that the Government will sustain no disadvantage through consummation of such an agreement.

(*b*) *Use of prescribed forms.*—In cases in which it is proposed to close conclusively the total tax liability for a taxable period ended prior to the date of the agreement, Form 866, Agreement as to Final Determination of Tax Liability, will be used. In cases in which agreement has been reached as to the disposition of one or more issues and a closing agreement is considered necessary to insure consistent treatment of such issues in any other taxable period, Form 906, Closing Agreement as to Final Determination Covering Specific Matters, generally will be used. A request for a closing agreement which relates to a past period (Form 866 or Form 906) may be submitted at any time before the case is docketed in the Tax Court of the United States. The request should be submitted to the District Director of Internal Revenue with whom the return for the period involved was filed, or if the matter to which the request relates is pending before an office of the Appellate Division, the request should be submitted to such office. A request for a closing agreement which relates to a

subsequent period should be submitted to the Commissioner of Internal Revenue, Washington 25, D. C.

(*c*) *Review and approval.*—All closing agreements initiated in the field offices are reviewed in the Appellate Division in Washington. After review in the Appellate Division proposed closing agreements are referred to the Office of the Commissioner for consideration. Proposed closing agreements which are acceptable to the Service are finally approved by the Commissioner or other officer to whom such authority has been delegated. After approval of a closing agreement affecting or relating to tax liability for a period ending subsequent to the date of the agreement, the appropriate regional commissioner or District Director is fully advised as to the basis of the agreement in order that, through maintenance of proper controls, the Government may be insured against loss through failure to give effect to all the terms thereof in the determination of taxes for periods ending subsequent to the date of the agreement.

(*d*) *Applicability of ruling requirements.*—The requirements relating to rulings (see sec. 601.201) shall be applicable with respect to requests for closing agreements, whether for closing agreements with respect to total tax liability (Form 866) or for closing agreements with respect to a determination as to one or more separate issues affecting the tax liability of a taxpayer (Form 906).

SEC. 601.203. OFFERS IN COMPROMISE.—(*a*) *General.*—(1) Under section 7122 of the Code the Commissioner may compromise any civil or criminal case arising under the internal revenue laws prior to reference to the Department of Justice for prosecution or defense. Certain functions of the Commissioner with respect to compromises of civil cases involving liability under $500 have been delegated to District Directors of internal revenue. See par. (C) of this section. In civil cases involving liability of $500 or over and in criminal cases the functions of the General Counsel are performed by the Chief Counsel for the Internal Revenue Service.

(2) An offer in compromise of taxes, interest, ad valorem penalties, or specific penalties may be based on either inability to pay or doubt as to liability. Offers in compromise arise usually when payments of assessed liabilities are demanded, ad valorem penalties for delinquency in filing returns are asserted, or specific civil or criminal penalties are incurred by taxpayers. A criminal liability will not be compromised unless it involves only the regulatory provisions of the Internal Revenue Code and related statutes. However, if the violations involving the regulatory provisions are deliberate and with intent to defraud, the criminal liabilities will not be compromised.

(*b*) *Use of prescribed forms.*—Offers in compromise are required to be submitted on Form 656 or Form 656–C, properly executed, accompanied by a financial statement on Form 433. Form 656 is used in all cases where the amount of the offer is tendered in full at the time the offer is filed, and Form 656–C is used where the amount of the offer is to be paid by deferred payment or payments. Copies of these forms may be obtained from District Directors of Internal Revenue. An offer in compromise should be filed with the District Director charged with the duty of collecting the tax sought to be compromised.

(c) *Consideration of offer.*—(1) An offer in compromise is first considered by the District Director with whom the offer is filed. An internal revenue agent, after investigation of the financial condition of the taxpayer, makes a written recommendation for acceptance or rejection of the offer. If the District Director has jurisdiction over the processing of the offer he will—

(i) Reject the offer, or

(ii) Accept the offer if it involves a civil liability under $500, or

(iii) Recommend to the National Office the acceptance of the offer if it involves a liability of $500 or over.

If the District Director does not have jurisdiction over the entire processing of the offer, the offer is transmitted to the appropriate Regional Counsel if the case is one in which:

(a) Recommendations for prosecution are pending in the Office of the Chief Counsel, the Department of Justice, or in an office of a United States attorney including cases in which criminal proceedings have been instituted but not disposed of and related cases in which offers in compromise have been submitted or are pending;

(b) The taxpayer is in receivership or is involved in a proceeding under any provision of the Bankruptcy Act;

(c) The taxpayer is deceased (without regard to the class of tax involved);

(d) A proposal is made to discharge property from the effect of a tax lien or liens;

(e) An insolvent bank is involved;

(f) An assignment for the benefit of creditors is involved;

(g) A liquidation proceeding is involved; or

(h) Court proceedings are pending, except Tax Court cases.

(1) The Regional Counsel considers and processes offers submitted in cases described in subdivisions (a) through (h) of this subparagraph with the exception of offers submitted in those cases being handled in the Office of the Chief Counsel in Washington. Where a case described in subdivisions (a) through (h) of this subparagraph is being handled in the Office of the Chief Counsel in Washington, consideration and processing of the offer is accomplished in Washington, D. C.

(2) In those cases described in subdivision (a) of this subparagraph no investigation will be made unless specifically requested by the office having jurisdiction of the criminal case.

(3) In those cases described in subdivisions (b) through (h) of this subparagraph the district director retains the duplicate copy of the offer and the financial statement for investigation. After investigation, the District Director transmits to the appropriate Regional Counsel for consideration and processing his recommendation for acceptance or rejection of the offer together with the internal revenue agent's report of his investigation.

(4) An offer under the processing jurisdiction of the Regional Counsel which is considered acceptable is either referred to the district director or to the Office of the Chief Counsel in Washington for approval, depending upon whether the amount of civil liability involved is under $500 or $500 or more.

(2) The District Directors and the Director of the Audit Division of the National Office are authorized to reject any offer in compromise referred for their consideration. Offers considered in the Office of the Chief Counsel in Washington which are not acceptable are rejected by the Commissioner. Offers considered by Regional Counsel which are not acceptable are rejected by District Directors. If an offer is not acceptable, the taxpayer is promptly notified of the rejection of the offer. If an offer is rejected, the sum submitted with the offer is returned by the District Director to the proponent. An offer rejected by a District Director is surveyed in the Audit Division in the National Office.

(3) If an offer other than one accepted by the District Director is considered acceptable by the office having jurisdiction over the offer, a recommendation for acceptance is forwarded to the Audit Division in the National Office for review. If the Audit Division approves the recommendation for acceptance, the offer is forwarded to the Office of the Chief Counsel for approval. After approval by the Office of the Chief Counsel, it is forwarded to the Commissioner for acceptance. The taxpayer is notified of the acceptance of the offer in accordance with its terms. Acceptance of an offer in compromise of civil liabilities does not remit criminal liabilities, nor does acceptance of an offer in compromise of criminal liabilities remit civil liabilities.

(*d*) *Conferences.*—Before filing a formal offer in compromise, a taxpayer may request a conference in the office which would have jurisdiction of the offer filed by him for the purpose of exploring the possibilities of compromising the unpaid Federal tax liability. A conference may also be requested by the taxpayer in the office which has jurisdiction of the offer filed by him after all investigations have been made for the purpose of determining the amount which may be accepted as a compromise. Where the offer is one with respect to which the District Director has processing jurisdiction and the proponent does not agree with the rejection or proposed rejection, and neither the internal revenue agent nor the conferee of the District Director's office has been able to convince the proponent of the correctness of the conclusion reached, the proponent will be apprised of his privilege of submitting a request in writing for a hearing before the Chief of the Appellate Division of the region. Taxpayers and their representatives are required to fulfill and comply with the conference and practice requirements of the Internal Revenue Service (see secs. 601.501–601.512).

SEC. 601.204. CHANGES IN ACCOUNTING PERIODS AND IN METHODS OF ACCOUNTING.—(*a*) *Accounting periods.*—A taxpayer who changes his accounting period shall, before using the new period for income tax purposes, comply with the provisions of the income tax regulations relating to changes in accounting periods. In cases where the regulations require the taxpayer to secure the consent of the Commissioner to the change, the application for permission to change the accounting period shall be made on Form 1128 and shall be submitted to the Commissioner of Internal Revenue, Washington 25, D. C., within the period of time prescribed in such regulations. See section 442 and the regulations thereunder (under the 1939 Code, sec. 39.46–1 of Regs. 118). If the change is approved by the Commissioner, the taxpayer

shall thereafter make his returns and compute his net income upon the basis of the new accounting period. A request for permission to change the accounting period will be considered by the Tax Rulings Division of the National Office.

(*b*) *Methods of accounting.*—A taxpayer who changes the method of accounting employed in keeping his books shall, before computing his income upon such method for purposes of income taxation, comply with the provisions of the income tax regulations relating to changes in accounting methods. The regulations require that, in the ordinary case, the taxpayer secure the consent of the Commissioner to the change. See section 446 and the regulations thereunder (under the 1939 Code, sec. 39.41–2 of Regs. 118). Application for permission to change the method of accounting employed and the basis upon which the return is made shall be filed with the Commissioner of Internal Revenue, Washington 25, D. C., within the period of time prescribed in the regulations. The application shall be accompanied by a statement specifying the classes of items differently treated under the two methods and specifying all amounts which will be duplicated or entirely omitted as a result of the proposed change. Permission to change the method of accounting will not be granted unless the taxpayer and the Commissioner agree to the terms and conditions under which the change will be affected. The request will be considered by the Tax Rulings Division, except that if the proposed change relates to depletion, depreciation or obsolescence the request will be considered by the Special Technical Services Division.

SEC. 601.205. TORT CLAIMS.—Claims for property loss or damage, personal injury, or death caused by the negligent or wrongful act or omission of any employee of the Service, acting within the scope of his office or employment, filed under the Federal Tort Claims Act, as amended, must be prepared and filed in accordance with Treasury Department regulations entitled "Central Office Procedures" and "Claims Regulations" (31 CFR, pts. 1 and 3). Such regulations contain the procedural and substantive requirements relative to such claims, and set forth the manner in which they are handled. The claims should be filed with the Commissioner of Internal Revenue, Washington 25, D. C., and must be filed within 2 years after the accident or incident occurred.

SUBPART C.—PROVISIONS RELATING TO ALCOHOL, TOBACCO, AND CERTAIN FIREARMS

SEC. 601.301. IMPOSITION OF TAXES, QUALIFICATION REQUIREMENTS, AND REGULATIONS—(a) *Imposition of taxes.*—Subchapter A, of chapter 51 of the Internal Rvenue Code of 1954 imposes taxes on distilled spirits (including alcohol), wine, and beer. Except as specifically provided, additional taxes are imposed when distilled spirits and wine are rectified by blending, compounding, etc. Subchapter A of chapter 51 of the Code also imposes taxes on stills, and condensers used to produce spirits. Occupational taxes are imposed upon still manufacturers, brewers, rectifiers, dealers in liquors, and as a prerequisite for drawback under section 5134 of the Code, upon manufacturers of nonbeverage products.

(b) *Qualification requirements.*—Distillers, winemakers, brewers, warehousemen, denaturers, rectifiers, bottlers, liquor bottle manu-

facturers, dealers in specially denatured alcohol, users and transporters of tax-free and specially denatured alcohol, and wholesalers and importers of liquors, are required to qualify with the Internal Revenue Service, usually by filing notice or application and bond with, and procuring permit from, the assistant regional commissioner (alcohol and tobacco tax) of the region in which operations are to be conducted. Detailed information respecting such qualification, including the forms to be used and the procedure to be followed, is contained in the respective regulations described in paragraph (c) of this section.

(c) *Regulations.*—The procedural requirements with respect to matters relating to liquors which are within the jurisdiction of the Alcohol and Tobacco Tax Division are published in the regulations described in this paragraph. These regulations contain full information as to the general course and method by which the functions concerning liquors are channeled and determined, including the nature and requirements of formal and informal procedures, the forms and other documents required and the contents of applications, notices, registrations, permits, bonds, and other documents. Copies of prescribed forms may be obtained from the offices of assistant regional commissioners (alcohol and tobacco tax) excepting Forms 45, 52–A, 52–B, 52–C, 52–D, 52–E, 52–F, 122, 230, 237, 338, 2051, and 2054–2060, and Records 133 and 134 which may be purchased from commercial printers, who may procure specimen copies of the forms from such offices. The following is a brief description of the several regulations arranged according to the principal subjects and operations concerned:

(1) *Production and disposition of industrial alcohol.*—Part 182, 26 CFR, contains the regulations relative to the production, disposition, and use of industrial alcohol, including denatured alcohol. The regulations cover the establishment and operation of industrial alcohol plants, bonded warehouses, and denaturing plants, the production, taxpayment, transfer, exportation, and denaturation of alcohol, formulas for denaturation, the use of alcohol free of tax, the sale and use of denatured alcohol, the transportation of tax-free and specially denatured alcohol, the packaging, labeling, and sale of articles containing denatured alcohol, and the bringing into this country of alcohol and articles containing alcohol. The regulations also cover the issuance of permits covering the production of alcohol and denatured alcohol, the sale of specially denatured alcohol, and the transportation and use of tax-free and specially denatured alcohol.

(2) *Production and removal of distilled spirits.*—Part 220, 26 CFR, contains the regulations relative to the production of distilled spirits and the removal thereof from a registered distillery. The regulations cover the location, construction and equipment of the distillery; action by the assistant regional commissioner (alcohol and tobacco tax) in connection with the establishment and operation of the distillery; control and supervision of the distillery; production and removal of distilled spirits; and concern the sale, shipment, losses, records and reports, of distilled spirits. The term "distilled spirits" includes whisky, brandy, rum, gin and spirits, but excludes alcohol. (The production of rectified products, such as blended whisky, liqueurs and cordials, is governed by Part 235, 26 CFR.)

(3) *Production and removal of brandy.*—Part 221, 26 CFR, contains the regulations relative to the production of brandy and the removal thereof from a fruit distillery under the exemptions from certain provisions of law as provided in such regulations pursuant to section 5215 of the Code. The regulations cover the location, construction and equipment of the distillery; action by the assistant regional commissioner (alcohol and tobacco tax) in connection with the establishment and operation of the distillery; control and supervision of the distillery; production and removal of brandy; and concern the sale, shipment, losses, records and reports, of brandy.

(4) *Warehousing and bottling in bond of distilled spirits.*—Part 225, 26 CFR, contains the regulations relative to the warehousing of distilled spirits (other than alcohol), and the bottling in bond, taxpayment and withdrawal thereof from internal revenue bonded warehouses. The regulations cover the location, construction and equipment of the warehouse; action by the assistant regional commissioner (alcohol and tobacco tax) in connection with the establishment and operation of the warehouse; control, custody, and supervision of the warehouse; deposit of spirits in the warehouse; losses of spirits in the warehouse or in transit thereto; withdrawal of distilled spirits from the warehouse for taxpaid or tax-free purposes; bottling of spirits in bond; alternate operations of bottling-in-bond department as taxpaid bottling house; transfers in bond between internal revenue bonded warehouses; exportation and shipment of distilled spirits; and records and reports of distilled spirits deposited, stored, bottled in bond, and withdrawn from internal revenue bonded warehouses.

