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Cumulative Bulletin 1955–1

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INTERNAL REVENUE BULLETIN

CUMULATIVE BULLETIN 1955-1

January–June 1955

in this issue

	Page
Finding List	III–VI
Introduction	1
Foreword	2
Tax Court of the United States, The	3–8
Special Announcement	9
Part I.—Rulings and Decisions Under the Internal Revenue Code of 1954	11–203
Part II.—Rulings and Decisions Under the Internal Revenue Code of 1939 and Related Public Laws	205–563
Part III.—Alcohol Tax Rulings and Decisions:	
Subpart A.—Rulings and Decisions Under the Internal Revenue Code of 1954	565–607
Subpart B.—Rulings and Decisions Under the Internal Revenue Code of 1939	608
Subpart C.—Rulings and Decisions Under the Federal Alcohol Administration Act or Related Laws	609–617
Part IV.—Legislation and Treaties:	
Subpart A.—Legislation	619–623
Subpart B.—Tax Conventions	624–679
Subpart C.—Committee Reports	680–693
Part V.—Administrative and Miscellaneous Matters	695–722
Index	723–749

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FINDING LIST

	Page
Court Decisions:	
1773	554
1774	248
1775	253
1776	545
1777	450
1778	547
1779	548
1780	549
1781	435
1782	520
1783	207
1784	210
1785	376
1786	378
Revenue Rulings:	
54-501 (correction)	9
55-1	26
55-2	211
55-3	282
55-4	291
55-5	331
55-6	409
55-7	499
55-8	518
55-9	675
55-10	47
55-11	212
55-12	259
55-13	285
55-14	302
55-15	361
55-16	386
55-17	388
55-18	475
55-19	496
55-20	516
55-21	540
55-22	198
55-23	275
55-24	283
55-25	283
55-26	338
55-27	350
55-28	359
55-29	413
55-30	430
55-31	476
55-32	557
55-33	128
55-34	226
55-35	286
55-36	340
55-37	347
55-38	389
55-39	403
55-40	570
55-41	598
55-42	610
55-43	617
55-44	129
55-45	34
55-46	126
55-47	239
55-48	281
55-49	431
55-50	506
55-51	514
55-52	528
55-53	528
55-54	533
55-55	537

	Page
Revenue Rulings—Continued	
55-56	569
55-57	315
55-58	97
55-59	35
55-60	37
55-61	40
55-62	212
55-63	227
55-64	228
55-65	277
55-66	282
55-67	357
55-68	372
55-69	461
55-70	506
55-71	110
55-72	206
55-73	236
55-74	230
55-75	238
55-76	239
55-77	339
55-78	357
55-79	370
55-80	387
55-81	392
55-82	520
55-83	523
55-84	531
55-85	15
55-86	334
55-87	112
55-88	241
55-89	284
55-90	348
55-91	364
55-92	390
55-93	404
55-94	419
55-95	480
55-96	488
55-97	512
55-98	524
55-99	531
55-100	565
55-101	566
55-102	569
55-103	31
55-104	46
55-105	94
55-106	102
55-107	127
55-108	140
55-109	261
55-110	280
55-111	333
55-112	344
55-113	481
55-114	573
55-115	575
55-116	576
55-117	233
55-118	320
55-119	352
55-120	382
55-121	382
55-122	390
55-123	443
55-124	482
55-125	518
55-126	536

FINDING LIST—Continued

	Page
Revenue Rulings—Continued	
55-127	559
55-128	589
55-129	595
55-130	603
55-131	614
55-132	213
55-133	138
55-134	196
55-135	213
55-136	213
55-137	215
55-138	223
55-139	277
55-140	317
55-141	337
55-142	339
55-143	465
55-144	483
55-145	503
55-146	528
55-147	534
55-148	538
55-149	139
55-150	14
55-151	28
55-152	67
55-153	199
55-154	216
55-155	245
55-156	292
55-157	293
55-158	319
55-159	391
55-160	464
55-161	508
55-162	541
55-163	674
55-164	609
55-165	613
55-166	610
55-167	610
55-168	611
55-169	612
55-170	342
55-171	80
55-172	98
55-173	104
55-174	141
55-175	562
55-176	577
55-177	305
55-178	322
55-179	340
55-180	358
55-181	594
55-182	77
55-183	542
55-184	500
55-185	513
55-186	39
55-187	197
55-188	226
55-189	265
55-190	275
55-191	366
55-192	294
55-193	266
55-194	434
55-195	484
55-196	492
55-197	493
55-198	510
55-199	511
55-200	633
55-201	269
55-202	495
55-203	114
55-204	300
55-205	325
55-206	485
55-207	424

	Page
Revenue Rulings—Continued	
55-208	530
55-209	531
55-210	544
55-211	676
55-212	299
55-213	596
55-214	597
55-215	599
55-216	600
55-217	604
55-218	606
55-219	28
55-220	247
55-221	275
55-222	349
55-223	381
55-224	414
55-225	460
55-226	469
55-227	551
55-228	231
55-229	75
55-230	71
55-231	72
55-232	115
55-233	116
55-234	217
55-235	274
55-236	274
55-237	317
55-238	335
55-239	382
55-240	406
55-241	470
55-242	489
55-243	490
55-244	73
55-245	16
55-246	92
55-247	117
55-248	117
55-249	218
55-250	270
55-251	288
55-252	319
55-253	320
55-254	326
55-255	374
55-256	405
55-257	428
55-258	433
55-259	513
55-260	525
55-261	307
55-262	141
55-263	16
55-264	11
55-265	22
55-266	23
55-267	23
55-268	28
55-269	29
55-270	76
55-271	196
55-272	199
55-273	221
55-274	279
55-275	295
55-276	401
55-277	456
55-278	471
55-279	486
55-280	529
55-281	538
55-282	634
55-283	17
55-284	25
55-285	69
55-286	75
55-287	130
55-288	267

FINDING LIST—Continued

	Page
Revenue Rulings—Continued	
55-289	278
55-290	320
55-291	317
55-292	331
55-293	352
55-294	368
55-295	373
55-296	386
55-297	393
55-298	394
55-299	402
55-300	406
55-301	442
55-302	446
55-303	471
55-304	525
55-305	345
55-306	19
55-307	22
55-308	30
55-309	69
55-310	45
55-311	72
55-312	80
55-313	219
55-314	235
55-315	258
55-316	312
55-317	329
55-318	509
55-319	119
55-320	526
55-321	572
55-322	596
55-323	603
55-324	605
55-325	18
55-326	24
55-327	25
55-328	98
55-329	205
55-330	236
55-331	271
55-332	320
55-333	449
55-334	449
55-335	455
55-336	519
55-337	534
55-338	543
55-339	557
55-340	558
55-341	129
55-342	562
55-343	568
55-344	597
55-345	606
55-346	607
55-347	21
55-348	132
55-349	232
55-350	290
55-351	343
55-352	372
55-353	381
55-354	396
55-355	418
55-356	673
55-357	13
55-358	561
55-359	570
55-360	574
55-361	575
55-362	577
55-363	595
55-364	599
55-365	600
55-366	17
55-367	25
55-368	40

	Page
Revenue Rulings—Continued	
55-369	68
55-370	122
55-371	139
55-372	339
55-373	363
55-374	370
55-375	384
55-376	421
55-377	426
55-378	447
55-379	449
55-380	462
55-381	464
55-382	559
55-383	79
55-384	94
55-385	100
55-386	120
55-387	131
55-388	233
55-389	276
55-390	290
55-391	306
55-392	422
55-393	448
55-394	458
55-395	458
55-396	522
55-397	525
55-398	535
55-399	572
55-400	599
55-401	611
55-402	615
55-403	609
55-404	615
55-405	26
55-406	73
55-407	77
55-408	113
55-409	126
55-410	297
55-411	303
55-412	318
55-413	323
55-414	385
55-415	412
55-416	416
55-417	434
55-418	445
55-419	458
55-420	527
55-421	539
55-422	14
55-423	41
55-424	42
55-425	43
55-426	68
Treasury Decisions:	
6116	601
6117	578
6118	698
6119	145
6120	623
6121	410
6122	641
6123	515
6124	719
6125	95
6126	466
6127	106
6128	123
6129	600
6130	665
6131	721
6132	142
6133	335
6134	50
49 (Narcotics)	201

FINDING LIST—Continued

	Page
Treaties:	
Canada	624
Federal Republic of Germany	635
Japan	654
Executive Orders:	
10289	695
10583	695
10585	17
10586	696
10602	696
10606	143
10607	144
Proclamation 3082	697
Public Laws:	
1	619
18	619
764 (Sept. 1, 1954)	620
IR-Circular:	
55-23 (Rev. Rul. 55-174)	141
News Releases:	
IR-109 (Rev. Rul. 55-371)	139
IR-111 (Rev. Rul. 55-262)	141

FINDING LIST OF PREVIOUSLY PUBLISHED RULINGS CURRENTLY MENTIONED

Previous ruling	Action	Current revenue ruling
A. R. R. 229, C. B. 3, 354 (1920)	Cited	Rev. Rul. 55-257, p. 428.
G. C. M. 10486, C. B. XI-1, 14 (1932).	Amplified	Rev. Rul. 55-273, p. 221.
G. C. M. 23623, C. B. 1943, 313	Modified	Rev. Rul. 55- 35, p. 286.
I. T. 1557, C. B. II-1, 172 (1923).	Cited	Rev. Rul. 55-227, p. 551.
I. T. 1776, C. B. II-2, 151 (1923).	Cited	Rev. Rul. 55-275, p. 295.
I. T. 1936, C. B. III-1, 122 (1924).	Cited	Rev. Rul. 55-250, p. 270.
I. T. 2405, C. B. VII-1, 72 (1928).	Modified	Rev. Rul. 55-227, p. 551.
I. T. 3472, C. B. 1941-1, 252	Modified	Rev. Rul. 55-294, p. 368.
I. T. 3827, C. B. 1946-2, 57	Modified	Rev. Rul. 55-170, p. 342.
I. T. 3910, C. B. 1948-1, 15	Revoked	Rev. Rul. 55-138, p. 223.
I. T. 4017, C. B. 1950-2, 12	Amplified	Rev. Rul. 55- 88, p. 241.
I. T. 4058, C. B. 1951-2, 22	Modified	Rev. Rul. 55-139, p. 277.
L. O. 1014, C. B. 2, 88 (1920)	Cited	Rev. Rul. 55-357, p. 13.
Mim. 4148, C. B. XIII-1, 87 (1934).	Modified	Rev. Rul. 55-407, p. 77.
Mim. 6136, C. B. 1947-1, 58	Modified	Rev. Rul. 55- 60, p. 37.
Mim. 6583, C. B. 1951-1, 97	Supplemented	Rev. Rul. 55- 31, p. 476.
O. D. 667, C. B. 3, 52 (1920)	Cited	Rev. Rul. 55-117, p. 233.
O. D. 745, C. B. 3, 355 (1920)	Cited	Rev. Rul. 55-257, p. 428.
O. D. 823, C. B. 4, 77 (1921)	Cited	Rev. Rul. 55-317, p. 329.
O. D. 945, C. B. 4, 44 (1921)	Modified	Rev. Rul. 55-119, p. 352.
O. D. 1031, C. B. 5, 141 (1921)	Cited	Rev. Rul. 55-110, p. 280.
Rev. Rul. 25, C. B. 1953-1, 431	Modified	Rev. Rul. 55- 41, p, 598.
Rev. Rul. 117, C. B. 1953-1, 498.	Amplified	Rev. Rul. 55-153, p. 199.
Rev. Rul. 119, C. B. 1953-2, 95.	Modified	Rev. Rul. 55-136, p. 213.
Rev. Rul. 168, C. B. 1953-2, 19	Amplified	Rev. Rul. 55- 12, p. 259.
Rev. Rul. 177, C. B. 1953-2, 341.	Amplified	Rev. Rul. 55-318, p. 509.
Rev. Rul. 199, C. B. 1953-2, 225.	Superseded	Rev. Rul. 55- 6, p. 409.
Rev. Rul. 291, C. B. 1953-2, 42	Superseded	Rev. Rul. 55-171, p. 80.
Rev. Rul. 54-63, C. B. 1954-1, 33.	Modified	Rev. Rul. 55-220, p. 247.
Rev. Rul. 54-185, C. B. 1954-1, 04. 3	Modified	Rev. Rul. 55-217, p. 604.
Rev. Rul. 54-329, I. R. B. 1954-33, 12.	Amplified	Rev. Rul. 55- 98, p. 524.
Rev. Rul. 54-352, I. R. B. 1954-34, 24.	Modified	Rev. Rul. 55-217, p. 604.
Rev. Rul. 54-366, I. R. B. 1954-35, 9.	Amplified	Rev. Rul. 55- 22, p. 198.
Rev. Rul. 54-392, I. R. B. 1954-37, 52.	Superseded	Rev. Rul. 55-169, p. 612.
Rev. Rul. 54-576, I. R. B. 1954-49, 21.	Modified	Rev. Rul. 55-362, p. 577.

FINDING LIST OF PREVIOUSLY PUBLISHED RULINGS CURRENTLY MENTIONED—Continued

Previous ruling	Action	Current revenue ruling
Rev. Rul. 54–608, I. R. B. 1954–51, 5.	Modified	Rev. Rul. 55–426, p. 68.
Rev. Rul. 54–625, I. R. B. 1954–52, 13.	Modified	Rev. Rul. 55–212, p. 299.
Rev. Rul. 55–56, I. R. B. 1955–5, 26.	Modified	Rev. Rul. 55–346, p. 607.
Rev. Rul. 55–72, I. R. B. 1955–7, 11.	Superseded	Rev. Rul. 55– 72, p. 206.
S. M. 3141A, C. B. IV–2, 183 (1925).	Modified	Rev. Rul. 55–119, p. 352.
S. R. 5128, C. B. IV–2, 156 (1925).	Cited	Rev. Rul. 55–389, p. 276.

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 gift tax ruling.
Em. T.—Employment tax ruling.
F. A. A. A.—Federal Alcohol Administration Act.
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.
S. T.—Sales tax ruling.
S. P. R.—Statement of Procedural Rules.
Stat.—Statutes at Large.
T. C.—The Tax Court of the United States Reports.
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 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 should be cited by reference to the Bulletin and page where reported. Thus, Revenue Ruling No. 55–80 should be cited as "Rev. Rul. 55–80, C. B. 1955–1, —." Rulings are keyed to the applicable sections of the Internal Revenue Code and regulations.

Internal Revenue Cumulative Bulletin 1955–1 contains all rulings, decisions, and legislation pertaining to Internal Revenue matters published in the weekly Internal Revenue Bulletins 1 to 26, inclusive, for the period January 1 to June 30, 1955. It also contains a cumulative list of announcements relating to decisions of The Tax Court of the United States published in those Bulletins.

FOREWORD

The Internal Revenue Bulletin is prepared in six 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 (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 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 JUNE 30, 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.

The Commissioner ACQUIESCES in the following decisions:

Taxpayer	Docket No.	Report	
		Volume	Page
B			
Bartholomew, Frederick Cecil, a minor, estate of [1] Bartholomew, Myllicent, guardian of estate of Frederick Cecil Bartholomew, a minor [1]	200	4	349
Bear Film Co	29743	18	354
Bernstein, Edward, executor of estate of William Bernstein	41976	22	1364
Bernstein, William, et al., estate of			
Bour, Elsie S	35641	23	237

[1] Nonacquiescence published in Cumulative Bulletin 1945, 8, is withdrawn.

ACQUIESCENCES—Continued

Taxpayer	Docket No.	Report Volume	Report Page
Bradford, J. C., et ux.[2]	35990, 36895	22	1057
Brooklyn Union Gas Co.[3]	[a] 23380, [a] 20176	22	507
C			
Campanari, Christopher C., et al., executors of estate of Nina M. Campanari [4 5]	4384	5	488
Campanari, Nina M., estate of [4 5]			
Carnegie Center Co., The	30353	22	1189
Caruso, Dorothy	46810	23	836
Central Outdoor Advertising Co., Inc	42346	22	549
Chang Hsiao Liang	43978	23	1040
Country Club Estates, Inc	44898	22	1283
Crawford County Printing and Publishing Co	22369	17	1404
Crawford County Printing and Publishing Co., a dissolved corporation	33509		
D			
Daggitt, Deloss, E., et ux	38570	23	31
Davis, Harold S., estate of	40005	22	807
Davis, Mary, executrix of estate of Harold S. Davis			
Dirksmeyer, Lafayette A	36074	23	208
Dittmar, Martin M., et ux	45442	23	789
Drachman, Eda Q	32977	23	558
Drachman, Fanchon	32976		
Drachman, Richard M	32975		
F			
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		
Fisher, Wilson John [6]	34413	23	218
Fort Wharf Ice Co	45937	23	202
Fullerton, George I	38572	22	372
Fulton Bag & Cotton Mills	43796	22	1044
G			
Gaynor News Co., Inc	45215	22	1172
Girard Trust Corn Exchange Bank	36015	22	1343
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		

[a] United States Board of Tax Appeals.

[2] Acquiescence in this case has been withdrawn and nonacquiescence substituted therefor in I. R. B. 1955-37, 7.

[3] Nonacquiescence published in Cumulative Bulletin X-2, 82 (1931), is withdrawn.

[4] Estate tax decision.

[5] Nonacquiescence published in Cumulative Bulletin 1947-1, 5, is withdrawn.

[6] 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.

ACQUIESCENCES—Continued

Taxpayer	Docket No.	Report	
		Volume	Page
H			
Henshaw, Paul A., et ux	48530	23	176
Henshaw, Walter A., et ux	48529		
Hooks, Jeanette, independent executrix and surviving wife of estate of Pat E. Hooks	45676	22	502
Hooks, Pat E., estate of			
Hurley, H. A	41210	22	1256
Hurley, H. A., et ux	41211		
I			
Imburgia, Frank	38559	22	1002
J			
Jillson, Leon R., et ux.[7]	45371	22	1101
Joslyn, George R	38212	23	126
Joslyn, George R., et ux	38214		
	38213		
K			
Kelly, Daniel S. W	37943	23	682
L			
Lake Eloise Groves, Inc	31896	20	136
Larsen, Leonard, et ux	37097	23	599
Lexmont Corporation	37759	20	185
Lindau, Miriam C	34244	21	911
Loewi & Co	36885	23	486
M			
Marcus, Frances (formerly Frances Blumenthal)	35733	22	824
Mill Lane Club, Inc	46759	23	433
Miller, Edward J.[8]	[a] 85083	37	830
Moore, R. E., former independent executor of estate of W. G. Farrier	24539	15	277
Morrell, John Edgerly, estate of [9]	[a] 103776	43	651
N			
National Bank of Topeka, Kans., administrator with the will annexed of John Edgerly Morrell estate [9]	[a] 103776	43	651
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		

[a] United States Board of Tax Appeals.

[7] 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 sec. 107(a) of the 1939 Code.

[8] Nonacquiescence published in Cumulative Bulletin 1938-2, 51, is withdrawn.

[9] Nonacquiescence published in Cumulative Bulletin 1941-1, 17, is withdrawn.

ACQUIESCENCES—Continued

Taxpayer	Docket No.	Report	
		Volume	Page
O			
O'Brien, Martin Thomas, et ux [10]	[a] 108648	47	561
P			
Paolozzi, Alice Spaulding [11]	46543	23	182
Parser, Emilie Polak	46222	21	953
Pasadena City Lines, Inc	42412	23	34
Polak, Jacob	46220	21	953
Polak, Jacob and Eliseba	46221		
Polak's Frutal Works, Inc	30131, 46219		
Potson, Michael [12]	20024	22	912
R			
Ray's Clothes, Inc	41759, 45093, 45094, 45095	22	1332
Reid, Joseph, et ux	38571	23	31
Ringling, John, estate of	35787	22	1307
Rockland Oil Co., transferee of estate of John Ringling	35784		
Ruwitch, Lee	41543	22	1053
S			
Showell, Jack, et ux	48153, 48154	23	495
Silberman, Frances	47886	22	1240
Silberman, Joseph	47888		
Silberman, Samuel	47887		
Smith, Weldon D. [13]	27569	17	135
Smoky Mountains Beverage Co	21778, 26761	22	1249
Snively, John A., Sr., 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	36218		
SoRelle, Elsie	39789		
SoRelle, Mabel Ruth			
Stewart, William Rhinelander, estate of [14] [15]	[a] 67776	31	201
Stewart, William Rhinelander, Jr., et al., executors of William Rhinelander Stewart estate [14] [15]			
Strauss, Leon, et ux. [16]	41549	22	140

[a] United States Board of Tax Appeals.

[10] Nonacquiescence published in Cumulative Bulletin 1942-2, 30, is withdrawn.

[11] Gift tax decision.

[12] 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.

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

[14] Estate tax decision.

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

[16] See Rev. Rul. 55-170, page 342.

ACQUIESCENCES—Continued

Taxpayer	Docket No.	Report	
		Volume	Page
T			
Trounstine, Adele, executrix of estate of Norman S. Goldberger	35388	18	1233
Tunningley, Melvin E.	41354	22	1108
W			
Walter, Inc., John W.	44002	23	550
Webb, Larry E., et ux.	47948	23	1035

The Commissioner does NOT ACQUIESCE in the following decisions:

Taxpayer	Docket No.	Report	
		Volume	Page
A			
Adams, Charles E.[1]	[a] 88274	39	387
Atlas Oil & Refining Corp.	40929, 40930	22	552
B			
Bridgeport Hydraulic Co.	43322	22	215
C			
Caulkins, George Peck [2]	108422	1	656
Cortese, Clara	40633	22	293
Cristo, Joe	40632		
F			
Fashion Park, Inc.	37054	21	600
J			
Jillson, Leon R., et ux.[3]	45371	22	1101
K			
Kilpatrick, Lillian	37233	22	446
L			
LoBue, Philip J.[4]	41555	22	440

[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] 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, page 213, this Bulletin.

[3] 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.

[4] 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.

NONACQUIESCENCES—Continued

Taxpayer	Docket No.	Report	
		Volume	Page
M			
Mahler, Benjamin, et ux.[5]	45231	22	1180
Mammoth Coal Co., The	32295	22	571
Miller, Mary	40631	22	293
N			
North American Mortgage Co.[6]	[a] 15798	18	418
P			
Pennroad Corporation & Affiliated Companies	33309	21	1087
Peters, Isabel	40813	21	55
R			
Rosenberg, Abraham, et ux.[7]	37719	20	5
S			
Schwartz, Hymie, et ux	45571	22	717
V			
Vargason, Velma B	44790	22	100

[a] United States Board of Tax Appeals.

[5] 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.

[6] In order to conform to the decision in the case of *Willard Heiburn, Inc.*, 20 T. C. 749, 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.

[7] 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.

SPECIAL ANNOUNCEMENT

The publication of Revenue Ruling 54–501 in Cumulative Bulletin 1954–2, beginning on page 197, failed to reflect one of the two corrections announced on page 6 of Internal Revenue Bulletin 1954–48, dated November 29, 1954. Accordingly, that correction is repeated in this publication to call particular attention to the error and to suggest that a pen and ink or pencilled notation be made on page 205 of Cumulative Bulletin 1954–2, as follows:

The words, "the principal of the Old Bonds but not in excess of" should be added after the words, "is in excess of" on the seventh line of the first paragraph beginning on page 205.

As so corrected, the paragraph should read as follows:

The gain or loss realized upon the exchange of the Old Bonds, including those acquired subsequent to December 11, 1941, will represent capital gain or capital loss under the provisions of section 117 of the Code. However, in cases where the Old Bonds were acquired prior to December 11, 1941, interest income will be realized to the extent that the fair market value of the assets received in the exchange is in excess of the principal of the Old Bonds but not in excess of such principal and the interest accrued and unpaid on the Old Bonds since the date of the recovery. In cases where Old Bonds were acquired subsequent to December 11, 1941, interest income will be realized to the extent that the fair market value of the assets received in the exchange is in excess of the principal of the Old Bonds but not in excess of such principal and the interest accrued and unpaid on such bonds since the date of their acquisition.

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 B.—COMPUTATION OF TAXABLE INCOME

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

SECTION 61.—GROSS INCOME DEFINED

(Also Section 162.) Rev. Rul. 55-264
(Also Part II, Sections 22(a), 23(a); Regulations 118, Sections 39.22(a)-1, 39.23(a)-1.)

Where a taxpayer purchases an insurance policy which, in accordance with its terms, would reimburse the taxpayer, to the extent specified in the policy, for certain business overhead expenses incurred by him during prolonged periods of disability due to injury or sickness, any proceeds derived under the terms of such policy constitute and are includible in gross income under the provisions of section 61 of the Internal Revenue Code of 1954 or section 22(a) of the Internal Revenue Code of 1939. Any premiums paid on such policy constitute business expenses and are deductible from gross income under the provisions of section 162 of the 1954 Code or section 23(a) of the 1939 Code.

Advice has been requested whether any proceeds derived from a professional overhead expense disability policy, which policy is for the purpose of reimbursing the holders thereof for business overhead expenses incurred by them during prolonged periods of disability due to injury or sickness, is excludable from gross income. Advice has also been requested whether the insurance premiums paid would be nondeductible from gross income as an expenditure attributable to tax exempt income.

Taxpayer purchased an insurance policy under the terms of which he would be reimbursed for overhead expenses incurred by him with respect to his occupation during prolonged periods of disability. The policy provides that if certain specified injuries or sickness, directly and independently of all other classes, shall wholly and continuously disable the insured and prevent him from performing any and every duty pertaining to his occupation for a period of more than x days, the company will pay certain specified monthly expenses actually incurred by the insured up to an amount not exceeding the limitation specified in the policy for the period of such continuous disability, not exceeding a period of $3x$ months.

The policy further provides that no indemnity shall be paid for the first x days of any period of disability unless such disability continues for more than said x days, nor for any period of disability prior to the first date of medical treatment by a licensed physician or surgeon, other than the insured. The expense benefits payable under the policy shall be the monthly expenses actually incurred by the insured in the operation of his office or, in the event of joint occupancy, the insured's portion of such expenses and shall be limited in the manner set forth in the policy. Such expenses shall include rent, electricity, heat, water, laundry, depreciation, employees' salaries and such other fixed expenses as are normal and customary in the conduct and operation of the insured's office but shall not include salary, fees, drawing account or any other remuneration for the insured or any other member of the insured's profession hired by or working with the insured, or the cost of pharmaceutical products.

The actual questions presented are whether any insurance proceeds received by the taxpayer, in accordance with the terms of the above policy, are excludable from his gross income and whether the insurance premiums paid would be nondeductible under section 24(a)(5) of the Internal Revenue Code of 1939 as an expenditure attributable to tax exempt income.

Gross income as defined under section 22(a) of the Internal Revenue Code of 1939 and section 61 of the Internal Revenue Code of 1954, means all income from whatever source derived, unless exempt from tax by law. In general, income is the gain derived from capital, from labor, or both combined.

Insurance policies issued to provide reimbursement for overhead expenses in cases of prolonged disability of the insured do not come within the purview of compensation for personal sickness or injury. Such insurance policies are issued strictly for business purposes and in no way compensate the insured for injuries or sickness within the meaning of section 22(b)(5) of the 1939 Code. The proceeds of such policies are in the nature of the proceeds of a "Use and Occupancy Contract," which insures against actual loss sustained of net profits, and the proceeds of which are income in the same manner that the profits for which they are substituted would have been. See section 39.112(f)-1(c)(8) of Regulations 118.

Section 23(a) of the 1939 Code and section 162 of the 1954 Code provide that there shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during a taxable year in carrying on any trade or business. Section 39.23(a)(1) of Regulations 118, in

enumerating deductible expenses, includes premiums against fire, storm, theft, accident, or other similar losses in the case of a trade or business.

Accordingly, it is held that where a taxpayer purchases an insurance policy which, in accordance with its terms, would reimburse the taxpayer, to the extent specified in the policy, for certain business overhead expenses incurred by him during prolonged periods of disability due to injury or sickness, any proceeds derived under the terms of such policy constitute and are includible in gross income under the provisions of section 61 of the 1954 Code or section 22(a) of the 1939 Code. Any premiums paid on such policy constitute business expenses and are deductible from gross income under the provisions of section 162 of the 1954 Code or section 23(a) of the 1939 Code.

SECTION 61.—GROSS INCOME DEFINED

Rev. Rul. 55–357

The insurance available to Government employees under the Federal Employees' Group Life Insurance Act of 1954, 68 Stat. 736, 5 U. S. C. 2091, is of the "group term" type. It has no cash surrender or loan value at any time. The Internal Revenue Service has previously held that premiums or portions of premiums paid by employers for insurance of this type on the lives of their employees are not income to such employees. See Law Opinion 1014, C. B. 2, 88 (1920); Rev. Rul. 54–165, C. B. 1954–1, 17. Accordingly, a Government employee is not required to include in his income that portion of the premiums on his Federal Employees' Group Life Insurance which is paid by the Government. However, the portion of the insurance premium paid by the employee by withholding from his salary is includible in his income and tax is withheld on this amount, as provided by section 3402 of the Internal Revenue Code of 1954, in the same manner as in the case of civil service retirement deductions.

SECTION 62.—ADJUSTED GROSS INCOME DEFINED

Tax attributable to a trade or business deductible in computing adjusted gross income. See Rev. Rul. 55–267, page 23.

PART II.—ITEMS SPECIFICALLY INCLUDED IN GROSS INCOME

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

Taxability of distributions from a qualified trust where employees merely act as the agent for the transfer of the funds from one funding instrumentality to another. See Rev. Rul. 55–368, page 40.

PART III.—ITEMS SPECIFICALLY EXCLUDED FROM GROSS INCOME

SECTION 102.—GIFTS AND INHERITANCES

(Also Part II, Section 22(b); Regulations 118, Section 39.22(b)(3)-1.) Rev. Rul. 55-422

The Internal Revenue Service will follow the decision in *Charles Schall et ux.* v. *Commissioner*, 174 Fed. (2d) 893, and other cited decisions, in deciding in other cases whether payments to retired ministers or rabbis under similar circumstances represent taxable compensation for past services or gifts excludable from gross income under section 102 of the 1954 Code.

Advice has been requested whether the Internal Revenue Service will continue to litigate issues similar to those involved in *Charles Schall et ux.* v. *Commissioner*, 174 Fed. (2d) 893; *Andrew Mutch* v. *Commissioner*, 209 Fed. (2d) 390; *Kavanagh* v. *Abraham M. Hershman et al.*, 210 Fed. (2) 654; and *William S. Abernethy et al. v. Commissioner*, 211 Fed. (2d) 651, all involving the question whether payments on an annual or monthly basis to a retired minister or rabbi, authorized for an indefinite period by his congregation at or about the time of his retirement, were taxable as additional compensation for past services or constituted gifts exempt under section 22(b)(3) of the 1939 Code. The same problem arises under section 102 of the 1954 Code, which excludes gifts from gross income.

In the cited cases the payments were not made in accordance with any enforceable agreement, established plan, or past practice; the recipient did not undertake to perform any further services for the congregation and was not expected to do so; there was a far closer personal relationship between the recipient and the congregation than is found in lay employment relationships; and the available evidence indicated that the amount paid was determined in the light of the financial position of the congregation and the needs of the recipient, who had been adequately compensated for his past services.

The decisions in the cited cases, to the effect that the amounts involved were exempt gifts rather than taxable income, are accepted by the Service on their particular facts. In other cases involving payments to retired ministers or rabbis under similar circumstances the amounts paid will accordingly be treated as gifts excludable from gross income under section 102 of the 1954 Code.

SECTION 103.—INTEREST ON CERTAIN GOVERNMENTAL OBLIGATIONS

(Also Part II, Section 22(b); Regulations 118, Section 39.22(b)(4)-1.) Rev. Rul. 55-150

The Genesee Valley Regional Market Authority, created by the Legislature of the State of New York pursuant to Chapter 420, 1951 Laws of New York, effective March 31, 1951, is a political subdivision of a State within the meaning of section 103(a)(1) of the Internal Revenue Code of 1954 and section 22(b)(4) of the Internal Revenue

Code of 1939. Accordingly, interest on bonds or notes issued by such Authority is exempt from Federal income tax. See *Commissioner* v. *Estate of Alexander J. Shamberg*, 144 Fed. (2d) 998, Ct. D. 1648, C. B. 1945, 335, certiorari denied, 323 U. S. 792; and *Commissioner* v. *Estate of Caroline White*, 144 Fed. (2d) 1019, Ct. D. 1647, C. B. 1945, 65, certiorari denied, 323 U. S. 792.

SECTION 105.—AMOUNTS RECEIVED UNDER ACCIDENT AND HEALTH PLANS

Rev. Rul. 55-85

The wages received by a civilian employee of the United States Government for a period during which he is absent from work on account of personal injuries or sickness are excludable from his gross income to the extent provided in section 105 (d) of the Internal Revenue Code of 1954. If the absence is, in fact, due to personal injury or illness, the manner in which the absence is reflected in the records of the employing agency will not be determinative of the right of the employee to the benefit of the exclusion under such section.

Advice has been requested whether the provisions of section 105 (d) of the Internal Revenue Code of 1954 are applicable to the compensation received by a civilian employee of the United States Government for a period during which the employee is absent from work on account of personal injuries or sickness.

Section 105 of the 1954 Code, relating to amounts received under accident and health plans, provides in part as follows:

(a) AMOUNTS ATTRIBUTABLE TO EMPLOYER CONTRIBUTIONS.—Except as otherwise provided in this section, amounts received by an employee through accident or health insurance for personal injuries or sickness shall be included in gross income to the extent such amounts (1) are attributable to contributions by the employer which were not includible in the gross income of the employee, or (2) are paid by the employer.

* * * * * * *

(d) WAGE CONTINUATION PLANS.—Gross income does not include amounts referred to in subsection (a) if such amounts constitute wages or payments in lieu of wages for a period during which the employee is absent from work on account of personal injuries or sickness; but this subsection shall not apply to the extent that such amounts exceed a weekly rate of $100. In the case of a period during which the employee is absent from work on account of sickness, the preceding sentence shall not apply to amounts attributable to the first 7 calendar days in such period unless the employee is hospitalized on account of sickness for at least one day during such period. If such amounts are not paid on the basis of a weekly pay period, the Secretary or his delegate shall by regulations prescribe the method of determining the weekly rate at which such amounts are paid.

Amounts received under an accident or health plan for employees are to be treated as amounts received through accident or health insurance for the purpose of section 105 of the Code and the provisions of such section are applicable with respect to taxable years beginning after December 31, 1953, and ending after August 16, 1954. Thus, in the case of a calendar-year taxpayer such provisions would apply to amounts received on and after January 1, 1954.

The various Acts of Congress which grant leave with pay to civilian employees of the United States Government for periods of absence on acount of personal injuries or sickness constitute accident or health

plans within the meaning of section 105 of the Code. Consequently, the wages received by such an employee for a period during which he is absent from work on account of personal injuries or sickness are excludable from his gross income to the extent provided in section 105 (d) of the Code. If the absence is, in fact, due to personal injury or illness, the manner in which the absence is reflected in the records of the employing agency will not be determinative of the right of the employee to the benefit of the exclusion under such section.

Rev. Rul. 55-245

To the extent of a weekly rate of $100, wages or payments in lieu of wages received by an officer or enlisted man as a member of the Armed Forces for a period during which he is confined as a patient in a hospital on account of personal injuries or sickness are excludable from gross income under section 105(d) of the Internal Revenue Code of 1954, even though such member may be convalescing and doing light work in the operation of the hospital to which he is confined.

Rev. Rul. 55-263

The term "sickness" as used in section 105(d) of the Internal Revenue Code of 1954 does not include the condition of pregnancy. However, an employee who is absent from work on account of sickness during a period of pregnancy may, to the extent provided in section 105(d), exclude from her gross income amounts received for the period of absence, even though the sickness is caused by her pregnancy.

Advice has been requested whether the provisions of section 105(d) of the Internal Revenue Code of 1954 are applicable to the compensation received under an accident and health plan by an employee who is absent from work during pregnancy.

Section 105 of the 1954 Code, relating to amounts received under accident and health plans, provides in part as follows:

(a) AMOUNTS ATTRIBUTABLE TO EMPLOYER CONTRIBUTIONS.—Except as otherwise provided in this section, amounts received by an employee through accident or health insurance for personal injuries or sickness shall be included in gross income to the extent such amounts (1) are attributable to contributions by the employer which were not includible in the gross income of the employe, or (2) are paid by the employer.

* * * * * * *

(d) WAGE CONTINUATION PLANS.—Gross income does not include amounts referred to in subsection (a) if such amounts constitute wages or payments in lieu of wages for a period during which the employee is absent from work on account of personal injuries or sickness; but this subsection shall not apply to the extent that such amounts exceed a weekly rate of $100. In the case of a period during which the employee is absent from work on account of sickness, the preceding sentence shall not apply to amounts attributable to the first 7 calendar days in such period unless the employee is hospitalized on account of sickness for at least one day during such period. If such amounts are not paid on the basis of a weekly pay period, the Secretary or his delegate shall by regulations prescribe the method of determining the weekly rate at which such amounts are paid.

Amounts received under an accident or health plan for employees are to be treated as amounts received through accident or health insurance for the purpose of section 105 of the Code and the provisions

of such section are applicable with respect to taxable years beginning after December 31, 1953, and ending after August 16, 1954. Thus, in the case of a calendar-year taxpayer, such provisions would apply to amounts received on and after January 1, 1954.

The term "sickness" as used in section 105(d) of the Internal Revenue Code of 1954 does not include the condition of pregnancy. *Mutual Benefit Health & Accident Association* v. *United Casualty Co., et al.*, 142 Fed. (2d) 390, 394. However, an employee who is absent from work on account of sickness during a period of pregnancy may, to the extent provided in section 105(d), exclude from her gross income amounts received for the period of absence, even though the sickness is caused by her pregnancy.

Rev. Rul. 55-283

Wages or payments in lieu of wages received by an employee for a period during which the employee is absent from work because he is under quarantine imposed by legal authority by reason of the illness of a member of his family, or because a member of his immediate family is afflicted with a contagious disease or is otherwise sick or physically incapacitated and requires the care and attendance of the employee, are not amounts received "for a period during which the employee is absent from work on account of personal injuries or sickness" within the meaning of section 105(d) of the Internal Revenue Code of 1954 even though, pursuant to an accident or health plan, the absence is charged to the employee's sick leave. Such amounts are not excludable from the employee's gross income under such section.

Rev. Rul. 55-366

An employee received wages or payments under a wage continuation plan for the period September 17, 1953, through February 1, 1954, during which he was absent from work on account of sickness. In October 1953 he was hospitalized, but none of the period of absence in 1954 was spent in the hospital. *Held*, the requirement with respect to the 7-day waiting period provided in section 105(d) of the Internal Revenue Code of 1954 is met at the end of the seventh day of absence on account of sickness even though the seventh day occurs prior to January 1, 1954. Similarly, the alternative requirement of hospitalization is met when the employee is hospitalized on account of sickness for 1 day during the period of absence, even though it is in the portion of the period of absence which occurs in 1953. Only wages or payments in lieu of wages received after December 31, 1953, however, are excludable under section 105(d).

SECTION 112.—CERTAIN COMBAT PAY OF MEMBERS OF THE ARMED FORCES

E. O. 10585

Designating the date of termination of combatant activities in Korea and waters adjacent thereto.

By virtue of the authority vested in me by section 112(c)(3) of the Internal Revenue Code of 1954, January 31, 1955, as of midnight

thereof, is hereby designated as the date of termination of combatant activities in the zone comprised of the area described in Executive Order No. 10195 of December 20, 1950, (15 F. R. 9177) [C. B. 1951–1, 6].

DWIGHT D. EISENHOWER.

THE WHITE HOUSE,
January 1, 1955.

(Filed with the Division of the Federal Register January 3, 1955, 10:46 a. m.)

PART V.—DEDUCTIONS FOR PERSONAL EXEMPTIONS

SECTION 151.—ALLOWANCE OF DEDUCTIONS FOR PERSONAL EXEMPTIONS

(Also Part II, Section 25; Regulations 118, Section 39.25–2.) Rev. Rul. 55–325

A spouse cannot qualify as a dependent under section 151 of the 1954 Code and an exemption is not allowable on a separate return for a spouse who has gross income in any amount within the meaning of such section.

The Internal Revenue Service has received inquiries relative to whether an individual may claim his spouse as a dependent on his separate Federal income tax return under the provisions of section 151 of the Internal Revenue Code of 1954. The inquiries indicate that the writers thereof interpret the above section of the Code to mean that a taxpayer is allowed a deduction of $600 for his wife as an exemption and an additional deduction of $600 for her as a dependent and further that the taxpayer may claim his wife as a dependent even though she has income of her own and files a separate return.

Section 151(b) of the Code provides, in part, as follows:

* * * An exemption of $600 for the taxpayer; and an additional exemption of $600 for the spouse of the taxpayer if a separate return is made by the taxpayer, and if the spouse, for the calendar year in which the taxable year of the taxpayer begins, has no gross income and is not the dependent of another taxpayer.

Under the provisions of section 25(b)(1)(A) of the Internal Revenue Code of 1939, which are substantially the same as section 151(b) of the Code of 1954, an exemption was not allowable on a separate return for the spouse of the taxpayer if the spouse had gross income of any amount or was the dependent of another taxpayer.

The Report of the Committee on Finance, United States Senate, No. 1622, Eighty-third Congress, on H. R. 8300 (Internal Revenue Code of 1954), 192, states with respect to section 151 of the Code in part as follows:

Subsection (b) corresponds to section 25(b)(1)(A) of the 1939 Code; * * * No substantive changes are made in these provisions.

Section 152 of the 1954 Code defines a "dependent" and adds to the list of individuals eligible as dependents any individual who is a member of the taxpayer's household and whose principal abode for the taxable year of the taxpayer is the home of the taxpayer. That sec-

tion has as its purpose the inclusion of certain persons for whom no exemption was allowed under prior law but does not have the effect of expanding the definition of dependent to include the taxpayer's spouse. Spouses are specifically dealt with in a separate subsection of section 151 of the Code.

Accordingly, it is held that since section 151 of the 1954 Code does not effect a change with respect to the allowance of an exemption for the spouse of a taxpayer provided in section 25(b)(1)(A) of the 1939 Code, for the purpose of such sections, a taxpayer's spouse cannot qualify as his dependent and an exemption is not allowable on a separate return for a spouse who has gross income in any amount. However, a taxpayer who files a separate return may obtain a deduction for the personal exemption of his wife, as well as a deduction for himself, provided his wife has no gross income and is not the dependent of another taxpayer.

SECTION 152.—DEPENDENT DEFINED

Rev. Rul. 55-306

The application of the provisions of section 152(c) of the Internal Revenue Code of 1954, in determining the allowance of a dependency exemption in cases of multiple support.

The application of the provisions of section 152(c) of the Internal Revenue Code of 1954, relating to multiple support agreements is illustrated by the following examples:

Example (1). Four brothers together contributed the entire support of their mother in 1954 in the following percentages: *A*, 30 percent; *B*, 20 percent; *C*, 29 percent; and *D*, 21 percent.

Example (2). An individual, *E*, who resides with his son received his entire support of $1,500 for the year 1954 in the following percentages: Social Security, 25 percent; *F*, an unrelated neighbor, 11 percent; *G*, a brother, 14 percent; *H*, a daughter, 10 percent; and *I*, a son, 40 percent.

Section 152 of the Code provides in part as follows:

(a) GENERAL DEFINITION.— * * * the term "dependent" means any of the following individuals over half of whose support, for the calendar year in which the taxable year of the taxpayer begins, was received from the taxpayer (or is treated under subsection (c) as received from the taxpayer):

* * * * * * *

(c) MULTIPLE SUPPORT AGREEMENTS.—For purposes of subsection (a), over half of the support of an individual for a calendar year shall be treated as received from the taxpayer if—

(1) no one person contributed over half of such support;

(2) over half of such support was received from persons each of whom, but for the fact that he did not contribute over half of such support, would have been entitled to claim such individual as a dependent for a taxable year beginning in such calendar year;

(3) the taxpayer contributed over 10 percent of such support; and

(4) each person described in paragraph (2) (other than the taxpayer) who contributed over 10 percent of such support files a written declaration (in such manner and form as the Secretary or his delegate may by regulations prescribe) that he will not claim such individual as a dependent for any taxable year beginning in such calendar year.

In example (1) above any one of the brothers, except for the fact that he did not contribute more than half of his mother's support,

would have been entitled to claim her as a dependent. Consequently, any one of the brothers could claim a deduction for the exemption of the mother provided a written declaration from each of the other brothers is attached to his Federal income tax return. Even though *A* and *D* together contributed more than one-half the support of their mother, if *A* wished to claim his mother as a dependent, he would be required to attach written declarations from *B* and *C* as well as from *D* to his income tax return, since each of those three contributed more than 10 percent of the total support of their mother.

In example (2) above *G*, *H*, and *I* are persons each of whom, except for the fact that neither contributed more than half of the $1,500, could claim *E* as a dependent for a taxable year beginning in 1954. The three together contributed 64 percent of the $1,500, and, thus, each is a member of the group to be considered for the purpose of section 152(c) of the Code. *G* and *I* are the only members of such group who can meet all the requirements of section 152(c) of the Code and either one could claim *E* as a dependent for his taxable year beginning in 1954 provided he attached to his income tax return a written declaration signed by the other, and furnished the other information required by the return with respect to all the contributions to *E*. Inasmuch as *H* did not contribute more than 10 percent of *E's* support, she would not be entitled to claim *E* as a dependent for a taxable year beginning in 1954 nor would she be required to file a written declaration with respect to her contributions to *E*. *F* contributed over 10 percent of the support of *E* in 1954 but he does not otherwise qualify as a member of the group for the purpose of the multiple support agreement under section 152(c) of the Code.

The member of a group of contributors who claims the dependency deduction for an individual under the multiple support agreement provisions of section 152(c) of the Code must attach to his income tax return for the year of the deduction a written declaration from each of the other persons who contributed more than 10 percent of the support of such individual and who, but for the failure to contribute more than half of the support of the individual, would have been entitled to claim the dependency exemption. The written declaration required may be made on Form 2120, Multiple Support Agreement, which contains a statement of the fact of contribution and a waiver of the claim for dependency exemption. Copies of Form 2120 will be supplied by District Directors to persons who request such forms. Any declaration made other than on Form 2120 shall conform to the substance of Form 2120. The taxpayer claiming the exemption should be prepared to furnish other information, when required, which will substantiate his right to claim such exemption. Such information may include a statement showing the names of *all* contributors (whether members of the group described in section 152(c) of the Code or not) and the amount contributed by each to the support of the dependent claimed.

This ruling will be applicable only for the period prior to the promulgation of regulations prescribed by the Commissioner, with the approval of the Secretary, in which will be set forth rules with respect to section 152(c) of the Code.

Rev. Rul. 55-347

An appointment to the United States Military Academy, the United States Naval Academy, the United States Air Force Academy or the United States Coast Guard Academy does not constitute a scholarship award within the meaning of section 152(d)(2) of the Internal Revenue Code of 1954. In the absence of evidence establishing that a taxpayer furnished more than half of the support of a cadet or midshipman and that the other requirements of section 151(a) of the Code are met, an exemption for a dependent is not allowable.

Advice has been requested whether an appointment to the United States Military Academy constitutes a scholarship award not to be considered in the determination of the amount of support furnished a dependent.

The taxpayer's son in the instant case is a cadet in the United States Military Academy. He receives monthly pay and allowances, and pays for his meals, uniforms, text books, etc. Taxes are withheld at the source from his wages. During vacations and holidays the son resides with the taxpayer.

Section 152 of the Internal Revenue Code of 1954 provides in part as follows:

(d) SPECIAL SUPPORT TEST IN CASE OF STUDENTS.—For purposes of subsection (a), in the case of any individual who is—

* * * * * * *

(2) a student (within the meaning of section 151(e)(4)), amounts received as scholarships for study at an educational institution (as defined in section 151(e)(4)) shall not be taken into account in determining whether such individual received more than half of his support from the taxpayer.

A scholarship is generally considered as an allowance to a student at an educational institution to aid him in pursuing his studies. Such a student does not receive wages nor is he usually obligated to perform any services for the institution subsequent to graduation. The opposite is true with respect to a cadet in the Military Academy. He is considered as being in the "Regular Army" and receives pay and allowances for the performance of services as a cadet, from which income tax is withheld. The Army Organization Act of 1950, 64 Stat. 263, at 268, 10 U. S. C. 1c(b). An obligation exists on the part of a cadet by reason of the articles of agreement signed by him upon entrance into the Academy to complete the course of training and to accept a commission in the Regular Army upon graduation. Act of June 30, 1950, Public Law 586, 81st Congress, 64 Stat. 304, 10 U. S. C. 1092c.

The rules governing the appointment of cadets, including the pay and allowances, apply equally to midshipmen at the United States Naval Academy, cadets at the United States Coast Guard Academy and cadets at the United States Air Force Academy. See Career Compensation Act of 1949, 63 Stat. 802, at 828, as amended 37 U. S. C. 308; Act of August 4, 1949, Public Law 207, 81st Congress, 63 Stat. 495, at 508, 14 U. S. C. 182; Air Force Academy Act, 68 Stat. 47, 10 U. S. C. 1854.

Accordingly, it is held that an appointment to the United States Military Academy, the United States Naval Academy, the United States Air Force Academy, or the United States Coast Guard Academy does not constitute a scholarship award within the meaning of section 152(d)(2) of the Code. Therefore, in the absence of evi-

dence establishing that the taxpayer furnished more than half of the support of a cadet or midshipman and that the other requirements of section 151(e) of the Code are met, an exemption for a dependent is not allowable.

PART VI.—ITEMIZED DEDUCTIONS FOR INDIVIDUALS AND CORPORATIONS

SECTION 162.—TRADE OR BUSINESS EXPENSES

Rev. Rul. 55-307

Expenditures for intoxicating liquor purchased in the State of Oklahoma, or purchased elsewhere and brought into that State, for business promotion and entertainment purposes, are not deductible business expenses. In view of the stringent limitations imposed upon the importation of liquor, and upon the transportation and sale or other distribution thereof within the State, by 37 Oklahoma Statutes Annotated, Sections 1, 31, 38, 50.1, 50.2 and 82, an individual or corporation purchasing intoxicating liquor in Oklahoma, or importing the same, for other than the limited purposes permitted therein, must be considered to have been a participant in a transaction proscribed by statute, in originally obtaining such liquor. Certain Oklahoma court decisions to the effect that the possession of liquor in certain amounts for personal use or the distribution of liquor for social purposes is not, in itself, in contravention of such statute are therefore not regarded as determinative. Payments which "frustrate sharply defined * * * State policies evidenced by a governmental declaration proscribing particular types of conduct" are not deductible for Federal income tax purposes. See the discussion in *Thomas B. Lilly, et ux.* v. *Commissioner*, 343 U. S. 90, Ct. D. 1741, C. B. 1952-1, 16, and I. T. 4096, C. B. 1952-2, 91.

(Also Part II, Section 23(a)(1); Regulations 118, Section 39.23(a)-1.) Rev. Rul. 55-265

A contribution by a taxpayer engaged in a trade or business in a locality to a committee organized for the purpose of bringing a national political convention to such locality constitutes an allowable deduction for Federal income tax purposes as an ordinary and necessary business expense under the provisions of section 162(a) of the Internal Revenue Code of 1954, provided such contribution is made with a reasonable expectation of a financial return commensurate with the amount of the contribution.

Deductibility of insurance policy premiums paid by a taxpayer for the purpose of reimbursing him for business overhead expenses incurred by him during prolonged period of inability to work because of injury or sickness. See Rev. Rul. 55-264, page 11.

SECTION 164.—TAXES

Rev. Rul. 55-266

The tax imposed by the State of Nebraska, section 77-2602 and section 77-2616 of Article 26 of Revised Statutes of Nebraska, 1943, Reissue of 1950, on cigarettes distributed and sold at wholesale and on the use of all cigarettes in the State evidenced by stamps affixed to the containers or printed thereon by the use of a cigarette tax meter is deductible for Federal income tax purposes under section 164 of the Internal Revenue Code of 1954 by the wholesale distributor or wholesale dealer or the user who pays for and affixes the stamp or meter impressions. The tax is not a retail sales tax imposed on persons selling tangible personal property at retail and is not deductible under section 164(c) of the Code by the consumer or purchaser of the cigarettes. Insofar as the ultimate consumer or purchaser is concerned the tax represents an additional cost of the article and is not deductible as a tax in computing his taxable income except where imposed directly upon him as a use tax. Compare I. T. 3669, C. B. 1944, 112, relating to motor vehicle fuel taxes imposed by the State of Nebraska.

(Also Sections 62 and 266.) Rev. Rul. 55-267

The sales tax imposed by the State of Louisiana, Act No. 75, Acts of the State of Louisiana, regular session 1936, revised by section 302, chapter 2, title 47, Louisiana Revised Statutes of 1950, paid with respect to property purchased for use in the purchaser's trade or business is allowable as a deduction to the purchaser, under section 164(a) of the Internal Revenue Code of 1954. Such tax may not be capitalized except as provided in section 266 of the 1954 Code.

Advice has been requested relative to the treatment for Federal income tax purposes of the Louisiana sales tax on property purchased for use in a trade or business.

I. T. 3042, C. B. 1937-1, 65, holds that the luxury or retail sales tax imposed under Act No. 75, Acts of the State of Louisiana, regular session 1936, effective October 1, 1936, is deductible as a tax, for Federal income tax purposes, by the consumer. If, however, the tax is added to or made a part of his business expense, it may not be deducted separately as a tax.

Section 164(a) of the Internal Revenue Code of 1954 provides for deductions, as follows:

(a) GENERAL RULE.—Except as otherwise provided in this section, there shall be allowed as a deduction taxes paid or accrued within the taxable year.

Section 302, chapter 2, title 47, Louisiana Revised Statutes of 1950, imposes a tax upon the sale at retail of each item or article of tangible personal property with certain exceptions not here material. Section 304 of chapter 2 provides that the tax levied in chapter 2 shall be collected by the dealer from the purchaser or consumer. The dealer or seller is permitted and required to state and collect the tax separately from the price paid by the purchaser. Section 306 of chapter 2, provides that for the purpose of collecting and remitting to the State the tax imposed by chapter 2, the dealer is declared to be the agent of the State.

In general the term "dealer" includes every person who sells tangible personal property at retail, or who offers for sale at retail, or has in his possession for sale at retail, or for use or consumption, or distribution, or storage to be used or consumed in the State, tangible personal property.

Since the Louisiana sales tax is levied upon "sales at retail" persons engaged in selling tangible property at retail are not subject to the tax. The sales tax is imposed on and payable by the purchaser with the retailer as a computing and collecting agent for the State.

Accordingly, it is held that the sales tax imposed by the State of Louisiana, Act No. 75, Acts of the State of Louisiana, regular session 1936, revised by section 302, chapter 2, title 47, Louisiana Revised Statutes of 1950, paid with respect to property purchased for use in the purchaser's trade or business is allowable as a deduction to the purchaser under section 164(a) of the Internal Revenue Code of 1954. Such tax may not be capitalized except as provided in section 266 of the 1954 Code.

In the event the purchaser is an individual engaged in a trade or business which does not consist of the performance of services as an employee, the Louisiana sales tax paid on property used in such trade or business is deductible from gross income under section 62 of the 1954 Code in determining adjusted gross income.

In the case of purchasers other than individuals where the Louisiana sales tax is attributable to a trade or business it is deductible from gross income in computing taxable income.

(Also Part II, Section 23(c); Regulations 118, Section 39.23(c)-1.) Rev. Rul. 55-326

The tax imposed by the State of Louisiana, Section 841, Chapter 8, Title 47, Louisiana Revised Statutes of 1950, on the privilege of selling, using, consuming, handling, or distributing cigarettes, payment of which must be evidenced by stamps affixed to the containers, is deductible for Federal income tax purposes under section 164(a) of the Internal Revenue Code of 1954 by the wholesale or retail dealer or other person receiving unstamped goods who purchases, affixes, and cancels the cigarette stamps. The tax is not a retail sales tax imposed on persons selling tangible personal property at retail within the meaning of section 164(c) of the Code and is not deductible by the consumer or purchaser of stamped cigarettes. Insofar as the ultimate consumer or purchaser of stamped cigarettes is concerned the tax represents an additional cost of the article.

Deductibility of real property taxes, imposed by section 5719.01 of the Revised Code of Ohio, effective October 13, 1953. See Rev. Rul. 55-152, page 67.

SECTION 164(b).—TAXES: DEDUCTIONS DENIED IN CASE OF CERTAIN TAXES

(Also Part II, Section 23(c); Regulations 118, Section 39.23(c)-3.) Rev. Rul. 55-284

The annual taxes levied by the Moffat Tunnel Improvement District of Colorado (created under Senate Bill No. 3, enacted by the State of Colorado and approved May 12, 1922, Chapter 138, 1935 Colorado Statutes Annotated) are levied within the requirements specified in section 164(b)(5)(B) of the Internal Revenue Code of 1954 and are deductible by taxpayers for taxable years beginning after December 31, 1953, and ending after August 16, 1954. See section 7851(a)(1)(A) of such Code. However, for taxable years beginning before December 31, 1953, or ending on or before August 16, 1954, the taxes assessed by the Moffat Tunnel Improvement District qualify for deduction only to the extent they are properly allocable to maintenance or interest charges, as provided by section 23(c)(1)(E) of the Internal Revenue Code of 1939. No part of the nondeductible taxes is subject to the allowance for depreciation even though capitalized by reason of section 23(c)(1)(E) of the 1939 Code.

SECTION 165.—LOSSES

Rev. Rul. 55-327

A loss sustained by a taxpayer caused by damage to a fur coat by moths is not a casualty loss within the purview of section 165(c)(3) of the Internal Revenue Code of 1954, since the element of suddenness is not present in such a loss. The term "other casualty" following the enumeration of certain specific casualties used in the statute contemplates a casualty of a character analogous to a fire, storm, or shipwreck embracing losses arising suddenly or unexpectedly. See *U. S.* v. *Betty Rogers, et al.*, 120 Fed. (2d) 244; and *Charles J. Fay, et al.* v. *Commissioner*, 120 Fed. (2d) 253.

(Also Section 263.) Rev. Rul. 55-367

The drying up of a well resulting from prolonged lack of rain is not such an unusual or unexpected happening and involves no such sudden, identifiable event fixing a point at which a loss can be measured as to constitute a casualty loss within the purview of section 165(c)(3) of the Internal Revenue Code of 1954. See Rev. Rul. 79, C. B. 1953-1, 41. Moreover, expenditures incurred by a taxpayer in deepening a well or constructing a new well are not deductible but are to be considered as capital expenditures which become part of the cost of the property. Compare *Richard A. Dow* v. *Commissioner*, 16 T. C. 1230.

Rev. Rul. 55-40

A question has arisen with respect to whether the failure to realiz anticipated interest on bonds or other obligations (having fixe maturity dates at which interest or increments in value cease) whic are inadvertently held past their maturity dates results in a deductibl loss for Federal income tax purposes for the year in which such bond were redeemed. It is well settled that disappointment in expectation of profit and mere lessening of income form no basis for a deductibl loss. For example, see *Warren Service Corporation* v. *Commissioner* 39 B. T. A. 856, affirmed (reversed and remanded on another issue) 110 Fed. (2d) 723, wherein it was held that the taxpayer suffere no deductible loss because of its inability to relet property on term as advantageous as those embodied in a canceled lease. See als *Walter M. Hort* v. *Commissioner*, 313 U. S. 28, Ct. D. 1502, C. B 1941-1, 319; *Frank F. Nicola* v. *Commissioner*, 1 B. T. A. 487; *Palme Hutcheson et ux.* v. *Commissioner*, 17 T. C. 14, acquiescence, C. B 1951-2, 2. Thus, the failure to realize anticipated interest for th period from the date of maturity to date of redemption does no result in a loss which is deductible under the provisions of sectio 165 or any other provisions of the Internal Revenue Code of 1954

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

Rev. Rul. 55-

A taxpayer pledges 30 percent of his adjusted gross income to an organized nonprofit charity fund-raising foundation and satisfies such pledge by delivering to the foundation two separate checks, one of which is in an amount equal to 10 percent of his adjusted gross income and drawn payable to a specific organization of the type designated in section 170(b)(1)(A) of the Internal Revenue Code of 1954. The foundation acts merely as transfer agent of this check and delivers it directly and unconditionally to the organization to whose order it is drawn. *Held:* the taxpayer is entitled to the special deduction for contributions in an amount not in excess of 10 percent of adjusted gross income provided under section 170(b)(1)(A) in addition to the deduction for contributions in an amount not in excess of 20 percent of adjusted gross income provided under section 170(b)(1)(B) of the Code. The foregoing has application under the circumstances stated only if the fund-raising foundation provides for such satisfaction of pledges and transfer of checks.

Advice has been requested whether a taxpayer who designates a portion of the satisfaction of a pledge, made to an organized non profit charity fund-raising foundation, in an amount equal to 10 per cent of his adjusted gross income by means of a check drawn payabl to a specific organization of a type specified in section 170(b)(1)(A) of the Internal Revenue Code of 1954, is entitled to the special deduc tion for contributions in an amount not in excess of 10 percent o adjusted gross income provided under such section 170(b)(1)(A) i addition to the deduction in an amount not in excess of 20 percen

of adjusted gross income provided under section 170(b)(1)(B) of the Code.

An individual taxpayer pledges 30 percent of his adjusted gross income as a contribution to an organized nonprofit independent charity fund-raising foundation without designation as to which institution in the foundation budget is to receive the contribution when paid. In satisfaction of the pledge he delivers two checks to the foundation, one drawn in favor of the foundation in an amount equal to 20 percent of his adjusted gross income and the second check drawn to the order of a specific organization of the type designated in section 170(b)(1)(A) of the Code. The foundation accepts these checks in full settlement of the pledge. The second check, drawn to the order of the specific organization is delivered to that organization, directly and unconditionally, by the foundation. No charge is made for delivering the check. The foundation has always permitted a donor to designate a specific organization which is to receive his contribution.

Section 170 of the Code reads, in part, as follows:

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

Section 503(b) of the Code reads, in part, 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.

Thus, a deduction is allowed in an amount not in excess of 10 percent of adjusted gross income for contributions paid to an organization of the type specified in section 170(b)(1)(A) of the Code. Where contributions of such nature are made to an extent greater than 10 percent of adjusted gross income the excess over 10 percent will be allowed together with other charitable contributions to an extent not in excess of 20 percent of adjusted gross income under section 170(b)(1)(B) of the Code.

Accordingly, it is held that the taxpayer, under the foregoing circumstances, is entitled to the special deduction for contributions

in an amount not in excess of 10 percent of adjusted gross income provided under section 170(b)(1)(A) in addition to the deduction for contributions in an amount not in excess of 20 percent of adjusted gross income provided under section 170(b)(1)(B) of the Code. The foregoing has application under the circumstances stated only if the fund-raising foundation provides for such satisfaction of pledges and transfer of checks.

Claims for deductions subject to the special limitation of section 170(b)(1)(A) of the Code must be substantiated, when required by the Commissioner, by a statement from the organization to which the contribution or gift was made showing whether the organization is of the type referred to in such section 170(b)(1)(A), the name and address of the contributor or donor, the amount of the contribution or gift and the date of the actual payment thereof, and by such other information as the Commissioner may deem necessary.

(Also Part II, Section 23(o); Regulations 118, Section 39.23(o)-1.) Rev. Rul. 55-151

A taxpayer incurs traveling expenses in connection with the performance of his official duties as an uncompensated officer and member of an organization exempt from Federal income tax under section 501(c)(4) of the Internal Revenue Code of 1954 (sec. 101(8) of the Internal Revenue Code of 1939). *Held*, since the organization is not one to which contributions are deductible within the meaning of section 170 of the 1954 Code (sec. 23(o) of the 1939 Code), any amounts expended by the taxpayer for such traveling expenses are not deductible as charitable contributions for Federal income tax purposes. Compare Rev. Rul. 55-4, page 291, this Bulletin.

Rev. Rul. 55-219

A museum, which is a corporation, maintains a regular faculty and curriculum and a regularly enrolled body of students or pupils at the place where its educational activities are regularly carried on. Contributions to the museums have been held to be charitable contributions under section 170 of the Internal Revenue Code of 1954. *Held*, the museum is an educational organization within the meaning of section 170(b)(1)(A)(ii) of the Code of 1954. Accordingly, contributions made thereto by individuals will be deductible in computing their taxable income not only to the extent of the general limitation of 20 percent of adjusted gross income under section 170(b)(1)(B), but also to the extent of the special limitation of 10 percent of adjusted gross income under section 170(b)(1)(A) of the Code of 1954.

Rev. Rul. 55-268

A rehabilitation center for handicapped individuals provides special treatment for patients under a doctor's prescription. It has become necessary to begin a drive for funds to erect a new building suitable for housing such rehabilitation center. *Held*, contributions made to the rehabilitation center to provide for a building for use in the

treatment of handicapped individuals constitute contributions to a hospital within the meaning of section 170(b)(1)(A)(iii) of the Internal Revenue Code of 1954. Therefore, such contributions are deductible by the donors to the extent that the aggregate of the contributions allowed as a deduction under section 170(b)(1)(A) of the Code does not exceed 10 percent of the taxpayer's adjusted gross income. Any such contributions in excess of 10 percent should be taken into account in computing the amount allowable as a deduction subject to the general limitation of 20 percent provided in section 170(b)(1)(B) of the Code.

Rev. Rul. 55-269

Payments to an organization of the character described in section 501(c)(4) of the Internal Revenue Code of 1954 for the purpose of subsidizing the dissemination of its literature to organizations of the character described in section 501(c)(3) of the Code are not deductible as charitable contributions for Federal income tax purposes.

Advice has been requested concerning the deductibility of payments made to a tax-exempt organization under the circumstances set forth below.

The *M* organization is engaged in the promotion of sound and economical Government operations. Its purposes include stimulating and developing the economic life of the United States by encouraging Government—national, state and local—to practice wise economy in public spending; encouraging business leaders and others to participate in public affairs and thus contribute to government the benefit of their experience and judgment; assisting in the development of an informed public opinion on major political, social and economic issues; and taking appropriate and lawful measures to effectuate these and its other purposes. One of its principal means of accomplishing these purposes is the printing and dissemination of literature devoted to advocating the principles which it supports. Occasionally, the literature may advocate or oppose pending legislation.

The *M* organization has been held to be exempt from Federal income taxes under section 101(8) of the Internal Revenue Code of 1939, now section 501(c)(4) of the 1954 Code, as an organization engaged in promoting the welfare of mankind. Contributions to it are not deductible for Federal income tax purposes.

In addition to soliciting direct contributions in support of its purposes, the *M* organization furnishes to prospective contributors a list of schools, libraries and other educational, religious and similar institutions so that in making payments to the *M* organization such persons may designate particular organizations to which subscriptions to the literature published by the *M* organization may be sent. The listed organizations are of the character described in section 501(c)(3) of the 1954 Code, and contributions to them would be deductible by donors under section 170. It has been contended that the payments are made to the *M* organization as agent of contributors for the purpose of distributing its literature to the designated organizations and that such payments will be deductible as contributions to such schools, libraries, etc.

It is deemed that the above method is an indirect means of subsidizing the dissemination of the literature produced by the *M* organization and constitutes in effect a contribution to the latter organization in support of its own purposes rather than a contribution to the recipients of the literature.

Accordingly, it is held that payments to the *M* organization, or any other organization of the character described in section 501(c)(4) of the 1954 Code, for the purpose of subsidizing the dissemination of its literature to organizations of the character described in section 501(c)(3) of the 1954 Code are not deductible as charitable contributions for Federal income tax purposes.

(Also Part II, Section 120; Regulations 118, Section 39.120–1.) Rev. Rul. 55–308

The term "income tax paid," as contained in section 170(b)(1)(C) of the Internal Revenue Code of 1954 (section 120 of the 1939 Code), relating to the unlimited deduction for charitable contributions for certain individuals, does not include *all* income taxes paid, whether to the Federal Government, a State or foreign country. Since the income tax referred to in this section must be determined without regard to chapter 2 of the Internal Revenue Code of 1954, relating to tax on self-employment income, it is held that the *only* income tax contemplated by such section is Federal income tax.

PART VII.—ADDITIONAL ITEMIZED DEDUCTIONS FOR INDIVIDUALS

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

Deductibility as medical expenses under section 213 of the Internal Revenue Code of 1954, of certain expenditures made by taxpayers for transportation, travel, special education, medical insurance, health institutes, air conditioners, special construction and equipment, special clothing, food and beverages, and other hygienic articles for purposes of health. See Rev. Rul. 55–261, page 307.

PART IX.—ITEMS NOT DEDUCTIBLE

SECTION 263.—CAPITAL EXPENDITURES

Costs incurred in deepening an existing well or constructing a new well as a result of a period of drought. See Rev. Rul. 55–367, page 25.

SECTION 266.—CARRYING CHARGES

No deduction allowable for taxes chargeable to capital account. See Rev. Rul. 55–267, page 23.

SUBCHAPTER C.—CORPORATE DISTRIBUTIONS AND ADJUSTMENTS

PART I.—DISTRIBUTIONS BY CORPORATIONS

SUBPART A.—EFFECTS ON RECIPIENTS

SECTION 301.—DISTRIBUTIONS OF PROPERTY

Distributions by a corporation to its stockholders of stock of a controlled corporation. See Rev. Rul. 55-103, below.

SUBPART C.—DEFINITIONS; CONSTRUCTIVE OWNERSHIP OF STOCK

SECTION 316.—DIVIDEND DEFINED

Distribution of stock by a corporation as a dividend. See Rev. Rul. 55-103, below.

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. 55-45, page 34.

The effects on shareholders as a result of exchanges between two corporations in pursuance of a plan of reorganization. See Rev. Rul. 55-59, page 35.

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

(Also Sections 301, 316.) Rev. Rul. 55-103

X Corporation owning 80 percent of the stock of Corporation Y, proposes to distribute its Y stock to the stockholders of X, just prior to the sale of all the stock of X to Z Corporation. *Held*, the distribution of such stock will be used principally as a device for the distribution of earnings and profits of the X Corporation and, therefore, the nonrecognition provision of section 355 of the Internal Revenue Code of 1954 will not apply. *Held further*, the

taxability of the distribution should be determined under section 301 and section 316 of such Code.

Advice has been requested with respect to the tax consequences of a proposed transaction under the circumstances set forth below.

The X Corporation is engaged in the manufacture of paper products. It also owns 80 percent of the stock of Y, a foreign corporation, which operates a lumber business. The Y Corporation's stock has greatly appreciated in value and constitutes a large proportion of the total asset value of X Corporation. The X Corporation has common stock of $120x$ dollars and an earned surplus of $100x$ dollars. For the past several years, the X Corporation has suffered severe operating losses and its stockholders have received no dividends. For that reason the stockholders of X have voted to liquidate and start dissolution proceedings on a specified date, unless negotiations to sell their stock have been completed on or before such date.

The Z Corporation is interested in buying all of the outstanding common stock of X Corporation and has made an offer to purchase such stock which has not yet been acted upon by X or its stockholders. However, the Z Corporation's offer does not contemplate payment for the value of the Y Corporation's stock as an asset of X Corporation.

Since the Z Corporation has no interest in Y stock held by X Corporation, the latter corporation proposes to distribute this stock to its shareholders, prior to the completion of the sale negotiations.

Section 355(a) of the Internal Revenue Code of 1954 states that, if all the requirements of that section are satisfied, the distribution by a corporation of the stock of a controlled corporation to its shareholders will not result in the recognition of any gain or loss to a shareholder upon receipt of the stock. However, one of the requirements of section 355 (a)(1) is that:

> (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), * * *.

In the instant case, subsequent to the proposed distribution of Y stock by X, the stock of X Corporation may be sold by the present stockholders pursuant to an arrangement negotiated immediately prior to the distribution. The sale of stock of the distributing corporation immediately subsequent to a distribution of stock of a controlled corporation, when negotiations for such a sale are already in process, is generally considered sufficient evidence that the distribution of stock was used principally as a device for the distribution of earnings and profits of the distributing corporation. The purpose of the requirement that the transaction not be used principally as a device for the distribution of earnings and profits is to limit the application of section 355 of such Code to those cases in which the distribution of stock of the controlled corporation effects only a readjustment of continuing interests in property under modified corporate forms.

In the instant case, the purpose in distributing the Y stock is to facilitate the sale of stock of X Corporation. No continuing interest in X on the part of any of the present stockholders is contemplated. The distribution of the Y stock is merely a device to give to the X stockholders certain assets for which the prospective purchaser of their stock is unwilling to pay. Therefore, it is an arrangement for distributing the earnings and profits of X Corporation and section 355 of the Code is not applicable to such a transaction.

Accordingly, it is held that the amount and taxability of the distribution of the stock of Y Corporation to the stockholders of X Corporation will be determined in accordance with the provisions of section 301(c)(1) of the Internal Revenue Code of 1954. The portion of the distribution constituting a dividend will be determined under the provisions of section 316 of such Code.

SECTION 358.—BASIS TO DISTRIBUTEES

The treatment of the basis to stockholders of their stock in exchange pursuant to a reorganization. See Rev. Rul. 55–45, page 34.

Basis to stockholders of stock received in exchange for stock pursuant to a reorganization. See Rev. Rul. 55–59, page 35.

SUBPART C.—EFFECTS ON CORPORATION

SECTION 361.—NONRECOGNITION OF GAIN OR LOSS TO CORPORATIONS

The exchanges of property between two domestic corporations in pursuance of a plan of reorganization. See Rev. Rul. 55–45, page 34.

Exchange of property between two corporations in pursuance of a plan of reorganization. See Rev. Rul. 55–59, page 35.

SECTION 362.—BASIS TO CORPORATIONS

Property acquired by a corporation in connection with a reorganization. See Rev. Rul. 55–45, page 34.

Property acquired by a corporation in connection with a reorganization. See Rev. Rul. 55–59, page 35.

SUBPART D.—SPECIAL RULE; DEFINITIONS

SECTION 367.—FOREIGN CORPORATIONS

(Also Sections 354, 358, 361, 362, 368, 381, 1223.) Rev. Rul. 55-45

Where a plan of reorganization is proposed for bona fide business reasons providing for a statutory merger of two domestic corporations which are wholly owned subsidiaries of a foreign corporation, it is not necessary to establish prior to the merger that such transaction is not in pursuance of a plan of tax avoidance under section 367 of the Internal Revenue Code of 1954. The herein described transaction constitutes a nontaxable reorganization within the purview of section 368(a)(1)(A) of such Code.

Advice has been requested with respect to the tax consequences of a proposed reorganization under the following circumstances.

X and Y are both American corporations engaged in the business of manufacturing and selling agricultural implements and are located in different States. Both corporations have both preferred and common stock outstanding. Y Corporation holds about 10 percent of its issued common stock in its treasury.

Both X and Y are wholly owned subsidiaries of Z Corporation, a Canadian corporation.

To promote greater business efficiency and economy in management of X and Y Corporations, a plan of reorganization and agreement of merger is proposed whereby the X Corporation will acquire the business and assets of the Y Corporation through a statutory merger in compliance with the statutes of the respective States in which they are incorporated. Upon completion of the merger, Y Corporation will cease as a separate corporate entity, while the X Corporation will be the surviving and continuing corporation.

Under the plan the articles of incorporation of X will be amended to provide for an increase in its authorized common stock, and newly issued common stock of X will be exchanged for all of the common and preferred stock of Y. The treasury shares held by Y will be cancelled and the name of the surviving corporation will be changed.

The questions presented are (1) whether, under the provisions of section 367 of the Internal Revenue Code of 1954, it is necessary to establish in advance of the transaction that the exchanges to be made are not in pursuance of a plan having as one of its principal purposes the avoidance of Federal income taxes and (2) whether the transfers, exchanges, and the termination of Y's corporate existence will result in recognition of gain or loss to any of the parties involved.

With respect to the first question, section 367 of the Internal Revenue Code of 1954, which relates to foreign corporations, reads in part as follows:

In determining the extent to which gain shall be recognized in the case of any of the exchanges described in section * * * 354, 355, * * * 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 * * *.

In the instant case the plan of reorganization as proposed provides for the merger of two domestic corporations all of the stock of which

is owned by the same foreign corporation. However, if all of the stock of both corporations were owned by an individual (instead of a corporation) this would not prevent the transaction from being a reorganization under the terms of section 368 of the Code. It is therefore not necessary to establish prior to the merger that it is not in pursuance of a plan having as one of its principal purposes the avoidance of Federal income tax within the meaning of section 367 of the Code, inasmuch as the transaction has the same effect whether or not the foreign corporation is "considered as a corporation."

In the instant case, the merger meets the provisions of section 368(a)(1)(A) of the Internal Revenue Code. Both corporations are in the same business and the purpose of the transaction is to promote greater business efficiency and economy in management. Therefore, no gain or loss will be recognized to either corporation or to their stockholder as a result of the merger. The basis of the assets of the Y Corporation acquired by the X Corporation will be the same as the cost or other basis in the hands of Y; and the basis to the stockholder of Y Corporation of the stock of X Corporation received will be the same as the basis of the stock exchanged. In determining the holding period of the new shares, there will be included the period for which the shares exchanged were held. The undistributed earnings and profits of Y Corporation will be deemed to have been received by the X Corporation as of the date of the transfer.

SECTION 368.—DEFINITION RELATING TO CORPORATE REORGANIZATIONS

(Also Sections 354, 358, 361, 362, 381.) Rev. Rul. 55-59

A nonstatutory merger between two corporations under certain circumstances for bona fide business reasons will constitute a reorganization within the purview of section 368(a)(1)(C) of the Internal Revenue Code of 1954 and, therefore, a nontaxable exchange as to each corporation and its shareholders under sections 361 and 354 of such Code.

Advice has been requested with respect to the tax consequences of a proposed reorganization under the following circumstances.

The X Corporation is engaged in the business of manufacturing and selling certain products. Its authorized capital consists of 2,500 shares of common stock of which 1,450 shares are outstanding in the hands of the public and 50 shares are held in the treasury of the corporation. Of the treasury stock 35 shares are reserved for options granted to officers and executives of the corporation.

The Y Corporation is engaged in the same business as X Corporation. Its authorized capital consists of 100 shares of preferred stock and 500 shares of common stock. None of the preferred stock has ever been issued. Of the authorized common stock 240 shares are outstanding not including 15 shares which have been reserved for the purpose of Y's restricted stock option plan for key employees. The corporation has outstanding $750x$ dollars principal amount of sinking fund debenture bonds.

Pursuant to an agreement between the respective corporations, the X Corporation will acquire the property and assets of the Y Corpora-

tion in exchange solely for voting stock of the X Corporation, and the assumption by X of the liabilities of Y, including the outstanding debenture bonds. Furthermore, the X Corporation will change its name to "X-Y Corporation"; reclassify its stock so as to provide for 1,500 authorized shares of voting common stock, having a different par value; issue 300 shares of new common stock in exchange for the 1,500 shares of its old common stock outstanding, the exchange being on a pro rata basis; and make certain other incidental changes in X's articles of incorporation.

The X Corporation will issue to the Y Corporation 350 shares of its new common stock, and will assume the liabilities of Y Corporation in exchange for the property and assets of Y Corporation which will be acquired by X. Upon the receipt by Y of the stock of the X Corporation, the latter corporation will distribute such stock to its stockholders in exchange for the stock of Y Corporation held by them in the ratio provided by the plan of reorganization. The X Corporation in issuing its new common stock to its own stockholders and to the stockholders of Y Corporation will issue scrip certificates representing fractional shares which will be exchangeable for full shares. Such scrip certificates will become void after a specified date if they are not theretofore surrendered. Upon consummation of the transaction the Y Corporation will be liquidated and dissolved.

The purpose of the transaction is to advance the interests of the said corporations by presenting a strengthened organization in a highly competitive industry through a broadened line of products, lower unit costs, and a combination of successful managerial talent.

Section 368 of the Internal Revenue Code of 1954 provides, in part, as follows:

(a) REORGANIZATION.—
(1) IN GENERAL * * * the term "reorganization" means—
* * * * * * *
(C) the acquision 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;
* * * * * * *

(b) PARTY TO A REORGANIZATION. * * * 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.

Section 361 of such Code in regard to the effects on corporations states, in part:

(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.

As to the effect on shareholders, section 354 reads, in part:

(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.

In the instant case, all requirements of a nontaxable transaction within the meaning of the above sections of the Code have been met. Therefore, no gain or loss will be recognized to either corporation or its stockholders as a result of the reorganization. The basis of the assets of Y Corporation acquired by the X Corporation will be the same as the cost or other basis in the hands of Y; and the basis of the new stock of X Corporation in the hands of the stockholders of X Corporation and in the hands of the stockholders of Y Corporation will be the same as the basis of the old stock exchanged therefor. The undistributed earnings and profits of Y Corporation will retain its character for dividends in the X Corporation.

Merger of two domestic corporations which are wholly owned subsidiaries of a foreign corporation. See Rev. Rul. 55-45, page 34.

PART V.—CARRYOVERS

SECTION 381.—CARRYOVERS IN CERTAIN CORPORATE ACQUISITIONS

The undistributed earnings and profits acquired by the surviving corporation pursuant to the plan of reorganization. See Rev. Rul. 55-45, page 34.