(5) *Bottling of taxpaid distilled spirits.*—Part 230, 26 CFR, contains the regulations relative to the bottling of taxpaid distilled spirits. The regulations cover the location, construction and equipment of the bottling house; alternate operations of the taxpaid bottling house as a bottling-in-bond department of an internal revenue bonded warehouse; the bottling of distilled spirits under trade names; action by the assistant regional commissioner (alcohol and tobacco tax) in connection with the establishment and operation of the bottling house; the operation and supervision of the taxpaid bottling house; the transfer of spirits to the taxpaid bottling house; the dumping, bottling, rebottling, labeling, relabeling, stamping, and restamping of bottled spirits; the removal of spirits from the taxpaid bottling house for exportation and shipment; and records and reports of spirits bottled at the taxpaid bottling house.

(6) *Rectification of distilled spirits and wines.*—Part 235, 26 CFR, contains the regulations relative to the rectification of spirits and wines. The regulations cover the location, construction and equipment of the rectifying plant; action by the assistant regional commissioner (alcohol and tobacco tax) in connection with the establishment and operation of the rectifying plant; the operation and supervision of the rectifying plant; the receipt, dumping, rectification, bottling, rebottling, packaging, stamping, restamping, labeling and relabeling of spirits; the removal of spirits from the rectifying plant; special taxes; and records and reports of operations at rectifying plants.

(7) *Gauging of alcohol and distilled spirits.*—Part 186, 26 CFR, contains the regulations for measuring alcohol at industrial alcohol

plants, bonded warehouses and denaturing plants and distilled spirits at registered distilleries, fruit distilleries, internal revenue bonded warehouses, rectifying plants and taxpaid distilled spirits bottling houses.

(8) *Manufacture and use of containers for distilled spirits.*—Part 175, 26 CFR, contains the regulations relative to the traffic in containers of distilled spirits. The regulations cover the manufacture and sale of bottles for packaging distilled spirits; use of bottles for packaging distilled spirits; reports and inventories of liquor bottles; imports and exports of liquor bottles; labeling of distilled spirits; permits and revocaton proceedings; and the purchase, sale and possession of used containers.

(9) *Labeling and advertising of distilled spirits.*—Regulations No. 5 (27 CFR, Part 5), issued under the Federal Alcohol Administration Act, as amended, contain the requirements relative to the labeling and advertising of distilled spirits, including standards of identity for distilled spirits, standards of fill for bottled distilled spirits, and the issuance of certificates of label approval and certificates of exemption from label approval.

(10) *Denaturation of rum.*—Part 216, 26 CFR, contains the regulations relative to the denaturation of rum and its withdrawal from the distillery denaturing bonded warehouse. The regulations cover the location, construction and equipment of the distillery denaturing bonded warehouse; action by the assistant regional commissioner (alcohol and tobacco tax) in connection with the establishment and operation of the warehouse; the control, custody, and supervision of the warehouse; transfer of rum to the warehouse; the denaturation of rum; the disposition of denatured rum; and the use, exportation, shipment, losses, records and reports, of rum and denatured rum.

(11) *Production and removal of beer.*—Part 245, 26 CFR, contains the regulations relative to the production, taxpayment, and withdrawal from breweries of beer and cereal beverages. The regulations cover the location and use of breweries, brewery construction, equipment and meters; action by the assistant regional commissioner (alcohol and tobacco tax) in connection with the establishment and operation of the brewery; special taxes; tax on beer; marks, and brands; exportation, free of tax, of beer; use of beer as supplies on vessels and aircraft; and the maintenance of records and filing of reports in connection with the foregoing operations and conditions.

(12) *Labeling and advertising of malt beverages.*—Regulations No. 7 (27 CFR, Part 7), issued under the Federal Alcohol Administration Act, as amended, contain the requirements relative to the labeling and advertising of malt beverages, including the withdrawal of imported malt beverages from customs custody and the issuance of certificates of label approval and release for imported malt beverages, and certificates of approval of labels for malt beverages domestically bottled or packed.

(13) *Production and removal of wine.*—Part 240, 26 CFR, contains the regulations relative to the establishment and operation of bonded wine cellars, including bonded wineries, for the production, cellar treatment, and storage of wines, including amelioration, sweetening, addition of wine spirits, blending, and other cellar treatment; the taxpayment, exportation, and use of wine for distilling material and manufacture of vinegar.

(14) *Bottling of taxpaid wine.*—Part 231, 26 CFR, contains the regulations relative to the bottling of taxpaid wine at premises other than rectifying plants and taxpaid distilled spirits bottling houses. The regulations cover the establishment and operation of taxpaid wine bottling houses for the bottling and packaging of taxpaid United States and foreign wines, including the bottling or packaging of wine under trade names.

(15) *Labeling and advertising of wine.*—Regulations No. 4 (27 CFR, Part 4), issued under the Federal Alcohol Administration Act, as amended, contain the requirements relative to the labeling and advertising of wine under the Federal Alcohol Administration Act, including standards of identity for wine, standards of fill for containers of wine, and the issuance of certificates of label approval and certificates of exemption from label approval.

(16) *Bulk sales and bottling of distilled spirits.*—Regulations No. 3 (27 CFR, Part 3), issued under the Federal Alcohol Administration Act, as amended, contain the requirements relative to bulk sales and bottling of distilled spirits under the Federal Alcohol Administration Act, including the terms of warehouse receipts for distilled spirits in bulk.

(17) *Wholesale and retail dealers in liquors.*—Part 194, 26 CFR, contains the regulations relative to the payment of occupational taxes by liquor dealers, maintenance of records, destruction of marks on containers, and packaging of alcohol for industrial purposes.

(18) *Removals of alcoholic liquors, tobacco products and other articles of domestic manufacture to foreign-trade zones.*—Part 253, 26 CFR, contains the regulations governing the removal to, and deposit in, foreign-trade zones, of liquor, flavoring extracts, medicinal or toilet preparations made with taxpaid alcohol, stills, and condensers, and tobacco and tobacco products, under the fourth proviso of section 3 of the Foreign-Trade Zones Act (48 Stat. 999; 19 U. S. C. 81c), as amended. The regulations also cover requirements governing the filing of applications, and the issuance of permits, for the removal of such articles to foreign-trade zones; the filing of bonds and consents of surety covering such removals; and the accounting for the deposit of articles in foreign-trade zones.

(19) *Importation of liquors.*—Part 251, 26 CFR, contains the regulations relative to the importation of distilled spirits, wine, and beer into the United States, and includes requirements relative to special (occupational) and commodity taxes, permits, marking, branding, labeling, and stamping of containers and packages, and records and reports.

(20) *Liquors and articles from Puerto Rico and Virgin Islands.*—Part 250, 26 CFR, contains the regulations relative to the collection of internal revenue taxes on alcoholic products coming into the United States from Puerto Rico and the Virgin Islands, including procedure in those countries in connection with shipment of the products to the continental United States, the submission of formulas, and the stamping and marking of containers.

(21) *Drawback of tax on distilled spirits, wine and beer.*—Part 252, 26 CFR, contains the regulations relative to the allowance of drawback of internal revenue tax on (i) domestic alcohol used in the manufacture or production of flavoring extracts, and medicinal or toilet prepa-

rations (including perfumery), upon the exportation of such products, (ii) distilled spirits and wine bottled or packaged especially for export, upon the exportation thereof, (iii) distilled spirits exported in distillers' original packages containing not less than 20 wine gallons each, and (iv) beer brewed or produced in the United States, and exported.

(22) *Drawback of tax on distilled spirits used in the manufacture of nonbeverage products.*—Part 197, 26 CFR, contains the regulations relative to the allowance of drawback of internal revenue tax on tax-paid domestic distilled spirits used in the manufacture or production of medicine, medicinal preparations, food products, flavors, or flavoring extracts which are unfit for beverage purposes, including payment of occupational tax, maintenance of records, and filing of claims for drawback.

(23) *Nonindustrial use of distilled spirits and wine.*—Regulations No. 2 (27 CFR, Part 2), issued under the Federal Alcohol Administration Act, as amended, contain the requirements relative to the nonindustrial use of distilled spirits and wine under the Federal Alcohol Administration Act, including distilled spirits in containers of a capacity of one gallon or less.

(24) *Disposition of substances used in the manufacture of distilled spirits, and articles.*—Part 173, 26 CFR, contains the regulations relative to the returns and records of the dispositions of substances or articles of the character used in the manufacture or recovery of distilled spirits.

(25) *Production of vinegar by the vaporizing process.*—Part 195, 26 CFR, contains the regulations relative to the production of vinegar by the vaporizing process (fermentation and distillation of alcoholic liquid), including the location, use, construction, equipment, process used, and records of vinegar plants using such process.

(26) *Production of volatile fruit-flavor concentrates.*—Part 198, 26 CFR, contains the regulations relative to the manufacture of volatile fruit-flavor concentrates; the storage, removal, sale, transportation, and use of such concentrates and the mash and juice from which produced; the alcoholic content thereof; and the addition of substances that will render the concentrates unfit for use as beverages. The regulations cover the location, use and qualification of concentrate plants; their construction and equipment; action by the assistant regional commissioner (alcohol and tobacco tax) in connection with the establishment and operation of concentrate plants; and the recording and reporting of the receipt, use, removal and disposal of concentrates and the mash and juice from which produced.

(27) *Stills and distilling apparatus.*—Part 196, 26 CFR, contains the regulations relative to the manufacture, taxpayment, removal, use, and registration of stills and worms or condensers, and the exportation of stills with benefit of drawback of internal revenue tax and the exportation free of tax of distilling apparatus not intended for use in distilling spirits.

(28) *Basic permit requirements under the Federal Alcohol Administration Act.*—Regulations No. 1 (27 CFR, Part 1), contain the requirements relative to the procurement of basic permits by importers, producers, rectifiers, blenders, bottlers, warehousemen, and wholesalers of distilled spirits, wine, or malt beverages.

(29) *Rules of practice in permit proceedings.*—Part 200, 26 CFR, contains the regulations for the issuance of citations covering the contemplated disapproval of initial or renewal applications and for orders to show cause why basic permits should not be suspended, revoked or annulled. The procedures set forth therein apply to all permit proceedings under the Federal Alcohol Administration Act (27 U. S. C. 201) and chapters 51 and 52 of the Internal Revenue Code of 1954. Such rules also govern, insofar as applicable, any adversary proceeding involving adjudication required by statute to be determined on the record, after opportunity for hearing, under laws administered by the Alcohol and Tobacco Tax Division.

(30) *Inducements furnished to retailers.*—Regulations No. 6 (27 CFR, Part 6), issued under the Federal Alcohol Administration Act, as amended, contain the requirements relative to the furnishing of equipment, fixtures, signs, supplies, money, services, or other things of value to retailers of distilled spirits, wine, and malt beverages, by other members of the liquor industry (principally vendors), including the furnishing of samples and advertising cuts.

(31) *Credit period to be extended to retailers of alcoholic beverages.*—Regulations No. 8 (27 CFR, Part 8), contain the requirements relative to the credit period which may be extended to retailers of alcoholic beverages under the Federal Alcohol Administration Act.

(32) *National emergency transfers of distilled spirits.*—Treasury Decision 5864 [C. B. 1951–2, 248], which added Subpart G to 26 CFR (1939), Part 171, Miscellaneous Regulations Relating to Liquor, contains requirements, in addition to the applicable provisions of Regulations 3, 4, 5, and 10 (26 CFR (1939), Parts 182, 183, 184, 185), concerning national emergency transfers of distilled spirits, including removals, free of tax, for use of the United States, pursuant to section 3183 of the 1939 Internal Revenue Code, as made applicable to section 5217 of the 1954 Code by Treasury Decision 6091 [C. B. 1954–2, 47].

(33) *Remission or mitigation of forfeitures.*—Treasury Decision 5535 [C. B. 1946–2, 194], which added Subpart E to 26 CFR (1939), Part 171, Miscellaneous Regulations Relating to Liquor, contains the regulations concerning remission or mitigation of forfeitures under section 3726 of the 1939 Internal Revenue Code, as made applicable to section 7327 of the 1954 Code by Treasury Decision 6091.

Sec. 601.302. TAXES—(a) *Collection.*—Taxes on distilled spirits are paid principally by stamps purchased from the district director of internal revenue. In the case of distilled spirits taxpaid in bulk gauging tanks for removal in tank cars, tank trucks or by pipeline, there is the optional method of paying by purchase of a certificate of payment (Form 1595) or by use of distilled spirits excise tax stamps (series of 1950), issued in various denominations. Form 1595 is attached to the tank and later, in the case of removal by pipeline, canceled and surrendered to the appropriate internal revenue officer. In the case of removals in tank cars and tank trucks it is canceled and attached to the route board of such container for removal and scalping at the consignee premises. The distilled spirits excise tax stamps are canceled and surrendered in the exact amount to the appropriate internal revenue officer. In the case of removals in tank cars and tank trucks, a wholesale liquor dealer stamp is issued by the appropriate internal revenue officer for attachment to the route board of such con-

tainer for removal and scalping at the consignee premises. Distilled spirits excise tax stamps are also used to taxpay distilled spirits bottled in bond and the cases are marked appropriately to indicate taxpayment. Taxes on wine are paid by return (Form 2050), filed with remittance with the district director of internal revenue. Taxes on beer are paid by return (Form 2034), filed with remittance with the district director of internal revenue. Special tax stamps are issued to denote the payment of occupational taxes by liquor dealers and others. Such stamps are required to be posted in the taxpayer's place of business as evidence of taxpayment. Detailed information respecting the payment of taxes on liquors and the payment of occupational taxes by still manufacturers, brewers, rectifiers, dealers in liquors, and manufacturers of nonbeverage products, including the forms to be used and the procedure to be followed, is contained in the respective regulations described in section 601.301.

(b) *Assessment.*—If additional or delinquent tax liability is disclosed by an investigation, or by an examination of records, of a qualified plant or permittee, a notice (except where delay may jeopardize collection of the tax, or where the amount involved is nominal or the result of an evident mathematical error) is sent to the taxpayer advising him of the basis and amount of the liability and affording him an opportunity to submit a protest, with supporting facts, or to request a conference.

Sec. 601.303 CLAIMS—(a) *Claims for remission.*—When untaxpaid distilled spirits or wine have been lost or destroyed the assistant regional commissioner (alcohol and tobacco tax) may require the person responsible for the tax to file a claim for remission if such person desires to be relieved of the liability. Upon receipt of the claim, the assistant regional commissioner (alcohol and tobacco tax) makes a factual determination and notifies the claimant of the allowance or rejection of the claim. If the claim for remission of tax on distilled spirits is rejected, and the circumstances warrant, the assistant regional commissioner (alcohol and tobacco tax) may require that the spirits be immediately taxpaid upon the original quantity entered into the warehouse.

(b) *Claims for abatement.*—When the tax on distilled spirits, wine or beer, or the rectification tax is assessed and the taxpayer thinks that the tax is not due under the law, he may file a claim for abatement of the tax on Form 843 with the district director of internal revenue. Forms 843 may be procured from a district director. The district director forwards the claim to the assistant regional commissioner (alcohol and tobacco tax) for consideration, and the district director may call upon the taxpayer to file a bond in double the amount of the tax in order to insure collection of the tax if the claim is rejected. When the claim is acted upon, both the taxpayer and the district director are notified of the allowance or rejection of the claim. If the claim is rejected, the district director will proceed to collect the tax.

(c) *Claims for refund.*—The taxpayer may, after payment of the tax, file a claim for refund on Form 843 with the district director of internal revenue to whom the tax was paid. Such claim must be filed within three years (two years under certain circumstances) after the date of payment of the tax. The district director forwards the

claim to the assistant regional commissioner (alcohol and tobacco tax) for consideration. If the claim is rejected, the taxpayer is notified of the rejection by registered mail, and he may then bring suit in the United States District Court or the Court of Claims for recovery of the tax. Such suits must be filed generally within two years from the date of mailing of the rejection notice. If the claim is allowed, an appropriate notice of allowance with a check for the amount of the refund and allowable interest is forwarded to the taxpayer, unless there are other unpaid taxes outstanding against the taxpayer, in which event delivery of the refund check to the taxpayer is held in abeyance pending payment of the unpaid taxes.

Sec. 601.304. PREPARATION AND FILING OF CLAIMS—(a) *Alcohol.*—Claims for remission of tax on alcohol lost at industrial alcohol plants, bonded warehouses, and denaturing plants, and for losses of tax-free and specially denatured alcohol at denaturing plants and at dealers' and users' premises, must be prepared and filed in accordance with Part 182, 26 CFR. These regulations contain full information in respect to the procedure in the verification and examination of such claims.

(b) *Distilled spirits at distilleries.*—Claims for remission of tax on distilled spirits lost at distilleries must be prepared and filed in accordance with Parts 220 and 221, 26 CFR, which contain complete information respecting the procedure followed in verifying and examining such claims.

(c) *Distilled spirits at bonded warehouses.*—Claims for losses of spirits at bonded warehouses and for losses of spirits withdrawn free of tax for exportation, etc., must be prepared and filed in accordance with Part 225, 26 CFR. These regulations contain full information relative to the investigation and consideration of such claims.

(d) *Rum.*—Claims for losses of rum and specially denatured rum at distillery denaturing bonded warehouses and in transit after removal from the warehouse must be prepared and filed in accordance with Part 216, 26 CFR, which set out the procedure followed in the handling and consideration of such claims.

(e) *Low wines at vinegar plants.*—Claims for remission of tax on low wines (distilled spirits) lost at vinegar plants producing vinegar by the vaporizing process must be prepared and filed in accordance with Part 195, 26 CFR, which regulations set forth the procedure followed in the handling of such claims.

(f) *Special taxes.*—Claims for abatement or refund of occupational taxes and penalties erroneously assessed or collected, and claims for redemption of special tax stamps for occupational taxes, must be prepared and filed in accordance with Part 194, 26 CFR. When claim for redemption of a special tax stamp is filed, the stamp (or a Certificate in Lieu of Lost or Destroyed Special Tax Stamp, accompanied by affidavits attesting to destruction of the stamp) must be surrendered with the claim and the claim must be submitted within three years from the date of payment of the tax.

(g) *Stills and distilling apparatus.*—Claims for drawback of tax paid on stills or distilling apparatus manufactured for export and actually exported must be prepared and filed in accordance with Part 196, 26 CFR, which regulations set forth the procedure to be followed and the forms to be used.

(h) *Drawback of tax on distilled spirits and wines.*—Claims for drawback of taxes paid on (1) domestic alcohol used in the manufacture of flavoring extracts, medicinal or toilet preparations, which are exported, (2) distilled spirits and wines bottled or packaged especially for export and actually exported, (3) distilled spirits exported in distillers' original packages, and (4) beer exported, must be prepared and filed in accordance with Part 252, 26 CFR. These regulations contain full information in respect to the procedure to be followed, the forms to be used, the time within which the claims must be filed, and the supporting documents which must be submitted with the claim.

(i) *Drawback of tax on distilled spirits used in nonbeverage products.*—Claims for drawback of tax on domestic distilled spirits used in the manufacture or production of medicine, medicinal preparations, food products, flavors, or flavoring extracts, which are unfit for beverage purposes, must be prepared and filed in accordance with Part 197, 26 CFR. Such claims must be filed within the three months next succeeding the quarter in which the spirits are used. Part 197 contains full information respecting the preparation of such claims, the supporting documents to be filed therewith, and the verification of, and action on, the claims by the assistant regional commissioner (alcohol and tobacco tax).

SEC. 601.305. OFFERS IN COMPROMISE—(a) *Liability under Internal Revenue Code.*—Persons desiring to submit offers in compromise in order to avoid forfeiture or prosecution proceedings, and taxpayers who disclaim liability for the amount of taxes assessed, or claim inability to pay the taxes in full, may submit offers in compromise to the district director of internal revenue, or to an internal revenue officer. (For offers in compromise generally, see section 601.203.) Form 656 is used in all cases where the amount of the offer is tendered in full at the time the offer is filed. Form 656–C is used when the offer is payable in installments. Such offers are forwarded by the district director to the assistant regional commissioner (alcohol and tobacco tax) for consideration and transmittal to the Commissioner for appropriate action. When the offer is acted upon, the district director and the assistant regional commissioner (alcohol and tobacco tax) are notified of the acceptance or rejection of the offer, and the assistant regional commissioner (alcohol and tobacco tax) in turn notifies the proponent. If the offer is rejected, the sum submitted with the offer is returned to the proponent and forfeiture, prosecution, or collection proceedings are resumed. If the offer is accepted, the taxpayer is notified and the case is closed. Acceptance of an offer in compromise of civil liabilities does not remit criminal liabilities, nor does acceptance of an offer in compromise of criminal liabilities remit civil liabilities.

(b) *Violation of Federal Alcohol Administration Act.*—The Federal Alcohol Administration Act provides penalties for violations of its provisions. The Director of the Alcohol and Tobacco Tax Division in the National Office is authorized to compromise such liabilities. Persons desiring to submit offers in compromise of such liabilities, in order to avoid prosecution proceedings, may submit offers in compromise on Form 656–D to the assistant regional commissioner (alcohol and tobacco tax) or one of his inspectors. Such offers are considered by such assistant regional commissioner and are forwarded

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to the Director of the Alcohol and Tobacco Tax Division for final action. When the offer is acted upon, the proponent and the assistant regional commissioner (alcohol and tobacco tax) are notified of the acceptance or rejection of the offer. If the offer is rejected, the sum submitted with the offer in compromise is returned to the proponent. If the offer is accepted, the proponent is notified and the case is closed.

SEC. 601.306. APPLICATION FOR APPROVAL OF INTERLOCKING DIRECTORS AND OFFICERS UNDER SECTION 8 OF THE FEDERAL ALCOHOL ADMINISTRATION ACT.—Any person who is an officer or director of a corporation now engaged in business as a distiller, rectifier or blender of distilled spirits, or of an affiliate thereof, who desires to take office in other companies similarly engaged, must obtain permission to do so from the Director of the Alcohol and Tobacco Tax Division. Applications for such permission to take office shall be prepared and filed in accordance with AT-Circular, A. T. No. 956,[2] issued January 15, 1948, copies of which have been furnished to distillers, rectifiers, and blenders of distilled spirits, and additional copies of which may be procured from the assistant regional commissioner (alcohol and tobacco tax) or from the Director of the Alcohol and Tobacco Tax Division, Internal Revenue Service, Washington 25, D. C.

SEC. 601.307. RULINGS.—Any person who is in doubt as to any matter arising in connection with his operations or transactions with respect to liquors may request a ruling thereon by addressing a letter to the Director, Alcohol and Tobacco Tax Division, Internal Revenue Service, Washington 25, D. C., or to the assistant regional commissioner (alcohol and tobacco tax) of the region in which his business is located.

SEC. 601.308. CONFERENCES.—Any person desiring a conference in the office of the assistant regional commissioner (alcohol and tobacco tax) of his region or of the Director, Alcohol and Tobacco Tax Division, in Washington, relative to any matter arising in connection with his operations, will be accorded such a conference upon request. No formal requirements are prescribed for such conference.

SEC. 601.309. ATTORNEYS AND AGENTS.—Attorneys and agents representing taxpayers before the Service, in the office of the Director, Alcohol and Tobacco Tax Division, or in the office of the assistant regional commissioner (alcohol and tobacco tax), must be enrolled to practice before the Treasury Department and be authorized by power of attorney, filed with the Service, to represent the taxpayer in the matter under discussion. (See Subpart E of this Part.)

SEC. 601.310. FORMS.—For forms to be used, see section 601.301 (c).

TOBACCO PRODUCTS, TOBACCO MATERIALS, AND CIGARETTE PAPERS AND TUBES

SEC. 601.311. IMPOSITION OF TAXES; REGULATIONS—(a) *Taxes.*—Subchapter A of chapter 52 of the Internal Revenue Code imposes certain taxes on cigars, cigarettes, tobacco, and cigarette papers and tubes manufactured in or imported into the United States.

(b) *Regulations.*—Rules bearing upon the functions of the Service, the forms used, etc., in connection with these taxes are contained in the following regulations:

[2] Not published in the Bulletin.

(1) Part 270, 26 CFR, relating to the taxes on cigars and cigarettes, and the operations of manufacturers and importers of and dealers in such products.

(2) Part 275, 26 CFR, relating to the taxes on manufactured tobacco and the operations of manufacturers and importers of and dealers in such products.

(3) Part 280, 26 CFR, relating to the operations of dealers in tobacco materials and the purchase and sale of tobacco materials.

(4) Part 285, 26 CFR, relating to the taxes on cigarette papers and tubes and the operations of manufacturers and importers of and dealers in such articles.

(5) Part 290, 26 CFR, relating to exportation of tobacco materials, tobacco products, and cigarette papers and tubes, without payment of tax, or with benefit of drawback of tax.

(6) Part 295, 26 CFR, relating to removal of tobacco products and cigarette papers and tubes, without payment of tax, for use of the United States.

SEC. 601.312. SPECIAL QUALIFICATION AND BONDING REQUIREMENTS.—(a) *Manufacturers and dealers.*—Before commencing business, every dealer in tobacco materials, manufacturer of tobacco, cigars, or cigarettes, and cigarette papers and tubes must make application to the appropriate assistant regional commissioner (alcohol and tobacco tax) for a permit to carry on such business. The application shall show his name or style, and place where the business is to be carried on. The application for permit form is Form 2093, copies of which may be obtained from any assistant regional commissioner (alcohol and tobacco tax). Every person required to file application for permit must support such application by a bond, in duplicate, on the prescribed form and in such amount, as well as other documents, required by the applicable regulations referred to in section 601.311(b). When the application for permit, supporting bond and other required documents are received and approved by the assistant regional commissioner (alcohol and tobacco tax), he will issue to the person named in the application an appropriate permit. This permit must be posted in accordance with the requirements of the regulations.

(b) *Warehouse proprietors.*—Every proprietor of an internal revenue tobacco warehouse, as defined in part 290 is also required to file application to establish such a warehouse and furnish a bond to the proper assistant regional commissioner (alcohol and tobacco tax) to cover the operation of the warehouse to protect the Government with respect to any liability incurred in connection with the operation of the warehouse. A proprietor of a customs bonded manufacturing warehouse, Class 6, desiring to remove cigars from his warehouse, without payment of tax, for export to a foreign country or a possession of the United States, shall, prior to making the first removal, file with the assistant regional commissioner (alcohol and tobacco tax) a bond on the prescribed form.

(c) *Drawback of tax.*—Tobacco products on which the tax has been paid may be exported with benefit of drawback of such tax.

SEC. 601.313. COLLECTION OF TAXES—(a) *Cigars, cigarettes, and manufactured tobacco.*—The taxes on cigars, cigarettes, and manufac-

tured tobacco are paid by stamps affixed to the box or package, and are due upon removal of domestic products from the factory and release of imported products from customs custody. Information reports are required to be filed monthly with the assistant regional commissioner (alcohol and tobacco tax) of the region in which the manufacturer is located, on or before the 20th day of the month following the month in which domestic products are removed from the factory. Such reports show the quantities of tobacco materials, tobacco products, and internal revenue tobacco products tax stamps handled. In addition to the monthly information reports, each manufacturer is required to prepare on the prescribed form and submit to the assistant regional commissioner (alcohol and tobacco tax) a true inventory of any tobacco materials, tobacco products and tax stamps on hand, at commencement of business and at the time of discontinuing business.

(b) *Cigarette papers and tubes.*—The taxes on cigarette papers and tubes, unlike the taxes on tobacco and tobacco products, are payable by the manufacturer or importer by return. In the case of a domestic manufacturer the return, accompanied by remittance of tax, must be filed with the proper district director on or before the 10th day of the month following that in which the liability to tax occurs. With respect to cigarette papers and tubes subject to tax, which are imported into the United States, importers are required to file a return covering each importation, accompanied by remittance of the amount of the tax.

SEC. 601.314. RULINGS.—The procedure to be followed in securing a ruling on any question arising in connection with the tobacco taxes is the same as set forth in section 601.307.

SEC. 601.315. PROPOSED ASSESSMENT OF ADDITIONAL OR DELINQUENT TAXES.—When additional or delinquent tax liability with respect to tobacco, tobacco products, cigarette papers and tubes, is discovered, a notice to show cause against the proposed assessment of such tax shall be forwarded to the taxpayer. (See section 5703(d) of the Internal Revenue Code.)

SEC. 601.316. ADMINISTRATIVE REMEDIES AVAILABLE TO TAXPAYERS AFTER THE PURCHASE OF TOBACCO TAX STAMPS OR AFTER ASSESSMENT OR PAYMENT OF TOBACCO TAXES—(a) *Redemption of stamps.*—Tobacco products tax stamps which have been spoiled, destroyed, or rendered useless or unfit for the purpose intended, or for which the owner may have no use, or which through mistake may have been improperly or unnecessarily used, or have been used in excess of the amount of tax actually due, or affixed to tobacco products withdrawn from the market, or affixed to tobacco products which are lost (otherwise than by theft) or destroyed by fire, casualty, or act of God while in the possession or ownership of the manufacturer or importer, may be redeemed if proper claim is filed with the assistant regional commissioner (alcohol and tobacco tax). Such claims must be prepared on Form 843 in accordance with the instructions shown on the form and in accordance with the provisions of the regulations referred to in section 601.311 (b). Copies of Form 843 are obtainable from offices of assistant regional commissioners (alcohol and tobacco tax).