Status of undistributed earnings and profits acquired by the surviving corporation pursuant to the plan of reorganization. See Rev. Rul. 55-59, page 35.

SUBCHAPTER D.—DEFERRED COMPENSATION, ETC.

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

SECTION 401.—QUALIFIED PENSION, PROFIT-SHARING, STOCK BONUS PLANS, ETC.

(Also Part II, Section 165; Regulations 118, Section 39.165-1.) Rev. Rul. 55-60

Where an employees' pension plan, held to meet the requirements for qualification for tax exemption under section 165(a) of the Internal Revenue Code of 1939, contains a provision for limitation of benefits for the 25 most highly compensated employees in accordance with Mimeograph No. 5717, C. B. 1944, 321, and has been in operation for more than 10 years, a variance in the distributive shares of participants upon bona fide termination of the plan because of adverse business conditions will not result in the prohibited discrimination in favor of employees who are officers, shareholders, supervisors, or highly compensated, nor adversely affect the qualification of the plan under section 401(a) of the 1954 Code.

Mimeograph 6136, C. B. 1947-1, 58, and P. S. 52 dated August 9, 1945, modified.

Advice has been requested whether upon bona fide termination of an employees' pension plan, because of adverse business conditions, a variation in the distributive shares of participants in the plan would result in the prohibited discrimination in favor of employees who are officers, shareholders, supervisors, or highly compensated, and adversely affect the qualification of the plan under section 401(a) of the Internal Revenue Code of 1954.

An employer established a pension plan of the unit benefit type for its employees during 1943. Benefits under the plan were provided by means of individual level premium annuity contracts. The plan had been amended during 1944 to include limitations on benefits for the 25 most highly compensated employees in accordance with the provisions of Mimeograph 5717, C. B. 1944, 321, and upon consideration as to its qualification under section 165(a) of the Internal Revenue Code of 1939 was held to satisfy the requirements for such qualification. The benefits under the plan were integrated with the Old Age and Survivors Insurance benefits under the social security program. The plan had been maintained and operated in accordance with its terms until 1954 when it was terminated because of adverse business conditions.

Upon such termination it was found that distribution of the available assets under the plan, in accordance with provisions therefor, would result in the respective participants receiving distributions equal to the following percentages of their total compensation:

Employees	*Percentage of total compensation*
Controlling stockholder	33
Minority stockholder	21
Highly paid nonstockholder employees	17
All other employees	11

It was also found that the plan was operated in accordance with its provisions and that the variance in distributions, as indicated above, was occasioned by: (1) the older ages of the stockholders and highly paid employees, (2) integration of the benefits under the plan with the Old Age and Survivors Insurance benefits under the social security program which resulted in relatively greater benefits based on compensation above $3,600 than on the first $3,600 of compensation for each year of credited service, and (3) the fact the stockholders and highly compensated employees had relatively long periods of credited service.

Since the plan had been in operation for more than 10 years, the limitations on benefits for the 25 most highly compensated employees in accordance with Mimeograph 5717, *supra*, are no longer applicable. Thus, the issue is whether the distribution as indicated above is discriminatory within the purview of section 401(a)(4) of the 1954 Code (section 165(a)(4) of the Internal Revenue Code of 1939) which prohibits discrimination in favor of employees who are officers, shareholders, supervisors, or highly compensated.

It is recognized that in a pension plan of the unit benefit or fixed benefit type contributions for the respective participants will vary in accordance with such factors as age, years of service, and nearness to retirement, and that in integrated plans variances will result when comparisons are made solely on the basis of assets distributable under the plan. This, however, is not discrimination within the statutory

sense. The variance in distribution is merely a fortuitous circumstance resulting from the bona fide termination of the plan which could not have been foreseen when the plan was established and which resulted from causes beyond the employer's control.

Accordingly, under the above circumstances, it is held that a variance in the distributive shares of participants upon bona fide termination, because of adverse business conditions, of an employees' pension plan which contains a provision for the limitation of benefits for the 25 most highly compensated employees and which has been in operation for more than 10 years, will not result in the prohibited discrimination in favor of employees who are officers, shareholders, supervisors, or highly compensated, nor adversely affect the qualification of the plan under section 401(a) of the 1954 Code.

Mimeograph 6136, C. B. 1947-1, 58, and P. S. 52, dated August 9, 1945, to the extent inconsistent herewith are hereby modified.

(Also Part II, Section 165; Regulations 118, Section 39.165–4.) Rev. Rul. 55-186

A plan which is intended to qualify under section 401(a) of the Internal Revenue Code of 1954 must contain an appropriate provision for the purpose of granting fully vested rights to participants upon discontinuance of contributions by the employer, similar to a case in which actual termination takes place.

Advice has been requested as to whether an employees' profit-sharing plan must contain a provision for granting fully vested rights to participants upon discontinuance of contributions by the employer.

Under the provisions of the employees' profit-sharing plan in the instant case, if the board of directors deems it inadvisable or impossible for the corporation to continue to make contributions under the plan, it shall have the power to discontinue the corporation's contributions by an appropriate resolution. However, should this be done, the other provisions of the plan remain in force and the trust remains in existence. The plan further provides that a participant shall forfeit the amount credited to him in the trust fund in the event of his termination of employment prior to retirement.

Section 401(a)(4) of the Internal Revenue Code of 1954 (sec. 165(a)(4) of the 1939 Code) provides that a trust forming part of a stock bonus, pension, or profit-sharing plan of an employer for the exclusive benefit of his employees shall constitute a qualified trust if the contributions or benefits provided under the plan do not discriminate in favor of employees who are officers, shareholders, persons whose principal duties consist in supervising the work of other employees, or highly compensated employees.

In a profit-sharing plan, unless the participants are vested in their respective interests at the time of discontinuance of contributions, discrimination in favor of employees who are officers, shareholders, supervisors, or highly compensated may result. Such employees would usually be the last to have their services terminated and stand to benefit from the forfeitures arising from severance of employment of other participants.

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In a pension plan, forfeitures arising from severance of employment or other reasons must be used to reduce subsequent employer contributions rather than be allocated among remaining participants. However, if contributions are discontinued there is nothing against which to apply the forfeitures.

Accordingly, a plan which is intended to qualify under section 401(a) of the 1954 Code (sec. 165(a) of the 1939 Code) must contain an appropriate provision for the purpose of granting fully vested rights to participants upon discontinuance of contributions by the employer, similar to a case in which actual termination of the plan and trust takes place.

Extension of time granted in filing annual return required of an employees' trust qualified under section 401(a) of the Internal Revenue Code of 1954. See Rev. Rul. 55–371, page 139.

SECTION 402.—TAXABILITY OF BENEFICIARY OF EMPLOYEES' TRUST

(Also Part II, Section 165; Regulations 118, Section 39.165–6.) Rev. Rul. 55-61

Although a distribution from an employees' trust meeting the requirements of section 401 of the Internal Revenue Code of 1954 is made in whole or in part from funds received by the trust as interest on tax-free securities, such distribution, when received or made available, is taxable income to the distributee in the manner and to the extent provided by section 402(a) of the Code.

(Also Section 72.) Rev. Rul. 55-368

The distribution of all funds of a pension trust to the employee participants, each of whom has previously executed and who thereafter carries out a legally enforceable agreement to pay over his distributive share to a new pension trust which, like the former, constitutes a qualified trust under section 401(a) of the Internal Revenue Code of 1954, is considered a transfer of funds from one such trust to another through the agency of the employees, who will realize no taxable income from such transactions. The deferment of taxation to the participants granted with respect to the employer's contributions and any earnings credited to the participants will accordingly continue until such subsequent time as they may be distributed or made available to the distributees.

Advice has been requested with regard to the tax consequences of distributions from a pension trust which has been held to be qualified under section 401(a) of the Internal Revenue Code of 1954 and exempt under section 501(a) of the Code, upon discontinuance of the plan, where funds are distributed to the employee participants who in turn pay them over to the trustees of a new plan also qualified under section 401(a) of the Code.

A savings and loan association that had been a member of the Retirement Fund of the Federal Home Loan Bank System, which fund had been held to meet the requirements of section 401(a) of the Code, desired to sever its connection with the System and fund its pension

obligations to its employees under its own plan, which plan was also to qualify under section 401(a) of the Code. Under the bylaws of the System it was required that, upon discontinuance by an employer of participation in the System, the contributions of both the employer and employees be distributed to the employee participants. As a condition precedent to the establishment of its new plan the association required that each and every one of its employees participating in the System sign an agreement requiring them to deposit in the new trust all funds received from the System.

Section 402(a) of the Code provides that the amount actually distributed or made available to any distributee by an employees' trust described in section 401(a) which is exempt from the tax under section 501(a) shall be taxable in the year in which so distributed or made available.

It is held that the distribution of all funds of a pension trust to the employee participants, each of whom has previously executed and who thereafter carries out a legally enforceable agreement to pay over his distributive share to a new pension trust which, like the former, constitutes a qualified trust under section 401(a) of the Internal Revenue Code of 1954, is considered a transfer of funds from one such trust to another through the agency of the employees, who will realize no taxable income from such transactions. The deferment of taxation to the participants granted with respect to the employer's contributions and any earnings credited to the participants will accordingly continue until such subsequent time as they may be distributed or made available to the distributees. See Revenue Ruling 55–317, page 329, this Bulletin, involving a similar issue, but with respect to city employees having certain options not present in this case.

Rev. Rul. 55–423

A participant's interest in an employees' trust described in section 401(a) and exempt under section 501(a) of the Internal Revenue Code of 1954 is not made available to him within the purview of section 402(a) of the Code where there are substantial conditions or restrictions on his right of withdrawal.

Advice has been requested as to the circumstances under which a participant's interest in an employees' trust described in section 401(a) and exempt under section 501(a) of the Internal Revenue Code of 1954 is made available to him within the purview of section 402(a) of the Code.

Section 402(a) of the Code provides that the amount distributed or made available from a trust described under section 401(a) which is exempt under section 501(a) of the Code, shall be taxable to the distributee "in the year in which so distributed or made available." It is clear from the language used in section 402(a) of the Code that it was intended, in some circumstances, that a participant, even in a qualified plan, should be subjected to tax upon his interests in such a trust in a particular year even though such interests shall not be actually distributed to him in that year.

A participant's interest in such a trust is not made available to him unless and until it is unconditionally credited to or set apart for him and made subject to his withdrawal or other disposition. Conditions upon such withdrawal or disposition which are without substance

however, are not deemed to prevent the participant's interest from being made available. See Rev. Rul. 54-265, C. B. 1954-2, 239. Most cases in which the issue arises as to whether a participant's interest has been made available fall into two general classes, namely, (1) penalties for withdrawal, and (2) a prior irrevocable election to defer distribution to a fixed or determinable future time.

In the penalty type of case a participant, who makes a withdrawal, is required to discontinue his participation in the trust or suffer a forfeiture with respect to a portion of his distributable interest. Discontinuance of participation is the surrender of a valuable right and, as long as that remains a condition for withdrawal of his interest, such interest is not made available to the participant. Compare, *Dillis C. Knapp et al.* v. *Commissioner*, 41 B. T. A. 23, and *Estate of A. M. Berry* v. *Commissioner*, 44 B. T. A. 1254.

In the deferment by prior election type of case, if the trust indenture, or the plan of which it is a part, provides for an irrevocable election by the employee prior to the time his interest becomes distributable to him to have distribution of such interest deferred to a fixed or determinable future time, such as ten years or upon his prior retirement, severance of employment, death, or disability, his interest is not made available prior to such time or occurrence of any of the events enumerated. So long as an employee's election to defer the actual receipt of a distribution is irrevocable, it is immaterial whether the exercise thereof takes the form of positive action or merely inaction on the part of the employee.

Both in the penalty and deferment by prior election type of case, a penalty or period of deferment which is inconsequential lacks substance and is not deemed to prevent the participant's interest from being made available at the earliest date upon which he could have received a distribution. What is consequential and what constitutes substance depends upon the facts in a particular case, and will be further amplified in subsequent rulings.

(Also Part II, Section 165; Regulations 118, Section 39.165-6.) Rev. Rul. 55-424

Where an employee after 10 years of participation in an employees' profit-sharing trust, which is qualified under section 401(a) of the Internal Revenue Code of 1954 (section 165(a) of the 1939 Code), may elect to withdraw a stated percentage of the full amount standing to his credit in the account established for a particular 10 year period only after the approval of an administrative committee in the case of proved financial necessity, such amounts will not be deemed to be made available under section 402(a)(1) of the 1954 Code.

Advice has been requested whether a participant in a qualified employees' profit-sharing trust will be considered to be in receipt of income when after 10 years of participation in the trust he may elect to withdraw a stated percentage of the amount standing to his credit in the account established for a particular 10 year period only upon the approval of an administrative committee in the case of proved financial necessity.

The *M* company established an employees' profit-sharing plan and trust which has been held to be qualified under section 165(a) of the Internal Revenue Code of 1939 (sec. 401(a) of the 1954 Code). Ad-

ministration of the plan is accomplished by an administrative committee appointed from among the participating employees. Company contributions are allocated to each participant's account on the basis of compensation and vest in the employee at the rate of 10 percent for each year of participation. Debits and credits are made to each participant's account for successive periods of 10 years.

After 10 years of participation, an employee may elect to withdraw 10 percent of the full amount standing to his credit in the account established for him for a particular 10 year period only with the express approval of the administrative committee and only after making a written request therefor. Committee approvals for withdrawal of vested amounts can only be made in the case of financial necessity which has been proved by the participant making the application. A similar election, if approved, may be made with respect to each year thereafter until the account has been exhausted. If a request is not made in a particular year, the amount may be paid in a subsequent year if requested by the participant and approved by the committee. Withdrawals may likewise be made from accounts of succeeding 10 year periods.

Section 402(a) of the 1954 Code provides that the amount distributed or made available from a trust described under section 401(a) of the Code shall be taxable to the distributee in the year in which so distributed or made available. Rev. Rul. 55–423, page 41 of this Bulletin, holds that a participant's interest in an employees' trust which meets the qualifications of section 401(a) of the 1954 Code is not made available to him within the purview of section 402(a) of the Code where there are substantial conditions or restrictions on his right of withdrawal and unless and until such interest is made subject to his withdrawal or disposal. It is considered that in the instant case the requirement that withdrawals can be made only with the approval of the administrative committee and only in the case of proved financial necessity constitutes a substantial restriction upon such withdrawal.

Accordingly, it is held that where an employee after 10 years of participation in an employees' profit-sharing trust, which is qualified under section 401(a) of the 1954 Code, may elect to withdraw a stated percentage of the full amount standing to his credit in an account established for a particular 10 year period only after the approval of an administrative committee in the case of proved financial necessity, such amounts will not be deemed to be made available under section 402(a)(1) of the 1954 Code.

Rev. Rul. 55–425

Where a participant in an employees' profit-sharing trust, which has been held to meet the requirements of section 165(a) of the Internal Revenue Code of 1939 (section 401(a) of the 1954 Code), may elect at any time prior to the completion of 14 years of continuous service to receive distribution of his trust funds upon completion of 15 years of continuous service, it is held that the trust funds are not "made available" by reason of the right to make such an election.

Advice has been requested whether the trust funds of an employees' profit-sharing trust, which has been held to meet the requirements of section 165(a) of the Internal Revenue Code of 1939 (section 401(a) of the 1954 Code), will be considered to have been "made available" within the meaning of section 402(a) of the 1954 Code, merely

by reason of a participant's right to elect, within a specified time, to receive distribution of trust funds upon completion of 15 years of service.

An employer established an employees' profit-sharing plan which was held to be qualified under section 165(a) of the 1939 Code (section 401(a) of the 1954 Code). Under the terms of the trust agreement which forms a part of the profit-sharing plan each employee had a severable and personal trust which terminated at the end of a period of 15 years of participation. The individual employee's trust could also be terminated upon his death or other termination of his services. Upon termination of a particular employee's trust for any reason the funds held thereunder (or such part with respect to which he had a nonforfeitable right) would be distributed to him in a lump sum.

An amendment to the plan and trust has been executed whereby a participant may receive a distribution from the trust only upon the termination of his services except in a case where he may elect to file a written declaration prior to his completion of 14 years of continuous employment to have his trust terminated at the completion of 15 years of service. The written declaration is irrevocable and no further election may be made after the completion of the 14th year.

If he should fail to file such an election, within the time specified, then he may not receive any of the trust funds except upon his death or other termination of his services.

Section 402(a) of the 1954 Code provides that the amount actually distributed or made available to any distributee by an employees' trust, described in section 401(a) which is exempt under section 501(a), shall be taxable to him in the year in which so distributed or made available. Where total distributions payable with respect to any employee are paid to the distributee within 1 taxable year of the distributee on account of the employee's death or other separation from the service, or on account of the death of the employee after separation from service, the amount of such distribution, to the extent exceeding the amounts contributed by the employee shall be considered a gain from the sale or exchange of a capital asset held for more than 6 months.

Revenue Ruling 55-423, page 41 of this Bulletin, holds that a participant's interest in an employees' trust which meets the qualifications of section 401(a) of the 1954 Code is not made available to him within the purview of section 402(a) of the Code where there are substantial conditions or restrictions on his right of withdrawal.

On the basis of the above, it is held that where a participant in a qualified employees' profit-sharing trust may elect at any time prior to the completion of 14 years of continuous service to file a written declaration for distribution of his trust funds upon completion of 15 years of continuous service and where he may otherwise receive a distribution of the trust funds only upon the termination of his services, the trust funds are not "made available" within the purview of section 402(a) of the 1954 Code, by reason of the right to make such an election. Compare Rev. Rul. 54-265, C. B. 1954-2, 239. Where total distributions payable with respect to an employee are paid to the distributee within 1 taxable year of the distributee on account of the employee's death or other termination of service or death after termination of service, long-term capital gain treatment will be accorded such a distribution.

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)-11.) Rev. Rul. 55-310

Deposits made by an employer to a temporary depository are not deemed to be contributions or payments to or under a plan qualified under section 401(a) of the Internal Revenue Code of 1954 (section 165(a) of the 1939 Code). A contribution is deemed to be made at the time the funds are irrevocably turned over to the trustee by the temporary depository or agent and is deductible within the limits of section 404 of the Code, only if then paid to an existing trust which is part of a qualified pension, profit-sharing, or stock bonus plan, or in the event that the trust is not so qualified, if the rights of the employees in the contributions are nonforfeitable at the time so paid.

Advice has been requested relative to the deductibility of amounts placed by an employer in an escrow fund which may be used to pay pension benefits.

The *M* corporation is negotiating with a labor union, which represents its employees, in an effort to establish a pension plan designed to cover all employees of the corporation. Each month, during the process of negotiation, the corporation places in escrow one-twelfth of the estimated annual cost of the proposed plan. If within a specified time the plan is consummated, the escrow funds are to be transferred to the trustee designated under the plan and applied to the payment of pension benefits. In the event the plan has not been agreeably accepted by all parties within the time specified, the escrow funds are to revert to the corporation.

Section 404(a) of the Internal Revenue Code of 1954 (sec. 23(p)(1) of the 1939 Code) provides in part that contributions to or under a pension, stock bonus or profit-sharing trust which meets the requirements of section 401(a) of the 1954 Code (sec. 165a of the 1939 Code) shall be deductible subject to certain limitations (not here pertinent) as to the amount deductible in any year, "if the contributions are paid into a pension trust" or "if the contributions are paid into a stock bonus or profit-sharing trust."

Section 404(a)(5) of the 1954 Code (section 23(p)(1)(D) of the 1939 Code) provides, in substance, that if contributions are paid under a plan which does not meet the requirements of section 401(a) of the 1954 Code (section 165(a) of the 1939 Code) such contributions shall be deductible in the year paid only if the employees' rights to, or derived from, the employer's contributions are nonforfeitable at the time paid.

In the instant case, the monthly payments are made under a plan which does not meet the requirements of section 401(a) of the 1954 Code (section 165(a) of the 1939 Code) and the employees' rights to the contributions are forfeitable inasmuch as the funds will revert to the corporation, in the event no agreement is reached between the labor union and the corporation. Moreover, deposits with a temporary depository are not deemed to be contributions or payments to or under a plan meeting the requirements of section 401(a) of the 1954 Code under such circumstances. Therefore, the monthly deposits in

the escrow fund will not be deductible from gross income for Federal income tax purposes when so deposited. See Mim. 5985, C. B. 1946-1, 72, and Mim. 6021, C. B. 1946-2, 43.

Accordingly, deposits to a temporary depository will not be considered as contributions or payments to or under a plan qualified under section 401(a) of the 1954 Code (section 165(a) of the 1939 Code). A contribution is deemed to be made at the time the funds are irrevocably turned over to the trustee by the temporary depository or agent and is deductible only if then paid to an existing trust which is part of a qualified pension, profit-sharing, or stock bonus plan, or in the event the trust is not so qualified, if the rights of the employees in the contributions are nonforfeitable at the time so paid. A payment by the temporary depository or agent is not considered to meet the requirements of section 404(a) of the 1954 Code and is not deductible thereunder if made to a trust prior to (1) the date the plan is actually in effect and (2) the date upon which it is deemed to meet the requirements of section 401(a).

Information required to be filed by an individual employer supporting deductions claimed for contributions to an employees' trust or annuity plan on an industry-wide or area-wide basis, negotiated by a labor union, when the trustees of the plan file the complete data required for all contributing employers. See Rev. Rul. 55-204, page 300.

PART II.—MISCELLANEOUS PROVISIONS

SECTION 421.—EMPLOYEE STOCK OPTIONS

(Also Part II, Section 130A; Regulations 118, Section 39.130A-2.) Rev. Rul. 55-104

> For the purpose of applying the 10 percent combined voting power rule contained in section 421(d)(1)(C) of the Internal Revenue Code of 1954 an employee who is granted a stock option by his corporate employer is considered to be the owner of all stock owned directly or indirectly by him, his wife, father, mother, brothers and sisters.

Advice has been requested relative to the extent to which the direct and indirect ownership rule contained in section 421(d)(1)(C) of the Internal Revenue Code of 1954 applies under the conditions stated below.

The taxpayer has been granted a stock option by his corporate employer. In addition to stock of the company which is owned directly by the taxpayer, his father, mother, brothers and sisters, certain shares are held by various trusts of which he or they are the beneficiaries. Also the taxpayer, his father and mother and some of the trusts own shares of stock in a foreign corporation which in turn owns certain shares of stock in the corporation granting the option.

Section 421(d)(1)(C) of the Code provides, in part, as follows:

> For the purposes of this subparagraph—
>
> (i) such individual shall be considered as owning the stock owned, directly or indirectly, by or for his brothers and sisters (whether by

the whole or half blood), spouse, ancestors, and lineal descendants; and

(ii) stock owned, directly or indirectly, by or for a corporation, partnership, estate, or trust, shall be considered as being owned proportionately by or for its shareholders, partners, or beneficiaries; and * * *

Accordingly, it is held that for the purpose of applying the stock ownership provisions of section 421(d)(1)(C) of the Internal Revenue Code of 1954, an employee of a corporation granting a stock option is considered to be the owner of all shares of stock owned directly or indirectly by him, his wife, father, mother, brothers and sisters and all shares of stock held by trusts of which he or they are the beneficiaries. Further, he is considered to own, proportionately, any shares of stock in the corporation granting the option which are owned by another corporation of which he or any of the above-designated persons or trusts are shareholders.

SUBCHAPTER E.—ACCOUNTING PERIODS AND METHODS OF ACCOUNTING

PART I.—ACCOUNTING PERIODS

SECTION 441.—PERIOD FOR COMPUTATION OF TAXABLE INCOME

Procedure to be followed by taxpayers who elect to change to 52–53-week taxable years ending after August 16, 1954, pending issuance of regulations under the Internal Revenue Code of 1954. See Rev. Rul. 55–10, below.

SECTION 442.—CHANGE OF ANNUAL ACCOUNTING PERIOD

(Also Section 441; Section 706(b).) Rev. Rul. 55–10

Procedure to be followed, pending issuance of regulations under the Internal Revenue Code of 1954, with respect to changes to 52–53-week taxable years ending after August 16, 1954, changes to other taxable years beginning after December 31, 1953, and ending after August 16, 1954, and changes by partnerships and partners to taxable years beginning after April 1, 1954.

SECTION 1. PURPOSE.

The purpose of this Revenue Ruling is to state the procedure to be followed, pending the issuance of regulations under the Internal Revenue Code of 1954 (hereinafter referred to as "the 1954 Code"), with respect to the approval by the Commissioner of Internal Revenue of changes of annual accounting periods where the new accounting period is subject to the provisions of the 1954 Code. Accordingly, the following rules apply to changes to 52–53-week taxable years ending after August 16, 1954, and to changes to other taxable years beginning after December 31, 1953, and ending after August 16,

1954. Section 4 states the special rules for partnerships and partners in the case of taxable years beginning after April 1, 1954.

SEC. 2. APPLICATION OF STOPGAP REGULATIONS.

In accordance with the provisions of stopgap regulations promulgated by T. D. 6091, C. B. 1954–2, 47, the provisions of section 39.46–1 of Regulations 118, as amended by T. D. 6099, C. B. 1954–2, 113, continue in effect, insofar as they are not inconsistent with the provisions of the 1954 Code, until they are superseded by regulations issued under the 1954 Code. For certain situations with respect to which the 1954 Code contains new provisions not covered by or inconsistent with section 39.46–1 of Regulations 118, interim rules are set forth in the following sections of this Revenue Ruling. Such rules are temporary and will be superseded by regulations.

SEC. 3. CHANGES TO 52–53–WEEK TAXABLE YEARS.

.01 Section 441(f) of the 1954 Code authorizes a taxpayer to elect to compute his taxable income on the basis of an annual accounting period which varies from 52 to 53 weeks, always ends on the same day of the week and either (a) always ends on whatever date this same day of the week last occurs in a designated calendar month or (b) always ends on whatever date this same day of the week falls which is nearest to the last day of a designated calendar month.

.02 The election to compute taxable income on the basis of a 52–53–week taxable year may be made for taxable years ending after August 16, 1954, by taxpayers who regularly keep their books of account on that basis. A taxpayer will be considered to comply with this requirement if at the time he elects a 52–53–week taxable year he conforms his books to that basis and thereafter regularly keeps his books of account and reports his income on such basis.

.03 If a taxpayer has been reporting taxable income on the basis of a calendar year or a fiscal year ending on the last day of a calendar month, and elects to change to a 52–53–week taxable year ending on a particular day with reference to the end of the same month, advance approval of the change will not be required. For example, advance approval will not be required if a taxpayer who has been reporting his income on the basis of a taxable year ending on October 31, changes to a 52–53–week taxable year which will either always end on the last Saturday in October or will always end on the Saturday which is nearest to the last day of October. If, however, a change is made to a 52–53–week taxable year which ends with reference to the end of a month other than the month on the last day of which his prior taxable year ended, the rules referred to in section 2 or section 4, as the case may be, are applicable in determining whether advance approval is required. The election to change to a taxable year of 52–53–weeks shall be indicated by a statement attached to the return for the first taxable year to which such election is applicable. This statement shall furnish full details as to the time the new taxable year will end.

.04 For the purpose of determining the time for filing an application (where necessary) for approval of a change of annual accounting period and for filing the return for the short period required to effect a change to a 52–53–week taxable year, the short period shall be treated as ending with the last day of the month which ends nearest to the

last day of such short period. For example, if the short period ends within the period from November 24, 1954, to December 3, 1954, inclusive, it shall be treated as ending November 30, 1954. See section 441(f)(2)(A) of the 1954 Code.

SEC. 4. PARTNERSHIPS AND PARTNERS.

.01 This section applies to changes by partnerships and partners to taxable years beginning after April 1, 1954 and to the adoption by a newly organized partnership of a taxable year beginning after that date. See section 771(b)(1) of the 1954 Code. The rules referred to in section 2 apply to changes to taxable years beginning before April 2, 1954, in determining whether advance approval is required.

.02 A partnership is required to obtain advance approval of a change to or the adoption of a taxable year which is different from that of any of its principal partners. Advance approval is not required where (a) a partnership changes to or adopts a taxable year which is the same as that of all its principal partners or (b) where a partnership and all its principal partners concurrently change to or adopt the same taxable year.

.03 For the purpose of this section a "principal partner" is a partner having an interest of 5 percent or more in partnership profits or capital.

.04 A partner is required to obtain advance approval of a change to a taxable year which is not the same as that of every partnership in which he is a principal partner. Unless required by section 39.46–1 of Regulations 118, advance approval is not necessary in the case of a partner who changes to a taxable year which is the same as that of every partnership in which he is a principal partner or which is the same as that to which every such partnership having a different taxable year concurrently changes. Unless required by section 39.46–1 of Regulations 118, advance approval is not necessary in the case of a change of taxable year by a partner's spouse who is not a principal partner in any partnership.

.05 The procedure for obtaining advance approval is the same as that prescribed in the regulations referred to in section 2. Where advance approval is required, permission to change to or to adopt the desired taxable year will be granted only if a business purpose therefor is established to the satisfaction of the Commissioner of Internal Revenue.

.06 Any newly formed partnership which adopts a taxable year with respect to which advance approval is not required shall file with its first return a statement to the effect that the taxable year which it is adopting is the same as that of all the principal partners, or that all the principal partners are concurrently changing to the taxable year which it is adopting. If a partner or an existing partnership changes to a taxable year with respect to which advance approval is not required a similar statement shall be filed with the return for the short period resulting from the change of taxable year. In each such case the statement shall cite the authority for the change. Pending the issuance of regulations under the 1954 Code, this section of this Revenue Ruling constitutes such authority.

.07 If, without obtaining the approval of the Commissioner of Internal Revenue, a partner or partnership has changed to or adopted an annual accounting period beginning after April 1, 1954, and, under

the foregoing provisions of this section, advance approval is required for the change or adoption, such annual accounting period will not be accepted as a taxable year until approval thereof is secured. Under these circumstances an application to change to or adopt the desired taxable year will be considered timely if filed within 30 days after the date of the Internal Revenue Bulletin in which this Revenue Ruling is published.

PART II.—METHODS OF ACCOUNTING

SUBPART B.—TAXABLE YEAR FOR WHICH ITEMS OF GROSS INCOME INCLUDED

SECTION 452.—PREPAID INCOME

26 CFR 1.452-1: Prepaid income in general. T. D. 6134
(Also Section 462; 26 CFR 1.462-1.)

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

Regulations prescribed under sections 452 and 462 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:

On January 22, 1955, a notice of proposed rulemaking with respect to sections 452 and 462 of the Internal Revenue Code of 1954 was published in the Federal Register (20 F. R. 515). After consideration of such relevant suggestions as were presented by interested persons regarding the proposals, it was determined that no change should be made in the proposed regulations. Accordingly, the proposed regulations so published are hereby adopted.

SEC. 1.452 STATUTORY PROVISIONS; PREPAID INCOME.

SEC. 452. PREPAID INCOME.

(a) PREPAID INCOME TO BE EARNED OVER SHORT OR INDEFINITE PERIOD.—

(1) SHORT PERIOD.—In the case of any prepaid income to which this section applies, if the liability described in subsection (e)(2) is (at the time the income is received) to end before the first day of the sixth taxable year after the taxable year in which such income is received, then such income shall be included in gross income for the taxable year in which received, and for each of the 5 succeeding taxable years, to the extent proper under the method of accounting used under section 446 in computing taxable income for such year. If the liability does not in fact end before the first day of such sixth taxable year, such income shall be included in gross income for the taxable years specified in the preceding sentence except that with the consent of the Secretary or his delegate it shall be included in gross income in such proportions, and for such taxable years, as are specified in such consent.

(2) INDEFINITE PERIOD.—In the case of any prepaid income to which this section applies, if the liability described in subsection

(e) (2) is (at the time the income is received) of indefinite duration, then such income shall be included in gross income for the taxable year in which received and for each of the 5 succeeding taxable years, consistently with the principles prescribed in paragraph (1) and subsection (b), under regulations prescribed by the Secretary or his delegate. With the consent of the Secretary or his delegate the prepaid income shall be included in gross income in such proportions, and for such taxable years, as are specified in such consent.

(b) PREPAID INCOME TO BE EARNED OVER LONG PERIOD.—In the case of any prepaid income to which this section applies, if the liability described in subsection (e) (2) is (at the time the income is received) to end after the close of the fifth taxable year after the taxable year in which such income is received, then—

(1) one-sixth of the prepaid income shall be included in gross income for the taxable year in which received, and one-sixth shall be included in gross income for each of the 5 succeeding taxable years; except that

(2) with the consent of the Secretary or his delegate, the prepaid income shall be included in gross income in such proportions, and for such taxable years, as are specified in such consent.

(c) WHERE TAXPAYERS LIABILITY CEASES.—In the case of any prepaid income to which this section applies—

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

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

(d) PREPAID INCOME TO WHICH THIS SECTION APPLIES.—

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

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

(3) WHEN ELECTION MAY BE MADE.—

(A) WITHOUT CONSENT.—A taxpayer may, without the consent of the Secretary or his delegate, make an election under this section for his first taxable year (i) which begins after December 31, 1953, and ends after the date on which this title is enacted, and (ii) in which he receives prepaid income in the trade or business. Such an election shall be made not later than the time prescribed by this subtitle for filing the return for such year (including extensions thereof).

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

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

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

received. Such term does not include any income treated as gain from the sale or other disposition of a capital asset.

(2) LIABILITY TO RENDER SERVICES, ETC.—The term "liability" means a liability to render services, furnish goods or other property, or allow the use of property.

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

SEC. 1.452–1 PREPAID INCOME IN GENERAL.—(a) Prepaid income, regardless of the method of accounting used by the taxpayer, is generally includible in gross income by the taxpayer at the time of receipt if it is subject to his free and unrestricted use. However, in the case of a taxpayer who uses a method of accounting other than the cash receipts and disbursements method in computing taxable income, section 452 permits the taxpayer to elect a method of accounting for prepaid income under which portions of prepaid income received in the taxable year shall be deferred to subsequent taxable years. The general purpose of section 452 is to bring tax accounting more closely into harmony with generally accepted accounting principles; it is not intended to permit, for tax purposes, deferrals of income not properly deferred under the taxpayer's method of accounting.

(b) Section 446 provides that taxable income shall be computed under the method of accounting on the basis of which the taxpayer regularly computes his income in keeping his books. Section 452 provides a specific method of accounting and, accordingly, the books of the taxpayer must be kept in accordance with such method if taxable income is to be computed under the method so elected. No election under section 452 may be made unless the prepaid income is deferred on the regular books of account which are used in computing the taxpayer's income and on the basis of which the taxpayer prepares his financial statements (such as reports to creditors, stockholders, etc.). If a taxpayer closes such books for the taxable year without making the necessary entries thereon to record such deferral, and issues his financial statements on the basis of the books as so closed, any such entries made thereafter will not be deemed to meet the requirements of the preceding sentence with respect to such taxable year; however, this rule is not applicable in the case of a taxpayer who has closed his books and issued financial statements for the taxable year before January 24, 1955, if he makes the necessary entries before making the election under section 452(d)(3)(A) and section 1.452–7(b). In the case of a taxpayer (such as a regulated public utility defined in section 1503(c)) which is required by the rules of a governmental agency to maintain its books in accordance with a method of accounting different from that permitted by section 452, the method of accounting permitted by section 452 may be reflected in auxiliary records which shall be kept with, and reconciled with, the taxpayer's regular books. The deferral of prepaid income must be reflected on the books for a period not shorter than that prescribed for tax purposes. This is not to be construed as preventing the taxpayer from deferrring prepaid income on his books, where proper, over a period longer than the period prescribed by section 452.

(c) For applicable definitions, see section 452(c) and section 1.452–8.

SEC. 1.452–2. PREPAID INCOME TO BE EARNED OVER SHORT PERIOD.—(a) If prepaid income is attributable to a liability which will end

before the first day of the sixth taxable year after the taxable year in which it is received, the income is deemed for purposes of section 452 to be "short-period prepaid income." Such income shall be included in gross income, to the extent properly allocable under the taxpayer's method of accounting, in the taxable year in which received and in each of the succeeding taxable years (not exceeding five) over which the liability may extend. The amount properly allocable to each of such taxable years shall be determined in the light of all the facts and circumstances involved, including the taxpayer's experience with such liabilities.

(b) Short-period prepaid income need not be allocated equally over the period, nor must any portion necessarily be included in the taxable year of receipt. A proper allocation under this section requires that such income be included in gross income as the liability to which the income relates is discharged or as it is deemed to be discharged on the basis of the taxpayer's experience. (Where experience is the basis for allocation, the taxpayer must follow the rules provided in section 1.452–3(b).) For example, if the rent for the 5th year under a 5-year lease is paid at the beginning of the lease and the taxpayer-lessor has elected the benefits of section 452, and if the 5th year of the lease falls within 2 taxable years of the taxpayer, such rent shall be allocated to each of such 2 taxable years to the extent that the 5th year of the lease falls within each such taxable year. On the other hand, if the rent for the entire 5 years is received in advance, such rent shall be allocated to the taxable years covered by the lease. The preceding sentence may be illustrated by the following example:

Example.—Taxpayer A, using the accrual method, whose taxable year is a calendar year, leases a building to B for a period of 48 months commencing on February 1, 1955, for a total rent of $48,000 paid on December 1, 1954. Assuming that A has elected the benefits of section 452, rent from the lease shall be included in gross income as follows:

Taxable year	*Amount included in gross income*
1954	$ zero
1955	11,000
1956	12,000
1957	12,000
1958	12,000
1959	1,000
Total	$48,000

No part of the short-period prepaid rent is includible in gross income for the year 1954 since no part of the liability was discharged in that year.

(c) The determination of the period over which the liability extends is to be made on the basis of the facts known at the time the income is received. In order to treat prepaid income as short-period prepaid income, the taxpayer must be able to ascertain at the time of receipt of such income that the liability will end before the first day of the 6th taxable year after the taxable year in which the income is received.

(d) If subsequent events extent the period of liability, but it is not extended beyond the last day of the 5th taxable year following the taxable year of receipt of the prepaid income, the portion of the

prepaid income not previously includible in gross income shall be allocated, in accordance with paragraphs (a) and (b), over the period remaining between the time the subsequent events become known and the expiration of the liability as changed.

(e) If subsequent events extend the period of liability beyond the close of the 5th taxable year following the taxable year of receipt of the prepaid income, the portion of the prepaid income not previously includible in gross income shall be allocated ratably over the period between the time the extended liability becomes known and the close of such 5th taxable year.

(f) If subsequent events shorten the period of liability, the portion of the prepaid income not previously includible in gross income shall be included in gross income for the taxable year in which the subsequent events occur if the liability does not extend beyond that taxable year. If the liability does extend beyond that taxable year, such portion shall be included in gross income over the period remaining between the time the subsequent events become known and the expiration of the liability as changed, in accordance with paragraphs (a) and (b).

(g) In the case of a change in the period of the liability described in paragraph (e) of this section, a taxpayer may request permission from the Commissioner to allocate the amount of prepaid income not previously includible in gross income in some manner other than that provided in such paragraph. The consent of the Commissioner shall be requested in accordance with section 1.452–5. Ordinarily, permission will not be granted to reallocate amounts properly includible in gross income for taxable years prior to the taxable year in which the change in the period of the liability occurs.

(h) For the purposes of the allocation under this section, the taxpayer may consider each transaction separately or may aggregate similar transactions during the taxable year in any reasonable manner provided the method of aggregation is consistently followed.

SEC. 1.452–3. PREPAID INCOME TO BE EARNED OVER INDEFINITE PERIOD.—(a) Prepaid income attributable to a liability, which on the basis of the facts known at the time such income is received extends over an indefinite period, shall be included in gross income in accordance with the provisions of this section. An example of prepaid income of this type is an amount received by a retail store for gift certificates which may be redeemed for merchandise at any time. There is to be included in gross income for the taxable year of receipt of an item of prepaid income described in this section and in gross income for each succeeding taxable year (not more than 5 years and not necessarily ratably) that portion of such prepaid income with respect to which the experience of the taxpayer indicates the liability will be discharged during each such taxable year. The remainder of the prepaid income must be accounted for one-sixth in the taxable year of receipt and one-sixth in each of the 5 succeeding taxable years.

(b) The allocation of income to be earned over an indefinite period shall be based upon the taxpayer's own experience, if adequate for a reasonable allocation. Ordinarily, the most recent 6 years of experience with this kind of prepaid income will be considered adequate for the purpose of this paragraph. However, if the taxpayer's experience is not adequate, he may use the experience of other taxpayers engaged

in a similar trade or business if he establishes to the satisfaction of the Commissioner that such experience is representative of the taxpayer's business. In such case, if the taxpayer attaches to his return a complete statement of the experience relied upon, he may use such experience in computing taxable income on his return, subject to approval by the Commissioner upon subsequent examination of the return.

(c) The following example illustrates the provisions of this section:

Example.

Sale of service coupons		$1,000
Experience indicates that the coupons will be presented in payment for services as follows:		
50 percent in the year of sale	$500	
9 percent in the 1st succeeding year	90	
5 percent in the 2nd succeeding year	50	
3 percent in the 3rd succeeding year	30	
2 percent in the 4th succeeding year	20	
1 percent in the 5th succeeding year	10	
Total	700	
Amount to be accounted for during the first 6 years on the basis of experience		$700
Amount subject to pro rata allocation over the 6-year period		300
Allocated to each year, one-sixth of $300		50

Thus, the amount of income from the sale of service coupons to be included in gross income for the taxable year of sale is $500 plus $50, or $550, and for the first succeeding year is $90 plus $50, or $140, etc. However, if any portion of the amount received represents payment for coupons which the experience of the taxpayer indicates will never be presented for redemption, such portion may not be deferred beyond the taxable year in which the amount was received and shall be included in gross income for such taxable year. For example, if sales of coupons had been $1,100 instead of $1,000 and experience indicated that $100 of such amount would never be presented for redemption, the income from the sale of service coupons to be included in gross income for the taxable year of sale would be $500 plus $50 plus $100, or $650.

(d) For the purposes of the allocation under this section, the taxpayer may consider each transaction separately or may aggregate similar transactions during the taxable year in any reasonable manner provided the method of aggregation is consistently followed. It will be necessary for the taxpayer to evaluate annually his past experience in arriving at the proper allocation of prepaid income received during that taxable year.

(e) A taxpayer may not defer prepaid income relating to a liability of indefinite duration beyond the 5th taxable year after the taxable year of receipt unless he secures the consent of the Commissioner. A request for such consent shall be submitted in accordance with the provisions of section 1.452-5.

SEC. 1.452-4. PREPAID INCOME TO BE EARNED OVER LONG PERIOD.—(a) Prepaid income attributable to a liability which, based upon the facts known at the time the income is received, will end after the close of the 5th taxable year following the taxable year in which

such income is received shall be regarded as "long-period prepaid income". One-sixth of such income shall be included in gross income for the taxable year of receipt and one-sixth for each of the 5 succeeding taxable years unless the Commissioner consents to a different treatment. (See sec. 1.452–5.) For example, assume that the taxpayer, reporting taxable income on a calendar year basis, receives in the 1st year of a 10-year lease commencing on January 1, the 1st and last year's rent. The annual rental is $6,000; the amount received in the 1st year is $12,000, of which only the $6,000 allocable to the 10th year's rent is prepaid income. The 10th year's rent shall be allocated $1,000 to each of the first 6 years of the lease, and taking into account the $6,000 rent for each such year, there will be a total of $7,000 included in income for each of the first 6 years. In each of the 7th, 8th, and 9th years only the $6,000 rent for such year shall be taken into income. Since the 10th year's rent was included in income for the first 6 years, it is not to be included in income for the 10th year.

(b) One-sixth of the amount of long-period prepaid income shall be included in gross income for the taxable year of receipt. For example, if a taxpayer on the accrual method, on a calendar year basis receives a rental payment of $60,000 on December 1, 1954, covering full payment on a 6-year lease commencing on January 1, 1955, $10,000 of such income is allocable to 1954, the taxable year of receipt, and a like amount to each of the 5 succeeding taxable years.

(c) Whether amounts received are short-period prepaid income or long-period prepaid income shall be determined by reference to the periods to which such amounts relate. For example, if, in connection with a 10-year lease beginning January 1, 1955, the rent for the 4th and 6th years is received in 1954, the amount of the rent for the 4th year is short-period prepaid income and the amount of the rent for the 6th year is long-period prepaid income. However, if in such example the lease were to begin on January 1, 1957, the rent for the 4th year would also be long period prepaid income since the 4th year would fall more than 5 years after 1954, the year of receipt.

SEC. 1.452–5. MANNER OF OBTAINING CONSENT FOR DIFFERENT TREATMENT OF PREPAID INCOME.—A taxpayer may, with the consent of the Commissioner, include prepaid income in gross income in such proportions, and for such taxable years, as are specified in the consent. The request for consent, in the case of prepaid income to which section 452(a)(2) or 452(b) applies, shall be made to the Commissioner not later than 30 days after the close of the taxable year in which such prepaid income is received. In the case of a request for consent described in section 452(a)(1), the request shall be made to the Commissioner not later than 30 days after the close of the taxable year in which the change in the period of the liability became known. However, if the period described above for the filing of the request expires less than 90 days after the promulgation of these regulations under section 452, the taxpayer may file the request for consent not later than 90 days after the promulgation of such regulations. The request shall contain both a detailed recital of the circumstances upon which the taxpayer bases his request for a method of allocation different from that provided in these regulations under section 452 and all the information necessary for the Commissioner to determine whether the proposed method of allocation would be proper and, if

so, to what taxable years and in what amounts such allocations should be made. The request for consent should be directed to the Commissioner of Internal Revenue, Washington 25, D. C. Such permission will be granted by the Commissioner only in cases where it is shown to his satisfaction that a different method of treating prepaid income is proper.

SEC. 1.452-6. TREATMENT OF PREPAID INCOME WHERE TAXPAYER'S LIABILITY CEASES.—If the liability of the taxpayer ends, then so much of the prepaid income as was not includible in gross income for preceding taxable years shall be included in the gross income of the taxpayer for the taxable year in which the liability ends. See section 381(c)(7) for rules applicable to the treatment of prepaid income in the case of certain corporate acquisitions. If an individual taxpayer dies or a taxpayer other than an individual goes out of existence, the amount deferred under section 452 and not previously includible in his gross income shall, notwithstanding the provisions of section 451(b), be included in his gross income for the taxable year in which such event occurs. Similarly, when a partnership terminates such amount shall be included in gross income for the year of termination of the partnership.

SEC. 1.452-7. ELECTION OF BENEFITS.—(a) *In general.*—(1) An election under section 452 shall be applicable to all prepaid income (of the trade or business for which the election is made) which is received in the taxable year of the election and all subsequent taxable years. Such election shall not apply to any prepaid income received before the taxable year for which the election is made, even though the amounts will not be earned until after such year. The taxpayer may elect to include in his gross income for the taxable year of receipt all prepaid income with respect to which the liability is to end within 12 months of its receipt, if he files a statement to that effect at the time he makes his election under section 452. In such a case this treatment shall be consistently followed.

(2) An election under section 452 shall be binding for the taxable year for which made and all subsequent taxable years unless the consent of the Commissioner is obtained to change such method of treating prepaid income. See section 446 and the regulations thereunder.

(3) No election shall be permitted with respect to a trade or business if the cash receipts and disbursements method of accounting is used in computing taxable income or if such method is used, under a combination of methods, in reporting items of gross income for such trade or business for income tax purposes.

(4) If the taxpayer clearly evidences a bona fide intent to comply with the provisions of section 452 and the regulations thereunder, his election under that section will not be invalidated by:

(i) His failure to take certain items of prepaid income into account in accordance with the provisions of section 452 and these regulations;

(ii) His failure correctly to allocate prepaid income in accordance with such provisions; or

(iii) His improper deferral of items to which section 452 does not apply.

(b) *Manner of making election not requiring consent.*—The election under section 452 may be made without the consent of the Commissioner if made for the 1st taxable year beginning after December

31, 1953 and ending after August 16, 1954 in which there is received prepaid income of the particular trade or business for which the election is made. The election must be made not later than the time prescribed by law for filing the return for such taxable year (including extensions thereof). The election shall be made in a statement attached to the taxpayer's return for the 1st taxable year to which the election is applicable. The statement shall contain the information required by paragraph (d).

(c) *Election requiring consent.*—(1) If a taxpayer does not elect under paragraph (b) he may elect the benefits of section 452 for his 2nd taxable year beginning after December 31, 1953, and ending after August 16, 1954, provided that on or before June 30, 1955, he notifies the Commissioner of Internal Revenue, Washington 25, D. C., of his intention to make such election. The notification shall state that the taxpayer has not elected the benefits of section 452 for his 1st taxable year beginning after December 31, 1953, and ending after August 16, 1954, but desires to elect the benefits of such section for the next succeeding taxable year. The notification shall be in triplicate, shall identify the trade or business to which the election is to apply, shall show the name and address of the taxpayer and the district in which the return of the taxpayer is to be filed. In such a case the taxpayer's notification will be treated as an election to have the benefits of section 452 apply to such taxable year and to all subsequent taxable years. A copy of the notification will be stamped with the approval of the Commissioner and returned to the taxpayer. Such copy, together with a statement containing the information required by paragraph (d) shall be attached to the return for the 1st taxable year to which the election applies.

(2) In the event that a taxpayer does not make an election under paragraph (b) or subparagraph (1) of this paragraph, he may, at a later date, elect the benefits of the provisions of section 452 only if he obtains the consent of the Commissioner. In such a case, a written request for consent shall be made to the Commissioner not later than 90 days after the beginning of the 1st taxable year for which the election is applicable or 90 days after the date of promulgation of the regulations under section 452, whichever is later. Such request shall contain the information required by paragraph (d).

(d) *Information required.*—The statement or request filed under paragraph (b) or (c) of this section shall set forth the following:

(1) The name and description of each trade or business for which the election is to apply;

(2) A declaration that the election is intended to apply to all prepaid income of the trade or business;

(3) The method of accounting used by the taxpayer in such trade or business;

(4) A description of each type of prepaid income of such trade or business, the proposed method of allocation, and the basis therefor;

(5) Whether a previous election under the provisions of section 452 has been made for such trade or business and, if so, for what taxable years such election was in effect; and

(6) The name and description of each trade or business, if any, for which the election does not apply.

SEC. 1.452-8. DEFINITIONS—(a) *Prepaid income.*—The term "prepaid income" means any amount (includible in gross income) which is received in connection with, and is directly attributable to, a liability which extends beyond the close of the taxable year in which such amount is received. However, amounts which represent receipts for goods or services or for the use of property to have been provided or furnished during or prior to the taxable year of receipt are not prepaid income. The term may include, for example, amounts received in advance for rents and warehouse fees and amounts received from the sale of tickets, car tokens, subscriptions, club dues, and service coupons and contracts. Such term does not include any income treated as a gain from the sale or other disposition of a capital asset.

(b) *Liability.*—The term "liability" means a liability to render services, furnish goods or other property, or allow the use of property. For example, an appliance service contract is a liability to render services for the purposes of section 452 if the contract is a separate transaction for which a charge is made and which is entered into at the option of the purchaser. The term does not include a liability under a warranty the consideration for which is, in effect, included in the selling price of a product.

(c) *Receipt of prepaid income.*—For the purposes of section 452, prepaid income shall be treated as received during the taxable year for which it would be includible in gross income under section 451 and the regulations thereunder (determined without regard to section 452).

SEC. 462. RESERVES FOR ESTIMATED EXPENSES, ETC.—

(a) 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.

(b) ADJUSTMENTS WHERE RESERVE BECOMES EXCESSIVE.—If it is determined that the amount of any reserve for estimated expenses to which this section applies is (as of the close of the taxable year) excessive, then (under regulations prescribed by the Secretary or his delegate) such excess shall be taken into account in computing taxable income for the taxable year.

(c) ESTIMATED EXPENSES TO WHICH THIS SECTION APPLIES—

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

(2) SCOPE OF ELECTION.—An election made under this section shall apply to all estimated expenses attributable to the trade or business.

(3) WHEN ELECTION MAY BE MADE—

(A) *Without consent.*—A taxpayer may, without the consent of the Secretary or his delegate, make an election under this section for his first taxable year (i) which begins after December 31, 1953, and ends after the date on which this title is enacted, and (ii) for which there are estimated expenses attributable to the trade or business. Such an election shall be made not later than the time prescribed by law for filing the return for such year (including extensions thereof).

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

(d) ESTIMATED EXPENSE DEFINED—

(1) GENERAL RULE.—For purposes of this section, the term "estimated expense" means a deduction allowable by this subtitle—

(A) Part or all of which would (but for this section) be required to be taken into account for a subsequent taxable year;

(B) Which is attributable to the income of the taxable year or prior taxable years for which an election under this section is in effect; and

(C) Which the Secretary or his delegate is satisfied can be estimated with reasonable accuracy.

(2) EXCEPTIONS.—The term "estimated expense" does not include—

(A) Any deduction attributable to income taken into account in computing taxable income for taxable years preceding the first taxable year for which the election is made;

(B) Any deduction attributable to prepaid income to which section 452 applies by reason of an election made under such section by the taxpayer; or

(C) Any deduction allowable under section 166 (relating to bad debts).

(e) SPECIAL RULE FOR DEDUCTIONS ATTRIBUTABLE TO PERIOD BEFORE ELECTION.—Any deduction attributable to income taken into account in computing taxable income for taxable years preceding the first taxable year for which the election is made shall be allowable in the same manner and to the same extent as if this section had not been enacted.

SEC. 1.462–1. RESERVES FOR ESTIMATING EXPENSES—(a) *In general.*—(1) Ordinarily, in computing taxable income expenses are not deductible for a taxable year prior to the taxable year in which paid or incurred, or paid or accrued, depending upon the taxpayer's method of accounting. However, section 462 permits a taxpayer, in the discretion of the Commissioner, to deduct a reasonable addition to a reserve for certain expenses (designated as estimated expenses), which, in the opinion of the Commissioner, can be estimated with reasonable accuracy. The general purpose of section 462 is to bring tax accounting more closely into harmony with generally accepted accounting principles; it is not intended to permit taxpayers to deduct an addition to a reserve for estimated expenses in any taxable year unless such treatment would be proper for such year under the taxpayer's method of accounting. The election under section 462 may be made with respect to any trade or business of the taxpayer provided that the cash receipts and disbursements method of accounting is not used in computing the taxable income of such trade or business, and the election shall apply to all estimated expenses of such trade or business.

(2) Section 446 provides that taxable income shall be computed under the method of accounting on the basis of which the taxpayer regularly computes his income in keeping his books. Section 462 provides a specific method of accounting and, accordingly, the books of the taxpayer must be kept in accordance with such method if taxable income is to be computed under the method so elected. In computing taxable income, no amount shall be taken into account with respect to estimated expenses under section 462 unless a reserve therefor has been established and is properly recorded on the regular books of account which are used in computing the taxpayer's income and on the basis of which the taxpayer prepares his financial statements (such as reports to creditors, stockholders, etc.). If a taxpayer closes such books for the taxable year without making the necessary entries thereon to establish and record the reserve, and issues his financial

statements on the basis of the books as so closed, any such entries made thereafter will not be deemed to meet the requirements of the preceding sentence with respect to such taxable year; however, this rule is not applicable in the case of a taxpayer who has closed his books and issued financial statements for the taxable year before January 24, 1955, if he makes the necessary entries before making the election under section 462(c)(3)(A) and section 1.462-4(a). In the case of a taxpayer (such as a regulated public utility defined in section 1503(c)) which is required by the rules of a governmental agency to maintain its books in accordance with a method of accounting different from that permitted by section 462, the method of accounting permitted by section 462 may be reflected in auxiliary records which shall be kept with, and reconciled with, the taxpayer's regular books.

(3) For applicable definitions, see section 462(d) and section 1.462-5.

(b) *Reasonable additions.*—(1) Whether an addition to a reserve for estimated expenses is reasonable shall be determined in each particular case in the light of the pertinent facts known at the close of the taxable year. Among such pertinent facts to be considered is the experience of the taxpayer. However, in cases where the taxpayer has no such experience or his experience is inadequate, the experience of a taxpayer or group of taxpayers in a similar trade or business operating under similar conditions may be used if the taxpayer establishes to the satisfaction of the Commissioner that such experience is representative of the taxpayer's business. In case actual expenses prove to be more or less than those estimated in arriving at an addition to the reserve for prior years, the amount of the excess or inadequacy in the existing reserve shall be reflected in the determination of a reasonable addition for the current taxable year.

(2) A taxpayer claiming deductions on account of additions to reserves for estimated expenses shall, with respect to each reserve for estimated expenses, attach to his tax return for the taxable year a statement disclosing a summary of his experience with respect to such expenses for the taxable year and the four preceding taxable years. Ordinarily, the taxpayer's experience for such a period will be an acceptable basis for computing the addition to the reserve. If, however, the taxpayer's experience does not extend over such period, the statement should disclose that fact and give a summary of the taxpayer's experience with respect to such expenses. This statement shall include the following information for the taxable year and each of such preceding taxable years: (i) a description of each expense, (ii) taxable income (loss), (iii) the amount added to the reserve, (iv) the amount charged against the reserve, (v) the balance in the reserve as of the end of the taxable year, (vi) the amount deducted from income for such expenses in taxable years in which a reserve was not maintained, and (vii) the name and amount of the item to which the experience ratio is applied in determining the amount of the reasonable addition, such as credit sales, net sales, gross income, etc.

(3) The following example will serve to illustrate the provisions of this paragraph:

Example.—A taxpayer, using an accrual method of accounting, who sells appliances subject to a warranty, elects to deduct additions to a reserve for expenses which he estimates will be necessary to fulfill his

obligation under the warranty on appliances sold during 1954. The taxpayer has not, prior to the election, maintained such a reserve on his books. The statement attached to his return shows:

Appliance warranty expenses

Taxable year	Net sales	Taxable income	Addition to reserve	Charges to reserve	Balance in the reserve	Actual expenses
1950	$100,000	$15,000				$900
1951	110,000	16,000				1,100
1952	125,000	18,000				1,450
1953	150,000	17,000				1,550
1954	165,000	20,000	[1] $1,650	[2] $700	$950	[2] 700 [3] 800
Totals	650,000					6,500

[1] Since the total of actual expenses for the most recent 5 years' experience amounts to 1 percent of the most recent 5 years' net sales, a reasonable addition to the reserve for 1954 would be 1 percent of $165,000 or $1,650. The amount deductible in 1954 is $2,450, composed of the addition to the reserve of $1,650 plus $800 actual expense attributable to sales of years prior to 1954 (allowable without regard to this section).
[2] Actual expense applicable to 1954 sales.
[3] Applicable to sales of years prior to 1954.

While in this example net sales have been used as a basis upon which the addition to the reserve is calculated, it should be understood that other items may be applicable under other circumstances and therefore such items should be substituted where appropriate.

(4) If the taxpayer has no experience with this type of expense, the statement shall include a complete description of the basis used in computing the addition to the reserve. In any event, the addition to the reserve is subject to the approval of the Commissioner upon subsequent examination of the return.

(5) In any case, the statement and accompanying data shall set forth for the taxable year such information as is necessary in order to establish clearly that (i) the reserve is one for which an addition is allowable under section 462 in computing taxable income, (ii) the amount of the addition is reasonable, and (iii) the amount of the reserve at the end of the taxable year is not excessive. The reserves to which section 462 applies shall be segregated from any reserves which may have been established by the taxpayer for taxable years prior to the taxable year for which the election under that section is exercised.

SEC. 1.462–2. ADJUSTMENTS WHERE RESERVE BECOMES EXCESSIVE.—In any case in which a reserve for estimated expenses as of the close of any taxable year is determined to be excessive, such excess shall be taken into account in computing the taxable income for the taxable year for which such determination is made. For example, if for the taxable year ending December 31, 1956, it is determined by the Commissioner that a reserve (including a claimed addition for the year 1956) is excessive, such excess shall be taken into account in computing taxable income for the year 1956. In any case in which it is determined that a particular reserve for estimated expenses is no longer necessary, the amount of the reserve as of the close of the taxable year for which such determination is made shall be taken into account in computing the taxable income for such year. Similarly, in any case in which the use of reserves for estimated expenses is discontinued,

the balance of each such reserve shall be included in taxable income for the year of change.

SEC. 1.462–3. ELECTION OF BENEFITS.—(a) The election referred to in section 1.462–1 shall apply to all estimated expenses attributable to the trade or business to which the election is applicable both for the taxable year for which the election is made and for all subsequent taxable years unless a change to a different method is authorized by the Commissioner under the provisions of section 446. However, the election does not apply to any estimated expenses which are attributable to prepaid income deferred at the close of the taxable year under the provisions of section 452. If the taxpayer is engaged in more than one trade or business, he may make a separate election with respect to each such trade or business.

(b) In no event shall an election under section 462 be applicable in the computation of taxable income for any taxable year preceding the taxable year for which such election is made. Such an election cannot be made for any taxable year beginning before January 1, 1954, or ending before August 17, 1954.

(c) No election shall be permitted with respect to a trade or business if the cash receipts and disbursements method of accounting is used in computing taxable income or if, under a combination of methods, the cash receipts and disbursements method is used in reporting items other than items of gross income for income tax purposes for such trade or business.

(d) If the taxpayer clearly evidences a bona fide intent to comply with the provisions of section 462 and the regulations thereunder, his election under that section will not be invalidated by:

(i) His failure to take into account certain estimated expenses in establishing his reserve;

(ii) His failure correctly to determine the amount of any such reserve or additions thereto, or

(iii) His establishment of a reserve for an expense to which section 462 does not apply.

SEC. 1.462–4. TIME AND MANNER OF MAKING ELECTION.—(a) *Without consent.*—The election under section 462 may be made without the consent of the Commissioner if made for the first taxable year beginning after December 31, 1953, and ending after August 16, 1954, in which there are estimated expenses of the particular trade or business for which the election is made. The election must be made not later than the time prescribed by law for filing the return for such taxable year (including extensions thereof). The election shall be made in a statement attached to the taxpayer's return for the first taxable year to which the election is applicable. Such statement shall contain the information required by paragraph (c).

(b) *With consent.*—(1) If a taxpayer does not make the election under paragraph (a) he may elect the benefits of section 462 for his second taxable year beginning after December 31, 1953, and ending after August 16, 1954, provided that on or before June 30, 1955, he notifies the Commissioner of Internal Revenue, Washington 25, D. C., of his intention to make such election. The notification shall state that the taxpayer has not elected the benefits of section 462 for his first taxable year beginning after December 31, 1953, and ending after August 16, 1954, but desires to elect the benefits of such section for the

rext succeeding taxable year. The notification shall be in triplicate, shall identify the trade or business to which the election is to apply, shall show the name and address of the taxpayer and the district in which the return of the taxpayer is to be filed. In such a case the taxpayer's notification will be treated as an election to have the benefits of section 462 apply to such taxable year and to all subsequent taxable years. A copy of the notification will be stamped with the approval of the Commissioner and returned to the taxpayer. Such copy, together with a statement containing the information required by paragraph (c), shall be attached to the return for the first taxable year to which the election applies.

(2) In the event that a taxpayer does not make an election under paragraph (a) or subparagraph (1) of this paragraph, he may, at a later date, elect the benefits of the provisions of section 462 only if he obtains the consent of the Commissioner. In such a case, a written request for consent shall be made to the Commissioner not later than 90 days after the beginning of the first taxable year for which the election is applicable or 90 days after the date of promulgation of the regulations under section 462, whichever is later. Such request shall contain the information set forth in paragraph (c).

(c) *Information required.*—The statement or request filed under paragraph (a) or (b) of this section shall set forth the following:

(1) The name and description of each trade or business to which the election is to apply;

(2) A declaration that the election is intended to apply to all estimated expenses of the trade or business;

(3) The method of accounting used by the taxpayer in such trade or business;

(4) A description of each type of estimated expenses of such trade or business;

(5) Whether a previous election under the provisions of section 462 has been made for such trade or business and, if so, for what taxable years such election was in effect; and

(6) The name and description of each trade or business, if any, to which the election does not apply.

SEC. 1.462–5. ESTIMATED EXPENSE DEFINED—(a) *General rule.*—For purposes of section 462(a) (which provides that 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 section 462 applies), the term "estimated expense" means a deduction which:

(1) Is allowable in commuting taxable income;

(2) Is attributable to income of the taxable year or of prior taxable years for which an election under section 462 is in effect;

(3) In the opinion of the Commissioner can be estimated with reasonable accuracy; and

(4) Is a deduction, a part or all of which would be required except for section 462, to be taken into account for a subsequent taxable year.

(b) *Exceptions.*—The term "estimated expense" does not include any deduction which is:

(1) Attributable to income taken into account in computing taxable income for taxable years preceding the first taxable year for which the election is made;

(2) Attributable to income deferred as of the close of the taxable year under section 452; or

(3) Allowable under section 166 relating to bad debts.

(c) *Rules for application of paragraphs (a) and (b).*—(1) Estimated expenses are those which are attributable to a transaction or undertaking in the taxable year or a prior taxable year under which:

(i) Income is realized which is includible in income for the taxable year or a prior taxable year; and

(ii) The taxpayer is under a liability to perform service, furnish goods, supply property, or assume obligations, which necessitate the making of expenditures by the taxpayer during a subsequent taxable year.

(2) Expenses attributable to income of future years are not expenses for which an addition to a reserve under section 462 is allowable. An expenditure to be made in a year subsequent to the taxable year is not attributable to the income of the taxable year or prior taxable years merely because it is incurred in order to restore operating or productive capacity which has been diminished by operations in the taxable year or prior taxable years.

(3) The following examples illustrate the application of paragraphs (a) and (b): If the taxpayer, as an incentive or inducement to employment, offers vacations for faithful service, amounts to be expended for such purpose may be estimated expenses within the meaning of section 462. Likewise, if the taxpayer, in order to promote sales or to encourage prompt payment for articles sold, agrees to keep the product sold in repair for subsequent years or offers cash discounts, amounts set aside for these purposes may constitute estimated expenses. However, that term does not include expenses for maintenance and repairs unless the taxpayer is under a liability to make repairs or incur maintenance expenses in a subsequent taxable year as a condition to the realization of income in the taxable year. For example, if, as a condition to obtaining machinery under a rental contract, the taxpayer is required to make certain periodic repairs in subsequent taxable years, an addition to a reserve to meet the costs thereof may be estimated expenses within the meaning of section 462. Further, the cost of repairs to delivery equipment used to fulfill an obligation under the taxpayer's warranty agreement to keep a product in repair or in service may be treated as an estimated expense. On the other hand, estimated costs of repairs and maintenance to the taxpayer's property may not be considered estimated expenses to which the provisions of section 462 apply unless such costs are undertaken pursuant to a liability to another person as a condition to the realization of income.

(4) Reserves created for general undetermined contingencies, for indefinite possible future losses, for expenses and losses not reasonably related to the income of the taxable year or prior taxable years, or for expenses and losses that are being contested or are in litigation, cannot ordinarily be estimated with reasonable accuracy and may not be the basis for additions to reserves for estimated expenses. With respect to items involving related reserves, only one deduction against taxable income will be allowed. Section 462 does not have the effect of converting into deductible expenses amounts which would not otherwise be deductible in computing taxable income for subsequent tax-

able years. The provisions of section 462 have no application with respect to the renegotiation or price redetermination of contracts.

(5) Section 462 is not applicable to any item of deduction for which the Code provides a specific method of reporting, such as deductions referred to in—

(i) Section 404, relating to contributions of an employer to an employee's trust or annuity plan and compensation under a deferred payment plan,

(ii) Section 461(c), relating to accrual of real property taxes,

(iii) Section 174, relating to research and experimental expenditures,

(iv) Section 175, relating to soil and water conservation expenditures,

(v) Section 615, relating to exploration expenditures, and

(vi) Section 616, relating to development expenditures.

(6) Examples of expenses which ordinarily meet the requirements of this section are cash discounts, product warranties, sales returns and allowances, freight allowances, quantity discounts, vacation pay, and self-insurance by common carriers for liability for cargo damages. Examples of expenses which ordinarily do not meet the requirements of this section are inventory adjustments, self-insurance for losses of the taxpayer's own property, franchise and other taxes levied for a period subsequent to the taxable year, and fees for professional services not yet rendered.

SEC. 1.462–6. SPECIAL RULE FOR DEDUCTIONS ATTRIBUTABLE TO PERIOD BEFORE ELECTION.—Any deduction attributable to income taken into account in computing taxable income for taxable years preceding the first taxable year for which the election is made shall be allowable in the same manner, and to the same extent, as if section 462 had not been enacted. For example, merchandise returned in 1954, attributable to sales made in 1953 (the year prior to the election), will be taken into account in 1954 as returned sales, even though for 1954 the taxpayer has elected to deduct a reasonable addition to reserves for estimated expenses. See example in section 1.462–1(b)(3).

SEC. 1.462–7. EXAMPLES.—The following examples illustrate the provisions of the regulations under section 462:

Example (1).—A taxpayer who has elected the benefits of section 462 sells air-conditioning units which he guarantees for 1 year. Taxpayer's experience indicates that the average cost per unit of fulfilling the guarantee is as follows:

Material and parts	$8.00
Labor	12.00
Operating overhead	4.00
Total	$24.00

For each unit sold $24.00 shall be credited to the reserve account. As expenses are actually incurred, the reserve shall be charged with the amount of these expenses. In no event will a double deduction be permitted. At the close of each taxable year the reserve shall be adjusted to reflect changes in the actual cost experience of the taxpayer.

Example (2).—A calendar year taxpayer who has elected the benefits of section 462 estimates from past experience that 1 percent of all

sales will be returned for credit and that one-half of the returns applicable to any month's sales will be returned during that month and one-half during the following month. Gross sales for the month of December 1954 totaled $1,000,000. Cost of December's sales amount to $700,000. A reasonable addition to a reserve for sales returns as of December 31, 1954, is calculated as follows:

Gross sales for December	$1,000,000
Cost of sales for December	700,000
Gross profit for December	300,000
Reasonable addition (1% of ½ of $300,000)	1,500

Example (3).—A taxpayer, engaged in the business of transporting property for hire, has elected the benefits of section 462 for the taxable year 1954, and has established a proper reserve for claims for property damaged while in transit. The reserve for property damage claims at the beginning of the taxable year 1955 carries a credit balance of $15,000. His experience shows that 1 percent of his gross revenues will be paid out to meet claims for property damaged while in transit. For the taxable year 1955 he has gross revenue of $2,000,000. A reasonable addition to this reserve for the taxable year 1955 is 1 percent of $2,000,000 or $20,000. An analysis of the reserve for the year 1955 is as follows:

Balance in reserve at beginning of year	$15,000
Claims paid during the year	17,000
Excess of charges over credits	(2,000)
Current year's addition allowed as deduction	20,000
Balance at end of year	18,000

(This Treasury Decision is issued under the authority contained in secs. 446, 452, 462 and 7805 of the Internal Revenue Code of 1954 (68A Stat. 151, 152, 158, 917; 26 U. S. C. 446, 452, 462 and 7805).)

T. COLEMAN ANDREWS,
Commissioner of Internal Revenue.

Approved June 8, 1955.

G. M. HUMPHREY,
Secretary of the Treasury.

(Filed with the Division of the Federal Register June 9, 1955, 12:30 p. m.)

SUBPART C.—TAXABLE YEAR FOR WHICH DEDUCTIONS TAKEN

SECTION 461.—GENERAL RULE FOR TAXABLE YEAR OF DEDUCTION

(Also Section 164.) Rev. Rul. 55-152
(Also Part II, Sections 23(c), 43; Regulations 118, Sections 39.23(c)-1, 39.43-2.)

Effective for 1954 and subsequent years, real property taxes imposed by the State of Ohio accrue, for Federal income tax purposes,

on the first day of January, annually. See section 5719.01 of Page's Ohio Revised Code, Annotated, 1954 edition, effective October 13, 1953. G. C. M. 8218, C. B. IX-2, 106 (1930) which holds, in part, that real property taxes imposed by the State of Ohio, shall accrue as of the day preceding the second Monday of April, is modified accordingly with respect to 1954 and subsequent years. Further, as a result of the change in the lien date of Ohio real property taxes, an accrual basis taxpayer, on a fiscal year basis which includes April 12, 1953, as well as January 1, 1954, will have two accrual dates of real property taxes for such fiscal year. Compare I. T. 4043, C. B. 1951-1, 22.

Rev. Rul. 55-369

Irrespective of the taxable year (or years) in which retroactive increases in mail pay are first includible in the gross income of a taxpayer, no deduction is accruable with respect to amounts of such pay which are potentially refundable by the taxpayer to the Post Office Department resulting from a proposed downward adjustment of the retroactive increases, until the taxable year in which the Civil Aeronautics Board issues an order which establishes its final decision as to the amount, if any, of such downward adjustment. For such purposes, an order by the Civil Aeronautics Board does not constitute its final decision as long as the order is the subject of a bona fide contest. Compare Rev. Rul. 169, C. B. 1953-2, 139.

(Also Part II, Section 43; Regulations 118, Section 39.43-2.) Rev. Rul. 55-426[1]

It was announced in Internal Revenue Bulletin 1955-6, 6, that Revenue Ruling 54-608, C. B. 1954-2, 8 (relating to the accrual of vacation pay), was amended so that the ruling would be applied only to taxable years ending on or after June 30, 1955. The Revenue Ruling was amended to afford taxpayers time to consider its effect, particularly for determining whether to elect to establish reserves for estimated expenses under section 462 of the Internal Revenue Code of 1954. On June 15, 1955, section 462 was repealed by Public Law 74 (84th Cong.), for all taxable years to which the 1954 Code applies. In order to afford taxpayers a reasonable time to consider the effect of the repeal, particularly for determining whether the accrual of vacation pay will be allowable under Revenue Ruling 54-608, *supra*, such ruling will be applied only to taxable years ending after December 31, 1955.

Accordingly, the last paragraph of Revenue Ruling 54-608, *supra*, is hereby amended and as amended will read as follows:

I. T. 3956, *supra*, is hereby revoked, and G. C. M. 25261, *supra*, is modified to the extent that it is inconsistent with the views expressed herein. However, under the authority of sections 3791(b) of the 1939 Code and 7805(b) of the 1954 Code, such revocation and modification will not be applicable with respect to taxable years ending prior to January 1, 1956.

[1] This date has been extended to July 1, 1956. See Announcement, I. R. B. 1955-52, p. 9.

SECTION 462.—RESERVES FOR ESTIMATED EXPENSES, ETC.

26 CFR 1.462-1: Reserves for estimated expenses.

Regulations under the Internal Revenue Code of 1954. See T. D. 6134, page 12.

SUBPART D.—INVENTORIES

SECTION 471.—GENERAL RULE FOR INVENTORIES

(Also Part II, Section 22(c); Regulations 118, Section 39.22(c)-2.) Rev. Rul. 55-285

In determining gross income, for Federal income tax purposes, the use of inventories reflecting the value at retail of merchandise on hand at the beginning and end of a taxable year is not permitted. Such method is not a recognized method of inventory valuation either according to best accounting practice under section 471 of the Internal Revenue Code of 1954, or section 22(c) of the Internal Revenue Code of 1939 and the regulations promulgated under such 1939 Code provision.

The inventory method referred to herein is not the same as the "retail method" described in section 39.22(c)-8 of Regulations 118 which is a recognized method of approximating cost of inventory if properly adopted and consistently used in determining gross income.

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

Rev. Rul. 55-309

Price indexes for January 1955, published by the Bureau of Labor Statistics on March 8, 1955, for use by department stores employing the retail inventory and the last-in, first-out inventory methods.

The following price indexes for January 1955, published by the Bureau of Labor Statistics on March 8, 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 December 31, 1954 and January 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.

Effective with the July 1954 Department Store Inventory Price Indexes the revision program which began in 1952 was completed.

The final change, that of the necessary adjustments in the departmental groupings to make them conform with the new departmentalization plan of the Controllers' Congress of the National Retail Dry Goods Association, was incorporated into the July 1954 indexes. These adjustments were minor and had practically no effect on index for the 20 departments.

The Controllers' Congress of the National Dry Goods Association has revised its system of numbering the departments in its "Manual of Departmental Merchandise Content for Departmentized Stores." For taxpayers employing the new numbering system, table II shows the department or departments to which each of the 20 group indexes is applicable:

TABLE I.—*Bureau of Labor Statistics, department store inventory price indexes, by department groups*

[January 1941=100]

Department groups	Jan. 1954	Jan. 1955	Percent change from January 1954 to January 1955
I. Piece goods	204.1	200.7	−1.7
II. Domestics and draperies	197.0	189.6	−3.8
III. Women's and children's shoes	213.3	215.3	+0.9
IV. Men's and boys' shoes	213.1	213.0	0
V. Infants' wear	170.2	170.3	+0.1
VI. Women's underwear	172.5	171.6	−0.5
VII. Women's and girls' hosiery	173.7	168.1	−3.2
VIII. Women's and girls' accessories	170.1	172.4	+1.4
IX. Women's outerwear and girls' wear	180.1	177.7	−1.3
X. Men's clothing	204.4	205.3	+0.4
XI. Men's furnishings	201.3	197.9	−1.7
XII. Boys' clothing and furnishings	203.2	199.7	−1.7
XIII. Jewelry	164.3	163.6	−0.4
XIV. Notions	161.7	158.7	−1.9
XV. Toilet articles and drugs	164.0	166.1	+1.3
XVI. Furniture and bedding	211.4	207.7	−1.8
XVII. Floor covering	192.9	188.9	−2.1
XVIII. Housewares	197.7	198.1	+0.2
XIX. Major appliances	154.3	148.4	−3.8
XX. Radios and television sets	157.0	142.4	−9.3
Total, Groups I-XV	188.8	186.9	−1.0
Total, Groups XVI-XX	190.6	186.8	−2.0
Store total	189.2	186.8	−1.3

TABLE II.—*Revised coding of Controllers' Congress Departments*

Revised Department Groups		*Revised Controllers' Congress Department*	
No.	Name	No.	Name
I.	Piece goods	11–00	Piece goods
II.	Domestics and draperies	15–00	Household textiles
		64–11	Curtains, draperies and decorator fabrics
III.	Women's and children's shoes	39–00	Women's and children's shoes
IV.	Men's and boys' shoes	53–00	Men's and boys shoes
V.	Infants' wear	44–12	Infants' apparel and furniture
VI.	Women's underwear	36–00	Corsets and brassieres
		38–00	Underwear and negligees
VII.	Women's and girls' hosiery	37–00	Women's and children's hosiery
VIII.	Women's and girls' accessories	32–00	Neckwear and accessories
		33–00	Handbags and small leathers
		35–00	Women's and children's gloves and mittens

TABLE II.—*Revised coding of Controllers' Congress Departments*—Continued

Revised Department Groups		*Revised Controllers' Congress Department*	
No.	Name	No.	Name
IX.	Women's outerwear and girls' wear	34–00	Millinery
		41–00	Coats and suits, women's, misses' and juniors'
		42–00	Dresses, women's, misses' and juniors'
		45–00	Housedresses, aprons, and uniforms
		43–00	Blouses and sportswear
		46–00	Furs
		44–11	Girls' and teen age apparel
X.	Men's clothing	51–11	Men's clothing
		or	
		51–14	Men's clothing
		and	
		51–26	Men's sport clothing
XI.	Men's furnishings	51–12	Men's furnishings
		or	
		51–15	Men's furnishings
		and	
		51–27	Men's casual furnishings
XII.	Boys' clothing and furnishings	52–00	Boys' clothing and furnishings
XIII.	Jewelry and silverware	24–00	Jewlery and silverware
XIV.	Notions	12–00	Patterns
		21–00	Notions, laces, trimmings and ribbons
		25–00	Art needlework
		31–00	Umbrellas
XV	Toilet articles and drugs	22–00	Toilet articles and drug sundries
XVI.	Furniture and bedding	61–00	Furniture and beds
XVII.	Floor covering	62–00	Oriental rugs
		63–00	Domestic floor covering
XVIII.	Housewares	65–00	China, glassware and gift shop
		66–21	Housewares
		67–00	Pictures, frames and mirrors
XIX.	Major appliances	64–12	Lamps and shades
		66–12	Major appliances
XX.	Radio and television sets	68–00	Radio, television and records
		69–00	Pianos and musical instruments
XXI.	No separate index computed	26–00	Books and stationery
		66–22	Wall paper and paint
		71–00	Flower shop
		72–00	Automobile accessories
		73–00	Pet accessories and pet shop
		74–00	Toys, sporting goods and cameras
		75–00	Luggage
		76–00	Candy
		77–00	Foods and groceries
		78–00	Fresh and smoked meats
		79–00	Liquor shop
		81–00	Smoke shop

SUBCHAPTER F.—EXEMPT ORGANIZATIONS

PART I.—GENERAL RULE

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

Rev. Rul. 55–230

An association was organized to guard the purity of the breed of Welsh ponies; to promote interest therein; and to establish, maintain,

and publish authoritative records, registers, and transfers of ownership of that breed. Its activities consist of registering and maintaining records of pure bred Welsh ponies, recording transfers of ownership, and publishing literature describing the Welsh pony for the benefit of its members or others interested in improving or raising the breed. Membership in the association is open to any person, firm or corporation interested in improving or raising pure bred Welsh ponies. Its receipts are derived from membership fees, registrations and transfers. Expenditures are for operating expenses and for premiums for association-sponsored classes at a State fair. No part of the net income inures to the benefit of any member. Persons engaged in raising Welsh ponies are considered livestock producers engaged in agricultural pursuits. *Held*, the association is entitled to exemption from Federal income tax under the provisions of section 501(c)(5) of the Internal Revenue Code of 1954 as an agricultural organization.

Rev. Rul. 55-231

The *M* organization was incorporated for the purpose of (1) making known to the world the contents and meaning of certain books written by a designated author who was also one of the incorporators of the organization and (2) acquiring property necessary to the operation and maintenance of centers, reading rooms, lecture halls and camps in furtherance of the dissemination of such writings. The principal activity consists of purchasing books of the designated author and distributing them to libraries, educational institutions and the public. Expenditures are made principally for the purchase of books written by the designated author. *Held*, that an organization whose primary purpose is to promote the circulation of books of one of its incorporators and whose activities consist of purchasing such works and making them available for public use, is not organized and operated exclusively for educational purposes within the meaning of section 501(c)(3) of the Internal Revenue Code of 1954 or for any of the other purposes provided therein.

(Also Part II, Section 101(8); Regulations 118, Section 39.101(8)-1.) Rev. Rul. 55-311

A local association of employees, the membership of which is limited to employees of the *M* corporation, operates a bus for the convenience of its members. The income of the association is derived from bus fares and is used to pay for the operation of the bus. The bus is operated primarily for the benefit of the members. No part of the association's earnings is devoted to charitable, educational, or recreational purposes. *Held*, the association does not qualify for exemption from Federal income tax as a local association of employees under the provisions of section 501(c)(4) of the Internal Revenue Code of 1954, which provision of law corresponds to section 101(8) of the Code of 1939. There is no other subsection of section 501(c) of the

1954 Code, or of section 101 of the 1939 Code, under which the association may qualify for exemption.

Rev. Rul. 55-406

The *M* organization was incorporated as a nonprofit corporation for the purposes of receiving and investing funds and property and for distributing voluntarily and gratuitously said funds and property, together with the income therefrom, solely to, or for the benefit of, dependent widows and children of policemen or firemen who lose their lives in the line of duty. The selection of recipients and the amounts distributable to them are determined in the absolute discretion of *M*'s board of directors. The organization's sources of funds and property are derived from membership dues, contributions, and income from investments. Except for disbursements for necessary administrative expenses, such funds and property are expended solely for the purposes enumerated above. No part of the funds or property shall inure to or for the benefit of any member of *M*. In the event of dissolution, the funds and property shall be distributed to the City of *N*. *Held*, the *M* organization qualifies for exemption from Federal income tax as a charitable organization under the provisions of section 501(c)(3) of the Internal Revenue Code of 1954.

State instrumentality which qualifies for exemption under section 501(c)(3) of the Internal Revenue Code. See Rev. Rul. 55-319, page 119.

SUBCHAPTER I.—NATURAL RESOURCES

PART I.—DEDUCTIONS

SECTION 611.—ALLOWANCE OF DEDUCTION FOR DEPLETION

The decision in the case of *United States* v. *Cherokee Brick & Tile Company*, 218 Fed. (2d) 424, does not affect the position of the Service with respect to ordinary treatment processes in the case of brick and tile clay as set forth in Revenue Ruling 54-109, C. B. 1954-1, 62. See Rev. Rul. 55-244, below.

SECTION 613.—PERCENTAGE DEPLETION

(Also Section 611.) Rev. Rul. 55-244
(Also Part II, Sections 23(m), 114; Regulations 118, Sections 39.23(m)-1, 39.114-1.)

With respect to the manufacture of brick and tile from brick and tile clay, ordinary treatment processes as set forth in section 114(b)(4)(B) of the Internal Revenue Code of 1939 (sec. 613(c)

of the Internal Revenue Code of 1954) do not include transforming the clay into brick or tile by molding machine, by burning the units in kilns, and by loading the burnt brick and tile for shipment. The fact that the Government did not apply for certiorari in the case of *United States* v. *Cherokee Brick & Tile Company*, 218 Fed. (2d) 424, in no way represents an acceptance of the decision by the Internal Revenue Service.

Advice has been requested whether the decision of the United States Court of Appeals for the Fifth Circuit in the case of *United States* v. *Cherokee Brick & Tile Company*, 218 Fed. (2d) 424, will affect the position of the Internal Revenue Service as set forth in Revenue Ruling 54–109, C. B. 1954–1, 62, as to the "ordinary treatment processes" with respect to the manufacture of brick and tile from brick and tile clay which are to be included within the meaning of section 114(b)(4)(B) of the Internal Revenue Code of 1939 and section 613(c) of the Internal Revenue Code of 1954.

In the Cherokee Brick & Tile Company case, affirming the decision of the court below, the Court of Appeals held that ordinary treatment process normally applied to clay, in order to obtain the first commercially marketable mineral product, include transforming the clay into brick or tile by molding machine, by burning the units in kilns, and by loading the burnt brick and tile for shipment.

In Revenue Ruling 54–109, *supra*, the Internal Revenue Service considered the processes involved in the manufacture of brick and tile and kindred products from shale and brick and tile clay. It was specifically held that processes such as transforming clay into brick by extrusion or molding machine, burning units in kilns and loading for shipment or storage were not "ordinary treatment processes" as that phrase is used in section 114(b)(4)(B) of the 1939 Code (section 613(G)(4) of the 1954 Code) to define the term "mining".

Section 613(b)(5)(A) of the 1954 Code, section 114(b)(4)(A) of the 1939 Code) permits a percentage depletion allowance for mines and natural deposits of brick and tile clay but not of brick and tile as such. The fact that a particular taxpayer does not sell the clay to others for brick but sells only the completely manufactured brick cannot transform manufacturing processes into ordinary treatment processes.

Accordingly, the Revenue Service will adhere to the position set forth in Revenue Ruling 54–109 as to the processes properly includible in the term "ordinary treatment processes" with respect to the manufacture of brick and tile from brick and tile clay for percentage depletion purposes.

The fact that the Government did not apply for certiorari in the Cherokee Brick & Tile Company case does not represent an acceptance of the decision by the Internal Revenue Service. See also Revenue Ruling 55–78, page 357, this Bulletin, wherein it is held that furnacing or heating in rotary kilns, removal from the kilns and cooling, crushing and screening and loading for shipment, are not includible in the "ordinary treatment processes" applicable to the manufacture of lightweight aggregate from shale and slate.

SUBCHAPTER J.—ESTATES, TRUSTS, BENEFICIARIES, AND DECEDENTS

PART I.—ESTATES, TRUSTS, AND BENEFICIARIES

SUBPART C.—ESTATES AND TRUSTS WHICH MAY ACCUMULATE INCOME OR WHICH DISTRIBUTE CORPUS

SECTION 661.—DEDUCTION FOR ESTATES AND TRUSTS ACCUMULATING INCOME OR DISTRIBUTING CORPUS

(Also Section 662.) Rev. Rul. 55-286
(Also Part II, Section 162; Regulations 118, Section 39.162-1.)

Under the terms of an irrevocable trust agreement, the trustee is required to set aside a certain portion of the net income of the trust in a separate fund and is authorized to provide and maintain out of the fund annuities and/or gifts for the use and benefit of such persons employed by or connected with the grantor's business as the trustee in his uncontrolled discretion may determine and designate as deserving of the same. *Held*, payments made out of the fund are deductible under section 661(a)(2) of the Internal Revenue Code of 1954 (section 162(c) of the Internal Revenue Code of 1939) in computing the taxable income of the trust subject to the limitation that the amount so deductible when added to amounts otherwise deductible under section 661(a)(1) and (2) of the Internal Revenue Code of 1954 (sections 162 (b) and (c) of the 1939 Code) cannot exceed the distributable net income of the trust. Further, the amounts so deducted by the trust shall be included in the gross income of the recipients to the extent provided in section 662 of the Internal Revenue Code of 1954 (section 162 (b) and (c) of the 1939 Code).

SECTION 662.—INCLUSION OF AMOUNTS IN GROSS INCOME OF BENEFICIARIES OF ESTATES AND TRUSTS ACCUMULATING INCOME OR DISTRIBUTING CORPUS

Payments made out of a fund which has been set aside out of the net income of an irrevocable trust. See Rev. Rul. 55-286, above.

PART II.—INCOME IN RESPECT OF DECEDENTS

SECTION 691.—RECIPIENTS OF INCOME IN RESPECT OF DECEDENTS

Rev. Rul. 55-229

A lump sum payment to a Federal Government employee upon separation from the service for accumulated or accrued annual leave represents salary or compensation for services rendered and is includible in gross income for Federal income tax purposes. See I. T. 3969, C. B. 1949-2, 13. The death of such an employee and the

receipt by his widow or other beneficiary of such lump sum leave payment does not change its nature and identity. See the Act of August 3, 1950, 64 Stat. 395, 5 U. S. C. 61f, 61g. Therefore, where such income is not properly includible in the gross income of the decedent for the taxable period in which falls the date of the decedent's death and the right to receive the amount due is acquired by the widow or other beneficiary, or by the decedent's estate, the lump sum payment is includible in the gross income of the recipient in the taxable year received, under the provisions of section 691(a) of the Internal Revenue Code of 1954.

SUBCHAPTER K.—PARTNERS AND PARTNERSHIPS

PART I.—DETERMINATION OF TAX LIABILITY

SECTION 706.—TAXABLE YEARS OF PARTNER AND PARTNERSHIP

Procedure to be followed with respect to changes by partnerships and partners in the cases of taxable years beginning after April 1, 1954, pending issuance of regulations under the Internal Revenue Code of 1954. See Rev. Rul. 55-10, page 47.

SUBCHAPTER L.—INSURANCE COMPANIES

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

SECTION 822.—DETERMINATION OF MUTUAL INSURANCE COMPANY TAXABLE INCOME

Rev. Rul. 55-270

Capital loss deductions taken by mutual insurance companies to meet abnormal insurance losses, provided by section 822(c)(6) of the Internal Revenue Code of 1954, must be computed on the basis of actual losses paid reduced by actual (rather than expected) reinsurance recoveries received in the taxable year.

SUBCHAPTER N.—TAX BASED ON INCOME FROM SOURCES WITHIN OR WITHOUT THE UNITED STATES

PART II.—NONRESIDENT ALIENS AND FOREIGN CORPORATIONS

SUBPART A.—NONRESIDENT ALIEN INDIVIDUALS

SECTION 871.—TAX ON NONRESIDENT ALIEN INDIVIDUALS

Request by a United Kingdom bank for data appearing on the Corporation Income Tax Return, Form 1120, filed by a domestic corporation. See Rev. Rul. 55-9, page 675.

SECTION 872.—GROSS INCOME: EXCLUSIONS

(Also Section 883.) Rev. Rul. 55-407
(Also Part II, Sections 212, 231; Regulations 118, Sections 39.212-2, 39.231-3.)

The reciprocal exemption requirements of sections 872(b) and 883 of the Internal Revenue Code of 1954 (sections 212(b) and 231(d) of the Internal Revenue Code of 1939) are not satisfied by Venezuela since that country now has an income tax law in effect which provides for the imposition of a tax on transportation companies but does not grant an exemption to citizens of the United States nonresident in that country or to corporations organized in the United States.

Mimeograph 4148, C. B. XIII-1, 87 (1934), which holds that Venezuela satisfied the equivalent exemption requirements of section 212(b) and 231(b) of the Revenue Act of 1932, since at that time Venezuela imposed no income tax, is hereby modified to the extent that it is inconsistent with the views expressed herein.

SUBPART B.—FOREIGN CORPORATIONS

SECTION 881.—TAX ON FOREIGN CORPORATIONS NOT ENGAGED IN BUSINESS IN UNITED STATES

(Also Section 882.) Rev. Rul. 55-182
(Also Part II, Section 231;
Regulations 118, Section 39.231-1.)

> A Canadian mutual investment company, composed substantially of stockholders who are residents of the United States, operates as an open-end management investment company. It is restricted to investments which derive no income from sources within the United States. It maintains no office in the United States and its transactions in the United States are effected only through a resident broker, commission agent or custodian. *Held*, such mutual investment company constitutes a foreign corporation not engaged in trade or business within the United States, taxable under the provisions of section 881(a) of the Internal Revenue Code of 1954 only on amounts received from sources within the United States.

Advice has been requested regarding the taxability of a Canadian mutual investment company which was formed under the Companies Act of Canada and has elected to qualify as a "nonresident owned investment corporation," pursuant to section 63(4) of the Canadian Income Tax Act. In order to retain such classification, a minimum of 95 percent of its outstanding stock must at all times be held by stockholders other than Canadian residents.

The offer and sale of the investment company's shares to residents of the United States was made pursuant to the rules of the Securities and Exchange Commission and the company is subject to the applicable provisions of the Investment Company Act of 1940.

The company does not deal in its own stock, it does not have an office in the United States and its shares are issued to investors either (a) through its officers or employees at its office in Canada or (b) through underwriters and dealers in the United States and England.

The common shares issued are, at the option of the holder, subject to repurchase for cancellation by the company at a price based on net asset value at the time of repurchase. The shares of common stock repurchased are canceled and retired and are not to be reissued or resold by the company. In accordance with the provisions of the Companies Act of Canada the company will notify the Secretary of State of Canada, periodically, of the repurchase for cancellation of its common shares and its authorized capital will be reduced to reflect the repurchase and cancellation of the shares subject to confirmation by the Canadian Secretary of State.

The company is a mutual investment company and its investment portfolio is restricted at all times to securities of Canadian corporations, Canadian Government provincial and municipal obligations, Canadian investments generally and securities of corporations which derive no income from sources within the United States. Purchases and sales of its portfolio securities made in Canada or other foreign countries are made in the established Canadian or other foreign markets. Purchases and sales of its portfolio securities which are made within the United States are, in all cases, effected through an independent broker, commission agent or custodian. Its income is derived solely from interest and dividends and from gains from the disposition of securities and other investments in its investment portfolio.

The offices of the company are maintained in Canada where all major decisions with respect to its policies are made. All regular meetings of the board of directors and of the stockholders are held in Canada. An occasional special meeting of the board of directors may be held within the United States in order to accommodate those directors who are United States citizens and residents.

Section 881 of the Internal Revenue Code of 1954 provides that a foreign corporation not engaged in trade or business within the United States is subject to Federal income tax only with respect to fixed or determinable annual or periodical income from sources within the United States as determined under section 861 of the Code. See section 231 of the Internal Revenue Code of 1939 and section 39.231-1(b) of Regulations 118. Taxable income does not include profits derived from the effecting of transactions in the United States in stocks, securities, or commodities through a resident broker, commission agent, or custodian or profits derived from the sale within the United States of personal property or real property located therein. Section 39.231-2(c) of Regulations 118 (applicable under the Code of 1954 by virtue of T. D. 6091, C. B. 1954-2, 47) states that a foreign corporation which effects transactions in the United States in stocks, securities, or commodities (including hedging transactions) through a resident broker, commission agent, or custodian is not merely by reason of such transactions considered as being engaged in trade or business within the United States which would cause it to be classed as a resident foreign corporation.

In the case of *The Scottish American Investment Co., Ltd.*, v. *Commissioner*, 12 T. C. 49, it is held that a foreign investment corporation which made all decisions as to purchase and sale of securities and investment policies in the home office in Scotland, handled all transactions in securities directly by the home office through resident brokers,

and maintained an office in the United States only for the purpose of maintaining records, collecting dividends, filing reports to the home office, and otherwise performing clerical and routine services for the home office, was not engaged in business within the United States.

In view of the foregoing, it is held that a Canadian mutual investment company constitutes a foreign corporation not engaged in trade or business in the United States, taxable under the provisions of section 881(a) of the Internal Revenue Code of 1954 only on amounts received from sources within the United States.

This ruling has no effect upon any question concerning the taxation of the stockholders of the investment company.

SECTION 882.—TAX ON RESIDENT FOREIGN CORPORATIONS

Canadian mutual investment company composed substantially of stockholders resident in the United States. See Rev. Rul. 55-182, page 77.

Determination of whether a Canadian corporation has a permanent establishment in the United States as defined in the income tax convention between the United States and Canada, page 624 of this Bulletin. See Rev. Rul. 55-282, page 634.

SECTION 883.—EXCLUSIONS FROM GROSS INCOME

Equivalent exemption requirement with respect to Venezuela. See Rev. Rul. 55-407, page 77.

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

Rev. Rul. 55-383

India satisfies the similar credit requirement of section 901(b)(3) of the Internal Revenue Code of 1954.

The Internal Revenue Service has been requested to consider whether India is a country which satisfies the similar credit requirements of section 901(b)(3) of the Internal Revenue Code of 1954.

Section 901(b)(3) of the Internal Revenue Code of 1954 provides for the allowance of a credit for income taxes paid or accrued during the taxable year to any foreign country by an alien resident of the United States or Puerto Rico provided the foreign country of which the alien resident is a citizen or subject, in imposing such taxes, allows

a similar credit to citizens of the United States residing in such country.

Section 49 D of the Indian Income Tax Law, as submitted to the Internal Revenue Service for consideration in this matter, provides as follows:

(1) If any person who is resident in the taxable territories in any year proves that, in respect of his income which accrues or arises during that year without the taxable territories (and which is not deemed to accrue or arise in the taxable territories), he has paid in any country, with which there is no reciprocal arrangement for relief or avoidance of double taxation, income tax, by deduction or otherwise, under the law in force in that country, he shall be entitled to the deduction from the Indian income tax payable by him of a sum calculated on such doubly taxed income at the Indian rate of tax or the rate of tax of the said country, whichever is the lower.

Since section 49 D of the Indian Income Tax Law provides, subject to certain conditions and limitations substantially similar to those in section 904(a) of the Code, for the allowance as a credit against income taxes which accrue or arise within the taxable territories of India, of income taxes paid to foreign countries by any person who is a resident of such territories, India satisfies the similar credit requirements of section 901(b)(3) of the Code.

SECTION 902.—CREDIT FOR CORPORATE STOCKHOLDER IN FOREIGN CORPORATION

Rev. Rul. 55-312

Section 902(d) of the Internal Revenue Code of 1954 provides for the treatment to be accorded specified distributions of property received by a domestic corporation from a wholly-owned foreign corporation, in lieu of the general treatment of property distributions as provided for in section 301 of the Code. The term "property" as used in section 301 is defined in section 317(a) of the Code as specifically including "money." Consequently, the term "property" as used in section 902(d) of the Code is deemed to include "money."

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. 55-171

Income tax liability of United States citizens resident or physically present in foreign countries for taxable years beginning on or after January 1, 1951. Rev. Rul. 291, C. B. 1953-2, 42, superseded.

SECTION 1. PURPOSE.

The purpose of this Revenue Ruling is to supersede Revenue Ruling 291, C. B. 1953-2, 42 (published also as a pamphlet entitled *Income*

Tax Guides for United States Citizens Abroad) and in conformity with the Internal Revenue Code of 1954 to include additional information for use in providing assistance and guidance to United States citizens, residing or physically present in foreign countries, in the preparation of their Federal income tax returns.

SEC. 2. SCOPE.

The information set forth herein relates only to the tax problems peculiar to United States citizens residing or physically present in foreign countries for taxable years beginning on or after January 1, 1951, and is intended to supplement information issued by the Internal Revenue Service for taxpayers generally. Therefore, in the preparation of their Federal income tax returns and other forms, such citizens should follow the instructions issued in connection with the forms insofar as they are applicable. The guides set forth in this Revenue Ruling do NOT apply to (1) taxable years beginning prior to January 1, 1951, except to the extent hereinafter noted; (2) resident aliens temporarily absent from the United States; and (3) citizens performing civilian or military services for the United States or any agency or instrumentality thereof. A resident alien temporarily absent from the United States is, in general, taxable on income derived from all sources. Compensation for personal services performed by a citizen as an employee of the United States, or any agency or instrumentality thereof, is required to be included in gross income regardless of where the services are performed. (For Federal income tax purposes, the nonappropriated fund activities of the Armed Forces, such as the Army and Air Force Exchange Service, the Navy Exchange, officers' and enlisted men's clubs and other similarly organized activities under the jurisdiction of the Armed Forces, are agencies of the United States.)

SEC. 3. APPLICABILITY OF TAX TO UNITED STATES CITIZENS ABROAD.

.01 *Taxable years beginning on or after January 1, 1954, and ending after August 16, 1954.*—The right of the United States to impose income tax upon its citizens, wherever resident, is based on citizenship. *United States citizens residing or physically present in foreign countries are taxable in the same manner as those residing within the United States, unless they can satisfy the requirements of section 911 of the Internal Revenue Code of 1954.* If the citizen meets either the "foreign residence" test or the "presence in a foreign country" test provided by section 911, he is entitled to exclude from gross income amounts received as "earned income" for personal services rendered outside the United States.

.02 *Taxable years beginning on or after January 1, 1951, and fiscal years ending in 1954.*—Section 116(a) of the Internal Revenue Code of 1939, as amended by the Revenue Act of 1951 and the Technical Changes Act of 1953, is, in substance, identical with section 911 of the 1954 Code, except that in the definition of earned income, in a situation where *both* personal services *and capital* are material income-producing factors, the limitation is 20 percent, as contrasted to 30 percent under the present law.

SEC. 4. EXCLUSION UNDER SECTION 911(a)(1) BASED UPON BONA FIDE RESIDENCE IN FOREIGN COUNTRIES.

.01 *General.*—A United States citizen is entitled to exclude from gross income under section 911(a)(1) of the 1954 Code, his "earned income" (as defined in sec. 7 of this Revenue Ruling) if—

(a) He has been a bona fide resident of a foreign country or countries for an uninterrupted period which includes an entire taxable year; and

(b) Such income is—

(1) Received for personal services rendered outside the United States;

(2) Attributable to such uninterrupted period; and

(3) Not paid by the United States or any agency or instrumentality thereof.

All of these requirements must be met by the citizen in order to claim the exclusion from gross income. For example, a privately employed citizen was a bona fide resident of a foreign country for an uninterrupted period, as hereinafter defined, beginning August 1, 1952, and ending June 30, 1954, and files his returns on the calendar year basis. He is entitled to exclude from gross income the amount of compensation received for personal services rendered abroad during such period. (These same rules are also applicable to taxable years beginning on or after January 1, 1951, which fall within the scope of the 1939 Code. See par. .04 of this section for rules applicable to prior taxable years.)

.02 *Bona fide foreign residence.*—No specific rule can be stated for determining whether a United States citizen is a bona fide resident of a foreign country, since it involves his intentions with respect to the length and nature of his stay. The intention of the taxpayer to establish a bona fide residence in a foreign country may be evidenced by words and acts, but where they conflict, more emphasis will be placed on the acts than on the words. Generally, a citizen who goes to a foreign country for a definite purpose, which is of a temporary nature, and who returns to the United States after it has been accomplished, is not a bona fide resident of such foreign country. However, if his purpose is of such a nature that an extended and indefinite stay may be necessary for its accomplishment, and to that end he establishes residence in the foreign country, he may be a bona fide resident of such foreign country for Federal income tax purposes. For example, American citizens who go to foreign countries to work on construction projects, which are obviously of a temporary nature, cannot be classified as bona fide residents of such countries for the purposes of section 911(a)(1) of the 1954 Code, even though they remain abroad for an entire taxable year or longer. (For information as to whether the "earned income" attributable to such personal services rendered abroad is excludable under the "presence in a foreign country" rule, see sec. 5 of this Revenue Ruling.) However, citizens of the United States who are permanently assigned to foreign divisions of business concerns and who establish and maintain their residence in a foreign country or countries for a period of indefinite duration may be classified as bona fide residents of a foreign country or countries for the purposes of section 911(a)(1) of the 1954 Code.

.03 *Temporary absence from foreign country.*—Once bona fide residence in a foreign country or countries has been established, temporary visits to the United States or elsewhere on vacation or business trips will not necessarily deprive the citizen of his STATUS as a bona fide resident of a foreign country. (But see sec. 8 of this Revenue Ruling for the effect of such trips on source of income.) Such absences must not be unreasonable in length, there must be full intention on the part of the individual to return to his foreign post, and there must be substantial evidence that the foreign residence has not been relinquished. Long periods of time spent in the United States or any possessions thereof would be considered as evidence that the citizen had relinquished bona fide residence in a foreign country.

.04 *Prior law relating to "bona fide foreign residence."*—For taxable years beginning on or after January 1, 1951, which are subject to the provisions of the 1939 Code, the law in effect with respect to the exclusion under the "bona fide foreign residence" rule was, in substance, identical with such exclusion under section 911(a)(1) of the 1954 Code, except for the revision from 20 percent to 30 percent regarding the definition of "earned income." (See sec. 7.02 of this Revenue Ruling.) Under the law in effect prior to January 1, 1951 (and after 1942), a United States citizen was permitted to exclude earned income from sources outside the United States if he had been a bona fide resident of a foreign country or countries "during the entire taxable year." Therefore, a citizen who established residence in a foreign country in the course of the taxable year was not entitled to such exclusion for such taxable year. However, if he had been a bona fide resident of a foreign country or countries for a period of at least two years before the date on which he ceased to be resident of such foreign country or countries, he could exclude from gross income, for the year in which he relinquished his foreign residence, earned income from sources outside the United States attributable to that part of such period of foreign residence before the date of relinquishment. However, under section 116(a)(1) of the 1939 Code, as amended by the Revenue Act of 1951, a citizen who was a bona fide resident of a foreign country or countries for an uninterrupted period which included an entire taxable year is entitled to exclude from gross income the amount of compensation received on or after January 1, 1951, for personal services rendered abroad, attributable to such uninterrupted period. For example, a privately employed citizen, who files his returns on the calendar-year basis, was a bona fide resident of a foreign country for an uninterrupted period beginning July 1, 1949, and ending October 31, 1951. Under section 116(a)(1) of the 1939 Code, as amended by the Revenue Act of 1951, the taxpayer is entitled to exclude the "earned income" attributable to such period and received on or after January 1, 1951, since his period of bona fide foreign residence includes an entire taxable year (1950).

SEC. 5. EXCLUSION UNDER SECTION 911(a)(2) BASED ON PRESENCE IN A FOREIGN COUNTRY.

.01 *General.*—A citizen of the United States may exclude from gross income under section 911(a)(2) of the 1954 Code, amounts constituting "earned income" (as defined in sec. 7 of this Revenue Ruling) if—

(a) He is present in a foreign country or countries during a total

of at least 510 full days during any period of 18 consecutive months; and

(b) Such earned income is—

(1) Received for personal services rendered outside the United States;

(2) Attributable to such 18-month period; and

(3) Not paid by the United States or any agency or instrumentality thereof.

All of these requirements must be met in order for the citizen to qualify for the exclusion. The excluded gross income may be attributable to any 18-consecutive-month period during which the citizen is in a foreign country or countries for 510 full days. For example, a citizen of the United States, privately employed, arrives in a foreign country on August 3, 1953, and remains there continuously until his departure therefrom on December 27, 1954, a period during which he is present in the foreign country 510 full days. The citizen may exclude from gross income the "earned income" from sources without the United States that is attributable to any 18-consecutive-month period which includes the above 510 full days, notwithstanding that the citizen was actually present in the foreign country for a period of less than 18 months. For example, the exclusion would be applicable but not limited to the following 18-month periods: an 18-month period which commences August 4, 1953, and ends February 3, 1955; an 18-month period which commences June 28, 1953, and ends December 27, 1954; or an 18-month period which commences July 1, 1953, and ends December 31, 1954.

.02 *Limitation on amount excludable.*—The amount excluded from gross income under the provisions of section 911(a)(2) of the 1954 Code shall not exceed $20,000 in those cases in which the 18-month period includes the entire taxable year. In those cases in which the 18-month period does not include the entire taxable year, the $20,000 annual limitation shall be prorated in the following manner: The amount excluded from gross income under such section for such taxable year shall not exceed an 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. For example, a taxpayer was present in a foreign country 510 full days during the 18-month period ending June 30, 1954, during which the requirements of section 911(a)(2) of the 1954 Code were satisfied. During the calendar year 1953 he received $26,000, and during the period January 1, 1954, through June 30, 1954, he received $13,000 as salary. If the taxpayer reported on a calendar year basis, only $20,000 of the $26,000 received during 1953 would be excludable, and only $9,917.81 (181/365 of $20,000) would be excludable in 1954. The balance of $6,000 would be includible in the taxpayer's gross income for 1953 and $3,082.19 for 1954. (There is no limitation upon the amount of "earned income" which may be excluded from gross income under the "bona fide foreign residence" rule.)

.03 *Computation of 510 full days presence in foreign country.*—In computing the minimum of 510 full days presence in a foreign country or countries, all separate periods of such presence during the 18-month period are to be aggregated. For the purpose of section 911(a)(2) of the 1954 Code, if an individual travels over international waters from

one place in a foreign country to another place in the same country, or to a place in another foreign country, and if such travel extends over a period of less than 24 hours and does not involve travel within the United States or any possession thereof, such individual shall not be deemed outside a foreign country during the period of such travel. For example, a citizen of the United States, privately employed, departs by aircraft from Tokyo, Japan, at 11 p. m. on July 23 and arrives in Manila, Philippines, at 8 a. m. on the following morning. The citizen, for the purpose of section 911(a)(2) of the 1954 Code, will not be deemed outside a foreign country during the period of travel from Tokyo to Manila, inasmuch as such period of travel is less than 24 hours. On the other hand, if a privately employed citizen of the United States departs by vessel from Genoa, Italy, on August 20 and arrives in Naples, Italy, on August 22, the citizen, for the purpose of section 911(a)(2) of the 1954 Code, will be deemed outside a foreign country for a period of 3 days from August 20 to August 22. The 510 full days need not be consecutive, but may be interrupted by periods during which the citizen is not present in a foreign country. Time spent in a foreign country in the employment of the United States Government will count toward satisfaction of the 510 full-day requirement, even though amounts paid by such Government are not excludable from gross income. The period during which the citizen was present in a foreign country, or countries, prior to January 1, 1951, may be taken into account in determining whether such citizen is present in a foreign country or countries during at least 510 full days during any 18-month period. However, the income attributable to the period prior to January 1, 1951, is not excludable from gross income if received before such date, since the exclusion is applicable only to taxable years beginning on or after January 1, 1951.

.04 *Computation of 18-month period.*—The 18-consecutive-month period may be part of a longer period of presence in a foreign country and need not commence with the citizen's day of arrival therein or terminate with the day of his departure therefrom. For example, a citizen who arrives in a foreign country on January 1, 1953 and finally departs therefrom on February 14, 1955, may not be present in such country for 510 full days during the 18-month period commencing with January 1, 1953, and ending with the close of June 30, 1954, because of his visits to the United States during such period. However, he may satisfy the 510 full-day requirement during the 18-month period commencing with February 15, 1953, and ending with the close of August 14, 1954. In such event, the exclusion will apply to income attributable to the latter period, but not to income attributable to the period commencing with January 1, 1953, and ending with the close of February 14, 1953. The exclusion is applicable as long as there is a continuing period throughout which the citizen satisfies the requirement of 510 full days presence in a foreign country or countries during an 18-month period.

.05 *Definitions.*—The term "full day" means a continuous period of 24 hours commencing from midnight and ending with the following midnight. The term "18 consecutive months" means any 18-month period commencing with the beginning of any day of any month and ending with the close of the day preceding the corresponding day in the succeeding eighteenth month; or if there is no such corresponding day, with the close of the last day of the succeeding eighteenth month.

For example, the period July 3, 1953, through January 2, 1955, and the period July 1, 1953, through December 31, 1954, would both be periods of "18 consecutive months." The term "foreign country" includes only territory under the sovereignty of a government other than that of the United States; it does not include the territories (Hawaii and Alaska) or the possessions of the United States.

.06 *Prior law relating to "presence in a foreign country."*—The exclusion under the "presence in a foreign country" rule is applicable only to taxable years beginning on or after January 1, 1951. Under the law in effect for taxable years beginning on or after that date and ending before January 1, 1953, there was no limitation upon the amount of earned income received during such period which could be excluded from gross income under the "presence in a foreign country" rule. However, for taxable years ending after December 31, 1952, but only with respect to amounts received after such date, the amount excluded from gross income under such rule, as under present law, could not exceed $20,000 in those cases in which the 18-month period included the entire taxable year. In those cases in which the 18-month period did not include the entire taxable year, the $20,000 annual limitation was subject to the same proration explained in section 5.02 of this Revenue Ruling. A special rule was applicable to a fiscal year beginning in 1952 and ending in 1953. (For taxable years beginning before January 1, 1951, a citizen was entitled to exclude earned income from sources outside the United States only if he could establish that he was a *bona fide* foreign resident.)

SEC. 6. INCOME DERIVED FROM POSSESSIONS OF THE UNITED STATES.

Income derived from possessions of the United States may, under certain circumstances, be excluded from gross income in accordance with the provisions of section 931 and section 933 and, in some rare instances, under section 911 of the 1954 Code. Generally, section 911 of the 1954 Code has no application to citizens of the United States performing personal services or engaged in a trade or business within the possessions. However, a citizen who has qualified for the "foreign residence" or "presence in a foreign country" exclusion under section 911 of the 1954 Code may exclude earned income attributable to a period he is temporarily present in a possession during such qualifying period. For example: A privately employed citizen arrived in Brazil on December 31, 1952, and remained there continuously until May 26, 1954, a period during which he qualified for the "presence in a foreign country" exclusion. (See sec. 5 of this Revenue Ruling.) On May 26, 1954, he left Brazil for a temporary assignment in the Panama Canal Zone, a possession of the United States, where he remained until July 15, 1954, when he returned to the United States for a permanent assignment. The citizen may exclude from gross income under the "presence in a foreign country" rule, the earned income attributable to the period beginning January 1, 1953, and ending June 30, 1954, subject to the limitation of $20,000, since he was present in a foreign country for 510 full days during such 18-month period and such income was for personal services rendered outside the United States. He may not exclude, under this rule, the earned income attributable to the period July 1 to July 15, 1954, since he did not qualify for the "presence in a foreign country" exclusion for an 18-month period which included such period. (However, such

income may, under certain circumstances, be excludible under the provisions of sec. 931 of the 1954 Code.) For purposes of section 911, some of the more important possessions of the United States are the Panama Canal Zone, Guam, American Samoa, Wake, Midway Island, Puerto Rico, and the Virgin Islands.

SEC. 7. EARNED INCOME.

.01 *Compensation for personal services rendered.*—The term "earned income" means wages, salaries, professional fees, and other amounts received as compensation for personal services actually rendered. It does not include such income as dividends, other distributions of corporate earnings or profits, gambling gains, interest, rents, or gains or profits from dealing in real or personal property. For example, where a citizen performs personal services for a corporation in which he owns stock, "earned income" means only such portion of any income received from the corporation which represents a *reasonable allowance as compensation for the personal services actually rendered.* The entire amount received as professional fees by a citizen engaged in a professional occupation, such as a doctor or lawyer, may be treated as "earned income" even though he employs assistants in the performance of the services, if the patients or clients are those of the citizen and look to him as the person responsible for the services rendered, and capital is not a material income-producing factor.

.02 *Profit from trade or business.*—If a citizen is engaged in a trade or business, either as sole proprietor or as a member of a partnership, in which *both* personal services *and capital* are material income-producing factors, a reasonable allowance as compensation for the personal services actually rendered by him shall be considered to be "earned income," but the amount which may be treated as "earned income" from such trade or business may not exceed 30 percent of his share of the net profits therefrom. To illustrate: A citizen qualifying for the "foreign residence" exclusion operates a retail sales outlet in a foreign country. Since capital is a material income-producing factor in the business, not more than 30 percent of the net profits from the business may be treated as "earned income" and excluded. The balance of the profits must be included in gross income for Federal income tax purposes. (For taxable years beginning before January 1, 1954, and for short taxable years beginning in 1954 and ending before August 17, 1954, not more than 20 percent of the net profits from such trade or business could be treated as "earned income.")

SEC. 8. SOURCE OF INCOME.

For the purpose of section 911 of the 1954 Code, the place where personal services are performed is considered to be the source of the income for such services, irrespective of the place where payment is made. Therefore, if "earned income" is attributable to a period in which the citizen satisfies either the "foreign residence" test or the "presence in a foreign country" test, the amounts of such income received for personal services rendered outside the United States may be excluded from gross income, subject to the limitations set forth in section 5.02 of this Revenue Ruling, even though received within the United States. Compensation for personal services rendered

within the United States is taxable and is not excludable from gross income, regardless of the place where payment is made. For example, a United States citizen who is a bona fide resident of a foreign country returns to the United States on a business trip. The compensation for the services rendered while in the United States is taxable and includible in gross income, even though payment for such services may be received by the taxpayer after his return to the foreign country.

SEC. 9. INCOME RECEIVED IN FOREIGN CURRENCY.

The income reported on a Federal income tax return must be expressed in terms of United States dollars. Where income is actually or constructively received in foreign currency, the computation in terms of United States dollars must be based on the rate of exchange at the time of receipt by the citizen, or when credited to his account in the foreign country, even though not actually converted into United States currency at that time. (In the case of blocked foreign income, see sec. 10 of this Revenue Ruling.)

SEC. 10. BLOCKED FOREIGN INCOME.

Generally, all income (other than that excludable by law) of United States citizens from sources within a foreign country or countries, whether in terms of United States dollars or foreign currencies, is includible in gross income for Federal income tax purposes, notwithstanding the fact that under the laws or regulations of the foreign country or countries conversion of such foreign income into United States dollars, or into other money or property which is readily convertible into United States currency, may be blocked. The citizen must include the blocked income in his gross income when such income is either actually or constructively received or is credited to his account in the foreign country, unless he takes affirmative action to elect to defer the reporting of such income until it ceases to be blocked. If he wishes to make such election and defer the income taxes otherwise due on such income he must comply with the procedural requirements of the Internal Revenue Service relating to blocked foreign income, including the filing, with his regular return, of a tentative return reflecting such blocked income, but on which no tax is computed. Details of the requirements are published in the Internal Revenue Bulletins. See 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. Income ceases to be blocked and is includible in gross income when it is convertible, or has been converted, into United States dollars or into other money or property which is convertible into United States currency; or the citizen uses the income for his personal expenditures; or disposes of it by way of gift, bequest, devise or inheritance, or in some other manner.

SEC. 11. FILING OF INCOME TAX RETURNS.

.01 *Gross income.*—A citizen of the United States, wherever resident, who has gross income of $600 or more (other than income excluded by law) during the taxable year must file an income tax return, regardless of his marital status, the number of his dependents, or the amount of his deductions. For example, a citizen who qualifies for the "foreign residence" exclusion files his return on a calendar-year basis. For the year 1954 he received a salary of $10,000 for services performed in a foreign country, dividends of $500 from a foreign corporation,

and interest of $200 from investments in foreign countries. The citizen must file a return for such year since he had gross income of $600 or more exclusive of the salary of $10,000 excludable under the provisions of section 911(a)(1) of the 1954 Code. A self-employed citizen not meeting the above requirements may nevertheless be required to file a return for purposes of the self-employment tax if he is engaged in a trade or business as defined in section 1402 of the 1954 Code, and has net earnings of $400 or more from self-employment. (See sec. 12.01 of this Revenue Ruling.)

.02 *Deductions.*—Any expenses, losses, and other deductions which are attributable to income properly excluded under section 911 are not allowable as deductions in a Federal income tax return. For example, a salesman residing and traveling abroad, who properly excluded from gross income under section 911 of the 1954 Code income earned abroad, may not deduct in his Federal income tax return traveling and other expenses incurred by him in earning such excluded income. Expenses, losses, and other deductions which cannot be identified as being attributable exclusively to either includible or excludable income but are attributable to both must be allocated or apportioned.

.03 *Income taxes paid to foreign countries.*—If a citizen is required to include in his Form 1040, Individual Income Tax Return, income from foreign sources on which income taxes to a foreign country or countries are paid or accrued, he may claim credit for such foreign *income* taxes against his United States income tax in accordance with the provisions of section 901 of the Internal Revenue Code, *provided* he does not claim the standard deduction or compute his tax by the use of the optional tax table included in the instructions for Form 1040. The foreign tax credit should be claimed on the line provided therefor (line 9 of the 1954 Form 1040) at the bottom of page 3 of the return. The method of computing the foreign tax credit allowable under section 901 of the 1954 Code is explained on Form 1116, which must be filed with the income tax return by every taxpayer claiming credit under that section. If credit is claimed under section 901 of the 1954 Code and a redetermination of the taxpayer's foreign income tax liability discloses that he has overpaid or underpaid such tax, he should immediately notify the Commissioner of Internal Revenue in order that appropriate adjustment may be made of the foreign tax credit claimed on his Federal income tax return. As an alternative to claiming the foreign income tax as a direct *credit* against his United States income tax, the taxpayer may claim the amount of income taxes paid to a foreign country or countries as a *deduction* on page 3 of Form 1040 in computing his taxable income, provided he itemizes his deductions. In most cases, however, it will be to the taxpayer's advantage to claim foreign income taxes as a credit against the Federal tax under section 901 of the 1954 Code. Taxpayers who claim the foreign *income* taxes either as a credit or as a deduction may not also have the benefit of the standard deduction.

.04 *Where right to exemption not yet established.*—If a citizen employed abroad has not been there long enough to qualify for exemption under either the "foreign residence" rule or the "presence in a foreign country" rule at the time his income tax return is due to be filed, he must either include the compensation in his gross income and pay the Federal tax due thereon, or obtain an extension of time for the filing of his return. (See par. .06 of this section.) If he *elects* to in-

clude the compensation in his gross income, he may, after he has met the statutory requirements for exemption and within the statutory period, file an amended return or a claim on Form 843 for refund or credit of any tax thus overpaid. For example, a citizen was a bona fide resident of a foreign country from November 1, 1953, through January 31, 1955, during which period he performed personal services abroad. He would be required to include in his 1953 return, filed on the calendar year basis, all income for the year, including the "earned income" received during the period November 1, 1953, through December 31, 1953, since he had not met the requirements of section 911(a)(1) of the 1954 Code as of the due date for the filing of such return. However, since the requirements of that section would be met as of December 31, 1954, he would then be entitled to a refund or credit of any overpayment of tax resulting from the exclusion of the "earned income" received during the period November 1, 1953, through December 31, 1953, and a claim on Form 843, Claim for Abatement, or Refund, or an amended return should then be filed.

.05 *Due date for filing returns.*—Citizens of the United States who, on April 15, are residing or traveling outside of the United States and who file their returns on the calendar year basis are automatically allowed an extension of time until June 15 for filing the return for the preceding taxable year. Similarly, an extension of 2 months is granted to fiscal-year taxpayers. A taxpayer who takes advantage of this extension must attach to his return a statement showing that he was residing or traveling outside the United States on the due date (April 15, for calendar-year taxpayers), and he must pay interest at the rate of 6 percent per annum on the unpaid tax, if any, from the due date until paid.

.06 *Extensions of time for filing returns.*—An extension of time for filing income tax returns may be granted for more than 6 months in the case of citizens of the United States who are abroad. A citizen desiring an extension of time, in addition to the 2 months automatically granted, for filing his return until after the completion of the qualifying period under section 911 of the 1954 Code should make application therefor with the district director of internal revenue with whom the return is required to be filed. The application must be in writing, properly signed by the taxpayer or his duly authorized agent, and must be made before the due date for filing the return with respect to which the extension is requested. The application should set forth the facts relied upon to justify the extension of time requested and should include a statement as to the earliest date the taxpayer expects to be in a position to determine whether he will be entitled to the exclusion provided by section 911 of the 1954 Code.

SEC. 12. SELF-EMPLOYMENT TAX

.01 *Taxable years ending on or before December 31, 1954.*—In general, a citizen of the United States, wherever resident, who derives income during the taxable year from a trade or business carried on by him or from a partnership of which he is a member is subject to the self-employment tax. Such citizen is required to file a return on Form 1040 for the purpose of reporting the self-employment tax if he has net earnings from self-employment of $400 or more, even though he may not have sufficient income to require the filing of an income tax return. For self-employment tax purposes, "earned in-

come" which qualifies for either the "bona fide foreign residence" exclusion or the "presence in a foreign country" exclusion is not to be taken into account in computing net earnings from self-employment. A schedule for the computation of the tax is provided on page 3 of separate Schedule C of the income tax return (Form 1040), and instructions for its completion are shown on page 4 of the Schedule. "Net earnings from self-employment" is the gross income derived by an individual from any trade or business carried on by him, less the allowable deductions attributable to such trade or business, plus his share of self-employment net earnings (or loss) from a partnership of which he is a member. The deductions for personal exemptions are not allowable in determining the net earnings from self-employment. The term "trade or business" as used herein includes all self-employment activities of the citizen except those specifically excluded by law. Some of the self-employment activities so excluded by law for taxable years ending before January 1, 1955, are the practice of certain professions, such as the medical, accounting and legal professions; or services as a minister or member of a religious order; or farming. For a list of excluded activities and income, see "EXCLUSIONS" on page 4 of separate Schedule C (Form 1040).

.02 *Taxable years ending after December 31, 1954.*—The Social Security Amendments of 1954 brings certain self-employed individuals, previously excluded, within the social security system. These changes are effective for taxable years ending after December 31, 1954. A citizen who is a Christian Science practitioner, architect, accountant, funeral director, engineer, minister, member of a religious order, or a farmer *and reports his income on the basis of a fiscal year beginning in 1954 and ending in 1955* should communicate with the district director of internal revenue with whom he files his return for detailed information regarding the changes in the law which affect his liability for self-employment tax.

SEC. 13. DECLARATION OF ESTIMATED TAX.

.01 *Who must file.*—Every citizen of the United States who, for taxable years beginning on or after January 1, 1955, expects to receive more than $100 of gross income during the taxable year from sources other than wages subject to withholding must file a declaration of estimated tax on Form 1040-ES if his gross income from all sources (exclusive of income exempt from tax) is reasonably expected to exceed the sum of $600 multiplied by the number of exemptions to which he is entitled, plus $400. A citizen who expects no more than $100 of gross income during the taxable year from sources other than wages subject to withholding is required to file a declaration if his gross income is reasonably expected to exceed $5,000 in the case of a single individual or a married person filing a separate declaration, $10,000 for a person who qualifies as a head of household or surviving widow or widower, and $5,000 in the case of a married person who files a joint declaration and the total income of both husband and wife can reasonably be expected to exceed $10,000. Specific instructions for the preparation and filing of the declaration are printed on Form 1040-ES and, with the exceptions mentioned herein, should be followed by citizens outside the United States.

.02 *Due date for filing declarations.*—The declaration is required to be filed on or before the 15th day of the 4th month of the taxable

year for which it is made. However, a citizen traveling or residing in a foreign country on the due date for filing the declaration is allowed an extension of time to and including the 15th day of the 6th month of the taxable year (June 15, for calendar-year taxpayers) for filing the declaration and payment, without interest, of all installments of estimated tax then due.

SEC. 14. WHERE RETURNS AND DECLARATIONS SHOULD BE FILED.

Income tax returns and declarations of estimated tax should be filed with the district director of internal revenue for the district in which the taxpayer's legal residence or principal place of business in the United States is located, or if he has no legal residence or place of business in the United States, with the District Director of Internal Revenue, Baltimore 2, Maryland, U. S. A.

SEC. 15. PENALTIES.

Citizens of the United States residing or present in foreign countries are liable, to the same extent as taxpayers within the United States, for all the penalties and additions to the tax imposed by law, including penalties and additions to the tax in respect of declarations and payments of estimated tax.

SEC. 16. WHERE FORMS MAY BE OBTAINED.

Necessary forms for the filing of returns, declarations, and/or claims for refund may be obtained from any district director of internal revenue and from most United States embassies and consulates.

SEC. 17. CORRESPONDENCE.

Any taxpayer desiring additional information concerning this Revenue Ruling or information relating to the law or regulations applicable to taxable years for which no return has been filed, may address a communication to the Commissioner of Internal Revenue, Attention: Assistant Commissioner (Technical), Washington 25, D. C. A taxpayer desiring information relating to a taxable year for which a return has been filed should communicate with the DISTRICT DIRECTOR OF INTERNAL REVENUE with whom his income tax return was filed.

SEC. 18. EFFECT ON OTHER DOCUMENTS.

Revenue Ruling 291, C. B. 1953-2, 42, is superseded by this Revenue Ruling.

(Also Part II, Section 116; Regulations 118, Section 39.116-1.) Rev. Rul. 55-246

The division of income on the community property basis does not alter the exempt character of income entitled to exemption under section 911(a) of the Internal Revenue Code of 1954. If the bona fide residence requirements of section 911(a)(1) or the physical presence requirements of section 911(a)(2) of the Code are met by the spouse who earns the income and the income qualifies as earned income within the meaning of section 911(b) of the Code, such income (subject to any limitations of the applicable section of the Code) is exempt from taxation on the individual income tax returns of the husband and wife filing separate returns in a community property State regardless of whether the other spouse meets the requirements specified in section 911(a) of the Code.

Advice has been requested relative to the application of section 911(a) of the Internal Revenue Code of 1954 (sec. 116(a) of the 1939 Code) to the wife's share of income earned by her husband without the United States, where the parties are domiciled in a community property State within the United States and file separate returns on the community property basis.

Section 911(a) of the Code provides with certain exceptions not here pertinent for the statutory exclusion from gross income of earned income from sources without the United States in the case of a United States citizen who is a bona fide resident of a foreign country or who during any period of 18 consecutive months is present in a foreign country or countries during at least 510 full days in such period.

The specific questions presented relate to whether the wife is required to include in her taxable income one-half of the income of her husband from foreign sources in the following cases:

(1) Husband and wife are citizens of the United States domiciled in a community property State in the United States. Husband accepted work in a foreign country with the wife remaining in the community property State. Husband remained in such foreign country for the period required to qualify under section 911(a)(2) of the Code and his income qualifies as earned income under section 911(b) of the Code. The community property system was in effect in the foreign country in which the husband was employed.

(2) The same situation as above except that the foreign country in which the husband worked was not subject to community property laws.

(3) Husband qualifies as a bona fide resident of a foreign country under section 911(a)(1) of the Code. His wife and family continue to live in a community property State in the United States and the marital domicile continues in such State.

The division of income on the community property basis does not alter the exempt character of income entitled to exemption under section 911(a) of the Code. See Revenue Ruling 54–16, C. B. 1954–1, 157. If the bona fide residence requirements of section 911(a)(1) or the physical presence requirements of section 911(a)(2) of the Internal Revenue Code of 1954 are met by the spouse who earns the income and the income qualifies as earned income within the meaning of section 911(b) of the Code, such income subject to any limitations of the applicable section of the Code is exempt from taxation on the individual income tax returns of the husband and wife filing separate returns in a community property State regardless of whether the other spouse meets the requirements specified in section 911(a) of the Code. Whether the community property system is in effect in the foreign country where the income is earned is immaterial.

Accordingly, in each of the situations presented, the wife may exclude from gross income on her separate return her share of the income earned by her husband without the United States which is excludable from gross income under the applicable provisions of section 911(a) of the Code. However, with respect to that portion of the earned income of the husband which is not exempt under the

provisions of 911(a) of the Code, the wife must include in gross income on her separate return her share of such earned income.

(Also Section 931.) Rev. Rul. 55-384
(Also Part II, Sections 116, 251(j); Regulations 118, Section 39.116-1.)

Kindergarten and nursery schools organized and operated on United States bases or installations located in foreign countries or possessions of the United States when operated on a permissive basis rather than under official instructions or regulations and the support of which is furnished by the parents of the pupils are not agencies or instrumentalities of the United States within the meaning of section 911(a) or 931(i) of the Internal Revenue Code of 1954 (sections 116(a) or 251(j) of the 1939 Code). Accordingly, United States citizens who receive compensation from such organizations are entitled to the benefits accorded by section 911(a)(1) or section 911(a)(2) or section 931 of the Code with respect to such income, provided the provisions of the applicable section of the Code are otherwise met. Compare Rev. Rul. 54-612, C. B. 1954-2, 169.

SUBPART C.—WESTERN HEMISPHERE TRADE CORPORATIONS

SECTION 921.—DEFINITION OF WESTERN HEMISPHERE TRADE CORPORATIONS

Rev. Rul. 55-105

The Internal Revenue Service has no comprehensive list of all the countries includible in the geographical territories referred to in section 921 of the Internal Revenue Code of 1954, relating to Western Hemisphere trade corporations. The Virgin Islands, Puerto Rico, the Greater Antilles, the Lesser Antilles, the Bahamas and the islands off the coast of Venezuela, in addition to the numerous islands in the West Indies, are considered to be Western Hemisphere trade corporation countries. See I. T. 3748, C. B. 1945, 152, and I. T. 4067, C. B. 1951-52, 55. However, neither Bermuda nor the Falkland Islands are considered to be Western Hemisphere trade corporation countries. See I. T. 3990, C. B. 1950-1, 57. Alaska, being a territory of the United States and therefore an integral part of this country, is not a country in North America within the contemplation of this section.

SUBPART D.—POSSESSIONS OF THE UNITED STATES

SECTION 931.—INCOME FROM SOURCES WITHIN POSSESSIONS OF THE UNITED STATES

Compensation received by a United States citizen, from kindergarten and nursery schools operated on United States bases or installations located in possessions of the United States which are operated on a permissive basis rather than under official instructions or regulations. See Rev. Rul. 55-384, above.

SUBCHAPTER O.—GAIN OR LOSS ON DISPOSITION OF PROPERTY

PART II.—BASIS RULES OF GENERAL APPLICATION

SECTION 1020.—ELECTION IN RESPECT OF DEPRECIATION, ETC., ALLOWED BEFORE 1952

26CFR, 1.1020-1: Election as to amounts allowed in respect of depreciation, etc., before 1952. T. D. 6125

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

Regulations prescribed under section 1020 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:

On December 14, 1954, a notice of proposed rulemaking with respect to section 1020 of the Internal Revenue Code of 1954 (Public Law 591, 83d Cong., approved August 16, 1954) was published in the Federal Register (19 F. R. 8537). No protests were received. The regulations so published have been modified and are hereby adopted as set forth below:

SEC. 1.1020. STATUTORY PROVISIONS; ELECTION IN RESPECT OF DEPRECIATION, ETC., ALLOWED BEFORE 1952.

SEC. 1020. ELECTION IN RESPECT OF DEPRECIATION, ETC., ALLOWED BEFORE 1952.

Any person may elect to have subparagraph (B) of section 1016(a)(2) apply in respect of periods since February 28, 1913, and before January 1, 1952. Such an election shall be made in such manner as the Secretary or his delegate may by regulations prescribe and shall be irrevocable when made, except that an election made on or before December 31, 1952, may be revoked at any time before January 1, 1955. A revocation of an election shall be made in such manner as the Secretary or his delegate may by regulations prescribe, and no election may be made by any person after he has so revoked an election. The election shall apply in respect of all property held by the person making the election at any time on or before December 31, 1952, and in respect of all periods since February 28, 1913, and before January 1, 1952, during which such person held such property or for which adjustments must be made under section 1016(b). An election or a revocation of an election by a transferor, donor, or grantor made after the date of the transfer, gift or grant of property shall not affect the basis of such property in the hands of the transferee, donee, or grantee. No election may be made under this section after December 31, 1954.

SEC. 1.1020-1. ELECTION AS TO AMOUNTS ALLOWED IN RESPECT OF DEPRECIATION, ETC., BEFORE 1952.—(a) *In general.*—(1) Any person may elect to have the adjustments to the cost or other basis of property under section 1016(a)(2) determined in accordance with subparagraph (B) of such section by filing a statement of election in accordance with the requirements set forth in paragraph (b), below. Any election made after 1952 shall be irrevocable when made. Any election made after 1952 shall apply with respect to all property held by the person making the election at any time on or before December 31, 1952, and shall apply to all periods since February 28, 1913, and before January 1, 1952, during which

such person held such property or for which adjustments must be made under section 1016(b). For rules with respect to an election made on or before December 31, 1952, see paragraph (c) of this section.

(2) An election by a partner on his own behalf is not an election for the partnership of which he is a member. A separate election must be made on behalf of the partnership. See section 703(b) (relating to elections of the partnership). An election on behalf of the partnership applies only with respect to the partnership, and does not apply to the separate property of the partners. A similar rule applies with respect to elections by trusts and beneficiaries of trusts. These rules also apply with respect to a revocation of an election where such election was made on or before December 31, 1952.

(b) *Rules applicable to making of election.*—The following rules are applicable to the making of an election under section 1020:

(1) *Form of election.*—The election shall be in the form of a statement in writing, shall state the name and address of the taxpayer making the election, and shall contain a statement that such taxpayer elects to have the provisions of section 1016(a)(2)(B) apply in respect of all periods since February 28, 1913, and before January 1, 1952.

(2) *Signature.*—The statement shall be signed by the taxpayer making the election, if an individual, or, if the taxpayer making the election is not an individual, the statement shall be signed by the person or persons required to sign the income return of such taxpayer.

(3) *Filing.*—The statement must be filed on or before December 31, 1954, in the office of the district director of internal revenue for the district in which the income return for the year of the election is required to be filed. For rules as to when timely mailing will be treated as timely filing of the statement see section 7502.

(4) *Filing of duplicate.*—A copy of the statement of election must be filed with the first return, amended return, or claim for refund filed on or after the date on which the election is made.

(c) *Election made on or before December 31, 1952*—An election made on or before December 31, 1952, in accordance with the provisions of section 113(d) of the Internal Revenue Code of 1939, may be revoked by filing on or before December 31, 1954, in the same office in which the election was filed, a statement of revocation signed in the same manner as the election. Such statement made by any person is irrevocable when made with respect to such person, and no new election may thereafter be made by such person. A copy of the revocation must be filed with the first return, amended return or claim for refund, filed after the date of the revocation. For additional rules with respect to election made on or before December 31, 1952, see sections 39.113(b)(1)-1 and 39.113(d)-1 of Regulations 118 (26 CFR, 1953 revision, pt. 39).

(d) *Validity of elections or revocation of elections.*—An election or revocation of an election which conforms in substance to the provisions of this section will not be deemed invalid solely because it was filed before the date the regulations under section 1020 were promulgated.

(e) *Effect of election.*—For rules relating to the effect of an election under this section see section 1016(a)(2) and the regulations thereunder.

(These regulations are issued under the authority contained in secs. 1020 and 7805 of the Internal Revenue Code of 1954 (68A Stat. 302, 917; 26 U. S. C. 1020, 7805).)

JUSTIN F. WINKLE,
Acting Commissioner of Internal Revenue.

Approved March 8, 1955.

M. B. FOLSOM,
Acting Secretary of the Treasury.

(Filed with the Division of the Federal Register March 10, 1955, 8:48 a. m.)

SUBCHAPTER P.—CAPITAL GAINS AND LOSSES

PART III.—GENERAL RULES FOR DETERMINING CAPITAL GAINS AND LOSSES

SECTION 1223.—HOLDING PERIOD OF PROPERTY

The period of new shares of the surviving corporation in exchange for the old shares pursuant to a reorganization. See Rev. Rul. 55-45, page 34.

PART IV.—SPECIAL RULES FOR DETERMINING CAPITAL GAINS AND LOSSES

SECTION 1235.—SALE OR EXCHANGE OF PATENTS

(Also Part II, Section 22(a); Regulations 118, Section 39.22(a)-1. Rev. Rul. 55-58

Many requests have been received for reconsideration of Mimeograph 6490, C. B. 1950-1, 9, relating to the treatment of amounts received by inventors from the assignment of a patent, or the exclusive right to make, use and sell a patented article under a license agreement, where such amounts are not subject to the provisions of section 1235 of the Internal Revenue Code of 1954.

Mimeograph 6490, *supra*, holds that, effective for taxable years beginning after May 31, 1950, payments received by inventors from the assignment of a patent or the license of the exclusive right to make, use and sell a patented article under an agreement whereby payments are measured by production, sale, or use by the transferee, or are payable periodically over a period generally coterminous with the transferee's use of the patent, constitute ordinary income.

A careful study of the problem has been made, taking into consideration, among other things, recent court decisions which support the position taken by the Internal Revenue Service in 1950. See *Bloch* v. *United States*, 200 Fed. (2d) 63, certiorari denied, 345 U. S. 935; and *Broderick* v. *Neale*, 201 Fed. (2d) 621. Accordingly, it is concluded that Mimeograph 6490, *supra*, should not be disturbed. In reaching this conclusion, the Revenue Service has considered the decisions in *Edward C. Myers* v. *Commissioner*, 6 T. C. 258; *Commissioner* v. *Celanese Corp. of America*, 140 Fed. (2d) 339; and *Allen* v. *Werner*, 190 Fed. (2d) 840.

Although section 1235 of the Internal Revenue Code of 1954 specifically provides that, with specified exceptions, such payments received in 1954 and subsequent years will receive capital gains treatment in the hands of the inventor, this provision of the 1954 Code is applicable only to amounts received in taxable years beginning after December 31, 1953, and therefore does not apply to amounts received in taxable years beginning after May 31, 1950, and before January 1, 1954.

Accordingly, except as section 1235 of the Internal Revenue Code of 1954 applies, the Internal Revenue Service will continue to treat as ordinary income the payments received by inventors during taxable years beginning after May 31, 1950, from such transfers.

CHAPTER 2.—TAX ON SELF-EMPLOYMENT INCOME

SECTION 1402.—DEFINITIONS

(Also Part II, Section 481; Regulations 118, Section 39.481–1.) Rev. Rul. 55–172

Income derived from sources without the United States by an American citizen engaged in a trade or business as a scientific consultant, is includible in computing net earnings from self-employment for purposes of the Self-Employment Contributions Act, subject to the provisions of section 911 of the Internal Revenue Code of 1954.

A question has been raised whether income derived from sources without the United States by an American citizen engaged in a trade or business as a scientific consultant is includible in computing net earnings from self-employment for purposes of the Self-Employment Contributions Act (chapter 2, subtitle A, Internal Revenue Code of 1954).

In the instant case, an American citizen is engaged in carrying on scientific research as an independent contractor in a foreign country.

Section 1402(a) of the Self-Employment Contributions Act defines "net earnings from self-employment," in part, as follows:

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, of the Code] which are attributable to such trade or business, * * *

It is held that income derived from sources without the United States by an American citizen engaged in a trade or business as a scientific consultant is includible in computing net earnings from self-employment for purposes of the Self-Employment Contributions Act, subject to the provisions of section 911 of the 1954 Code. See Rev. Rul. 55–171, page 80.

(Also Section 3121.)
(Also Part II, Sections 481, 1426; Regulations 118, Section 39.481–3, Regulations 128, Section 408.204.) Rev. Rul. 55–328

The owner of a cemetery entered into a contract with an individual to perform services as sexton of the cemetery for a 6-months' period. The individual agreed to furnish all labor and maintain the cemetery to the satisfaction of the owner for a lump-sum payment. *Held*, (1) the individual is not an employee of the cemetery owner with respect to his services as sexton; and (2) the income derived by him for such services should be considered in computing net earnings from self-employment for purposes of the Self-Employment Contributions Act.

An inquiry has been received relative to the status, for purposes of the Federal Insurance Contributions Act (chapter 21, subtitle C, Internal Revenue Code of 1954) and the Self-Employment Contributions Act (chapter 2, subtitle A, Internal Revenue Code of 1954) of a cemetery sexton under the circumstances described below.

The cemetery is owned and operated by a corporation which entered into a contract with an individual to perform services as sexton of the

cemetery for a 6-months' period. Under the terms of the contract, the sexton agreed to maintain the cemetery to the satisfaction of the corporation and to furnish all labor necessary for its maintenance. The corporation agreed to compensate the sexton on a lump-sum basis for the 6-months' period. The contract specifically provided that "the sexton is engaged as an independent contractor."

The sexton determines his own routine, works when he chooses, and receives no instructions in the performance of his services. His duties consist of mowing grass, taking care of the graves, and maintaining all walks and avenues. He has complete control over the individuals who assist him and all Federal Insurance Contributions Act taxes and income tax on their wages are withheld and paid by him. He installs all memorial footings, furnishes the materials for the footings, and receives all revenue therefrom. He uses his own pickup truck and hand tools.

Section 3121(d) of the Federal Insurance Contributions Act as amended 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 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, until superseded by regulations issued under the 1954 Code.

The determination whether an employer and employee relationship exists depends upon the particular facts of each case. If 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 the facts show that such relationship exists, it is of no consequence that the employee is designated as an independent contractor. In the instant case, however, the facts substantiate the designation in the contract of the sexton as an "independent contractor." The sexton entered into the contract with the corporation to maintain the cemetery to the satisfaction of the corporation for a specified amount. He agreed to furnish all labor necessary to maintain the cemetery and received no instructions in the performance of his services. He determined his own routine and worked when he chose. It is, therefore, held that the sexton is not an employee of the corporation with respect to such services for Federal Insurance Contributions Act purposes.

Since the individual is not an employee for Federal Insurance Contributions Act purposes, the question arises as to whether his activities as a sexton of the cemetery constitute a "trade or business," for purposes of the Self-Employment Contributions Act, and whether the income derived therefrom is subject to the tax imposed under that Act.

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 Internal Revenue Code, with certain exceptions not here material.

As a general rule, a person who is regularly engaged in an occupation or profession for profit, which constitutes, in whole or in part, his livelihood, and who is not an employee for purposes of the Federal Insurance Contributions Act, is engaged in a "trade or business."

Under the circumstances stated herein, it is concluded that the individual is engaged in a "trade or business" with respect to his services as sexton of the cemetery and the income he derives from such services should be included in computing net earnings from self-employment.

(Also Part II, Section 481; Regulations 118, Section 39.481–1.) Rev. Rul. 55-385

An individual is employed as a professor by a State university. As sideline activities, separate and apart from his services for the university, the individual is engaged in writing books and giving lectures for profit. *Held*, the royalties and other income received by the individual from the sideline activities are includible in computing net earnings from self-employment for purposes of the Self-Employment Contributions Act of 1954.

An inquiry has been received whether royalties and other income received by a professor employed by a State university, who writes books and gives lectures as sideline activities, may be includible in computing net earnings from self-employment under the Self-Employment Contributions Act of 1954 (chapter 2, subtitle A, Internal Revenue Code of 1954).

In the instant case, a professor, employed by a State university to perform full-time teaching services at the university, is engaged in sideline activities involving public lecturing and the writing of several books. One of his books is a college textbook which he revises from time to time under contract with the publisher; another is a laboratory manual which he has devised for the use of students at the university where he teaches and which he sells direct to them. He receives royalties from the publisher from the sale of his textbook. During the past year, the publisher made him an advance on his royalties with respect to the preparation of a current revision of the textbook. Although the books and lectures are in the general field of education, they are the result of his own initiative and are not instigated pursuant to his employment contract with the university. Also, although the amounts which he receives from these sideline activities vary from year to year, they exceed the minimum requirement of $400 per year for self-employment tax purposes.

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, * * * except that such term shall not include—

* * * * * * *

(2) the performance of service by an individual as an employee * * *.

Admittedly, the relationship between the university and the professor is that of employer and employee under the common law rules used, for Federal employment tax purposes, in arriving at such a determination. See S. S. T. 341, C. B. 1938-2, 297. This is true even though, for Federal employment tax purposes, such services are excepted from "employment" by sections 3121(b)(7) and 3306(c)(7) of the Federal Insurance Contributions Act and the Federal Unemployment Tax Act (chapters 21 and 23, respectively, subtitle C, Internal Revenue Code of 1954). Therefore, the services of the individual as a professor for the university are excluded from the term "trade or business," by virtue of section 1402(c)(2) of the Act. However, the sideline activities engaged in by the professor are entirely separate from his services for the university and with respect to such activities he is not an employee.

Whether or not an individual is engaged in a trade or business depends upon the facts in the particular case. As a general rule, a person who is regularly engaged in an occupation or profession for profit which constitutes in whole or in part his livelihood, and who is not regarded as an employee for Federal Insurance Contributions Act purposes, is engaged in a trade or business for self-employment tax purposes. If an individual writes only one book as a sideline and never revises it, he would not be considered to be "regularly engaged" in an occupation or profession and his royalties therefrom would not be considered net earnings from self-employment. However, where an individual prepares new editions of the book from time to time, writes other books and materials, and lectures professionally, such activities reflect the conduct of a trade or business, and, if it is not one of the excluded professions of section 1402(c) of the Self-Employment Contributions Act, the income from it is includible in computing net earnings from self-employment, subject to the limitations of section 1402(b) of the Act.

In the instant case, it is held that the sideline activities of the professor constitute a trade or business for purposes of the Self-Employment Contributions Act. To the extent that the income from those activities does not exceed the limitations of $3,600 (for 1954) and $4,200 (for any taxable year ending after 1954), after considering the amount of any wages paid to him during the year, as set forth in section 1402(b) of that Act, the royalties and other income received by him from those sideline activities are to be taken into account in computing his net earnings from self-employment for such purposes.

Income derived from the operation of a watch repair department within a jewelry store. See Rev. Rul. 55-248, page 117.

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 Part II, Section 143; Regulations 118, Section 39.143-3.) Rev. Rul. 55-106

Letters of notification of exemption from withholding tax, which are filed by nonresident aliens with a withholding agent as an authorization for the payment of income without withholding of United States income tax at source, pursuant to a tax convention between the United States and the country of residence of the nonresident alien, shall be filed with the withholding agent for each successive three-calendar-year period during which the income is paid.

Advice has been requested whether a letter of notification of exemption from withholding of United States income tax filed with a withholding agent by a nonresident alien pursuant to a tax convention is required to be renewed and filed every three calendar years.

Section 1441 of the Internal Revenue Code of 1954 requires that all persons, in whatever capacity acting, having the control or payment of certain items of income, to the extent that such items constitute gross income from sources within the United States, of any nonresident alien individual, shall deduct and withhold from such items a tax equal to 30 percent thereof.

Pursuant to reciprocal income tax, conventions between the United States and various foreign countries, certain items of income are exempt from United States tax and the withholding rate on certain other items of income is less than 30 percent thereof. In order to stop the withholding of United States income tax at source on exempt income, it is necessary for the nonresident alien to file with the withholding agent a letter of notification of exemption. See, for example, Treasury Decision 5499, C. B. 1946-1, 134, section 7.418, with regard to regulations prescribed for the convention between the United States and France. These letters of notification of exemption are used in the place of forms prescribed in regulations governing some conventions.

Where forms are prescribed, as in the administration of the convention between the United States and the Kingdom of Denmark, Treasury Decision 5692, C. B. 1949-1, 104, it is required that they be filed for each 3-calendar-year period. However, it is not stated whether the letters of exemption prescribed in Treasury Decision 5499, *supra*, and in some other cases, cover an indefinite period of exemption or must be renewed every 3 years as in the case of the forms.

It will be noted that after the use of forms became general under later conventions, regulations prescribing the use of letters instead

of forms followed the pattern established with respect to forms generally and made the same provisions as to the effective period applicable to both. In this regard, Treasury Decision 5897, C. B. 1952-1, 89, prescribing withholding regulations under the convention between the United States and the Republic of Ireland, provides that the letter of notification there prescribed, in section 7.1002(b), must be renewed for each 3-calendar-year period.

Accordingly, it is held that letters of notification of exemption from withholding tax, used where forms are not prescribed, filed with a withholding agent, by a nonresident alien, as an authorization for the payment of income without withholding of United States income tax at source, pursuant to a tax convention, shall be renewed and filed with the withholding agent for each successive 3-calendar-year period during which the income is payable.

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 Federal Republic of Germany, as affected by the income tax convention between the United States and the Federal Republic of Germany. See T. D. 6122, page 641.

Release of excess tax withheld, and exemption from, or reduction in rate of, withholding tax at source in the case of residents of Japan, as affected by the income tax convention between the United States and Japan. See T. D. 6130, page 665.

Earnings of a pension trust derived by a resident trustee of a United State subsidiary of a Canadian corporation. See Rev. Rul. 55-200, page 633.

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 German companies, as affected by the income tax convention between the United States and the Federal Republic of Germany. See T. D. 6122, page 641.

Release of excess tax withheld, and exemption from, or reduction in rate of, withholding of tax at source in the case of Japanese corporations, as affected by the income tax convention between the United States and Japan. See T. D. 6130, page 665.

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CHAPTER 4.—RULES APPLICABLE TO RECOVERY OF EXCESSIVE PROFITS ON GOVERNMENT CONTRACTS

SUBCHAPTER A.—RECOVERY OF EXCESSIVE PROFITS ON GOVERNMENT CONTRACTS

SECTION 1471.—RECOVERY OF EXCESSIVE PROFITS ON GOVERNMENT CONTRACTS

(Also Section 1481.) Rev. Rul. 55-173
(Also Part II, Section 3806.)

Contracts or subcontracts subject to renegotiation under the Renegotiation Act of 1951, 65 Stat. 7, 50 U. S. C. 1211-1233, C. B. 1951-1, 180, as amended and extended by Public Law 764, approved September 1, 1954, page 620 of this Bulletin, 68 Stat. 1116, 50 App. U. S. C. 1519, are exempt from the profit-limitation provisions of the Vinson Act, 48 Stat. 503, 505, 34 U. S. C. 494, as amended. Contracts or subcontracts exempted from renegotiation under section 106(a)(8) of the Renegotiation Act of 1951, *supra*, or which otherwise are not subject to renegotiation, are subject to the profit-limitation provisions of the Vinson Act, *supra*, if they are for the construction and/or manufacture of any complete naval vessel or Army or Navy aircraft, or any portion thereof, and are otherwise within the scope of such provisions.

Advice has been requested as to whether the exemption from renegotiation of certain contracts and subcontracts under the provisions of section 106(a)(8) of the Renegotiation Act of 1951, 65 Stat. 7, 50 U. S. C. 1211-1233, C. B. 1951-1, 180, as amended and extended by Public Law 764, approved September 1, 1954, 68 Stat. 1116, 50 App. U. S. C. 1519, will cause the profit-limitation provisions (sec. 3) of the Vinson Act, 48 Stat. 503, 505, 34 U. S. C. 494, as amended, which were suspended in certain cases under the provisions of section 102(d) of the Renegotiation Act of 1951, *supra*, to be applicable with respect to such contracts and subcontracts.

Section 106 of the Renegotiation Act of 1951, as amended, *supra*, provides in part as follows:

(a) MANDATORY EXEMPTIONS.—The provisions of this title shall not apply to—

* * * * * * *

(8) any contract or subcontract for the making or furnishing of a standard commercial article, unless the Board makes a specific finding that competitive conditions affecting the sale of such article are such as will not reasonably prevent excessive profits. This paragraph shall apply to any such contract or subcontract only if (1) the contractor or subcontractor files, at such time and in such form and detail as the Board shall by regulations prescribe, such information and data as may be required by the Board under its regulations for the purpose of enabling it to reach a decision with respect to the making of a specific finding under this paragraph, and (2) within a period of six months after the date of filing of such information and data, the Board fails to make a specific finding that competitive conditions affecting the sale of such article are such as will not reasonably prevent excessive profits, or (3) within such six-month period, the Board makes a specific finding that competitive conditions affecting the sale of such article are such as will reasonably prevent excessive profits. Any contractor or subcontractor may waive the exemption provided in this paragraph with respect to receipts or accruals in any fiscal year by including a

statement to such effect in the financial statement filed by such contractor or subcontractor for such fiscal year pursuant to section 105(e)(1). * * *

Under section 5(b) of Public Law 764, *supra*, section 106(a)(8) of the Renegotiation Act of 1951, as amended, *supra*, "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."

Under the Renegotiation Act of 1948, 62 Stat. 259, 50 U. S. C. 1193, C. B. 1948-1, 238, and the Renegotiation Act of 1950, 64 Stat. 754, C. B. 1950-2, 248, all Vinson Act contracts entered into after May 21, 1948, and all subcontracts thereunder generally are exempt from the profit-limitation provisions of the Vinson Act, except those which have been exempted from renegotiation by the Secretary of Defense (or his delegate) as authorized in subsections (d) and (g) of the Renegotiation Act of 1948, *supra*. See I. T. 4022, C. B. 1950-2, 147.

Section 102(d) of the Renegotiation Act of 1951, *supra*, provides that the profit-limitation provisions of the Vinson Act shall not apply to any contract or subcontract if any of the receipts or accruals therefrom are subject to Title 1 of that Renegotiation Act. Public Law 764, *supra*, extended and amended the Renegotiation Act of 1951 without change as to such suspension or exemption provisions. Under the provisions of section 1 of Public Law 764, *supra*, renegotiation will not be applicable to receipts or accruals attributable to performance after December 31, 1954.

Accordingly, based on the foregoing provisions, it is held that contracts or subcontracts subject to renegotiation under the Renegotiation Act of 1951, *supra*, as amended and extended, are exempt from the profit-limitation provisions of the Vinson Act. Contracts and subcontracts exempted from renegotiation under section 106(a)(8) of the Renegotiation Act of 1951, *supra*, or which otherwise are not subject to renegotiation, are subject to the profit-limitation provisions of the Vinson Act if they are for the construction and/or manufacture of any complete naval vessel or Army or Navy aircraft, or any portion thereof, and are otherwise within the scope of such provisions.

SUBCHAPTER B.—MITIGATION OF EFFECT OF RENEGOTIATION OF GOVERNMENT CONTRACTS

SECTION 1481.—MITIGATION OF EFFECT OF RENEGOTIATION OF GOVERNMENT CONTRACTS

Effect of Vinson Act, 48 Stat. 503 at 505, 34 U. S. C. 494, as amended, on contracts and subcontracts subject to or exempted from renegotiation under the Renegotiation Act of 1951, 65 Stat. 7, 51 U. S. C. 5, C. B. 1951-1, 180, as amended and extended. See Rev. Rul. 55-173, page 104.

CHAPTER 5.—TAX ON TRANSFERS TO AVOID INCOME TAX

SECTION 1491.—IMPOSITION OF TAX

26 CFR 1.1491-1: Imposition of tax. T. D. 6127
(Also Sections 1492, 1493, 1494; 26 CFR 1.1492-1, 1.1493-1, 1.1494-1.)

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

Regulations prescribed under chapter 5 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:

On January 28, 1955, notice of proposed rulemaking with respect to regulations under chapter 5 (relating to tax on transfers to avoid income tax) of the Internal Revenue Code of 1954 (Public Law 591, 83d Cong., approved August 16, 1954), was published in the Federal Register (20 F. R. 619). No comments regarding the regulations proposed were received during the 30-day period prescribed in such notice, and the regulations as so published are hereby adopted.

TAX ON TRANSFERS TO AVOID INCOME TAX

SEC. 1.1491, STATUTORY PROVISIONS; IMPOSITION OF TAX.

SEC. 1491. IMPOSITION OF TAX.

There is hereby imposed on the transfer of stock or securities by a citizen or resident of the United States, or by a domestic corporation or partnership, or by a trust which is not a foreign trust, to a foreign corporation as paid-in surplus or as a contribution to capital, or to a foreign trust, or to a foreign partnership, an excise tax equal to 27½ percent of the excess of—

(1) The value of the stock or securities so transferred, over

(2) Its adjusted basis (for determining gain) in the hands of the transferor.

SEC. 1.1491-1. IMPOSITION OF TAX.—Section 1491 imposes an excise tax upon transfers of stock or securities by a citizen or resident of the United States, or by a domestic corporation or partnership, or by a trust which is not a foreign trust, to a foreign corporation as paid-in surplus or as a contribution to capital, or to a foreign trust, or to a foreign partnership. The tax is in an amount equal to 27½ percent of the excess of (a) the value of the stock or securities so transferred over (b) its adjusted basis, as provided in section 1011, for determining gain in the hands of the transferor.

SEC. 1.1492. STATUTORY PROVISIONS; NONTAXABLE TRANSFERS.

SEC. 1492. NONTAXABLE TRANSFERS.

The tax imposed by section 1491 shall not apply—

(1) If the transferee is an organization exempt from income tax under part I of subchapter F of chapter 1 (other than an organization described in section 401(a)); or

(2) If before the transfer it has been established to the satisfaction of the Secretary or his delegate that such transfer is not in pursuance of a plan having as one of its principal purposes the avoidance of Federal income taxes.

SEC. 1.1492-1. NONTAXABLE TRANSFERS.—(a) The tax imposed by section 1491 does not apply:

(1) If the transferee is an organization (other than an organization described in section 401(a)) exempt from income tax under the provisions of sections 501 to 504, inclusive; or

(2) If before the transfer it has been established to the satisfaction of the Commissioner of Internal Revenue that the transfer is not in pursuance of a plan having as one of its principal purposes the avoidance of Federal income taxes.

(b) Whether a transfer of stock or securities is in pursuance of a plan having as one of its principal purposes the avoidance of Federal income taxes is a question to be determined from the facts and circumstances of each particular case. In any such case where a transferor desires to establish that the transfer is not in pursuance of such a plan, a statement of the facts relating to the plan under which the transfer is to be made or was made, together with a copy of the plan if in writing, shall be forwarded to the Commissioner of Internal Revenue, Washington 25, D. C., for a ruling. This statement shall contain, or be verified by, a written declaration that it is made under the penalties of perjury. A letter notifying the transferor of the Commissioner's determination will be mailed to the transferor.

SEC. 1.1493. STATUTORY PROVISIONS; DEFINITION OF FOREIGN TRUST.