(b) *Drawback claims.*—Section 5706 of the Internal Revenue Code authorizes allowance of drawback of internal revenue taxes paid on tobacco products, and cigarette papers and tubes which are shipped from the United States for consumption or use beyond the jurisdiction

of the internal revenue laws of this country. Form 2147 is required to be used for this purpose. Copies are obtainable from offices of assistant regional commissioners (alcohol and tobacco tax). As a condition precedent to the allowance of any such drawback claim, the claimant is required to file a bond on Form 2148 in a penal sum equal to the amount for which the claim is made, conditioned that he will furnish satisfactory evidence that the articles covered by his claim have been landed at a port outside the jurisdiction of the United States, or that the articles were lost (otherwise than by theft) or destroyed by fire, casualty, or act of God, and have not been relanded within the limits of the United States.

(c) *Claims for abatement or refund.*—Where a tobacco tax has been paid other than by stamp, the taxpayer may file a claim for refund for any part of the payment. Similarly, any person against whom an assessment has been made but which has not been paid, may file a claim for abatement. In either case, the procedure to be followed by the claimant is the same as that set forth in the case of claims for abatement or refund of taxes as described in section 601.303(b) and (c). All claims for refund of tobacco taxes paid pursuant to an assessment must be filed within three years after payment of the tax.

(d) *Claims for remission of tax.*—Where tobacco products on which the tax has not been paid, are lost (otherwise than by theft) or destroyed by fire, casualty, or act of God, while in the possession or ownership of the manufacturer, a claim for remission of such tax may be filed. Such claim shall be in letter form, in duplicate, accompanied by evidence necessary to support the claim.

(e) *General.*—Detailed instructions as to the requirements necessary to be complied with in connection with the filing of claims for redemption, drawback, refund, and remission are fully set forth in the regulations referred to in section 601.311(b).

SEC. 601.317. OFFERS IN COMPROMISE.—The procedure in the case of offers in compromise of liability under the Internal Revenue Code relating to tobacco, cigars, cigarettes, and cigarette papers and tubes, is the same as that set forth in section 601.305(a).

SEC. 601.318. FORMS.—Detailed information as to all forms prescribed for use in connection with the taxes referred to in section 601.311(a) is contained in the regulations referred to in section 601.311(b). Copies of these regulations, together with copies of all necessary forms and instructions as to their preparation and filing, may be obtained from assistant regional commissioners (alcohol and tobacco tax).

FIREARMS

SEC. 601.319. APPLICABLE LAWS.—Chapter 53 of the Internal Revenue Code of 1954 (26 U. S. C. 5801-5862), the provisions of which are chiefly derived from the National Firearms Act, as amended (Act of June 26, 1934, 48 Stat. 1236), imposes a tax on the manufacture, and transfer in the United States, of machine guns and certain types of short-barreled firearms, and an occupational tax upon every importer and manufacturer of, and dealer and pawnbroker in, such machine guns and firearms. Section 1(b) (2) of the Act of August 9, 1939 (53 Stat. 1291; 49 U. S. C. 781-788) makes provision for the seizure of vessels, vehicles, and aircraft on which art transported, carried,

or possessed, any firearm with respect to which there has been committed any violation of the National Firearms Act or any regulations issued pursuant thereto. The Federal Firearms Act (53 Stat. 1250; 15 U. S. C. 901–909) makes it unlawful for any manufacturer or dealer (except a manufacturer or dealer having a license issued under the provisions of the Act), or any person who is under indictment or who has been convicted of a crime of violence or who is a fugitive from justice, to transport, ship, or receive any firearms or ammunition in interstate or foreign commerce.

SEC. 601.320. TAXES RELATING TO MACHINE GUNS AND CERTAIN OTHER FIREARMS—Part 179, 26 CFR, contains the regulations relative to the (a) payment of special taxes by manufacturers and importers of, and dealers (including pawnbrokers) in, certain types of firearms, including machine guns and silencers or mufflers, (b) payment of the tax on the making or transfer of such firearms, (c) registration, identification, importation and exportation of such firearms, (d) keeping of books and records and rendering of returns, and (e) the forfeiture and disposition of seized firearms under the provisions of the National Firearms Act.

SEC. 601.321. LICENSING UNDER THE FEDERAL FIREARMS ACT OF MANUFACTURERS OF, AND DEALERS IN, FIREARMS OR AMMUNITION—Part 315, 26 CFR (1939), contains the regulations relative to the licensing of manufacturers of, and dealers in, firearms and ammunition, the records required to be kept by the licensees, and the forfeiture and disposition of seized firearms or ammunition, under the provisions of the Federal Firearms Act.

SEC. 601.322. SEIZURES OF VESSELS, VEHICLES, AND AIRCRAFT IN CONNECTION WITH CONTRABAND FIREARMS—Part 468, 26 CFR (1939) covered by Section 1(b)(2), Act of August 9, 1939, and Treasury Decision 5067 [C. B. 1941–2, 366], approved August 29, 1941, as amended by Treasury Decision 5791 [C. B. 1950–1, 274], approved May 22, 1950, contain the procedural and substantive requirements relative to the seizure of vessels, vehicles, and aircraft in connection with contraband firearms, the custody and disposition including forfeitures of such conveyances or firearms, the filing of claims therefor and petitions for remission or mitigation of forfeiture, and awards for seizures or furnishing information leading to forfeiture by persons not officers of the United States.

SUBPART D—PROVISIONS SPECIAL TO CERTAIN EMPLOYMENT AND EXCISE TAXES

SEC. 601.401. EMPLOYMENT TAXES.—(*a*) *General.*—(1) *Description of taxes.*—Federal employment taxes are imposed by Subtitle C of the Internal Revenue Code. Chapter 21 (Federal Insurance Contributions Act) imposes a tax on employers of one or more individuals and also a tax on employees, with respect to "wages" paid and received. Chapter 22 (Railroad Retirement Tax Act) imposes a tax on employers and their employees with respect to "compensation" paid and received. It also imposes a tax on employee representatives with respect to "compensation" received. Chapter 23 (Federal Unemployment Tax Act) imposes a tax on employers of eight or more individuals (four or more individuals beginning with the calendar year 1956) with respect to "wages" paid. Chapter 24 (collection of income tax

at source on wages) requires every employer making payment of "wages" to deduct and withhold upon such wages the tax computed or determined as provided therein. The tax so deducted and withheld is allowed as a credit against the income tax liability of the employee receiving such wages.

(2) *Applicable regulations.*—The descriptive terms used in this section to designate the various classes of taxes are intended only to indicate their general character. Specific information relative to the scope of each tax, the forms used, and the functioning of the Service with respect thereto is contained in the applicable regulations. Copies of all necessary forms, and instructions as to their preparation and filing, may be obtained from the district director of internal revenue.

(3) *Collection methods.*—Employment taxes are collected by means of returns and by withholding by employers. Employment tax returns are not required to be filed by employees, but taxes imposed upon them must be deducted and withheld by employers from their wages. Employee representatives (as defined in the Railroad Retirement Tax Act) are required to file returns. All employers who are liable for or who must withhold employment taxes are required to file returns with the District Director of Internal Revenue. The return of the Federal unemployment tax is required to be filed annually on Form 940 with respect to wages paid during the calendar year. All other returns of Federal employment taxes are required to be filed for each calendar quarter. The employer and employee taxes imposed by chapter 21 and the tax required to be deducted and withheld upon wages by chapter 24 are combined in a single return on Form 941. In the case of wages paid by employers for domestic service performed in a private home not on a farm operated for profit, the return of both the employee tax and the employer tax imposed by chapter 21 is on Form 942. However, if the employer is required to file a return for the same quarter on Form 941, he may at his election include the taxes with respect to such domestic service on Form 941. For information relating to the employee tax and the employer tax with respect to wages paid for agricultural labor, see the applicable regulations under chapter 21. Under the Railroad Retirement Tax Act, the return required of the employer is on Form CT-1, and the return required of each employee representative is on Form CT-2.

(4) *Receipts for employees.*—Employers are required to furnish each employee a receipt or statement, in duplicate, showing the total wages subject to income tax withholding, the amount of income tax withheld, the amount of wages subject to tax under the Federal Insurance Contributions Act, and the amount of employee tax withheld. See section 6051 of the Code.

(5) *Use of Federal Reserve banks and authorized commercial banks in connection with payment of Federal employment taxes.*—If during any calendar month the aggregate amount of

(i) The employer tax and the employee tax imposed by chapter 21, and

(ii) The income tax withheld at source on wages under chapter 24,

exclusive of taxes reportable on Form 942, exceeds $100, it is the duty of the employer to deposit such amount within 15 days after the close of such calendar month with a Federal Reserve bank or a commercial

bank authorized in accordance with Treasury Department Circular No. 848 to accept remittance of these taxes for transmission to a Federal Reserve bank. The remittance of such amount must be accompanied by a Federal Depositary Receipt (Form 450). After the Federal Reserve bank has validated the depositary receipt, it will be returned to the employer. The validated receipts must be attached to the return on Form 941 for the calendar quarter with respect to which such deposits are made, and the employer shall pay to the District Director the balance, if any, of the taxes due for the quarter. In the case of the last month of any calendar quarter the employer may either include with his return direct remittance to the District Director for the amount of such taxes or attach to the return a depositary receipt validated by a Federal Reserve bank. If a deposit is made for the last month of the quarter, it must be made in ample time to enable the Federal Reserve bank to return the validated receipt to the employer so that it can be attached to and filed with the employer's return at the time prescribed for filing such return. A similar procedure is prescribed with respect to the tax on employers and employees imposed by chapter 22, except that the depositary receipt prescribed in such cases is Form 515 (Railroad Retirement Depositary Receipt).

(*b*) *Provisions special to the Federal Insurance Contributions Act.*—(1) *Employers' identification numbers.*—For purposes of the Federal Insurance Contributions Act each employer who files Form 941 must have an identification number. Any such employer who does not have an identification number must secure a Form SS-4 from the District Director of Internal Revenue or from a district office of the Social Security Administration and, after executing the form in accordance with the instructions contained thereon, file it with the District Director or the district office of the Social Security Administration. At a subsequent date the District Director will assign the employer a number which must appear in the appropriate space on each tax return, Form 941, filed thereafter. The requirement to secure an identification number does not apply to an employer who has in his employ only employees who are engaged exclusively in the performance of domestic service in his private home not on a farm operated for profit.

(2) *Employees' account numbers.*—Each employee (or individual making a return of net earnings from self-employment) who does not have an account number must file an application on Form SS-5, a copy of which may be obtained from any district office of the Social Security Administration or from a District Director of Internal Revenue. The form, after execution in accordance with the instructions thereon, must be filed with the district office of the Social Security Administration, and at a later date the employee will be furnished an account number. The employee must furnish such number to each employer for whom the employee works, in order that such number may be entered on each tax return filed thereafter by the employer.

(3) *Reporting of wages.*—Form 941 requires as a part of the return that the wages of each employee paid during the quarter be reported thereon. It is necessary at times that employers correct wage information previously reported. A special form, Form 941c, has been adopted for use in correcting erroneous wage information

or omissions of such wage information on Schedule A of Form 941. Instructions on Form 941 and on Form 941c explain the manner of preparing and filing the forms. Any further instructions should be obtained from the District Director for the district in which the returns are filed.

(*c*) *Quarterly adjustments by employers.*—(1) *Adjustments with respect to income tax withheld at source upon wages.*—If an employer for any quarter of a calendar year deducts and withholds more or less than the correct amount of tax upon wages, or pays more or less than the correct amount of tax to the District Director, such employer may make proper adjustment without interest in any subsequent quarter in the same calendar year. No adjustment may be made in respect of an underpayment for any quarter after the District Director sends notice and demand for payment of the additional tax. In such case the additional tax must be paid in accordance with the notice and demand. Nor may any adjustment be made in respect of an overpayment for any quarter after the employer files a claim for refund of such overpayment. If an employer makes an adjustment on any return in respect of errors in a preceding quarter there must be attached to the return a detailed explanation of the adjustment and a designation of the quarterly return period in which the errors occurred. If an adjustment relates to an excess withholding of tax from an employee, the explanation attached to the return must include the fact that such tax has been repaid to the employee. Errors occurring in any quarterly return period may be corrected in making the return for such period, if such errors are ascertained prior to the filing of the return. For information as to the manner of correcting errors in withholding which cannot be adjusted in a return for a subsequent quarter of the same calendar year, employers should consult the local District Director of Internal Revenue. Refunds or credits with respect to an overpayment of income tax withheld may be made to an employer only to the extent that the amount of the overpayment was not deducted and withheld by the employer.

(2) *Adjustments with respect to employee tax or employer tax under the Federal Insurance Contributions Act or the Railroad Retirement Tax Act.*—Errors in withholding during any quarterly period under the Federal Insurance Contributions Act or the Railroad Retirement Tax Act should be corrected in the return for such quarter, if such errors are ascertained prior to the time the return is required to be filed with the District Director. In the case of errors in withholding of employee tax or in payments of employer tax under either the Federal Insurance Contributions Act or the Railroad Retirement Tax Act, where such errors are ascertained subsequent to the time prescribed for filing the return for the quarterly period in which they occurred, the regulations relating to such taxes prescribed the conditions under which such errors may be adjusted. If adjustments cannot be made in accordance with the provisions of such regulations, underpayments of both the employer and employee tax will be assessed and collected in the usual manner, and refunds of overpayments must be claimed on Form 843.

(*d*) *Special refunds of employee social security tax.*—(1) In the case of an employee receiving wages from more than one employer during the calendar year, amounts may be deducted and withheld as

employee social security tax (that is, employee tax under the Federal Insurance Contributions Act) with respect to wages in excess of $4,200 ($3,600 for certain calendar years prior to 1955). Under certain conditions, the employee may receive a so-called "special refund" of the amount of employee social security tax deducted and withheld from wages in excess of such amount. An employee who is entitled to a special refund of employee tax with respect to wages received during a calendar year commencing after December 31, 1950, and who is required to file an income tax return for such calendar year (or for his last taxable year beginning in such calendar year) may obtain the benefits of such special refund only by claiming credit for such special refund on such income tax return in the same manner as if such special refund were an amount deducted and withheld as income tax at source on wages.

(2) The amount of the special refund allowed as a credit shall be considered as an amount deducted and withheld as income tax at source on wages. If the amount of such special refund when added to amounts deducted and withheld as income tax under chapter 24 exceeds the income tax imposed by chapter 1, the amount of the excess constitutes an overpayment of income tax, and interest on such overpayment is allowed to the extent provided under section 6611 of the Code upon an overpayment of income tax resulting from a credit for income tax withheld at source on wages.