SEC. 1493. DEFINITION OF FOREIGN TRUST

A trust shall be considered a foreign trust within the meaning of this chapter if, assuming a subsequent sale by the trustee, outside the United States and for cash, of the property so transferred, the profit, if any, from such sale would not be included in the gross income of the trust under this subtitle.

SEC. 1.1493-1 DEFINITION OF FOREIGN TRUST.—(a) A trust is to be considered a "foreign trust" within the meaning of chapter 5 if, assuming a subsequent sale by the trustee, outside the United States and for cash, of the property transferred to the trust, the profit, if any, from such sale (being income from sources without the United States under the provisions of sections 861 to 864, inclusive) would not be included in the gross income of the trust under subtitle A.

(b) A domestic corporation or partnership is one organized or created in the United States, including only the States, the Territories of Alaska and Hawaii, and the District of Columbia, or under the law of the United States or of any State or Territory; and a foreign corporation or partnership is one which is not domestic.

SEC. 1.1494. STATUTORY PROVISIONS; PAYMENT AND COLLECTION.

SEC. 1494. PAYMENT AND COLLECTION.

(a) TIME FOR PAYMENT.—The tax imposed by section 1491 shall, without assessment or notice and demand, be due and payable by the transferor at the time of the transfer, and shall be assessed, collected, and paid under regulations prescribed by the Secretary or his delegate.

(b) ABATEMENT OR REFUND.—Under regulations prescribed by the Secretary or his delegate, the tax may be abated, remitted, or refunded if after the transfer it has been established to the satisfaction of the Secretary or his delegate that such transfer was not in pursuance of a plan

having as one of its principal purposes the avoidance of Federal income taxes.

SEC. 1.1494-1. RETURNS; PAYMENT AND COLLECTION OF TAX.—(a) *Returns and payment.*—Every person making a transfer described in section 1491 shall make a return to the district director on the day on which the transfer is made and, unless the transfer is nontaxable under section 1492, pay the tax due on such transfer. This return, which shall contain, or be verified by, a written declaration that it is made under the penalties of perjury, shall be made on Form 926 and shall be filed with the district director to whom the transferor's return of income is required to be made. The return shall set forth in detail the following information:

(1) Name and address of transferor, and place of organization or creation, if a corporation, partnership, or trust.

(2) Name and address of transferee, place of organization or creation, and whether the transferee is a foreign corporation, a foreign trust, or a foreign partnership. If the transferee is a foreign trust or a foreign partnership, the name and address of the fiduciary and each beneficiary, in the case of a trust, or of each partner, in the case of a partnership, must be shown.

(3) Description and amount of stock or securities transferred, the date of transfer, and a complete statement showing all the facts relating to the transfer, accompanied by a copy of the plan under which the transfer was made.

(4) The fair market value of the stock or securities transferred as of the date of transfer, and the adjusted basis provided in section 1011 for determining gain in the hands of the transferor.

(5) Whether the transfer was made in pursuance of a plan submitted to and approved by the Commissioner of Internal Revenue as not having as one of its principal purposes the avoidance of Federal income taxes. If the plan has been so approved, a copy of the Commissioner's letter approving the plan shall accompany the return.

(6) Such other information as may be required by the return form.

(b) *Certificate.*—(1) If the transferee of the stock or securities, the transfer of which is reported in the return, is a foreign organization meeting the tests of exemption from income tax provided in sections 501 to 504, inclusive, and the transferor on that account claims that no liability for tax is imposed by section 1491, such transferor must file with Form 926 a certificate establishing the exemption of the transferee under sections 501 to 504, inclusive. This certificate, which shall contain, or be verified by, a written declaration that it is made under the penalties of perjury, shall contain complete information showing the character of the transferee, the purpose for which it was organized, its actual activities, the source of its income and the disposition of such income, whether or not any of its income is credited to surplus or may inure to the benefit of any private shareholder or individual, and in general all facts relating to its operations which affect its right to exemption. To such certificate shall be attached a copy of the charter or articles of incorporation, the by-laws of the organization, and the latest financial statement showing the assets, liabilities, receipts, and disbursements of the organization.

(2) If the transferee is a foreign organization which has been held to be exempt from income tax under sections 501 to 504, inclusive (or corresponding provisions of prior law), a copy of the Commissioner's letter so holding shall be filed with Form 926 in lieu of the above certificate and attachments.

(c) *Assessment and collection.*—The determination, assessment, and collection of the tax and the examination of returns and claims filed pursuant to chapter 5 will be made under such procedure as may be prescribed from time to time by the Commissioner.

SEC. 1.1494–2. EFFECTIVE DATE.—Chapter 5 of the Internal Revenue Code of 1954 (secs. 1491 through 1494) and the regulations prescribed thereunder apply with respect to transfers occurring after December 31, 1954. (See sec. 7851(a)(1)(B).) Chapter 7 of the Internal Revenue Code of 1939 (secs. 1250 through 1254) and the regulations applicable thereto apply with respect to transfers occurring prior to January 1, 1955.

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

T. COLEMAN ANDREWS,
Commissioner of Internal Revenue.

Approved March 15, 1955.

M. B. FOLSOM,
Acting Secretary of the Treasury.

(Filed with the Division of the Federal Register March 17, 1955, 8:49 a. m.)

SECTION 1492.—NONTAXABLE TRANSFERS

26 CFR 1.1492–1: Nontaxable transfers.

Regulations under chapter 5 of the Internal Revenue Code of 1954 relating to transfers of stock and securities to foreign enterprises to avoid income tax. See T. D. 6127, page 106.

SECTION 1493.—DEFINITIONS OF FOREIGN TRUST

26 CFR 1.1493–1: Definition of foreign trust.

Regulations under chapter 5 of the Internal Revenue Code of 1954 relating to transfers of stock and securities to foreign enterprises to avoid income tax. See T. D. 6127, page 106.

SECTION 1494.—PAYMENT AND COLLECTION

26 CFR 1.1494–1: Returns; payment and collection of tax.

Regulations under chapter 5 of the Internal Revenue Code of 1954 relating to transfers of stock and securities to foreign enterprises to avoid income tax. See T. D. 6127, page 106.

CHAPTER 6.—CONSOLIDATED RETURNS

SUBCHAPTER A.—RETURNS AND PAYMENT OF TAX

SECTION 1501.—PRIVILEGE TO FILE CONSOLIDATED RETURNS

Extension of time for filing a short taxable year return of a subsidiary corporation. See Rev. Rul. 55-108, page 140.

Extension of time for filing consolidation returns. See Rev. Rul. 55-174, page 141.

SUBTITLE B.—ESTATE AND GIFT TAXES

CHAPTER 11.—ESTATE TAX

SUBCHAPTER A.—ESTATE OF CITIZENS OR RESIDENTS

PART III.—GROSS ESTATE

SECTION 2031.—DEFINITION OF GROSS ESTATE

(Also Sections 2032, 2512.) Rev. Rul. 55-71
(Also Part II, Sections 811, 1005; Regulations 105, Section 81.10; Regulations 108, Section 86.19.)

The Federal excise tax on jewelry, furs, and related articles of personal property is a relevant factor which should be considered in determining the fair market value of such property for Federal estate and gift tax purposes.

Advice has been requested whether the Federal excise tax on jewelry, furs and related articles of personal property should be considered in determining the fair market value of such property for Federal estate and gift tax purposes.

Sections 2031, 2032, and 2512 of the Internal Revenue Code of 1954 (sections 811 and 1005 of the Internal Revenue Code of 1939) require that the property to be included in the decedent's gross estate, or made the subject of a gift, shall be taxed on the basis of the value of the property at the time of the death of the decedent, the optional valuation date, if so elected, or the date of gift.

Section 81.10 of Estate Tax Regulations 105 and section 86.19 of Gift Tax Regulations 108, made applicable here by Treasury Decision 6091, C. B. 1954-2, 47, provide that the value of property includible in the decedent's gross estate or made the subject of a gift, is its

fair market value as of the applicable valuation date or at the time of the gift. Those sections define fair market value as the price at which the property would change hands between a willing buyer and a willing seller when the former is not under any compulsion to buy and the latter is not under any compulsion to sell. The regulations further provide that all relevant facts and elements of value as of the applicable valuation date should be considered.

While the determination of fair market value is a question of fact, the question of which criterion or standard should be used in determining the value of property for estate or gift tax purposes is a question of law. See *Madeleine D. Powers* v. *Commissioner*, 312 U. S. 259, Ct. D. 1489, C. B. 1941-1, 448.

In *Rose Publicker* v. *Commissioner*, 206 Fed. (2d) 250, certiorari denied, 346 U. S. 924, it was held that where jewelry was purchased at retail by a taxpayer and made the subject of gifts, the Federal excise tax should be included in ascertaining the value of the jewelry for Federal gift tax purposes. The court stated that in view of the irreconcilable conflict of testimony of the expert witnesses, the cost of the jewelry, including that part of the donor's cost of the gifts which represented the Federal excise tax, was considered as the best evidence of value. To the same effect, see *Anthony D. Duke* v. *Commissioner*, 200 Fed. (2d) 82, certiorari denied, 345 U. S. 906, and *Estate of Frank M. Gould* v. *Commissioner*, 14 T. C. 414.

In *Florence Guggenheim* v. *Rasquin*, 312 U. S. 254, Ct. D. 1487, C. B. 1941-1, 445, it was held that the value of single premium life insurance policies, which were irrevocably assigned simultaneously with issuance, is cost to the donor rather than their cash surrender value at the time of the transfer. The Court stated, "Presumptively the value of these policies at the date of the gift was the amount which the insured had expended to acquire them. Cost is cogent evidence of value. And here it is the only suggested criterion which reflects the value to the owner * * *. Cost in this situation is not market price in the normal sense of the term. But the absence of market price is no barrier to valuation." See also *Estate of Richard C. DuPont* v. *Commissioner*, 18 T. C. 1134, wherein the Tax Court held that, for estate tax purposes, the proper measure of the value of certain insurance policies, owned by the decedent on the life of his father, was the replacement cost thereof or, in the absence of such replacement cost, the respective interpolated terminal reserve value thereof.

The existence of the Federal excise tax on jewelry, furs, and other related articles of personal property sold by dealers, is an item which will tend to increase the amount at which an individual or an estate would be willing to sell such property. It is an element which affects the general market for that type of property.

In view of the foregoing, it is held that the Federal excise tax on jewelry, furs, and related articles of personal property is a relevant factor which should be considered in determining the fair market value of such property for Federal estate and gift tax purposes.

SECTION 2032.—ALTERNATE VALUATION

Valuation of jewelry, furs, and related articles of personal property in Federal estate tax returns. See Rev. Rul. 55–71, page 110.

SECTION 2033.—PROPERTY IN WHICH THE DECEDENT HAD AN INTEREST

(Also Part II, Section 811(a); Regulations 105, Section 81.13.) Rev. Rul. 55–87

The lump sum payable under Title II of the Social Security Act, as amended, to the widow or widower of the deceased or to any person or persons equitably entitled thereto is not includible in the decedent's gross estate for Federal estate tax purposes.

Advice has been requested whether the lump sum payment received by the executors or administrators of the estate pursuant to section 202(i) of the Social Security Act, as amended, Public Law 269, Eighty-third Congress, approved August 14, 1953, 67 Stat. 580, 42 U. S. C. 402(i), is includible in the decedent's gross estate for Federal estate tax purposes.

Section 2033 of the Internal Revenue Code of 1954 (section 811(a) of the 1939 Code) provides as follows:

The value of the gross estate shall include the value of all property (except real property situated outside of the United States) to the extent of the interest therein of the decedent at the time of his death.

Section 202(i) of the Social Security Act, as amended, provides in part as follows:

Upon the death, after August 1950, of an individual who died a fully or currently insured individual, an amount equal to three times such individual's primary insurance amount shall be paid in a lump sum to the person, if any, determined by the Administrator to be the widow or widower of the deceased and to have been living with the deceased at the time of death. If there is no such person, or if such person dies before receiving payment, then such amount shall be paid to any person or persons equitably entitled thereto, to the extent and in the proportions that he or she shall have paid the expenses of burial of such insured individual. * * *.

Examination of the nature of the payments under the above-quoted section of the Social Security Act discloses that the decedent had no control over the designation of the beneficiary or the amount of the payment since these are fixed by the statute. Furthermore, the decedent had no property interest in the "Federal Old Age and Survivors Insurance Trust Fund" from which the payment is made.

In view of the foregoing, it is held that the lump sum death payment received by the executors or administrators of the estate of the decedent under Title II of the Social Security Act, as amended, does not constitute property of the decedent at the time of his death within the meaning of section 2033 of the Internal Revenue Code of 1954. Accordingly, the lump sum death payment is not includible in the decedent's gross estate for Federal estate tax purposes. Compare E. T. 10, C. B. 1937–2, 469, and E. T. 18, C. B. 1940–2, 285.

CHAPTER 12.—GIFT TAX

SUBCHAPTER A.—DETERMINATION OF TAX LIABILITY

SECTION 2503.—TAXABLE GIFTS

(Also Part II, Section 1003(b); Regulations 108, Section 86.11.) Rev. Rul. 55-408

Where a policy of insurance, which grants to the owner the usual incidents of ownership, including the right to change the beneficiary and the right to surrender the policy for its cash value, if any, is transferred or assigned to a donee as absolute owner, and the donee, or his guardian, is not restricted in any manner from exercising all legal incidents of ownership in the policy, by prior endorsement or otherwise, a gift of the policy and subsequent payment of premiums thereon by the donor will constitute gifts of present interests for the purpose of determining the gift tax exclusion authorized by section 2503(b) of the Internal Revenue Code of 1954.

Advice has been requested in view of the decision in *Nashville Trust Company* v. *Commissioner*, Tax Court Memorandum Opinion entered November 15, 1943, whether gifts of life insurance policies, which have no immediate cash value, are gifts of present or future interests for Federal gift tax purposes.

The Nashville Trust Company case involved gifts of insurance policies having no cash values, the policies having been assigned immediately after their issuance. Before assigning the policies the donor had executed settlement options which, by the terms thereof, limited the interests of the donees to future interests and in the audit of the gift tax return the claimed exclusions were disallowed. The donor filed a petition with The Tax Court of the United States. In sustaining the Commissioner's determination that the gifts were of future interests, the Tax Court commented upon the fact that the policies had no cash or loan values. However, as the gifts were of future interests by reason of the terms of the settlement options exercised by the donor prior to the assignments, it is not believed the decision can be considered as authority for holding that a gift of an insurance policy is a gift of a future interest unless it has a cash value.

Section 86.11 of Gift Tax Regulations 108, definies the term "future interests" as follows:

"Future interests" is a legal term, and includes reversions, remainders, and other interests or estates, whether vested or contingent, and whether or not supported by a particular interest or estate, which are limited to commence in use, possession, or enjoyment at some future date or time. The term has no reference to such contractual rights as exist in a bond, note (though bearing no interest until maturity), or in a policy of life insurance, the obligations of which are to be discharged by payment in the future. But a future interest or interests in such contractual obligations may be created by the limitations contained in a trust or other instrument of transfer employed in effecting a gift.

Under the regulations a gift of an insurance policy having no cash value is not a gift of a future interest merely because the policy has no cash value. However, a gift of an insurance policy, whether or not it has a cash value, may or may not be a gift of a future interest,

depending upon whether, by the terms of the gift, the interests of the donee in the policy are in some manner restricted. Compare *Nashville Trust Company* v. *Commissioner*, *supra*.

Accordingly, it is held that where a policy of insurance, which grants to the owner the usual incidents of ownership, including the right to change the beneficiary and the right to surrender the policy for its cash value, if any, is transferred or assigned to a donee as absolute owner, and the donee, or his guardian, is not restricted in any manner from exercising all legal incidents of ownership in the policy, by prior endorsement or otherwise, a gift of the policy and subsequent payment of premiums thereon by the donor will constitute gifts of present interests for the purpose of determining the gift tax exclusion authorized by section 2503(b) of the Internal Revenue Code of 1954.

SUBCHAPTER B.—TRANSFERS

SECTION 2512.—VALUATION OF GIFTS

Valuation of jewelry, furs, and related articles of personal property in Federal gift tax returns. See Rev. Rul. 55–71, page 110.

SUBTITLE C.—EMPLOYMENT TAXES

CHAPTER 21.—FEDERAL INSURANCE CONTRIBUTIONS ACT

SUBCHAPTER C.—GENERAL PROVISIONS

SECTION 3121.—DEFINITIONS

(Also Section 3402.)
(Also Part II, Sections 1426, 1622; Regulations 128, Section 408.226; Regulations 120, Section 406.300.)

Rev. Rul. 55–203

Amounts paid pursuant to section 16(c) of the Fair Labor Standards Act, as amended effective January 25, 1950, on account of unpaid minimum wages or unpaid overtime compensation constitute "wages" for purposes of Federal employment taxes and income tax withholding. The employee tax under section 3101 of the Federal Insurance Contributions Act and the income tax required to be collected at source under section 3402 of the Internal Revenue Code of 1954 should be deducted by the employer at the time the wages are paid over to the Government for distribution to the employees. Such taxes, and the employer tax under section 3111 of the Federal Insurance Contributions Act should be reported in the current quarterly return filed by the employer.

An inquiry has been received relative to the taxability and treatment for purposes of the Federal Insurance Contributions Act and Col-

lection of Income Tax at Source on Wages (chapters 21 and 24, respectively, subtitle C, Internal Revenue Code of 1954) of wages recovered pursuant to section 16(c) of the Fair Labor Standards Act, as amended effective January 25, 1950, 29 U. S. C. 216(c).

Section 16(c) of the Fair Labor Standards Act, as amended, authorizes the Administrator of the Wage and Hour Division, U. S. Department of Labor, to bring an action in court against an employer on behalf of one or more employees to recover unpaid minimum wages and unpaid overtime compensation due employees. The sums thus recovered are held in a special deposit account and are paid, on the order of the Administrator, directly to the employee or employees affected. The names of the employers who paid the judgments are furnished to the District Director of Internal Revenue in order that employment tax returns may be secured.

Amounts paid by employers pursuant to section 16(c), *supra*, on account of unpaid minimum wages or unpaid overtime compensation are paid in consideration of services performed for the employer and constitute "wages" for purposes of Federal employment taxes and income tax withholding. The Federal Insurance Contributions Act employee tax and the income tax required to be collected at source should be deducted and withheld at the time the employer turns the money over to the Government for distribution to the individuals involved. Such taxes, together with the employer tax imposed by the Federal Insurance Contributions Act, should be reported in the Employer's Quarterly Federal Tax Return, Form 941, for the quarter during which the taxes were deducted and withheld and should be paid to the Government in the usual manner. The employer should furnish the employee a Withholding Tax Statement, Form W-2, showing the amount of the payment attributable to his services and the amount of the Federal income tax withheld. Where other wages are paid to the employee during the calendar year, the wages paid pursuant to section 16(c) should be included in the total wages reported in the withholding statement. See S. S. T. 393, C. B. 1940-1, 213, with respect to payments made to employees pursuant to section 16(b) of the Fair Labor Standards Act of 1938.

(Also Section 3401.) Rev. Rul. 55-232
(Also Part II, Sections 1426, 1621; Regulations 128, Section 408.226; Regulations 120, Section 406.207.)

The cash value of awards earned by salesmen through their efforts to increase sales for their employer constitutes additional wages to the salesmen for purposes of Federal employment taxes and the withholding of income tax, even though the awards are made to the wives of the salesmen.

A question has been raised whether the cash value of awards made to salesmen's wives by the salesmen's employer, as a result of efforts of the salesmen to make additional sales during a sales promotion campaign, constitutes additional wages 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).

In S. S. T. 29, C. B. XV-2, 417 (1936), it is held that for Federal employment tax purposes prizes awarded to salesmen as winners of contests conducted by their employer constitute additional wages.

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.

It is held that the cash value of awards earned by salesmen through their efforts to increase sales for their employer constitutes additional "wages" for purposes of the Federal Insurance Contributions Act and income tax withholding, irrespective of the fact that such awards, although earned by the salesmen, are issued to the salesmen's wives by the employer.

(Also Part II, Section 1426; Regulations 128, Section 408.204.) Rev. Rul. 55-233

An individual entered into an agreement with an organization to perform services on its behalf as an organizer of "forum-type dinner clubs." The individual selects the cities in which he establishes clubs, determines the help required, and engages, pays, and directs such help. He is not required to give preference to the organization's affairs, to work a specified number of hours, to establish a minimum number of clubs, or to furnish reports, other than a report on the number of members secured. He receives a commission based on the membership of each club established by him. He is not allowed a drawing account and he is not reimbursed for expenses. *Held*, the individual is not an employee of the organization for Federal employment tax purposes.

A ruling has been requested whether an individual who organizes "forum-type dinner clubs" on behalf of an organization, under the circumstances described below, is an employee of the organization for purposes of the Federal Insurance Contributions Act (chapter 21, subtitle C, Internal Revenue Code of 1954).

An organization whose purposes generally are to promote social contacts among business and professional leaders and to keep the public at large informed on modern public and private problems of government, business, industry, finance and the professions through addresses by national leaders, engaged an individual to perform services as an organizer of forum-type dinner clubs. Under the organization's operational procedure, clubs are organized from coast to coast; dinners are arranged monthly, except during the summer, for the club members; and nationally known individuals are obtained as guest speakers at such dinners. Under the terms of an agreement between the parties, the "organizer" receives a portion of the membership fee for each person who becomes a member during the club's first fiscal year. He has no financial interest in a club established by him after that period. He selects the cities in which he establishes the clubs and is not required to confine his activities to any specified territory. Should he be unable to organize a group sufficiently large to be accepted by the organization, he would be obliged to refund all fee payments and all expenses incurred in such effort would be borne by him. He is not required to work any specified number of hours per day or week, or to furnish any reports other than to advise the organization of the number of members secured after the organization of a

club is completed. He is not obligated to establish a minimum number of clubs and is furnished no leads by the organization concerning members, or places where clubs might be organized. If needed, he engages helpers and they are subject to his direction and control and are paid by him. He performs no other services for the organization and is not required to give preference to his services on the organization's behalf. The arrangement may be terminated by either party at any time for any reason.

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 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, until superseded by regulations issued under the 1954 Code.

In the instant case, it is determined that the organization for which the individual performs services as an organizer of "forum-type dinner clubs" neither exercises nor 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 for Federal employment tax purposes.

(Also Part II, Section 1426; Regulations 128, Section 408.214.) Rev. Rul. 55–247

Services of civilian employees of State National Guards and units thereof are excepted from "employment" as services performed in the employ of a State under section 3121(b)(7) of the Federal Insurance Contributions Act (chapter 21, subtitle C, Internal Revenue Code of 1954). Accordingly, the taxes imposed by the Act are not applicable to the remuneration for such services. This ruling is also applicable under the provisions of section 1426(b)(8) of the Internal Revenue Code of 1939.

Effective as of January 1, 1951, section 218(b)(5) of the Social Security Act, as amended by the Social Security Amendments of 1954, provides that certain civilian employees of State National Guard units shall be deemed to be employees of the State for purposes of coverage under Title II of that Act. The matter of coverage of State employees pursuant to a voluntary agreement under section 218, *supra*, is within the jurisdiction of the Secretary of Health, Education and Welfare, Washington, D. C. Questions relating to such matters should be addressed to that Department.

(Also Section 1402.)
(Also Part II, Sections 481, 1426; Regulations 118, Section 39.481–3, Regulations 128, Section 408.204.) Rev. Rul. 55–248

An individual conducting a watch repair business in a jewelry store, paying the jeweler a percentage of receipts as rent for space

occupied, furnishing all his own equipment, tools, instruments and materials required in the conduct of such business, regulating his own working hours, fixing his own prices for his work, and doing all repair work in accordance with his own methods, is not an employee of the jeweler for Federal employment tax purposes.

Income derived from such activity should be considered in computing net earnings from self-employment for purposes of the Self-Employment Contributions Act.

An inquiry has been received relative to the status, for purposes of the Federal Insurance Contributions Act (chapter 21, subtitle C, Internal Revenue Code of 1954) and the Self-Employment Contributions Act (chapter 2, subtitle A, Internal Revenue Code of 1954) of a watch repairman performing services under the circumstances described below.

In order to provide a facility for watch repair in his jewelry store, *A* entered into an agreement with *B*, a watch repairman, whereby he would furnish *B* the space in his store to operate such facility in return for 40 percent of the proceeds from *B's* work. *B* furnishes all labor, tools (including a workbench), supplies, and parts necessary in the business of watch repair, deals directly with the customer and determines the fees to be charged. B has complete control over the time to be taken in completing a repair and is responsible for all work done by him, it being understood that any guarantee made by him would not be binding upon the jewelry store. In instances where he may be called upon to repair a watch for the store, he determines the value of his work and the transaction is handled as a regular repair. Either *A* or *B* may deliver the repaired article to the customer and collect for the work. For the purpose of maintaining a correct accounting system, assuring each party of his share of the proceeds, all monies collected are handled through the store, *B* receiving his share of the proceeds semi-monthly in accordance with the agreement. *B* determines his hours of work and receives no instructions from *A* as to how the work should be done.

Section 3121(d) of the Federal Insurance Contributions Act, as amended, 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 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, until superseded by regulations issued under the 1954 Code.

Whether an individual is an independent contractor or an employee is largely a question to be determined upon consideration of the particular facts in each case. In the instant case, it is determined that *A*, the jeweler, neither exercises nor has the right to exercise such control over *B*, the watch repairman, in the performance of his services as is necessary under the usual common law rules to establish the relationship of employer and employee for Federal employment tax purposes.

Since *B* is not an "employee" with respect to his services as a watch repairman, the question resolves itself into whether such activities constitute a "trade or business" for purposes of the Self-Employment

Contributions Act and whether the income derived therefrom is subject to the tax imposed under the Act.

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 Internal Revenue Code, with certain exceptions not here material.

As a general rule, a person who is regularly engaged in an occupation or profession for profit, which constitutes, in whole or in part, his livelihood, and who is not an employee for purposes of the Federal Insurance Contributions Act, is engaged in a "trade or business."

Under the circumstances stated herein, it is concluded that *B* is engaged in a "trade or business" with respect to his services as a watch repairman and the income derived therefrom is includible in computing net earnings from self-employment.

(Also Section 501.)
(Also Part II, Section 1426; Regulations 128, Section 408.214.)

Rev. Rul. 55-319

A wholly-owned State instrumentality may in some circumstances qualify for exemption from Federal income tax under section 501(c)(3) of the Internal Revenue Code of 1954.

Coverage under the Social Security Act of employees of a wholly-owned State instrumentality may be effected only pursuant to a compact under section 218 of the Social Security Act. The "waiver" procedure provided in section 3121(k) of the Federal Insurance Contributions Act is not applicable to a wholly-owned State instrumentality irrespective of whether the particular instrumentality is exempt under section 501(c)(3) of the Code.

An inquiry has been received whether (1) a wholly-owned State instrumentality may also qualify for exemption from Federal income tax under section 501(c)(3) of the Internal Revenue Code of 1954 and (2), if so, whether the "waiver" procedure provided in section 3121(k) of the Federal Insurance Contributions Act (chapter 21, subtitle C, Internal Revenue Code of 1954) is applicable in effecting coverage for its employees under the Social Security Act.

It is held that where an organization desires to have the benefit of a particular tax feature extended to its employees, such as the exception provided by section 403 of the Code, which depends on exemption under section 501 (a) of an employer described in section 501 (c) (3), and the particular organization meets the statutory requirements for exemption under section 501 (c) (3) of the Code, it may be granted exemption thereunder, regardless of the fact that it also qualifies as a wholly-owned State instrumentality and, as such, would not be subject to Federal income tax.

It does not follow, however, that coverage under the Social Security Act may be effected for employees of such an organization by the "waiver" procedure provided by section 3121(k) of the Federal Insurance Contributions Act.

Section 3121(b)(8)(B) of the Act, as amended by the Social Security Amendments of 1954, excepts from "employment" service performed in the employ of an organization exempt from income tax

under section 501(c)(3) of the Code. However, such an organization may waive its exception as to certain employees by complying with the provisions of section 3121(k) of the Act.

Section 3121(b)(7) of the Act excepts from "employment" service performed in the employ of a State, or any political subdivision thereof, or any instrumentality of any one or more of the foregoing, which is wholly owned by one or more States or political subdivisions. Section 218 of the Social Security Act, as amended, 42, 4 S. C. 418, provides for the coverage of employees of wholly-owned State organizations if the State and the Department of Health, Education, and Welfare enter into a compact providing for such coverage.

To secure coverage under the Social Security Act of employees of an organization exempt under section 501(c)(3) of the Code, section 3121(k) of the Federal Insurance Contributions Act requires the consent of the particular organization and two-thirds of its employees; but to secure coverage for a wholly-owned State instrumentality, section 218 of the Social Security Act requires the consent of the State, rather than that of the particular instrumentality.

In view of the Congressional purpose behind section 218 of the Social Security Act of allowing State governments, rather than a particular State instrumentality, discretion in determining which State employees should be covered under the Social Security Act, it is held that employees of wholly-owned State instrumentalities may secure social security coverage only by the procedure outlined in section 218 of the Social Security Act. See Senate Report No. 1669 on Social Security Act Amendments of 1950, C. B. 1950–2, 302, at 307, and 324. Therefore, the "waiver" procedure provided in section 3121(k) of the Federal Insurance Contributions Act is not applicable to a wholly-owned State instrumentality irrespective of whether the particular instrumentality also qualifies for exemption under section 501(c)(3) of the Code.

Rev. Rul. 55–386

An individual performs services of a domestic nature in the private nonfarm home of the employer and, in addition, services at his place of business. *Held*, the taxes imposed under the Federal Insurance Contributions Act should be computed on the total "wages" paid to the employee provided the individual meets the "$50 a quarter" test with respect to the domestic services. The included and excluded service rule contained in section 3121(c) of the Act is not applicable.

An inquiry has been received relative to the procedure which should be followed in computing the taxes imposed under the Federal Insurance Contributions Act (chapter 21, subtitle C, Internal Revenue Code of 1954) on wages paid by an employer to an employee who performs services of a domestic nature in the private nonfarm home of the employer and, in addition, services at his place of business; also, whether the included and excluded service rule contained in section 3121(c) of the Act is applicable to this employment.

Under section 3121(a) of the Act 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—

(1) that part of the remuneration which, after remuneration (other than remuneration referred to in the succeeding paragraphs of this subsection) equal to $4,200 with respect to employment has been paid to an individual by an employer during any calendar year, is paid to such individual by such employer during such calendar year. * * *

* * * * * * *

(7)(A) remuneration paid in any medium other than cash to an employee for * * * domestic service in a private home of the employer;

(B) cash remuneration paid by an employer in any calendar quarter to an employee for domestic service in a private home of the employer, if the cash remuneration paid in such quarter by the employer to the employee for such service is less than $50. * * *

Before determining whether wages paid to a domestic servant are subject to the Federal employment taxes, it is necessary to consider whether $50 in cash was paid to the servant for the domestic service performed during a calendar quarter. Where an employee meets the "$50 a quarter" test for services of a domestic nature in the private nonfarm home of an employer and also receives taxable wages from the same employer for services of a business nature, the taxes imposed under the Act should be computed with respect to all wages paid by the employer for services of a business nature and with respect to the cash wages paid for services of a domestic nature, subject to the limitation provided by section 3121(a)(1) of the Act. However, if the "$50 a quarter" test is not met with respect to the services of a domestic nature, no liability for the taxes under the Act is incurred with respect to such services and the remuneration paid therefor should not be included in computing taxable wages under the Act.

Section 3121(c) of the Act provides, in part:

* * * if the services performed during one-half or more of any pay period by an employee for the person employing him constitute employment, all the services of such employee for such period shall be deemed to be employment; but if the services performed during more than one-half of any such pay period by an employee for the person employing him do not constitute employment, then none of the services of such employee for such period shall be deemed to be employment. As used in this subsection, the term "pay period" means a period (of not more than 31 consecutive days) for which a payment of remuneration is ordinarily made to the employee by the person employing him. * * *

The included and excluded service rule contained in section 3121(c) of the Act is applicable only in those instances where the relationship of employer and employee exists and a portion of the services performed by an employee for the person employing him during a pay period constitutes "employment" and the remainder does not constitute "employment." Domestic services in the private nonfarm home of the employer constitute "employment" even though by reason of section 3121(a)(7)(B), *supra*, certain remuneration therefor is not taxable as "wages." Therefore, since both the business services and the domestic services of an employee for his employer constitute "employment," the included and excluded service rule has no application.

Form 941, Employer's Quarterly Federal Tax Return, is the regular tax and information return prescribed for use by employers of business employees. Form 942, Employer's Quarterly Tax Return for Household Employees, is the form prescribed for use by every employer in reporting wages paid by him for domestic service in a private home not on a farm operated for profit. Taxable wages of business employees should not be reported by an employer on Form 942, but an employer who files Form 941 for business employees may

include his domestic employees on such form if he so desires by following the special instructions which appear on Form 941, or he may report his domestic employees on a separate Form 942. If the employer has only one employee and taxable wages are paid to this employee for both business and domestic services, the employer may combine the wages for each type of service and report all of the employee's taxable wages on Form 941. See Section 408.601, Regulations 128, applicable to the provisions of the 1954 Code by virtue of T. D. 6091, C. B. 1954–2, 47. Where the employer elects to combine the wages, and the services performed by the employee are predominantly of a domestic nature, the letter "H" should be inserted at the extreme right-hand side of column 20 of the return, Form 941, opposite the employee's name.

Individual performing services as sexton of cemetery. See Rev. Rul. 55–328, page 98.

SECTION 3121.—DEFINITIONS

(Also Part II, Section 1426, Regulations 128, Section 408.204) Rev. Rul. 55–370

An individual performs automobile repair services in the repair department of an automobile sales company. He works regular hours and is paid on a percentage basis. He has no investment in the repair department. The company furnishes all facilities, including materials and paint, checks all estimates and repair orders, and issues instructions relative to amount to be charged. *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 who performs automobile repair services in a repair department of an automobile sales company.

The company sells automobiles and trucks and operates a repair department in connection with its sales department. For several years the company engaged the individual as an automobile body and fender man in the repair department, during which time he was paid 60 percent of the labor charges. Later he worked as foreman of the department on a weekly salary basis. At all times the company considered him to be its employee. However, during 1954 the company advised the individual that he would no longer be carried on the payroll; that if he wished to continue working in the establishment he could make estimates and repair vehicles, for which he would be charged 40 percent of his weekly receipts to defray costs of rent, utilities, and shop facilities; and that the 40 percent charge would be deducted from the receipts for completed work. The company agreed to furnish all materials and paints and the individual agreed to pay his own taxes and keep his own books.

The individual continued to perform the same repair services and he observed regular working hours. The company checked all estimates and repair orders, instructed the worker as to the amount he was allowed to charge for a job, advised when to use new or used parts,

and set the date for the completion of the job. The individual performed his services in the company's place of business on a full-time basis, had no investment in the repair shop, and furnished only small hand tools for his work. He operated under the company's name, did not hold himself out to the public as available to do work of a similar or related nature, and did not perform services for others.

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 a person is an independent contractor or an employee is largely a question to be determined upon the particular facts of 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, until superseded by regulations issued under the 1954 Code.

Under the circumstances stated, it is apparent that the company has the right to exercise such control over the individual in the performance of his services as will assure the company a reasonable income from the arrangement. The fact that the individual's remuneration is on a percentage basis is immaterial. Accordingly, it is held that, for Federal employment tax purposes, the relationship between the company and the individual is that of employer and employee, both prior and subsequent to the date on which he was notified that his name would no longer be carried on the company's payroll.

CHAPTER 24.—COLLECTION OF INCOME TAX AT SOURCE ON WAGES

SECTION 3401.—DEFINITIONS

26 CFR 406.207: Wages. T. D. 6128
(Also Section 6001; 26 CFR 406.607.)
(Also Part II, Sections 1621, 3603; Regulations 120, Sections 406.207, 406.607.)

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER D, PART 406.—COLLECTION OF INCOME TAX AT SOURCE ON WAGES; APPLICABLE ON AND AFTER JANUARY 1, 1954

Regulations 120 amended to provide rules for withholding on payments under section 105(d) 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:

On September 24, 1954, a notice of proposed rulemaking relating to Regulations 120 (26 CFR (1939) pt. 406) was published in the

Federal Register (19 F. R. 6144) in order to provide rules for withholding on payments subject to section 105(d) of the Internal Revenue Code of 1954. Regulations 120 were made applicable to the Internal Revenue Code of 1954 by Treasury Decision 6091 [C. B. 1954–2, 47], which was signed on August 16, 1954. After consideration of the relevant suggestions presented by interested parties regarding the proposed rules, the following amendments to Regulations 120 are hereby adopted:

PARAGRAPH 1. Section 406.207 is hereby amended by inserting at the end thereof the following new paragraph:

SEC. 406,207. WAGES.—* * *

(i) COMPENSATION FOR PERSONAL INJURIES OR SICKNESS; AMOUNTS PAID AFTER 1953 AND BEFORE 1956 UNDER WAGE CONTINUATION PLANS.—(1) *Amounts paid by employer for whom services are performed.*—(i) Withholding is not required upon amounts paid after December 31, 1953, and before January 1, 1956, to an employee by his employer under a wage continuation plan for a period during which the employee is absent from work on account of personal injuries or sickness, if such amounts are excludable from the gross income of the employee under section 105(d) of the Internal Revenue Code of 1954 and the records maintained by the employer in accordance with the provisions of section 406.607(a)—

(*a*) Separately show the amounts of such payments and distinguish such amounts from all other payments, and

(*b*) Establish the facts necessary to show that the employee is entitled to the exclusion provided by section 105(d) of the Internal Revenue Code of 1954, either by means of a written statement from the employee as to the injury, illness, or hospitalization, or by any other information which the employer believes to be accurate and which he is willing to accept for purposes of payments under the wage continuation plan.

(ii) For the purpose of section 406.501, relating to the requirement of receipts for employees, amounts paid after December 31, 1953, and before January 1, 1956, which are excludable from gross income under the provisions of section 105(d) of the Internal Revenue Code of 1954 shall be included in the total wages required to be shown on Form W–2. The amount of any such wages on which the employer, in reliance on section 105(d) of the Internal Revenue Code of 1954, does not withhold must be shown separately, and properly identified, on Form W–2 in such manner that it may be read on each copy of the form.

(iii) See section 406.607 for general requirements relating to the keeping of records by employers.

(2) *Amounts paid by person other than employer for whom services are performed.*—Withholding is not required upon any amounts paid after December 31, 1953, and before January 1, 1956, to an employee for a period during which the employee is absent from work on account of personal injuries or sickness, whether or not such amounts are excludable from the gross income of the employee, if such amounts are paid through accident or health insurance or under an accident or health plan by a person who is not the employer for whom the employee performs services but who is regarded as an employer under section 406.205(c). For example, no withholding is required in connection with accident or health benefits paid by an insurance company under an accident or health policy, by a separate trust under an accident or health plan, or by a State agency from a sickness and disability fund maintained under State law.

PAR. 2. Section 406.607(a) is hereby amended by inserting at the end thereof the following new subparagraph:

SEC. 406.607. RECORDS.—(a) *Records of employers.*—* * *

(4) For additional record-keeping requirements in the case of payments under section 105(d) of the Internal Revenue Code of 1954, see section 406.207(i).

(This Treasury Decision is issued under the authority contained in sections 1429 and 3791 (53 Stat. 178, 467; 26 U. S. C. 1429, 3791) and section 1627 (57 Stat. 138; 26 U. S. C. 1627) of the Internal

Revenue Code of 1939 and section 7805 (68A Stat. 917; 26 U. S. C. 7805) of the Internal Revenue Code of 1954.)

T. COLEMAN ANDREWS,
Commissioner of Internal Revenue.

Approved March 25, 1955.

DAVID W. KENDALL,
Acting Secretary of the Treasury.

(Filed with the Division of the Federal Register March 25, 1955, 4:02 p. m.)

Cash value of awards earned by employee salesmen. See Rev. Rul. 55-232, page 115.

SECTION 3402.—INCOME TAX COLLECTED AT SOURCE

Wages paid under the Fair Labor Standards Act. See Rev. Rul. 55-203, page 114.

CHAPTER 32.—MANUFACTURERS EXCISE TAXES

SUBCHAPTER D.—RECREATIONAL EQUIPMENT

PART III.—FIREARMS

SECTION 4181.—IMPOSITION OF TAX

Liability to the manufacturer's excise tax by reason of the sale of firearms assembled from component parts by other than the manufacturer of such parts. See Rev. Rul. 55-342, page 562.

CHAPTER 33.—FACILITIES AND SERVICES

SUBCHAPTER A.—ADMISSIONS AND DUES

PART II.—CLUB DUES

SECTION 4241.—IMPOSITION OF TAX [LIFE MEMBERSHIPS]

Application of the club dues tax on life memberships to certain classes of honorary members. See Rev. Rul. 55-198, page 510.

SUBCHAPTER C.—TRANSPORTATION

PART I.—PERSONS

SECTION 4261.—IMPOSITION OF TAX

(Also Part II, Section 3469; Regulations 42, Section 130.54.) Rev. Rul. 55-409

A resident of the United States drives his automobile from a point in the United States to Whitehorse, Yukon Territory, Canada. On the return trip, in order to avoid traveling over the same route, he purchases a ticket in Canada for transportation via railroad and steamship from Whitehorse to Vancouver, British Columbia, Canada. This journey crosses a portion of Alaska. *Held*, since the payment made in Canada is for a trip which begins and ends outside the United States, the tax on the transportation of persons, imposed by section 4261 of the Internal Revenue Code of 1954 (section 3469 of the 1939 Code), is not applicable to such payment even though the person purchasing such transportation is a resident of the United States.

CHAPTER 34.—DOCUMENTARY STAMP TAXES

SUBCHAPTER B.—SALES OR TRANSFERS OF CAPITAL STOCK AND CERTIFICATIONS OF INDEBTEDNESS OF A CORPORATION

PART I.—SALES OR TRANSFERS OF CAPITAL STOCK AND SIMILAR INTERESTS

SECTION 4321.—TRANSFERS OF CAPITAL STOCK—IMPOSITION OF TAX

Rev. Rul. 55-46

The rules on section 1802 of the Internal Revenue Code of 1939 contained in Regulations 71 should be applied to section 4321 of the Internal Revenue Code of 1954 until the regulations are issued under section 4321.

Advice has been requested relative to the computation of the documentary stamp tax on sales and transfers of capital stock under section 4321(1) of the Internal Revenue Code of 1954 on and after January 1, 1955, the effective date of such section, in view of the difference in wording between that section and section 1802(b), the corresponding section of the Internal Revenue Code of 1939.

Under the provisions of section 1802(b) of the 1939 Code a stamp tax was imposed on sales and transfers of capital stock at specified rates on each $100 of the par value or fraction thereof of the certificates sold or transferred. The methods of computing the tax imposed by section 1802(b) on the sale or transfer of shares or certificates of stock are stated in section 113.32 of Regulations 71.

Treasury Decision 6091, C. B. 1954-2, 47, approved August 16, 1954, prescribing stopgap regulations under the Internal Revenue Code of 1954, provides, in part:

All regulations (including all Treasury Decisions) * * * applicable under any provision of law in effect on the date of enactment of the [1954] Code, to the extent such provision of law is repealed by the Code, are hereby prescribed under and made applicable to the provisions of the Code corresponding to the provision of law so repealed insofar as any such regulation is not inconsistent with the Code. Such regulations shall become effective as regulations under the various provisions of the Code as of the dates the corresponding provisions of law are repealed by the Code, until superseded by regulations issued under the Code.

The reports on the 1954 Code submitted by the committees of both houses of Congress state that any changes in the excise tax statutes under the new Code would be structural rather than substantive. In view of the foregoing, the rules on section 1802 of the 1939 Code contained in Regulations 71 should be applied to section 4321 of the 1954 Code until the regulations are issued under section 4321.

CHAPTER 38.—IMPORT TAXES

SUBCHAPTER F.—OLEOMARGARINE

SECTION 4591.—IMPOSITION OF TAX

(Also Sections 4803, 4871.) Rev. Rul. 55-107

Interim procedure for affixing adhesive stamps to packages or boxes of white phosphorus matches and imported oleomargarine, and to contracts or memoranda in the case of cotton futures.

SECTION 1. PURPOSE.

The purpose of this Revenue Ruling is to provide an interim procedure for affixing adhesive stamps to packages or boxes of white phosphorus matches and imported oleomargarine, and to contracts or memoranda in the case of cotton futures, as evidence of the payment of the internal revenue taxes imposed by law.

SEC. 2. BACKGROUND.

Section 4801 of the Internal Revenue Code of 1954 imposes a tax at the rate of 2 cents per hundred on white phosphorus matches, and section 4803 provides that this tax shall be represented by adhesive stamps. Section 4591 imposes a tax of 15 cents per pound on all oleomargarine imported from foreign countries, and states this tax will be represented by coupon stamps. Section 4851 imposes an excise tax of 2 cents for each pound of cotton involved in any contract of sale of such cotton for future delivery, subject to certain exemptions, and section 4871 provides that this tax shall be paid by means of stamps. It is not anticipated that there will be many, if any, cases which will require the imposition of these taxes. Under the circumstances, it is not contemplated that special internal revenue stamps will be provided for use in evidencing the payment of the taxes in these 3 instances.

SEC. 3. PROCEDURE.

Until further notice, any orders for stamps for use in taxpaying the articles and the transactions mentioned herein will be filled by District

Directors by furnishing documentary internal revenue stamps in the appropriate denominations. Upon presentation of a requisition, taxpayers will be advised by letter that no special types of stamps have been provided, and that the documentary stamps should be affixed to the packages, boxes or contracts and canceled in the manner set forth in the regulations on documentary stamp taxes.

CHAPTER 39.—REGULATORY TAXES

SUBCHAPTER B.—WHITE PHOSPHORUS MATCHES

SECTION 4803.—STAMPS

Interim procedure for affixing adhesive stamps to packages or boxes of white phosphorus matches. See Rev. Rul. 55–107, page 127.

SUBCHAPTER D.—COTTON FUTURES

PART III.—ADMINISTRATIVE PROVISIONS

SECTION 4871.—METHOD OF PAYMENT

Interim procedure for affixing adhesive stamps to contracts or memoranda in the case of cotton futures. See Rev. Rul. 55–107, page 127.

CHAPTER 53.—MACHINE GUNS AND CERTAIN OTHER FIREARMS

SUBCHAPTER A.—TAXES

PART I.—SPECIAL (OCCUPATIONAL) TAXES

SECTION 5801.—TAX

REGULATIONS 88, SECTION 319.36: Rates of tax. (Also Federal Firearms Act, Section 3; Section 315.40, Regulations 131.) Rev. Rul. 55-33

Liability to special (occupational) tax imposed under section 5801 of the Internal Revenue Code of 1954 would not be incurred by a licensed dealer under the Federal Firearms Act for transmitting orders for firearms to a bona fide manufacturer of firearms.

Advice has been requested whether firearms dealers licensed under the Federal Firearms Act must pay special (occupational) tax under

section 5801 of the Internal Revenue Code of 1954 if they receive a commission for referring orders for firearms to manufacturers.

In the instant case, the dealer has no active part in the sales transaction other than the referral of the sale to the manufacturer for which he receives a commission.

A licensed dealer under the Federal Firearms Act would not incur liability to the special (occupational) tax imposed under section 5801 of the Internal Revenue Code of 1954 for transmitting an order for a firearm to a bona fide manufacturer of firearms, notwithstanding the fact such dealer receives a commission for the service rendered. A person acting in this capacity would be considered as an "agent" or "finder" and the function he performs may be conducted under the special (occupational) tax stamp issued to the manufacturer to whom the sale is referred.

SUBCHAPTER B.—GENERAL PROVISIONS

SECTION 5848.—DEFINITIONS

REGULATIONS 88, SECTION 319.5a: Any other weapon. Rev. Rul. 55-44

(Also Sections 319.26, 319.27.)

The following types of "gadget" guns have been examined by the Internal Revenue Service for the purpose of determining whether they come within the purview of section 5848(5) of the Internal Revenue Code of 1954, and are classified as follows: the "Knuckle-duster," the "French Apache Fist Revolver," and the "Pepperbox," all of which employ the multiple rotating barrel principle of design, are entitled to exception as a "pistol or revolver" under section 5848(1) of the Internal Revenue Code of 1954 and sections 319.26 and 319.27 of Regulations 88. Accordingly, these weapons are exempt from the requirements of chapter 53 of the Code.

The "Chicago Palm Protector" is neither a pistol nor a revolver but a device capable of being concealed on the person from which a shot can be discharged through the energy of an explosive. Accordingly, it comes within the category of "any other weapon" as defined in section 5848(5) of the Internal Revenue Code of 1954 and section 319.5a of Regulations 88, as added by Treasury Decision 6094, C. B. 1954-2, 44, and is therefore a "firearm" subject to the requirements of chapter 53 of the Code.

REGULATIONS 88, SECTION 319.12: Firearm. Rev. Rul. 55-341

The Internal Revenue Service has had the occasion to examine a 20 gauge gun having two barrels pointing in opposite directions, each of which is threaded to a center piece containing a firing mechanism. The center piece is fitted with two slip bolt firing pins, each capable of firing a shell from only one of the barrels. The overall length of the weapon is approximately 11⅞ inches, each barrel having a length of 4¼ inches with inside measurements of 3⅞ inches. The

gun is loaded by unscrewing the barrel and inserting a shell in the breech end. The center section containing the firing mechanism is approximately 3½ inches in length and is encased in a metal grip. Ostensibly, the device was designed to fire 20 gauge tear gas cartridges. However, it has been established that the device is also capable of chambering and repeatedly firing, without apparent structural damage, 20 gauge fixed shotgun shells. *Held*, since the above-described gun is a weapon or device capable of being concealed on the person, it is a firearm within the purview of the National Firearms Act, as amended (Chapter 53 of the Internal Revenue Code of 1954). See specifically sections 5848(1) and 5848(5) of such code.

REGULATIONS 88, SECTION 319.26: Pistol.

Classification of "gadget" guns under section 5848 of the Internal Revenue Code of 1954. See Rev. Rul. 55-44, page 129.

REGULATIONS 88, SECTION 319.27: Revolver.

Classification of "gadget" guns under section 5848 of the Internal Revenue Code of 1954. See Rev. Rul. 55-44, page 129.

SUBTITLE F.—PROCEDURE AND ADMINISTRATION

CHAPTER 61.—INFORMATION AND RETURNS

SUBCHAPTER A.—RETURNS AND RECORDS

PART I.—RECORDS, STATEMENTS, AND SPECIAL RETURNS

SECTION 6001.—NOTICE OR REGULATIONS REQUIRING RECORDS, STATEMENTS, AND SPECIAL RETURNS

26 CFR 406.607: Records.

Regulations 120, amended to provide rules for withholding during 1954 and 1955 on payments under wage continuation plans. See T. D. 6128, page 123.

PART II.—TAX RETURNS OR STATEMENTS

SUBPART B.—INCOME TAX RETURNS

SECTION 6012.—PERSONS REQUIRED TO MAKE RETURNS OF INCOME

Rev. Rul. 55-287

A trust continues in existence for Federal income tax purposes during the period within which the trustee is allowed by the laws of the

State in which the trust is being administered to distribute the assets of the trust to the distributees upon the termination of the trust. Form 1041, United States Fiduciary Income Tax Return, should be filed for each year that the trust so continues in existence and has taxable income, or gross income of $600 or over, regardless of the amount of taxable income.

SECTION 6012.—PERSONS REQUIRED TO MAKE RETURNS OF INCOME

(Also Part II, Section 51; Regulations 118, Section 39.51–1.) Rev. Rul. 55-387

A legally appointed guardian of a taxpayer who has disappeared must file the required Federal income tax returns for such missing person for the taxable year in which he disappeared and for any subsequent taxable years during which he continues in the status of a missing person, *i. e.*, until found or declared dead by a court under the provisions of the pertinent State laws. The fact that the taxpayer's spouse is appointed as his guardian does not preclude the filing of a joint return by the spouse for herself and as guardian for her missing husband (taxpayer).

Advice has been requested relative to the requirements for filing Federal income tax returns in a case where a taxpayer has disappeared and his spouse is appointed as his legal guardian.

The facts in the instant case disclose that the taxpayer disappeared while on a flight in his privately owned plane over a sparsely settled coastal region in the southern part of the United States during the taxable year and has not been heard from or otherwise accounted for since his disappearance. During the portion of the taxable year prior to the date of his disappearance he was in receipt of taxable income; and taxable income will continue to accrue to his benefit thereafter. At the time of the flight the taxpayer and his spouse were living together as man and wife. The wife was appointed legal guardian to act for her husband until the termination of such missing status.

Section 6012(b) provides in part that:

(2) PERSONS UNDER A DISABILITY.—If an individual is unable to make a return required under subsection (a) or section 6015(a), the return of such individual shall be made by a duly authorized agent, his committee, guardian, fiduciary or other person charged with the care of the person or property of such individual. * * *

In this respect the above-quoted provision of the 1954 Code is substantially the same as the provision of section 51(c) of the Internal Revenue Code of 1939.

The law of the State in which the missing spouse resided provides for the presumption of death of an individual after an unexplained absence of 7 years. Thus, where such a person is not heard from or seen or where no evidence of his death is presented before the expiration of that period he is presumed to be alive. Compare I. T. 3750, C. B. 1945, 126. Since such individual is unable to make a return, a return should be made by his guardian under the provisions of the above section of the Code. It follows that where the guardian is also

the spouse of the missing taxpayer an election may be made to file a joint return. Satisfactory evidence of the appointment of the guardian should be filed with the return.

In view of the foregoing, it is held that the legally appointed guardian of a taxpayer who has disappeared must file the required Federal income tax returns for such missing taxpayer for the taxable year in which he disappeared and for any subsequent taxable years during which the taxpayer continues in the status of a missing person, *i. e.*, until found or declared dead by a court under the provisions of the pertinent State laws. The fact that the taxpayer's spouse is appointed as his guardian does not preclude the filing of a joint return by the spouse for herself and as guardian for her missing husband (taxpayer).

SECTION 6015.—DECLARATION OF ESTIMATED TAX BY INDIVIDUALS

Rev. Rul. 55-348[1]

Answers to certain questions pertaining to the "Declarations of Estimated Tax," Form 1040-ES, and clarification of instructions with respect to such declaration.

The purpose of this Revenue Ruling is to provide answers to some of the questions which have been raised regarding the filing of declarations and payment of estimated income tax by individuals and to clarify the instructions pertaining to the "Declaration of Estimated Tax," Form 1040-ES, for the year 1955.

Attention is called to the statement made in paragraph 9 of the instructions on Form 1040-ES relative to the nonimposition of the charge for underpayment where the amount paid on or before the installment date equals 90 percent of the tax computed on the actual taxable income received for the months in the taxable year ending before the month in which the installment date falls. It is possible to construe the language used in this paragraph to mean that, in determining whether the charge should be imposed, 90 percent of the tax so computed is to be treated as if it were the entire estimated tax but such interpretation is not correct. The correct interpretation is made clear in paragraph 4 of the answer to question 2.

New rules are provided by the Internal Revenue Code of 1954 which will govern whether you are required to file a declaration of estimated tax, Form 1040-ES, for 1955, on or before April 15, 1955, or on or before a subsequent installment date. Such rules are contained in the instructions on Form 1040-ES. Problems affecting certain classes of taxpayers, as well as problems which may be encountered by taxpayers generally, are discussed in the following questions and answers:

PROBLEMS AFFECTING TAXPAYERS GENERALLY

1. Q. What factors should I take into account in computing the amount of estimated tax to be shown on my declaration?

A. You may compute your estimated tax by taking into account the amount of gross income which you can reasonably expect to report

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[1] Based on IRS Publication No. 186, dated March 30 1955.

for 1955, and the amount of your estimated allowable deductions and credits for that year. You should determine these estimates of income, deductions, and credits upon the basis of facts and circumstances existing at the time prescribed for filing your declaration. You are also permitted to use any of the methods of computation described in the answer to question 2. These methods take into account your tax liability for last year, or your income and deductions for last year, or the amount of your taxable income received in the current year during the months preceding the month in which the installment date falls.

2. Q. Is it true that I will not be subject to any charge for underpayment of my estimated tax for 1955 if I file a declaration showing as my estimated tax for that year the amount of my tax for 1954, and make proper installment payments on that basis?

A. Yes. No charge for underpayment of an installment is made if the total amount of all payments made on or before the last date prescribed for the payment of the installment equals or exceeds any of the amounts under the following four methods:

(1) The amount which you would have been required to pay on or before the installment date if your estimated tax was the tax shown on your return for 1954 (if your return for 1954 showed a liability for tax and covered a taxable year of 12 months);

(2) The amount which you would have been required to pay on or before the installment date if your estimated tax was an amount determined by computing a tax on the basis of the facts shown on your return for 1954 and the law applicable to that year but using in the computation the rates applicable for 1955 and the personal exemptions to which you are entitled for 1955 in lieu of the rates and exemptions applicable for 1954;

(3) The amount which you would have been required to pay on or before the installment date if your estimated tax was an amount determined by computing 70 percent (66⅔ percent in the case of farmers) of a tax computed on your taxable income for the months in 1955 preceding the month in which the installment date falls. For the purpose of this computation your taxable income is placed on an annual basis by using the method described in the answer to question 3.

(4) The amount determined by computing 90 percent of a tax, at the rates applicable to 1955, on the basis of your actual taxable income for the months in 1955 preceding the month in which the installment date falls as if such months constituted a taxable year. (This method requires payment on or before the installment date of 90 percent of such tax.)

If you use either the first or second method as a basis for determining and paying your estimated tax, you may not adjust these amounts by eliminating the portion of the tax which is attributable to capital gains or other non-recurring items of income received in 1954.

If you use either the third or fourth method as a basis for determining and paying your estimated tax, it will usually be necessary for you to make amended declarations and adjust the amount of your installment payments at subsequent installment dates since the amount of your taxable income to be used in computations under these methods will usually change between installment dates.

3. Q. How do I place my taxable income for months preceding the month in which the installment date falls on an annual basis for the purpose of making the computation required by the third method discussed in the answer to question 2?

A. The following method should be used in the case of a taxable year of 12 months:

(1) Multiply by 12 the amount of your taxable income computed without deduction of personal exemptions for the months in your taxable year which precede the month in which the installment date falls;

(2) Divide the resulting amount by the number of months in your taxable year which precede the month in which the installment date falls; and

(3) Subtract from such amount your allowable deductions for personal exemptions (determined as of the installment date).

4. Q. My income is derived from a business which I operate and in which the production, purchase, or sale of merchandise is an income-producing factor. I use the accrual method of accounting for reporting income. If I use the fourth method discussed in the answer to question 2 for the purpose of determining my estimated tax, must I take inventories and determine the amount of accrued items so that actual taxable income for the months preceding the month in which the installment date falls can be determined?

A. If you use this method, it will be necessary for you to establish the amounts of your inventories and accruals at the end of the month preceding the month in which the installment date falls.

5. Q. I own and operate a retail hardware store and employ 10 persons. It is my custom to distribute year-end bonuses to my employees but the size of the bonuses is not determined until the last month of the taxable year. I intend to use the fourth method discussed in the answer to question 2 for determining and paying my estimated tax. May I take into account as a deduction in determining my actual taxable income for the months which precede the month in which the April 15 installment date falls a proportionate part of the year-end bonus to employees?

A. No. Deductions are not allowable until paid or accrued, depending on the method of accounting used by the taxpayer.

6. Q. I now discover that the estimated tax shown on my original declaration, filed April 15, and the payments made on April, June, and September 15 are insufficient in amount to prevent existence of underpayments as of such installment dates. None of the relief provisions discussed in the answer to question 2 will apply to relieve me from the imposition of the addition to the tax for such underpayments. Will the filing of an amended declaration, or a final return in lieu of such amended declaration, on January 15, together with payment of any tax shown to be due on such amended declaration or final return, relieve me of such imposition?

A. No. However, payment on January 15 will terminate the period of time for which the addition to the tax is to be computed.

7. Q. I intend to use the fourth method discussed in the answer to question 2 in computing my estimated tax for 1955 to be shown on my Form 1040-ES to be filed on April 15. If I file an amended Form 1040-ES on or before any of the subsequent installment dates must

I use the same method in computing the estimated tax to be shown on such amended declaration?

A. No. The fact that you originally used one of the available methods in computing your estimated tax does not prevent you from later using any of the other methods.

8. Q. How is the amount of an underpayment determined?

A. The amount of any underpayment of any installment is always determined by subtracting (i) the amount actually paid in respect of such installment from (ii) the amount required to be paid on or before the installment date. *The amount of the underpayment is never determined by subtracting the amount actually paid from the amount computed under any of the methods discussed in the answer to question 2.* However, no penalty will be imposed if any of these methods applies. The amount required to be paid is determined by dividing 70 percent (66-⅔ percent in the case of farmers) of the tax which is shown on your Form 1040 return for 1955 by the number of installment dates in your taxable year. The amount actually paid in respect of the installment includes amounts paid on prior installments in excess of the amounts required to be paid by such prior installment dates.

To illustrate the foregoing, assume that a taxpayer (other than a farmer) who reports a tax liability of $40,000 on his final return, has paid a total of $20,000 estimated tax in equal installments of $5,000 during the year. There is an underpayment of estimated tax as of each installment date computed as follows:

Tax liability	$40,000
70 percent of tax liability	28,000
One-quarter of 70 percent	7,000
Deduct installment payment	5,000
Underpayment on each installment date	2,000

If, in this example, the taxpayer, instead of paying his estimated tax in equal installments, paid $10,000 on April 15 and $10,000 on June 15, there would not be an underpayment on either of those dates but there would be an underpayment of $1,000 on September 15 and an underpayment of $7,000 on January 15 computed as follows:

Installment	*Required to be paid*	*Paid*	*Underpayment*
April 15	$7,000	$10,000	------
June 15	7,000	10,000	------
Sept. 15	7,000	*6,000	$1,000
Jan. 15	7,000	0	7,000

*Amount paid on prior installments in excess of amounts equired to be paid.

9. Q. Does the amount actually paid in respect of an installment include amounts of income tax withheld at source on wages?

A. Yes. The total amount of the credit for tax withheld at source on wages is considered to be a payment of estimated tax and, in general, an equal part of such amount is considered to have been paid on each installment date. For example, if $1,000 tax has been withheld from the wages of a taxpayer who makes his return on the basis of the calendar year, one-fourth of such amount or $250 is considered to have been paid in respect of each installment. However, if the tax-

payer can establish dates and amounts of the actual withholding, the actual amount withheld during each installment period will be considered as a payment in respect of that installment. In the above example, if the taxpayer can establish that $800 of the $1,000 was withheld during the first three months of the taxable year, such $800 will be considered as a payment on the installment due April 15.

10. Q. How is the addition to the tax computed in the case of an underpayment?

A. The amount of addition to the tax is computed at the rate of six percent a year on the amount of the underpayment for the period from the installment date when the underpayment arises until the date paid or the date prescribed for filing the Form 1040 return for the taxable year, whichever date is the earlier.

11. Q. If I should move from the district in which I filed my original declaration on Form 1040–ES, where should I make installment payments and file amendments to my original declaration?

A. If you move from the district in which you filed your original declaration, you should continue to make installment payments or file amendments of this declaration with the District Director with whom you filed your original declaration. Provision is made for you to show on your Form 1040 return the District Director's office to which you paid the amounts claimed as a credit on account of estimated tax paid.

PROBLEMS AFFECTING MEMBERS OF PARTNERSHIPS

12. Q. I am a member of a partnership in which profits and losses are shared according to a ratio prescribed in the partnership agreement. Both the partnership return and my return are made on the basis of a calendar year. What amount, if any, of the income of the partnership should I take into account for the purpose of filing a declaration of estimated tax on April 15?

A. You should take into account your distributive share of the partnership's estimated income for 1955. As in the case of all other individual taxpayers, you are entitled to use any method of computation described in the answer to question 2. However, if you use the third or fourth method described in the answer to that question, you must take into account in determining the amount of your taxable income for the months preceding the month in which the installment date falls your distributive share of the partnership income for such months, whether or not actually distributed to you in those months.

13. Q. Assume the same set of circumstances as in the preceding question, except that I receive guaranteed payments under the partnership agreement. What then do I take into account for the purpose of determining the amount of my estimated tax?

A. Guaranteed payments, to the extent determined without regard to the income of the partnership, are included in gross income of the partner. Accordingly, you should take into account the total amount of guaranteed payments to which you are entitled plus any other amount of the partnership earnings to which you are also entitled.

14. Q. I am a partner in a law firm and I receive a guaranteed payment each month determined without regard to the income of the partnership. Both the partnership return and my return are made on a calendar-year basis. The partnership agreement provides that any

earnings in excess of guaranteed payments shall be allocated to the various partners during the last month of the year. It further provides that the allocation is to be made by the senior partner after taking into consideration each partner's work during the year. How can I use the fourth method discussed in the answer to question 2 to determine the amount of my estimated tax to be declared and paid by April 15?

A. In order for any taxpayer to use this method with certainty, he must establish his actual taxable income for the months in his taxable year preceding the month in which the installment date falls. Your actual taxable income will include both the amount of guaranteed payments and your distributive share of the partnership earnings for the months that precede the month in which the installment date falls, whether or not your share was actually distributed to you in those months. If, prior to the installment date, the partnership in good faith furnishes the partners with information enabling them to determine their distributive shares of partnership earnings for such months, you will be able to use the fourth method with certainty by taking into account your distributive share so determined of the actual partnership earnings for such months and all your other income for those months, even though the partnership may later reconsider and fix a different percentage allocation of partnership earnings for the year. If, prior to the installment date, the partnership does not furnish you with information that will enable you to determine your distributive share of the partnership earnings for such months, you will be unable to use the fourth method with certainty that your installment payment will be in an amount sufficient to relieve you from a possible addition to the tax for underpayment. Under such circumstances, you may find it desirable to use the first or second method discussed in the answer to question 2.

15. Q. The partnership of which I am a member reports income on the basis of a fiscal year ending June 30 while my returns are made on the basis of a calendar year. I do not intend to use any of the methods discussed in question 2 for the purpose of determining my estimated tax. What portion of the partnership earnings for the fiscal year ending June 30, 1955, and for the fiscal year ending June 30, 1956, should I take into account for the purpose of determining the amount of my estimated tax for 1955?

A. You should take into account in connection with your declaration of estimated tax due April 15, 1955, all of your estimated distributive share of the partnership earnings for the fiscal year ending June 30, 1955, since this amount will be properly reportable by you in your Form 1040 return for 1955. No part of the partnership earnings for the fiscal year ending June 30, 1956, should be taken into account in determining the amount of your estimated tax for 1955.

16. Q. Assume the same circumstances as in question 15 except that I intend to use the fourth method discussed in the answer to question 2 in determining and paying my estimated tax. What portion of the partnership earnings for the fiscal year ending June 30, 1955, should I take into account in determining the amount of each installment payment?

A. You should take into account in determining the amount of the April 15 installment your distributive share of the partnership earn-

ings for the period July 1, 1954, to March 31, 1955; for the June 15 installment, your distributive share of the partnership earnings for period July 1, 1954, to May 31, 1955; and for the September 15 and January 15 installments, your distributive share of the partnership earnings for the period July 1, 1954, to June 30, 1955. (Note that in determining the amount of an installment, you should take into account the total amount paid on prior installments.)

17. Q. Assume the same circumstances as in question 16, except that the partnership uses a fiscal year ending January 31. What portion of the partnership earnings for the fiscal year ending January 31, 1955, should I take into account in determining the amount of the April 15 installment payment?

A. You should take into account in determining the amount of the April 15 installment payment your distributive share of the partnership earnings for the period February 1, 1954 to January 31, 1955.

PROBLEMS AFFECTING BENEFICIARIES OF ESTATES AND TRUSTS

18. Q. I am the beneficiary of a trust. How should I take into account distributions of income from the trust in computing my estimated tax?

A. You may use any of the methods discussed in the answer to question 2 in computing your estimated tax. For the purpose of using either of the methods based on actual taxable income, you must take into account your distributable share of the trust income (whether or not actually distributed) for the months preceding the month in which the installment date falls if the trust is one which is required to distribute income to you currently. If the trust is not required to distribute income to you currently, you will be required to take into account only the amounts actually distributed to you during such months.

Where you report income on a calendar-year basis and the trust reports on a fiscal-year basis, portions of the trust income should be taken into account in determining your income at the same time as income from a partnership. See the answers to questions 15, 16, and 17.

Regulations will be issued under sections 6015, 6073, 6153, and 6654 of the Internal Revenue Code of 1954. The opportunity to comment on the proposed construction of these sections, provided by the Administrative Procedure Act, will be available when the regulations are published as a notice of proposed rulemaking.

PART III.—INFORMATION RETURNS

SUBPART A.—INFORMATION CONCERNING PERSONS SUBJECT TO SPECIAL PROVISIONS

SECTION 6033.—RETURNS BY EXEMPT ORGANIZATIONS

(Also Part II, Section 54; Regulations 118, Section 39.54–1) Rev. Rul. 55–133

Federal credit unions are recognized as instrumentalities of the United States within the meaning of section 501(c)(1) of the Internal

Revenue Code of 1954 (sec. 101(15) of the 1939 Code). They are, however, required to file annual information returns on Form 990 since they are not wholly owned by the United States or any agency or instrumentality thereof within the intendment of section 6033(a) of the 1954 Code (sec. 54(f) of the 1939 Code).

The Bureau of Federal Credit Unions, Department of Health, Education, and Welfare, periodically furnishes the Internal Revenue Service lists of Federal credit unions which have been chartered by it. A group ruling and supplements thereto have been issued holding the chartered Federal credit unions included in the lists to be entitled to exemption from Federal income tax as instrumentalities of the United States within the meaning of section 501(c)(1) of the Code of 1954, which corresponds to section 101(15) of the Code of 1939. As provided in these rulings, the Federal credit unions included in the lists are required to file annual information returns on Form 990.

Rev. Rul. 55-371*

(Also Section 401.)

Section 6033 of the Internal Revenue Code of 1954 provides, in effect, that every organization, with certain exceptions, exempt from taxation under section 501(a) of the Code, shall file an annual return stating specifically the items of gross income, receipts, disbursements, and other information. These returns are required to be filed on or before the 15th day of the 5th month following the close of the annual accounting period.

Pursuant to the authority contained in section 6081(a) of the Code, employees' trusts qualified under section 401(a) of the Code and exempt under section 501(a), with annual accounting periods beginning after December 31, 1953, and ending on or before May 31, 1955, are granted an extension of time until November 15, 1955, in which to file 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.

PART IV.—SIGNING AND VERIFYING OF RETURNS AND OTHER DOCUMENTS

SECTION 6065.—VERIFICATION OF RETURNS

Rev. Rul. 55-149

If a return is prepared for a taxpayer by a person(s) or a firm (including partnerships, corporations, etc.), the individual or firm responsible for such preparation shall complete the statement of verification provided on the income return forms in the following manner:

(a) if the person, (or persons) responsible for the preparation of the return is an individual acting in his own capacity, the statement of verification shall be signed by such individual;

*Based on IR News Release No. IR-109, dated March 28, 1955.

(b) if a firm is responsible for the preparation of the return, the statement of verification shall be signed with the firm name. However, if the firm name is stamped or typed, it should be followed by the signature of a person authorized to sign the verification on behalf of the firm. The firm may authorize any officer, member, or employee to sign the verification.

Such verification is not required if the actual preparation of the return is a regular and usual incident of the employment of one regularly and continuously employed for full time by the person for whom the return is made (such as a clerk, secretary, bookkeeper, etc.).

PART V.—TIME FOR FILING RETURNS AND OTHER DOCUMENTS

SECTION 6072.—TIME FOR FILING INCOME TAX RETURNS

(Also Section 1501.) Rev. Rul. 55-108
(Also Part II, Section 53; Regulations 118, Section 39.53-1.)

The District Director of Internal Revenue may prescribe a date for filing the short taxable year return of a dissolved subsidiary corporation to correspond with the due date of the return of the common parent corporation where the short period return of the subsidiary is not delinquent and where the subsidiary may elect to or is required to be included in a consolidated return. The amount of tax paid upon the basis of the return of the subsidiary will be considered as having been paid by the common parent corporation.

Advice has been requested whether a subsidiary corporation on the calendar year basis which was dissolved and merged into its parent corporation on March 31, 1954, and which had been granted a 6-months extension of time to December 15, 1954, in which to file its short period return may (1) receive a further extension of time in which to file its return, or (2) if the return is filed on December 15, 1954, whether the subsidiary is required to be included in a consolidated return for the calendar year 1954.

In the instant case, the subsidiary filed a tentative return on June 15, 1954, and that date paid one-half of its estimated tax, and paid the balance on September 15, 1954.

Section 39.53-1(4) of Regulations 118, promulgated under section 53 of the Internal Revenue Code of 1939 which is the counterpart of section 6081 of the 1954 Code, provides that in the case of any return for a fractional part of a year, the District Director of Internal Revenue may, upon a showing by the taxpayer of unusual circumstances, prescribe a later time for the filing of the return. The term "unusual circumstances" is construed to include the situation where a subsidiary has been merged into the common parent before the end of the taxable year of the parent and it is not known at that time whether a consolidated return will be filed by the affiliated group.

Section 1501 of the Internal Revenue Code of 1954 provides that in the case of a corporation which is a member of an 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. If the affiliated group has and elects to exercise the privilege of making a consolidated return, the privilege must be exercised at the time of making the return of the common parent corporation. In the case of a calendar year taxpayer, the return shall be filed on or before March 15, or such later time as is prescribed by the District Director.

Accordingly, the District Director may prescribe a date for filing the short taxable year return of a dissolved subsidiary corporation to correspond with the due date of the return of the common parent in a case where the return of the subsidiary is not delinquent and where the subsidiary may elect to or is required to be included in a consolidated return. The amount of tax paid upon the basis of the return of the subsidiary will be considered as having been paid by the common parent corporation.

PART VI.—EXTENSION OF TIME FOR FILING RETURNS

SECTION 6081.—EXTENSION OF TIME FOR FILING RETURNS

(Also Section 1501.) Rev. Rul. 55-174*

The time for filing consolidated returns for taxable years ending on or after December 31, 1954, but before June 30, 1955, is extended to September 15, 1955.

1. Pursuant to the authority contained in section 6081(a) of the Internal Revenue Code of 1954, the time for filing the return for a taxable year ending on or after December 31, 1954, but before June 30, 1955, by a corporation which is a member of an affiliated group having the privilege of making a consolidated return for such taxable year under section 1501 of the Internal Revenue Code of 1954 is hereby extended to September 15, 1955.

2. Requests for an additional extension of time for filing such return beyond that set forth in paragraph 1, to which a taxpayer may be entitled under section 6081 (a) or (b), should be addressed to the District Director of Internal Revenue for the district in which the consolidated return will be filed.

3. The extension of time granted in paragraph (1) of this Revenue Ruling shall not be construed as an extension of time for payment of tax nor as a waiver of liability for interest on any amount of tax due and unpaid as provided by law.

Rev. Rul. 55-262†

Fiduciaries of estates and trusts are hereby granted an extension of time up to and including May 16, 1955, for filing nontaxable returns

*Originally issued as IR-Circular No. 55-23, dated March 14, 1955.
†Originally issued as IR News Release No. IR-111, dated April 13, 1955.

on Form 1041, U. S. Fiduciary Income Tax Return, for taxable years ending on December 31, 1954. This extension applies only if the return contains, or has attached to it, a statement that the beneficiaries or other distributees of the estate or trust were apprised on or before April 15, 1955, of their distributive shares of income of the estate or trust.

Date interest will commence to run on additional tax due to the change in law provided by section 7851(a)(1)(D). See Rev. Rul. 55-22, page 198.

SUBCHAPTER B.—MISCELLANEOUS PROVISIONS

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. T. D. 6132

TITLE 26—INTERNAL REVENUE, 1954.—CHAPTER I, SUBCHAPTER F, PART 301.—PROCEDURE AND ADMINISTRATION

Inspection of certain returns by committees of Congress other than those ennumerated in section 6103(d) of 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)-101. INSPECTION OF RETURNS BY COMMITTEES OF CONGRESS OTHER THAN THOSE ENUMERATED IN SECTION 6103(d) OF THE INTERNAL REVENUE CODE OF 1954.—(a)(1) Pursuant to the provisions of section 6103(a) of the Internal Revenue Code of 1954 (68A Stat. 753; 26 U. S. C. 6103(a)), any return with respect to income, estate, or gift tax imposed by the Internal Revenue Code of 1954 shall be open to inspection by any committee of the Congress, or any subcommittee of a committee of the Congress, specially authorized to inspect such returns by an Executive order issued under the aforementioned statutory provisions on or after the date of the approval of this Treasury Decision. Such inspection shall be subject to the conditions and restrictions imposed by the Executive order and the rules and regulations hereinafter prescribed.

(2) Only such of the aforementioned returns as are specified in a resolution adopted by the committee in accordance with the rules of the appropriate house of the Congress then applicable to the reporting of a measure or recommendation from such committee shall be open to inspection. Such resolution shall set forth the names and addresses of the taxpayers whose returns it is necessary to inspect and the taxable periods covered by the returns. The inspection of returns authorized in this section may be made by the committee of the Con-

gress, or the subcommittee of a committee of the Congress, authorized as provided in subparagraph (1) of this paragraph, acting directly as a committee or as a subcommittee, or by or through such examiners or agents as such committee or subcommittee may designate or appoint in its written request hereinafter mentioned. Upon written request by the chairman of such committee or of such subcommittee to the Secretary of the Treasury, giving the names and addresses of the taxpayers whose returns it is desired to inspect and the taxable periods covered by the returns and stating that the resolution hereinbefore mentioned with respect to the inspection of such returns has been duly adopted by such committee or by the committee under which such subcommittee functions, the Secretary or any officer or employee of the Department of the Treasury, with the approval of the Secretary, shall furnish such committee or subcommittee with any data relating to or contained in any such return or shall make such return available for inspection by such committee or subcommittee or by the examiners or agents designated or appointed by such committee or subcommittee. Such data shall be furnished, or such return shall be made available for inspection, in an office of the Internal Revenue Service. Any information thus obtained by such committee or subcommittee shall be held confidential: *Provided, however*, That any portion thereof relevant or pertinent to the purpose of the investigation may be submitted by the investigating committee to the appropriate house of the Congress.

(3) This section shall not be applicable to any committee authorized by section 6103(d) of the Internal Revenue Code of 1954 to inspect returns.

(b) Because this Treasury Decision constitutes a general statement of policy and establishes a rule of Departmental practice and procedure, it is found that it is unnecessary to issue this Treasury Decision with notice and public procedure thereon under section 4(a) of the Administrative Procedure Act, approved June 11, 1946, or subject to the effective date limitation of section 4(c) of that Act.

(c) This Treasury Decision shall be effective upon its filing for publication in the Federal Register.

G. M. HUMPHREY,
Secretary of the Treasury.

Approved: May 3, 1955,

DWIGHT D. EISENHOWER,
THE WHITE HOUSE.

(Filed with the Division of the Federal Register May 3, 1955, 5: 02 p. m.)

EXECUTIVE ORDER 10606

(Also Part II.)

Inspection of income, excess-profits, declared value excess-profits, capital-stock, estate, and gift tax returns by the Senate Committee on Government Operations.

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 the years 1945 to 1954, inclusive, shall, during the Eighty-fourth Congress, be open to inspection by the Senate Committee on Government Operations, or any duly authorized subcommittee thereof, in connection with its studies of the operation of Government activities at all levels with a view to determining its economy and efficiency, 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 returns by certain committees of the Congress, 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,
May 3, 1955.

(Filed with the Division of the Federal Register May 3, 1955, 5: 02 p. m.)

EXECUTIVE ORDER 10607

(Also Part II.)

Inspection of income, excess-profits, declared-value excess-profits, capital-stock, estate, and gift tax returns by the Committee on Government Operations, 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 1954, shall, during the Eighty-fourth Congress, be open to inspection by the Committee on Government Operations, House of Representatives, or any duly authorized subcommittee thereof, in connection with its studies of the operation of Government activities at all levels with a view to determining the economy and efficiency of the Government, such inspection to be in accordance and upon compliance with the rules and regulations prescribed by the Secretary of the Treasury in the two Treasury Decisions, relating to the inspection of returns by committees of the Congress, approved by me this date.

This order shall be effective upon its filing for publication in the Federal Register.

DWIGHT D. EISENHOWER.

THE WHITE HOUSE,
May 3, 1955.

(Filed with the Division of the Federal Register May 3, 1955, 5: 02 p. m.)

CHAPTER 63.—ASSESSMENT

SUBCHAPTER A.—IN GENERAL

SECTION 6201.—ASSESSMENT AUTHORITY

26 CFR 301.6201–1: Assessment authority. T. D. 6119
(Also Sections 6301, 6402, 6404; 26 CFR 301.6301–1, 301.6402–1, 301.6404–1.)

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER F, PART 301

Regulations under chapters 63, 64, and 65 of the Internal Revenue Code of 1954, relating to assessment, collection, abatements, credits, and refunds.

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

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

On December 11, 1954, there was published in the Federal Register (19 F. R. 8457) a notice of proposed rule making regarding regulations under chapter 63, relating to assessment, chapter 64 (except section 6316), relating to collection, and chapter 65, relating to abatements, credits, and refunds, of the Internal Revenue Code of 1954. On December 15, 1954, a correction notice making four changes in the proposed regulations was published in the Federal Register (19 F. R. 8580). After consideration of all relevant matter presented by interested parties regarding the rules proposed, the following regulations are hereby adopted.

ASSESSMENT

IN GENERAL

Sec.
301.6201 Statutory provisions; assessment authority.
301.6201–1 Assessment authority.
301.6202 Statutory provisions; establishment by regulations of mode or time of assessment.
301.6203 Statutory provisions; method of assessment.
301.6203–1 Method of assessment.
301.6204 Statutory provisions; supplemental assessments.
301.6204–1 Supplemental assessment.
301.6205 Statutory provisions; special rules applicable to certain employment taxes.
301.6205–1 Special rules applicable to certain employment taxes.
301.6206 Statutory provisions; cross references.

DEFICIENCY PROCEDURES

301.6211 Statutory provisions; definition of a deficiency.
301.6211–1 Deficiency defined.
301.6212 Statutory provisions; notice of deficiency.
301.6212–1 Notice of deficiency.
301.6213 Statutory provisions; restrictions applicable to deficiencies; petition to Tax Court.
301.6213–1 Restrictions applicable to deficiencies; petition to Tax Court.
301.6214 Statutory provisions; determinations by Tax Court.

Sec.
301.6215 Statutory provisions; assessment of deficiency found by Tax Court.
301.6215–1 Assessment of deficiency found by Tax Court.
301.6216 Statutory provisions; cross references.

COLLECTION

GENERAL PROVISIONS

301.6301 Statutory provisions; collection authority.
301.6301–1 Collection authority.
301.6302 Statutory provisions; mode or time of collection.
301.6302–1 Use of Federal reserve banks and authorized commercial banks in connection with the payment of certain employment and excise taxes.
301.6303 Statutory provisions; notice and demand for tax.
301.6303–1 Notice and demand for tax.
301.6304 Statutory provisions; collection under the Tariff Act.

RECEIPT OF PAYMENT

301.6311 Statutory provisions; payment by check or money order.
301.6311–1 Payment by check or money order.
301.6312 Statutory provisions; payment by United States notes and certificates of indebtedness.
301.6312–1 Treasury certificates of indebtedness, Treasury notes, and Treasury bills acceptable in payment of internal revenue taxes or stamps.
301.6312–2 Certain Treasury savings notes acceptable in payment of certain internal revenue taxes.
301.6313 Statutory provisions; fractional parts of a cent.
301.6313–1 Fractional parts of a cent.
301.6314 Statutory provisions; receipt for taxes.
301.6314–1 Receipt for taxes.
301.6315 Statutory provisions; payments of estimated income tax.
301.6315–1 Payments of estimated income tax.
301.6316 Statutory provisions; payment by foreign currency.

LIEN FOR TAXES

301.6321 Statutory provisions; lien for taxes.
301.6321–1 Lien for taxes.
301.6322 Statutory provisions; period of lien.
301.6323 Statutory provisions; validity against mortgagees, pledgees, purchasers, and judgment creditors.
301.6323–1 Validity of lien against mortgagees, pledgees, purchasers, and judgment creditors.
301.6324 Statutory provisions; special liens for estate and gift taxes.
301.6324–1 Special liens for estate and gift taxes; personal liability of transferees and others.
301.6325 Statutory provisions; release of lien or partial discharge of property.
301.6325–1 Release of lien or partial discharge of property.
301.6326 Statutory provisions; cross references.

SEIZURE OF PROPERTY FOR COLLECTION OF TAXES

301.6331 Statutory provisions; levy and distraint.
301.6331–1 Levy and distraint.
301.6332 Statutory provisions; surrender of property subject to levy.
301.6332–1 Surrender of property subject to levy.
301.6333 Statutory provisions; production of books.
301.6333–1 Production of books.
301.6334 Statutory provisions; property exempt from levy.
301.6334–1 Property exempt from levy.
301.6335 Statutory provisions; sale of seized property.
301.6335–1 Sale of seized property.
301.6336 Statutory provisions; sale of perishable goods.
301.6336–1 Sale of perishable goods.
301.6337 Statutory provisions; redemption of property.

Sec.
301.6337-1 Redemption of property.
301.6338 Statutory provisions; certificate of sale; deed of real property.
301.6338-1 Certificate of sale; deed of real property.
301.6339 Statutory provisions; legal effect of certificate of sale of personal property and deed of real property.
301.6339-1 Legal effect of certificate of sale of personal property and deed of real property.
301.6340 Statutory provisions; records of sale.
301.6340-1 Records of sale.
301.6341 Statutory provisions; expense of levy and sale.
301.6341-1 Expense of levy and sale.
301.6342 Statutory provisions; application of proceeds of levy.
301.6342-1 Application of proceeds of levy.
301.6343 Statutory provisions; authority to release levy.
301.6343-1 Authority to release levy.
301.6344 Statutory provisions; cross references.

ABATEMENTS, CREDITS, AND REFUNDS

PROCEDURE IN GENERAL

301.6401 Statutory provisions; amounts treated as overpayments.
301.6401-1 Amounts treated as overpayments.
301.6402 Statutory provisions; authority to make credits or refunds.
301.6402-1 Authority to make credits or refunds.
301.6402-2 Claims for credit or refund.
301.6402-3 Special rules applicable to income tax.
301.6402-4 Payments in excess of amounts shown on return.
301.6402-5 Claim for payment of judgment obtained against district director.
301.6402-6 Claim for payment of judgment obtained in United States district court against the United States.
301.6402-7 Claim for payment of judgment obtained in the Court of Claims against the United States.
301.6403 Statutory provisions; overpayment of installment.
301.6403-1 Overpayment of installment.
301.6404 Statutory provisions; abatements.
301.6404-1 Abatements.
301.6405 Statutory provisions; reports of refunds and credits.
301.6405-1 Reports of refunds and credits.
301.6406 Statutory provisions; prohibition of administrative review of decisions.
301.6407 Statutory provisions; date of allowance of refund or credit.
301.6407-1 Date of allowance of refund or credit.

RULES OF SPECIAL APPLICATION

301.6411 Statutory provisions; tentative carryback adjustments.
301.6411-1 Tentative carryback adjustments.
301.6412 Statutory provisions; floor stock refunds.
301.6412-1 Floor stocks refunds.
301.6413 Statutory provisions; special rules applicable to certain employment taxes.
301.6413-1 Special rules applicable to certain employment taxes.
301.6414 Statutory provisions; income tax withheld.
301.6414-1 Income tax withheld.
301.6415 Statutory provisions; credits or refunds to persons who collected certain taxes.
301.6415-1 Credits or refunds to persons who collected certain taxes
301.6416 Statutory provisions; certain taxes on sales and services.
301.6416-1 Certain taxes on sales and services.
301.6417 Statutory provisions; coconut and palm oil.
301.6417-1 Coconut and palm oil.
301.6418 Statutory provisions; sugar.
301.6418-1 Sugar.
301.6419 Statutory provisions; excise tax on wagering.
301.6419-1 Excise tax on wagering.
301.6420 Statutory provisions; cross references.

EFFECTIVE DATE AND RELATED PROVISIONS

Sec.
301.7851 Statutory provisions; applicability of revenue laws.

AUTHORITY: § § 301.6201 to 301.7851 issued under sec. 7805, 68A Stat. 917; 26 U. S. C. 7805.

ASSESSMENT

IN GENERAL

SEC. 301.6201. STATUTORY PROVISIONS; ASSESSMENT AUTHORITY.

SEC. 6201. ASSESSMENT AUTHORITY.

(a) *Authority of Secretary or delegate.* The Secretary or his delegate is authorized and required to make the inquiries, determinations, and assessments of all taxes (including interest, additional amounts, additions to the tax, and assessable penalties) imposed by this title, or accruing under any former internal revenue law, which have not been duly paid by stamp at the time and in the manner provided by law. Such authority shall extend to and include the following:

(1) *Taxes shown on return.*—The Secretary or his delegate shall assess all taxes determined by the taxpayer or by the Secretary or his delegate as to which returns or lists are made under this title.

(2) *Unpaid taxes payable by stamp.*

(A) *Omitted stamps.*—Whenever any article upon which a tax is required to be paid by means of a stamp is sold or removed for sale or use by the manufacturer thereof or whenever any transaction or act upon which a tax is required to be paid by means of a stamp occurs without the use of the proper stamp, it shall be the duty of the Secretary or his delegate, upon such information as he can obtain, to estimate the amount of tax which has been omitted to be paid and to make assessment therefor upon the person or persons the Secretary or his delegate determines to be liable for such tax.

(B) *Check or money order not duly paid.*—In any case in which a check or money order received under authority of section 6311 as payment for stamps is not duly paid, the unpaid amount may be immediately assessed as if it were a tax imposed by this title, due at the time of such receipt, from the person who tendered such check or money order.

(3) *Erroneous income tax prepayment credits.*—If on any return or claim for refund of income taxes under subtitle A there is an overstatement of the credit for income tax withheld at the source, or of the amount paid as estimated income tax, the amount so overstated which is allowed against the tax shown on the return or which is allowed as a credit or refund may be assessed by the Secretary or his delegate in the same manner as in the case of a mathematical error appearing upon the return.

(b) *Estimated income tax.*—No unpaid amount of estimated tax under section 6153 or 6154 shall be assessed.

(c) *Compensation of child.*—Any income tax under chapter 1 assessed against a child, to the extent attributable to amounts includible in the gross income of the child, and not of the parent, solely by reason of section 73 (a), shall, if not paid by the child, for all purposes be considered as having also been properly assessed against the parent.

(d) *Deficiency proceedings.*—For special rules applicable to deficiencies of income, estate, and gift taxes, see subchapter B.

SEC. 301.6201-1. ASSESSMENT AUTHORITY—(a) *In general.*—The District Director is authorized and required to make all inquiries necessary to the determinations and assessments of all taxes imposed by the Internal Revenue Code of 1954 or any prior internal revenue law. He is further authorized and required to make the determinations and the assessments of such taxes. However, certain inquiries and determinations are, by direction of the Commissioner, made by other officials, such as Assistant Regional Commissioners. The term "taxes" includes interest, additional amounts, additions to the taxes, and assessable penalties. The authority of the District Director to make assessments includes the following:

(1) *Taxes shown on return.*—The District Director shall assess all taxes determined by the taxpayer or by the District Director and disclosed on a return or list.

(2) *Unpaid taxes payable by stamp.* (i) If without the use of the proper stamp:

(*a*) Any article upon which a tax is required to be paid by means of a stamp is sold or removed for sale or use by the manufacturer thereof, or

(*b*) Any transaction or act upon which a tax is required to be paid by means of a stamp occurs:

the District Director, upon such information as he can obtain, must estimate the amount of the tax which has not been paid and must make assessment therefor upon the person the District Director determines to be liable for the tax. However, the District Director may not assess any tax which is payable by stamp unless the taxpayer fails to pay such tax at the time and in the manner provided by law or regulations.

(ii) If a taxpayer gives a check or money order as payment for stamps but the check or money order is not paid upon presentment, then the District Director shall assess the amount of the check or money order against the taxpayer as if it were a tax due at the time the check or money order was received by the District Director.

(3) *Erroneous income tax prepayment credits.*—If the amount of income tax withheld or the amount of estimated income tax paid is overstated by a taxpayer on a return or on a claim for refund, the amount so overstated which is allowed against the tax shown on the return or which is allowed as a credit or refund shall be assessed by the District Director in the same manner as in the case of a mathematical error on the return. See section 6213(b)(1), relating to exceptions to restrictions on assessment.

(*b*) *Estimated income tax.*—The District Director shall not assess any amount of estimated income tax required to be paid under section 6153 or 6154 which is unpaid.

(*c*) *Compensation of child.*—Any income tax assessed against a child, to the extent of the amount attributable to income included in the gross income of the child solely by reason of section 73(a) or the corresponding provision of prior law, if not paid by the child, shall, for the purposes of the income tax imposed by chapter 1 (or the corresponding provisions of prior law), be considered as having also been properly assessed against the parent. In any case in which the earnings of the child are included in the gross income of the child solely by reason of section 73(a) or the corresponding provision of prior law, the parent's liability is an amount equal to the amount by which the tax assessed against the child (and not paid by him) has been increased by reason of the inclusion of such earnings in the gross income of the child. Thus, if for the calendar year 1954 the child has income of $1,000 from investments and of $3,000 for services rendered, and the latter amount is includible in the gross income of the child under section 73(a) and the child has no wife or dependents, the tax liability determined under section 3 is $625. If the child had only the investment income of $1,000, his tax liability would be $62. If the tax of $625 is assessed against the child, the difference between $625 and $62, or $563, is the amount of such tax which is considered to have been properly assessed against the parent, if not paid by the child.

SEC. 301.6202. STATUTORY PROVISIONS; ESTABLISHMENT BY REGULATIONS OF MODE OR TIME OF ASSESSMENT.

SEC. 6202. ESTABLISHMENT BY REGULATIONS OF MODE OR TIME OF ASSESSMENT.

If the mode or time for the assessment of any internal revenue tax (including interest, additional amounts, additions to the tax, and assessable penalties) is not otherwise provided for, the Secretary or his delegate may establish the same by regulations.

SEC. 301.6203. STATUTORY PROVISIONS; METHOD OF ASSESSMENT.

SEC. 6203. METHOD OF ASSESMENT.

The assessment shall be made by recording the liability of the taxpayer in the office of the Secretary or his delegate in accordance with rules or regulations prescribed by the Secretary or his delegate. Upon request of the taxpayer, the Secretary or his delegate shall furnish the taxpayer a copy of the record of the assessment.

SEC. 301.6203–1. METHOD OF ASSESSMENT.

The District Director shall appoint one or more assessment officers, and the assessment shall be made by an assessment officer signing the summary record of assessment. The summary record, through supporting records, shall provide identification of the taxpayer, the character of the liability assessed, the taxable period if applicable, and the amount of the assessment. The amount of the

assessment shall in the case of tax shown on a return by the taxpayer, be the amount so shown, and in all other cases the amount of the assessment shall be the amount shown on the supporting list or record. The date of the assessment is the date the summary record is signed by an assessment officer. If the taxpayer requests a copy of the record of assessment, the District Director shall furnish the taxpayer a copy of the pertinent parts of the assessment which set forth the name of the taxpayer, the date of assessment, the character of the liability assessed, the taxable period, if applicable, and the amounts assessed.

SEC. 301.6204. STATUTORY PROVISION; SUPPLEMENTAL ASSESSMENTS.

SEC. 6204. SUPPLEMENTAL ASSESSMENT.

(a) *General rule.*—The Secretary or his delegate may, at any time within the period prescribed for assessment, make a supplemental assessment whenever it is ascertained that any assessment is imperfect or incomplete in any material respect.

(b) *Restrictions on assessment.*—For restrictions on assessment of deficiencies in income, estate, and gift taxes, see section 6213.

SEC. 301.6204–1. SUPPLEMENTAL ASSESSMENT.—If any assessment is incomplete or incorrect in any material respect, the District Director, subject to the restrictions with respect to the assessment of deficiencies in income, estate, and gift taxes, and subject to the applicable period of limitation, may make a supplemental assessment for the purpose of correcting or completing the original assessment.

SEC. 301.6205. STATUTORY PROVISIONS; SPECIAL RULES APPLICABLE TO CERTAIN EMPLOYMENT TAXES.

SEC. 6205. SPECIAL RULES APPLICABLE TO CERTAIN EMPLOYMENT TAXES.

(a) *Adjustment of tax.*

(1) *General rule.*—If less than the correct amount of tax imposed by section 3101, 3111, 3201, 3221, or 3402 is paid with respect to any payment of wages or compensation, proper adjustments, with respect to both the tax and the amount to be deducted, shall be made, without interest, in such manner and at such times as the Secretary or his delegate may by regulations prescribe.

(2) *United States as employer.*—For purposes of this subsection, in the case of remuneration received from the United States or a wholly owned instrumentality thereof during any calendar year, each head of a Federal agency or instrumentality who makes a return pursuant to section 3122 and each agent, designated by the head of a Federal agency or instrumentality, who makes a return pursuant to such section shall be deemed a separate employer.

(b) *Underpayments.*—If less than the correct amount of tax imposed by section 3101, 3111, 3201, 3221, or 3402 is paid or deducted with respect to any payment of wages or compensation and the underpayment cannot be adjusted under subsection (a) of this section, the amount of the underpayment shall be assessed and collected in such manner and at such times (subject to the statute of limitations properly applicable thereto) as the Secretary or his delegate may by regulations prescribe.

SEC. 301.6205–1. SPECIAL RULES APPLICABLE TO CERTAIN EMPLOYMENT TAXES. For regulations under this section, see the Employment Tax Regulations (Pt. 31 of this chapter).

SEC. 301.6206. STATUTORY PROVISIONS; CROSS REFERENCES.

SEC. 6206. CROSS REFERENCES.

(1) For prohibition of suits to restrain assessment of any tax, see section 7421.

(2) For prohibition of assessment of taxes against insolvent banks, see section 7507.

(3) For assessment where property subject to tax has been sold in a distraint proceeding without the tax having been assessed prior to such sale, see section 6342.

(4) For assessment in case of sale or removal of tobacco, snuff, cigars, and cigarettes without the use of proper stamps, see section 5703(d).

(5) For assessment in case of distilled spirits removed from place where distilled and not deposited in bonded warehouse, see section 5006(c).

(6) For assessment in case of certain spirits subject to excessive leakage, see section 5006(b).

(7) For assessment of deficiencies in production of distilled spirits, see section 5007(e)(1).

(8) For period of limitation upon assessment, see chapter 66.

(9) For assessment under the provisions of the Tariff Act of 1930 of the taxes imposed by section 4501(b), and subchapters A, B, C, D, and E of chapter 38, see sections 4504 and 4601, respectively.

DEFICIENCY PROCEDURES

SEC. 301.6211. STATUTORY PROVISIONS; DEFINITION OF A DEFICIENCY.

SEC. 6211. DEFINITION OF A DEFICIENCY.

(a) *In general.* For purposes of this title in the case of income, estate, and gift taxes, imposed by subtitles A and B, the term "deficiency" means the amount by which the tax imposed by subtitles A or B exceeds the excess of:

(1) The sum of:

(A) The amount shown as the tax by the taxpayer upon his return, if a return was made by the taxpayer and an amount was shown as the tax by the taxpayer thereon, plus

(B) The amounts previously assessed (or collected without assessment) as a deficiency, over:

(2) the amount of rebates, as defined in subsection (b)(2), made.

(b) *Rules for application of subsection* (a). For purposes of this section:

(1) The tax imposed by chapter 1 and the tax shown on the return shall both be determined without regard to payments on account of estimated tax, without regard to the credit under section 31, and without regard to so much of the credit under section 32 as exceeds 2 percent of the interest on obligations described in section 1451.

(2) The term "rebate" means so much of an abatement, credit, refund, or other repayment, as was made on the ground that the tax imposed by subtitles A or B was less than the excess of the amount specified in subsection (a)(1) over the rebates previously made.

(3) The computation by the Secretary or his delegate, pursuant to section 6014, of the tax imposed by chapter 1 shall be considered as having been made by the taxpayer and the tax so computed considered as shown by the taxpayer upon his return.

SEC. 301.6211-1 DEFICIENCY DEFINED.—(a) In the case of the income tax imposed by subtitle A, the estate tax imposed by chapter 11, or the gift tax imposed by chapter 12, the term "deficiency" means the excess of the tax (income, estate, or gift tax, as the case may be) over the sum of the amount shown as such tax by the taxpayer upon his return and the amounts previously assessed (or collected without assessment) as a deficiency; but such sum shall first be reduced by the amount of rebates made. If no return is made, or if the return (except a return of income tax on Form 1040A pursuant to section 6014) does not show any tax, for the purpose of the definition "the amount shown as the tax by the taxpayer upon his return" shall be considered as zero. Accordingly, in any such case, if no deficiencies with respect to the tax have been assessed, or collected without assessment, and no rebates with respect to the tax have been made, the deficiency is the amount of the tax imposed by subtitle A, chapter 11, or chapter 12. Additional tax shown on an "amended return," so-called, filed after the due date of the return, is a deficiency within the meaning of the Internal Revenue Code.

(b) For purposes of the definition, the income tax imposed by subtitle A and the income tax shown on the return shall both be determined without regard to the credit provided in section 31 for income tax withheld at the source and without regard to so much of the credit provided in section 32 for income taxes withheld at the source as exceeds 2 percent of the interest on tax-free covenant bonds described in section 1451. Payments on account of estimated income tax, like other payments of tax by the taxpayer, shall likewise be disregarded in the determination of a deficiency.

(c) The computation by the District Director, pursuant to section 6014(a), of the income tax imposed by subtitle A shall be considered as having been made by the taxpayer and the tax so computed shall be considered as the tax shown by the taxpayer upon his return.

(d) If so much of the credit claimed on the return for income taxes withheld at the source as exceeds 2 percent of the interest on tax-free covenant bonds is

greater than the amount of such credit allowable, the unpaid portion of the tax attributable to such difference will be collected not as a deficiency but as an underpayment of the tax shown on the return.

(e) This section may be illustrated by the following examples:

Example (1). The amount of income tax shown by the taxpayer upon his return for the calendar year 1954 was $1,600. The taxpayer had no amounts previously assessed (or collected without assessment) as a deficiency. He claimed a credit in the amount of $2,050 for tax withheld at source on wages under section 3402 and a refund of $450 (not a rebate under sec. 6211) was made to him as an overpayment of tax for the taxable year. It is later determined that the correct tax for the taxable year is $1,850.

A deficiency of $250 is determined as follows:

Tax imposed by subtitle A		$1,850
Tax shown on return	$1,600	
Tax previously assessed (or collected without assessment) as a deficiency	None	
Total	1,600	
Amount of rebates made	None	
Balance		1,600
Deficiency		250

Example (2). The taxpayer made a return for the calendar year 1954 showing a tax of $1,250 before any credits for tax withheld at the source. He claimed a credit in the amount of $800 for tax withheld at source on wages under section 3402 and $60 for tax paid at source under section 1451 upon interest on bonds containing a tax-free covenant. The taxpayer had no amounts previously assessed (or collected without assessment) as a deficiency. The District Director determines that the 2 percent tax paid at the source on tax-free covenant bonds is $40 instead of $60 as claimed by the taxpayer and that the tax imposed by subtitle A is $1,360 (total tax $1,400 less $40 paid at source on tax-free covenant bonds). A deficiency in the amount of $170 is determined as follows:

Tax imposed by subtitle A ($1,400 minus $40)		$1,360
Tax shown on return ($1,250 minus $60)	$1,190	
Tax previously assessed (or collected without assessment) as a deficiency	None	
Total	1,190	
Amount of rebates made	None	
Balance		1,190
Deficiency		170

(f) As used in section 6211, the term "rebate" means so much of an abatement, credit, refund, or other repayment as is made on the ground that the tax imposed by subtitle A or B is less than the excess of (1) the amount shown as the tax by the taxpayer upon his return increased by the amount previously assessed (or collected without assessment) as a deficiency over (2) the amount of rebates previously made. For example, assume that the amount of income tax shown by the taxpayer upon his return for the taxable year is $600 and the amount claimed as a credit under section 31 for income tax withheld at the source is $900. If the District Director determines that the tax imposed by subtitle A is $600 and makes a refund of $300, no part of such refund constitutes a "rebate" since the refund is not made on the ground that the tax imposed by subtitle A is less than the tax shown on the return. If, however, the District Director determines that the tax imposed by subtitle A is $500 and refunds $400, the amount of $100 of such refund would contsitute a rebate since it is made on the ground that the tax imposed by subtitle A ($500) is less than the tax shown on the return ($600). The amount of such rebate ($100) would be taken into account in arriving at the amount of any deficiency subsequently determined.

SEC. 301.6212. STATUTORY PROVISIONS; NOTICE OF DEFICIENCY.

SEC. 6212. NOTICE OF DEFICIENCY.

(a) *In general.*—If the Secretary or his delegate determines that there is a deficiency in respect of any tax imposed by subtitles A or B, he is authorized to send notice of such deficiency to the taxpayer by registered mail.

(b) *Address for notice of deficiency.*

(1) *Income and gift taxes.*—In the absence of notice to the Secretary or his delegate under section 6903 of the existence of a fiduciary relationship, notice of a deficiency in respect of a tax imposed by chapter 1 or 12, if mailed to the taxpayer at his last known address, shall be sufficient for purposes of such chapter and this chapter even if such taxpayer is deceased, or is under a legal disability, or, in the case of a corporation, has terminated its existence.

(2) *Joint income tax return.* In the case of a joint income tax return filed by husband and wife, such notice of deficiency may be a single joint notice, except that if the Secretary or his delegate has been notified by either spouse that separate residences have been established, then, in lieu of the single joint notice, a duplicate original of the joint notice shall be sent by registered mail to each spouse at his last known address.

(3) *Estate tax.*—In the absence of notice to the Secretary or his delegate under section 6903 of the existence of a fiduciary relationship, notice of a deficiency in respect of a tax imposed by chapter 11, if addressed in the name of the decedent or other person subject to liability and mailed to his last known address, shall be sufficient for purposes of chapter 11 and of this chapter.

(c) *Further deficiency letters restricted.*

(1) *General rule.*—If the Secretary or his delegate has mailed to the taxpayer a notice of deficiency as provided in subsection (a), and the taxpayer files a petition with the Tax Court within the time prescribed in section 6213(a), the Secretary or his delegate shall have no right to determine any additional deficiency of income tax for the same taxable year, of gift tax for the same calendar year, or of estate tax in respect of the taxable estate of the same decedent, except in the case of fraud, and except as provided in section 6214(a) (relating to assertion of greater deficiencies before the Tax Court), in section 6213(b)(1) (relating to mathematical errors), or in section 6861(c) (relating to the making of jeopardy assessments).

(2) *Cross references.*—For assessment as a deficiency notwithstanding the prohibition of further deficiency letters, in the case of:

(A) Deficiency attributable to change of election to take standard deduction where taxpayer and his spouse made separate returns, see section 144(b).

(B) Deficiency attributable to gain on involuntary conversion, see section 1033(a)(3) (C) and (D).

(C) Deficiency attributable to gain on sale or exchange of personal residence, see section 1034(j).

(D) Deficiency attributable to war loss recoveries where prior benefit rule is elected, see section 1335.

SEC. 301.6212-1. NOTICE OF DEFICIENCY—(a) *General rule.*—If a District Director (or an Assistant Regional Commissioner, Appellate) determines that there is a deficiency in respect of income, estate, or gift tax imposed by subtitle A or B, he is authorized to notify the taxpayer of the deficiency by registered mail.

(b) *Address for notice of deficiency*—(1) *Income and gift taxes.*—Unless the District Director for the district in which the return in question was filed has been notified under the provisions of section 6903 as to the existence of a fiduciary relationship, notice of a deficiency in respect of income tax or of gift tax shall be sufficient if mailed to the taxpayer at his last known address, even though such taxpayer is deceased, or is under a legal disability, or, in the case of a corporation, has terminated its existence.

(2) *Joint income tax returns.*—If a joint income tax return has been filed by husband and wife, the District Director (or Assistant Regional Commissioner, Appellate) may, unless the District Director for the district in which such joint return was filed has been notified by either spouse that a separate residence has been established, send either a joint or separate notice of deficiency to the taxpayers at their last known address. If, however, the proper district Director has been so notified, a separate notice of deficiency, that is, a duplicate original of the joint notice, must be sent by registered mail to each spouse at his or her last known address. The notice of separate residences should be addressed to the District Director for the district in which the joint return was filed.

(3) *Estate tax.*—In the absence of notice, under the provisions of section 6903 as to the existence of a fiduciary relationship, to the District Director for the district in which the estate tax return was filed, notice of a deficiency in respect of the estate tax imposed by chapter 11 of subtitle B shall be sufficient if addressed in the name of the decedent or other person subject to liability and mailed to his last known address.

(c) *Further deficiency letters restricted.*—If the District Director (or Assistant Regional Commissioner, Appellate) mails to the taxpayer notice of a deficiency, and the taxpayer files a petition with the Tax Court within the prescribed period, no additional deficiency may be determined with respect to income tax for the same taxable year, gift tax for the same calendar year, or estate tax with respect to the taxable estate of the same decedent. This restriction shall not apply in the case of fraud, assertion of greater deficiencies before the Tax Court as provided in section 6214(a), mathematical errors as provided in section 6213(b)(1), or jeopardy assessments as provided in section 6861(c).

SEC. 301.6213. STATUTORY PROVISIONS; RESTRICTIONS APPLICABLE TO DEFICIENCIES; PETITION TO TAX COURT.

SEC. 6213. RESTRICTIONS APPLICABLE TO DEFICIENCIES; PETITION TO TAX COURT.

(a) *Time for filing petition and restriction on assessment.* Within 90 days, or 150 days if the notice is addressed to a person outside the States of the Union and the District of Columbia, after the notice of deficiency authorized in section 6212 is mailed (not counting Saturday, Sunday, or a legal holiday in the District of Columbia as the last day), the taxpayer may file a petition with the Tax Court for a redetermination of the deficiency. Except as otherwise provided in section 6861 no assessment of a deficiency in respect of any tax imposed by subtitle A or B and no levy or proceeding in court for its collection shall be made, begun, or prosecuted until such notice has been mailed to the taxpayer, nor until the expiration of such 90-day or 150-day period, as the case may be, nor, if a petition has been filed with the Tax Court, until the decision of the Tax Court has become final. Notwithstanding the provisions of section 7421(a), the making of such assessment or the beginning of such proceeding or levy during the time such prohibition is in force may be enjoined by a proceeding in the proper court.

(b) *Exceptions to restrictions on assessment.*

(1) *Mathematical errors.*—If the taxpayer is notified that, on account of a mathematical error appearing upon the return, an amount of tax in excess of that shown upon the return is due, and that an assessment of the tax has been or will be made on the basis of what would have been the correct amount of tax but for the mathematical error, such notice shall not be considered as a notice of deficiency for the purposes of subsection (a) (prohibiting assessment and collection until notice of the deficiency has been mailed), or of section 6212(c)(1) (restricting further deficiency letters), or section 6512(a) (prohibiting credits or refunds after petition to the Tax Court), and the taxpayer shall have no right to file a petition with the Tax Court based on such notice, nor shall such assessment or collection be prohibited by the provisions of subsection (a) of this section.

(2) *Assessments arising out of tentative carryback adjustments.*—If the Secretary or his delegate determines that the amount applied, credited, or refunded under section 6411 is in excess of the overassessment attributable to the carryback with respect to which such amount was applied, credited, or refunded, he may assess the amount of the excess as a deficiency as if it were due to a mathematical error appearing on the return.

(3) *Assessment of amount paid.*—Any amount paid as a tax or in respect of a tax may be assessed upon the receipt of such payment notwithstanding the provisions of subsection (a). In any case where such amount is paid after the mailing of a notice of deficiency under section 6212, such payment shall not deprive the Tax Court of jurisdiction over such deficiency determined under section 6211 without regard to such assessment.

(c) *Failure to file petition.*—If the taxpayer does not file a petition with the Tax Court within the time prescribed in subsection (a), the deficiency, notice of which has been mailed to the taxpayer, shall be assessed, and shall be paid upon notice and demand from the Secretary or his delegate.

(d) *Waiver of restrictions.*—The taxpayer shall at any time (whether or not a notice of deficiency has been issued) have the right, by a signed notice in writing filed with the Secretary or his delegate, to waive the restrictions provided in subsection (a) on the assessment and collection of the whole or any part of the deficiency.

(e) *Cross references.*—(1) For assessment as if a mathematical error on the return, in the case of erroneous claims for income tax prepayment credits, see section 6201(a)(3).

(2) For assessments without regard to restrictions imposed by this section in the case of—

(A) Recovery of foreign income taxes, see section 905(c).

(B) Recovery of foreign estate tax, see section 2016.

SEC. 301.6213-1. RESTRICTIONS APPLICABLE TO DEFICIENCIES; PETITION TO TAX COURT—(a) *Time for filing petition and restrictions on assessment*—(1) *Time for filing petition.*—Within 90 days after notice of the deficiency is mailed (or within 150 days after mailing in the case of such notice addressed to a person outside the States of the Union and the District of Columbia), as provided in section 6212, a petition may be filed with the Tax Court of the United States for a redetermination of the deficiency. In determining such 90-day or 150-day period, Saturday, Sunday, or a legal holiday in the District of Columbia is not counted as the 90th or 150th day. The term "States of the Union" referred to in this paragraph does not include the Territories of Alaska and Hawaii.

(2) *Restrictions on assessment.*—Except as otherwise provided by this section, by section 6861(a) (relating to jeopardy assessments of income, estate, and gift taxes), by section 6871(a) (relating to immediate assessment of claims for income, estate, and gift taxes in bankruptcy and receivership cases), or by section 7485 (in case taxpayer petitions for a review of a Tax Court decision without filing bond), no assessment of a deficiency in respect of a tax imposed by subtitle A or B and no levy or proceeding in court for its collection shall be made until notice of deficiency has been mailed to the taxpayer, nor until the expiration of the 90-day or 150-day period within which a petition may be filed with the Tax Court, nor, if a petition has been filed with the Tax Court, until the decision of the Tax Court has become final. As to the date on which a decision of the Tax Court becomes final, see section 7481. Notwithstanding the provisions of section 7421(a), the making of an assessment or the beginning of a proceeding or levy which is forbidden by this paragraph may be enjoined by a proceeding in the proper court.

(b) *Exceptions to restrictions on assessment of deficiencies*—(1) *Mathematical errors.*—If a taxpayer is notified of an additional amount of tax due on account of a mathematical error appearing upon the return, such notice is not deemed a notice of deficiency, and the taxpayer has no right to file a petition with the Tax Court upon the basis of such notice, nor is the assessment of such additional amount prohibited by section 6213(a).

(2) *Tentative carryback adjustments.*—(i) If the District Director determines that any amount applied, credited, or refunded under section 6411(b) with respect to an application for a tentative carryback adjustment is in excess of the overassessment properly attributable to the carryback upon which such application was based, he may assess the amount of the excess as a deficiency as if such deficiency were due to a mathematical error appearing on the return. That is, the District Director may assess an amount equal to the excess, and such amount may be collected, without regard to the restrictions on assessment and collection imposed by section 6213(a). Thus, the District Director, for example, may assess such amount without regard to whether he has mailed the taxpayer a prior notice of deficiency. Either before or after assessing such an amount, the District Director will notify the taxpayer that he has made, or will make, such assessment. Such notice will not constitute a notice of deficiency, and the taxpayer may not file a petition with the Tax Court of the United States based on such notice. However, the taxpayer within the applicable period of limitation may file a regular claim for credit or refund based on the carryback, if he has not already filed such a claim, and may maintain a suit based on such claim if it is disallowed or if it is not acted upon by the Internal Revenue Service within 6 months from the date the claim was filed.

(ii) The method provided in subdivision (i) of this paragraph to recover any amount applied, credited, or refunded in respect of an application for a tentative carryback adjustment which the District Director later determines should not have been so applied, credited, or refunded is not an exclusive method. Two other methods are available to recover such amount: (*a*) By way of a deficiency notice under section 6212; or (*b*) by a suit to recover an erroneous refund under section 7405. The District Director, in his discretion, may proceed by way of any one or more of the three available methods to recover any

amount which he determines was improperly applied, credited, or refunded in respect of an application for a tentative carryback adjustment.

(3) *Assessment of amount paid.*—Any payment made after the mailing of a notice of deficiency which is made by the taxpayer as a payment with respect to the proposed deficiency may be assessed without regard to the restrictions on assessment and collection imposed by section 6213(a) even though the taxpayer has not filed a waiver of restrictions on assessment as provided in section 6213(d). A payment of all or part of the deficiency asserted in the notice together with the assessment of the amount so paid will not affect the jurisdiction of the Tax Court. If any payment is made before the mailing of a notice of deficiency, the District Director is not prohibited by section 6213(a) from assessing such amount, and the District Director may assess such amount if he deems such action to be proper. If the District Director assesses such amount, the assessment is taken into account in determining whether or not there is a deficiency for which a notice of deficiency must be issued. Thus, if such a payment satisfies the taxpayer's tax liability, no notice of deficiency will be mailed and the Tax Court will have no jurisdiction over the matter. In any case in which there is a controversy as to the correct amount of the tax liability, the assessment of any amount pursuant to the provisions of section 6213(b)(3) shall in no way be considered to be the acceptance of an offer by the taxpayer to settle such controversy.

(4) *Jeopardy.*—If the District Director believes that the assessment or collection of a deficiency will be jeopardized by delay, such deficiency shall be assessed immediately, as provided in section 6861(a).

(c) *Failure to file petition.*—If no petition is filed with the Tax Court within the period prescribed in section 6213(a), the District Director shall assess the amount determined as the deficiency and of which the taxpayer was notified by registered mail and the taxpayer shall pay the same upon notice and demand therefor. In such case the District Director will not be precluded from determining a further deficiency and notifying the taxpayer thereof by registered mail. If a petition is filed with the Tax Court the taxpayer should notify the District Director who issued the notice of deficiency that the petition has been filed in order to prevent an assessment of the amount determined to be the deficiency.

(d) *Waiver of restrictions.*—The taxpayer may at any time by a signed notice in writing filed with the District Director waive the restrictions on the assessment and collection of the whole or any part of the deficiency. The notice must in all cases be filed with the District Director or other authorized official under whose jurisdiction the audit or other consideration of the return in question is being conducted. The filing of such notice with the Tax Court does not constitute filing with the District Director within the meaning of the International Revenue Code. After such waiver has been acted upon by the District Director and the assessment has been made in accordance with its terms, the waiver cannot be withdrawn.

SEC. 301.6214. STATUTORY PROVISIONS; DETERMINATIONS BY TAX COURT.

SEC. 6214. DETERMINATIONS BY TAX COURT.

(a) *Jurisdiction as to increase of deficiency, additional amounts, or additions to the tax.*—The Tax Court shall have jurisdiction to redetermine the correct amount of the deficiency even if the amount so redetermined is greater than the amount of the deficiency, notice of which has been mailed to the taxpayer, and to determine whether any additional amount, or addition to the tax should be assessed, if claim therefor is asserted by the Secretary or his delegate at or before the hearing or a rehearing.

(b) *Jurisdiction over other years.*—The Tax Court in redetermining a deficiency of income tax for any taxable year or of gift tax for any calendar year shall consider such facts with relation to the taxes for other years as may be necessary correctly to redetermine the amount of such deficiency, but in so doing shall have no jurisdiction to determine whether or not the tax for any other years has been overpaid or underpaid.

(c) *Final decisions of Tax Court.*—For purposes of this chapter and subtitles A or B the date on which a decision of the Tax Court becomes final shall be determined according to the provisions of section 7481.

SEC. 301.6215. STATUTORY PROVISIONS; ASSESSMENT OF DEFICIENCY FOUND BY TAX COURT.

SEC. 6215. ASSESSMENT OF DEFICIENCY FOUND BY TAX COURT.

(a) *General rule.*—If the taxpayer files a petition with the Tax Court, the entire amount redetermined as the deficiency by the decision of the Tax Court which has become final shall be assessed and shall be paid upon notice and demand from the Secretary or his delegate. No part of the amount determined as a deficiency by the Secretary or his delegate but disallowed as such by the decision of the Tax Court which has become final shall be assessed or be collected by levy or by proceeding in court with or without assessment.

(b) *Cross references.*—(1) For assessment or collection of the amount of the deficiency determined by the Tax Court pending appellate court review, see section 7485.

(2) For dismissal of petition by Tax Court as affirmation of deficiency as determined by the Secretary or his delegate, see section 7459(d).

(3) For decision of Tax Court that tax is barred by limitation as its decision that there is no deficiency, see section 7459(e).

(4) For assessment of damages awarded by Tax Court for instituting proceedings merely for delay, see section 6673.

(5) For treatment of certain deficiencies as having been paid, in connection with sale of surplus war-built vessels, see section 9(b)(8) of the Merchant Ship Sales Act of 1946 (60 Stat. 48; 50 U. S. C. App. 1742).

(6) For rules applicable to Tax Court proceedings, see generally subchapter C of chapter 76.

(7) For proration of deficiency to installments, see section 6152(c).

(8) For extension of time for paying amount determined as deficiency, see section 6161(b).

SEC. 301.6215–1. ASSESSMENT OF DEFICIENCY FOUND BY TAX COURT.—Where a petition has been filed with the Tax Court, the entire amount redetermined as the deficiency by the decision of the Tax Court which has become final shall be assessed by the District Director and the unpaid portion of the amount so assessed shall be paid by the taxpayer upon notice and demand therefor.

SEC. 301.6216. STATUTORY PROVISIONS; CROSS REFERENCES.

SEC. 6216. CROSS REFERENCES.

(1) For procedures relating to bankruptcy and receivership, see subchapter B of chapter 70.

(2) For procedures relating to jeopardy assessments, see subchapter A of chapter 70.

(3) For procedures relating to claims against transferees and fiduciaries, see chapter 71.

COLLECTION

GENERAL PROVISIONS

SEC. 301.6301. STATUTORY PROVISIONS; COLLECTION AUTHORITY.

SEC. 6301. COLLECTION AUTHORITY.

The Secretary or his delegate shall collect the taxes imposed by the internal revenue laws.

SEC. 301.6301–1. COLLECTION AUTHORITY.—The taxes imposed by the internal revenue laws shall be collected by District Directors of internal revenue. See, however, section 6304, relating to the collection of certain taxes under the provisions of the Tariff Act of 1930.

SEC. 301.6302. STATUTORY PROVISIONS; MODE OR TIME OF COLLECTION.

SEC. 6302. MODE OR TIME OF COLLECTION.

(a) *Establishment by regulations.* If the mode or time for collecting any tax is not provided for by this title, the Secretary or his delegate may establish the same by regulations.

(b) *Discretionary method.* Whether or not the method of collecting any tax imposed by chapters 21, 31, 32, 33, sections 4501(a) or 4511 of chapter 37, or sections 4701 or 4721 of chapter 39 is specifically provided for by this title, any such tax may, under regulations prescribed by the Secretary or his delegate, be collected by means of returns, stamps, coupons, tickets, books, or such other reasonable devices or methods as may be necessary or helpful in securing a complete and proper collection of the tax.

(c) *Use of Government depositaries.* The Secretary or his delegate may authorize Federal Reserve banks, and incorporated banks or trust companies which are depositaries or financial agents of the United States, to receive any tax imposed under the internal revenue laws, in such manner, at such times, and under such conditions as he may prescribe; and he shall prescribe the manner, times, and conditions under which the receipt of such tax by such banks and trust companies is to be treated as payment of such tax to the Secretary or his delegate.

SEC. 301.6302–1. USE OF FEDERAL RESERVE BANKS AND AUTHORIZED COMMERCIAL BANKS IN CONNECTION WITH THE PAYMENT OF CERTAIN EMPLOYMENT AND EXCISE TAXES.—For regulations under this section—

(a) With respect to employment taxes under the Federal Insurance Contributions Act and the income tax withheld at source on wages, see section 31.6302(c)–1 of this chapter;

(b) With respect to the employer tax and the employee tax under the Railroad Retirement Tax Act, see section 31.6302(c)–2 of this chapter; and

(c) With respect to certain excise taxes, see section 40.6151–1, section 42.6011–1, and section 46.6011–1 of this chapter.

SEC. 301.6303. STATUTORY PROVISIONS; NOTICE AND DEMAND FOR TAX.

SEC. 6303. NOTICE AND DEMAND FOR TAX.

(a) *General rule.*—Where it is not otherwise provided by this title, the Secretary or his delegate shall, as soon as practicable, and within 60 days, after the making of an assessment of a tax pursuant to section 6203, give notice to each person liable for the unpaid tax, stating the amount and demanding payment thereof. Such notice shall be left at the dwelling or usual place of business of such person, or shall be sent by mail to such person's last known address.

(b) *Assessment prior to last date for payment.*—Except where the Secretary or his delegate believes collection would be jeopardized by delay, if any tax is assessed prior to the last date prescribed for payment of such tax, payment of such tax shall not be demanded under subsection (a) until after such date.

SEC. 301.6303–1. NOTICE AND DEMAND FOR TAX—(a) *General rule.*—Where it is not otherwise provided by the Code, the district director shall, after the making of an assessment of a tax pursuant to section 6203, give notice to each person liable for the unpaid tax, stating the amount and demanding payment thereof. Such notice shall be given as soon as possible and within 60 days. However, the failure to give notice within 60 days does not invalidate the notice. Such notice shall be left at the dwelling or usual place of business of such person, or shall be sent by mail to such person's last known address.

(b) *Assessment prior to last date for payment.*—If any tax is assessed prior to the last date prescribed for payment of such tax, the District Director will not demand that such tax be paid before such last date, except where the District Director believes collection would be jeopardized by delay.

SEC. 301.6304. STATUTORY PROVISIONS; COLLECTION UNDER THE TARIFF ACT.

SEC. 6304. COLLECTION UNDER THE TARIFF ACT.

For collection under the provisions of the Tariff Act of 1930 of the taxes imposed by section 4501(b), and subchapters A, B, C, D, and E of chapter 38, see sections 4504 and 4601, respectively.

RECEIPT OF PAYMENT

SEC. 301.6311. STATUTORY PROVISIONS; PAYMENT BY CHECK OR MONEY ORDER.

SEC. 6311. PAYMENT BY CHECK OR MONEY ORDER.

(a) *Authority to receive.*—It shall be lawful for the Secretary or his delegate to receive for internal revenue taxes, or in payment for internal revenue stamps, checks or money orders, to the extent and under the conditions provided in regulations prescribed by the Secretary or his delegate.

(b) *Check or money order unpaid.*

(1) *Ultimate liability.*—If a check or money order so received is not duly paid, the person by whom such check or money order has been tendered shall remain liable for the payment of the tax or for the stamps, and for all legal penalties and additions, to the same extent as if such check or money order had not been tendered.

(2) *Liability of banks and others.*—If any certified, treasurer's, or cashier's check or any money order so received is not duly paid, the United States shall,

in addition to its right to exact payment from the party originally indebted therefor, have a lien for the amount of such check upon all the assets of the bank or trust company on which drawn or for the amount of such money order upon all the assets of the issuer thereof; and such amount shall be paid out of such assets in preference to any other claims whatsoever against such bank or issuer except the necessary costs and expenses of administration and the reimbursement of the United States for the amount expended in the redemption of the circulating notes of such bank.

SEC. 301.6311-1. PAYMENT BY CHECK OR MONEY ORDER—(a) *Authority to receive*—(1) *In general.*—(i) District Directors may accept checks 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 or money orders in payment for internal revenue taxes, provided such checks or money orders are collectible in United States currency at par. District Directors may accept such checks or money orders in payment for internal revenue stamps, or for the prepayment of the taxes on wines as authorized by the Wine Regulations prescribed under chapter 51 (pt. 240 of this chapter), to the extent and under the conditions prescribed in subparagraph (2) of this paragraph. A check or money order is payable at par only if the full amount thereof is payable without any deduction for exchange or other charges. As used in this section, the term "money order" means: (*a*) United States postal, bank, express, or telegraph money order; (*b*) money order issued by a domestic building and loan association (as defined in section 7701 (a) (19)) or by a similar association incorporated under the laws of a possession of the United States; (*c*) a money order issued by such other organization as the Commissioner may designate; and (*d*) a money order described in subdivision (ii) of this subparagraph in cases therein described. However, the District Director may refuse to accept any personal check whenever he has good reason to believe that such check will not be honored upon presentment.

(ii) An American citizen residing in a country with which the United States maintains direct exchange of money orders on a domestic basis may pay his tax by postal money order of such country. 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, and Trinidad and Tobago.

(iii) If one check or money order is remitted to cover two or more persons' taxes, the remittance should be accompanied by a letter of transmittal clearly identifying—

(*a*) Each person whose tax is to be paid by the remittance;

(*b*) The amount of the payment on account of each such person; and

(*c*) The kind of tax paid.

(2) *Payment for internal revenue stamps; prepayment of wine tax.*—The District Director may accept checks and money orders described in subparagraph (1) of this paragraph in payment for internal revenue stamps other than stamps for taxes imposed under subchapter F of chapter 39 (relating to silver bullion), stamps for taxes imposed under chapter 34 (relating to documentary stamps), stamps for taxes on distilled spirits imposed under chapter 51, including the rectification tax, and stamps for taxes imposed under chapter 52 (relating to tobacco and manufactures), and in prepayment of the taxes on wines as authorized by the Wine Regulations prescribed under chapter 51 (pt. 240 of this chapter). The District Director may accept in payment for such taxes certified, cashiers' or treasurers' checks 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 or money orders described in subparagraph (1) of this paragraph. However, if an application has been submitted by a person desiring to tender personal checks for such taxes or in prepayment of wine taxes, and the application has been approved by the District Director, the District Director may accept such personal checks as are described in subdivision (i) of subparagraph (1) of this paragraph. The application shall be made to the District Director and shall contain the applicant's name, address, firm name (if any), such financial information as will enable the District Director to determine the amount of the credit to be extended to the applicant, and the approximate value of stamps to be purchased or the amount of wine taxes to be prepaid during the period fixed by the District Director. The District Director is authorized to approve or disapprove such application and, if the application is approved, to fix the maximum amount of the value of the

internal revenue stamps or of the prepayment of the taxes on wines for which personal checks will be accepted and to prescribe such other limitations and conditions as he deems appropriate. The District Director may, for good cause, discontinue at any time the acceptance of personal checks under the provisions of this subparagraph.

(b) *Checks or money orders not paid*—(1) *Ultimate liability.*—The person who tenders any check (whether certified or uncertified, cashier's, treasurer's, or other form of check) or money order in payment for taxes or stamps is not released from his liability until the check or money order is paid; and, if the check or money order is not duly paid, he shall also be liable for all legal penalties and additions, to the same extent as if such check or money order had not been tendered. For the penalty in case a check or money order is not duly paid, see section 6657 and the regulations thereunder. For assessment of the amount of a check or money order not duly paid, see section 6201 (a) (2) (B) and the regulations thereunder.

(2) *Liability of banks and others.*—If any certified treasurer's or cashier's check or money order is not duly paid, the United States shall have a lien for the amount of such check upon all assets of the bank or trust company on which drawn or for the amount of such money order upon the assets of the issuer thereof. The unpaid amount shall be paid out of such assets in preference to any other claims against such bank or issuer except the necessary costs and expenses of administration and the reimbursement of the United States for the amount expended in the redemption of the circulating notes of such bank. In addition, the Government has the right to exact payment from the person required to make the payment.

SEC. 301.6312. STATUTORY PROVISIONS; PAYMENT BY UNITED STATES NOTES AND CERTIFICATES OF INDEBTEDNESS.

SEC. 6312. PAYMENT BY UNITED STATES NOTES AND CERTIFICATES OF INDEBTEDNESS

(a) *General rule.*—It shall be lawful for the Secretary or his delegate to receive, at par with an adjustment for accrued interest, Treasury bills, notes and certificates of indebtedness issued by the United States in payment of any internal revenue taxes, or in payment for internal revenue stamps, to the extent and under the conditions provided in regulations prescribed by the Secretary or his delegate.

(b) *Cross references.*—(1) For authority to receive silver certificates, see section 5 of the act of June 19, 1934 (48 Stat. 1178; 31 U. S. C. 405a).

(2) For full legal tender status of all coins and currencies of the United States, see section 43(b)(1) of the Agricultural Adjustment Act, as amended (48 Stat. 52, 113; 31 U. S. C. 462).

(3) For authority to receive obligations under the Second Liberty Bond Act, see section 20(b) of that act, as amended (56 Stat. 189; 31 U. S. C. 754b).

SEC. 301.6312-1. TREASURY CERTIFICATES OF INDEBTEDNESS, TREASURY NOTES, AND TREASURY BILLS ACCEPTABLE IN PAYMENT OF INTERNAL REVENUE TAXES OR STAMPS.—(a) Treasury certificates of indebtedness. Treasury notes or Treasury bills of any series (not including interim receipts issued by Federal reserve banks in lieu of definitive certificates, notes, or bills) may be tendered at or before maturity in payment of internal revenue taxes due on the date (or in payment for stamps purchased on the date), on which the certificates, notes, or bills mature, or in payment of internal revenue taxes due on a specified prior date, but only if such certificates, notes, or bills, according to the express terms of their issue, are made acceptable in payment of such taxes or for the purchase of stamps. If the taxes for which the certificates, notes, or bills are tendered in payment become due, or the stamps are purchased, on the same date as that on which such certificates, notes, or bills mature, they will be accepted at par plus accrued interest, if any, payable with the principal (not represented by coupons attached) in payment of such taxes or stamps. If the taxes for which the certificates, notes, or bills are tendered in payment become due, or the stamps are purchased, on a date prior to that on which the certificates, notes, or bills mature, they will be accepted at the value specified in the terms under which such certificates, notes, or bills were issued. All interest coupons attached to Treasury certificates of indebtedness or Treasury notes shall be detached by the taxpayer before such certificates or notes are tendered in payment of taxes or stamps.

(b) Receipts given by a District Director for Treasury certificates of indebtedness, Treasury notes, or Treasury bills received in payment of internal revenue

taxes or for stamps as provided in this section shall contain an adequate description of such certificates, notes, or bills, and a statement of the value, including accrued interest, if any, payable with the principal (not represented by coupons attached), at which accepted, and shall show that the certificates, notes, or bills are tendered by the taxpayer and received by the District Director, subject to no condition, qualification, or reservation whatsoever, in payment of an amount of taxes or for stamps no greater than such value. Any certificate, note, or bill offered in payment of internal revenue taxes or for stamps subject to any condition, qualification, or reservation, or for any greater amount than the value at which acceptable in payment of taxes or stamps, as specified in the terms under which such certificate, note, or bill was issued, shall not be deemed to be duly tendered and shall be returned to the taxpayer.

(c) For the purpose of saving taxpayers the expense of transmitting Treasury certificates of indebtedness, Treasury notes, or Treasury bills to the office of the District Director in whose district the taxes are payable, or stamps are to be purchased, taxpayers desiring to pay taxes, or purchase stamps, with such certificates, notes, or bills acceptable in payment of taxes or for the purchase of stamps may deposit such certificates, notes, or bills with a Federal reserve bank or branch. In such cases, the Federal reserve bank or branch shall issue a receipt in the name of the District Director, describing the certificates, notes, or bills by par or dollar face amount and stating on the face of the receipt that the certificates, notes, or bills represented thereby are held by the bank or branch for redemption at the value specified in the terms under which the certificates, notes, or bills were issued, and for application of the proceeds in payment of taxes due or for the purchase of stamps on a specified date by the taxpayer named therein.

SEC. 301.6312-2. CERTAIN TREASURY SAVINGS NOTES ACCEPTABLE IN PAYMENT OF CERTAIN INTERNAL REVENUE TAXES.—According to the express terms of their issue, the following series of Treasury savings notes are presently acceptable in payment of income taxes (current and back, personal and corporation taxes, and excess profits taxes) and estate and gift taxes (current and back):

(a) Treasury Savings Notes, Series A,
(b) Treasury Savings Notes, Series B,
(c) Treasury Savings Notes, Series C.

SEC. 301.6313. STATUTORY PROVISIONS; FRACTIONAL PARTS OF A CENT.

SEC. 6313. FRACTIONAL PARTS OF A CENT.

In the payment of any tax imposed by this title not payable by stamp, a fractional part of a cent shall be disregarded unless it amounts to one-half cent or more, in which case it shall be increased to 1 cent.

SEC. 301.6313-1. FRACTIONAL PARTS OF A CENT.—In the payment of any tax not payable by stamp, a fractional part of a cent shall be disregarded unless it amounts to one-half cent or more, in which case it shall be increased to one cent. Fractional parts of a cent shall not be disregarded in the computation of taxes.

SEC. 301.6314. STATUTORY PROVISIONS; RECEIPT FOR TAXES.

SEC. 6314. RECEIPT FOR TAXES.

(a) *General rule.*—The Secretary or his delegate shall, upon request, give receipts for all sums collected by him, excepting only when the same are in payment for stamps sold and delivered; but no receipts shall be issued in lieu of a stamp representing a tax.

(b) *Duplicate receipts for payment of estate taxes.*—The Secretary or his delegate shall, upon request, give to the person paying the tax under chapter 11 (relating to the estate tax) duplicate receipts, either of which shall be sufficient evidence of such payment, and shall entitle the executor to be credited and allowed the amount thereof by any court having jurisdiction to audit or settle his accounts.

(c) *Cross references.*—(1) For receipt required to be furnished by employer to employee with respect to employment taxes, see section 6051.

(2) For receipt of discharge of executor from personal liability, see section 2204.

SEC. 301.6314-1. RECEIPT FOR TAXES—(a) *In general.*—The District Director shall issue a receipt for each tax payment made in cash (other than a payment for stamps sold and delivered). In the case of payments made by check, the canceled check is usually a sufficient receipt. However, upon request, the District

Director shall issue a receipt for such payment (other than a payment for stamps sold and delivered). No receipt shall be issued in lieu of a stamp representing a tax, whether the payment is in cash or otherwise.

(b) *Duplicate receipt for payment of estate taxes.* Upon request, the District Director will issue duplicate receipts to the person paying the estate tax, either of which will be sufficient evidence of such payment and entitle the executor to be credited with the amount by any court having jurisdiction to audit or settle his accounts. For definition of the term "executor," see section 2203.

SEC. 301.6315. STATUTORY PROVISIONS; PAYMENTS OF ESTIMATED INCOME TAX.

SEC. 6315. PAYMENTS OF ESTIMATED INCOME TAX.

Payment of the estimated income tax, or any installment thereof, shall be considered payment on account of the income taxes imposed by subtitle A for the taxable year.

SEC. 301.6315-1. PAYMENTS OF ESTIMATED INCOME TAX.—The payment of any installment of the estimated income tax (see sections 6015 and 6016) shall be considered payment on account of the income tax for the taxable year for which the estimate is made. The aggregate amount of the payments of estimated tax should be entered upon the income tax return for such taxable year as payments to be applied against the tax shown on such return.

SEC. 301.6316. STATUTORY PROVISIONS; PAYMENT BY FOREIGN CURRENCY.

SEC. 6316. PAYMENT BY FOREIGN CURRENCY.

The Secretary or his delegate is authorized in his discretion to allow payment of taxes in the currency of a foreign country under such circumstances and subject to such conditions as the Secretary or his delegate may by regulations prescribe.

LIEN FOR TAXES

SEC. 301.6321. STATUTORY PROVISIONS; LIEN FOR TAXES.

SEC. 6321. LIEN FOR TAXES.

If any person liable to pay any tax neglects or refuses to pay the same after demand, the amount (including any interest, additional amount, addition to tax, or assessable penalty, together with any costs that may accrue in addition thereto) shall be a lien in favor of the United States upon all property and rights to property, whether real or personal, belonging to such person.

SEC. 301.6321-1. LIEN FOR TAXES.—If any person liable to pay any tax neglects or refuses to pay the same after demand, the amount (including any interest, additional amount, addition to tax, or assessable penalty, together with any costs that may accrue in addition thereto) shall be a lien in favor of the United States upon all property and rights to property, whether real or personal, tangible or intangible, belonging to such person. The lien attaches to all property and rights to property belonging to such person at any time during the period of the lien, including any property or rights to property acquired by such person after the lien arises. For the special lien for estate and gift taxes, see section 6324 and section 301.6324-1.

SEC. 301.6322. STATUTORY PROVISIONS; PERIOD OF LIEN.

SEC. 6322. PERIOD OF LIEN.

Unless another date is specifically fixed by law, the lien imposed by section 6321 shall arise at the time the assessment is made and shall continue until the liability for the amount so assessed is satisfied or becomes unenforceable by reason of lapse of time.

SEC. 301.6323. STATUTORY PROVISIONS; VALIDITY AGAINST MORTGAGEES, PLEDGEES, PURCHASERS, AND JUDGMENT CREDITORS.

SEC. 6323. VALIDITY AGAINST MORTGAGEES, PLEDGEES, PURCHASERS, AND JUDGMENT CREDITORS.

(a) *Invalidity of lien without notice.*—Except as otherwise provided in subsection (c), the lien imposed by section 6321 shall not be valid as against any mortgagee, pledgee, purchaser, or judgment creditor until notice thereof has been filed by the Secretary or his delegate.

(1) *Under State or territorial laws.*—In the office designated by the law of the State or Territory in which the property subject to the lien is situated, whenever the State or Territory has by law designated an office within the State or Territory for the filing of such notice; or

(2) *With clerk of district court.*—In the office of the clerk of the United States district court for the judicial district in which the property subject to the lien is situated, whenever the State or Territory has not by law designated an office within the State or Territory for the filing of such notice; or

(3) *With clerk of district court for District of Columbia.*—In the office of the clerk of the United States District Court for the District of Columbia, if the property subject to the lien is situated in the District of Columbia.

(b) *Form of notice.*—If the notice filed pursuant to subsection (a)(1) is in such form as would be valid if filed with the clerk of the United States district court pursuant to subsection (a)(2), such notice shall be valid notwithstanding any law of the State or Territory regarding the form or content of a notice of lien.

(c) *Exception in case of securities.*

(1) *Exception.*—Even though notice of a lien provided in section 6321 has been filed in the manner prescribed in subsection (a) of this section, the lien shall not be valid with respect to a security, as defined in paragraph (2) of this subsection, as against any mortgagee, pledgee, or purchaser of such security, for an adequate and full consideration in money or money's worth, if at the time of such mortgage, pledge, or purchase such mortgagee, pledgee, or purchaser is without notice or knowledge of the existence of such lien.

(2) *Definition of security.*—As used in this subsection, the term "security" means any bond, debenture, note, or certificate or other evidence of indebtedness, issued by any corporation (including one issued by a government or political subdivision thereof), with interest coupons or in registered form, share of stock, voting trust certificate, or any certificate of interest or participation in, certificate of deposit or receipt for, temporary or interim certificate for, or warrant or right to subscribe to or purchase, any of the foregoing; negotiable instrument; or money.

(d) *Disclosure of amount of outstanding lien.*—If a notice of lien has been filed under subsection (a), the Secretary or his delegate is authorized to provide by rules or regulations the extent to which, and the conditions under which, information as to the amount of the outstanding obligation secured by the lien may be disclosed.

SEC. 301.6323–1. VALIDITY OF LIEN AGAINST MORTGAGEES, PLEDGEES, PURCHASERS, AND JUDGMENT CREDITORS.—(a) *Invalidity of lien without notice*—(1) *Filing of notice.* The lien imposed by section 6321 shall not be valid as against any mortgagee, pledgee, purchaser, or judgment creditor until notice of lien has been filed. (See, however, section 6323(c) and paragraph (b) of this section, relating to the circumstances under which the lien is not valid with respect to a security even though notice thereof is duly filed.) The place for the filing of the notice of lien is—

(i) The office designated by the law of the State or Territory in which the property subject to the lien is situated, whenever the State or Territory has designated an office within the State or Territory for the filing of such notice;

(ii) The office of the clerk of the United States district court for the judicial district in which the property subject to the lien is situated, whenever the State or Territory has not by law designated an office within the State or Territory for the filing of such notice; or

(iii) The office of the clerk of the United States District Court for the District of Columbia if the property subject to the lien is situated in the District of Columbia.

(2) *Meaning of terms.* (i) As used in section 6323 and this section—

(*a*) The term "purchaser" means a person who, for a valuable present consideration, acquires property or an interest in property.

(*b*) The term "judgment creditor" means a person who has obtained a valid judgment in a court of record and of competent jurisdiction for the recovery of specifically designated property or for a certain sum of money and, in the case of a judgment for the recovery of a certain sum of money, who has a perfected lien under such judgment on the property involved. The term "judgment" does not include an inchoate lien, such as an attachment lien, unless and until such lien has ripened into a judgment. *United States* v. *Security Trust and Savings Bank* (1950) 340 U. S. 47. Nor does the term "judgment" include the determination of a quasi-judicial body or of an individual acting in a quasi-judicial capacity, such as, for example, the action of State taxing authorities. *United States* v. *Gilbert Associates* (1953) 345 U. S. 361; and *United States* v. *City of New Britain* (1954) 347 U. S. 81.

(ii) The determination whether a person is a mortgagee, pledgee, purchaser, or judgment creditor, entitled to the protection of section 6323(a), shall be made by reference to the realities and the facts in a given case rather than to the technical form or terminology used to designate such person. Thus, a person who is in fact and in law a mortgagee, pledgee, or purchaser will be entitled as such to the protection of section 6323(a) even though such person is otherwise designated under the law of a State, such as the Uniform Commercial Code.

(3) *Form of notice.* The form to be used for filing the notice of lien shall be Form 668, "Notice of Federal Tax Lien under Internal Revenue Laws." Such notice, filed in the office designated by the law of a State or Territory, shall be valid notwithstanding any law of the State or Territory regarding the form or content of a notice of lien. For example, the omission from the notice of lien of a description of the property subject to the lien will not affect the validity thereof, even though the law of the State or Territory requires that the notice of lien contain a description of the property subject to the lien.

(b) *Exception in case of securities*—(1) *Exception.*—Even though a notice of lien provided for in section 6321 has been filed in the manner prescribed in section 6323(a), the lien shall not be valid with respect to a security, as defined in section 6323(c)(2), as against any mortgagee, pledgee, or purchaser of such security, for an adequate and full consideration in money or money's worth, if at the time of such mortgage, pledge, or purchase such mortgagee, pledgee, or purchaser is without notice or knowledge of the existence of such lien. An adequate and full consideration in money or money's worth, as used in section 6323(c), means that the consideration must have been an adequate and full equivalent reducible to a money value. A purchase of property made in the ordinary course of business (that is, a transaction which is bona fide and made at arm's length) will be considered as made for an adequate and full consideration in money or money's worth. A relinquishing or promised relinquishment of dower, curtesy, or of a statutory estate created in lieu of dower or curtesy, or of other marital rights is not a consideration in money or money's worth. Nor is love and affection, promise of marriage, or any other consideration not reducible to a money value a consideration in money or money's worth.

(2) *Definition of security.*—As used in section 6323(c), the term "security" means: Any bond, debenture, note or certificate or other evidence of indebtedness, issued by any corporation (including one issued by a government or political subdivision thereof), with interest coupons or in registered form, share of stock, voting trust certificate, or any certificate of interest or participation in, certificate of deposit or receipt for, temporary or interim certificate for, or warrant or right to subscribe to or purchase, any of the foregoing; negotiable instrument; or money.

(c) *Disclosure of amount of outstanding lien.*—(1) If a notice of lien has been filed, the District Director to whom the assessment which gave rise to the lien is charged is authorized to disclose information as to the amount of the outstanding obligation secured by the lien to any person who has a proper interest in determining the amount of the outstanding obligation. Any person desiring such information should present to the District Director a written request. Such request should clearly describe the property subject to the lien, identify the applicable lien, and give the reasons for requesting such information. Any person who has a right in the property or intends to obtain a right in the property by purchase or otherwise will, upon satisfactory proof of such right or of the intention to obtain such right, be considered to have a proper interest.

(2) If the District Director determines that the applicant is entitled to the information requested, he will disclose to such applicant the total amount of the outstanding obligation secured by the lien.

(3) The Commissioner may disclose the amount of any outstanding obligation secured by the lien if he determines such action is warranted under the facts and circumstances in the particular case.

(4) The provisions of this paragraph apply to any notice of lien filed under section 6323 or corresponding provisions of prior internal revenue laws.

(d) *Application of section 6323 to liens imposed under section 3670 of the Internal Revenue Code of 1939.*—In the case of any lien arising under section 3670 of the Internal Revenue Code of 1939 or the corresponding provisions of prior law (relating to the general tax lien) which is in effect on January 1, 1955, the provisions of section 6323 shall be applicable to such lien on and after such date in lieu of the provisions of section 3672 of the Internal Revenue Code of 1939 or the corresponding provisions of prior law.

SEC. 301.6324 STATUTORY PROVISIONS; SPECIAL LIENS FOR ESTATE AND GIFT TAXES.

SEC. 6324. SPECIAL LIENS FOR ESTATE AND GIFT TAXES.

(a) *Liens for estate tax.* Except as otherwise provided in subsection (c) (relating to transfers of securities).

(1) *Upon gross estate.*—Unless the estate tax imposed by chapter 11 is sooner paid in full, it shall be a lien for 10 years upon the gross estate of the decedent, except that such part of the gross estate as is used for the payment of charges against the estate and expenses of its administration, allowed by any court having jurisdiction thereof, shall be divested of such lien.

(2) *Liability of transferees and others.*—If the estate tax imposed by chapter 11 is not paid when due, then the spouse, transferee, trustee (except the trustee of an employee's trust which meets the requirements of section 401(a)), surviving tenant, person in possession of the property by reason of the exercise, nonexercise, or release of a power of appointment, or beneficiary, who receives, or has on the date of the decedents' death, property included in the gross estate under sections 2034 to 2042, inclusive, to the extent of the value, at the time of the decedent's death, of such property, shall be personally liable for such tax. Any part of such property transferred by (or transferred by a transferee of) such spouse, transferee, trustee, surviving tenant, person in possession of property by reason of the exercise, nonexercise, or release of a power of appointment, or beneficiary, to a bona fide purchaser, mortgagee, or pledgee, for an adequate and full consideration in money or money's worth shall be divested of the lien provided in paragraph (1) and a like lien shall then attach to all the property of such spouse, transferee, trustee, surviving tenant, person in possession, beneficiary, or transferee of any such person, except any part transferred to a bona fide purchaser, mortgagee, or pledgee for an adequate and full consideration in money or money's worth.

(3) *Continuance after discharge of executor.*—The provisions of section 2204 (relating to discharge of executor from personal liability) shall not operate as a release of any part of the gross estate from the lien for any deficiency that may thereafter be determined to be due, unless such part of the gross estate (or any interest therein) has been transferred to a bona fide purchaser, mortgagee, or pledgee for an adequate and full consideration in money, or money's worth, in which case such part (or such interest) shall not be subject to a lien or to any claim or demand for any such deficiency, but the lien shall attach to the consideration received from such purchaser, mortgagee, or pledgee by the heirs, legatees, devisees, or distributees.

(b) *Lien for gift tax.*—Except as otherwise provided in subsection (c) (relating to transfers of securities), the gift tax imposed by chapter 12 shall be a lien upon all gifts made during the calendar year, for 10 years from the time the gifts are made. If the tax is not paid when due, the donee of any gift shall be personally liable for such tax to the extent of the value of such gift. Any part of the property comprised in the gift transferred by the donee (or by a transferee of the donee) to a bona fide purchaser, mortgagee, or pledgee for an adequate and full consideration in money or money's worth shall be divested of the lien herein imposed and the lien, to the extent of the value of such gift, shall attach to all the property (including after-acquired property) of the donee (or the transferee) except any part transferred to a bona fide purchaser, mortgagee, or pledgee for an adequate and full consideration in money or money's worth.

(c) *Exception in case of securities.* The lien imposed by subsection (a) or (b) shall not be valid with respect to a security, as defined in section 6323(c)(2), as against any mortgagee, pledgee, or purchaser of any such security, for an adequate and full consideration in money or money's worth, if at the time of such mortgage, pledge, or purchase such mortgagee, pledgee, or purchaser is without notice or knowledge of the existence of such lien.

SEC. 301.6324-1. SPECIAL LIENS FOR ESTATE AND GIFT TAXES; PERSONAL LIABILITY OF TRANSFEREES AND OTHERS.—(a) *Estate tax.* (1) The lien imposed by section 6324(a) attaches at the date of the decedent's death to every part of the gross estate, whether or not the property comes into the possession of the duly qualified executor or administrator. It attaches to the extent of the tax shown to be due by the return and of any deficiency in tax found to be due upon review and audit. If the estate tax is not paid when due, then the spouse, transferee, trustee (except the trustee of an employee's trust which meets the requirements of section 401(a)), surviving tenant, person in possession of the property by reason of the exercise, nonexercise, or release of a power of appointment, or beneficiary,

who receives, or has on the date of the decedent's death, property included in the gross estate under sections 2034 to 2042, inclusive, shall be personally liable for such tax to the extent of the value, at the time of the decedent's death, of such property.

(2) Unless the tax is paid in full, and except as otherwise provided in section 6324(c) (relating to transfers of securities), the lien upon the entire property constituting the gross estate continues for a period of 10 years after the decedent's death, except that such lien shall be divested with respect to:

(i) Such portion of the gross estate as is used for the payment of charges against the estate and expenses of its administration allowed by any court having jurisdiction thereof;

(ii) Such property as is transferred to a bona fide purchaser, mortgagee, or pledgee, for an adequate and full consideration in money or money's worth, by the spouse, transferee, trustee, surviving tenant, person in possession of the property by reason of the exercise, nonexercise, or release of a power of appointment, or beneficiary, who receives, or has on the date of the decedent's death, property included in the gross estate under sections 2034 to 2042, inclusive (or the corresponding provisions of the Internal Revenue Code of 1939), or such property as is transferred by the transferee of such person. In such case, a like lien attaches to all the property of such spouse, transferee, trustee, surviving tenant, person in possession, beneficiary, or transferee of any such person, except such part thereof as may be transferred to a bona fide purchaser, mortgagee, or pledgee for an adequate and full consideration in money or money's worth. See paragraph (b)(1) of section 301.6323-1 for the meaning of the term "an adequate and full consideration in money or money's worth";

(iii) Such portion of the gross estate (or any interest therein) as has been transferred to a bona fide purchaser, mortgagee, or pledgee for an adequate and full consideration in money or money's worth, if payment is made of the full amount of tax determined by the District Director pursuant to a request of the executor for discharge from personal liability as authorized by section 2204 (relating to discharge of executor from personal liability), but there is substituted a like lien upon the consideration received from such purchaser, mortgagee, or pledgee by the heirs, legatees, devisees, or distributees; and

(iv) Such property as to which the District Director has issued a certificate releasing the lien pursuant to section 6325.

(b) *Lien for gift tax.*—Except as provided in section 6324(c) (relating to securities), a lien attaches upon all gifts made during the calendar year for the amount of the tax imposed upon the gifts made during such year. The lien extends for a period of 10 years from the time the gifts were made, unless the tax is sooner paid. If the tax is not paid when due, the donee of any gift becomes personally liable for the tax to the extent of the value of his gift. Any part of the property comprised in the gift which is transferred by the donee (or by a transferee of the donee) to a bona fide purchaser, mortgagee, or pledgee, for an adequate and full consideration in money or money's worth, is divested of the lien, but a like lien to the extent of the value of such gift attaches to all the property (including after-acquired property) of the donee (or the transferee), except any part transferred to a bona fide purchaser, mortgagee, or pledgee, for an adequate and full consideration in money or money's worth. See paragraph (b)(1) of section 301.6323-1 for the meaning of the term "an adequate and full consideration in money or money's worth."

(c) *Application of lien imposed by section 6321.*—The general lien under section 6321 and the special lien under subsection (a) or (b) of section 6324 for the estate or gift tax are not exclusive of each other, but are cumulative. Each lien will arise when the conditions precedent to the creation of such lien are met and will continue in accordance with the provisions applicable to the particular lien. Thus, the special lien may exist without the general lien being in force, or the general lien may exist without the special lien being in force, or the general lien and the special lien may exist simultaneously, depending upon the facts and pertinent statutory provisions applicable to the respective liens.

(d) *Application of section 6324 to estate and gift tax liens imposed under the Internal Revenue Code of 1939.*—In the case of any lien arising under section 827 or 1009 of the Internal Revenue Code of 1939 (relating to liens for estate and gift taxes, respectively) which is in effect on January 1, 1955, the provisions of section 6324 shall be applicable to such lien on and after such date in lieu of the provisions of section 827 or 1009 of the 1939 Code.

SEC. 301.6325. STATUTORY PROVISIONS; RELEASE OF LIEN OR PARTIAL DISCHARGE OF PROPERTY.

SEC. 6325. RELEASE OF LIEN OR PARTIAL DISCHARGE OF PROPERTY.

(a) *Release of lien.*—Subject to such rules or regulations as the Secretary or his delegate may prescribe, the Secretary or his delegate may issue a certificate of release of any lien imposed with respect to any internal revenue tax if—

(1) *Liability satisfied or unenforceable.*—The Secretary or his delegate finds that the liability for the amount assessed, together with all interest in respect thereof, has been fully satisfied, has become legally unenforceable, or, in the case of the estate tax imposed by chapter 11 or the gift tax imposed by chapter 12, has been fully satisfied or provided for; or

(2) *Bond accepted.*—There is furnished to the Secretary or his delegate and accepted by him a bond that is conditioned upon the payment of the amount assessed, together with all interest in respect thereof, within the time prescribed by law (including any extension of such time), and that is in accordance with such requirements relating to terms, conditions, and form of the bond and sureties thereon, as may be specified by such rules or regulations.

(b) *Partial discharge of property.*

(1) *Property double the amount of the liability.*—Subject to such rules or regulations as the Secretary or his delegate may prescribe, the Secretary or his delegate may issue a certificate of discharge of any part of the property subject to any lien imposed under this chapter if the Secretary or his delegate finds that the fair market value of that part of such property remaining subject to the lien is at least double the amount of the unsatisfied liability secured by such lien and the amount of all other liens upon such property which have priority to such lien.

(2) *Part payment or interest of United States valueless.*—Subject to such rules or regulations as the Secretary or his delegate may prescribe, the Secretary or his delegate may issue a certificate of discharge of any part of the property subject to the lien if—

(A) There is paid over to the Secretary or his delegate in part satisfaction of the liability secured by the lien an amount determined by the Secretary or his delegate, which shall not be less than the value, as determined by the Secretary or his delegate, of the interest of the United States in the part to be so discharged, or

(B) The Secretary or his delegate determines at any time that the interest of the United States in the part to be so discharged has no value.

In determining the value of the interest of the United States in the part to be so discharged, the Secretary or his delegate shall give consideration to the fair market value of such part and to such liens thereon as have priority to the lien of the United States.

(c) *Effect of certificate of release or partial discharge.*—A certificate of release or of partial discharge issued under this section shall be held conclusive that the lien upon the property covered by the certificate is extinguished.

(d) *Cross references.*—(1) For single bond complying with the requirements of both subsection (a) (2) and section 6165, see section 7102.

(2) For other provisions relating to bonds, see generally chapter 73.

(3) For provisions relating to suits to enforce lien, see section 7403.

(4) For provisions relating to suits to clear title to realty, see section 7424.

SEC. 301.6325–1. RELEASE OF LIEN OR PARTIAL DISCHARGE OF PROPERTY—(a) *Release of lien*—(1) *Liability satisfied or unenforceable.* The District Director to whom is charged an assessment in respect of any internal revenue tax shall issue a certificate of release of any lien imposed with respect to such tax, whenever he finds that the liability for the amount assessed (together with all interest in respect thereof) has been satisfied or has become unenforceable as a matter of law (and not merely uncollectible or unenforceable as a matter of fact). Tax liabilities frequently are unenforceable in fact for the time being, due to the temporary nonpossession by the taxpayer of discoverable property or property rights. In all cases the liability for the payment of the tax continues until satisfaction of the tax in full or until the expiration of the statutory period for collection, including such extension of the period for collection as may be agreed upon in writing by the taxpayer and the District Director. The form to be used by the District Director is Form 669, "Certificate of Release of Federal Tax Lien."

(2) *Estate or gift tax liability fully satisfied or provided for.*—(i) If the District Director determines that the tax liability for estate or gift tax has been fully satisfied, he may issue his certificate releasing any or all property from the lien imposed thereon. If the District Director determines that the tax liability for estate or gift tax has been adequately provided for, he may issue his certificate releasing particular items of property from the lien. The issuance of such a certificate is a matter resting within the discretion of the District Director, and a certificate will be issued only in case there is actual need therefor. The primary purpose of such release is not to evidence payment or satisfaction of the tax, but to permit the transfer of property free from the lien in case it is necessary to clear title. The tax will be considered fully satisfied only when investigation has been completed and payment of the tax, including any deficiency determined, has been made.

(ii) An application for a release of the lien for estate or gift tax should be filed with the District Director charged with the assessment in respect of the tax. It should be made in writing under penalties of perjury and should explain the circumstances that require the release, and should fully describe the particular items for which the release is desired. In the case of an estate tax lien, the application should show the applicant's relationship to the estate, such as executor, heir, devisee, legatee, beneficiary, transferee, or purchaser. If the estate or gift tax return has not been filed, a statement under penalties of perjury may be required showing (*a*) the value of the property to be released, (*b*) the basis for such valuation, (*c*) in the case of the estate tax, the approximate value of the gross estate and the approximate value of the total real property included in the gross estate, and (*d*) in the case of the gift tax, the total amount of gifts made during the calendar year and the prior calendar years subsequent to the enactment of the Revenue Act of 1932 and the approximate value of all real estate subject to the gift tax lien, and (*e*) if the property is to be sold or otherwise transferred, the name and address of the purchaser or transferee and the consideration, if any, paid or to be paid by him.