(3) If an employee entitled to a special refund of employee social security tax is not required to file an income tax return for the year in which such special refund may be claimed as a credit, he may file a claim for refund of the excess social-security tax on Form 843. The employee shall submit with the claim as a part thereof a statement executed by him on Form SS-9a. Claims must be filed with the District Director of Internal Revenue for the district in which the employee resides.

SEC. 601.402. SALES TAXES COLLECTED BY RETURN.—(*a*) *General.*— Sales taxes collected by return include the following:

(1) The retailers excise taxes, imposed by chapter 31 of the Code, with respect to the following articles:

Jewelry and related items.
Furs.
Toilet preparations.
Luggage, handbags, etc.
Special fuels.

(2) The manufacturers excise taxes, imposed by chapter 32 of the Code, with respect to the following items:

(i) Automotive and related items:
Motor vehicles.
Tires and tubes.
Petroleum products.

(ii) Household type equipment, etc.:
Refrigeration equipment.
Electric, gas, and oil appliances.
Electric light bulbs.

(iii) Entertainment equipment:
Radio and television sets, phonographs and records.
Musical instruments.

(iv) Recreational equipment:
Sporting goods.
Photographic equipment.
Firearms.
(v) Other items:
Business machines.
Pens and mechanical pencils and lighters.
Matches.

(*b*) *Applicable regulations.*—The descriptive terms used in this section to designate the various articles and commodities subject to tax are intended only to indicate their general classes. Specific information relative to the scope of each tax, the forms used, and the functioning of the Service with respect thereto is contained in the applicable regulations. Copies of all necessary forms, and instructions as to their preparation and filing, may be obtained from any District Director of Internal Revenue.

(*c*) *Returns, refunds, and credits.*—(1) *Returns.*—The sales taxes referred to in paragraph (*a*) of this section are collected by means of returns. Any person liable for tax is required to file returns with the District Director of Internal Revenue for the district in which the principal place of business of such person is located. A procedure similar to the Depositary Receipt procedure with respect to the payment of certain Federal employment taxes, described in section 601.401(*a*)(5), is prescribed with respect to the sales taxes referred to in paragraph (*a*) of this section. For information relating to the use of depositary receipts for the payment of such taxes, see the applicable regulations and the instructions on Form 720, Quarterly Federal Excise Tax Return.

(2) *Refunds and credits.*—After the assessment and collection of a sales tax which the taxpayer claims is not due, the taxpayer may either file a claim for refund of such tax on Form 843 or claim a credit for such amount on a return filed by him for a period subsequent to that in respect of which the alleged erroneous payment has been made. However, no claim for refund may be filed or credit taken on a return after the expiration of the applicable period of limitations on the allowance of refunds and credits. In the case of a credit claimed for an amount of tax alleged to have been erroneously paid, no particular forms for the claiming of such a credit are prescribed. The procedure to be followed in such a case is for the taxpayer to enter on the line provided for credits on the return form the amount claimed to have been erroneously paid and to file with the return a supporting statement which should set out clearly and fully the basis on which the credit is claimed. Notice as to the disallowance of any credit is forwarded to the taxpayer and the amount of the credit is then entered on an assessment list for collection in the usual manner.

(*d*) *Registration and bonding requirements.*—(1) Every producer or importer of gasoline and every producer of lubricating oils must make application for registry to the District Director of Internal Revenue for the district in which his principal place of business is located. In addition, the regulations relating to manufacturers excise taxes under chapter 32 of the Code provide, with respect to the sale or purchase of a taxable article (other than a tire, inner tube, or

automobile radio or television receiving set) for further manufacture of other taxable articles or for resale for such purpose, that persons desiring to sell or purchase an article tax-free must make application for registry in the same manner. The form provided is Form 637-A, Application for Registry, copies of which may be obtained from the District Director. The form should be prepared in accordance with the instructions shown thereon and the provisions of the applicable regulations. In the case of producers and importers of gasoline and producers of lubricating oil, the application must also be accompanied by a bond on Form 928 in a sum equivalent to the approximate amount of tax which might be incurred by the taxpayer during an average 3-month period at the rates of the tax then in effect, but in no case shall the bond be for less than $2,000.

(2) Upon receipt by the District Director of the application for registry and, in the case of gasoline and lubricating oil, upon acceptance of the bond required, the District Director will furnish to the applicant Form 637, Certificate of Registry, which will bear the applicant's registration number. Detailed instructions as to the use of this number and as to the requirements to be complied with in connection with the filing of applications for registry and the submission of bonds are set forth in the applicable regulations.

SEC. 601.403.—MISCELLANEOUS EXCISE TAXES COLLECTED BY RETURN.—(*a*) *General.*—Miscellaneous excise taxes collected by return include the following:

(1) *Admissions, cabaret, dues and initiation fees.*—Subchapter A of chapter 33 of the Internal Revenue Code imposes a tax on admissions (including a tax on amounts charged by ticket brokers, box office employees, and others in excess of the established price), and on charges made by cabarets, roof gardens and other similar places. Subchapter A of chapter 33 also imposes certain taxes on amounts paid as dues or initiation fees to any social, athletic, or sporting club or organization.

(2) *Communications.*—Subchapter B of chapter 33 of the Code imposes a tax on amounts paid for local telephone service; long-distance telephone and radio telephone messages or conversations; telegraph, cable or radio dispatches or messages; leased wire or teletypewriter services; and wire and equipment services.

(3) *Transportation.*—Subchapter C of chapter 33 of the Code imposes a tax with respect to various kinds of transportation services as follows:

(i) Transportation of persons, including seating or sleeping accommodations furnished in connection with such transportation.

(ii) Transportation of property.

(iii) Transportation of oil by pipe line.

(4) *Wagers.*—Subchapter A of chapter 35 of the Code imposes a tax on wagers as defined therein.

(5) *Safe deposit boxes.*—Subchapter D of chapter 33 of the Code imposes a tax on the amount collected for the use of a safe deposit box.

(6) *Coconut and other vegetable oils.*—Chapter 37 of the Code imposes a tax upon the first domestic processing of coconut oil, palm oil, palm-kernel oil, fatty acids derived from any of the foregoing oils, salts from any of the foregoing or any combination or mixture con-

taining a substantial quantity of any one or more of such oils, fatty acids or salts.

(7) *Sugar.*—Chapter 37 of the Code also imposes a tax upon manufactured sugar manufactured in the United States.

(8) *Circulation other than of national banks.*—Subchapter E of chapter 39 of the Code imposes a tax with respect to (i) the average circulation outstanding of any bank, association, corporation, company or person, and (ii) the circulation paid out by every person, firm, association other than national bank associations, and every corporation, State bank, or State banking association.

(9) *Hydraulic mining.*—The act entitled "An Act to Create the California Debris Commission and Regulate Hydraulic Mining in the State of California." approved March 1, 1893, as amended (33 U. S. C. 661–687), imposes a tax with respect to certain hydraulic gold mining in the State of California.

(*b*) *Applicable regulations.*—The descriptive terms used in this section to designate the various classes of taxes are intended only to indicate their general character. Specific information relative to the scope of each tax, the forms used, and the functioning of the Service with respect thereto is contained in the applicable regulations. Copies of all necessary forms. and instructions as to their preparation and filing, may be obtained from the District Director of Internal Revenue.

(*c*) *Collection of tax.*—(1) *Imposed taxes.*—The tax on charges made by cabarets, roof gardens and other similar places, the taxes on admission charges in excess of the established price, the tax on the transportation of oil by pipeline, the tax on the first domestic processing of certain vegetable oils, and the tax on the manufacture of sugar, are collected in the same manner as manufacturers' and retailers' sales taxes. See section 601.402. The tax on wagers, the tax on hydraulic mining, and the tax on circulation other than of national banks are also collected by means of returns. The returns of the tax on wagers are required to be filed monthly; returns of tax on hydraulic mining are required to be filed annually; and the returns of the tax on circulation are required to be filed on June 1 and December 1 of each calendar year.

(2) *Collected taxes.*—The other miscellaneous excise taxes referred to in this section are imposed on the person making the payment for the admission, telephone, transportation or other service involved. These taxes are required to be collected by the theater, telephone company, railroad, or other person receiving the payment. All taxes collected in this manner are held by the collecting agent in trust for the United States until deposited in accordance with the Depositary Receipt procedure or paid over to the District Director of Internal Revenue. The collecting agencies are required to file returns and the tax is payable, without notice from the District Director, at the time fixed for filing the returns. If the person from whom the tax is required to be collected refuses to pay it or, if for any reason it is impossible for the collecting agency to collect the tax from such person, the collecting agency is required to report to the District Director of Internal Revenue for the district in which its returns are required to be filed the name and address of such person, the nature of the service or facility rendered, the amount paid therefor, and the date on which paid. Upon receipt of this information the amount of the

tax due will be assessed against the person to whom the facilities were provided or the services rendered.

(3) *Depositary Receipts.*—A procedure similar to the Depositary Receipt procedure with respect to the payment of certain Federal employment taxes, described in section 601.401(*a*)(5), is prescribed with respect to the miscellaneous excise taxes (except the taxes on wagers, hydraulic mining, and circulation other than of national banks) referred to in paragraph (*a*) of this section. For information relating to the use of depositary receipts for the payment of such taxes, see the applicable regulations and the instructions on Form 720, Quarterly Federal Excise Tax Return.

(*d*) *Licensing and registration.*—(1) *Admissions.*—Every person (i) required by any provision of law to collect any tax on admissions, or (ii) being the owner or lessee of any place which he ordinarily or at times leases or subleases to other persons who impose charges for admissions to it, or (iii) required to pay any tax on charges in excess of established prices, or (iv) required to pay tax on charges for admission, refreshment, service and merchandise at any roof garden, cabaret, or other similar place furnishing a public performance for profit, is required to make application for registry. The form provided for this purpose is Form 752, Application for Registry, which may be obtained from District Directors of Internal Revenue. The form should be prepared in accordance with the instructions shown thereon and the provisions of the applicable regulations. The District Director, if satisfied that all statements made in the application for registry are correct, will issue a certificate of registry on Form 753 to the person who made the application. This certificate of registry must be kept conspicuously posted in the principal place of business of the registrant, or be carried about with him if he has no fixed place of business. This certificate is not transferable from one person or firm to another.

(2) *Hydraulic mining.*—Every person who desires to engage in hydraulic mining operations in the State of California within the scope of the Act (see par. (*a*) (9) of this section) must procure a license to operate the mine from the California Debris Commission before beginning operations, in accordance with the rules and regulations promulgated by that Commission.

(3) *Transportation of property.*—Every person engaged in the business of transporting property for hire shall, within 60 days after first engaging in such business, register his name and place of business with the District Director of Internal Revenue for the district in which is located his principal place of business. The form provided for this purpose is Form 800, Application for Registry, which may be obtained from the District Director. The form should be prepared in accordance with the instructions shown thereon and the provisions of the applicable regulations. The District Director receiving the application for registry will issue Certificate of Registry, Form 800A, which must be posted in the registered place of business.

(4) *Wagering.*—For the occupational tax upon any person liable for the tax on wagers or engaged in receiving wagers for or on behalf of any person so liable, see section 601.404(*d*)(1).

SEC. 601.404. MISCELLANEOUS EXCISE TAXES COLLECTED BY SALE OF REVENUE STAMPS.—(*a*) *General.*—Miscellaneous excise taxes collected

by sale of revenue stamps may be grouped into three general classes. A brief description of each class is set forth in the three paragraphs immediately following.

(*b*) *Documentary stamp taxes.*—(1) *Capital stock, certificates of indebtedness, deeds of conveyance, and foreign insurance policies.*—Chapter 34 of the Internal Revenue Code imposes a tax on the issuance of corporate certificates of indebtedness, capital stock, or similar instruments, and foreign insurance policies. Chapter 34 of the Code also imposes a tax on all sales or transfers of corporate certificates of indebtedness, capital stock, or similar instruments, and on deeds of conveyance of realty sold.

(2) *Cotton futures.*—Subchapter D of chapter 39 of the Code imposes a tax on each contract of sale of any cotton for future delivery unless the contract complies with certain specified conditions.

(3) *Silver bullion.*—Subchapter F of chapter 39 of the Code imposes a tax on the net profit realized on the transfer of any interest in silver bullion, subject to certain exemptions and abatements to registered dealers and producers.

(*c*) *Commodity stamp taxes.*—(1) *Oleomargarine.*—Subchapter F of chapter 38 of the Code imposes a tax with respect to all oleomargarine imported from foreign countries.

(2) *Adulterated and process or renovated butter.*—Part I of subchapter C of chapter 39 of the Code imposes taxes with respect to adulterated and process or renovated butter and also imposes an occupational tax on manufacturers of adulterated and process or renovated butter and on wholesale and retail dealers in adulterated butter.

(3) *Filled cheese.*—Part II of subchapter C of chapter 39 imposes a tax with respect to filled cheese and also imposes an occupational tax on manufacturers of, and wholesale and retail dealers in, filled cheese.

(4) *Opium, isonipecaine, opiates, and coca leaves.*—Part I of subchapter A of chapter 39 of the Code imposes a tax upon narcotic drugs produced in or imported into the United States, and sold, or removed for consumption or sale and also imposes an occupational tax on (i) importers, manufacturers, producers or compounders of such drugs; (ii) wholesale or retail dealers in such drugs; (iii) physicians, dentists, veterinary surgeons or other practitioners dispensing such drugs; (iv) persons engaged in research, instruction or analysis using such drugs; and (v) persons not otherwise taxed dispensing preparations containing such drugs. The responsibility for the administration and enforcement of these taxes is jointly shared by the Internal Revenue Service and the Bureau of Narcotics.

(5) *Opium for smoking purposes.*—Subpart B of part I of subchapter A of chapter 39 of the Code imposes a tax upon all opium manufactured in the United States for smoking purposes. The responsibility for the administration and enforcement of this tax is jointly shared by the Internal Revenue Service and the Bureau of Narcotics.

(6) *Marihuana.*—Part II of subchapter A of chapter 39 of the Code imposes a tax upon all transfers of marihuana and also imposes an occupational tax with respect to marihuana on similar classes of persons as those enumerated in subparagraph (4) of this paragraph and in addition imposes a tax on millers of marihuana. The responsibility for the administration and enforcement of this tax is jointly shared by the Internal Revenue Service and the Bureau of Narcotics.

(7) *Playing cards.*—Subchapter A of chapter 36 of the Code imposes a tax on playing cards manufactured or imported, and sold, or removed for consumption or sale.

(8) *White phosphorous matches.*—Subchapter B of chapter 39 of the Code imposes a tax upon white phosphorous matches.

(*d*) *Occupational stamp taxes.*—(1) *Wagers.*—Subchapter A of chapter 35 of the Code imposes a tax on wagers. Subchapter B of chapter 35 of the Code imposes an occupational tax upon each person who is liable for the tax on wagers or who is engaged in receiving wagers for or on behalf of any person so liable.