(3) *Bond accepted.*—The District Director may, in his discretion, issue a certificate of release of any tax lien if he is furnished and accepts a bond that is conditioned upon the payment of the amount assessed (together with all interest in respect thereof), within the time agreed upon in the bond, but not later than 6 months before the expiration of the statutory period for collection, including any period for collection agreed upon in writing by the District Director and the taxpayer. For provisions relating to bonds, see sections 7101 and 7102 and the regulations thereunder.

(b) *Discharge of specific property from the lien*—(1) *Property double the amount of the liability.*—(i) The District Director may, in his discretion, issue a certificate of discharge of any part of the property subject to any tax lien if he determines that the fair market value of that part of the property remaining subject to the lien is at least double the sum of the amount of the unsatisfied liability secured by such lien and of the amount of all other liens upon such property which have priority to such lien. In general, fair market value is that amount which one ready and willing but not compelled to buy would pay to another ready and willing but not compelled to sell the property. The form to be used by the District Director is Form 669–A, "Certificate of Discharge of Property from Federal Tax Lien." For information required to be submitted in an application for a certificate of discharge, see subparagraph (4) of this paragraph.

(ii) The following example illustrates a case in which a certificate of discharge may not be given under this subparagraph:

Example: The Federal tax liability secured by a lien is $1,000. The fair market value of all property which after the discharge will continue to be subject to the Federal tax lien is $10,000. There is a prior mortgage on the property of $5,000, including interest, and the property is subject to a prior lien of $100 for real estate taxes. Accordingly, the taxpayer's equity in the property over and above the amount of the mortgage and real estate taxes is $4,900, or nearly five times the amount required to pay the assessed tax on which the Federal tax lien is based. Nevertheless, a discharge under this subparagraph is not permissible. In the illustration, the sum of the amount of the Federal tax liability ($1,000) and of the amount of the prior mortgage and the lien for real estate taxes ($5,000+$100=$5,100) is $6,100. Double this sum is $12,200, but the fair market value of the remaining property is only $10,000. Hence, a discharge of the property is not permissible under this subparagraph, since the Code requires

that the fair market value of the remaining property be at least double the sum of two amounts, one amount being the outstanding Federal tax liability and the other amount being all prior liens upon such property. In order that the discharge may be issued, it would be necessary that the remaining property be worth not less than $12,200.

(2) *Part payment.*—The District Director may, in his discretion, issue a certificate of discharge of any part of the property subject to the lien if there is paid over to him in part satisfaction of the liability secured by the lien an amount determined by him to be not less than the value of the interest of the United States in the property to be so discharged. In determining the amount to be paid, the District Director will take into consideration all the facts and circumstances of the case, including the expenses to which the Government has been put in the matter. In no case shall the amount to be paid be less than the value of the interest of the United States in the property with respect to which the certificate of discharge is to be issued, as such value has been determined by the District Director in the light of the fair market value of the property and the amount of all liens and encumberances thereon having priority over the Federal tax lien. The form to be used by the District Director is Form 669–B, "Certificate of Discharge of Property from Federal Tax Lien." For information required to be submitted in an application for a certificate of discharge, see subparagraph (4) of this paragraph.

(3) *Interest of United States valueless.*—The District Director may, in his discretion, issue a certificate of discharge of any part of the property subject to the lien if he determines that the interest of the United States in the property to be so discharged has no value. The form to be used by the District Director is Form 669–C, "Certificate of Discharge of Property from Federal Tax Lien." For information required to be submitted in an application for a certificate of discharge, see subparagraph (4) of this paragraph.

(4) *Application for certificate of discharge.*—Any person desiring a certificate of discharge of property from a Federal tax lien shall submit to the District Director to whom the assessment is charged a written application in triplicate, under penalties of perjury, requesting that the certificate be issued. The application shall contain the following information:

(i) A clear description of the property with respect to which the discharge is desired and, where applicable, of the property remaining subject to the lien;

(ii) The reason the discharge is sought;

(iii) A description of the Federal tax lien in respect of which the certificate of discharge is sought, including the amount, nature of the tax, the dates of assessment, and, if applicable, an appropriate reference to the registry and the page and volume of the book in which the notice of Federal tax lien is filed, indexed, or recorded, and the date of the filling of the notice;

(iv) A statement in numbered paragraphs of all facts material to the application, including the amount, character, and dates (both of execution and of record) of all encumbrances of record prior to the Federal lien, with an appropriate reference to the registry and the page and volume of the book in which each such encumbrance is recorded;

(v) The amounts, character, and dates of execution of any unrecorded encumbrances believed to be prior to the Federal tax lien, including information as to how and when such encumbrances arose;

(vi) In support of the application, the applicant must furnish proof sufficient to establish the fair market value of the property with respect to which the discharge is sought, and where applicable, proof sufficient to establish the fair market value of the property which will remain subject to the lien; and

(vii) Any other information which in the opinion of the applicant might have a bearing upon the determination to be made.

Applications submitted under subparagraph (1) or (3) of this paragraph do not require the submission of any sum of money for the discharge of the property from a tax lien. Since the amount to be paid for the issuance, under subparagraph (2) of this paragraph, of a certificate of discharge of property from a Federal tax lien is a matter for the determination of the District Director after consideration of the facts and law involved, no sum of money or check should be submitted with the application. The District Director shall cause a thorough investigation to be made as to the proof and accuracy of all material statements made in the application. Upon completion of such investigation the District Director will make his determination and advise the applicant of the decision reached.

(c) *Effect of certificate of release or discharge of specific property.*—A certificate of release of lien or a certificate discharging specific property from the lien issued under section 6325 shall be conclusive that the lien upon the property covered by the certificate is extinguished.

SEC. 301.6326. STATUTORY PROVISIONS; CROSS REFERENCES.

SEC. 6326. CROSS REFERENCES. (1) For lien in case of tax on distilled spirits, see section 5004.

(2) For exclusion of tax liability from discharge in bankruptcy, see section 17 of the Bankruptcy Act, as amended (52 Stat. 851; 11 U. S. C. 35).

(3) For limit on amount allowed in bankruptcy proceedings on debts owing to the United States, see section 57(j) of the Bankruptcy Act, as amended (52 Stat. 867; 11 U. S. C. 93).

(4) For recognition of tax liens in proceedings under the Bankruptcy Act, see section 67 (b) and (c) of that act, as amended (52 Stat. 876–877; 11 U. S. C. 107).

(5) For collection of taxes in connection with wage earners' plans in bankruptcy courts, see section 680 of the Bankruptcy Act, as added by the act of June 22, 1938 (52 Stat. 938; 11 U. S. C. 1080).

(6) For provisions permitting the United States to be made party defendant in a proceeding in a State court for the foreclosure of a lien upon real estate where the United States may have a claim upon the premises involved, see section 2410 of Title 28 of the United States Code.

(7) For priority of lien of the United States in case of insolvency, see R. S. 3466 (31 U. S. C. 191).

SEIZURE OF PROPERTY FOR COLLECTION OF TAXES

SEC. 301.6331. STATUTORY PROVISIONS; LEVY AND DISTRAINT.

SEC. 6331. LEVY AND DISTRAINT.

(a) *Authority of Secretary or Delegate.* If any person liable to pay any tax neglects or refuses to pay the same within 10 days after notice and demand, it shall be lawful for the Secretary or his delegate to collect such tax (and such further sum as shall be sufficient to cover the expenses of the levy) by levy upon all property and rights to property (except such property as is exempt under section 6334) belonging to such person or on which there is a lien provided in this chapter for the payment of such tax. Levy may be made upon the accrued salary or wages of any officer, employee, or elected official, of the United States, the District of Columbia, or any agency or instrumentality of the United States or the District of Columbia, by serving a notice of levy on the employer (as defined in section 3401 (d)) of such officer, employee, or elected official. If the Secretary or his delegate makes a finding that the collection of such tax is in jeopardy, notice and demand for immediate payment of such tax may be made by the Secretary or his delegate and, upon failure or refusal to pay such tax, collection thereof by levy shall be lawful without regard to the 10-day period provided in this section.

(b) *Seizure and sale of property.*—The term "levy" as used in this title includes the power of distraint and seizure by any means. In any case in which the Secretary or his delegate may levy upon property or rights to property, he may seize and sell such property or rights to property (whether real or personal, tangible or intangible).

(c) *Successive seizures.*—Whenever any property or right to property upon which levy has been made by virtue of subsection (a) is not sufficient to satisfy the claim of the United States for which levy is made, the Secretary or his delegate may, thereafter, and as often as may be necessary, proceed to levy in like manner upon any other property liable to levy of the person against whom such claim exists, until the amount due from him, together with all expenses, is fully paid.

(d) *Cross references.*—(1) For provisions relating to jeopardy, see subchapter A of chapter 70.

(2) For proceedings applicable to sale of seized property, see section 6335.

SEC. 301.6331–1. LEVY AND DISTRAINT—(a) *Authority to levy*—(1) *In general.* If any person liable to pay any tax neglects or refuses to pay such tax within 10 days after notice and demand, the District Director to whom the assessment is charged or, upon his request, any other District Director may proceed to collect the tax by levy upon any property, or rights to property, whether real or personal, tangible or intangible, belonging to such person or on which there is a lien pro-

vided by section 6321 or 6324 (or the corresponding provision of prior law) for the payment of such tax. As used in section 6331 and this section, the term "tax" includes any interest, additional amount, addition to tax, or assessable penalty, together with any costs and expenses that may accrue in addition thereto. For exemption of certain property from levy, see section 6334 and the regulations thereunder. Property subject to a Federal tax lien, which has been sold or otherwise transferred by the taxpayer, may be seized in the hands of the transferee or of any subsequent transferee. Levy may be made by serving a notice of levy on any person in possession of, or obligated with respect to, property or rights to property subject to levy, such as, for example, receivables, bank accounts, evidences of debt, securities, and accrued salaries, wages, commissions, and other compensation.

(2) *Jeopardy cases.* If the District Director finds that the collection of any tax is in jeopardy, he may make notice and demand for immediate payment of such tax and, upon failure or refusal to pay such tax, collection thereof by levy shall be lawful without regard to the 10-day period provided in section 6331 (a).

(3) *Bankruptcy or receivership cases.* During a bankruptcy proceeding or a receivership proceeding in either a Federal or a State court, the assets of the taxpayer are in general under the control of the court in which such proceeding is pending. Taxes cannot be collected by levy upon assets in the custody of a court, whether or not such custody is incident to a bankruptcy or receivership proceeding, except where the proceeding has progressed to such a point that the levy would not interfere with the work of the court or where the court grants permission to levy. Any assets which under applicable provisions of law are not under the control of the court may be levied upon, for example, property exempt from court custody under State law or the bankrupt's earnings and property acquired after the date of bankruptcy. However, levy upon such property is not mandatory and the Government may rely upon payment of taxes in the proceeding.

(4) *Certain types of compensation*—(i) *Federal employees.*—Levy may be made upon the accrued salary or wages of any officer or employee (including members of the Armed Forces), or elected or appointed official, of the United States, the District of Columbia, or any agency or instrumentality of either, by serving a notice of levy on the employer of the delinquent taxpayer. As used in this subdivision, the term "employer" means (*a*) the officer or employee of the United States, the District of Columbia, or of the agency or instrumentality of the United States or the District of Columbia, who has control of the payment of the wages, or (*b*) any other officer or employee designated by the head of the branch, department, agency, or instrumentality of the United States or of the District of Columbia as the party upon whom service of the notice of levy may be made. If the head of such branch, department, agency, or instrumentality designates an officer or employee other than one who has control of the payment of the wages, as the party upon whom service of the notice of levy may be made, such head shall promptly notify the Commissioner of the name and address of each officer or employee so designated and the scope or extent of his authority as such designee.

(ii) *State and municipal employees.*—Accrued salaries, wages, or other compensation of any officer, employee, or elected or appointed official of a State or Territory, or of any agency, instrumentality, or political subdivision thereof, are also subject to levy to enforce collection of any Federal tax.

(iii) *Seamen.*—Notwithstanding the provisions of section 12 of the Seamen's Act of 1915 (38 Stat. 1169; 46 U. S. C. 601), accrued wages of seamen, apprentice seamen, or fishermen employed on fishing vessels are subject to levy. See section 6334(c).

(b) *Successive seizures.*—Whenever any property or rights to property upon which a levy has been made are not sufficient to satisfy the claim of the United States for which the levy is made, the District Director may thereafter, and as often as may be necessary, proceed to levy in like manner upon any other property or rights to property subject to levy of the person against whom such claim exists or on which there is a lien imposed by section 6321 or 6324 (or the corresponding provision of prior law) for the payment of such claim until the amount due from such person, together with all costs and expenses, is fully paid.

SEC. 301.6332. STATUTORY PROVISIONS; SURRENDER OF PROPERTY SUBJECT TO LEVY.

SEC. 6332. SURRENDER OF PROPERTY SUBJECT TO LEVY.

(a) *Requirement.*—Any person in possession of (or obligated with respect to) property or rights to property subject to levy upon which a levy has been made

shall, upon demand of the Secretary or his delegate, surrender such property or rights (or discharge such obligation) to the Secretary or his delegate, except such part of the property or rights as is, at the time of such demand, subject to an attachment or execution under any judicial process.

(b) *Penalty for violation.*—Any person who fails or refuses to surrender as required by subsection (a) any property or rights to property, subject to levy, upon demand by the Secretary or his delegate, shall be liable in his own person and estate to the United States in a sum equal to the value of the property or rights not so surrendered, but not exceeding the amount of the taxes for the collection of which such levy has been made, together with costs and interest on such sum at the rate of 6 percent per annum from the date of such levy.

(c) *Person defined.*—The term "person," as used in subsection (a), includes an officer or employee of a corporation or a member or employee of a partnership, who as such officer, employee, or member is under a duty to surrender the property or rights to property, or to discharge the obligation.

SEC. 301.6332-1. SURRENDER OF PROPERTY SUBJECT TO LEVY.—(a) *Requirement.*—Any person in possession of (or obligated with respect to) property or rights to property subject to levy upon which a levy has been made shall, upon demand of the District Director, surrender such property or rights (or discharge such obligation) to the district director, except such part of the property or right as is, at the time of such demand, subject to an attachment or execution under any judicial process.

(b) *Penalty for violation.*—Any person who fails or refuses, upon demand of the District Director, to surrender any property or rights to property subject to levy, as required by section 6332(a), shall be liable in his own person and estate to the United States in a sum equal to the value of the property or rights not so surrendered, but not exceeding the amount of the taxes for the collection of which such levy has been made, together with costs and interest on such sum at the rate of 6 percent per annum from the date of such levy.

(c) *Person defined.*—The term "person," as used in section 6332(a) and this section, includes an officer or employee of a corporation or a member or employee of a partnership, who as such officer, employee, or member is under a duty to surrender the property or rights to property or to discharge the obligation. Thus, in the case of a levy upon the salary or wages of an officer, employee, or elected or appointed official, of the United States, the District of Columbia, or any agency or instrumentality of either, the term "person" includes the officer or employee of the United States, of the District of Columbia, or of such agency or instrumentality, who as such officer or employee is under a duty to discharge the obligation. As to the officer or employee who is under such duty, see § 301.6331-1(a)(4)(i).

SEC. 301.6333. STATUTORY PROVISIONS; PRODUCTION OF BOOKS.

SEC. 6333. PRODUCTION OF BOOKS.

If a levy has been made or is about to be made on any property, or right to property, any person having custody or control of any books or records, containing evidence or statements relating to the property or right to property subject to levy, shall, upon demand of the Secretary or his delegate, exhibit such books or records to the Secretary or his delegate.

SEC. 301.6333-1. PRODUCTION OF BOOKS.—If a levy has been made or his about to be made on any property or rights to property, any person, having custody or control of any books or records containing evidence or statements relating to the property or rights to property subject to levy, shall, upon demand of the internal revenue officer who has made or is about to make the levy, exhibit such books or records to such officer.

SEC. 301.6334. STATUTORY PROVISIONS; PROPERTY EXEMPT FROM LEVY.

SEC. 6334. PROPERTY EXEMPT FROM LEVY.

(a) *Enumeration.*—There shall be exempt from levy—

(1) *Wearing apparel and school books.* Such items of wearing apparel and such school books as are necessary for the taxpayer or for members of his family;

(2) *Fuel, provisions, furniture, and personal effects.*—If the taxpayer is the head of a family, so much of the fuel, provisions, furniture, and personal effects in his household, and of the arms for personal use, livestock, and poultry of the taxpayer, as does not exceed $500 in value;

(3) *Books and tools of a trade, business, or profession.*—So many of the books and tools necessary for the trade, business, or profession of the taxpayer as do not exceed in the aggregate $250 in value.

(b) *Appraisal.*—The officer seizing property of the type described in subsection (a) shall appraise and set aside to the owner the amount of such property declared to be exempt. If the taxpayer objects at the time of the seizure to the valuation fixed by the officer making the seizure, the Secretary or his delegate shall summon three disinterested individuals who shall make the valuation.

(c) *No other property exempt.*—Notwithstanding any other law of the United States, no property or rights to property shall be exempt from levy other than the property specifically made exempt by subsection (a).

SEC. 301.6334–1. PROPERTY EXEMPT FROM LEVY.—(a) *Enumeration.*—There shall be exempt from levy—

(1) *Wearing apparel and school books.* Such items of wearing apparel and such school books as are necessary for the taxpayer or for members of his family. Expensive items of wearing apparel, such as furs, which are luxuries and are not necessary for the taxpayer or for members of his family, are not exempt from levy.

(2) *Fuel, provisions, furniture, and personal effects.*—If the taxpayer is the head of a family, so much of the fuel, provisions, furniture, and personal effects in his household, and of the arms for personal use, livestock, and poultry of the taxpayer, as does not exceed $500 in value.

(3) *Books and tools of a trade, business, or profession.*—So many of the books and tools necessary for the trade, business, or profession of the taxpayer as do not exceed in the aggregate $250 in value.

(b) *Appraisal.*—The internal revenue officer seizing property of the type described in section 6334(a) shall appraise and set aside to the owner the amount of such property declared to be exempt. If the taxpayer objects at the time of the seizure to the valuation fixed by the officer making the seizure, such officer shall summon three disinterested individuals who shall make the valuation.

(c) *No other property exempt.*—No property or rights to property are exempt from levy other than the property specifically exempted by section 6334(a). No provision of a State law may exempt property or rights to property from levy for the collection of any Federal tax. Thus, property exempt from execution under State personal or homestead exemption laws is, nevertheless, subject to levy by the United States for collection of its taxes.

SEC. 301.6335. STATUTORY PROVISIONS; SALE OF SEIZED PROPERTY.

SEC. 6335. SALE OF SEIZED PROPERTY.

(a) *Notice of seizure.* As soon as practicable after seizure of property, notice in writing shall be given by the Secretary or his delegate to the owner of the property (or, in the case of personal property, the possessor thereof), or shall be left at his usual place of abode or business if he has such within the internal revenue district where the seizure is made. If the owner cannot be readily located, or has no dwelling or place of business within such district, the notice may be mailed to his last known address. Such notice shall specify the sum demanded and shall contain, in the case of personal property, an account of the property seized and, in the case of real property, a description with reasonable certainty of the property seized.

(b) *Notice of sale.*—The Secretary or his delegate shall as soon as practicable after the seizure of the property give notice to the owner, in the same manner as that prescribed in subsection (a), and shall cause a notification to be published in some newspaper within the county wherein such seizure is made, or, if there be no newspaper published in such county, shall post such notice at the post office nearest the place where the seizure is made, and in not less than two other public places. Such notice shall specify the property to be sold, and the time, place, manner, and conditions of the sale thereof. Whenever levy is made without regard to the 10-day period provided in section 6331(a), public notice of sale of the property seized shall not be made within such 10-day period unless section 6336 (relating to sale of perishable goods) is applicable.

(c) *Sale of indivisible property.*—If any property liable to levy is not divisible, so as to enable the Secretary or his delegate by sale of a part thereof to raise the whole amount of the tax and expenses, the whole of such property shall be sold.

(d) *Time and place of sale.*—The time of sale shall not be less than 10 days nor more than 40 days from the time of giving public notice under subsection (b). The place of sale shall be within the county in which the property is seized, except by special order of the Secretary or his delegate.

(e) *Manner and conditions of sale.*

(1) *Minimum price.*—Before the sale the Secretary or his delegate shall determine a minimum price for which the property shall be sold, and if no person offers for such property at the sale, the amount of the minimum price, the property shall be declared to be purchased at such price for the United States; otherwise the property shall be declared to be sold to the highest bidder. In determining the minimum price, the Secretary or his delegate shall take into account the expense of making the levy and sale.

(2) *Additional rules applicable to sale.*—The Secretary or his delegate shall by regulations prescribe the manner and other conditions of the sale of property seized by levy. If one or more alternative methods or conditions are permitted by regulations, the Secretary or his delegate shall select the alternatives applicable to the sale. Such regulations shall provide:

(A) That the sale shall not be conducted in any manner other than—

(i) By public auction, or

(ii) By public sale under sealed bids.

(B) In the case of the seizure of several items of property, whether such items shall be offered separately, in groups, or in the aggregate; and whether such property shall be offered both separately (or in groups) and in the aggregate, and sold under whichever method produces the highest aggregate amount.

(C) Whether the announcement of the minimum price determined by the Secretary or his delegate may be delayed until the receipt of the highest bid.

(D) Whether payment in full shall be required at the time of acceptance of a bid, or whether a part of such payment may be deferred for such period (not to exceed 1 month) as may be determined by the Secretary or his delegate to be appropriate.

(E) The extent to which methods (including advertising) in addition to those prescribed in subsection (b) may be used in giving notice of the sale.

(F) Under what circumstances the Secretary or his delegate may adjourn the sale from time to time (but such adjournments shall not be for a period to exceed in all 1 month).

(3) *Payment of amount bid.*—If payment in full is required at the time of acceptance of a bid and is not then and there paid, the Secretary or his delegate shall forthwith proceed to again sell the property in the manner provided in this subsection. If the conditions of the sale permit part of the payment to be deferred, and if such part is not paid within the prescribed period, suit may be instituted against the purchaser for the purchase price or such part thereof as has not been paid, together with interest at the rate of 6 percent per annum from the date of the sale; or, in the discretion of the Secretary or his delegate, the sale may be declared by the Secretary or his delegate to be null and void for failure to make full payment of the purchase price and the property may again be advertised and sold as provided in subsections (b) and (c) and this subsection. In the event of such readvertisement and sale any new purchaser shall receive such property or rights to property, free and clear of any claim or right of the former defaulting purchaser, of any nature whatsoever, and the amount paid upon the bid price by such defaulting purchaser shall be forfeited.

(f) *Stay of sale of seized property pending Tax Court decision.*—For restrictions on sale of seized property pending Tax Court decision, see section 6863(b)(3).

SEC. 301.6335-1.[1] SALE OF SEIZED PROPERTY.—(a) *Notice of seizure.*—As soon as practicable after seizure of property, the internal revenue officer seizing the property shall give notice in writing to the owner of the property (or, in the case of personal property, to the possessor thereof). The written notice shall be delivered to the owner (or to the possessor, in the case of personal property) or left at his usual place of abode or business if he has such within the internal revenue district where the seizure is made. If the owner cannot be readily located, or has no dwelling or place of business within such district, the notice may be mailed to his last known address. Such notice shall specify the sum demanded and shall contain, in the case of personal property, a list sufficient to identify the property seized and, in the case of real property, a description with reasonable certainty of the property seized.

(b) *Notice of sale.*—(1) As soon as practicable after seizure of the property, the District Director shall give notice of sale in writing to the owner. Such notice shall be delivered to the owner or left at his usual place of abode or

[1] This section has the effect of superseding Commissioner's Reorganization Order No. 33, C. B. 1954-2, 734.

business if he has such within the internal revenue district where the seizure is made. If the owner cannot be readily located, or has no dwelling or place of business within such district, the notice may be mailed to his last known address. The notice shall specify the property to be sold, and the time, place, manner, and conditions of the sale thereof, and shall expressly state that only the right, title, and interest of the delinquent taxpayer in and to such property is to be offered for sale. The notice shall also be published in some newspaper within the county wherein such seizure is made. However, if there is no newspaper published in such county, such notice shall be posted at the post office nearest the place where the seizure is made, and in not less than two other public places.

(2) The district director may use other methods of giving notice of sale and of advertising seized property in addition to those referred to in subparagraph (1) when he believes that the nature of the property to be sold is such that a wider or more specialized advertising coverage will enhance the possibility of obtaining a higher price for the property.

(3) Whenever levy is made without regard to the 10-day period provided in section 6331(a) (relating to cases in which collection is in jeopardy), a public notice of sale of the property seized shall not be made within such 10-day period unless section 6336 (relating to perishable goods) is applicable.

(c) *Time, place, manner, and conditions of sale.*—The time. place, manner, and conditions of the sale of property seized by levy shall be as follows:

(1) *Time and place of sale.*—The time of sale shall not be less than 10 days nor more than 40 days from the time of giving public notice under section 6335(b) (see par. (b) of this section). The place of sale shall be within the county in which the property is seized, except that if it appears to the District Director under whose supervision the seizure was made that substantially higher bids may be obtained for the property if the sale is held at a place outside such county, he may order that the sale be held in such other place. The sale shall be held at the time and place stated in the notice of sale.

(2) *Adjournment of sale.*—When it appears to the District Director that an adjournment of the sale will best serve the interest of the United States or that of the taxpayer, the District Director may adjourn, or cause the internal revenue officer conducting the sale to adjourn, the sale from time to time, but the date of the sale shall not be later than one month after the date fixed in the original notice of sale.

(3) *Minimum price.*—The District Director shall determine a minimum price, taking into account the expenses of levy and sale, for which the property shall be sold. If no person offers for such property at the sale the amount of the minimum price, the property shall be declared purchased at such price for the United States; otherwise, the property shall be declared to be sold to the highest bidder. The internal revenue officer conducting the sale shall either announce the minimum price before the sale begins or defer announcement of the minimum price until after the receipt of the highest bid, and, if the highest bid is greater than the minimum price, no announcement of the minimum price shall be made.

(4) *Offering of property*—(i) *Sale of indivisible property.*—If any property levied upon is not divisible, so as to enable the District Director by sale of a part thereof to raise the whole amount of the tax and expenses of levy and sale, the whole of such property shall be sold. For application of surplus proceeds of sale, see section 6342(b).

(ii) *Separately, in groups, or in the aggregate.*—The seized property may be offered for sale—

(*a*) As separate items, or

(*b*) As groups of items, or

(*c*) In the aggregate, or

(*d*) Both as separate items (or in groups) and in the aggregate. In such cases, the property shall be sold under the method which produces the highest aggregate amount.

The District Director shall select whichever of the foregoing methods of offering the property for sale as, in his opinion, is most feasible under all the facts and circumstances of the case, except that if the property to be sold includes both real and personal property, only the personal property may be grouped for the purpose of offering such property for sale. However, real and personal property may be offered for sale in the aggregate, provided the real property, as separate items, and the personal property as a group, or as groups, or as separate items, are first offered separately.

(iii) *Condition of title and of property.*—Only the right, title, and interest of the delinquent taxpayer in and to the property seized shall be offered for sale, and such interest shall be offered subject to any prior outstanding mortgages, encumbrances, or other liens in favor of third parties which are valid as against the delinquent taxpayer and are superior to the lien of the United States. All seized property shall be offered for sale "as is" and "where is" and without recourse against the United States. No guaranty or warranty, express or implied, shall be made by the internal revenue officer offering the property for sale, as to the validity of the title, quality, quantity, weight, size, or condition of any of the property, or its fitness for any use or purpose. No claim shall be considered for allowance or adjustment or for rescission of the sale based upon failure of the property to conform with any representation, express or implied.

(iv) *Terms of payment.*—The property shall be offered for sale upon whichever of the following terms is fixed by the District Director in the public notice of sale:

(*a*) Payment in full upon acceptance of the highest bid, without regard to the amount of such bid, or

(*b*) If the aggregate price of all property purchased by a successful bidder at the sale is more than $200, an initial payment of $200 or 20 percent of the purchase price, whichever is the greater, and payment of the balance (including all costs incurred for the protection or preservation of the property subsequent to the sale and prior to final payment) within a specified period, not to exceed one month from the date of the sale.

(5) *Method of sale.*—The District Director shall sell the property either—

(i) At public auction, at which open competitive bids shall be received, or

(ii) At public sale under sealed bids. The following rules, in addition to the other rules provided in this paragraph, shall be applicable to public sale under sealed bids:

(*a*) *Invitation to bidders.*—Bids shall be solicited through a public notice of sale.

(*b*) *Form for use by bidders.*—A bid shall be submitted on a form which will furnished by the District Director upon request. The form shall be completed in accordance with the instructions thereon.

(*c*) *Remittance with bid.*—If the total bid is $200 or less, the full amount of the bid shall be submitted therewith. If the total bid is more than $200, 20 percent of such bid or $200, whichever is greater, shall be submitted therewith. (In the case of alternative bids submitted by the same bidder for items of property offered separately, or in groups, or in the aggregate, the bidder shall remit the full amount of the highest alternative bid submitted, if that bid is $200 or less. If the highest alternative bid submitted is more than $200, the bidder shall remit 20 percent of the highest alternative bid or $200, whichever is greater.) Such remittance shall be by a certified, cashier's or treasurer's check 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, or by a United States postal, bank, express, or telegraph money order.

(*d*) *Time for receiving and opening bids.*—Each bid shall be submitted in a securely sealed envelope. The bidder shall indicate in the upper left hand corner of the envelope his name and address and the time and place of sale as announced in the public notice of sale. A bid will not be considered unless it is received by the internal revenue officer conducting the sale prior to the opening of the bids. The bids will be opened at the time and place stated in the notice of sale, or at the time fixed in the announcement of the adjournment of the sale.

(*e*) *Consideration of bids.*—The public notice of sale shall specify whether the property is to be sold separately, by groups, or in the aggregate or by a combination of these methods, as provided in subparagraph (4) (ii) of this paragraph. If the notice specifies an alternative method, bidders may submit bids under one or more of the alternatives. In case of error in the extension of prices in any bid, the unit price will govern. The internal revenue officer conducting the sale shall have the right to waive any technical defects in a bid. In the event two or more highest bids are equal in amount, the internal revenue officer conducting the sale shall determine the successful bidder by drawing lots. After the opening, examination, and consideration of all bids, the internal revenue officer conducting the sale shall announce the amount of the highest bid or bids and the name of the successful bidder or bidders. Any remittance submitted in connection with an unsuccessful bid shall be returned at the conclusion of the sale.

(f) *Withdrawal of bids.*—A bid may be withdrawn on written or telegraphic request received from the bidder prior to the time fixed for opening the bids. A technical defect in a bid confers no right on the bidder for the withdrawal of his bid after it has been opened.

(6) *Payment of bid price.*—All payments for property sold under this section shall be made by cash or by a certified, cashier's, or treasurer's check 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, or by a United States postal, bank, express, or telegraph money order. If payment in full is required upon acceptance of the highest bid, the payment shall be made at such time. If deferred payment is permitted, the initial payment shall be made upon acceptance of the bid, and the balance shall be paid on or before the date fixed for payment thereof. Any remittance submitted with a successful sealed bid shall be applied toward the purchase price.

(7) *Delivery and removal of personal property.*—Responsibility of the United States for the protection or preservation of seized personal property shall cease immediately upon acceptance of the highest bid. The risk of loss is on the purchaser of personal property upon acceptance of his bid. Possession of any personal property shall not be delivered to the purchaser until the purchase price has been paid in full. If payment of part of the purchase price for personal property is deferred, the United States will retain possession of such property as security for the payment of the balance of the purchase price and, as agent for the purchaser, will cause the property to be cared for until the purchase price has been paid in full or the sale is declared null and void for failure to make full payment of the purchase price. In such case, all charges and expenses incurred in caring for the property after the acceptance of the bid shall be borne by the purchaser.

(8) *Default in payment.*—If payment in full is required upon acceptance of the bid and is not then and there paid, the internal revenue officer conducting the sale shall forthwith proceed again to sell the property in the manner provided in section 6335(e) and the regulations thereunder. If the conditions of the sale permit part of the payment to be deferred, and such part is not paid within the prescribed period, suit may be instituted against the purchaser for the purchase price or such part thereof as has not been paid, together with interest at the rate of 6 percent per annum from the date of the sale; or, in the discretion of the District Director, the sale may be declared by the District Director to be null and void for failure to make full payment of the purchase price and the property may again be advertised and sold as provided in subsections (b), (c), and (e) of section 6335 and the regulations thereunder. In the event of such readvertisement and sale, any new purchaser shall receive such property or rights to property free and clear of any claim or right of the former defaulting purchaser, of any nature whatsoever, and the amount paid upon the bid price by such defaulting purchaser shall be forfeited to the United States.

(9) *Stay of sale of seized property pending Tax Court decision.*—For restrictions on sale of seized property pending Tax Court decision, see section 6863(b)(3) and the regulations thereunder.

SEC. 301.6336. STATUTORY PROVISIONS; SALE OF PERISHABLE GOODS.

SEC. 6336. SALE OF PERISHABLE GOODS.

If the Secretary or his delegate determines that any property seized is liable to perish or become greatly reduced in price or value by keeping, or that such property cannot be kept without great expense, he shall appraise the value of such property and—

(1) *Return to owner.*—If the owner of the property can be readily found, the Secretary or his delegate shall give him notice of such determination of the appraised value of the property. The property shall be returned to the owner if, within such time as may be specified in the notice, the owner—

(A) Pays to the Secretary or his delegate an amount equal to the appraised value, or

(B) Gives bond in such form, with such sureties, and in such amount as the Secretary or his delegate shall prescribe, to pay the appraised amount at such time as the Secretary or his delegate determines to be appropriate in the circumstances.

(2) *Immediate sale.* If the owner does not pay such amount or furnish such bond in accordance with this section, the Secretary or his delegate shall as soon

as practicable make public sale of the property in accordance with such regulations as may be prescribed by the Secretary or his delegate.

SEC. 301.6336-1. SALE OF PERISHABLE GOODS—(a) *Appraisal of certain seized property.*—If the District Director determines that any property seized by levy is liable to perish or become greatly reduced in price or value by keeping, or that such property cannot be kept without great expense, he shall appraise the value of such property and return it to the owner if the owner complies with the conditions prescribed in paragraph (b) of this section or, if the owner does not comply with such conditions, dispose of the property in accordance with paragraph (c) of this section.

(b) *Return to owner.*—If the owner of the property can be readily found, the district director shall give him written notice of his determination of the appraised value of the property. However, if the District Director determines that the circumstances require immediate action, he may give the owner an oral notice of his determination of the appraised value of the property, which notice shall be confirmed in writing prior to sale. The property shall be returned to the owner if, within the time specified in the notice, the owner—

(1) Pays to the District Director an amount equal to the appraised value, or

(2) Gives an acceptable bond as prescribed by section 7101 and the regulations thereunder. Such bond shall be in an amount not less than the appraised value of the property and shall be conditioned upon the payment of such amount at such time as the District Director determines to be appropriate in the circumstances.

(c) *Immediate sale.*—If the owner does not pay the amount of the appraised value of the seized property within the time specified in the notice, or furnish bond as provided in paragraph (b) within such time, the District Director shall as soon as practicable make public sale of the property in accordance with the following terms and conditions—

(1) *Notice of sale.*—If the owner can readily be found, a notice shall be given to him. A notice of sale also shall be posted in two public places in the county in which the property is to be sold. The notice shall specify the time and place of sale, the property to be sold, and the manner and conditions of sale. The District Director may give such other notice and in such other manner as he deems advisable under the circumstances.

(2) *Sale.*—The property shall be sold at public auction to the highest bidder.

(3) *Terms.*—The purchase price shall be paid in full upon acceptance of the highest bid. The payment shall be made in cash, or by a certified, cashier's, or treasurer's check 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, or by a United States postal, bank, express, or telegraph money order.

SEC. 301.6337. STATUTORY PROVISIONS; REDEMPTION OF PROPERTY.

SEC. 6337. REDEMPTION OF PROPERTY.

(a) *Before sale.*—Any person whose property has been levied upon shall have the right to pay the amount due, together with the expenses of the proceeding, if any, to the Secretary or his delegate at any time prior to the sale thereof, and upon such payment the Secretary or his delegate shall restore such property to him, and all further proceedings in connection with the levy on such property shall cease from the time of such payment.

(b) *Redemption of real estate after sale.*

(1) *Period.*—The owners of any real property sold as provided in section 6335, their heirs, executors, or administrators, or any person having any interest therein, or a lien thereon, or any person in their behalf, shall be permitted to redeem the property sold, or any particular tract of such property, at any time within 1 year after the sale thereof.

(2) *Price*—Such property or tract of property shall be permitted to be redeemed upon payment to the purchaser, or in case he cannot be found in the county in which the property to be redeemed is situated, then to the Secretary or his delegate, for the use of the purchaser, his heirs, or assigns, the amount paid by such purchaser and interest thereon at the rate of 20 percent per annum.

(c) *Record.*—When any lands sold are redeemed as provided in this section, the Secretary or his delegate shall cause entry of the fact to be made upon the record mentioned in section 6340, and such entry shall be evidence of such redemption.

SEC. 301.6337-1. REDEMPTION OF PROPERTY—(a) *Before sale.*—Any person whose property has been levied upon shall have the right to pay the amount due, together with costs and expenses of the proceeding, if any, to the District Director at any time prior to the sale of the property. Upon such payment the District Director shall restore such property to the owner and all further proceedings in connection with the levy on such property shall cease from the time of such payment.

(b) *Redemption of real estate after sale*—(1) *Period.*—The owner of any real estate sold as provided in section 6335, his heirs, executors, or administrators, or any person having any interest therein, or a lien thereon, or any person in their behalf, shall be permitted to redeem the property sold, or any particular tract of such property, at any time within one year after the sale thereof.

(2) *Price.*—Such property or tract of property may be redeemed upon payment to the purchaser, or in case he cannot be found in the county in which the property to be redeemed is situated, then to the District Director for the internal revenue district in which the property is situated, for the use of the purchaser, his heirs, or assigns, the amount paid by such purchaser and interest thereon at the rate of 20 percent per annum. In case real and personal property (or several tracts of real property) are purchased in the aggregate, the redemption price of the real property (or of each of the several tracts) shall be determined on the basis of the ratio, as of the time of sale, of the value of the real property (or tract) to the value of the total property purchased. For this purpose the minimum price or the highest bid price, whichever is higher, offered for the property separately or in groups shall be treated as the value.

(c) *Record.*—When any real property is redeemed, the District Director shall cause entry of the fact to be made upon the record of sale kept in accordance with section 6340, and such entry shall be evidence of such redemption. The party who redeems the property shall notify the District Director of the internal revenue district in which the property is situated of the date of such redemption and of the transfer of the certificate of sale, the amount of the redemption price, and the name of the party to whom such redemption price was paid.

SEC. 301.6338. STATUTORY PROVISIONS; CERTIFICATE OF SALE; DEED OF REAL PROPERTY.

SEC. 6338. CERTIFICATE OF SALE; DEED OF REAL PROPERTY.

(a) *Certificate of sale.*—In the case of property sold as provided in section 6335, the Secretary or his delegate shall give to the purchaser a certificate of sale upon payment in full of the purchase price. In the case of real property, such certificate shall set forth the real property purchased, for whose taxes the same was sold, the name of the purchaser, and the price paid therefor.

(b) *Deed to real property.*—In the case of any real property sold as provided in section 6335 and not redeemed in the manner and within the time provided in section 6337, the Secretary or his delegate shall execute (in accordance with the laws of the State in which such real property is situated pertaining to sales of real property under execution) to the purchaser of such real property at such sale, upon his surrender of the certificate of sale, a deed of the real property so purchased by him, reciting the facts set forth in the certificate.

(c) *Real property purchased by United States.*—If real property is declared purchased by the United States at a sale pursuant to section 6335, the Secretary or his delegate shall at the proper time execute a deed therefor after its preparation and the endorsement of approval as to its form by the United States district attorney for the district in which the property is situated, and the Secretary or his delegate shall, without delay, cause the deed to be duly recorded in the proper registry of deeds.

SEC. 301.6338-1. CERTIFICATE OF SALE; DEED OF REAL PROPERTY—(a) *Certificate of sale.* In the case of property sold as provided in section 6335 (relating to sale of seized property), the District Director shall give to the purchaser a certificate of sale upon payment in full of the purchase price. A certificate of sale of real property shall set forth the real property purchased, for whose taxes the same was sold, the name of the purchaser, and the price paid therefor.

(b) *Deed to real property.*—In the case of any real property sold as provided in section 6335 and not redeemed in the manner and within the time prescribed in section 6337, the District Director shall execute (in accordance with the laws of the State in which the real property is situated pertaining to sales of real property under execution) to the purchaser of such real property at the sale or

his assigns, upon surrender of the certificate of sale, a deed of the real property so purchased, reciting the facts set forth in the certificate.

(c) *Deed to real property purchased by the United States.*—If real property is declared purchased by the United States at a sale pursuant to section 6335, the District Director shall at the proper time execute a deed therefor after its preparation and the endorsement of approval as to the form by the United States district attorney for the district in which the property is situated, and the District Director shall, without delay, cause the deed to be duly recorded in the proper registry of deeds.

SEC. 301.6339. STATUTORY PROVISIONS; LEGAL EFFECT OF CERTIFICATE OF SALE OF PERSONAL PROPERTY AND DEED OF REAL PROPERTY.

SEC. 6339. LEGAL EFFECT OF CERTIFICATE OF SALE OF PERSONAL PROPERTY AND DEED OF REAL PROPERTY.

(a) *Certificate of sale of property other than real property.*—In all cases of sale pursuant to section 6335 of property (other than real property), the certificate of such sale—

(1) *As evidence.*—Shall be prima facie evidence of the right of the officer to make such sale, and conclusive evidence of the regularity of his proceedings in making the sale; and

(2) *As conveyances.*—Shall transfer to the purchaser all right, title, and interest of the party delinquent in and to the property sold; and

(3) *As authority for transfer of corporate stock.*—If such property consists of stocks, shall be notice, when received, to any corporation, company, or association of such transfer, and shall be authority to such corporation, company, or association to record the transfer on its books and records in the same manner as if the stocks were transferred or assigned by the party holding the same, in lieu of any original or prior certificate, which shall be void, whether canceled or not; and

(4) *As receipts.*—If the subject of sale is securities or other evidences of debt, shall be a good and valid receipt to the person holding the same, as against any person holding or claiming to hold possession of such securities or other evidences of debt; and

(5) *As authority for transfer of title to motor vehicle.*—If such property consists of a motor vehicle, shall be notice, when received, to any public official charged with the registration of title to motor vehicles, of such transfer and shall be authority to such offical to record the transfer on his books and records in the same manner as if the certificate of title to such motor vehicle were transferred or assigned by the party holding the same, in lieu of any original or prior certificate, which shall be void, whether canceled or not.

(b) *Deed of real property.*—In the case of the sale of real property pursuant to section 6335—

(1) *Deed as evidence.*—The deed of sale given pursuant to section 6338 shall be prima facie evidence of the facts therein stated; and

(2) *Deed of conveyance of title.*—If the proceedings of the Secretary or his delegate as set forth have been substantially in accordance with the provisions of law, such deed shall be considered and operate as a conveyance of all the right, title, and interest the party delinquent had in and to the real property thus sold at the time the lien of the United States attached thereo.

SEC. 301.6339-1. LEGAL EFFECT OF CERTIFICATE OF SALE OF PERSONAL PROPERTY AND DEED OF REAL PROPERTY—(a) *Certificate of sale of property other than real property.* In all cases of sale pursuant to section 633 of property (other than real property), the certificate of such sale—

(1) *As evidence.*—Shall be prima facie evidence of the right of the officer to make such sale, and conclusive evidence of the regularity of his proceedings in making the sale; and

(2) *As conveyance.*—Shall transfer to the purchaser all right, title, and interest of the party delinquent in and to the property sold; and

(3) *As authority for transfer of corporate stock.*—If such property consists of corporate stocks, shall be notice, when received, to any corporation, company, or association of such transfer, and shall be authority to such corporation, company, or association to record the transfer on its books and records in the same manner as if the stocks were transferred or assigned by the party holding the stock certificate, in lieu of any original or prior certificate, which shall be void, whether canceled or not; and

(4) *As receipts.*—If the subject of sale is securities or other evidences of debt, shall be a good and valid receipt to the person holding the certificate of sale as against any person holding or claiming to hold possession of such securities or other evidences of debt; and

(5) *As authority for transfer of title to motor vehicle.*—If such property consists of a motor vehicle, shall be notice, when received, to any public official charged with the registration of title to motor vehicles, of such transfer and shall be authority to such official to record the transfer on his books and records in the same manner as if the certificate of title to such motor vehicle were transferred or assigned by the party holding the certificate of title, in lieu of any original or prior certificate, which shall be null and void, whether canceled or not.

(b) *Deed to real property.*—In the case of the sale of real property pursuant to section 6335—

(1) *Deed as evidence.*—The deed of sale given pursuant to section 6338 shall be prima facie evidence of the facts therein stated; and

(2) *Deed as conveyance of title.*—If the proceedings of the District Director as set forth have been substantially in accordance with the provisions of law, such deed shall be considered and operate as a conveyance of all the right, title, and interest the party delinquent had in and to the real property thus sold at the time the lien of the United States attached thereto.

SEC. 301.6340. STATUTORY PROVISIONS; RECORDS OF SALE.

SEC. 6340. RECORDS OF SALE.

(a) *Requirement.*—The Secretary or his delegate shall, for each internal revenue district, keep a record of all sales of real property under section 6335 and of redemptions of such property. The record shall set forth the tax for which any such sale was made, the dates of seizure and sale, the name of the party assessed and all proceedings in making such sale, the amount of expenses, the names of the purchasers, and the date of the deed.

(b) *Copy as evidence.*—A copy of such record, or any part thereof, certified by the Secretary or his delegate shall be evidence in any court of the truth of the facts therein stated.

SEC. 301.6340–1. RECORDS OF SALE—(a) *Requirement.*—Such District Director shall keep a record of all sales under section 6335 of real property situated within his district and of redemptions of such property. The records shall set forth (1) the tax for which any such sale was made, the dates of seizure and sale, the name of the party assessed and all proceedings in making such sale, the amount of expenses, the names of the purchasers, the date of the deed, and, in the case of redemption of the property, (2) the date of such redemption and of the transfer of the certificate of sale, the amount of the redemption price, and the name of the party to whom such redemption price was paid.

(b) *Copy as evidence.*—A copy of such record, or any part thereof, certified by the District Director shall be evidence in any court of the truth of the facts therein stated.

SEC. 301.6341. STATUTORY PROVISIONS; EXPENSE OF LEVY AND SALE.

SEC. 6341. EXPENSE OF LEVY AND SALE.

The Secretary or his delegate shall determine the expenses to be allowed in all cases of levy and sale.

SEC. 301.6341–1. EXPENSE OF LEVY AND SALE. The District Director shall determine the expenses to be allowed in all cases of levy and sale. Such expenses shall include the expenses of protection and preservation of the property during the period subsequent to the levy, as well as the actual expenses incurred in connection with the sale thereof. In case real and personal property (or several tracts of real property) are sold in the aggregate, the District Director shall properly apportion the expenses to the real property (or to each tract).

SEC. 301.6342. STATUTORY PROVISIONS; APPLICATION OF PROCEEDS OF LEVY.

SEC. 6342. APPLICATION OF PROCEEDS OF LEVY.

(a) *Collection of liability.*—Any money realized by proceedings under this subchapter (whether by seizure, by surrender under section 6332, or by sale of seized property) shall be applied as follows:

(1) *Expense of levy and sale.*—First, against the expenses of the proceedings under this subchapter;

(2) *Specific tax liability on seized property.*—If the property seized and sold is subject to a tax imposed by any internal revenue law which has not been paid, the amount remaining after applying paragraph (1) shall then be applied against such tax liability (and, if such tax was not previously assessed, it shall then be assessed);

(3) *Liability of delinquent taxpayer.*—The amount, if any, remaining after applying paragraphs (1) and (2) shall then be applied against the liability in respect of which the levy was made.

(b) *Surplus proceeds.*—Any surplus proceeds remaining after the application of subsection (a) shall, upon application and satisfactory proof in support thereof, be credited or refunded by the Secretary or his delegate to the person or persons legally entitled thereto.

SEC. 301.6342-1. APPLICATION OF PROCEEDS OF LEVY—(a) *Collection of liability.*—Any money realized by proceedings under subchapter D of chapter 64 of the Internal Revenue Code (whether by seizure, by surrender under sec. 6332, or by sale of seized property), shall be applied as follows:

(1) *Expense of levy and sale.*—First, against the expenses of the proceedings as allowable under section 6341;

(2) *Specific tax liability on seized property.*—If the property seized and sold is subject to a tax imposed by any internal revenue law which has not been paid, the amount remaining after applying subparagraph (1) shall then be applied against such tax liability (and, if such tax was not previously assessed, it shall then be assessed);

(3) *Liability of delinquent taxpayer.*—The amount, if any, remaining after applying subparagraphs (1) and (2) of this paragraph shall then be applied against the liability in respect of which the levy was made.

(b) *Surplus proceeds.*—Any surplus proceeds remaining after the application of paragraph (a) of this section shall, upon application and satisfactory proof in support thereof, be credited or refunded by the District Director to the person or persons legally entitled thereto. The delinquent taxpayer is the person entitled to the surplus proceeds unless another person establishes a superior claim thereto.

SEC. 301.6343. STATUTORY PROVISIONS; AUTHORITY TO RELEASE LEVY.

SEC. 6343. AUTHORITY TO RELEASE LEVY.

It shall be lawful for the Secretary or his delegate, under regulations prescribed by the Secretary or his delegate, to release the levy upon all or part of the property or rights to property levied upon where the Secretary or his delegate determines that such action will facilitate the collection of the liability, but such release shall not operate to prevent any subsequent levy.

SEC. 301.6343-1. AUTHORITY TO RELEASE LEVY—(a) *Authority.*—The District Director may release the levy upon all or part of the property or rights to property levied upon, if the delinquent taxpayer complies with such of the conditions under paragraph (b) of this section as the District Director may require and if the District Director determines that such action will facilitate the collection of the liability. The release shall not operate to prevent any subsequent levy.

(b) *Conditions for release.*—The District Director may release the levy as authorized under paragraph (a) of this section, if—

(1) *Escrow arrangement.*—The delinquent taxpayer offers, and there is accepted by the District Director, a satisfactory arrangement placing property in escrow to secure the payment of the liability (including the expenses of levy) which is the basis of the levy.

(2) *Bond.*—The delinquent taxpayer delivers an acceptable bond to the District Director conditioned upon the payment of the liability (including the expenses of levy) which is the basis of the levy. Such bond shall be in the form as provided in section 7101 and the regulations thereunder.

(3) *Payment of amount of United States' interest in the property.*—There is paid to the District Director an amount determined by him to be equal to the interest of the United States in the seized property or the part of the seized property to be released.

(4) *Assignment of salaries and wages.*—The delinquent taxpayer executes an agreement directing his employer to pay to the District Director amounts deducted from the employee's wages on a regular, continuing, or periodic basis, in such manner and in such amount as is agreed upon with the District Director,

until the full amount of the liability is satisfied, and such agreement is accepted by the employer.

(5) *Installment payment arrangement.*—The delinquent taxpayer makes satisfactory arrangements with the District Director to pay the amount of the liability in installments.

(6) *Extension of statute of limitations.*—The delinquent taxpayer executes an agreement to extend the statute of limitations in accordance with section 6502 (a) (2) and the regulations thereunder.

SEC. 301.6344. STATUTORY PROVISIONS; CROSS REFERENCES.

SEC. 6344. CROSS REFERENCES.

(a) *Length of period.* For period within which levy may be begun in case of—

(1) Income, estate, and gift taxes, see sections 6502 (a) and 6503 (a) (1).

(2) Employment and miscellaneous excise taxes, see section 6502 (a).

(b) *Delinquent collection officers.* For distraint proceedings against delinquent internal revenue officers, see section 7803 (d).

(c) *Other references.* For provisions relating to—

(1) Stamps, marks and brands, see section 6807.

(2) Administration of real estate acquired by the United States, see section 7506.

ABATEMENTS, CREDITS, AND REFUNDS

PROCEDURE IN GENERAL

SEC. 301.6401 STATUTORY PROVISIONS; AMOUNTS TREATED AS OVERPAYMENTS.

SEC. 6401. AMOUNTS TREATED AS OVERPAYMENTS.

(a) *Assessment and collection after limitation period.*—The term "overpayment" includes that part of the amount of the payment of any internal revenue tax which is assessed or collected after the expiration of the period of limitation properly applicable thereto.

(b) *Excessive withholding.*—If the amount allowable as a credit under section 31 (relating to credit for tax withheld at the source under ch. 24) exceeds the taxes imposed by chapter 1 against which such credit is allowable, the amount of such excess shall be considered an overpayment.

(c) *Rule where no tax liability.* An amount paid as tax shall not be considered not to constitute an overpayment solely by reason of the fact that there was no tax liability in respect of which such amount was paid.

SEC. 301.6401-1. AMOUNTS TREATED AS OVERPAYMENTS.—(a) The term "overpayment" includes:

(1) Any payment of any internal revenue tax which is assessed or collected after the expiration of the period of limitation applicable thereto.

(2) Any amount allowable for a taxable year as a credit under section 31 (relating to credit for income tax withheld at source on wages) which exceeds the correct income tax imposed by chapter 1 for such year.

(b) An amount paid as tax shall not be considered not to constitute an overpayment solely by reason of the fact that there was no tax liability in respect of which such amount was paid.

SEC. 301.6402. STATUTORY PROVISIONS; AUTHORITY TO MAKE CREDITS OR REFUNDS.

SEC. 6402. AUTHORITY TO MAKE CREDITS OR REFUNDS.

(a) *General rule.*—In the case of any overpayment, the Secretary or his delegate, within the applicable period of limitations, may credit the amount of such overpayment, including any interest allowed thereon, against any liability in respect of an internal revenue tax on the part of the person who made the overpayment and shall refund any balance to such person.

(b) *Credits against estimated tax.*—The Secretary or his delegate is authorized to prescribe regulations providing for the crediting against the estimated income tax for any taxable year of the amount determined by the taxpayer or the Secretary (or his delegate) to be an overpayment of the income tax for a preceding taxable year.

SEC. 301.6402-1. AUTHORITY TO MAKE CREDITS OR REFUNDS.—The Commissioner, within the applicable period of limitations, may credit any overpayment of tax,

including interest thereon, against any outstanding liability for any tax (or for any interest, additional amount, addition to the tax, or assessable penalty) owed by the person making the overpayment, and the balance, if any, shall be refunded to such person by the Commissioner.

SEC. 301.6402-2. CLAIMS FOR CREDIT OR REFUND—(a) *Requirement that claim be filed.*—(1) Credits or refunds of overpayments may not be allowed or made after the expiration of the statutory period of limitation properly applicable unless, before the expiration of such period, a claim therefor has been filed by the taxpayer. Furthermore, under section 7422, a civil action for refund may not be instituted unless a claim has been filed within the properly applicable period of limitation.

(2) The claim, together with appropriate supporting evidence, must be filed in the office of the District Director for the internal revenue district in which the tax was paid. As to interest in the case of credits or refunds, see section 6611. See section 7502 for provisions treating timely mailing as timely filing and section 7503 for time for filing claim when the last day falls on Saturday, Sunday, or a legal holiday.

(b) *Grounds set forth in claim.*—(1) No refund or credit will be allowed after the expiration of the statutory period of limitation applicable to the filing of a claim therefor except upon one or more of the grounds set forth in a claim filed before the expiration of such period. The claim must set forth in detail each ground upon which a credit or refund is claimed and facts sufficient to appraise the Commissioner of the exact basis thereof. The statement of the grounds and facts must be verified by a written declaration that it is made under the penalties of perjury. A claim which does not comply with this paragraph will not be considered for any purpose as a claim for refund or credit.

(2) The District Director has no authority to refund on equitable grounds penalties or other amounts legally collected.

(c) *Form for filing claim.*—Claims by the taxpayer for the refunding of overpayments of taxes, interest, penalties, and additions to tax shall be made on Form 843. For special rules applicable to income taxes, see section 301.6402-3.

(d) *Separate claims for separate taxable periods.*—In the case of income, gift, and Federal unemployment taxes, a separate claim shall be made for each type of tax for each taxable year or period.

(e) *Proof of representative capacity.*—If a return is filed by an individual and, after his death, a refund claim is filed by his legal representative, certified copies of the letters testamentary, letters of administration, or other similar evidence must be annexed to the claim, to show the authority of the legal representative to file the claim. If an executor, administrator, guardian, trustee, receiver, or other fiduciary files a return and thereafter a refund claim is filed by the same fiduciary, documentary evidence to establish the legal authority of the fiduciary need not accompany the claim, provided a statement is made in the claim showing that the return was filed by the fiduciary and that the latter is still acting. In such cases, if a refund is to be paid, letters testamentary, letters of administration, or other evidence may be required, but should be submitted only upon the receipt of a specific request therefor. If a claim is filed by a fiduciary other than the one by whom the return was filed, the necessary documentary evidence should accompany the claim. A claim may be executed by an agent of the person assessed, but in such case a power of attorney must accompany the claim.

(f) *Mailing of refund check.*—Checks in payment of claims allowed will be drawn in the names of the persons entitled to the money and may be sent to such persons in care of an attorney or agent who has filed a power of attorney specifically authorizing him to receive such checks. The District Director may, however, send any such check direct to the claimant. In this connection, see section 3477 of the Revised Statutes (31 U. S. C. 203).

SEC. 301.6402-3. SPECIAL RULES APPLICABLE TO INCOME TAX.—(a) In the case of income tax, claims for refund may not only be made on Form 843 but may also be made on Form 1040, Form 1040A, Form 1040B, Form 1040NB, Form 1040NB-a, or an amended return.

(b) A properly executed income tax return on Form 1040, Form 1040B, Form 1040NB, or Form 1040NB-a shall, at the election of the taxpayer, constitute a claim for refund or credit within the meaning of section 6402 and section 6511 for the amount of the overpayment disclosed by such return. For purposes of section 6511, such claim shall be considered as filed on the date on which such return is considered as filed. An election to treat the return as a claim for

refund or credit shall be evidenced by a statement on the return setting forth the amount determined as an overpayment and advising whether such amount shall be refunded to the taxpayer or shall be applied as a credit against the taxpayer's estimated income tax for the taxable year immediately succeeding the taxable year for which such return is filed. If the taxpayer elects to have all or part of the overpayment shown by his return applied to his estimated income 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 income tax for such year or the installments thereof.

(c) The filing of a properly executed income tax return on Form 1040A shall constitute an election by the taxpayer to have the return treated as a claim for refund, and such return shall constitute a claim for refund within the meaning of section 6402 and section 6511 for the amount of the overpayment shown by the District Director's computation of the tax on the basis of the return. For purposes of section 6511, such claim shall be considered as filed on the date on which such return is considered filed.

(d) In any case in which a taxpayer elects to have an overpayment refunded to him he may not thereafter change his election to have the overpayment applied as a payment on account of his estimated income tax.

SEC. 301.6402-4. PAYMENTS IN EXCESS OF AMOUNTS SHOWN ON RETURN.—In certain cases, the taxpayer's payments in respect of his tax liability, made before the filing of his return, may exceed the amount of tax shown on the return. For example, such payments may arise in the case of the income tax when the estimated tax or the credit for income tax withheld at the source on wages exceeds the amount of tax shown on the return, or where a corporation obtains an extension of time for filing its return and makes installment payments based on its estimate of its tax liability which exceed the tax liability shown on the return subsequently filed. In any case in which the District Director determines that the payments by the taxpayer (made within the period prescribed for payment and before the filing of the return) are in excess of the amount of tax shown on the return, he may make credit or refund of such overpayment without awaiting examination of the completed return and without awaiting filing of a claim for refund. However, the provisions of sections 301.6402-2 and 301.6402-3 are applicable to such overpayment, and taxpayers should submit claims for refund (if the income tax return is not itself a claim for refund, as provided in sec. 301.6402-3) to protect themselves in the event the District Director fails to make such determination and credit or refund. The provisions of section 6405 (relating to reports of refunds of more than $100,000 to the Joint Committee on Internal Revenue Taxation) are not applicable to the overpayments described in this section caused by timely payments of tax which exceed the amount of tax shown on a timely return.

SEC. 301.6402-5. CLAIM FOR PAYMENT OF JUDGMENT OBTAINED AGAINST DISTRICT DIRECTOR.—(a) A claim for the amount of a judgment against a District Director for the recovery of taxes, penalties, or other sums should be made on a properly executed Form 843, and filed directly with the Commissioner of Internal Revenue, Washington 25, D. C. The claim must be verified by a written declaration that it is made under the penalties of perjury. Two certified copies of the final judgment and a certificate of probable cause should be attached to the claim. If the payment of court costs is claimed, an itemized bill of the court costs paid, receipted by the clerk of the court, should also accompany the claim. With respect to the certificate of probable cause, 28 U. S. C. 2006 provides:

SEC. 2006. EXECUTION AGAINST REVENUE OFFICER.

Execution shall not issue against a * * * revenue officer on a final judgment in any proceeding against him for any of his acts, or for the recovery of any money exacted by or paid to him and subsequently paid into the Treasury, in performing his official duties, if the court certifies that:

(1) Probable cause existed; or

(2) The officer acted under the directions of the Secretary of the Treasury or other proper Government officer.

When such certificate has been issued, the amount of the judgment shall be paid out of the proper appropriation by the Treasury.

If the case was appealed, two certified copies of the mandate of the appellate court should also be attached to the claim. A judgment will not be paid until the period for appeal has expired unless a stipulation, signed by both parties to the

suit, waiving the right to appeal, has been filed with the clerk of the court, and two certified copies of such waiver are furnished to the Commissioner.

(b) If the judgment debtor shall have already paid the amount recovered against him, the claim should be made in his name, accompanied by two certified copies of the final judgment, and an itemized bill of the court costs paid. A certificate of the clerk of the court in which the judgment was recovered (or other satisfactory evidence) showing that the judgment has been satisfied and specifying the exact sum paid in its satisfaction, should accompany the claim.

SEC. 301.6402-6. CLAIM FOR PAYMENT OF JUDGMENT OBTAINED IN UNITED STATES DISTRICT COURT AGAINST THE UNITED STATES.—A claim for the payment of a judgment rendered by a United States district court against the United States representing taxes, penalties, or other sums should be made on a properly executed Form 843 and filed directly with the Commissioner of Internal Revenue, Washington 25, D. C. The claim must be verified by a written declaration that it is made under the penalties of perjury. Two certified copies of the final judgment should be attached to the claim. If the judgment specifically provides for the recovery of costs, an itemized bill of such court costs paid, receipted by the clerk of the court, should also accompany the claim. If the case was appealed, two certified copies of the mandate of the appellate court should also be attached to the claim. A judgment will not be paid until the period for appeal has expired unless a stipulation, signed by both parties to the suit, waiving the right to appeal, has been filed with the clerk of the court, and two certified copies of such waiver are furnished to the Commissioner.

SEC. 301.6402-7. CLAIM FOR PAYMENT OF JUDGMENT OBTAINED IN THE COURT OF CLAIMS AGAINST THE UNITED STATES.—A claim for the payment of a judgment rendered by the United States Court of Claims against the United States representing taxes, penalties, or other sums should be made on a properly executed Form 843 and filed directly with the Commissioner of Internal Revenue, Washington 25, D. C. The claim must be verified by a written declaration that it is made under the penalties of perjury. The claim shall be accompanied by a certificate of judgment issued by the clerk of the court and two copies of the printed opinion of the Court, if an opinion was rendered. A judgment will not be paid until the period for appeal has expired unless a stipulation, signed by both parties to the suit, waiving the right to appeal, has been filed with the clerk of the court, and two certified copies of such waiver are furnished to the Commissioner.

SEC. 301.6403. STATUTORY PROVISIONS; OVERPAYMENT OF INSTALLMENT.

SEC. 6403. OVERPAYMENT OF INSTALLMENT.

In the case of a tax payable in installments, if the taxpayer has paid as an installment of the tax more than the amount determined to be the correct amount of such installment, the overpayment shall be credited against the unpaid installments, if any. If the amount already paid, whether or not on the basis of installments, exceeds the amount determined to be the correct amount of the tax, the overpayment shall be credited or refunded as provided in section 6402.

SEC. 301.6403-1. OVERPAYMENT OF INSTALLMENT.—If any installment of tax is overpaid, the overpayment shall first be applied against any outstanding installments of such tax. If the overpayment exceeds the correct amount of tax due, the overpayment shall be credited or refunded as provided in section 6402 and the regulations thereunder.

SEC. 301.6404. STATUTORY PROVISIONS; ABATEMENTS.

SEC. 6404. ABATEMENTS.

(a) *General rule.*—The Secretary or his delegate is authorized to abate the unpaid portion of the assessment of any tax or any liability in respect thereof, which—

(1) Is excessive in amount, or

(2) Is assessed after the expiration of the period of limitation properly applicable thereto, or

(3) Is erroneously or illegally assessed.

(b) *No claim for abatement of income, estate, and gift taxes.*—No claim for abatement shall be filed by a taxpayer in respect of an assessment of any tax imposed under subtitle A or B.

(c) *Small tax balances.*—The Secretary or his delegate is authorized to abate the unpaid portion of the assessment of any tax, or any liability in respect there-

of, if the Secretary or his delegate determines under uniform rules prescribed by the Secretary or his delegate that the administration and collection costs involved would not warrant collection of the amount due.

SEC. 301.6404–1. ABATEMENTS. (a) The District Director may abate any assessment, or unpaid portion thereof, if the assessment is in excess of the correct tax liability, if the assessment is made subsequent to the expiration of the period of limitations applicable thereto, or if the assessment has been erroneously or illegally made.

(b) No claim for abatement may be filed with respect to income, estate, or gift tax.

(c) Except in case of income, estate, or gift tax, if more than the correct amount of tax, interest, additional amount, addition to the tax, or assessable penalty is assessed but not paid to the District Director, the person against whom the assessment is made may file a claim for abatement of such overassessment. Each claim for abatement under this section shall be made on Form 843 and shall be filed with the District Director for the internal revenue district in which the tax was assessed. Form 843 shall be made in accordance with the instructions relating to such form.

(d) The Commissioner may issue uniform instructions to District Directors authorizing them, to the extent permitted in such instructions to abate amounts the collection of which is not warranted because of the administration and collection costs.

SEC. 301.6405. STATUTORY PROVISIONS; REPORTS OF REFUNDS AND CREDITS.

SEC. 6405. REPORTS OF REFUNDS AND CREDITS.

(a) *By Treasury to Joint Committee.* No refund or credit of any income, war profits, excess profits, estate, or gift tax in excess of $100,000 shall be made until after the expiration of 30 days from the date upon which a report giving the name of the person to whom the refund or credit is to be made, the amount of such refund or credit, and a summary of the facts and the decision of the Secretary or his delegate, is submitted to the Joint Committee on Internal Revenue Taxation.

(b) *By Joint Committee to Congress.*—A report to Congress shall be made annually by such committee of such refunds and credits, including the names of all persons and corporations to whom amounts are credited or payments are made, together with the amounts credited or paid to each.

(c) *Tentative adjustments.*—Any credit or refund allowed or made under section 6411 shall be made without regard to the provisions of subsection (a) of this section. In any such case, if the credit or refund, reduced by any deficiency in such tax thereafter assessed and by deficiencies in any other tax resulting from adjustments reflected in the determination of the credit or refund, is in excess of $100,000, there shall be submitted to such committee a report containing the matter specified in subsection (a) at such time after the making of the credit or refund as the Secretary or his delegate shall determine the correct amount of the tax.

SEC. 301.6405–1. REPORTS OF REFUNDS AND CREDITS.—Section 6405 requires that a report be made to the Joint Committee on Internal Revenue Taxation of proposed refunds or credits of any income, war profits, excess profits, estate, or gift tax in excess of $100,000.

SEC. 301.6406. STATUTORY PROVISIONS; PROHIBITION OF ADMINISTRATIVE REVIEW OF DECISIONS.

SEC. 6406. PROHIBITION OF ADMINISTRATIVE REVIEW OF DECISIONS.

In the absence of fraud or mistake in mathematical calculation, the findings of fact in and the decision of the Secretary or his delegate upon the merits of any claim presented under or authorized by the internal revenue laws and the allowance or nonallowance by the Secretary or his delegate of interest on any credit or refund under the internal revenue laws shall not, except as provided in subchapters C and D of chapter 76 (relating to the Tax Court), be subject to review by any other administrative or accounting officer, employee, or agent of the United States.

SEC. 301.6407. STATUTORY PROVISIONS; DATE OF ALLOWANCE OF REFUND OR CREDIT.

SEC. 6407. DATE OF ALLOWANCE OF REFUND OR CREDIT.

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.

SEC. 301.6407-1. DATE OF ALLOWANCE OF REFUND OR CREDIT.—The date on which the District Director, or an authorized certifying officer designated by him, first certifies the allowance of an overassessment in respect of any internal revenue tax shall be considered as the date of allowance of refund or credit in respect of such tax.

RULES OF SPECIAL APPLICATION

SEC. 301.6411 STATUTORY PROVISIONS; TENTATIVE CARRYBACK ADJUSTMENTS.

SEC. 6411. TENTATIVE CARRYBACK ADJUSTMENTS.

(a) *Application for adjustment.*—A taxpayer may file an application for a tentative carryback adjustment of the tax for the prior taxable year affected by a net operating loss carryback, provided in section 172(b), from any taxable year. The application shall be verified in the manner prescribed by section 6065 in the case of a return of such taxpayer, and shall be filed, on or after the date of filing of the return for the taxable year of the net operating loss from which the carryback results and within a period of 12 months from the end of such taxable year, in the manner and form required by regulations prescribed by the Secretary or his delegate. The application shall set forth in such detail and with such supporting data and explanation as such regulations shall require—

(1) The amount of the net operating loss;

(2) The amount of the tax previously determined for the prior taxable year affected by such carryback, the tax previously determined being ascertained in accordance with the method prescribed in section 1314(a);

(3) The amount of decrease in such tax, attributable to such carryback, such decrease being determined by applying the carryback in the manner provided by law to the items on the basis of which such tax was determined;

(4) The unpaid amount of such tax, not including any amount required to be shown under paragraph (5);

(5) The amount, with respect to the tax for the taxable year immediately preceding the taxable year of such loss, as to which an extension of time for payment under section 6164 is in effect; and

(6) Such other information for purposes of carrying out the provisions of this section as may be required by such regulations.

An application under this subsection shall not constitute a claim for credit or refund.

(b) *Allowance of adjustments.*—Within a period of 90 days from the date on which an application for a tentative carryback adjustment is filed under subsection (a), or from the last day of the month in which falls the last date prescribed by law (including any extension of time granted the taxpayer) for filing the return for the taxable year of the net operating loss from which such carryback results, whichever is the later, the Secretary or his delegate shall make, to the extent he deems practicable in such period, a limited examination of the application, to discover omissions and errors of computation therein, and shall determine the amount of the decrease in the tax attributable to such carryback upon the basis of the application and the examination, except that the Secretary or his delegate may disallow, without further action, any application which he finds contains errors of computation which he deems cannot be corrected by him within such 90-day period or material omissions. Such decrease shall be applied against any unpaid amount of the tax decreased (including any amount of such tax as to which an extension of time under section 6164 is in effect) and any remainder shall be credited against any unsatisfied amount of any tax for the taxable year immediately preceding the taxable year of the net operating loss the time for payment of which tax is extended under section 6164. Any remainder shall, within such 90-day period, be either credited against any tax or installment thereof then due from the taxpayer, or refunded to the taxpayer.

(c) *Consolidated returns.*—If the corporation seeking a tentative carryback adjustment under this section, made or was required to make a consolidated return, either for the taxable year within which the net operating loss arises, or for the preceding taxable year affected by such loss, the provisions of this section shall apply only to such extent and subject to such conditions, limitations, and exceptions as the Secretary or his delegate may by regulations prescribe.

SEC. 301.6411-1. TENTATIVE CARRYBACK ADJUSTMENTS.—For regulations under this section, see the Income Tax Regulations (pt. 1 of this chapter).

SEC. 301.6412. STATUTORY PROVISIONS; FLOOR STOCKS REFUNDS.

SEC. 6412. FLOOR STOCKS REFUNDS.

(a) *Motor vehicles.*

(1) *In general.*—Where before April 1, 1955, any article subject to the tax imposed by section 4061 (a) or (b) has been sold by the manufacturer, producer, or importer, and on such date is held by a dealer and has not been used and is intended for sale, there shall be credited or refunded (without interest) to the manufacturer, producer, or importer an amount equal to the difference between the tax paid by such manufacturer, producer, or importer on his sale of the article and the amount of tax made applicable to such article on and after April 1, 1955.

(2) *Definitions.*—For purposes of this subsection—

(A) The term "dealer" includes a wholesaler, jobber, distributor, or retailer.

(B) An article shall be considered as "held by a dealer" if title thereto has passed to such dealer (whether or not delivery to him has been made), and if for purposes of consumption title to such article or possession thereof has not at any time been transferred to any person other than a dealer.

(3) *Refunds to dealers.*—Under regulations prescribed by the Secretary or his delegate, the refund provided by this subsection may be made to the dealer instead of the manufacturer, producer, or importer, if the manufacturer, producer, or importer waives any claim for the amount so to be refunded.

(4) *Reimbursement of dealers.*—When the credit or refund provided for in this subsection has been allowed to the manufacturer, producer, or importer, he shall remit to the dealer to whom was sold the article in respect of which the credit or refund was allowed so much of that amount of the tax corresponding to the credit or refund as was included in or added to the price paid or agreed to be paid by the dealer.

(5) *Limitation on eligibility for credit or refund.*—No person shall be entitled to credit or refund under this subsection unless (A) he has in his possession such evidence of the inventories with respect to which the credit or refund is claimed as may be required by regulations prescribed under this subsection, and (B) claim for such credit or refund is filed with the Secretary or his delegate before July 1, 1955.

(b) *Gasoline.*

(1) *In general.*—With respect to any gasoline taxable under section 408, upon which tax (including floor stocks tax) at the applicable rate has been paid, and which, on April 1, 1955, is held and intended for sale by any person, there shall be credited or refunded (without interest) to the producer or importer who paid the tax, subject to such regulations as may be prescribed by the Secretary or his delegate, an amount equal to so much of the difference between the tax so paid and the amount of tax made applicable to such gasoline on and after April 1, 1955, as has been paid by such producer or importer to such person as reimbursement for the tax reduction on such gasoline, if claim for such credit or refund is filed with the Secretary or his delegate prior to July 1, 1955. No credit or refund shall be allowable under this subsection with respect to gasoline in retail stocks held at the place where intended to be sold at retail, nor with respect to gasoline held for sale by a producer or importer of gasoline.

(2) *Limitation on eligibility for credit or refund.*—No producer or importer shall be entitled to a credit or refund under paragraph (1) unless he has in his possession satisfactory evidence of the inventories with respect to which he has made the reimbursements described in such paragraph, and establishes to the satisfaction of the Secretary or his delegate with respect to the quantity of gasoline as to which credit or refund is claimed under such paragraph that on or after April 1, 1955, such quantity of gasoline was sold to the ultimate consumer at a price which reflected the amount of the tax reduction.

(c) *Other laws applicable to certain floor stocks refunds.*—All provisions of law, including penalties, applicable in respect of the taxes imposed under sections 4061 and 4081 shall, insofar as applicable and not inconsistent with subsections (a) and (b) of this section, be applicable in respect of the credits and refunds provided for in such subsections to the same extent as if such credits or refunds constituted overpayments of such taxes.

(d) *Sugar.*—With respect to any sugar or articles composed in chief value of sugar upon which tax imposed under section 4501(b) has been paid and which, on June 30, 1957, are held by the importer and intended for sale or other disposition, there shall be refunded (without interest) to such importer, subject to such regulations as may be prescribed by the Secretary or his delegate, an amount

equal to the tax paid with respect to such sugar or articles composed in chief value of sugar.

(e) *Cross reference.*—For floor stocks refunds in case of certain alcohol and tobacco taxes, see sections 5063 and 5707.

SEC. 301.6412–1. FLOOR STOCKS REFUNDS. For regulations under this section, see the Manufacturers' and Retailers' Excise Tax Regulations (pt. 40 of this chapter).

SEC. 301.6413. STATUTORY PROVISIONS; SPECIAL RULES APPLICABLE TO CERTAIN EMPLOYMENT TAXES.

SEC. 6413. SPECIAL RULES APPLICABLE TO CERTAIN EMPLOYMENT TAXES.

(a) *Adjustment of tax*—(1) *General rule.*—If more than the correct amount of tax imposed by section 3101, 3111, 3201, 3221, or 3402 is paid with respect to any payment of remuneration, proper adjustments, with respect to both the tax and the amount to be deducted, shall be made, without interest, in such manner and at such times as the Secretary or his delegate may by regulations prescribe.

(2) *United States as employer.*—For purposes of this subsection, in the case of remuneration received from the United States or a wholly-owned instrumentality thereof during any calendar year, each head of a Federal agency or instrumentality who makes a return pursuant to section 3122 and each agent, designated by the head of a Federal agency or instrumentality, who makes a return pursuant to such section shall be deemed a separate employer.

(b) *Overpayments of certain employment taxes.*—If more than the correct amount of tax imposed by section 3101, 3111, 3201, 3221, or 3402 is paid or deducted with respect to any payment of remuneration and the overpayment cannot be adjusted under subsection (a) of this section, the amount of the overpayment shall be refunded in such manner and at such times (subject to the statute of limitations properly applicable thereto) as the Secretary or his delegate may by regulations prescribe.

(c) *Special refunds*—(1) *In general.*—If by reason of an employee receiving wages from more than one employer during a calendar year after the calendar year 1950 and prior to the calendar year 1955, the wages received by him during such year exceed $3,600, the employee shall be entitled (subject to the provisions of sec. 31(b)) to a credit or refund of any amount of tax, with respect to such wages, imposed by section 1400 of the Internal Revenue Code of 1939 and deducted from the employee's wages (whether or not paid to the Secretary or his delegate), which exceeds the tax with respect to the first $3,600 of such wages received; or if by reason of an employee receiving wages from more than one employer during any calendar year after the calendar year 1954, the wages received by him during such year exceed $4,200, the employee shall be entitled (subject to the provisions of sec. 31(b)) to a credit or refund of any amount of tax, with respect to such wages, imposed by section 3101 and deducted from the employee's wages (whether or not paid to the Secretary or his delegate), which exceeds the tax with respect to the first $4,200 of such wages received.

(2) *Applicability in case of Federal and State employees and employees of certain foreign corporations*—(A) *Federal employees.*—In the case of remuneration received from the United States or a wholly-owned instrumentality thereof during any calendar year, each head of a Federal agency or instrumentality who makes a return pursuant to section 3122 and each agent, designated by the head of a Federal agency or instrumentality, who makes a return pursuant to such section shall, for purposes of this subsection, be deemed a separate employer; and the term "wages" includes, for purposes of this subsection, the amount, not to exceed $3,600 for the calendar year 1951, 1952, 1953, or 1954, or $4,200 for any calendar year after 1954, determined by each such head or agent as constituting wages paid to an employee.

(B) *State employees.*—For purposes of this subsection, in the case of remuneration received during any calendar year, the term "wages" includes such remuneration for services covered by an agreement made pursuant to section 218 of the Social Security Act as would be wages if such services constituted employment; the term "employer" includes a State or any political subdivision thereof, or any instrumentality of any one or more of the foregoing; the term "tax" or "tax imposed by section 3101" includes, in the case of services covered by an agreement made pursuant to section 218 of the Social Security Act, an amount equivalent to the tax which would be imposed by section 3101, if such services constituted employment as defined in section 3121; and the provisions of this subsection shall apply whether or not any amount deducted from the

employee's remuneration as a result of an agreement made pursuant to section 218 of the Social Security Act has been paid to the Secretary.

(C) *Employees of certain foreign corporations.*—For purposes of paragraph (1) of this subsection, the term "wages" includes such remuneration for services covered by an agreement made pursuant to section 3121(l) as would be wages if such services constituted employment; the term "employer" includes any domestic corporation which has entered into an agreement pursuant to section 3121(l); the term "tax" or "tax imposed by section 3101," includes, in the case of services covered by an agreement entered into pursuant to section 3121(l), an amount equivalent to the tax which would be imposed by section 3101, if such services constituted employment as defined in section 3121; and the provisions of paragraph (1) of this subsection shall apply whether or not any amount deducted from the employee's remuneration as a result of the agreement entered into pursuant to section 3121(l) has been paid to the Secretary or his delegate.

(d) *Refund or credit of Federal unemployment tax.*—Any credit allowable under section 3302, to the extent not previously allowed, shall be considered an overpayment, but no interest shall be allowed or paid with respect to such overpayment.

[Sec. 6413 as amended by sec. 202(a)(1), (b), Social Security Amendments of 1954]

SEC. 301.6413–1. SPECIAL RULES APPLICABLE TO CERTAIN EMPLOYMENT TAXES. For regulations under this section, see the Employment Tax Regulations (pt. 31 of this chapter).

SEC. 301.6414. STATUTORY PROVISIONS; INCOME TAX WITHHELD.

SEC. 6414. INCOME TAX WITHHELD.

In the case of an overpayment of tax imposed by chapter 24, or by chapter 3, refund or credit shall be made to the employer or to the withholding agent, as the case may be, only to the extent that the amount of such overpayment was not deducted and withheld by the employer or withholding agent.

SEC. 301.6414–1. INCOME TAX WITHHELD. For regulations under this section, see the Income Tax Regulations (pt. 1 of this chapter) and the Employment Tax Regulations (pt. 31 of this chapter).

SEC. 301.6415. STATUTORY PROVISIONS; CREDITS OR REFUNDS TO PERSONS WHO COLLECTED CERTAIN TAXES.

SEC. 6415. CREDITS OR REFUNDS TO PERSONS WHO COLLECTED CERTAIN TAXES.

(a) *Allowance of credits or refunds.*—Credit or refund of any overpayment of tax imposed by section 4231(1), 4231(2), 4231(3), 4241, 4251, 4261, 4271, or 4286 may be allowed to the person who collected the tax and paid it to the Secretary or his delegate if such person establishes under such regulations as the Secretary or his delegate may prescribe, that he has repaid the amount of such tax to the person from whom he collected it, or obtains the consent of such person to the allowance of such credit or refund.

(b) *Credit on returns.*—Any person entitled to a refund of tax imposed by section 4231(1), 4231(2), 4231(3), 4241, 4251, 4261, 4271, or 4286 paid, or collected and paid, to the Secretary or his delegate by him may, instead of filing a claim for refund, take credit therefor against taxes imposed by such section due upon any subsequent return.

(c) *Refund of overcollections.*—In case any person required under section 4231(1), 4231(2), 4231(3), 4241, 4251, 4261, 4271, or 4286 to collect any tax shall make an overcollection of such tax, such person shall, upon proper application, refund such overcollection to the person entitled thereto.

(d) *Refund of taxable payment.*—Any person making a refund of any payment on which tax imposed by section 4231(1), 4231(2), 4231(3), 4241, 4251, 4261, 4271, or 4286 has been collected may repay therewith the amount of tax collected on such payment.

SEC. 301.6415–1. CREDITS OR REFUNDS TO PERSONS WHO COLLECTED CERTAIN TAXES.—For regulations under this section, see the Facilities and Services Excise Tax Regulations (pt. 42 of this chapter).

SEC. 301.6416. STATUTORY PROVISIONS; CERTAIN TAXES ON SALES AND SERVICES.

SEC. 6416. CERTAIN TAXES ON SALES AND SERVICES.

(a) *Condition to allowance.*—No credit or refund of any overpayment of tax imposed by section 4231(6) or 4281 or by chapter 31 (other than sec. 4041(a)(2)

or (b)(2)) or chapter 32 (except an overpayment of tax under paragraph (1) or (3) of subsection (b) of this section) shall be allowed unless the person who paid the tax establishes under regulations prescribed by the Secretary or his delegate—

(1) That he has not included the tax in the price of the article or service with respect to which it was imposed or has not collected the amount of the tax from the vendee; or

(2) Has repaid the amount of the tax to the purchaser (in case of retailers' taxes) or to the ultimate purchaser (in the case of manufacturers' taxes and the tax under section 4041(a)(1) or (b)(1)) of the article or service or, in any case within subsection (b)(2), has repaid or has agreed to repay the amount of the tax to the ultimate vendor of the article; or

(3) Has filed with the Secretary or his delegate the written consent of such purchaser, ultimate purchaser, or ultimate vendor, as the case may be, to the allowance of the credit or refund or has obtained the written consent of such ultimate vendor thereto.

(b) *Special cases in which tax payments considered overpayments.*—Under regulations prescribed by the Secretary or his delegate credit or refund, without interest, shall be made of the overpayments determined under the following paragraphs:

(1) *Price readjustments.*—If the price of any article in respect of which a tax, based on such price, is imposed by chapter 31 or 32, is readjusted by reason of the return or repossession of the article or a covering or container, or by a bona fide discount, rebate or allowance, the part of the tax proportionate to the part of the price repaid or credited to the purchaser shall be deemed to be an overpayment.

(2) *Specified uses and resales.*—The tax paid under subchapter E of chapter 31 or chapter 32 in respect of any article shall be deemed to be an overpayment if such article was, by any person—

(A) Resold for the exclusive use of any State, Territory of the United States, or any political subdivision of the foregoing, or the District of Columbia, or, in the case of musical instruments embraced in section 4151, resold for the use of any religious or nonprofit educational institution for exclusively religious or educational purposes;

(B) Used or resold for use for any of the purposes, but subject to the conditions, provided in section 4222;

(C) In the case of a liquid taxable under section 4041, sold for use as fuel in a diesel-powered highway vehicle or as fuel for the propulsion of a motor vehicle, motorboat, or airplane, if the vendee used such liquid otherwise than as fuel in such a vehicle, motorboat, or airplane or resold such liquid;

(D) In the case of lubricating oils, used or resold for nonlubricating purposes;

(E) In the case of unexposed motion picture films, used or resold for use in the making of newsreel motion picture films;

(F) In the case of articles taxable under section 4061(b) (other than spark plugs, storage batteries, leaf springs, coils, timers, and tire chains), used or resold for use as repair or replacement parts or accessories for farm equipment (other than equipment taxable under sec. 4061(a));

(G) In the case of a communication, detection, or navigation receiver of the type used in commercial, military, or marine installations, resold to the United States for its exclusive use;

(H) In the case of gasoline, used in production of special motor fuels referred to in section 4041(b).

(3) *Tax-paid articles used for further manufacture.*—If the tax imposed by chapter 32 has been paid with respect to the sale of—

(A) Any article (other than a tire, inner tube, or automobile radio or television receiving set taxable under section 4141) purchased by a manufacturer or producer and used by him as material in the manufacture or production of, or as a component part of, an article with respect to which tax under chapter 32 has been paid, or which has been sold free of tax by virtue of section 4220 or 4224, relating to tax-free sales;

(B) Any article described in sections 4142 and 4143(b) purchased by a manufacturer or producer and used by him as material in the manufacture or production of, or as a component part of, communication, detection, or navigation receivers of the type used in commercial, military, or marine installations if such receivers have been sold by him to the United States for its exclusive use;

such tax shall be deemed an overpayment by such manufacturer or producer.

(c) *Credit for tax paid on tires, inner tubes, radios or television receiving sets.*—If tires, inner tubes, or automobile radio or television receiving sets on which tax has been imposed under chapter 32 are sold on or in connection with, or with the sale of, an article taxable under section 4061(a) (relating to automobiles, trucks, etc.), there shall (under regulations prescribed by the Secretary or his delegate) be credited, without interest, against the tax under section 4061 an amount equal to, in the case of an article taxable under paragraph (1) or (2) of subsection (a) of section 4061, the applicable percentage rate of tax provided in such subsections—

(1) Of the purchase price (less, in the case of tires, the part of such price attributable to the metal rim or rim base) if such tires or inner tubes were taxable under section 4071 (relating to tax on tires and inner tubes) or, in the case of automobile radio or television receiving sets, if such sets were taxable under section 4141; or

(2) If such tires, inner tubes, or automobile radio or television receiving sets were taxable under section 4218 (relating to use by manufacturer, producer, or importer), then of the price (less, in the case of tires, the part of such price attributable to the metal rim or rim base) at which such or similar tires, inner tubes, or sets are sold, in the ordinary course of trade, by manufacturers, producers, or importers thereof, as determined by the Secretary or his delegate.

(d) *Mechanical pencils taxable as jewelry.*—If any article, on the sale of which tax has been paid under section 4201, is further manufactured or processed resulting in an article taxable under section 4001, the person who sells such article at retail shall, in the computation of the retailers' excise tax due on such sale, be entitled to a credit or refund, without interest, in an amount equal to the tax paid under section 4201.

(e) *Refund to exporter or shipper.*—Under regulations prescribed by the Secretary or his delegate the amount of any tax imposed by subchaper E of chapter 31, or chapter 32 erroneously or illegally collected in respect of any article exported to a foreign country or shipped to a possession of the United States may be refunded to the exporter or shipper thereof, if the person who paid such tax waives his claim to such amount.

(f) *Credit on returns.*—Any person entitled to a refund of tax imposed by chapter 31 or 32 or section 4281, paid to the Secretary or his delegate may, instead of filing a claim for refund, take credit therefor against taxes imposed by such chapter or section due on any subsequent return.

SEC. 301.6416–1. CERTAIN TAXES ON SALES AND SERVICES.—For regulations under this section see the Manufacturers' and Retailers' Excise Tax Regulations (pt. 40 of this chapter) and the Facilities and Services Excise Tax Regulations (pt. 42 of this chapter).

SEC. 301.6417. STATUTORY PROVISIONS; COCONUT AND PALM OIL.

SEC. 6417. COCONUT AND PALM OIL.

(a) *Sales to States or political subdivisions.* Subject to such rules or regulations as the Secretary or his delegate may prescribe, any person who has sold to a State, or a political subdivision thereof, for use in the exercise of an essential governmental function any article containing any oil, combination, or mixture, upon the processing of which a tax has been paid under section 4511, shall be entitled to a credit or refund of the tax paid with respect to the quantity of such oil, combination, or mixture contained in such article.

(b) *Exportation.* Upon the exportation to any foreign country or to a possession of the United States of any article, wholly or in chief value of an article, with respect to the processing of which a tax has been paid under subchapter B of chapter 37, the exporter thereof shall be entitled to a refund of the amount of such tax.

SEC. 301.6417–1. COCONUT AND PALM OIL. For regulations under this section, see the Regulations Relating to Miscellaneous Excise Taxes Payable by Return (pt. 46 of this chapter).

SEC. 301.6418. STATUTORY PROVISIONS; SUGAR.

SEC. 6418. SUGAR.

(a) *Use as livestock feed or for distillation of alcohol.*—Upon the use of any manufactured sugar, or article manufactured therefrom, as livestock feed, or in the production of livestock feed, or for the distillation of alcohol, there shall

be paid by the Secretary 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) with respect thereto.

(b) *Exportation.*—Upon the exportation from the United States to a foreign country, or the shipment from the United States to any possession of the United States except Puerto Rico, of any manufactured sugar, or any article manufactured wholly or partly from manufactured sugar, with respect to which tax under the provisions of section 4501(a) has been paid, the amount of such tax shall be paid by the Secretary or his delegate to the consignor named in the bill of lading under which the article was exported or shipped to a possession, or to the shipper, or to the manufacturer of the manufactured sugar or of the articles exported, if the consignor waives any claim thereto in favor of such shipper or manufacturer; except that no such payment shall be allowed with respect to any manufactured sugar, or article, upon which, through substitution or otherwise, a drawback of any tax paid under section 4501(b) has been or is to be claimed under any provisions of law made applicable by section 4504.

SEC. 301.6418–1. SUGAR.—For regulations under this section, see the Regulations Relating to Miscellaneous Excise Taxes Payable by Return (pt. 46 of this chapter).

SEC. 301.6419. STATUTORY PROVISIONS; EXCISE TAX ON WAGERING.

SEC. 6419. EXCISE TAX ON WAGERING.

(a) *Credit or refund generally.*—No overpayment of tax imposed by chapter 35 shall be credited or refunded (otherwise than under subsec. (b)), in pursuance of a court decision or otherwise, unless the person who paid the tax establishes, in accordance with regulations prescribed by the Secretary or his delegate, (1) that he has not collected (whether as a separate charge or otherwise) the amount of the tax from the person who placed the wager on which the tax was imposed, or (2) that he has repaid the amount of the tax to the person who placed such wager, or unless he files with the Secretary or his delegate written consent of the person who placed such wager to the allowance of the credit or the making of the refund. In the case of any laid-off wager, no overpayment of tax imposed by chapter 35 shall be so credited or refunded to the person with whom such laid-off wager was placed unless he establishes, in accordance with regulations prescribed by the Secretary or his delegate, that the provisions of the preceding sentence have been complied with both with respect to the person who placed the laid-off wager with him and with respect to the person who placed the original wager.

(b) *Credit or refund on wagers laid-off by taxpayer.*—Where any taxpayer lays off part or all of a wager with another person who is liable for tax imposed by chapter 35 on the amount so laid off, a credit against such tax shall be allowed, or a refund shall be made to, the taxpayer laying off such amount. Such credit or refund shall be in an amount which bears the same ratio to the amount of tax which such taxpayer paid on the original wager as the amount so laid off bears to the amount of the original wager. Credit or refund under this subsection shall be allowed or made only in accordance with regulations prescribed by the Secretary or his delegate; and no interest shall be allowed with respect to any amount so credited or refunded.

SEC. 301.6419–1. EXCISE TAX ON WAGERING. For regulations under this section, see the Wagering Tax Regulations (pt. 44 of this chapter).

SEC. 301.6420. STATUTORY PROVISIONS; CROSS REFERENCES.

SEC. 6420. CROSS REFERENCES.

(1) For limitations on credits and refunds, see subchapter B of chapter 66.

(2) For overpayment arising out of adjustments incident to involuntary liquidation of inventory, see section 1321.

(3) For overpayment in case of adjustments to accrued foreign taxes, see section 905(c).

(4) For credit or refund in case of deficiency dividends paid by a personal holding company, see section 547.

(5) For refund, credit, or abatement of amounts disallowed by courts upon review of Tax Court decision, see section 7486.

(6) For abatement or refund of tax on transfers to avoid income tax, see section 1494(b).

(7) For abatement or refund in case of tax on silver bullion, see section 4894.

(8) For overpayment in certain renegotiations of war contracts, see section 1481.
(9) For refund or redemption of stamps, see chapter 69.
(10) For abatement, credit, or refund in case of jeopardy assessments, see chapter 70.
(11) For treatment of certain overpayments as having been refunded, in connection with sale of surplus war-built vessels, see section 9(b)(8) of the Merchant Ship Sales Act of 1946 (60 Stat. 48; 50 U. S. C. App. 1742).
(12) For restrictions on transfers and assignments of claims against the United States, see R. S. 3477 (31 U. S. C. 203).
(13) For set-off of claims against amounts due the United States, see the act of March 3, 1875, as amended by section 13 of the act of March 3, 1933 (47 Stat. 1516; 31 U. S. C. 227).
(14) For special provisions relating to alcohol and tobacco taxes, see sections 5011, 5044, 5057, 5063, 5705, and 5707.

EFFECTIVE DATE AND RELATED PROVISIONS

SEC. 301.7851. STATUTORY PROVISIONS; APPLICABILITY OF REVENUE LAWS.

SEC. 7851. APPLICABILITY OF REVENUE LAWS.
(a) *General rules.*—Except as otherwise provided in any section of this title—
* * * * * * *
(6) *Subtitle F.*
(A) *General rule.*—The provisions of subtitle F shall take effect on the day after the date of enactment of this title and shall be applicable with respect to any tax imposed by this title. The provisions of subtitle F shall apply with respect to any tax imposed by the Internal Revenue Code of 1939 only to the extent provided in subparagraphs (B) * * * of this paragraph.
(B) *Assessment, collection, and refunds.*—Notwithstanding the provisions of subparagraph (A), and notwithstanding any contrary provision of subchapter A of chapter 63 (relating to assessment), chapter 64 (relating to collection), or chapter 65 (relating to abatements, credits, and refunds) of this title, the provisions of part II of subchapter A of chapter 28 and chapters 35, 36, and 37 (except sec. 3777) of subtitle D of the Internal Revenue Code of 1939 shall remain in effect until January 1, 1955, and shall also be applicable to the taxes imposed by this title. On and after January 1, 1955, the provisions of subchapter A of chapter 63, chapter 64, and chapter 65 (except sec. 6405) of this title shall be applicable to all internal revenue taxes (whether imposed by this title or by the Internal Revenue Code of 1939), notwithstanding any contrary provision of part II of subchapter A of chapter 28, or of chapter 35, 36, or 37, of the Internal Revenue Code of 1939. The provisions of section 6405 (relating to reports of refunds and credits) shall be applicable with respect to refunds or credits allowed after the date of enactment of this title, and section 3777 of the Internal Revenue Code of 1939 is hereby repealed with respect to such refunds and credits.
* * * * * * *

Because the regulations prescribed by this Treasury Decision are necessary for the enforcement of the applicable provisions of the Internal Revenue Code which are generally effective January 1, 1955, it is hereby found that it is impracticable and contrary to the public interest to issue these regulations subject to the effective date limitation of section 4(c) of the Administrative Procedure Act.

The regulations prescribed by this Treasury Decision shall be effective January 1, 1955.

JUSTIN F. WINKLE,
Acting Commissioner of Internal Revenue.

Approved December 30, 1954.

M. B. FOLSOM,
Acting Secretary of the Treasury.

(Filed with the Division of the Federal Register, December 31, 1954, 10:08 a. m.)

CHAPTER 64.—COLLECTION

SUBCHAPTER A.—GENERAL PROVISIONS

SECTION 6301.—COLLECTION AUTHORITY

26 CFR 301.6301–1: Collection authority.

New regulations under Subtitle F of the Internal Revenue Code of 1954 relating to assessment, collection, abatement, credit, and refund. See T. D. 6119, page 145.

SECTION 6302.—MODE OR TIME OF COLLECTION

Rev. Rul. 55–271

Section 6302 of the Internal Revenue Code of 1954, provides, in part, that the Secretary of the Treasury or his delegate may authorize Federal Reserve banks and incorporated banks or trust companies which are depositaries or financial agents of the United States to receive any tax imposed under the internal revenue laws, in such manner, at such times, and under such conditions as he may prescribe. Section 6656 of the Code provides for the imposition of a penalty for the failure of any person required to make a timely deposit of tax imposed under the internal revenue laws, unless such failure is due to reasonable cause and not due to willful neglect.

The Internal Revenue Service is unable to approve any plan or method whereby taxes required to be deposited may be deposited in an amount less than the amount of taxes actually collected. However, if at the time required by law, the quarterly return is filed and the correct amount of the taxes due is paid, or has been paid, and it is ascertained that the amount of the monthly deposits was not less than 99 percent of the tax required to be deposited in accordance with the applicable regulations, the penalty provided by section 6656, *supra*, will not be imposed. In the event the deficiency in the amount deposited is in excess of one percent, the imposition of the penalty will depend upon whether the failure to deposit the full amount was due to reasonable cause and not due to willful neglect.

SUBCHAPTER C.—LIEN FOR TAXES

SECTION 6323.—VALIDITY AGAINST MORTGAGEES, PLEDGEES, PURCHASERS, AND JUDGMENT CREDITORS

26 CFR 301.6323–1: Validity of lien against mortgagees, pledgees, purchasers, and judgment creditors. Rev. Rul. 55–134

(Also Part II, Section 3672.)

The statute enacted by the Legislature of the State of New Hampshire, approved May 11, 1951 (ch. 107, New Hampshire Laws, 1951,

sec. 44–48 of ch. 264, Revised Laws of New Hampshire) is accepted by the Internal Revenue Service as legislation of the nature contemplated in section 6323 of the Internal Revenue Code of 1954 (sec. 3672 of the Internal Revenue Code of 1939) authorizing the filing of notices of Federal tax liens in certain offices.

Whenever it becomes necessary, in the State of New Hampshire, to file a notice of Federal tax lien, or a certificate of release or discharge of such a lien, District Directors of Internal Revenue should file the same in the offices designated in the above-cited statute.

Status of a trustee in bankruptcy as judgment creditor. See Ct. D. 1776, page 545.

SUBCHAPTER D.—SEIZURE OF PROPERTY FOR COLLECTION OF TAXES

SECTION 6331.—LEVY AND DISTRAINT

26 CFR 301.6331–1: Levy and distraint. Rev. Rul. 55–187

A joint checking account is subject to levy only to the extent of a taxpayer's interest therein, which will be determined from the facts in each case. Where one of the persons in whose name a joint account has been established can prove that the funds deposited therein are his sole property, no levy can be made on such funds to satisfy an outstanding tax liability of the other. Factors bearing on the question of the extent of a taxpayer's interest in such an account include the nature of the tenancy created under State law; the source of the funds deposited; the intent of the person opening the joint account; and whether in actual practice the account was under the control of one party even though the other had authority to withdraw funds from the account.

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26 CFR 301.6331–1: Levy and distraint.

Notice of levy served or instrumentality of a State. See Rev. Rul. 55–227, page 551.

CHAPTER 65.—ABATEMENTS, CREDITS, AND REFUNDS

SUBCHAPTER A.—PROCEDURE IN GENERAL

SECTION 6402.—AUTHORITY TO MAKE CREDITS OR REFUNDS

26 CFR 301.6402–1: Authority to make credits or refunds.

New regulations under Subtitle F of the Internal Revenue Code of 1954 relating to assessment, collection, abatement, credit, and refund. See T. D. 6119, page 145.

SECTION 6404.—ABATEMENTS

26 CFR 301.6404–1: Abatements.

New regulations under Subtitle F of the Internal Revenue Code of 1954 relating to assessment, collection, abatement, credit, and refund. See T. D. 6119, page 145.

CHAPTER 67.—INTEREST

SUBCHAPTER A.—INTEREST ON UNDERPAYMENTS

SECTION 6601.—INTEREST ON UNDERPAYMENT, NONPAYMENT, OR EXTENSIONS OF TIME FOR PAYMENT, OF TAX

(Also Section 6081.) Rev. Rul. 55-22

Interest on an additional amount of corporate income tax made due and payable for a taxable year beginning in 1953 and ending after March 31, 1954, because of the provisions of section 7851(a)(1)(D) of the Internal Revenue Code of 1954, will be computed from August 16, 1954, the date of the enactment of the 1954 Code, rather than from the original due date.

Rev. Rul. 54–366, C. B. 1954–2, 36, amplified.

Advice has been requested as to the date from which interest should be computed on additional amounts shown to be due on amended corporation returns filed to reflect the changes in law referred to in section 3.01 of Revenue Ruling 54–366, C. B. 1954–2, 36.

Section 7851(a)(1)(D) of the Internal Revenue Code of 1954, which was enacted August 16, 1954, amends the Internal Revenue Code of 1939 to eliminate the reduction of the normal tax rate for corporations from 30 percent to 25 percent which was to take place on April 1, 1954. Accordingly, all corporations computing their tax under the 1939 Code for taxable years ending after March 31, 1954, are required to compute such taxes without regard to such reduction in the corporation's normal tax rate.

Revenue Ruling 54–366, *supra*, states, in part, that any corporation which has made a return for a taxable year beginning in 1953 and ending after March 31, 1954, or a short taxable year beginning in 1954 and ending after March 31, 1954, but before the date of enactment of the 1954 Code, upon specified forms, should file an amended return as promptly as possible and should "pay any additional tax due." No reference was made in the Revenue Ruling to interest upon such additional tax.

Any taxpayer which had filed its return for a period in question, and paid the tax due under the 1939 Code, had fully complied with the taxing statute as it existed, and did not, prior to the enactment of the Internal Revenue Code of 1954, owe any tax or withhold from the Government any tax then payable or to which the United States then had a right of collection. In this connection, attention is called

to the fact that "interest" upon Federal income tax is not a penalty, but is "clearly intended to compensate the delay in payment of the tax—the detriment of its nonpayment, to be continued during the time of its nonpayment—compensation, not punishment." *United States* v. *Edward H. Childs*, 266 U. S. 304, T. D. 3671, C. B. IV-1, 241 (1925).

Not until the effective date of enactment of section 7851(a)(1)(D) of the 1954 Code, could the additional amount of tax become actually payable. The effect of that section, for interest purposes, is similar to that of a new imposition of a 5 percent additional tax which itself could not be considered due or payable prior to date of enactment. Accordingly, it is held that interest on any additional tax considered due as a result of this section, will not commence to run until August 17, 1954, the day after the date of enactment of the 1954 Code.

SUBCHAPTER B.—INTEREST ON OVERPAYMENTS

SECTION 6611.—INTEREST ON OVERPAYMENTS

(Also Part II, Section 3771.) Rev. Rul. 55-272

Amounts of manufacturers' excise taxes erroneously or mistakenly paid by retail dealers will be regarded as overpayments of taxes and the statutory interest authorized by section 6611(a) of the Internal Revenue Code of 1954 or by section 3771(a) of the Code of 1939 will be allowed on refunds of such amounts. The policy previously in effect, which held that interest was not allowable on refund claims filed by retail dealers to recover the amounts paid by them as excise taxes properly due and payable by manufacturers, will no longer be followed.

CHAPTER 74.—CLOSING AGREEMENTS AND COMPROMISES

SECTION 7122.—COMPROMISES

(Also Part V, Administrative Matters.) Rev. Rul. 55-153

Jurisdiction and procedure relating to offers in compromise of narcotics, smoking opium, and marihuana liabilities under the internal revenue laws. Revenue Ruling 117, C. B. 1953-1, 498, amplified.

SECTION 1. PURPOSE

The purpose of this Revenue Ruling is to transfer to District Directors of Internal Revenue certain duties, functions, and responsibilities with respect to the compromise of narcotics, smoking opium, and marihuana liabilities under the Internal Revenue laws.

SEC. 2. AUTHORITY

The establishment of standards prescribed in this Revenue Ruling is being done pursuant to the authorities contained in Reorganization Plan No. 26 of 1950, effective July 31, 1950 (15 F. R. 4935, 64 Stat. 1280), Reorganization Plan No. 1 of 1952, effective March 14, 1952, Treasury Department Order No. 150-25, dated June 1, 1953, and Treasury Department Order No. 180, dated November 17, 1953.

SEC. 3. SCOPE

The provisions of this Revenue Ruling will apply to:

1. Any internal revenue taxes relating to narcotics, smoking opium, and marihuana;

2. Any ad valorem penalties or interest imposed by law for delinquency in registration or delinquency in payment of these taxes; or

3. Any criminal liability incurred through delinquency in registration or delinquency in payment of these taxes.

SEC. 4. COMPROMISE CASES—INVESTIGATED

District Directors of Internal Revenue will have investigative jurisdiction over offers in compromise coming within the scope of this Revenue Ruling, as outlined in Section 3.

SEC. 5. COMPROMISE CASES—NOT INVESTIGATED

.01 No investigations will be conducted by District Directors of offers in compromise of criminal cases which do not come within the scope of Section 3 of this Revenue Ruling, except upon the specific request of the District Supervisor of Narcotics. If offers are submitted as the result of negotiations by the District Supervisor of Narcotics, the District Directors will deposit and record the remittances and forward the original Forms 656 Offers in Compromise or 656-C, Offers in Compromise (Deferred Installment Payments) to the National Office, Attention O:A:C, without Form 879, Schedule of Offers in Compromise, for transmittal to the Commissioner of Narcotics.

.02 The procedure described in this section will likewise be applicable to any case in which an offer is made in compromise of civil liability compromisable by the Commissioner of Internal Revenue and of criminal liability compromisable by the Commissioner of Narcotics, who jointly exercise the authority to compromise.

SEC. 6. INFORMAL CONFERENCE AND APPEAL

The informal conference procedures and the procedures relating to appeals to the Assistant Regional Commissioner (Appellate), applied in certain cases, as set forth in Revenue Ruling 117, C. B. 1953-1, 498, will not be employed or available with respect to cases coming within the scope of this Revenue Ruling.

SEC. 7. EFFECT ON OTHER DOCUMENTS

Revenue Ruling 117, C. B. 1953-1, 498, is hereby amplified to the extent inconsistent herewith.

NARCOTICS

26 CFR 151.18: Retail dealers. (NARCOTICS) T. D. 49
(Also 151.168, 151.171 through 151.175, Narcotics Regulations 5.)

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBSCHAPTER C, PART 151.—REGULATIONS UNDER THE HARRISON NARCOTIC LAW, AS AMENDED

Oral prescriptions for narcotic drugs and compounds of narcotic drugs.

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

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

Narcotic Regulations 5 (26 CFR pt. 151), relating to narcotics subject to the Harrison Narcotic Law, and continued in effect under applicable provisions of the Internal Revenue Code of 1954, are amended as follows, pursuant to the amendment to that Code made by Public Law 729, 83d Congress [C. B. 1954–2, 599], approved August 31, 1954:

PARAGRAPH 1. The section heading and introductory material of section 151.18 (Art. 18) are amended to read as follows:

SEC. 151.18 RETAIL DEALERS.—Every person who sells narcotic drugs or preparations from original stamped packages, with or without compounding, pursuant to oral or written prescriptions issued by registered practitioners in the course of professional practice only, is liable to tax as a retail dealer at the rate of $3 per annum in Class III, with the following exceptions:

* * * * * * *

PAR. 2. The second sentence of section 151.18 (b) (Art. 18) is amended to read as follows: "A practitioner who operates a drug store and in his capacity as a druggist sells narcotic drugs or preparations, pursuant to oral or written prescriptions issued by other practitioners, incurs additional liability as a retail dealer."

PAR. 3. Section 151.168 (Art. 168) is amended to read as follows:

SEC. 151.168. MANNER OF EXECUTION; PRACTITIONERS.—All prescriptions for drugs and preparations not specifically exempt under section 4702 of the Internal Revenue Code of 1954 (see secs. 151.180 to 151.182) and not subject to the oral prescription procedure (see sec. 151.172) shall be dated as of and signed on the day when issued and shall bear the full name and address of the patient and the name, address, and registry number of the practitioner. A physician may sign a prescription in the same manner as he would sign a check or legal document, as, for instance, J. H. Smith, John H. Smith, or John Henry Smith. Prescriptions (other than oral prescriptions under sec. 151.172) should be written with ink or indelible pencil or typewriter; if typewritten, they shall be signed by the practitioner. The duty of properly preparing or telephoning prescriptions, as the case may be, is upon the practitioner, and he is liable to the penalties provided by the act in case of failure to insert or communicate, respectively, the information required by the law. A prescription required to be in writing may be prepared by a secretary or agent for the signature of a practitioner, but the practitioner is responsible in case the prescription does not conform in all essential respects to the law and regulations. A corresponding liability rests upon the druggist who fills a prescription not prepared in the form prescribed by law and regulations.

PAR. 4. Section 151.171 (Art. 171) is amended to read as follows:

SEC. 151.171. PARTIAL FILLING.—A a general rule, the partial filling of narcotic prescriptions is not permissible. If, however, a dealer is unable to supply the full quantity called for in a written or oral prescription and an emergency exists, he may supply a portion of the drugs called for by the prescription, provided he makes a suitable notation on the face of the written prescription (or written record of the oral prescription) of the quantity furnished and the reason for not supplying the full quantity on the back of the written prescription (or written record of the oral prescription) and advises the issuing practitioner thereof. No further quantity shall be supplied except upon a new prescription.

PAR. 5. Section 151.172 (Art. 172) is amended to read as follows:

SEC. 151.172. TELEPHONE ORDERS.—(a) Where written prescriptions signed by the practitioner are required, the furnishing of narcotics pursuant to telephone advice of practitioners is prohibited, whether signed prescriptions covering such orders are subsequently received or not, but in an emergency a druggist may deliver narcotics through his responsible employee or agent pursuant to a telephone order, provided the employee or agent is supplied with a properly prepared signed prescription before delivery is made, which prescription shall be turned over to the druggist and filed by him as required by law.

(b) A dealer (druggist) may fill an oral prescription communicated to him by a duly registered practitioner for such narcotic drugs or compounds of a narcotic drug which the Commissioner of Narcotics has found and by regulations designated to possess relatively little or no addiction liability, as described in paragraph (c) of this section. In issuing an oral prescription, the prescriber shall furnish the dealer with the same information as is required in the case of a written prescription (see sec. 151.168) except for the written signature of the prescriber. The oral prescription, including the information required to be furnished by the prescriber, shall promptly be reduced to writing by the dealer, who shall file and preserve the writing in his narcotic prescription file as described in section 151.174. The practitioner is responsible in case the oral prescription does not conform in all essential respects to the law and regulations. A corresponding liability rests upon the druggist who fills an oral prescription not communicated in the form prescribed by law and regulations.

(c) Any interested agency, association, or manufacturer may submit a recommendation in writing to the Commissioner of Narcotics for a finding and designation that a specifically identified narcotic drug or compound of a narcotic drug possesses relatively little or no addiction liability, giving reasons for the recommendation, or the said Commissioner may himself initiate a proposal for a prospective finding and designation with respect to a specifically identified narcotic drug or compound of a narcotic drug. The Commissioner of Narcotics shall request the officers, agencies, and associations designated in section 4705(c)(2) of the Internal Revenue Code of 1954 for an expression of their views on the subject, setting what he considers reasonable time limits for this purpose. After considering such expressions of views as shall be received within such time limits, he shall either (1) make the finding and designation by regulations, as authorized, with respect to the narcotic drug or compound of a narcotic drug, or (2) determine that the finding and designation cannot be made, notifying the recommending agency or association accordingly. After publication of regulations making the requisite finding and designation, the oral prescription procedure described in paragraph (b) of this section shall be applicable to the narcotic drug or compound of a narcotic drug which was the subject of the finding and designation.

(d) If the Commissioner of Narcotics shall subsequently determine that a narcotic drug or a compound of a narcotic drug, to which the oral prescription procedure described in paragraph (b) of this section has been made applicable, possesses a degree of drug addiction liability that, in his opinion, results in abusive use of such procedure, he shall by regulations publish the determination in the Federal Register. The determination shall be final and, after the expiration of a period of six months from the date of its publication, the oral prescription procedure described in paragraph (b) of this section shall cease to apply to the particular narcotic drug of to the particular compound of a narcotic drug which is the subject of the determination.

PAR. 6. Section 151. 173 (Art. 173) is amended to read as follows:

SEC. 151.173. FORMS TO BE USED.—The Government does not furnish forms for written prescriptions or for recording oral prescriptions, and the order forms which are supplied must not be used as prescriptions. Any form for a written prescription or for recording an oral prescription may be used, provided the required data are shown thereon.

PAR. 7. Section 151.174 (Art. 174) is amended to real as follows:

SEC. 151.174. FILING.—Dealers who fill prescriptions shall keep the written prescriptions, and the written records of oral prescriptions, in a separate file in such manner as to be readily accessible to inspection by investigating officers for not less than two years.

PAR. 8. Section 151.175 (Art. 175) is amended to read as follows:

SEC. 151.175. LABELS ON CONTAINERS.—The dealer filling a written or oral prescription shall affix to the package a label showing his name and registry number, the serial number of the prescription, the name, address and registry number of the practitioner issuing the prescription, and the name and address of the patent. (Sec. 7805, 68A Stat. 917; 26 U. S. C. 7805. Interpret or apply secs. 4704, 4705, 4724, 4773, as amended by Public Law 729, 83d Cong., 68A Stat. 550, 551, 555, 567; 26 U. S. C. 4704, 4705, 4724, 4773.)

Because the amendments made by this Treasury Decision relieve restrictions under the stated conditions, it is found unnecessary to issue this Treasury Decision with notice and public procedure thereon under section 4(a) of the Administrative Procedure Act, approved June 11, 1946, or subject to the effective date limitation of section 4(c) of that act.

This Treasury Decision shall be effective upon its filing for publication in the Federal Register.

T. COLEMAN ANDREWS,
Commissioner of Internal Revenue.
H. J. ANSLINGER,
Commissioner of Narcotics.

Approved February 17, 1955.

H. CHAPMAN ROSE,
Acting Secretary of the Treasury.

(Filed with the Division of the Federal Register February 23, 1955, 8:49 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 I.—RATES OF TAX

SECTION 12.—SURTAX ON INDIVIDUALS

REGULATIONS 118, SECTION 39.12-4: Surtax in case of head of household. Rev. Rul. 55-329

A widow, who maintained a household which constituted the principal place of abode of a granddaughter from the date of birth until the end of the taxable year, qualifies as the head of a household for Federal income tax purposes.

Advice has been requested whether an individual taxpayer, who maintained a household which constituted the principal place of abode of an infant granddaughter from the date of birth until the end of the taxable year, qualifies as the head of a household, for Federal income tax purposes, irrespective of the fact that the granddaughter was claimed as a dependent by another taxpayer.

In the instant case an employed widow owns and occupies her own home. The home is also occupied by the widow's son, his wife and baby daughter. The widow pays the entire cost of maintaining the house, including utilities, taxes, food, insurance and upkeep of the house. The widow's son and his wife both worked during the taxable year each earning more than $600, and they filed a joint income tax return for such year in which they claimed exemptions for themselves and the baby.

Section 12(c)(3) of the Internal Revenue Code of 1939 provides in part as follows:

(3) DEFINITION OF HEAD OF HOUSEHOLD.—For the purposes of this chapter [chapter 1 of the Code], an individual shall be considered a head of a

household if, and only if, such individual is not married at the close of his taxable year and maintains as his home a household which constitutes for such taxable year the principal place of abode, as a member of such household, of:

(A) A son, stepson, daughter, or stepdaughter of the taxpayer, or a descendant of a son or daughter of the taxpayer, but if such son, stepson, daughter, stepdaughter, or descendant is married at the close of the taxpayer's taxable year, only if the taxpayer is entitled to an exemption for the taxable year for such person under section 25(b);

* * * * * *

An individual shall be considered as maintaining a household only if over half of the cost of maintaining the household during the taxable year is furnished by such individual.

Section 39.12-4 of Regulations 118 provides that a taxpayer shall be considered the head of a household if he is not married at the close of his taxable year and maintains as his home a household which constitutes for such taxable year the principal place of abode, as a member of such household, of at least one of the individuals specified in section 12(c)(3)(A) of the Internal Revenue Code of 1939.

In the instant case since the granddaughter is an unmarried descendant of the widow's son she meets the specification of the persons listed in section 12(c)(3)(A) of the Code, and the widow qualifies as the head of a household irrespective of the fact that the granddaughter qualifies as a dependent in the joint return filed by the widow's son and daughter-in-law.

Accordingly, it is held that a widow, who maintained a household which constituted the principal place of abode of a granddaughter from the date of birth until the end of the taxable year, qualifies as the head of a household for Federal income tax purposes.

Since Revenue Ruling 55-72, published in I. R. B. 1955-7, 11, under date of February 14, 1955, may be subject to misinterpretation to the extent that it indicates that *each* of the two corporations involved in the merger referred to therein is entitled to file a return for the short period immediately preceding the merger it is superseded to read as follows:

SECTION 15.—SURTAX ON CORPORATIONS

REGULATIONS 118, SECTION 39.15-1: Surtax on corporations. — Rev. Rul. 55-72

Where a corporation is merged into another corporation during a taxable year, in a statutory merger, such merged corporation (not the continuing corporation), in filing its Federal income tax return for its short period immediately preceding the merger, is entitled to the full $25,000 surtax exemption allowed by section 15(b) of the Internal Revenue Code of 1939, since there is no provision in the law for prorating such exemption where a corporate Federal income tax return covers a taxable year of less than 12 months.

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. Ct. D. 1783

INCOME TAX—INTERNAL REVENUE CODE—DECISION OF SUPREME COURT

1. GROSS INCOME—PUNITIVE DAMAGES FOR FRAUD AND ANTITRUST VIOLATION.

Moneys received as exemplary damages for fraud and as the punitive two-thirds portion of treble damages for violation of the Federal antitrust laws constitute taxable income under section 22(a) of the Internal Revenue Code of 1939.

2. DECISION REVERSED.

Decision of the United States Court of Appeals for the Third Circuit, 211 F. 2d 928, affirming 18 T. C. 860 and 19 T. C. 637, reversed.

SUPREME COURT OF THE UNITED STATES

Commissioner of Internal Revenue, petitioner, v. *Glenshaw Glass Company and William Goldman Theatres, Inc.*

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

[March 28, 1955]

OPINION

Mr. Chief Justice WARREN delivered the opinion of the Court.

This litigation involves two cases with independent factual backgrounds yet presenting the identical issue. The two cases were consolidated for argument before the Court of Appeals for the Third Circuit and were heard *en banc.* The common question is whether money received as exemplary damages for fraud or as the punitive two-thirds portion of a treble damage antitrust recovery must be reported by a taxpayer as gross income under section 22(a) of the Internal Revenue Code of 1939.[1] In a single opinion, 211 F. 2d 928, the Court of Appeals affirmed the Tax Court's separate rulings in favor of the taxpayers. 18 T. C. 860, 19 T. C. 637. Because of the frequent recurrence of the question and differing interpretations by the lower courts of this Court's decisions bearing upon the problem, we granted the Commissioner of Internal Revenue's ensuing petition for certiorari. 348 U. S. 813.

The facts of the cases were largely stipulated and are not in dispute. So far as pertinent they are as follows:

Commissioner v. *Glenshaw Glass Co.*—The Glenshaw Glass Company, a Pennsylvania corporation, manufactures glass bottles and containers. It was engaged in protracted litigation with the Hartford-Empire Company, which manufactures machinery of a character used by Glenshaw. Among the claims advanced by Glenshaw were demands for exemplary damages for fraud[2] and treble damages for injury to its business by reason of Hartford's violation of the Federal antitrust laws.[3] In December, 1947, the parties concluded a settlement of all pending litigation, by which Hartford paid Glenshaw approximately $800,000. Through a method of allocation which was approved by the Tax Court, 18 T. C. 860, 870–872, and which is no longer in issue, it was ultimately determined that, of the total settlement, $324,529.94 represented payment of punitive damages for fraud and antitrust violations. Glenshaw did not report this portion of the settlement

[1] 53 Stat. 9, 53 Stat. 574, 26 U. S. C. sec. 22(a).

[2] For the bases of Glenshaw's claim for damages from fraud, see *Shawkee Manufacturing Co.* v. *Hartford-Empire Co.*, 322 U. S. 271; *Hazel-Atlas Glass Co.* v. *Hartford-Empire Co.*, 322 U. S. 238.

[3] See *Hartford-Empire Co.* v. *United States*, 323 U. S 386, 324, U. S. 570.

as income for the tax year involved. The Commissioner determined a deficiency claiming as taxable the entire sum less only deductible legal fees. As previously noted, the Tax Court and the Court of Appeals upheld the taxpayer.

Commissioner v. *William Goldman Theatres, Inc.*—William Goldman Theatres, Inc., a Delaware corporation operating motion picture houses in Pennsylvania, sued Loew's, Inc., alleging a violation of the Federal antitrust laws and seeking treble damages. After a holding that a violation had occurred, *William Goldman Theatres, Inc.* v. *Loew's, Inc.*, 150 F. 2d 738, the case was remanded to the trial court for a determination of damages. It was found that Goldman had suffered a loss of profits equal to $125,000 and was entitled to treble damages in the sum of $375,000. *William Goldman Theatres, Inc.* v. *Loew's, Inc.*, 69 F. Supp. 103, aff'd, 164 F. 2d 1021, cert. denied, 334 U. S. 811. Goldman reported only $125,000 of the recovery as gross income and claimed that the $250,000 balance constituted punitive damages and as such was not taxable. The Tax Court agreed, 19 T. C. 637, and the Court of Appeals, hearing this with the *Glenshaw* case, affirmed. 211 F. 2d 928.

It is conceded by the respondents that there is no constitutional barrier to the imposition of a tax on punitive damages. Our question is one of statutory construction: are these payments comprehended by section 22(a)?

The sweeping scope of the controverted statute is readily apparent:

> SEC. 22. GROSS INCOME.
>
> (a) GENERAL DEFINITION.—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service * * * of whatever kind and in whatever form paid, or from professions, 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, *or gains or profits and income derived from any source whatever.* * * * (Emphasis added.)[4]

This Court has frequently stated that this language was used by Congress to exert in this field "the full measure of its taxing power." *Helvering* v. *Clifford*, 309 U. S. 331, 334 [Ct. D. 1444, C. B. 1940-1, 105]; *Helvering* v. *Midland Mutual Life Ins., Co.*, 300 U. S. 216, 223 [Ct. D. 1206, C. B. 1937-1, 178]; *Douglas* v. *Willcuts*, 296 U. S. 1, 9; *Irwin* v. *Gavit*, 268 U. S. 161, 166 [Ct. D. 1041, C. B. XIV-2, (250 1935)]. Respondents contend that punitive damages, characterized as "windfalls" flowing from the culpable conduct of third parties, are not within the scope of the section. But Congress applied no limitations as to the source of taxable receipts, nor restrictive labels as to their nature. And the Court has given a liberal construction to this broad phraseology in recognition of the intention of Congress to tax all gains except those specifically exempted. *Commissioner* v. *Jacobson*, 336 U. S. 28, 49 [Ct. D. 1712, C. B. 1949-1, 40]; *Helvering* v. *Stockholms Enskilda Bank*, 293 U. S. 84, 87-91 [Ct. D. 887, C. B. XIII-2, 299 (1934)]. Thus, the fortuitious gain accruing to a lessor by reason of the forfeiture of a lessee's improvements on the rented property was taxed in *Helvering* v. *Bruun*, 309 U. S. 461 [Ct. D. 1450, C. B. 1940-1, 112]. Cf. *Robertson* v. *United States*, 343 U. S. 711; *Rutkin* v. *United States*, 343 U. S. 130 [Ct. D. 1742, C. B. 1952-1, 9]; *United States* v. *Kirby Lumber Co.*, 284 U. S. 1. [Ct. D. 420, C. B. X-2, 356 (1931)]. Such decisions demonstrate that we cannot but ascribe content to the catchall provision of section 22(a), "gains or profits and income derived from any source whatever." The importance of that phrase has been too frequently recognized since its first appearance in the Revenue Act of 1913[5] to say now that it adds nothing to the meaning of "gross income."

Nor can we accept respondent's contention that a narrower reading of section 22(a) is required by the Court's characterization of income in *Eisner* v. *Macomber*, 252 U. S. 189, 207 [T. D. 3010, C. B. 3, 25 (1920)], as "the gain derived from capital, from labor, or from both combined."[6] The Court was there en-

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[4] See note 1, *supra*.

[5] 38 Stat. 114, 167.

[6] The phrase was derived from *Stratton's Independence, Ltd.* v. *Howbert*, 231 U. S. 399, 415, and *Doyle* v. *Mitchell Bros. Co.*, 247 U. S. 179, 185, two cases construing the Revenue Act of 1909, 36 Stat. 11, 112. Both taxpayers were "wasting asset" corporations, one being engaged in mining, the other in lumbering operations. The definition was applied by the Court to demonstrate a distinction between a return on capital and "a mere conversion of capital assets." *Doyle* v. *Mitchell Bros. Co.*, *supra*, at 184. The question raised by the instant case is clearly distinguishable.

deavoring to determine whether the distribution of a corporate stock dividend constituted a realized gain to the shareholder, or changed "only the form, not the essence," of his capital investment. *Id.*, at 210. It was held that the taxpayer had "received nothing out of the company's assets for his separate use and benefit." *Id.*, at 211. The distribution, therefore, was held not a taxable event. In that context—distinguishing gain from capital—the definition served a useful purpose. But it was not meant to provide a touchstone to all future gross income questions. *Helvering* v. *Bruun*, *supra*, at 468–469; *United States* v. *Kirby Lumber Co.*, *supra*, at 3.

Here we have instances of undeniable accessions to wealth, clearly realized, and over which the taxpayers have complete dominion. The mere fact that the payments were extracted from the wrongdoers as punishment for unlawful conduct cannot detract from their character as taxable income to the recipients. Respondents concede, as they must, that the recoveries are taxable to the extent that they compensate for damages actually incurred. It would be an anomaly that could not be justified in the absence of clear congressional intent to say that a recovery for actual damages is taxable but not the additional amount extracted as punishment for the same conduct which caused the injury. And we find no such evidence of intent to exempt these payments.

It is urged that reenactment of section 22(a) without change since the Board of Tax Appeals held punitive damages nontaxable in *Highland Farms Corp.*, 42 B. T. A. 1314, indicates congressional satisfaction with that holding. Reenactment—particularly without the slightest affirmative indication that Congress ever had the *Highland Farms* decision before it—is an unreliable indicium at best. *Helvering* v. *Wilshire Oil Co.*, 308 U. S. 90, 100–101 [Ct. D. 1424, C. B. 1939–2, 213]; *Koshland* v. *Helvering*, 298 U. S. 441, 447 [Ct. D. 1124, C. B. XV-1, 219 (1936)]. Moreover, the Commissioner promptly published his nonacquiescence in this portion of the *Highland Farms* holding [7] and has, before and since, consistently maintained the position that these receipts are taxable.[8] It therefore cannot be said with certitude that Congress intended to carve an exception out of section 22(a)'s pervasive coverage. Nor does the 1954 Code's [9] legislative history, with its reiteration of the proposition that statutory gross income is "all-inclusive," [10] give support to respondent's position. The definition of gross income has been simplified, but no effect upon its present broad scope was intended.[11] Certainly punitive damages cannot reasonably be classified as gifts, cf. *Commissioner* v. *Jacobson*, 336 U. S. 28, 47–52, nor do they come under any other exemption provision in the Code. We would do violence to the plain meaning of the statute and restrict a clear legislative attempt to bring the taxing power to bear upon all receipts constitutionally taxable were we to say that the payments in question here are not gross income. See *Helvering* v. *Midland Mutual Life Ins. Co.*, *supra*, at 223.

Reversed.

Mr. Justice DOUGLAS dissents.

Mr. Justice HARLAN took no part in the consideration or decision of this case.

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[7] 1941–1 Cumulative Bulletin 16.

[8] The long history of departmental rulings holding personal injury recoveries nontaxable on the theory that they roughly correspond to a return of capital cannot support exemption of punitive damages following injury to property. See 2 Cumulative Bulletin 71; 1–1 Cumulative Bulletin 92, 93; VII–2 Cumulative Bulletin 123; 1954–1 Cumulative Bulletin 179, 180. Damages for personal injury are by definition compensatory only. Punitive damages, on the other hand, cannot be considered a restoration of capital for taxation purposes.

[9] 68A Stat. 3 *et seq.* Section 61(a) of the Internal Revenue Code of 1954, 68A Stat. 17, is the successor to sec. 22(a) of the 1939 Code.

[10] H. R. Rep. No. 1337, 83d Cong., 2d Sess. A18; S. Rep. No. 1622, 83d Cong., 2d Sess. 168.

[11] In discussing sec. 61(a) of the 1954 Code, the House Report states:

"This section corresponds to sec. 22(a) of the 1939 Code. While the language in existing section 22(a) has been simplified, the all-inclusive nature of statutory gross income has not been affected thereby. Section 61(a) is as broad in scope as sec. 22(a).

"Section 61(a) provides that gross income includes 'all income from whatever source derived.' This definition is based upon the 16th Amendment and the word 'income' is used in its constitutional sense." H. R. Rep. No. 1337, *supra*, note 10, at A18.

A virtually identical statement appears in S. Rep. No. 1622, *supra*, note 10, at 168.

REGULATIONS 118, SECTION 39.22(a)-1: What included in gross income. Ct. D. 1784

INCOME TAX—INTERNAL REVENUE CODE—DECISION OF SUPREME COURT

1. GROSS INCOME—"INSIDER PROFITS" RECOVERED BY INVESTMENT COMPANY.

"Insider profits" recovered by a corporation from one of its directors and a shareholder pursuant to the provisions of the Securities Exchange Act of 1934 and the Investment Company Act of 1940 constitute taxable income to the corporation under section 22(a) of the Internal Revenue Act of 1939.

2. DECISION FOLLOWED.

Commissioner v. *Glenshaw Glass Company and William Goldman Theaters, Inc.* (U. S. Sup. Ct. decided March 28, 1955) followed.

3. JUDGMENT AFFIRMED.

Judgment of the United States Court of Appeals for the Second Circuit, 211 F. 2d 522, affirming 19 T. C. 581, affirmed.

SUPREME COURT OF THE UNITED STATES

General American Investors Company, Inc., petitioner, v. *Commissioner of Internal Revenue*

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

[March 28, 1955]

OPINION

Mr. Chief Justice WARREN delivered the opinion of the Court.

The sole question presented by this case is whether a payment is taxable as gross income when received by a corporation pursuant to the "insider profits" provisions of the Securities Exchange Act of 1934[1] and the Investment Company Act of 1940.[2] Subject to exceptions not presently relevant, section 16(b) of the Securities Exchange Act provides that the profit realized from certain defined securities transactions undertaken by a director or major stockholder of the issuing corporation "shall inure to and be recoverable by the issuer."[3] This provision is made applicable to investment companies by section 30(f) of the Investment Company Act of 1940.[4] Under these provisions, petitioner, a registered closed-end investment company, received payments totaling $170,038.04. This sum represented the profits accruing to one of petitioner's directors and a stockholder through dealings covered by section 16(b); the money was paid over to petitioner on demand and without obligation. The payments were not reported as income on petitioner's tax returns. The Commissioner of Internal Revenue allowed a $13,000 deduction for legal expenses incurred in recovering the amounts due but asserted a deficiency for the balance on the ground that the receipts constituted taxable gains under section 22(a) of the Internal Revenue Code of 1939.[5] The Tax Court, 19 T. C. 581, and the Court of Appeals for the Second Circuit, 211 F. 2d 522, sustained the Commissioner's determination. We granted certiorari, 348 U. S. 812, because of an apparent similarity of issues here to those involved in *Commissioner* v. *Glenshaw Glass Co.*, 211 F. 2d 928 (C. A. 3d Cir.), and the possible conflict between that case and this.[6]

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[1] 48 Stat. 881, 15 U. S. C. sec. 78a.
[2] 54 Stat. 789, 15 U. S. C. sec. 80a-1.
[3] 48 Stat. 896, 15 U. S. C. sec. 78p.
[4] 54 Stat. 837, 16 U. S. C. sec. 80a-29.

[5] "SEC. 22. GROSS INCOME.

"(a) GENERAL DEFINITION.—'Gross income' includes gains, profits, and income derived from salaries, wages, or compensation for personal service * * * of whatever kind and in whatever form paid, or from professions, 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, *or gains or profits and income derived from any source whatever.* * * *" (Emphasis added.) 53 Stat. 9, 53 Stat. 574, 26 U. S. C. sec. 22(a).

[6] There was, however, no disagreement among lower courts which faced the question of the taxability of a sec. 16(b) recovery of "insider profits." See *Park & Tilford Distillers Corp.* v. *United States*, 107 F. Supp. 941; *Noma Electric Corp.*, 12 T. C. M. 1.

We have this day decided that the recovery of punitive damages for fraud or antitrust violation is reportable as gross income within the meaning of section 22(a). *Commissioner* v. *Glenshaw Glass Co.*, *ante*, p. 12. The reasons which dictated that result are equally compelling here. We see no significant difference in the nature of these receipts which might make that ruling inapplicable. As in *Glenshaw*, the taxpayer realized the money in question free of any restrictions as to use. The payments in controversy were neither capital contributions nor gifts. Cf. *Texas & Pacific R. Co.* v. *United States*, 268 U. S. 285 [Ct. D. 495, C. B. XI-1, 263 (1932)]. There is no indication that Congress intended to exempt them from coverage. In accordance with the legislative design to reach all gain constitutionally taxable unless specifically excluded, we conclude that the petitioner is liable for the tax and the judgment is affirmed.

Mr. Justice DOUGLAS concurs in the result.

Mr. Justice HARLAN took no part in the consideration or decision of this case.

REGULATIONS 118, SECTION 39.22(a)-1: What included in gross income. Rev. Rul. 55-2

Unpaid accounts receivable which represent compensation for personal services transferred by a taxpayer to an irrevocable trust for the benefit of his minor child are upon collection taxable to the taxpayer-grantor and not to the trust.

Advice has been requested whether accounts receivable transferred to an irrevocable trust created for the benefit of a taxpayer's minor child are upon collection taxable to the grantor or to the trust.

A taxpayer whose principal source of income arises from his professional practice as a surgeon created an irrevocable trust for a minor child to insure to him adequate educational and other opportunities and transferred to the trust annual gifts of selected accounts receivable. The trust agreement provides that the funds received upon collection of the accounts receivable and the income therefrom shall be accumulated until the beneficiary reaches the age of 21 years or enters college, whichever may occur first, whereupon the principal and income are to be paid in regular installments. A bank is designated to act as trustee and the taxpayer retains none of the rights of administration or control.

Section 39.22(a)-1 of Regulations 118 provides that gross income includes in general compensation for personal and professional services, business income, profits from sales of and dealings in property, interest, rent, dividends, and gains, profits, and income derived from any source whatever unless exempt from tax by law.

Payments for personal services are always due primarily to the person rendering the services. He remains "the owner of the right or title from which the income springs." See *A. D. Saenger et al.* v. *Commissioner*, 69 Fed. (2d) 631; *Edward J. Luce et al.* v. *Burnet*, 55 Fed. (2d) 751. When such earnings are assigned the assignee takes as representative of the assignor and the earnings continue to be taxable to him. In *Helvering* v. *Paul R. G. Horst*, 311 U. S. 112, Ct. D. 1472, C. B. 1940-2, 206, the Supreme Court said: "The power to dispose of income is the equivalent of ownership of it. The exercise of that power to procure the payment of income to another is the enjoyment and hence the realization of the income by him." See also *Lucas* v. *Guy C. Earl*, 281 U. S. 111 and *Helvering* v. *Gerald A. Eubank*, 311 U. S. 122, Ct. D. 1473, C. B. 1940-2, 209.

Accordingly, it is held that unpaid accounts receivable which represent compensation for personal services transferred by a taxpayer to an irrevocable trust for the benefit of his minor child are upon collection taxable to the taxpayer-grantor and not to the trust.

REGULATIONS 118, SECTION 39.22(a)-1: What included in gross income. (Also Section 23(m), Section 39.23(m)-1; Section 114, Section 39.114-1.) Rev. Rul. 55-11

Loam is an earthy material composed of sand and clay and is included in the term "soil in place" for purposes of Revenue Ruling 78, C. B. 1953-1, 18. Therefore, proceeds from the sale of loam constitute ordinary income subject to adjusted basis depletion.

REGULATIONS 118, SECTION 39.22(a)-1: What included in gross income. Rev. Rul. 55-62

A resident alien reporting income on the cash receipts and disbursements basis must include in his gross income the gross receipts from the sale of cattle which he raised for sale in a foreign country and which he sold there subsequent to acquiring residence in the United States.

Advice has been requested whether a resident alien, reporting income on the cash receipts and disbursements basis, must include in his gross income the gross receipts from the sale of cattle which he raised for sale in a foreign country and which he sold there subsequent to acquiring residence in the United States, or whether the fair market value of the cattle at the time he became a resident of the United States should be used as the basis for computing the gain on the sale.

Resident aliens of the United States are, in general, taxable the same as citizens of the United States, that is, on their entire income derived from all sources, including income from sources without the United States. See sections 39.211-1 and 39.212-1(a)(2) of Regulations 118. A taxpayer reporting his income on the cash receipts and disbursements basis who raises livestock for the purpose of sale is required to include in his gross income the gross receipts during the taxable year from the sale of livestock which was raised during the taxable year or prior years. See section 39.22(a)-7 of Regulations 118.

In the case of a taxpayer reporting income on the cash receipts and disbursements method who raises livestock for sale, an increase in the value of such property is not subject to tax until gain has been realized from the increase through some identifiable event such as a sale or exchange of the property. Where cattle were raised outside the United States and sold there subsequent to the date the owner became a resident alien of the United States, no part of the increase in the value of the cattle, which occurred while the owner was a nonresident as to the United States, was subject to Federal income tax. Therefore, in the case of a taxpayer reporting income on the cash receipts and disbursements basis, the entire amount of the gain

from the sale would be taxable in the United States in the year in which the sale was consummated.

Accordingly, it is held that a resident alien, reporting income on the cash receipts and disbursements basis, shall include in his gross income the gross receipts during the year from the sale of livestock which was raised for sale in a foreign country and which he sold there subsequent to acquiring residence in the United States.

REGULATIONS 118, SECTION 39.22(a)-1: What included in gross income. Rev. Rul. 55-132

Payments are authorized by the War Claims Act of 1948, 62 Stat. 1240, 50 U. S. C. 2005, to be made by the United States Government to a taxpayer who was a "Prisoner of War," as defined in section 6(a) of the Act by reason of any claims filed by him under the provisions of section 6(b) of that Act for the violation by the enemy government by which he was held prisoner of war of its obligation to furnish him the quantity or quality of food to which he was entitled as a prisoner of war under the terms of the Geneva Convention of July 27, 1929. Also, payments are authorized by reason of any claims filed by a taxpayer under the provisions of section 6(d)(2)(A) and section 6(d)(2)(B) of the War Claims Act, as added by amendments in 1952, 66 Stat. 47, 50 U. S. C. 2005, for violation by the enemy government of the terms of the Geneva Convention relating to labor of prisoners of war and inhumane treatment of such prisoners. *Held*, such amounts received by a "Prisoner of War" from the United States Government are in the nature of reimbursement for the loss of personal rights and are not includible in the gross income of such individual for Federal income tax purposes.

REGULATIONS 118, SECTION 39.22(a)-1: What included in gross income. Rev. Rul. 55-135
(Also Section 117(f).)

National Savings Bonds issued by the United States of Mexico are similar in many respects to United States Savings Bonds, Series E. The discount at which the bonds are originally issued is held to constitute interest which is taxable as ordinary income under section 22(a) of the Internal Revenue Code of 1939 when realized upon redemption. The discount does not represent an amount received upon retirement of the bond within the meaning of section 117(f) of the Code. See Rev. Rul. 55-136, below.

REGULATIONS 118, SECTION 39.22(a)-1: What included in gross income. Rev. Rul. 55-136
(Also Section 117(f).)

Section 117(f) of the Internal Revenue Code of 1939 applies only to amounts received by reason of redemption of bonds. It does not apply to the amount of interest (whether paid in the form of discount or not) which is received by reason of holding the bond. Such

interest or interest-equivalent payments are taxable as ordinary income under section 22(a) of the Code.
Revenue Ruling 119, C. B. 1953-2, 95, modified.

Advice has been requested whether the Internal Revenue Service will continue to follow the position taken in Revenue Ruling 119, C. B. 1953-2, 95, with respect to bonds issued at a discount prior to January 1, 1955.

Revenue Ruling 119, *supra*, holds that the discount at which a "Twelve Year Dollar Savings Bond" of the State of Israel is originally issued constitutes interest which is taxable as ordinary income under section 22(a) of the Internal Revenue Code of 1939 when realized upon redemption. It does not represent an amount received upon retirement of the bond within the meaning of section 117(f) of the Internal Revenue Code of 1939.

Section 117(f) of the Code provides in part as follows:

* * * For the purposes of this chapter [chapter 1], amounts received by the holder upon the retirement of bonds, debentures, notes, or certificates or other evidences of indebtedness issued by a 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.

Prior to the enactment of section 117(f) the gain realized by the holder of a bond, upon its retirement, constituted ordinary income whereas the gain realized from an actual sale or exchange of a bond to a third party immediately prior to retirement constituted capital gain. The legislative history in connection with the enactment of section 117(f) in the 1934 Revenue Act indicates clearly that Congress was directing its attention solely to treating the redemption of a bond the same as a sale or exchange of a bond and did not comtemplate covering the treatment of initial discount which under the law in effect prior to 1934, was treated as ordinary income. The committee reports imply that Congress was thinking of amounts received upon retirement altogether in terms of amounts which would have represented gain or loss under section 111 and section 112 of the Revenue Act of 1934.

In *Commissioner* v. *George Peck Caulkins*, 144 Fed. (2d) 482, affirming 1 T. C. 656, acquiescence, C. B. 1944, 5, the court held that the excess of the amount received by the taxpayer, pursuant to a contract with Investors Syndicate over the aggregate payments made by him for Accumulative Installment Certificate constitutes capital gain, and stated that the certificate in question was " 'an evidence of indebtedness' similar to a bond or debenture and hence falls within the statutory group governed by section 117(f)."

It has been the policy of the Internal Revenue Service to restrict the application of the Caulkins case to cases involving the identical facts. This position has been reconsidered in the light of the position taken in Revenue Ruling 119, *supra*, i. e., that the amount received upon the redemption of a bond which represents original or initial discount constitutes interest which is taxable as ordinary income. There is no logical basis in fact or in law to distinguish the discount element in the Accumulative Installment Certificate involved in the Caulkins case from the original discount element involved ordinarily in the issuance of any bonds. Accordingly, the acquiescence published in C. B. 1944, 5, has been withdrawn and a nonacquiescence has been published at page 7 of this Bulletin.

Revenue Ruling 119, *supra*, is modified to the extent that it is inconsistent with the views expressed herein. The provisions of this Revenue Ruling will not be applied to amounts received upon redemption of Accumulative Installment Certificates issued by Investors Syndicate which were purchased during the period beginning December 25, 1944, the date acquiescence in the Caulkins case was announced and March 14, 1955, the date this Revenue Ruling is published in the Internal Revenue Bulletin.

REGULATIONS 118, SECTION 39.22(a)-1: What included in gross income. Rev. Rul. 55-137

Possible excess revenues collected by an electric power company pending settlement by court order of the question of a disputed increase in service rates, are includible for Federal income tax purposes in gross income for the taxable years in which such excess revenues were received, even though amounts equivalent to the excess were deposited in a special bank account subject to the joint control of the company and a bonding company under an agreement by which the latter became surety on a bond required by court order to be posted by the company in order to secure repayment of the excess collections, if required upon ultimate settlement of the dispute.

Advice has been requested as to the Federal income tax treatment of possible excess revenues collected under bond by an electric power company pending settlement by court order of the question of a disputed increase in the service rates collected under the following circumstances.

In 1951 *X* Electric Company filed a new schedule of electric service rates with the State regulatory authority. The State authority immediately suspended the taking effect of the rates filed, and in 1952 issued an order that the schedule of rates filed by the Company be disallowed and disapproved. By the same order, the authority ordered the Company to file new rates higher than the rates in effect but less than the rates disapproved. The Company filed a bill of complaint in court for a stay of enforcement of the order, and after a bond was filed with the court, the court granted a stay of the order issued by the regulatory authority and permitted the schedule of rates filed by the Company in 1951 to become effective conditioned upon refund by the Company to its customers of any amounts collected in excess of the amounts collectible under the schedules ordered by the regulatory authority in the event that such schedules are later determined to be valid. The Company proceeded to collect from its customers thereafter in 1952 and in 1953 at the rate permitted by the court. The surety company which executed the bond in the Company's behalf required the Company to deposit in a special bank account, subject to the joint control of the Company and of an authorized representative of the surety company, amounts equalling the collections from customers in excess of the sums collectible according to the rates ordered by the regulatory authority. As of the end of the Company's 1953 taxable year, the special account included all of the excess revenues collected under bond during 1952 and 1953, less the amount of income tax paid on such excess revenue for the year 1952.

Earnings under a claim of right and without restriction as to their disposition, even though it may be claimed that the recipient is not

entitled to retain them, and even though the recipient may still be adjudged liable to restore their equivalent, are taxable income in the year in which received. See *North American Oil Consolidated* v. *Burnet*, 286 U. S. 417, Ct. D. 499, C. B. XI-1, 293 (1932); *United States* v. *Lewis*, 340 U. S. 590, Ct. D. 1738, C. B. 1951-1, 21. The filing of a bond as security for liability to return excess revenues places no restriction on the use of the moneys collected. See *Commissioner* v. *Brooklyn Union Gas Co.*, 62 Fed. (2) 505, acquiescence, page 4, this Bulletin. The fact that a corporation indicated in its account books an intention not to exercise its power of absolute dominion over funds received by it in satisfaction of judgment but subject to be returned to the judgment debtor did not change the status thereof as taxable income of the corporation in the year in which received. See *Commissioner* v. *Alamitos Land Co.*, 112 Fed. (2d) 648, certiorari denied 311 U. S. 679. Moreover, the setting up of a separate bank account to receive amounts equalling the excess revenues collected by agreement with the bonding company, did not differ in legal effect from the depositing of any other assets of the company as collateral to secure the bond, nor interfere with the company's exercise of the power of absolute dominion over the full amounts collected from the customers.

In view of the foregoing, it is held that possible excess revenues collected by the electric power company during the years 1952 and 1953 pending settlement by court order of the question of a disputed increase in service rates, are includible for Federal income tax purposes in gross income for the taxable years in which such excess revenues were received, even though amounts equivalent to the excess were deposited in a special bank account subject to the joint control of the company and the bonding company under the circumstances above stated.

REGULATIONS 118, SECTION 39.22(a)-1: What included in gross income. Rev. Rul. 55-154

(Also Section 23(a); Regulations 118, Section 39.23(a)-1.)

A real estate development company assesses an annual maintenance charge against the owner of each residential lot in its development in an amount not exceeding a stated amount for each square foot of lot area for the purpose of creating a "maintenance fund." The maintenance charge is secured by a vendor's lien upon each lot and is payable in advance on the first day of January of each year. The development company agrees to apply the total of the funds so collected, so far as they are sufficient, toward the maintenance of streets, sidewalks, paths, parks, etc.; providing fire and police protection and garbage and rubbish collection; and doing any other thing necessary or desirable in its opinion to maintain or improve the property for the general benefit of the owners of lots within the development. It is agreed that the decisions of the development company shall be final so long as such expenditures are made in good faith. The annual maintenance charges may be discontinued after 15 years if a majority of the lot owners file an instrument with the County Clerk agreeing to the abandonment of such charges. An annual balance sheet of the

maintenance fund will be furnished to each lot owner. *Held*, in view of the complete control and supervision which the development company has over the maintenance fund, the assessments against the property owners constitute taxable income to the development company in the year of receipt. However, any disbursements made for the maintenance of streets, etc., fire and police protection, garbage and rubbish collection, or other like services are deductible as paid or accrued, depending on the method of accounting employed by the development company. The maintenance charges paid by the lot owner-residents are not deemed to be assessed by a political subdivision within the purview of section 23(c) of the Internal Revenue Code of 1939 and no deduction therefor is otherwise provided for in any other section of the Code or the regulations. No portion of the amount assessed is deemed to be a capital expenditure in view of the general and indirect nature of the benefits which inure to the lot owners. Thus, such charges are regarded as personal expenses of such lot owner-residents and are not deductible by them for Federal income tax purposes. However, if the property is converted to rental property the amount of such charges paid by the lot owners would be deductible as ordinary and necessary (rental) business expenses.

REGULATIONS 118, SECTION 39.22(a)-1: What included in gross income. Rev. Rul. 55-234

Income realized from business transacted by a corporation through the nominal agency of one of its officers, acting as purported sole proprietor, is taxable to the corporation.

Advice has been requested whether a corporation is taxable upon the income from business transactions which for convenience are conducted in its behalf in the name of a sole proprietor.

A domestic corporation engaged in foreign trade is unable to make direct shipments of goods into the *X* country under the import regulations of such country. In order to execute the orders received from the *X* country and to facilitate doing business under the import regulations the corporation entered into a contract with one of its officers in which he undertook, under the trade name of a sole proprietorship, to act without compensation of any kind as the shipping agent for the corporation. The sole proprietorship has no capital or operating expenses. All shipments are financed by the corporation and all work is performed by the corporation employees. All financial transactions are reflected in the books of account of the corporation. The sole proprietor maintains no accounting records and renders no account to the corporation except to act as a conduit for funds belonging to the corporation. Under the contract the sole proprietor agreed to transfer to the corporation all profits realized from the business transacted with the *X* country, while the corporation agreed to be solely responsible for all claims and losses arising therefrom.

On the facts presented, from which it is apparent that the purported sole proprietorship is purely a nominal participant in the business transactions, it is held that the income and expenses involved are those of the corporation and are properly to be reported in its returns rather than in those of its officer.

REGULATIONS 118, SECTION 39.22(a)-1: What included in gross income. Rev. Rul. 55-249

Compensation received by members of the Armed Forces of the United States for the first 60 days of the accrued leave standing to their credit at the time of discharge, whether such leave accrued either on or before August 31, 1946, or subsequent thereto, does not fall within the purview of the tax-exempt payments for leave as referred to in section 7 of the Armed Forces Leave Act of 1946. [60 Stat. 963, as amended, 37 U. S. C. 36.] Such compensation constitutes active service pay and, as such, is taxable income subject to the exclusion provided for by section 22(b)(13) of the Internal Revenue Code of 1939. The compensation, to the extent taxable, is subject to the withholding of income tax at source under section 1622(a) of the Code.

Advice has been requested whether compensation received by a member of the Armed Forces of the United States upon discharge for the accrued leave standing to his credit at that time constitutes taxable income for Federal income tax purposes, or is exempt from tax under the provisions of section 7 of the Armed Forces Leave Act of 1946, 60 Stat. 963, as amended, 37 U. S. C. 36.

The taxpayer, an Army captain, was honorably discharged from the service in 1953 after 2 years of active service in the United States. At that time he was paid for 42 days of unused leave accrued during the 2-year period prior to the date of his discharge. He questioned the inclusion of the payment for such leave in the amount of the "Total wages" shown on the Withholding Tax Statement, Form W-2, given him by the Army.

The pertinent provisions of the Armed Forces Leave Act of 1946, *supra*, as amended, are as follows:

* * * * * * *

SECTION 3. * * *

* * * * * * *

(b) Notwithstanding any other provision of this Act or any other law or regulation, no member of the Armed Forces (other than a member on terminal leave on September 1, 1946) shall be permitted to accumulate or to have to his credit at any time after August 31, 1946, accumulated or accrued leave aggregating in excess of sixty days, except that leave actually taken during any fiscal year may be charged to leave accruing during such fiscal year without regard to such sixty-day limitation: *Provided*, That no cash settlement shall be made for unused or accumulated leave in excess of sixty days upon discharge or retirement subsequent to August 31, 1946.

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SECTION 4. * * *

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(c) Any member of the armed forces discharged after August 31, 1946, having unused accrued leave standing to his credit at time of discharge shall be compensated for such unused leave in cash on the basis of the base and longevity pay, and allowances, applicable to such member on the date of discharge including for enlisted persons the allowances as provided for such enlisted persons in subsection (a) of this section: *Provided*, that no cash settlement shall be made to any member (1) discharged for the purpose of accepting a commission or warrant or entering into an enlistment in his respective branch of the armed forces, or (2) electing to carry over such unused leave to a new enlistment in his respective branch of the armed forces on the day following date of discharge. * * *

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SECTION 5. * * *

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(b) In any case in which a member of the armed forces on active duty on September 1, 1946 (other than a member on terminal leave on such date) has to his credit on August 31, 1946, accumulated or accrued leave aggregating in excess of sixty days, such leave in excess of sixty days shall be settled and compensated for only in the manner provided in section 6 of this Act and if application is made to the Secretary not later than June 30, 1951.

* * * * * * *

Section 6 of the Act provides for the manner in which leave designated by section 5 of the Act shall be settled and compensated for section 5 generally relates to leave accumulated by Armed Forces members discharged prior to September 1, 1946, and to leave in excess of 60 days accumulated as of August 31, 1946.

Section 7 of the Act provides that all amounts paid or payable under section 6 of this Act, in cash, bonds, or both, shall not be assignable except as provided in subsection (d) of such section, shall be exempt from claims of creditors, including any claim of the United States, and shall not be subject to attachment, levy, or seizure by or under any legal or equitable process whatever. It further provides that all such amounts (except interest in the case of bonds) shall be exempt from taxation. See D. C. 793, C. B. 1946-2, 189.

As stated in Regulations 118, section 39.22(a)-1, gross income includes, in general, compensation for personal and professional services, business income, profits from sales of and dealings in property, interest, rent, dividends and gains, profits, and income derived from any source whatever unless exempt from tax by law. In the instant case the leave for which the taxpayer was compensated comes within the 60 days to which he was entitled as part of his basic pay for active duty. The pay received was for less than 60 days leave accumulated subsequent to August 31, 1946. The taxpayer was not discharged prior to that date and therefore he was not paid under section 6 of the Act and such payment does not come within the exemption granted in section 7 of the Act.

In view of the foregoing, it is held that compensation received by members of the armed forces for the first 60 days of the accrued leave standing to their credit at a time of discharge after August 31, 1946, whether such leave accrued either on or before August 31, 1946, or subsequent thereto, does not fall within the purview of the tax-exempt payments for leave as referred to in section 7 of the Armed Forces Leave Act of 1946, as amended, *supra* [37 U. S. C. 36]. Such compensation constitutes active service pay and, as such, is taxable income subject to the exclusion provided for by section 22(b)(13) of the Internal Revenue Code of 1939. The compensation, to the extent taxable, is subject to the withholding of income tax at source under section 1622(a) of the Code.

REGULATIONS 118, SECTION 39.22(a)-1: What included in gross income. Rev. Rul. 55-313

(Also Section 22(b)(1); Regulations 118, Section 39.22(b)(1)-1.)

A "death benefit" payment received by a beneficiary under the terms of a single premium deferred annuity contract where the

annuitant (the owner) dies prior to the due date of the first annuity payment is not exempt from Federal income tax as an amount received under a life insurance contract paid by reason of the death of the insured as provided by section 22(b)(1) of the Internal Revenue Code of 1939. Any excess of the cash surrender value over the amount of the consideration paid for the contract is not includible in the gross income of the annuitant. However, such excess constitutes ordinary income taxable to the beneficiary in the year received.

Advice has been requested whether any part of the amount of a "death benefit" payment made to a beneficiary under the terms of a single premium deferred annuity contract upon the death of the annuitant, the owner of the contract, prior to the due date of the first annuity payment is includible in gross income of the annuitant or of the beneficiary.

In the instant case the annuitant purchased a single premium deferred annuity contract from an insurance company. The contract provides that upon the death of the annuitant prior to the due date of the first annuity payment, if the policy is then in force, the insurance company shall pay to the beneficiary an amount equal to the consideration paid for the contract or the cash surrender value of the contract upon the date of death of the annuitant, whichever is greater.

The contract involved in the instant case does not involve any element of risk to the insurance company with respect to the death of the annuitant. Compare *Helvering* v. *Edyth LeGierse et al., Executors, Estate of Cecile LeGierse*, 312 U. S. 531, Ct. D. 1491, C. B. 1941-1, 430. On the contrary, death of the annuitant eliminates the risk to the company. Therefore, the amount of the death payment made to the beneficiary is not considered to be an amount paid by reason of the death of the insured within the meaning of section 22(b)(1) of the Internal Revenue Code of 1939.

Accordingly, it is held that the amount of the death payment made to the beneficiary is not exempt from Federal income tax, but that the excess of the amount of the death benefit payment over the amount of the consideration paid for the contract is includible in the gross income of the beneficiary in the taxable year in which received. Such excess is not includible in the gross income of the annuitant.

Regulations 118, Section 39.22(a)-1: What included in gross income.

Corporate distribution in kind where the earnings and profits of the corporation are sufficient to cover the adjusted cost of the property distributed but are insufficient to cover its full market value at the time of distribution. See Ct. D. 1774, page 248; Ct. D. 1775, page 253.

Regulations 118, Section 39.22(a)-1: What included in gross income.

Refund, by insurer, of employees' contributions to an annuity plan. See Rev. Rul. 55-14, page 302.

REGULATIONS 118, SECTION 39.22(a)-1: What included in gross income.

Payments received by inventors before January 1, 1954, from the assignment or exclusive license of a patent. See Rev. Rul. 55-58, page 97.

REGULATIONS 118, SECTION 39.22(a)-1: What included in gross income.

Treatment of appreciated property distributed in partial liquidation of trust principal. See Rev. Rul. 55-117, page 233.

REGULATIONS 118, SECTION 39.22(a)-1: What included in gross income.

Date on which interest on future payment funds held by a Federal land bank becomes taxable income. See Rev. Rul. 55-254, page 326.

REGULATIONS 118, SECTION 39.22(a)-1: What included in gross income.

Treatment, for Federal income tax purposes of amounts received by a taxpayer, in accordance with the terms of an insurance policy, as reimbursement for overhead expenses incurred by the taxpayer during prolonged periods of injury or sickness. See Rev. Rul. 55-264, page 11.

REGULATIONS 118, SECTION 39.22(a)-1: What included in gross income.

Interest on 2½ percent Treasury Bonds, Investment Series A-1965. See Rev. Rul. 55-274, page 279.

REGULATIONS 118, SECTION 39.22(a)-2: Compensation for personal services. Rev. Rul. 55-273

> The commission retained by an insurance salesman in the form of reduced costs on an insurance policy on his life and property, which was purchased from an insurance agency or company, constitutes income to the salesman. The amount of such commission retained is subject to withholding of Federal income taxes. G. C. M. 10486, C. B. XI-1, 14, (1932), amplified.

Advice has been requested whether the commission retained by an insurance salesman on an insurance policy which he purchased on his life and property under the following circumstances constitutes income to him subject to withholding of Federal income taxes.

In the instant case, an insurance salesman, as an employee of a general insurance agency who is entitled to commissions on policies which he sells, purchased policies for his own protection on his life and

property through the agency for which he works at the price charged by the agency for such insurance, less the salesman's commission.

Section 22(a) of the Internal Revenue Code of 1939, provides in part as follows:

"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service * * *.

G. C. M. 10486, C. B. XI-1, 14 (1932), holds that a commission retained by an agent on his own life insurance policy is income accruing to the agent due to the fact that an employer and employee relationship existed between the agent and the insurance company and the company was under contract to pay the agent commissions on all policies secured by him.

The principles of G. C. M. 10486, *supra*, are equally applicable to the facts in the instant case. There is no real distinction merely by reason of the fact that here the salesman was an employee of an insurance agency rather than a direct employee of an insurance company.

The agency was authorized to issue insurance contracts for insurance companies, employed its own salesmen and paid them a commission on each policy they secured. An employer and employee relationship existed between the insurance agency and its salesmen and the salesmen were entitled to a commission as compensation for policies sold by them irrespective of whether such commission was received in cash or in the form of reduced costs on policies taken through the agency.