(2) *Coin-operated amusement or gaming devices.*—Subchapter B of chapter 36 of the Code imposes an occupational tax with respect to coin-operated amusement or gaming devices.

(3) *Bowling alleys, billiard and pool tables.*—Subchapter C of chapter 36 of the Code imposes an occupational tax with respect to bowling alleys, billiard tables, and pool tables.

(*e*) *Applicable regulations.*—The descriptive terms used in this section to designate the various classes of taxes are intended only to indicate their general character. Specific information relative to the scope of each tax, the forms used, and the functioning of the Service with respect thereto is contained in the applicable regulations. Copies of all necessary forms, and instructions as to their preparation and filing, may be obtained from the District Director of Internal Revenue.

(*f*) *General procedure.*—(1) The documentary and commodity stamp taxes are paid by having affixed to the document, memorandum of sale, policy, package, container, etc., an internal revenue adhesive stamp or stamps in an amount equal to the tax due and by thereafter canceling such stamps in the manner prescribed. Payment of occupational taxes is evidenced by the posting or displaying of a special occupational tax stamp on the premises where the business is operated. If the taxpayer required to display the special occupational tax stamp has no fixed place of business, the stamp must be kept on his person. The stamps used for such purposes are prepared by the Internal Revenue Service and distributed through District Directors of Internal Revenue.

(2) Documentary stamp taxes are payable with respect to every transaction, i. e., each issue, sale, transfer, etc., of the instrument subject to tax. Commodity stamp taxes are payable with respect to the manufacture, importation, or transfer, as the case may be, of the contents of each package or container. Occupational taxes are payable annually for the privilege of doing business beginning with July 1 of each year, when the taxpayer is in business on that date, or from the beginning of the month in which the business is commenced on a pro rata basis.

(3) Documentary stamps may be purchased from (i) District Directors of Internal Revenue and duly authorized internal revenue employees; (ii) postmasters in all post offices of the first and second classes and such post offices of the third and fourth classes as are located in county seats; (iii) designated depositaries of the United States; and (iv) designated agents of any State. Commodity and occupational tax stamps may be purchased only from District Directors and duly authorized internal revenue agents. Such purchases may be made only upon the filing of the prescribed requisition, appli-

cation, or other form and from an official authorized by law to sell such stamps.

(4) Prior to January 1, 1955, payment for such stamps must be made by means of cash, post office money order or certified check. On and after January 1, 1955, payment for such stamps may be made by personal checks to the extent provided by regulations. In situations (i) where the instruments, documents, commodities, etc., subject to stamp tax are no longer in existence or (ii) where, for other reasons, such instruments, documents, etc., cannot be stamped, or (iii) where it is discovered that occupational tax stamps are due for prior taxable years, or (iv) where a taxpayer, after being advised of his liability, refuses to affix stamps, the tax is collected by assessment.

(5) Detailed information as to the person liable for tax, the forms of stamps, the prescribed applications or requisitions, and all other forms required in connection with miscellaneous excise taxes payable by revenue stamps is contained in the applicable regulations. Copies of all necessary forms, and instructions as to their preparation and filing, may be obtained from the District Director of Internal Revenue.

(*g*) *Liability for additional or delinquent tax.*—When liability for additional or delinquent tax is disclosed by the taxpayer or is discovered as a result of an examination of the taxpayer's books and records, payment thereof is evidenced by means of the prescribed stamp if the document, commodity, etc., is still in existence or, in the case of an occupational tax, if the liability is for the current period. Where the documents, commodities, etc., are no longer in existence, or where the taxpayer refuses to affix or purchase the stamps or where, in the case of an occupational tax, the liability is for a prior taxable period, the additional or delinquent tax is collected by assessment.

(*h*) *Administrative remedies available to taxpayers after purchase of documentary, commodity, or occupational tax stamps or after assessment or payment of tax.*—(1) *Redemption of stamps.*—Where stamps have been rendered useless by gumming or sticking together in transit or otherwise without fault of the purchaser, they may be exchanged by a District Director of Internal Revenue for other stamps of the same quantity and denomination. Stamps which have been spoiled, destroyed, or rendered useless, or unfit for the purpose intended, or for which the owner may have no use, or which through mistake have been improperly or unnecessarily used, or have been used in excess of the amount of tax actually due, may be redeemed upon proper claim filed with the District Director. All such claims must be prepared on Form 843 and must be filed with the District Director for the district in which is located the principal office of the claimant, or if he has no such office, with the District Director for the district in which he resides. The claim must be filed within 3 years after the date of purchase of the stamps from the Government. The stamps either must be submitted with the claim, or if it is impracticable to remove them from the instruments, documents, etc., to which they are attached they must be presented to an internal revenue agent or other internal revenue representative who will write on the face of the stamps the words "Claim for refund filed," and attach to the claim a statement showing that such endorsement has been made. In any case where the actual date of purchase of the stamps from the Government cannot be given, it must be definitely shown in the claim

whether they were so purchased within 3 years prior to the date of filing of the claim. Once filed, a claim for redemption follows generally the same channels as do all other claims for refund. See sections 601.103–601.106.

(2) *Claims for abatement or refund.*—Where a stamp tax is not paid by stamp but the amount thereof is assessed, the person against whom the assessment is made may file a claim for abatement of the tax or a claim for refund for any part of the assessment which has been paid. In either case the procedure to be followed by the claimant generally is the same as set forth in the case of claims for abatement or refund of other taxes. See sections 601.103–601.106. All claims for refund of stamp tax paid pursuant to an assessment must be filed within 3 years next after payment of the tax.

(3) *Instructions.*—Detailed instructions as to the manner in which claims for redemption of stamps and for abatement and refund of stamp taxes should be prepared and filed are contained in the applicable regulations.

(*i*) *Provisions special to documentary stamp taxes.*—(1) Every person engaged in any of the following businesses or activities is required to register with the District Director of Internal Revenue for each district in which such business or activity is conducted: (i) negotiating, making, or recording sales or transfers of stock, certificates of indebtedness, etc.; (ii) conducting or transacting a stock or bond brokerage business; (iii) accepting or procuring the transmission of orders for the purchase or sale or transfer of stocks, etc., to be executed at a stock or bond brokerage office or an exchange or similar place; (iv) transferring stock, certificates of indebtedness, etc., other than his own; and (v) conducting an exchange or clearing house, or clearing association, for the clearing, adjusting and settling of transactions made on exchanges or similar places.

(2) A statement for such registration is required to be made on Form 741 procurable from District Directors of Internal Revenue. The statement must set forth specifically the character of the business, the name under which it is operated, and the exact location. A concern having branches or agencies must file a statement in the district in which its principal office is located, showing the address of each branch office or agency and the name of the manager or agent thereof. A separate statement must also be filed in each of the other districts in which branches or agencies are maintained. The data shown in a statement covering a branch or agency must relate to such branch or agency rather than the principal office. For further information as to the proper execution of Form 741, see the applicable regulations.

(3) Any person conducting a stock brokerage business who has registered with the District Director as provided above may appoint some person to act as nominee in holding stock on his behalf. Also, any person acting in the capacity of a custodian may appoint some person to act as nominee in holding stocks or certificates of indebtedness on his behalf. Any corporation may appoint some person to act as nominee to hold stock on its behalf. The name of the person appointed as nominee of a broker, custodian, or a corporation shall be registered with the District Director for the district in which the principal place of business of the broker, custodian, or corporation is located. Substitution of a nominee may be effected by likewise regis-

tering the name of the successor nominee. No special form is prescribed for use in registering a nominee.

(4) Where proper registration statements have been filed, the District Director will issue to such person a certificate of registration signed by the District Director and setting forth the date of issue, the name of the person conducting the business and the nature of the business for which the certificate is issued. Such certificate must be kept at the place of business located within the district of the District Director by whom the certificate is issued.

(*j*) *Provisions special to commodity stamp taxes.*—(1) Provision is made for the withdrawal of filled cheese and playing cards from factories, free of tax, for the use of the United States. The procedure to be followed, the forms to be used, etc., in the case of such withdrawals are contained in the applicable regulations. Provision is also made for the exportation without payment of tax on adulterated butter and playing cards. The procedure to be followed, and the forms to be used, etc., in the case of such exportation are contained in the applicable regulations.

(2) Every manufacturer of opium manufactured in the United States for smoking purposes must, before commencing business, furnish to the District Director of the district in which his place of manufacture is located a notice on Form 268 and a bond on Form 269 with sureties satisfactory to the District Director and in a penal sum of not less than $100,000. There shall be not less than three personal sureties, each of whom shall qualify in the full amount of the bond. The District Director on approving the bond will issue to the manufacturer a certificate on Form 270 which will specify the penal sum of the bond furnished. This certificate shall contain a transcript from the manufacturer's notice, Form 268, giving an accurate description of the factory premises. This certificate must be posted by the manufacturer in a conspicuous place within his manufactory.

(3) Every manufacturer of adulterated and process or renovated butter, filled cheese, or white phosphorous matches must also give notice and register with the District Director on Form 213 before engaging in the business, and also furnish a satisfactory bond on Form 214. Every manufacturer of playing cards is required to register with the District Director on Form 277. Persons regularly engaged in the business of furnishing silver bullion for industrial, professional, or artistic use are required to register with the District Director on Form 1 (Silver). Persons required to register with the District Director or furnish bond should consult the applicable regulations and the appropriate forms.

(*k*) *Provisions applicable to special or occupational stamp taxes.*—Every person liable to pay any occupational tax imposed under subtitle D of the Code is required to register with the District Director of Internal Revenue his name or style, place of residence, trade or business, and the place where such trade or business is carried on. In the case of a partnership the names of the partners and their place of residence must be so registered. See section 7011 of the Code. The following forms are prescribed for registration: Form 678 (relating to occupational taxes with respect to opium, etc.), Form 678-A (relating to occupational taxes with respect to opium, etc., in the case of a person who has not previously registered in any of the classes or

occupations specified in sec. 4721 of the Code), Form 678–C, relating to occupational taxes with respect to marihuana), Form 11 (relating to adulterated and process or renovated butter and filled cheese), Form 11–B (relating to occupational taxes with respect to coin-operated amusement and gaming devices, bowling alleys, and billiard and pool tables), Form 11–C (relating to occupational tax with respect to wagering).

SUBPART E—CONFERENCE AND PRACTICE REQUIREMENTS

SEC. 601.501. SCOPE OF REQUIREMENTS.—The conference and practice requirements prescribed in this subpart apply to all offices of the Internal Revenue Service, including the Office of the Chief Counsel. Such requirements are applicable with respect to any matter involving any internal revenue tax.

SEC. 601.502. QUALIFICATIONS FOR CONFERENCES.—(*a*) *General.*—It is the policy of the Internal Revenue Service to encourage the discussion of disputed tax liability or any matter in connection with an internal revenue tax which affects the taxpayer's interest. Conferences, of course, may be accorded only to taxpayers or their duly authorized representatives. Conferences with taxpayers or their representatives will not ordinarily be held without previous arrangement. However, upon a proper showing a request for an immediate conference without previous arrangement will be given consideration, and Service officials responsible for the arrangement of conferences may, in their discretion, make an exception to the rule. Every protest, brief, or other statement in writing which the taxpayer or his representative desires to be considered at any conference should be submitted or filed at least 5 days prior to the date of the conference. If the taxpayer or his representative is unable to file such protest, brief, or other statement in writing at least 5 days prior to the date of the scheduled conference, the taxpayer or his representative should arrange with the appropriate Service representative for a postponement of the conference to a date mutually agreeable to the parties. The taxpayer or his representative remains free of course to submit additional or supporting facts or evidence within a reasonable time after the conference.

(b) *Requirement of enrollment.*—(1) Except as provided in this paragraph, or as authorized by Treasury Department Circular No. 230 as amended (31 CFR, pts. 10, 12, 13, and 14), which circular contains rules governing the recognition of attorneys and agents representing clients before the Treasury Department, no person appearing as an attorney or agent on behalf of any taxpayer, or of a transferee or fidiciary will be recognized by representatives of the Internal Revenue Service, unless such attorney or agent is duly enrolled and in good standing to practice before the Treasury Department in accordance with Department Circular No. 230. The appearance of such attorney or agent, and his representation of taxpayers in every respect, must be in strict compliance with the requirements of Department Circular No. 230 and all pertinent statutes, and also with the requirements of this subpart. Evidence of enrollment must be submitted upon request when the attorney or agent presents himself for conference.

(2) Certain individuals are authorized by Department Circular No. 230 to appear without enrollment under the circumstances and conditions described therein. However, such individuals must present satisfactory identification, and the requirement of a power of attorney will not be waived in the case of any individual appearing on behalf of another person. See paragraph (*c*) of this section. The formal requirements concerning identification and authority of a person to act in a fiduciary capacity are the same as those related to the execution of powers of attorney by such fiduciary. See section 601.505. Individuals who without enrollment appear on behalf of any person with respect to the tax liability of such person may also without enrollment appear with respect to the liability of such person as a transferee of property of a taxpayer and with respect to the liability of a fiduciary under section 3467 of the Revised Statutes, 31 U. S. C. 192.

(3) Unenrolled employees of enrolled attorneys or agents will not be recognized by offices of the Service, except for the purpose of filing papers or securing information as to the status of tax cases. Recognition of such employees for the purpose of securing information as to the status of tax cases will be given only when the employee presents with reference to a particular case written authority from his employer to request such information, and a power of attorney authorizing his employer to act in such matter has previously been filed and not revoked.

(4) If a proper power of attorney is filed authorizing only one of the following acts by the attorney or agent, enrollment will not be required:

(i) Authority to sign, but not to prosecute, any claim of the taxpayer; and

(ii) Authority to inspect or receive copies of returns filed by the taxpayer where an Executive order or regulations permit such action by agent.

The Commissioner reserves the right to withhold making the above exceptions in any specific cases. If the power of attorney authorizes the attorney or agent to do both of the above acts or one of the above acts and some other act or acts, enrollment will be required, notwithstanding that the attorney or agent does not expect to exercise the additional power conferred upon him.

(5) If at the time an attorney or agent appears for conference, he is not familiar with the requirement for enrollment or for a power of attorney, or can show that he has not had a reasonable opportunity to obtain a power of attorney from the person on whose behalf he appears, but is able to produce such evidence as will reasonably convince the Service's representative that he has authority to represent the taxpayer, such attorney or agent may be heard with the understanding that a power of attorney in proper form and evidence of enrollment will be promptly submitted. Pending the filing of a power of attorney and of evidence of enrollment, information concerning the Service's attitude with respect to the matter will not be disclosed to the attorney or agent.

(*c*) *Requirement of power of attorney.*—(1) No attorney or agent shall appear on behalf of any person before any office of the Internal Revenue Service or be recognized in any matter connected with the presentation of such person's interests, including the preparation and

filing of necessary written documents and correspondence with the Service relative to such interests, unless such attorney or agent presents and files a power of attorney in proper form, or a certified copy thereof, from such person authorizing the attorney or agent to represent him in the matter in question. Only one power of attorney to represent the taxpayer shall be in effect in any one case, and there shall be included in such power of attorney the names and addresses of all attorneys or agents to whom the taxpayer has delegated authority to represent him in the case. A power of attorney is not required in the case of an attorney appointed by a court having jurisdiction over a debtor to represent a trustee in bankruptcy, debtor in possession, or receiver. For evidence of authority to be submitted in such cases, see section 601.505(*c*).

(2) The Commissioner may, with respect to the performance of a specific act, substitute a requirement for appropriate evidence of authorization in lieu of the requirement in this section of a power of attorney. The requirement of a power of attorney to authorize prosecution of a claim for refund by an attorney or agent of the claimant shall not be waived.

(3) See paragraph (*b*)(5) of this section with respect to recognition of an attorney or agent in certain cases pending the filing of a power of attorney.

(4) A power of attorney filed after final determination of a tax liability will not be accepted, unless the power of attorney recites that the taxpayer is informed of such settlement and of the amount of the deficiency or overassessment determined.

SEC. 601.503. FILING POWER OF ATTORNEY AND STATEMENT RELATIVE TO FEES.—A power of attorney shall be filed in duplicate in the office of the District Director of Internal Revenue in which the case is under consideration, with one additional conformed copy for each taxable year in excess of one. If at the time the power of attorney is furnished the case is pending in the office of an assistant regional commissioner, the power of attorney may be filed in such office. In the case of a power of attorney authorizing representation in connection with a request for a ruling or a similar matter of a specific nature which will be originally considered by the National Office, the power of attorney shall be filed in the Office of the Director of Practice, Internal Revenue Service, Washington 25, D. C. A fee statement respecting contingent or partially contingent fees required to be filed by attorneys and agents under Department Circular No. 230 shall be signed only by the attorney or agent and filed with the power of attorney to which it relates.

SEC. 601.504. PROVISIONS RESPECTING POWERS OF ATTORNEY.—(*a*) *Formal requirements.*—The use of technical language in the preparation of a power of attorney is not necessary, but the instrument should clearly express the taxpayer's intention as to the scope of the authority granted to the attorney or agent, and the tax matters and the taxable years or periods to which the power relates. If it is desired that a copy of any correspondence addressed to the taxpayer should be sent to the attorney or agent in connection with any matter in respect of which he is authorized to act under the terms of the power of attorney, the power of attorney should contain a request to that effect and designate the mailing address of such attorney or agent.

(1) *Extent of authority delegated.*—The authority delegated to an attorney or agent in a power of attorney enumerating specific acts which the attorney or agent is authorized to perform will be considered to be limited to those acts. Express authority to perform the following acts must be granted in the power of attorney or such acts will be considered to be beyond the scope of the authority of the attorney or agent—

(i) To receive, but not to endorse and collect, checks in payment of any refund of internal revenue taxes, penalties, or interest (see sec. 3477 of the Revised Statutes (31 U. S. C. 203), which prohibits assignments of claims or portions thereof, and sec. 601.510).

(ii) To delegate authority or to substitute another agent or attorney.

(iii) To execute waivers or consents agreeing to a later assessment and collection of taxes than is provided by applicable statutes of limitations.

(iv) To execute a closing agreement in respect of a tax liability or a specific matter.

(2) *Signature of principal.*—A power of attorney shall be signed as follows:

(i) In the case of an individual taxpayer, by such individual.

(ii) In the case of any taxable year for which a joint return was made by husband and wife, by both husband and wife except that either spouse may sign for the other if such signature is duly authorized in writing.

(iii) In the case of a partnership, either by all members or in the name of the partnership by one of the partners duly authorized to act.

(iv) In the case of a corporation, by an officer of the corporation having authority to bind the corporation. The instrument shall also be attested by the secretary of the corporation and the corporate seal affixed. If the officer who signs the power of attorney is also secretary, another officer of the corporation, preferably the president, vice president, or treasurer, must also sign the authorization so that two different individuals' signatures will appear thereon. If the corporation has no seal, a certified copy of a resolution duly passed by the board of directors of the corporation authorizing the execution of the power of attorney should be attached.

(v) In the case of an association, the same requirements shall be applied as in the case of a corporation.

(vi) In case the taxpayer is dissolved, insolvent, or deceased, and in the case of a trustee, guardian, or other fiduciary, see section 601.505 for instructions for execution of powers of attorney in special cases.

(3) *Acknowledgment.*—The power of attorney must be acknowledged before a notary public, or, in lieu thereof, witnessed by two disinterested individuals. The notarial seal must be affixed unless such seal is not required under the laws of the State wherein the power of attorney is executed.

(4) *Certification of powers of attorney.*—The certification of copies of powers of attorney or papers or documents filed in connection

therewith must be made by a notary public or other proper official, who shall state that he has personally compared the copy with the original and finds it to be a true and correct copy.

(*b*) *Substitution of attorneys or agents.*—Substitution of attorneys or agents or delegations of authority can be recognized only if the power of attorney expressly confers the power of substitution or delegation. An attorney or agent who is enrolled and in good standing before the Department may, in pursuance of such express authority, substitute another or others in his stead or delegate authority to another or others. The Service reserves the right to refuse recognition to a substituted attorney or agent in any case where such substitution would only delay the closing of the case. Furthermore, a substitute power of attorney granted by an attorney or agent who is himself acting under a substitute power of attorney will not be accepted unless specific authority is granted in the principal's power of attorney to pass on to his substitute the right of substitution.

(*c*) *Designation of new attorneys or agents.*—In any case in which a power of attorney has been filed and thereafter the taxpayer desires to authorize an additional attorney or agent to represent him before the Service with respect to the same matter, a new power of attorney must be filed which shall include the names of all attorneys or agents authorized to act for the taxpayer. Such new power of attorney shall contain a clause specifically revoking any and all powers of attorney previously filed with respect to the same matter. If the taxpayer desires to revoke the authority granted to an attorney or agent in a power of attorney previously filed and to authorize a new attorney or agent to act with respect to the same matter, the revocation of the authority of the former attorney or agent shall in no case be effective so far as the Service is concerned prior to the giving of written notice to the Service that the authority of such attorney or agent has been revoked and that the former attorney or agent has been notified in writing by the taxpayer of such revocation.

(*d*) *Special authority required in Vinson Act cases.*—A power of attorney authorizing an attorney or agent to represent a taxpayer in connection with income and excess profits tax matters will not be recognized as adequate to authorize an attorney or agent to act as representative of the taxpayer in connection with its excess profit liability under section 3 of the Vinson Act (48 Stat. 503), as amended. A separate power of attorney must be furnished specifically authorizing the attorney or agent to appear on behalf of the taxpayer in such cases.

SEC. 601.505. INSTRUCTIONS FOR EXECUTION OF POWER OF ATTORNEY IN SPECIAL CASES.—(*a*) *Dissolved partnership.*—A power of attorney to act with respect to matters involving the affairs of a dissolved partnership must be signed by each of the former partners. In case some of the partners are dead, their legal representatives must sign in their stead. (See par. (*d*) of this section.) If, however, under the laws of the particular State, the surviving partners at the time of the execution of the power of attorney have exclusive right to the control and possession of the firm's assets for the purpose of winding up its affairs, their signatures alone will be sufficient. If only the surviving partners sign the power of attorney, a copy of the pertinent provisions of the State law under which they claim authority, exclusive of the legal

representatives of the deceased partners, should be noted and citation given thereto.

(*b*) *Dissolved corporation.*—If a liquidating trustee or trustee under dissolution has been appointed, or if a trustee derives authority under a statute of the State in which the corporation was organized, the power of attorney should be executed by such trustee. If there is more than one trustee, all must join unless it is established that less than all have authority to act in the premises. The power of attorney must be accompanied by a copy of the instrument under which the trustee derives his authority, properly authenticated, or if the authority is derived under a State statute, the statute should be cited and quoted, and an affidavit by a third party, setting forth the facts required by the statute as a condition precedent to the vesting of the authority in said trustee, must be furnished. It must also appear in the case of any trustee that his authority has not been terminated. If there is no trustee, then a power of attorney signed by a sufficient number of individuals to make up a representation of a majority of the voting stock of the corporation at the date of dissolution will be accepted for purposes of conference and correspondence relating to the tax liability in the particular case. Such instrument must show the total number of outstanding shares of voting stock at the date of dissolution and the number held by each signatory to the power of attorney. The instrument must also contain positive averments as to the nonexistence of any trustee, and the date of dissolution must appear.

(*c*) *Insolvent taxpayer.*—A certificate from the court having jurisdiction over the insolvent should be furnished showing the appointment and qualification of the trustee or receiver and that the authority has not been terminated. In cases pending before a district court of the United States an authenticated copy of the order approving the bond of the trustee or receiver will meet this requirement. If an attorney has been appointed under authority of court for the trustee or receiver, a copy of the court order appointing such attorney (where he is to represent the trustee or receiver) should be furnished. If no attorney has been appointed, the trustee or receiver should execute the power of attorney and the above-described evidence showing the appointment of the trustee or receiver should be furnished therewith. If the trustee or receiver does not wish to appoint an attorney, he will be recognized upon establishing his authority in the manner above described.

(*d*) *Deceased taxpayer.*—The executor or administrator should execute the power of attorney, which must be accompanied by a short-form certificate (or authenticated copies of letters testamentary or letters of administration) showing that his authority is in full force and effect at the time such power of attorney is submitted. In the event that the executor has been discharged and a trustee under the will is acting, the power of attorney must come from the trustee, and evidence of the discharge of the executor and of the appointment of the trustee must be submitted with the power of attorney. Where the executor is discharged and the estate is distributed to the residuary legatees, the power of attorney must come from the residuary legatee or legatees, and be accompanied by a statement from the court certifying to the discharge of the executor and naming the residuary legatees and indicating the proper share to which each is entitled. In

the event that the decedent died intestate and the administrator has been discharged or none was ever appointed, the power of attorney must be executed by the distributees and accompanied by evidence of the discharge of the administrator, if one had been appointed, and affidavits and such other evidence as can be adduced tending to show the relationship to the deceased of the signatories to the power of attorney and the right of each of them to the respective shares claimed under the law of the domicile of the deceased.

(*e*) *Guardians and other fiduciaries appointed by a court of record.*—The power of attorney should be executed by the fiduciary and must be accompanied by a court certificate or court order showing that such fiduciary has been appointed and that his appointment has not been terminated.

(*f*) *Trustee under agreement or declaration.*—Powers of attorney must be executed by the trustee and be accompanied by documentary evidence of the authority of the trustee to act. Such evidence may be either a copy of the trust instrument, properly certified, or a certified copy of extracts from the trust instrument, showing:

(1) Date of instrument.

(2) That it is or is not of record in any court.

(3) The beneficiaries.

(4) The appointment of the trustee, the authority granted, and such other information as may be necessary to show that such authority extends to Federal tax matters.

(5) That the trust has not been terminated, and that the trustee appointed therein is still acting.

Self-serving affidavits by the trustee in this connection are not acceptable. In the event that the trustee appointed in the original trust instrument is no longer acting and has been replaced by another trustee, documentary evidence of the appointment of the new trustee must be submitted. In cases where there are more than one trustee appointed, all must join unless it is shown that less than all have authority to act.

(*g*) *Cross reference.*—For additional requirement of execution and acknowledgment of power of attorney before a notary public, see section 601.504(*a*)(3).

SEC. 601.506. REFUSAL TO RECOGNIZE ATTORNEY OR AGENT.—Where consideration of a matter has been held in abeyance pending the furnishing of evidence which the Service has requested an attorney or agent to submit, failure to comply with such request within 3 months from the date it is made may be deemed by the administrative officer before whom the matter is pending cause for refusal further to recognize the authority of such attorney or agent. The administrative officer shall, however, give written notice of such refusal to the taxpayer represented by such attorney or agent, and shall briefly state the reason such action has been taken.

SEC. 601.507. POWER OF ATTORNEY NOT REQUIRED IN CASES DOCKETED IN THE TAX COURT OF THE UNITED STATES.—In a case docketed in the Tax Court of the United States the petitioner and the Commissioner stand in the position of parties litigant before a judicial body. The Tax Court has its own rules of practice and procedure and its own rules respecting admission to practice before it. Ordinarily, the Appellate Division of a region will not recognize counsel not of record

in a proceeding before the Tax Court. Therefore, correspondence in connection with cases docketed in the Tax Court will be addressed to counsel of record before the Court. In all cases pending in the Appellate Division, other than cases docketed in the Tax Court, the customary power of attorney is required.

SEC. 601.508. RECOGNITION BY CORRESPONDENCE.—If an attorney or agent of a taxpayer desires recognition through correspondence with the Service, enrollment and power of attorney requirements must be met even though no actual appearance is made. The attorney or agent should state in his first letter or other written communication with the Service whether he is enrolled to practice before the Department, and should enclose in duplicate the power of attorney authorizing him to act in the matter. In any matter in which a power of attorney has previously been filed copies of all correspondence relating to the same matter and addressed by the Service to the taxpayer shall be sent to the attorney or agent designated in such power of attorney, provided the power of attorney contains a request that copies of such correspondence be sent to such attorney or agent.

SEC. 601.509. EVIDENCE REQUIRED TO SUBSTANTIATE FACTS ALLEGED IN CONFERENCES.—All evidence except that of a supplementary or incidental character may be required to be submitted over the sworn signature of the taxpayer. In the case of any matter pending before the Service in respect of which the taxpayer submits a protest or other similar statement, such protest or statement should contain a sworn statement of facts on which the taxpayer relies, and should meet all the issues raised by the Service which the taxpayer desires to contest. Every claim, affidavit, written argument, brief, or statement of facts prepared or filed by an attorney or agent in any matter pending before the Service shall have endorsed thereon a statement signed by such attorney or agent stating whether or not he prepared such document and whether or not he knows of his own knowledge that the statements of fact contained therein are true and correct.

SEC. 601.510. DELIVERY OF CHECKS IN PAYMENT OF REFUNDS.—The Service is not bound to deliver any check in payment of refund of internal revenue taxes, penalties, or interest to a representative of any taxpayer acting under authority evidenced by a power of attorney. However, it will be the general policy of the Service to mail such checks in care of an enrolled attorney or agent who has filed a power of attorney from the principal, specifically authorizing him to receive but not to endorse such check, provided that such power of attorney shall have been filed in sufficient time for the section or division preparing the certificate of overassessment or other appropriate notice to show thereon the mailing address as "care of" the attorney or agent. When an attorney or agent has more than one address, request to mail the check to an address other than that shown in the power of attorney will not be granted unless the address shown in the power of attorney is no longer that of the attorney or agent. In the event that a power of attorney is filed specifically authorizing more than one attorney or agent to receive checks on the taxpayer's behalf, and such attorneys or agents have different addresses, the Service will mail the check direct to the taxpayer, unless a statement is furnished, signed by all of the attorneys or agents named in the power of attorney, requesting that the check be mailed in care of one of their number. Furthermore, it

will be the policy of the Service not to mail checks in payment of refunds to an attorney or agent who holds authority to receive such checks by reason of a substitute power of attorney obtained from the attorney or agent designated by the taxpayer.

SEC. 601.511. CONTEST BETWEEN ATTORNEYS OR AGENTS REPRESENTING TAXPAYERS.—Where there is a contest between members of a dissolved firm or between two or more attorneys or agents acting under the same power of attorney as to which one is entitled to represent a client in a matter pending before the Service or to receive a check, thereafter the taxpayer only shall be recognized, unless the members or survivors of the dissolved firm, or the contesting attorneys or agents, file an agreement signed by all designating which of them shall be entitled to represent the taxpayer in such matter or to receive any check. In no case shall the delivery of a check to the taxpayer be delayed more than 60 days by reason of failure to file such agreement.

SUBPART F—RULES, REGULATIONS, AND FORMS

SEC. 601.601. RULES AND REGULATIONS.—(*a*) *Formulation.*—(1) Internal revenue rules take various forms. The most important rules are issued as regulations and Treasury decisions, prescribed by the Commissioner and approved by the Secretary. Other rules may be issued over the signature of the Commissioner or the signature of any other official to whom authority has been delegated. The channeling of rules varies with the circumstances. Regulations and Treasury decisions, except those relating to alcohol, tobacco, and certain firearms, are prepared either in the office of the Assistant Commissioner (Technical) or in the office of the Chief Counsel. All such regulations and Treasury decisions are reviewed in the office of the Assistant Commissioner (Technical) and in the office of the Chief Counsel. Alcohol, tobacco, and certain firearms regulations and Treasury decisions are prepared in the office of the Assistant Commissioner (Operations) and reviewed in the office of the Chief Counsel. After approval by the Commissioner, regulations and Treasury decisions are forwarded to the Secretary of the Treasury for further consideration and final approval.

(2) Where required by section 4 of the Administrative Procedure Act (60 Stat. 237) and in such other instances as may be desirable, the Commissioner publishes in the Federal Register general notice of proposed rules (unless all persons subject thereto are named and either personally served or otherwise have actual notice thereof in accordance with law). This notice includes (i) a statement of the time, place, and nature of public rule-making proceedings; (ii) reference to the authority under which the rule is proposed; and (iii) either the terms or substance of the proposed rule or a description of the subjects and issues involved. Also, pursuant to section 5 of the Federal Alcohol Administration Act (27 U. S. C. 205(*f*)) public notice and opportunity for hearing is given prior to the adoption of regulations under that section.

(*b*) *Petition to change rules.*—Interested persons are privileged to petition for the issuance, amendment, or repeal of a rule, and such petitions will be given careful consideration. Petitions should be addressed to the Commissioner of Internal Revenue, Washington 25, D. C.

(*c*) *Publication of rules and regulations.*—All internal revenue regulations and Treasury decisions (whether interpretative or substantive) are published in the Federal Register and in the Code of Federal Regulations. The Treasury decisions are also published in the weekly Internal Revenue Bulletin and the semi-annual Cumulative Bulletin. The Internal Revenue Bulletin is the authoritative instrument of the Commissioner for the announcement of official rulings, and for the publication of Treasury decisions, Executive orders, legislation and court decisions pertaining to internal revenue matters. It is the policy of the Service to publish in the Bulletin all substantive and procedural rulings of importance or general interest, the publication of which is considered necessary to promote a uniform application of the laws administered by the Service. It is also the policy to publish all rulings which revoke, modify, amend or affect any published ruling. Rulings relating solely to matters of internal management are not published. The rulings are prepared in the various offices of the Service.

SEC. 601.602. FORMS AND INSTRUCTIONS.—(*a*) *Tax return forms and instructions.*—Forms and instructions are developed by the Internal Revenue Service to explain the requirements of the internal revenue laws and regulations and are issued for the assistance of taxpayers in exercising their rights and discharging their duties under the internal revenue laws. All internal revenue taxes which are not collected by stamps are assessed and collected through the self-determination and self-application of the law and the regulations by taxpayers. The tax return forms are the instruments through which this is accomplished.

(*b*) *Other forms and instructions.*—In addition to the forms and instructions for the return of internal revenue taxes, the Internal Revenue Service provides other necessary or appropriate forms for assisting the public in complying with the technical requirements of the internal revenue laws and regulations. The material contained in the forms and instructions, and the arrangement thereof, is carefully considered in the Internal Revenue Service and is designed to lead the taxpayer step-by-step through an orderly accumulation of data to an accurate report of the information required.

(*c*) *Procurement of forms and instructions.*—Copies of all necessary forms, and instructions as to their preparation and filing, may be obtained from District Directors of Internal Revenue.

SUBPART G—RECORDS

SEC. 601.701. CLASSIFICATION.—Matters of official record in the Internal Revenue Service include:

(*a*) Documents submitted by members of the public pursuant to the internal revenue laws or regulations, such as tax returns, information returns, statements required by statute or regulation, claims for credit, refund, or abatement, offers in compromise, bonds, applications for registration, and waivers of statutes of limitation.

(*b*) Final opinions and orders under the internal revenue laws and regulations in tax matters, such as records of assessment, certificates of overassessment, and statutory deficiency letters, and documents evidencing determinations of such matters as claims

for abatement, credit, or refund, offers in compromise, applications for excess profits tax relief, registration applications, closing agreements, and levies.

SEC. 601.702. PUBLICATION AND PUBLIC INSPECTION.—(*a*) *General.*—Sections 6103, 7213, and 7237(b) of the Code and the corresponding provisions of prior internal revenue laws contain broad prohibitive and penal provisions against the disclosure of certain information described therein obtained by the Internal Revenue Service from members of the public in the performance of its functions. See also 18 U. S. C. 1905. Publication and public inspection of the official records of the Service, including final opinions or orders in particular cases, are effected in the light of these provisions. The extent to which public disclosure is made of matters of official record to persons properly and directly concerned is set forth in this section.

(1) *Inspection of tax returns.*—The inspection of returns is governed by the provisions of the internal revenue laws and rules promulgated by the President or by the Secretary of the Treasury pursuant to such provisions. See Treasury Decision 4873 [C. B. 1938–2, 261], approved by the President November 12, 1938, as amended; Treasury Decision 4878 [C. B. 1939–1 (Part 1), 115], approved by the Secretary January 4, 1939; Treasury Decision 4929 [C. B. 1939–2, 91], approved by the President August 28, 1939, as amended; Treasury Decision 5138 [C. B. 1942–1, 99], approved by the President April 20, 1942 (26 CFR (1939), part 458, subpart A); Treasury Decision 4945 [C. B. 1939–2, 97], approved by the Secretary September 20, 1939 (26 CFR (1939), part 458, subpart B), as amended.

(2) *Public lists of persons making income tax returns.*—Lists of persons making income tax returns in each year are available to public inspection in the offices of District Directors of Internal Revenue. See sec. 6103(f) of the Code.

(3) *Public lists of persons paying occupational taxes.*—Lists of persons paying occupational taxes under subtitle D or E of the Code are available for public inspection in the offices of District Directors of Internal Revenue pursuant to the provisions and limitations of section 6107 of the Code.

(4) *Record of seizure and sale of real estate.*—Record 21, "Record of seizure and sale of real estate," is open for public inspection in offices of District Directors of Internal Revenue and copies are furnished on application. See Treasury Decision 5428 [C. B. 1945, 462], approved January 11, 1945, 10 F. R. 622.

(5) *State liquor cases.*—If the interests of the United States will not be jeopardized thereby, and if information will not be divulged contrary to section 7213(b) of the Code, assistant regional commissioners (alcohol and tobacco tax) may upon receipt of subpoenas or requests of State authorities, and at the expense of the State, authorize investigators and other employees under their supervision to attend trials and administrative hearings in liquor cases in which the State is a party, produce records and testify as to facts coming to their knowledge in their official capacities.

(6) *Public lists of employers making returns under the Federal Unemployment Tax Act.*—Lists of employers making annual returns on Form 940 under the Federal Unemployment Tax Act (chap. 23 of

the Code) are available for public inspection in the offices of District Directors of Internal Revenue. See sections 6103(f) and 6106 of the Code.

(7) *Information returns of certain tax-exempt organizations and certain trusts.*—Information returns filed pursuant to sections 6033(b) and 6034 of the Code by certain tax-exempt organizations and by trusts claiming charitable or other deductions under section 642(c) are available for public inspection in the offices of District Directors of Internal Revenue in which they are filed. The information returns so available are pages 3 and 4 of Form 990–A (tax-exempt organizations) and Form 1041–A (trusts). See section 6104 of the Code.

(*b*) *Final opinions and orders.*—In conformity with the policy of the provisions of law referred to in paragraph (*a*) of this section, final opinions and orders in the adjudication of cases arising under the internal revenue laws are, with limited exceptions, treated by the Service as confidential and are neither published nor made available for public inspection. The exceptions are:

(1) *Accepted offers in compromise.* In the case of offers in compromise in respect of income, profits, capital stock (repealed), estate or gift tax liability accepted on or after August 20, 1952, a copy of the summary sheet (abstract) of each such offer is available for public inspection in the office of the information officer of the National Office in Washington. Such summary sheet includes a brief description of the reasons for acceptance of the offer. If information in addition to that shown on the summary sheet is requested, such information, subject to the provisions set forth in Internal Revenue Cumulative Bulletin 1952–2, pages 299–300, will also be made available for inspection. In the case of offers in compromise of such tax liabilities accepted before August 20, 1952, a copy of the summary sheet will be made available for inspection upon request identifying the taxpayer. See Treasury Decision 5927 [C. B. 1952–2, 298], approved August 20, 1952, and Executive Order 10386 [C. B. 1952–2, 299], dated August 20, 1952.

(2) *Information regarding basic permits.*—Information with respect to the handling of applications for basic permits under the Federal Alcohol Administration Act and under section 5304 of the Code is maintained for public inspection in the offices of assistant regional commissioners (alcohol and tobacco tax) until the expiration of one year following final action on such applications. See Treasury Decision 5930 [C. B. 1952–2, 301], approved by the Acting Secretary September 2, 1952 (27 CFR, pt. 1).

(3) *Alcohol permits issued under section 5304 of the Code.*—A current card index record of all persons to whom basic permits have been issued, or who have filed application therefor, is available in the offices of assistant regional commissioners (alcohol and tobacco tax) for inspection by any permittee with respect to other permittees to whom he is authorized to sell, or from whom he is authorized to purchase, alcohol or specially denatured alcohol. (26 CFR 182.962)

(4) *Excess profits tax relief; publication of allowances.*—Pursuant to the provisions of section 6105 of the Code, there is published from time to time in the Federal Register the information specified in such section relative to excess profits tax relief allowed particular taxpayers.

(5) *Publication of decisions.*—Rulings and decisions on matters arising under the internal revenue laws 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, or which revoke, amend or affect in any manner a published ruling or decision are, after rephrasing to eliminate any confidential information relating to a particular case, including identity of persons, regularly published in the Internal Revenue Bulletin. See also section 601.601(*c*).

(*c*) *Rules.*—All rules relating to the functions of the Internal Revenue Service other than those dealing solely with internal management will, to the extent consist with the limitations contained in the provisions of law referred to in paragraph (*a*) of this section, be made available to public inspection. As to rules generally and their publication, see section 601.601 et seq.

(*d*) *Requests.*—(1) Requests for information in connection with matters of official record in which the procedure for inspection is not set out in rules referred to in the peceding paragraphs of this section should be submitted to the Commissioner of Internal Revenue, Washington 25, D. C. The request should clearly state the information desired and must set forth the interest of the applicant in the subject matter and purpose for which the information is desired. If the applicant is an agent or attorney acting for another he will attach to the application evidence of his authority to act for his principal. If such evidence is satisfactory, such agent or attorney will be given access to any record to which his principal would be given access. The determination as to whether the information requested is available for disclosure in any particular case will be made by the Commissioner of Internal Revenue or such other officer authorized under the provisions of law referred to in paragraph (*a*) of this section.

(2) Whenever it is determined that a matter of official record is available for disclosure in a particular case, a copy of said official record will be furnished the party requesting the same or the officer passing upon the request may in his discretion allow a personal inspection of the official record in question at the place where the document is normally kept. A reasonable fee may in the discretion of the determining officer be charged for furnishing copies of official records.

T. COLEMAN ANDREWS,
Commissioner of Internal Revenue.

(Filed by the Division of the Federal Register June 29, 1955, 8:57 a. m., except for Subpart C which was filed October 13, 1955, 8:50 a. m.)

ANNOUNCEMENT OF THE DISBARMENT AND SUSPENSION OF ATTORNEYS AND AGENTS FROM PRACTICE BEFORE THE TREASURY DEPARTMENT

Under section 261, Title 5 of the United States Code, the Secretary of the Treasury, after due notice and opportunity for hearing, is authorized to suspend or disbar from further practice before the Treasury Department any person, agent, or attorney shown to be incompetent, disreputable, or who refuses to comply with rules and regulations governing the recognition of agents, attorneys, or other persons representing clients before the Treasury Department, or who in any manner has willfully and knowingly deceived, misled, or threatened any client or prospective client by word, circular, letter, or advertisement. Enrolled persons are prohibited in any Treasury Department matter from directly or indirectly employing, accepting assistance from, being employed by, or sharing fees with, any person disbarred or under suspension from practice before the Treasury Department. To enable enrolled persons to identify such disbarred or suspended persons, the Internal Revenue Service will announce in the Internal Revenue Bulletin the names and addresses of persons who have been disbarred or suspended from such practice, their designation as attorney, agent, or other representative, and the date of disbarment or period of suspension. This announcement will appear in the weekly Bulletins at the earliest practicable date after such action and will continue to appear in the weekly Bulletins for a period of 2 months for each agent and attorney so suspended or disbarred and will later be consolidated and published in the Cumulative Bulletin.

The following persons, after due notice and opportunity of hearings, have been disbarred from further practice before the Treasury Department:

Name	Address	Designation	Date of disbarment
Hyman, Charles D....	Ventnor City, New Jersey..	Attorney..	Aug. 15, 1955
Leupold, John J.....	4713 Ramona Ave., Phila. 24, Pa.	Agent....	Sept. 23, 1955
Talanker, Murray.....	60 Oakwood Street, Albany, N. Y.	Agent....	Aug. 15, 1955
Wright, H. Winfield....	1802 Spring Garden St., Philadelphia 30, Pa.	Agent....	Sept. 16, 1955

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