Also, there may be insurance salesmen who might be considered independent contractors. These salesmen, like other insurance salesmen, are also entitled to a commission on each policy secured by them as compensation for their services irrespective of the manner in which received.

Accordingly, it is held that the commission retained by an insurance salesman in the form of reduced costs on an insurance policy on his life and property, which he purchased from an insurance agency or company, constitutes income to the salesman regardless of whether the salesman is an employee or independent contractor. The amount of such retained commission is subject to withholding of Federal income taxes.

REGULATIONS 118, SECTION 39.22(a)-2: Compensation for personal services.

Treatment of certain grants and fellowships received by nationals of the United Kingdom in this country on exchange visitor visas. See Rev. Rul. 55-211, page 676.

REGULATIONS 118, SECTION 39.22(a)-3: Compensation paid other than in cash.

Premium paid by an employer on a combination group term life insurance and group annuity contract for his employees. See Rev. Rul. 55-193, page 266.

REGULATIONS 118, SECTION 39.22(a)-4: Compensation paid in notes.

Secondary interest coupons on municipal bonds retained by brokers. See Rev. Rul. 55-73, page 236.

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. 55-138, page 223.

REGULATIONS 118, SECTION 39.22(a)-7: Gross income of farmers. Rev. Rul. 55-138

(Also Sections 22(a), 23(a), 23(o), 23(q); Regulations 118, Sections 39.22(a)-5, 39.23(a)-1, 39.23(o)-1, 39.23(q)-1.)

The fair market value of agricultural or manufactured products or property held for sale in the ordinary course of business which is contributed to an organization described in section 23(o) or section 23(q) of the Internal Revenue Code of 1939 is not includible in the gross income of the donor for Federal income tax purposes. The fair market value which may be deducted from gross income subject to the limitations contained in section 23(o) and section 23(q) of the Code will be the replacement cost to the donor in his most favorable market. There must be an adjustment to inventory effecting the removal of the donated asset and the costs pertaining thereto from the opening inventory in the year of the gift. Items of cost of the current year applicable to such property are not deductible by the donor, and similar items which have been deducted in prior years must be removed from the amount of the contribution in order to avoid a double deduction.

I. T. 3910, C. B. 1948-1, 15, revoked.

I. T. 3910, C. B. 1948-1, 15, has been reconsidered in the light of the decisions in *David C. White* v. *Broderick*, 104 Fed. Supp. 213, *Campbell* v. *Prothro*, 209 F. 2d 331, *Mamie F. Farrier* v. *Commissioner*, 15 T. C. 277, and *Elsie SoRelle* v. *Commissioner*, 22 T. C. 459.

I. T. 3910, *supra*, holds (1) that the fair market value of agricultural products contributed by a farmer or other producer to an organization described in section 23(o) or section 23(q) of the Internal Revenue Code of 1939 is includible in the gross income of the donor; (2) that such fair market value may be deducted from gross income, subject to the limitations contained in section 23(o) and section 23(q) of the Code; and (3) that expenses of production are deductible under section 23(a)(1)(A) of the Code as ordinary and necessary business expenses.

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 White case, the court had under consideration a charitable contribution in 1947 of wheat by a farmer to an organization described in section 23(o) of the Internal Revenue Code. This wheat had been raised by the taxpayer during 1946 and 1947 and all costs incurred in raising, harvesting, and storing the crops of wheat, of which wheat so donated was a part, had been allowed as deductions for those years. The court held that the taxpayer did not realize any taxable income or gain by the donation and disposition of the wheat.

In the Prothro case the taxpayer, who was a member of a partnership engaged in ranching, donated to the Young Men's Christian Association by an instrument in writing one hundred head of calves to be selected by the donee's agent from a larger number. The calves were kept for sale in the ordinary course of business of the partnership and the expense of raising them had been allowed as a deduction. A contract was entered into, to which the donee was a party, for the sale of the entire herd of calves. The calves were kept in a common pasture until delivery to the purchaser, at which time the proportionate part of the proceeds of sale was paid by the purchaser to the Young Men's Christian Association. The appellate court, affirming the judgment of the lower court, held that raised livestock do not constitute taxable income *per se*, that when the calves were transferred by gift they were not income to the taxpayer, and that no income was realized by him as a result of the transaction.

The same principle has been applied by the courts to gifts within a family unit in the Farrier and SoRelle cases.

In the light of the above cases it follows that no income is realized by a farmer or other producer by reason of his contribution of farm or other products to an organization described in section 23(o) or section (q) of the Internal Revenue Code of 1939.

Within the limits provided by section 23(o) and section 23(q) of the Internal Revenue Code of 1939 a donor is allowed a deduction for contributions to an organization described therein which, in the case of property other than money, is the fair market value of the property at the time of the contribution or gift. Regulations 118, section 39.23 (o)-1(g). For this purpose, the fair market value will be considered to be the amount which the donor would have to spend in his most favorable market to immediately replace the donated property. This represents the true measure of the detriment he has sustained by the contribution.

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 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 contribution or gift they are in effect 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 contribution, such costs allocable 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.

To allow a donor who is in business both the charitable deduction for property removed from business and donated to charity and a deduction for items of cost of such property would allow him, at least in part, a double deduction with respect to the same goods. The allowance of such a double deduction does not properly reflect income for tax purposes. Compare *Charles Ilfeld Co.* v. *Hernandez*, 292 U. S. 62, Ct. D. 819, C. B. XIII-1, 139 (1934); *Mergott Co.* v. *Commissioner*, 176 Fed. (2d) 860. One, who under permissible accounting methods reflects in inventory the cost items of prior years pertaining to the donated asset, must remove such costs from business channels by the indicated inventory adjustment, with the result that no deduction for such costs has ever been made or will be made. That is, if such costs so reflected in inventory total $500 and the fair market value of the donated goods is $1,000 at the time of the gift, the allowable contribution deduction is $1,000, and the inventory adjustment results in no further allowance for the $500 cost, thereby eliminating any possibility of double deduction.

It follows that similar costs incurred by one treating them as deductible items when paid or incurred must reduce the contribution deduction by any such deductions taken in prior years. To hold otherwise would make the total amount deducted respecting a donated asset variable depending upon the accounting method used. This would clearly be contrary to the well recognized principle that any permissible accounting method must clearly reflect items of income and deductions. If one has deducted $500 in costs of the donated property, the allowance of a contribution deduction of the full $1,000 would give him a total deduction amounting to $1,500. Thus, while the cost of a donated property is immaterial to a contribution deduction measured by its fair market value at the date of gift, if items of cost of the donated property have been deducted in prior years, the allowable contribution deduction must be reduced accordingly in order to avoid a double deduction as respects the same asset.

In view of the foregoing, it is held that the following treatment should be accorded contributions or gifts of property, other than money, to charitable organizations mentioned in section 23(o) and section 23(q) of the Internal Revenue Code:

(1) The fair market value of agricultural or manufactured products or property held for sale in the ordinary course of business which is contributed to an organization described in section 23(o) or section

23(q) of the Internal Revenue Code of 1939 is not includible in the gross income of the donor for Federal income tax purposes.

(2) The fair market value of the donated property as of the date of the gift will constitute an allowable deduction under section 23(o) and section 23(q) of the Code subject to the limitations provided therein, and for this purpose the fair market value will be the replacement cost to the donor in his most favorable market.

(3) There must be an adjustment to inventory effecting the removal of the donated asset and the costs pertaining thereto from the opening inventory in the year of the gift. Items of cost of the current year applicable to such property are not deductible by the donor, and similar items which have been deducted in prior years must be removed from the amount of the contribution in order to avoid a double deduction.

Accordingly, I. T. 3910, C. B. 1948-1, 15, is hereby revoked.

REGULATIONS 118, SECTION 39.22(a)-7: Gross income of farmers. — Rev. Rul. 55-188[1]

Where farmers use the accrual basis of accounting for farm income for Federal income tax purposes, and 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, they should enter in column 6, of such separate schedule, "Cost or other basis," of an amount representing inventory value of the animals at the beginning of the taxable year plus any additional normal costs incurred with respect to such animals during the taxable year. However, in such cases, the inventory value of such animals at the beginning of the taxable year must be eliminated from the opening inventory for such year. The additional normal costs incurred with respect to such animals for the taxable year must be eliminated from the farm expenses for such year.

REGULATIONS 118, SECTION 39.22(a)-21: Trust income taxable to the grantor as substantial owner thereof. — Rev. Rul. 55-34

> Income of a trust is taxable to the grantor under section 39.22(a)-21(c) of Regulations 118, where the grantor has a reversionary interest in the corpus which will revert to his estate at his death, if his life expectancy, according to appropriate United States life and actuarial tables, is less than 10 years or 15 years, whichever is applicable.

Advice has been requested with respect to the significance of the grantor's life expectancy in determining the taxability of trust income where the grantor has retained a reversionary interest in the corpus or income.

Under the provisions of section 39.22(a)-21(c) of Regulations 118, income of a trust is taxable to the grantor where the grantor has a reversionary interest in the corpus or income therefrom which will or may reasonably be expected to take effect in possession or enjoyment either (i) within 10 years commencing with the date of the transfer, or (ii) within 15 years commencing with the date of the transfer if

[1] This Revenue Ruling has been amplified by Revenue Ruling 55-736, I. R. B. 55-51, p. 18.

the income is or may be payable to a beneficiary other than a donee described in section 23(o) of the Internal Revenue Code of 1939 and if any one or more of certain powers of administration over the trust corpus or income are exercisable solely by the grantor or spouse, or both. The above section also provides that where the grantor's reversionary interest is to take effect in possession or enjoyment by reason of some event other than the expiration of a specific term of years, the trust income is nevertheless attributable to him if such event is the practical equivalent of the expiration of a period less than 10 or 15 years as the case may be.

Accordingly, it is held that where the grantor has a life expectancy based on appropriate United States life and actuarial tables of less than 10 or 15 years, whichever is applicable, and he establishes a trust with the corpus reverting to his estate at his death, the income therefrom is taxable to the grantor since the specific event provided in the trust instrument, that is, the life expectancy of the grantor, is the practical equivalent of the expiration of a period of less than 10 or 15 years.

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. Rev. Rul. 55-63

Payments to beneficiaries or estates of staff members and military observers killed in the service of the United Nations are exempt from Federal income tax under section 22(b)(1)(A) of the Internal Revenue Code of 1939 where the United Nations purchases life insurance, listing itself as beneficiary, solely to meet such payments and is, in effect, only a conduit of the insurance to such beneficiaries or estates.

Advice has been requested whether payments made to the beneficiaries or estates of staff members and military observers killed in the service of the United Nations are exempt from Federal income tax under section 22(b)(1)(A) of the Internal Revenue Code of 1939 where the United Nations purchases life insurance, listing itself as beneficiary, solely to meet such payments and is, in effect, only a conduit of the insurance to the beneficiaries or estates.

Pursuant to a policy adopted by the United Nations, the beneficiaries of staff members and military observers killed in the service of the United Nations in specified areas are guaranteed certain death benefit payments. Solely for the purpose of meeting such payments, the United Nations purchases insurance on the lives of its staff members and military observers, listing itself as beneficiary, and in the event of their death the proceeds which the United Nations receives from the insurer are paid either to the beneficiaries of the decedent or to his estate depending upon the circumstances involved.

Section 22(b)(1) of the Code of 1939 provides in part, as follows:

(b) EXCLUSIONS FROM GROSS INCOME.—The following items shall not be included in gross income and shall be exempt from taxation under this chapter [chapter 1 of the Code]:

(1) LIFE INSURANCE, ETC.—Amounts received—

(A) under a life insurance contract, paid by reasons of the death of the insured; * * *

In *Raymond J. Moore et al.* v. *Commissioner*, 45 B. T. A. 1073, acquiescence, C. B. 1943, 17, which involved the purchase of combination life insurance and annuity contracts on the lives of certain employees by a trustee for the purpose of making death benefit payments to the beneficiaries of the employees, the United States Board of Tax Appeals said, in considering the death benefits feature of the policies to determine the taxability of the insured employees, that from a practical standpoint the trustee was no more than a conduit from the insurer to the insured's beneficiaries. In substance, each petitioner, insofar as the death benefits feature was concerned, stood in the same relation to the policy as if it were taken out by him upon his life, and therefore, was taxable on the premium allocable to the death benefits.

In view of the foregoing, it is held that payments made to beneficiaries or estates of staff members and militiary observers killed in the service of the United Nations are exempt from Federal income tax under section 22(b)(1)(A) of the Code as the proceeds of life insurance where the United Nations purchases life insurance, listing itself as beneficiary, solely to meet such payments and is, in effect, only a conduit of the insurance to the beneficiaries or estates.

Regulations 118, Section 39.22(b)(1)–1: Life insurance amounts paid by reason of the death of the insured.

Death benefits derived from a combination group term life insurance and group annuity contract, the premiums on which were paid by the employer. See Rev. Rul. 55–193, page 266.

Regulations 118, Section 39.22(b)(1)–1: Life insurance; amounts paid by reason of the death of the insured.

"Death benefit" payments received by a beneficiary under the terms of a single premium deferred annuity contract where the annuitant dies prior to the due date of the first annuity payment. See Rev. Rul. 55–313, page 219.

Regulations 118, Section 39.22(b)(1)–2: Death payment by employer; amounts paid by reason of the death of an employee. Rev. Rul. 55–64

Installment payments made to beneficiaries of deceased employee participants of a pension or profit-sharing plan qualified under section 165(a) of the Internal Revenue Code of 1939 are excludable from gross income of the beneficiary, in an aggregate amount not in excess of $5,000, when such payments are specifically designated as a death payment, paid only by reason of the death of the employee and represent amounts in which the participant had a forfeitable interest immediately prior to death. Where such installment payments represent an amount in which the participant had a nonforfeitable interest as well as an amount in which he had a forfeitable interest at the time of his death, the beneficiary may exclude from his gross income each year a pro rata portion of such payments, until an aggregate of $5,000 is excluded.

Advice has been requested whether all or a portion of installment payments made to beneficiaries of deceased employee participants of a pension or profit-sharing plan qualified under section 165(a) of the Internal Revenue Code of 1939 are excludable from gross income of the beneficiary under section 22(b)(1)(B) of the Code.

Section 22(b) of the Internal Revenue Code of 1939 provides in part as follows:

> (b) EXCLUSIONS FROM GROSS INCOME.—The following items shall not be included in gross income and shall be exempt from taxation under this chapter [chapter 1 of the Code]:
>
> (1) LIFE INSURANCE, ETC.—Amounts received—
>
> * * * * * * *
>
> (B) under a contract of an employer providing for the payment of such amounts to the beneficiaries of an employee, paid by reason of the death of the employee; whether in a single sum or otherwise * * * The aggregate of the amounts excludible under subparagraph (B) 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 of Regulations 118, relating to death payments by an employer of amounts paid by reason of the death of an employee, provides in part, that the exclusion under section 22(b)(1)(B) of the Code 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.

Treatment of payments received attributable to a forfeitable interest and to payments received attributable to both a forfeitable and a nonforfeitable interest is best illustrated by the two following examples:

First, assume (1) the amount payable is $10,000, (2) the beneficiary elects to take payment in twenty-five monthly installments of $400, and (3) the employee's right, immediately prior to his death, to receive the amount while living was forfeitable. Under this assumption the employee would not have been entitled to any portion of the $10,000 upon termination of services other than by death. Under the regulations the $10,000 is a death payment, the excludable portion of which is limited by law to an amount not in excess of $5,000. In this case, the beneficiary may exclude from gross income the monthly payments received or made available under the plan, on account of the death of the employee, until such payments equal $5,000.

Secondly, assume that the total payment is $20,000 and the employee had a nonforfeitable interest, as explained above, of $14,000, and that $6,000 represented the forfeitable portion of the $20,000 payment which the beneficiary will receive at the rate of $2,000 per year for 10 years. Since the $20,000 payable in this example is comprised of both taxable and nontaxable income and the beneficiary elects to receive the aggregate over a period of years, it is deemed that the total amount received each year consists of nontaxable income (death benefit) and taxable income. Under these circumstances the beneficiary may exclude from his gross income each year, until $5,000 is excluded, that proportion of the total payments received in a taxable year which bears the same ratio to such total payments as the amount representing the forfeitable interest ($6,000) bears to the aggregate amount payable ($20,000) under the plan. The excess of the payments received each year over the amount excludable is taxable as provided under

section 22(b)(2) of the Code. Using the amounts in the foregoing assumption, it will be noted that 6,000/20,000 or 3/10×$2,000, or $600, is excludable each year for 8 years, and that $200 of the $2,000 payment for the ninth year is excludable.

REGULATIONS 118, SECTION 39.22(b)(1)-2: Death payment by employer—Amounts paid by reason of the death of an employee. (Also Section 39.22(b)(2)-2.) Rev. Rul. 55-74

Amounts not in excess of $5,000, paid under a group annuity contract by an insurance company on behalf of an employer to the beneficiaries of deceased employees, are excludable from the gross income of the beneficiaries under section 22(b)(1)(B) of the Internal Revenue Code of 1939, if under the terms of the contract with the employee (not rescinded before death) or the provisions of the plan providing for such payments, the payment is specifically designated and intended as a death payment made only by reason of the death of the employee. The exclusion is not applicable, for instance, to a payment made upon death from the reserve under a group annuity contract which had been or would have been applied to purchase an immediate or deferred annuity for the employee to which he would have had a right in the event he had separated from the service of his employer immediately prior to his death.

Advice has been requested whether the words "welfare fund" and "trust" as used in section 39.22(b)(1)-2(b) of Regulations 118, relating to the exclusion from gross income of amounts up to $5,000 paid to employees' beneficiaries by an employer, are illustrative of the means by which benefits may be paid but not exclusive of other means of indirect payment, such as payments made under group annuity contracts.

Amounts paid as death benefits under group annuity contracts of the type here considered do not exceed the reserve (or accumulated premiums) with respect to the annuity benefits being funded for each covered employee, and are not life insurance within the purview of section 22(b)(1)(A), but may be excludable in an amount not in excess of $5,000 under section 22(b)(1)(B) if they meet the requirements of that section.

The exclusion from gross income provided by section 22(b)(1)(B) of the Internal Revenue Code of 1939, may apply in the case of a death benefit paid to the beneficiary of an employee under a group annuity contract if the payment is made pursuant to an express contract between the employer and the employee. Under section 39.22(b)(1)-2(c) of Regulations 118 an express contract is deemed to exist between an employer and an employee when there is an established plan of the employer (or program having the effect of a plan) communicated to his employees, which plan has not been rescinded before the death of an employee. For this purpose a group annuity contract, the terms of which have been communicated to the employees of an employer, is deemed to constitute an established plan, and a payment by an insurance company under such a contract is deemed to be made on behalf of the employer whose employees it covers.

The application of such exclusion, however, is subject to the provisions of section 39.22(b)(1)-2(d)(1) of Regulations 118, which dis-

tinguishes death benefits from amounts which do not qualify as such, such as uncollected salary, payments for unused leave, and amounts paid by or on behalf of an employer to the survivor of a deceased retired employee as a survivor's annuity, as follows:

(d)(1) The exclusion from gross income provided by this section is limited solely to those amounts paid by or on behalf of an employer which, by the terms of the contract with the employee or by the provisions of the plan providing for such payments, 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. * * *.

It is apparent that a payment to be excludable under section 22(b)(1)(B) of the Code must be a designated amount paid only by reason of the death of an employee.

In view of the foregoing, it is held that amounts not in excess of $5,000, paid under a group annuity contract of the type here considered by an insurance company on behalf of an employer to the beneficiary of a deceased employee, are excludible from the gross income of the beneficiary under section 22(b)(1)(B) of the Internal Revenue Code, if under the terms of the contract with the employee (not rescinded before death) or the provisions of the plan providing for such payments, the payment is specifically designated and intended as a death payment made only by reason of the death of the employee. The exclusion is not applicable, for instance, to a payment made upon death from the reserve under a group annuity contract which had been or would have been applied to purchase an immediate or deferred annuity for the employee to which he would have had a right in the event he had separated from the service of his employer immediately prior to his death.

REGULATIONS 118, SECTION 39.22(b)(1)-2: Death payment by employer; amounts paid by reason of the death of an employee. Rev. Rul. 55-228

Amounts, not in excess of $5,000, paid by an employer under an established survivorship benefit plan to the beneficiaries of employees dying while employed by the taxpayer and prior to retirement, meet the requirements of section 22(b)(1)(B) of the Internal Revenue Code of 1939. Such payments are excludable from the gross income of the beneficiaries in accordance with that section.

Advice has been requested whether amounts, not in excess of $5,000, paid by an employer under an established survivorship plan to the beneficiaries of deceased employees, are excludable from the gross income of the beneficiaries.

In the case presented, the employer has a survivorship benefit plan under which the employee, to be eligible for the benefits of the plan, (1) shall have 20 years of service with the employer, (2) shall make a designation of beneficiary in accordance with the plan and (3) shall die in the active service of the employer before retirement. The plan further provides that the employer shall provide a benefit in an amount equal to twice the annual rate of pay of the deceased employee and

that a beneficiary must survive the employee in order to receive benefits. The employee may designate a contingent beneficiary to receive the benefit if the primary beneficiary predeceases the employee. The employer reserves the right at any time to terminate, withdraw, or modify the plan in whole or in part, but a benefit which has once accrued in consequence of the death of an employee will be paid in accordance with the terms of the plan on the date of death. The employer may terminate the employment of an employee as freely and with the same effect as if the plan were not in operation. No contributions were made by employees to the plan.

Section 39.22(b)(1)-2 of Regulations 118 provides in part that amounts, not in excess of $5,000, paid by an employer in 1951 and later years in pursuance of an express contract to the estate or to a beneficiary of an employee, by reason of the employee's death, shall be excluded from the gross income of such beneficiary. The exclusion is limited solely to those amounts paid by or on behalf of an employer which, by the terms of the contract with the employee or by the provisions of the plan providing for such payments, 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. See also section 39.165-7 of Regulations 118.

In the instant case the employees involved did not have any vested rights in the plan and the death payments were specifically designated and intended as death payments, paid only by reason of the death of the employees.

In view of the foregoing, it is held that amounts paid by the employer under its established survivorship benefit plan to the beneficiaries of employees dying while employed by the taxpayer and prior to retirement meet the requirements of section 22(b)(1)(B) of the Internal Revenue Code of 1939. Accordingly, such amounts, not in excess of $5,000, are excludable from the gross income of the beneficiaries. If the aggregate amounts paid by the employer to two or more beneficiaries exceed $5,000, the $5,000 exclusion shall be apportioned among the beneficiaries in the same proportion that the amount received by each beneficiary bears to the total amounts paid by the employer.

REGULATIONS 118, SECTION 39.22(b)(2)-1: Life insurance; endowment contracts; amounts paid other than by reason of the death of the insured. — Rev. Rul. 55-349

For the purpose of computing the aggregate premiums or consideration paid for an endowment contract under the provisions of section 22(b)(2)(A) of the Internal Revenue Code of 1939, any portion of the total premium paid which is attributable to other benefits, such as a disability income benefit, is not to be included as a part of the total premium paid for the endowment contract. Compare *Estate of Wong Wing Non* v. *Commissioner*, 18 T. C. 205.

REGULATIONS 118, SECTION 39.22(b)(2)-2: Annuities. (Also Section 1000; Regulations 108, Section 86.2.) Rev. Rul. 55-388

Taxpayer paid $30x$ dollars to a charitable organization with an agreement on the part of the organization to pay an annuity of $2x$ dollars per year to the taxpayer and his spouse and to the survivor for life. The annuity payments are to be divided equally between taxpayer and his spouse during their joint lives. The present value of the annuity, computed in accordance with recognized annuity tables, is in excess of the $30x$ dollars paid therefor. *Held*, such transaction constitutes a purchase of an annuity resulting in neither a gain nor a loss to the taxpayers. The $30x$ dollars paid for the contract is considered to be the consideration paid for the annuity and payments received pursuant to the agreement are subject to tax under the rules provided for the taxation of annuities. Further, since the present value of the annuity, computed in accordance with recognized annuity tables, is in excess of the amount paid therefor no charitable deduction is allowable. Also, the taxpayer has made a gift to his spouse, within the meaning of section 1000 of the Code, of that portion of the $30x$ dollars paid for the annuity allocable to her, computed in accordance with recognized annuity tables.

REGULATIONS 118, SECTION 39.22(b)(2)-2: Annuities.

Payments by insurance company on behalf of employer to beneficiaries of employees under group annuity contracts. See Rev. Rul. 55-74, page 230.

REGULATIONS 118, SECTION 39.22(b)(2)-2: Annuities.

Taxability of proceeds of annuity contracts surrendered by beneficiary of a participant in an employees' trust exempt under section 165(a) of the Internal Revenue Code of 1939. See Rev. Rul. 55-298, page 394.

REGULATIONS 118, SECTION 39.22(b)(2)-5: Employees' annuities.

Annuity benefits derived from a combination group term life insurance and group annuity contract, the premiums on which were paid by the employer. See Rev. Rul. 55-193, page 266.

REGULATIONS 118, SECTION 39.22(b)(3)-1: Gifts and bequests. (Also Sections 22(a), 113(a); Regulations 118, Sections 39.22(a)-1, 39.113(a)(5)-1.) Rev. Rul. 55-117

A partial distribution in kind, in accordance with the terms of a will, of trust principal which has appreciated in value, does not result in taxable income. Basis of such property to the beneficiary

for Federal income tax purposes will be the value of the property as of the date of death of the decedent as appraised for Federal estate tax purposes or the value as appraised at the optional valuation date for such purposes.

Advice has been requested with respect to the treatment, for Federal income tax purposes, of 20 shares of stock to be distributed from the principal of a trust in accordance with the terms of a will which set up such trust.

In the instant case a trust was formed from the residue of an estate as provided in the will of the decedent. The will directs that the net income of the trust be paid to the beneficiary until such beneficiary shall reach a specified age, at which time she is to receive one-fourth of the corpus or principal of the trust as it is valued at that time. The balance of the principal is to be retained in the trust and the net income therefrom distributed to the beneficiary for the next 5 years at which time the trust will terminate and the beneficiary will receive the remaining trust principal.

The will further provides that the trustees may, where they are required to divide any property into shares or parts or to distribute the same, make such division or distribution in kind or in money, or partly in kind and partly in money, and to that end to allot specific securities or other property, real or personal, or an undivided interest therein, to any share or part.

The beneficiary of the trust has now attained the specified age and is entitled to receive a one-fourth distribution of trust principal presently valued at $60x$ dollars. The trustees propose to transfer to the beneficiary 20 shares of stock presently valued at $15x$ dollars, which shares had been included in the decedent's gross estate for Federal estate tax purposes at $7x$ dollars.

Section 22(b)(3) of the Internal Revenue Code of 1939 provides that the value of property acquired by gift, bequest, devise, or inheritance shall not be included in gross income.

Where certain securities had appreciated in value while in the hands of a testamentary trustee, the distribution of such securities in kind by the trustee at their fair market value in payment of a pecuniary legacy was held to have resulted in taxable income to the trust. See *Sarah P. Suisman* v. *Eaton*, 15 F. Supp. 113, affirmed 83 Fed. (2d) 1019, certiorari denied, 299 U. S. 573; *William E. Kenan Jr. et al Trustee* v. *Commissioner*, 114 Fed. (2d) 217. In these cases the transfer of securities in satisfaction of the pecuniary legacy was considered to constitute a sale or exchange whereby the trustee realized a gain on the disposition of the securities.

The proposed distribution in the instant case, however, is not in satisfaction of an obligation of the trust for a definite amount of cash or equivalent value in securities, but is rather in the nature of a partial distribution of a share of the trust principal. Accordingly, there is no sale or exchange involved. See O. D. 667, C. B. 3, 52 (1920).

In view of the above, it is held that neither the trustees nor the beneficiary will realize taxable income by the distribution and receipt of the stock.

For Federal income tax purposes the basis of the stock to the beneficiary will be the value of the property as of the date of death of the decedent as appraised for Federal estate tax purposes or the value as appraised at the optional valuation date for such purposes.

REGULATIONS 118, SECTION 39.22(b)(3)-1: Gifts and bequests. Rev. Rul. 55-314

Certain awards specified below, administered by the American Chemical Society, are gifts, made in recognition of past achievements or present abilities, and the amounts of such awards are excludable from the gross income of the recipients under section 22(b)(3) of the Internal Revenue Code of 1939.

The American Chemical Society annually administers a number of awards, shown below, for scientific achievement in various fields of chemistry research:

American Chemical Society Award for Nuclear Applications in Chemistry;
American Chemical Society Award in Pure Chemistry;
Beckman Award in Chemical Instrumentation;
Borden Award in the Chemistry of Milk;
Fisher Award in Analytical Chemistry;
Fritzche Award;
Garvan Medal (Gold Medal);
Ipatieff Prize;
The Kendall Company Award in Colloid Chemistry;
Eli Lilly and Company Award in Biological Chemistry;
Charles Lathrop Parsons Award;
Paul-Lewis Laboratories Award in Enzyme Chemistry;
Precision Scientific Company Award in Petroleum Chemistry;
Priestly Medal (Gold Medal);
Scientific Apparatus Makers Award in Chemical Education.

Most of the awards consist of cash together with an allowance for traveling expenses to the meeting at which the awards are presented. Two awards are granted not oftener than once in every three years. The awards are non-competitive, the primary requisite for the awards being that the recipients must have done outstanding work in, or have made an outstanding contribution to, the particular field of chemistry for which the award is designated. In some of the awards, the only other requirements are residency in the United States or Canada, and certain age limitations. No substantial future services are required of the recipients as a condition to receiving the awards. A candidate for an award may be nominated by any member of the Society, a canvassing committee for award nominations operates to assure that no outstanding candidate is overlooked, and a committee of experts in the field of each award selects the recipient.

Section 22(b)(3) of the Internal Revenue Code of 1939 provides, in part, that the value of property acquired by gift shall be excluded from gross income. A gift is generally defined for Federal income tax purposes as a transfer of property from one person to another, for which transfer there is no consideration or compensation. If there is consideration, a valid gift is not effected.

Since the recipients of the above-described awards are selected by an award committee without any action on the recipients' part, the nominations made by any member of the Society are an aid to the committee and are not acceptances in behalf of a recipient of an offer to participate in a contest. The awards are made "in recognition of past achievements or present abilities," and are, therefore, within the class of tax-free gifts referred to in *Leroy J. Robertson* v. *United*

States, 343 U. S. 711, Ct. D. 1746, C. B. 1952-2, 66. See also Revenue Ruling 54-110, C. B. 1954-1, 28, with respect to a Pulitzer prize award for distinguished editorial writing.

Accordingly, it is held that the foregoing cash awards administered by the American Chemical Society are gifts, made in recognition of past achievements or present abilities, and the amounts of such awards are excludable from the gross income of the recipients under section 22(b)(3) of the International Revenue Code of 1939.

REGULATIONS 118, SECTION 39.22(b)(3)-1: Gifts and bequests. Rev. Rul. 55-330

The Acts approved December 17, 1919, 41 Stat. 367, as amended, 10 U. S. C. 903, and June 4, 1920, 41 Stat. 812, at page 824, as amended, 34 U. S. C. 943, respectively, provide, in general, for gratuitous payments to widows, children, or other dependent relatives of officers and enlisted members of the regular Army and regular Navy (including the regular Marine Corps) who die while on active duty. It is provided that such gratuity payments will be equal to 6 months' pay at the rate received by such deceased members at the time of their death. Various other Acts have provided that the gratuity payments shall also be made to members of the Air Force and, under certain conditions, to members of the various reserve components of the Armed Forces of the United States who die while on active duty. *Held*, the amounts paid gratuitously to the beneficiaries of a deceased officer or enlisted member of the Armed Forces, under the conditions described herein, represent a gift by the United States and are, therefore, excludable from the gross income of such beneficiaries under the provisions of section 22(b)(3) of the Internal Revenue Code of 1939.

REGULATIONS 118, SECTION 39.22(b)(3)-1: Gifts and bequests.

Amounts received by a retired minister or rabbi. See Rev. Rul. 55-422, page 14.

REGULATIONS 118, SECTION 39.22(b)(4)-1: Interest upon State obligations. Rev. Rul. 55-73
(Also Section 22(a); Regulations 118, Section 39.22(a)-4.)

Secondary or "Class B" interest coupons which are detached and retained by brokers of certain municipal bonds are considered to be the brokers' commission and do not represent "interest" as that term is generally used. The fair market value of such coupons is includible in gross income of the broker when received. Any gain realized by the broker from the sale of the coupons prior to maturity constitutes ordinary income. Any payments received by the broker from the municipality upon maturity of the coupons in excess of such fair market value previously reported constitute ordinary income.

Advice has been requested whether the proceeds, received by brokers of municipal bonds, of a secondary or "Class B" interest coupon, which

is attached to certain municipal bonds handled by such brokers, are excludable from gross income under section 22(b)(4) of the Internal Revenue Code of 1939.

Certain municipal bonds are now issued with two series of coupons attached. "Class A" coupons are sold with the bonds. "Class B" coupons, having an early maturity date, are detached and retained by the brokers. The "B" coupons may be sold at a discount to banks, individuals or other brokers.

As in the orthodox one-coupon series bonds, brokers place bids with the issuing authority on the basis of total interest cost over the life of the issue. One-coupon series bonds are usually sold at a premium which represents the brokers commission. The two coupon series bonds are sold at par, but at a reduced interest rate. The over-all interest cost to the municipality would be the same for both types of bonds. Similarly, the net yield to the investor would be the same.

Example. For purposes of illustration assume that a municipality has for issue one-coupon bonds of $1,000 par value bearing interest at 3 percent maturing 10 years from the date of issue.

The interest rate on a comparable two-coupon bond would be 2.8 percent on the "A" coupons and .2 percent on the "B" coupons maturing 1 year from date of issue.

	One Coupon Bond	Two Coupon Bond
Par value	$1000.	$1000.
Premium representing brokers commission	20.	
Investors cost	$1020.	$1000.
Brokers Commission		
Cash	$20.	
"B" coupons		$20.
Interest cost to municipality for life of bonds		
"A" coupons	$300.	$280.
"B" coupons		20.
Total interest cost	$300.	$300.
Net yield to investor for life of bonds		
Interest on bond	$300.	$280.
Less: Bond premium amortization	20.	
Net yield	$280.	$280.

Section 22(b)(4) of the Code provides generally that interest on obligations of a State, Territory, or any political subdivision thereof, or the District of Columbia is exempt from income tax.

The usual import of the term "interest" is the amount which one has contracted to pay for the use of borrowed money. *Old Colony Railroad Co.* v. *Commissioner*, 284 U. S. 552, Ct. D. 456, C. B. XI-1, 274 (1932).

A situation similar to that under consideration here is present in the case of *H. Gates Lloyd* v. *Commissioner*, 154 Fed. (2d) 642, certiorari denied, 329 U. S. 717. There, a syndicate would purchase old outstanding bonds, exchange them for new refunding bonds with "A" and "B" coupons attached, detach the "B" coupons, sell the bonds with "A" coupons attached to investors and sell the "B" coupons to

a bank at a discount. In holding the proceeds from the "B" coupons to be taxable, the court said in part:

> Finally, the Syndicate's money was invested in the City bonds for but an indefinite, short period of time in "an almost simultaneous" operation through which the Syndicate bought and held the new refunding bonds, detached the B coupons and then sold both the bonds and coupons to different purchasers. Obviously, the Syndicate could not have, simultaneously, a return of its capital investment and compensation for the use of such money. Consequently, we cannot conclude logically that the Syndicate received the $647,630.38 as "interest" on the new City bonds.

With respect to the question whether the payment to the taxpayer for services rendered in tax-free bonds, instead of cash money, rendered the income thus received, exempt from taxation, the court, in the case of *Joseph G. Hitner* v. *Lederer*, 63 Fed. (2d) 877, said in part:

> * * * if the tax was assessed, not upon the medium of payment, but upon income from wages or salary, it follows as a matter of law that the tax was legal. The income of the appellant was taxable and this could not be rendered nontaxable by being paid with tax-free bonds. * * *

Section 39.22(a)-4 of Regulations 118 provides in part as follows:

> Notes or other evidences of indebtedness received in payment for services constitute income to the amount of their fair market value. * * *

Under the long established position of the Internal Revenue Service notes and other evidences of indebtedness received in payment for services are includible in gross income to the extent of their fair market (discounted) value.

In view of the above, it is held that the fair market value of the so-called "B" coupons should be included in the gross income of the broker for the taxable year in which such coupons are received. Any gain realized by the broker from the sale of the coupons prior to maturity constitutes ordinary income and is includible in gross income when received. Any payments received by the broker from the municipality upon maturity of the coupons in excess of such fair market value previously reported constitute ordinary income.

REGULATIONS 118, SECTION 39.22(b)(4)-1: Interest upon State obligations. Rev. Rul. 55-75

The Mackinac Bridge Authority, Lansing, Michigan, was created as a body corporate and an agency and instrumentality of the State of Michigan by Act No. 21 of the Public Acts of 1950. By Act No. 214 of the Public Acts of 1952, as amended by Act No. 141 of the Public Acts of 1953, the Authority is authorized and empowered to construct and operate a bridge extending from the Upper Peninsula to the Lower Peninsula of Michigan, with the necessary facilities appurtenant thereto. The Authority is empowered to issue revenue bonds, payable solely from revenues derived from ownership and operation of the bridge, and to fix, revise, impose and collect tolls, fees, rents and charges and to enter into contracts for the use of the bridge services and facilities so as to make such revenues generally sufficient at all times to pay all operating, repair and maintenance expenses except to the extent that such expenses may be in whole or in part cared for by the State Highway Department, to pay principal and interest on the bonds. *Held*, the Mackinac Bridge Authority of

Lansing, Michigan, is a political subdivision within the meaning of section 22(b)(4) of the Internal Revenue Code of 1939. Accordingly, interest on the bonds issued by such Authority is exempt from Federal income tax. See *Commissioner* v. *Estate of Alexander J. Shamberg*, 144 Fed. (2d) 998, Ct. D. 1648, C. B. 1945, 335, certiorari denied, 323 U. S. 792; and *Commissioner* v. *Estate of Caroline White*, 144 Fed. (2d) 1019, Ct. D. 1647, C. B. 1945, 65, certiorari denied, 323 U. S. 792.

REGULATIONS 118, SECTION 39.22(b)(4)–1: Interest upon State obligations. Rev. Rul. 55–76

The Maine Turnpike Authority is a body corporate and politic created by an act of the Legislature of the State of Maine, Chapter 69 of the Private and Special Laws of 1941. Pursuant to the above Act, as subsequently amended, the Authority is authorized and empowered to construct, maintain and operate, in integral operating units, a turnpike, together with all connecting tunnels, bridges, approaches, overpasses and underpasses necessary to provide an all-weather highway between the southwestern and northeastern sections of the State of Maine, and to issue turnpike revenue bonds, payable solely from tolls, to pay the cost of such construction. The Authority is also empowered to acquire by purchase, or by condemnation, in order to insure immediate possession, such lands, rights, easements, franchises and other property as it may deem necessary to the construction of the turnpike. *Held*, the Maine Turnpike Authority is a political subdivision within the meaning of section 22(b)(4) of the Internal Revenue Code of 1939. Accordingly, interest on bonds issued by such Authority is exempt from Federal income tax. See *Commissioner* v. *Estate of Alexander J. Shamberg*, 144 Fed. (2d) 998, Ct. D. 1648, C. B. 1945, 335, certiorari denied, 323 U. S. 792; *Commissioner* v. *Estate of Caroline White*, 144 Fed. (2d) 1019, Ct. D. 1647, C. B. 1945, 65, certiorari denied, 323 U. S. 792.

REGULATIONS 118, SECTION 39.22(b)(4)–1: Interest upon State obligations.

Taxability of interest on bonds or notes issued by the Genesee Valley Regional Market Authority set up by the Legislature of the State of New York pursuant to Chapter 420, 1951 Laws of New York effective March 31, 1951. See Rev. Rul. 55–150, page 14.

REGULATIONS 118, SECTION 39.22(b)(15)–1: Payments to encourage exploration, development, and mining for defense purposes. (Also Section 23(m), Section 39.23(m)–1.) Rev. Rul. 55–47

Haulage allowances granted by the Atomic Energy Commission for the transportation of uranium ore from the mine to the custom mill or purchase depot, to the extent that costs thereof do not exceed the allowance, are not considered in arriving at the representative market or field price of the ore for percentage depletion purposes. However, where the costs do exceed the allowance, the excess must be used to reduce such representative market or field price.

Development allowances, which are not handled as loans or grants specifically made or arranged for before exploration and development work is undertaken, are taxable in the year of receipt and, since they are based on production, are depletable.

Advice has been requested (1) whether haulage allowances granted by the Atomic Energy Commission for the transportation of uranium ore from the mine to the custom mill or purchase depot should be taken into consideration in arriving at the representative market or field price for percentage depletion purposes, and (2) whether development allowances, which are not handled as loans or grants, but are paid on a unit basis as ores are delivered to purchase depots, constitute an addition to gross income and are subject to depletion.

The Atomic Energy Commission pays a fixed price for all ore produced within a hundred miles of the purchase depot plus an additional haulage allowance to cover transportation to the depot rather than pay a fixed price for ore at the purchase depot or custom mill. The Commission is the only purchaser of uranium ore and it sets a price for the ore with a view to treating alike all producers within one hundred miles of the purchase depot.

Where a haulage allowance is sufficient to cover transportation costs the depletable gross income for uranium producers is the Atomic Energy Commission's purchase price paid for the ore without addition of the haulage allowance, and the net income for the percentage depletion limitation is that purchase price, less mine operating costs. If the haulage allowance exceeds the haulage cost, the profit is ordinary income from an activity other than mining. Where, however, the haulage costs exceed the allowance, such excess must be used to reduce the depletable gross income.

These results are illustrated below, (1) where transportation costs exceed allowances, and (2) where allowances exceed costs:

		(1)		(2)
Sales income (AEC prices, premium and bonuses)		$50,000		$50,000
"Other income" (AEC haulage allowances)		10,000		10,000
Total gross income		$60,000		$60,000
Mine operating costs	$20,000		$20,000	
Actual haulage costs	15,000		8,000	
		35,000		28,000
Net income before depletion		$25,000		$32,000
Allowable depletion (see computation)		6,750		7,500
Taxable net income		$18,250		$24,500

Depletion computation—114(b)(4)

Sales income from mineral		$50,000		$50,000
Income from haulage	$10,000		$10,000	
Cost of haulage	15,000		8,000	
Excess of cost over income		5,000		0
Depletable gross income		$45,000		$50,000
Operating costs		20,000		20,000
Net income from property		$25,000		$30,000
50% of net income		12,500		15,000
15% of gross income (allowable)		6,750		7,500

In view of the above, it is held that haulage allowances granted by the Atomic Energy Commission for the transportation of uranium ore from the mine to the custom mill or purchase depot, to the extent that costs thereof do not exceed the allowance, are not to be taken into consideration in arriving at the representative market or field price of the ore for percentage depletion purposes. However, where the costs do exceed the allowance, the excess must be used to reduce such representative market or field price.

With respect to the issue of development allowances, section 22(b)(15) of the Internal Revenue Code of 1939 provides for the exclusion from gross income of certain amounts received for the encouragement of exploration, development, or mining of critical and strategic minerals or metals.

Section 39.22(b)(15)-1 of Regulations 118 provides in part that section 22(b)(15) of the Code is "applicable only to amounts (1) which are paid to a taxpayer (i) by the United States or by an agency or instrumentality of the United States; (ii) as a grant, gift, bounty, bonus, premium, incentive, subsidy, loan, or advance; (iii) for the encouragement of exploration for, or development or mining of, a critical and strategic mineral or metal; and (iv) pursuant to or in connection with an undertaking by the taxpayer to explore for, or develop or produce, such mineral or metal and to expend or use any amounts so received for the purpose and in accordance with the terms and conditions upon which such amounts are paid, which undertaking has been approved by the United States or by an agency or instrumentality of the United States. * * *."

Development allowances here considered are consistently made on a unit basis as the ores are delivered to the purchase depots. They are not handled as loans or grants specifically made or arranged for before the exploration and development work is undertaken as provided for in section 22(b)(15) of the Code. Accordingly, it is held that development allowances, which are not handled as loans or grants, are taxable in the year of receipt and, since they are based on production, are depletable.

(Also Section 1621; Regulations 120, Section 406.207.) Rev. Rul. 55-88

Treatment for Federal income tax purposes of retired pay received by a member of the "uniformed services" of the United States retired prior to October 1, 1949 who elected under the provisions of the Career Compensation Act of 1949, 63 Stat. 802, to receive retired pay computed under the methods provided by such Act.
I. T. 4017, C. B. 1950-2, 12, amplified.

Further questions have been presented with respect to the treatment for Federal income tax purposes of retired pay received by retired members of the "uniformed services" under the provisions of the Career Compensation Act of 1949, 63 Stat. 802. Advice has also been requested relative to the withholding of tax under section 1622 of the Internal Revenue Code of 1939 from such retirement payments.

Section 22(b) of the Internal Revenue Code of 1939 relating to exclusions from gross income provides in part as follows:

(5) COMPENSATION FOR INJURIES OR SICKNESS.—* * * amounts received as a pension, annuity, or similar allowance for personal injuries or

sickness resulting from active service in the Armed Forces of any country; * * *

Section 402 of the Career Compensation Act of 1949, *supra*, sets forth the requirements to qualify for disability retirement pay. Under this section it is necessary that the percentage of disability in accordance with the Veterans Administration rating schedule be 30 percent or more to entitle a member or members to disability retirement pay unless he has at least 20 years of active service in which case the percentage of disability may be less than 30 percent. Where the member has completed less than 8 years of active service he shall not be eligible for any disability retirement pay regardless of percentage of disability except when the disability results from an injury not the result of intentional misconduct or [willful] neglect of such member or was the proximate result of the performance of active duty.

Section 402(h) of the Act reads as follows:

That part of the disability retirement pay computed on the basis of years of active service which is in excess of the disability retirement pay that a member would receive if such disability pay were computed on the basis of percentage of disability shall not be deemed to be a pension, annuity, or similar allowance for personal injuries or sickness resulting from active service in the armed service in the armed forces of any country within the meaning of section 22(b)(5) of the Internal Revenue Code, as amended.

Section 411 of the Career Compensation Act, *supra*, provides substantially that pursuant to such regulations as the President may prescribe certain members or former members of the uniformed services retired prior to October 1, 1949 for physical disability and who are now receiving or are entitled to receive retirement pay for physical disability may elect, within the 5 year period following October 1, 1949,

(A) To qualify for disability retirement pay under the provisions of this Act and, dependent on his qualification, shall be entitled to receive either the disability retirement pay or the disability severance pay prescribed in this title; * * * or

(B) To receive retired pay or retirement pay computed by one of the two methods contained in section 511 of the Act: * * *

A member or former member of the uniformed services retired for physical disability prior to October 1, 1949, who elects to have his retired pay or retirement pay computed by one of the two methods contained in section 511 of the Act may receive—"(a) the monthly retired pay, retainer pay, or equivalent pay in the amount authorized for such members and former members by provisions of law in effect on the day immediately preceding the day of enactment of this Act, * * * or (b) monthly retired pay, retirement pay, retainer pay, or equivalent pay equal to 2½ per centum of the monthly basic pay of the highest Federally recognized rank, grade or rating whether under a permanent or temporary appointment, satisfactorily held, by such member or former member as determined by the Secretary concerned and which such member, former member, or person would be entitled to receive if serving on active duty in such rank, grade, or rating, multiplied by the number of years of active service creditable to him."

The questions presented are set forth below: [Reference to "the Act" means the Career Compensation Act of 1949, *supra*.]

1. Will a member heretofore retired for physical disability who elects to have his retired pay computed in accordance with one of the two methods set out in

section 511 of the Act be liable for Federal income taxes with respect to any part of such retired pay?

Assume that a member who was previously retired for disability resulting from active service elects to have his retired pay computed in accordance with one of the two methods set out in section 511 of the Act:

(a) If he elects to have his disability retired pay computed in the amount authorized therefor by provisions of law which were in effect prior to October 12, 1949, the pay is exempt under the provisions of section 22(b)(5) of the Code.

(b) If he elects to have his disability retirement pay computed on the basis of years of active service, it will, under the provisions of section 402(h) of the Act, be exempt under section 22(b)(5) of the Code to the extent that it does not exceed the disability retired pay that he would have received if such pay were computed solely on the basis of disability. The exemption granted by section 22(b)(5) of the Code does not apply to that part of the disability pay computed on the basis of years of active service which is in excess of the pay that he would receive if it were computed solely on the basis of percentage of disability.

2. Will a taxable portion of a lump sum received under an election retroactive to October 1, 1949, be taxable in (a) the year it is made, (b) the year when the lump sum is received, or (c) should it be allocated to the prior year or years for which paid?

Section 42 of the Code provides in part that all items of gross income shall be reported for the taxable year in which received by the taxpayer unless under the methods of accounting permitted by section 41 of the Code any such amounts are to be properly accounted for as of a different period. Inasmuch as a member or a former member would not have a legal right to the additional income prior to his election the taxable portion of the lump sum payment should be included in his gross income for the year in which it is received if he is on the cash basis and in the year of election if he is on the accrual basis.

3. Will an election retroactive to October 1, 1949 for the purpose of changing computation of disability retirement pay or the retired or retainer pay, be also retroactive so as to change the taxable status of such pay? [For example: A who was retired prior to October 1, 1949, for physical disability has been receiving $550 a month nontaxable retired pay. On October 1, 1953 he elects to qualify for disability retirement pay and on the basis of 30 years of active duty is entitled to $716.06 a month (2½ percent times $954.75 basic pay under the Act times 30) disability retirement pay. His percentage of disability at the time of his retirement in accordance with Veterans Administration rating schedule is determined as 30 percent. Under section 402(h) of the Act $286.43 of A's disability retirement pay would be excluded from gross income ($954.75 times 30 percent) and $429.63 a month would be included as part of his gross income. A would receive a lump sum payment in 1953 of $7,970.88 representing 48 times the difference between his previous pay of $550 and his newly determined pay of $716.06 a month. However, he has treated the $550 a month received for the 4-year period as nontaxable income. If the taxable status of A's disability retirement pay is retroactively changed, he would have been entitled during the 4-year period to an aggregate exclusion of only $13,749.64 whereas he actually excluded an aggregate of $26,400.00 from gross income during the 4-year period.]

The amount of exempt retirement pay ($550 per month) received by A under prior law for the period prior to the date of the election, October 1, 1953, was properly treated as exempt from Federal income tax under section 22(b)(5) of the Code and the exemption thereof will not be disturbed for the years or months prior to the election.

The amount of the new retirement pay ($716.06 per month) received for periods subsequent to the date of the election is exempt to the extent that it does not exceed the "percentage of disability" pay ($286.43 per month), and the balance ($429.63 per month) is subject to tax in accordance with the provisions of section 402(h) of the Act. The extent to which the statutory increase in the retirement pay for the period prior to the date of the election, October 1, 1953, is taxable depends on the extent to which the new pay based on years of service exceeds (1) the "percentage of disability" pay or (2) the exempt pay received under prior law, whichever is greater. The latter item, since it is already exempt under a prior law, cannot be disregarded in making the comparison for the purpose of section 402(h) of the Act. Thus, in the case of A, since the exempt pay under prior law, $550, exceeds his "percentage of disability" pay, $286.43, the difference of $166.06 per month ($716.06, new pay, minus $550, previously exempt pay) for 48 months (the period from October 1, 1949, to October 1, 1953), or $7,970.88 ($166.06 times 48), the entire amount of the lump sum payment is taxable in 1953 when received. However, had the exempt "percentage of disability" pay exceeded the exempt pay received under a prior law it is the proper amount to be compared with the new pay in determining the limitation applicable under section 402(h) of the Act to the retroactive pay received for the period prior to the election as well as for the periods subsequent to the election.

4. The Act of May 27, 1944, 58 Stat. 230, authorizes a member entitled to receive retirement pay for military service to waive as much of such retirement as he may be entitled to receive as a pension or compensation under laws administered by the Veterans Administration. See I. T. 3739, C. B. 1945, 61. Suppose in the case illustrated in question 3 A waived $90.00 of his disability retirement pay in order to receive a pension in like amount from the Veterans Administration under the above-cited law. His rate of disability at the time of his retirement is determined at 30 percent. Will he under section 402(h) of the Act be required to report as his gross income for Federal income tax purposes $429.63 or only $339.63? The $90 a month pension received from the Veterans Administration is, of course, nontaxable income.

He will be required to report $429.63 and may exclude from gross income the amount of $286.43 as in the preceding case. There is no statutory basis for assuming that the waiver of $90 applies to the taxable item of $429.63. A further exemption from income tax must be supported by an express statutory provision.

5. Section 402 of the Act provides that under certain circumstances members of the armed services shall be placed on the temporary disability retired list for a period of not longer than five years. Under subsection (d) thereof it is provided "That disability retirement pay of any member whose name is carried on the temporary disability retired list shall, for so long as his name is carried on such list, be not less than 50 per centum of the basic pay upon which the computation is based." In a case where the rated disability is 30 percent, and the member had no more than 20 years of service, is the difference between the 30 percent of basic pay and the 50 percent of basic pay included in gross income within the meaning of section 402(h) of the Act, or would the entire 50 percent received be excluded from gross income under section 22(b)(5) of the Code.

Section 402(d) of the Act permits the member who is retired for disability resulting from active service to elect to receive disability retirement pay computed either on the basis of years of service or on the basis of percentage of disability, provided that the resulting pay shall be not less than 50 per centum of the basic pay upon which the

computation is based. Where the pay computed on the method elected is less than the minimum 50 percent pay, the difference represents pay of the same character as the pay to which he is entitled under the method elected, i. e., pay based on percentage of disability or pay based on years of service, as the case may be.

If the former, the entire 50 percent pay received is excluded from gross income as exempt; if the latter, it is, under the provisions of section 402(h) of theAct, exempt under section 22(b)(5) of the Code to the extent that it does not exceed the disability retired pay that he would have received if such pay were computed solely on the basis of disability. Sec. I. T. 4017, C. B. 1950-2, 12. The exemption granted by section 22(b)(5) of the Code does not apply to that part of the disability pay computed on the basis of years of active service which is in excess of the pay that he would receive if it were computed solely on the basis of percentage of disability.

6. Further, continuing question 5, if the member had 24 years of service, which would give him 60 percent of basic pay, is the difference between the 60 percent and 50 percent minimum the taxable part under section 402(h) of the Act, or is the entire difference between the 60 percent and the 30 percent, which is his rated disability, taxable?

The entire difference between the 60 percent pay and the 30 percent pay, based on his rated disability, is taxable. See the last sentence in the answer to Question 5.

7. Will the withholding of income tax be based upon the total amount of disability retirement pay of the retired member or only that part which exceeds an amount computed on the basis of the member's percentage of disability?

Withholding will be required only on that part of the retirement pay which exceeds an amount computed on the basis of the member's percentage of disability. See section 402(h) of the Act of 1949, *supra*, sections 1621(a) and 1622(a) of the Code and Regulations 120, section 406.207(a)(2).

8. How should the withholding tax be computed on lump sum payments in cases where a retroactive election is made?

Withholding is required in the year in which the lump sum payments are made and only on that part which is held to be includible in gross income. See section 402(h) of the Career Compensation Act of 1949, *supra*, and the answer to question 2.

I. T. 4017, C. B. 1950-2, 12, amplified.

Rev. Rul. 55-155

A commissioned officer of the Armed Forces, retired for disability, who receives retired pay based on his length of service pursuant to the provisions of the Career Compensation Act of 1949, 63 Stat. 802, 37 U. S. C. 272, and also receives compensation on a daily basis for services performed as a civilian employee of the United States Government, and who elects under the provisions of section 212(a) of the Act of June 30, 1932, 47 Stat. 382 at 406, 5 U. S. C. 59(a), to refund his retired pay and retain his civilian pay should exclude his net retired pay in the same proportion that his total retired pay is excludable under section 22(b)(5) of the Internal Revenue Code of 1939. However, the taxable portion of the recipient's total retired pay would be subject to withholding of income tax at source under section 1622 of the Code.

Advice has been requested regarding the method to be used in determining the amount of retired pay received by a commissioned officer of the Armed Forces which is excludable under the provisions of section 22(b)(5) of the Internal Revenue Code of 1939, when he elects under the provisions of section 212(a) of the Act of June 30, 1932, 47 Stat. 382 at 406, 5 U. S. C. 59(a), to refund a portion of his retired pay in order to retain his pay as a civilian employee of the United States Government for certain days of the year.

The taxpayer, a commissioned officer, was retired from the United States Army on June 30 of the taxable year by reason of disability resulting from active service and pursuant to the Career Compensation Act of 1949, 63 Stat. 802, 37 U. S. C. 272, he elected to receive retired pay computed on the basis of his length of service. His annual retired pay is $9,000. The portion of his retired pay attributable to his established disability and which is therefore exempt from income tax is $7,200, or 80 percent. The remainder $1,800, or 20 percent is taxable. During the remainder of the taxable year, after retirement, he was employed in a civilian capacity by the United States Government and was compensated on a daily basis ($50 per day). The following amounts were paid to the taxpayer for the year in question:

	Totals	*Taxable*
U. S. Army (regular pay for 6 months)	$8,000	$8,000
U. S. Army (retired pay for 6 months)	4,500	900
Civilian Pay (50 days)	2,500	2,500
Total rates of	$15,000	$11,400

Inasmuch as the compensation from retired pay and other Government work amount to more than $3,000 a year, the taxpayer made occasional refunds during the taxable year to the Treasurer of the United States, thus making, for the days worked, an election, as permitted by law, to retain his civilian pay. The total retired pay refunded was $1,250 ($25 per day for 50 days).

The authority for the $3,000 limitation mentioned above is contained in section 212(a) of the Act of June 30, 1932, *supra*, which provides in part that after June 30, 1932, no person holding a civilian office or position under the United States Government, or the municipal government of the District of Columbia, or under any corporation, the majority of the stock of which is owned by the United States, shall be entitled, during the period of such incumbency, to retired pay from the United States for or on account of services as a commissioned officer in any of the services mentioned in title 37 of the United States Code (which relates to the pay and allowances in the Army, Navy, Marine Corps, Coast Guard, Coast and Geodetic Survey, and Public Health Service), at a rate in excess of an amount which when combined with the annual rate of compensation from such civilian office or position, makes the total rate from both sources more than $3,000; and when the retired pay amounts to or exceeds the rate of $3,000 per annum such person shall be entitled to the pay of the civilian office or position or the retired pay, whichever he may elect.

Under the facts in this case, it is held that a commissioned officer of the Armed Forces, retired for disability, who receives retired pay based on his length of service pursuant to the provisions of the Career

Compensation Act of 1949, *supra*, and also receives compensation on a daily basis for services performed as a civilian employee of the United States Government, and who elects under the provisions of section 212(a) of the Act of June 30, 1932, *supra*, to refund his retired pay and retain his civilian pay, should exclude his net retired pay in the same proportion that his total retired pay is excludible under section 22(b)(5) of the Code. However, the taxable portion of the recipient's total retired pay would be subject to withholding of income tax at source under section 1622 of the Code.

Thus, in the instant case, since 80 percent of the retired pay for the year is exempt from income tax because it is received by reason of physical disability then 80 percent of the net retired pay (i. e., the total retired pay less the amount refunded to the Treasurer) is also exempt from income tax. A computation indicating the exempt and taxable amounts of the retired pay is shown below:

		Exempt		*Taxable*	
Total retired pay.....	$4,500	$3,600		$900	
Less: Total amount refunded.....	1,250	1,000	(80%)	250	(20%)
Net amount of retired pay.....	$3,250	$2,600		$650	

Hence, $2,600 of the net retired pay of $3,250 is exempt from Federal income tax.

Amounts received because of personal injuries. See Rev. Rul. 55-331, page 271.

SECTION 22(c).—GROSS INCOME: INVENTORIES

REGULATIONS 118, SECTION 39.22(c)-2: Valuation of inventories.

Use of retail value of merchandise in valuation of inventories. See Rev. Rul. 55-285, page 69.

SECTION 22(d).—GROSS INCOME

REGULATIONS 118, SECTION 39.22(d)-1: Last-in first-out inventories. Rev. Rul. 55-220

Revenue Ruling 54-63, C. B. 1954-1, 33, is modified in view of the discontinuance of the publication of variety store inventory price indexes by the Bureau of Labor Statistics.

Revenue Ruling 54-63, C. B. 1954-1, 33, and Revenue Ruling 54-145, C. B. 1954-1, 38, set forth inventory price indexes for June, 1953, and December, 1953, respectively, and data in connection therewith, published by the Bureau of Labor Statistics for use by variety stores employing the retail and elective inventory methods. It also pre-

scribed the conditions under which the use of such indexes would be acceptable, under section 22(d) of the Internal Revenue Code of 1939, in the filing of Federal income tax returns. Thereafter, industry sponsors having terminated arrangements for the preparation by the Bureau of Labor Statistics of the variety store inventory price indexes, publication by that Bureau of such indexes was discontinued, as announced in I. R. B. 1954–31, 20.

The fifth paragraph of Revenue Ruling 54–63, *supra*, provides as follows:

> The use of such indexes published by the Bureau of Labor Statistics is not mandatory; indexes may be prepared by an individual taxpayer based upon his own data on prices and inventory quantities, if adequate, and if proof is submitted that sound statistical methods have been employed that assure reliable indexes, not only for the particular year in question, but for subsequent years. There may be no selective use of such indexes, however, combining the use of certain of the BLS indexes with respect to given departments and the use of other individual indexes with respect to other departments, except in the case of food, candy, and tobacco departments. Neither will alternate use of BLS indexes and individual indexes in successive taxable years be permitted.

However, publication by the Bureau of Labor Statistics of variety store inventory price indexes having been discontinued, variety store operators who had adopted such indexes in computing their inventories under the retail and elective inventory methods, will be permitted to use indexes prepared from their own data on prices and quantities, consistent with such Bureau of Labor Statistics indexes, in computing inventories under those methods on subsequent dates for which such indexes have not been published by the Bureau of Labor Statistics. Revenue Ruling 54–63, *supra*, is modified accordingly.

REGULATIONS 118, SECTION 39.22(d)–7: Involuntary liquidation and replacement.

Adjustment to be made in year of liquidation for inventory replaced. See Rev. Rul. 55–28, page 359.

SECTION 22(e).—GROSS INCOME: DISTRIBUTIONS BY CORPORATIONS

(Also Sections 22(a), 115(j); Regulations 118, Sections 39.22(a)–1, 39.115(j)–1.) Ct. D. 1774

INCOME TAXES—INTERNAL REVENUE CODE OF 1939—DECISION OF COURT

1. INCOME TAX—DISTRIBUTIONS BY CORPORATIONS—EFFECT ON EARNINGS OR PROFITS OF DISTRIBUTIONS IN KIND—AMOUNT TAXABLE TO STOCKHOLDERS—EARNINGS AND PROFITS TO BE CHARGED WITH COST OF PROPERTY DISTRIBUTED IN KIND WITHOUT REGARD TO UNREALIZED APPRECIATION IN VALUE.

Where a parent corporation distributed stock of a subsidiary corporation to stockholders of the parent as dividends, and earnings and profits of the parent, computed without regard to any appreciation in value of the subsidiary's stock above adjusted cost basis on the parent's books, were sufficient to cover the adjusted cost of the stock distributed but were not sufficient to cover its fair market value at time of distribution, the distributed stock was taxable to the parent's stockholders as ordinary income to the full extent of its market value.

2. DECISIONS REVERSED.

Decision of the United States Tax Court (T. C. M. Apr. 3, 1953) reversed.

UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

Commissioner of Internal Revenue, petitioner, v. *Fannie Hirshon Trust, U/A Charles Hirshon, Walter Hirshon, and Henry Siegbert, trustees, respondent*

Petition for review by the Commissioner of Internal Revenue of a decision of the Tax Court setting aside a ruling of the Tax Court setting aside a ruling of the Commissioner determining a deficiency in respondent's income taxes for the year 1947. Reversed.

Before CLARK, HINCKS, and HARLAN, Circuit Judges

[May 17, 1954]

OPINION

HARLAN, Circuit Judge: The question raised by this petition is the extent to which the fair market value of a corporate distribution in kind is taxable to the shareholder-distributees as ordinary dividend income where the earnings and profits of the distributing corporation are sufficient to cover the adjusted cost of the property distributed but are insufficient to cover its full fair market value at the time of the distribution.

In 1947, Southern Natural Gas Company (hereinafter called "Southern") distributed as dividends to its shareholders (of whom Respondent was one) $2,113,722.03 in cash and 1,409,162 shares of common stock of Southern Production Company, Inc. (hereinafter called "Southern Production"), a wholly owned subsidiary of Southern. The Southern Production stock had an adjusted cost value on Southern's books of $3,199,950. Its fair market value at the time of distribution was $8,983,407.75. Southern had earnings or profits before these distributions amounting to $5,674,586.32. The respondent taxpayer's proportion of these distributions amounted to $12,680.62, of which $2,416.87 represented its share of the cash distribution and $10,263.75 its share of the distribution payable in Southern Production stock, taken at market value.

In reporting these distributions in its federal income tax return for 1947, the taxpayer proceeded on the premise that the market value of the Southern Production stock was taxable to Southern's shareholders as dividend income *only* to the extent of Southern's earnings and profits, determined *without regard* to any appreciation in the value of Southern Production stock above its adjusted cost basis on Southern's books. The Commissioner, however, ruled that the Southern Production stock was taxable to Southern's shareholders as ordinary income to the full extent of its fair market value at the time of receipt, and accordingly determined that the taxpayer had understated its income for 1947. The Tax Court sustained the taxpayer's position, holding that the market value of Southern Production stock in excess of Southern's earnings and profits, as computed on the basis of its adjusted cost on Southern's books, was applicable first to reduce the basis of the shareholders' Southern stock and beyond that was taxable as a capital gain as provided in section 115(d).

The controlling sections of the Internal Revenue Code are section 22 (a) and (e), 26 U. S. C. section 22, and section 115 (a), (b), (d) and (j), 26 U. S. C. section 115. Their relevant portions are printed in the margin.[1]

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[1] SECTION 22. GROSS INCOME.

"(a) *General definition.* 'Gross income' includes gains, profits, and income derived from * * * dividends, * * * or gains or profits and income derived from any source whatever. * * *"

"(e) *Distribution by corporations.* Distributions by corporations shall be taxable to the shareholders as provided in section 115."

SECTION 115. DISTRIBUTIONS BY CORPORATIONS

"(a) *Definition of dividend.* The term 'dividend' when used in this chapter * * * means any distribution made by a corporation to its shareholders, whether in money or in other property, (1) out of its earnings or profits accumulated after February 28, 1913 * * *"

"(b) *Source of distributions.* For the purposes of this chapter every distribution is made out of earnings or profits to the extent thereof * * *"

"(d) *Other distributions from capital.* If any distribution made by a corporation to its shareholders is not out of increase in value of property accrued before March 1, 1913, and is not a dividend, then the amount of such distribution shall be applied against and reduce the adjusted basis of the stock provided in section 113, and if in excess of such basis, such excess shall be taxable in the same manner as a gain from the sale or exchange of property. * * *"

"(j) *Valution of dividend.* If the whole or any part of a dividend is paid to a shareholder in any medium other than money the property received other than money shall be included in gross income at its fair market value at the time as of which it becomes income to the shareholder."

The taxpayer's position is that the provisions of section 115(a), defining a dividend as any distribution made by a corporation "out of its earnings or profits accumulated after February 28, 1913," also measure the extent to which a distribution in kind is subject to dividend taxation in the hands of the shareholders, that is that the market value of the property distributed is not taxable as "dividend" income beyond the extent of the corporation's "earnings or profits," any excess value being subject to a different kind of tax treatment as held by the Tax Court.

More specifically, the taxpayer contends that after eliminating from Southern's "earnings or profits" the cash dividends of $2,113,722.03, which are concededly taxable to Southern's shareholders as ordinary income to their full extent, the value of the Southern Production stock ($8,983,407.75) is taxable as a dividend only to the extent of Southern's remaining "earnings and profits," *viz.*, $3,560,864.29. The remaining value of the Southern Production stock, $5,422,543.46, it is contended, is subject to the other tax treatment indicated above.

The Commissioner's position is that all that is excluded from individual income taxation under section 115 are distributions to shareholders which impair the capital of the distributing corporation. In essence his argument is that we should distinguish between the value of an asset in the hands of the corporation for the purpose of determining surplus or capital impairment, and the value of the asset for tax purposes when distributed to the shareholders. In the first aspect, so the Commissioner argues, the value of the asset is its historical cost to the corporation, without regard to any subsequent appreciation in value; in the second aspect, the worth of the asset is its full market value at the time of receipt by the shareholders; and under the statute there is no necessary *money* correlation between these two sets of values. Therefore, it is contended, once it is shown that a distribution in kind has left the corporate capital intact, the distribution is "out of" the corporation's "earnings or profits," and hence a dividend under section 115(a), which under section 115(j) becomes taxable to the shareholders to the full extent of its market value at the time of receipt.

More specifically, the Commissioner contends that Southern's earned surplus (5,674,586.32) being greater than the total value ($5,313,672.03) of the distributed cash and Southern Production stock (at its adjusted cost to Southern), the entire distribution constituted a dividend, and as such the part represented by Southern Production stock, equally with the cash part, was taxable as ordinary income to the full extent of its fair market value, *viz.*, $8,983,407.75.

We are thus called upon to decide between these two opposing views of the taxing pattern established by section 115. The decisions of the Tax Court have fairly consistently supported the taxpayer's position. *Estate of Godley* v. *Comm'r*, 19 T. C., No. 124 (1953), relating to the identical distributions here involved, and upon which the decision below was based; *Pauline du Pont Dean* v. *Comm'r*, 9 T. C. 256 (1947); *Estate of Acheson*, 3 T. C. M. 1242 (1944); and in its result *Beach Petroleum Corp.* v. *Comm'r*, 5 T. C. M. 638 (1946).

The cases in the Federal Courts, however, do not give us any clear signal. In *Binzel* v. *Comm'r*, 75 F. 2d 989 (2nd Cir.), cert. denied 296 U. S. 579 (1935) [Ct. D. 1079, C. B. XV–1, 217 (1936)], relied on by the Commissioner, it did not appear whether there was sufficient surplus to cover the full market value of the distribution in kind. If there was, then that case did not reach the issue before us. If there was not, we would hesitate to accept the alternative basis for decision, namely, that the distributed property was *acquired* out of post-1913 earnings or profits and retained that character upon distribution. See Paul, *Selected Studies in Federal Taxation*, 2d Series (1938), pp. 174–176; Molloy, *Some Tax Aspects of Corporate Distributions in Kind*, 6 Tax L. Rev. 57, 74–76 (1950). For the same reason we find *Comm'r* v. *Wakefield*, 139 F. 2d 280 (6th Cir. 1943), also cited by the Commissioner, not persuasive. The concurring opinion of Judge Whitaker in *Guinness* v. *United States*, 73 F. Supp. 119 (Ct. Claims 1947) is an acceptance of the Commissioner's position, but the decision of the majority went upon other grounds, based on facts not involved here. In *Comm'r* v. *Timken Estate*, 141 F. 2d 625 (6th Cir. 1944), cited by the taxpayer, a dividend in kind was held not taxable as income to the stockholder, but there the *cost* of the property distributed was not covered by any earnings or profits (which had been exhausted by prior cash dividend distributions), and in effect constituted a distribution of *capital*.

We also consider the legislative history of section 115, which has been referred to in the Respondent's brief, wholly unclear. Finally, we find tax lawyers, who

have written on the subject, on both sides of the question. See Paul, *Selected Studies, etc., supra*, 165-185, and Raum, *Dividends in Kind: Their Tax Aspects*, 63 Harv. L. Rev. 593-609 (1950).

We turn then to examine the provisions of the Internal Revenue Code themselves. Section 22(a) defines "gross income" to include "dividends * * * or gains or profits and income derived from any source whatever." No contention is made here that the Southern Production stock constituted "income" to Southern's shareholders otherwise than as a "dividend." Section 22(e) provides that corporate *distributions* are taxable to the shareholders as provided in section 115. So far as here relevant, section 115(a) defines a *dividend* as "any distribution made by a corporation to its shareholders, *whether in money or in other property*,[2] (1) out of its earnings or profits accumulated after February 28, 1913 * * *".

Both parties here agree with the premise of the Tax Court in the *Godley* case, citing *General Utilities & Operating Co.* v. *Helvering*, 296 U. S. 200 (1935), [Ct. D, 1055, C. B. XV-1, 211 (1936)], that under section 115(a) unrealized appreciation in corporate assets may not be reckoned in "earnings or profits"; or, as the Commissioner puts it, in computing "earnings or profits" corporate assets are to be taken at historical cost. Cf. *R. D. Merrill Co.* v. *Commissioner*, 4 T. C. 955 (1945), wherein the Tax Court held that in determining to what extent a distribution made in the stock of another corporation, which had *depreciated* in value below its cost to the distributing corporation, reduced earnings and profits available for later distributions, the earnings and profits of the distributing corporation should be charged with the *cost* of the stock rather than merely its depreciated value. The "capital impairment" statutes of some states permit unrealized appreciation to be calculated in determining corporate surplus available for dividends [*e. g.*, sec. 58, N. Y. Stock Corp. Law, *Randall* v. *Bailey*, 288 N. Y. 280 (1942)]. Other states, perhaps more in keeping with sound accounting and business practice, do not permit unrealized appreciation to be counted in computing corporate surplus, in determining which the corporate assets are to be reckoned at their historical cost. *E. g.*, Ill. Rev. Stats. 1951, C. 32, section 41(c); Penn. Stats., Tit. 15, sections 2852-701 A(1), 702 (Purdon 1936). If the matter be still open under the *General Utilities* case, *supra*, we agree with the Tax Court's conclusion in this respect, and think it is this latter view which Congress has adopted in section 115(a).

To continue with section 115, section 115(b) entitled "Source of Distributions" states that "every *distribution* is made out of earnings or profits to the extent thereof * * *". Section 115(d), entitled "Other Distributions from Capital" provides that if "* * * any distribution * * * is not a dividend * * *" it shall be applied to reduce the basis of the shareholders' stock in the distributing corporation, and any excess shall be taxable as a capital gain. And finally section 115(j) provides: "If the whole or any part of a *dividend* is paid to a shareholder in any medium other than money the property received other than money *shall be included in gross income at its fair market value at the time as of which it becomes income to the shareholder.*"

As we see it, the real nub of the dispute between the taxpayer and the Commissioner comes down to the question or whether, as the taxpayer contends, section 115(a) defining dividends as those corporate distributions which are made "out of earnings or profits," also measures the amount of a distribution in kind which is subject to ordinary income taxation as a dividend under section 115(j). The taxpayer's position is, in effect, that since under section 115(a) unrealized appreciation in the value of the property to be distributed is to be excluded in measuring the corporation's earnings or profits for the purpose of determining the extent to which the distribution is a dividend, likewise unrealized appreciation should be excluded in determining how much of the distribution is subject to ordinary income taxation as a dividend. The taxpayer achieves what it claims to be the proper result by applying the amount of the earnings or profits of the corporation against the *appreciated* value of the distributed property, and treating any excess in such value as a capital distribution rather than a dividend.

We do not think that the taxpayer's position withstands analysis. Fundamentally, it involves measuring a dividend distribution for taxation purposes differently from the way Congress has defined a dividend. Thus, as we have

[2] Italics, wherever used in this opinion, have been supplied.

seen, in determining whether the distribution of an asset in kind is a dividend under section 115(a) the earnings and profits of the corporation are charged with the *cost of the asset* to be distributed, without regard to any unrealized appreciation in its value. Yet when it comes to determining the nature of the distribution from the point of view of its taxability the taxpayer would have us charge the same asset against the corporate earnings or profits at its *appreciated value.* But surely the *nature* of a distribution under section 115 is not so elusive. If a distribution is a dividend when declared by the corporation, it is difficult to see how it can in part be something else when received by the stockholders. Stated otherwise, if corporate earnings and profits are to be *charged* with the appreciated value of a distributed asset, we think they should also be *credited* with that value. But if that were done here the problem we have would disappear. It is only by measuring the extent of the dividend differently in the hands of the shareholders from the way in which section 115(a) requires it to be measured in the hands of the corporation, that the taxpayer has a case.

No doubt Congress could have enacted two such different standards of measurement, but we do not think that it has done so, and we are left unpersuaded by the taxpayer's arguments to the contrary. We are referred to section 115(b) which provides that "every distribution is made out of earnings or profits to the extent thereof." But we think that all that this means is that any corporate distribution not *made* in the form of a dividend declaration is nonetheless to be regarded as such to the extent that it represents the earnings or profits of the corporation.

The taxpayer also argued that section 115(d) prescribing capital gains treatment for any distribution which "is not out of increase in value of property accrued before March 1, 1913, *and is not a dividend,*" embraces in that treatment the unrealized appreciation of a distribution in kind which exceeds the earnings or profits of the corporation before such distribution. However, we think that section 115(d), as its caption "Other Distributions from Capital" indicates, is rather designed to subject to capital gains taxation those distributions which have left the capital of the corporation impaired. And concededly these distributions did not have that result. Indeed section 115(d) seems to us to support the position of the Commissioner rather than that of the taxpayer.

The contention of the taxpayer encounters, we think, an insuperable obstacle in section 115(j) which requires a stockholder to include in his gross income the whole or any part of a dividend paid in property "at its full market value at the time as of which it becomes income to the shareholder." No argument is made that a dividend in kind does not become income to the shareholder until its value is realized by sale or other disposition. Cf. *Messer* v. *Comm'r,* 20 T. C., No. 31 (1953); *Helms Bakeries* v. *Comm'r,* 46 B. T. A. 308 (1942). All that the taxpayer argues is that this section was designed to settle merely the *time* at which a property dividend is to be valued for income tax purposes. We cannot accept so limited a construction of section 115(j). Rather, we think that section 115(j) removes whatever doubt there might otherwise be that dividends in kind, as defined in section 115(a), are taxable as *dividends* to the full extent of their market value at the time of receipt by the shareholders.

Finally, the taxpayer, conceding that the accounting practices underlying the Commissioner's position "may be impeccable," argues that there is frequently a divergence between the tax laws and generally accepted business concepts. That may be true, but where, as here, the statutory pattern of taxation and the language used to accomplish it are both in accord with sound accounting and business practices, such an argument furnishes no ground for reading the statute otherwise than it is written. The taxpayer's error, it seems to us, stems from attempting to tie the factors applicable to determining the *nature* of the distribution to its *valuation* after its nature has been determined. The appreciated value of the Southern Production stock was not, nor was it required to be, a distribution "out of" Southern's earnings or profits—it was simply a distribution *of* that appreciation which was not a part of Southern's earnings or profits or of its capital.

We hold that the Southern Production stock was taxable to the respondent at its full market value at the time of receipt.

Reversed.

(Also Section 22(a), 115(j); Regulations 118, Sections 39.22(a)-1, 39.115(j)-1.) Ct. D. 1775

INCOME TAXES—INTERNAL REVENUE CODE OF 1939—DECISION OF COURT

1. INCOME TAX—DISTRIBUTIONS BY CORPORATIONS—EFFECT ON EARNINGS OR PROFITS OF DISTRIBUTIONS IN KIND—AMOUNT TAXABLE TO STOCKHOLDERS—EARNINGS AND PROFITS TO BE CHARGED WITH COST OF PROPERTY DISTRIBUTED IN KIND WITHOUT REGARD TO UNREALIZED APPRECIATION IN VALUE.

Where a parent corporation distributed stock of a subsidiary corporation to stockholders of the parent as dividends, and earnings and profits of the parent, computed without regard to any appreciation in value of the subsidiary's stock above adjusted cost basis on the parent's books, were sufficient to cover the adjusted cost of the stock distributed but were not sufficient to cover its fair market value at time of distribution, the distributed stock was taxable to the parent's stockholders as ordinary income to the full extent of its market value.

2. DECISION REVERSED.

Decision of the United States Tax Court (19 T. C. 1082) reversed.

UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

Estate of Ida S. Godley, deceased; Paul F. Godley and John W. Young, Jr., co-executors, respondents, v. Commissioner of Internal Revenue, petitioner

On petition for review of the decision of the Tax Court of the United States

Before MARIS, KALODNER, and STALEY, Circuit Judges

[May 28, 1954]

OPINION

By STALEY, Circuit Judge. The Commissioner petitions for review of a decision of the Tax Court. 19 T. C. 1082 (1953). The facts were stipulated and were found accordingly. We will attempt to state them generally so that this opinion does not become a welter of figures.

Respondents' decedent held stock of the Southern Natural Gas Company. In 1947 she and the other shareholders of the gas company received a distribution partly in cash and partly in property. The property consisted of shares of stock of the Southern Production Company, Inc., which had been held by the gas company. The production company stock had been acquired by the gas company at a cost of $3,199,950. At the time of distribution, its fair market value was $8,983,407.75. The total cash distribution by the gas company was $2,113,722.03, making the total of the cash and property received by the shareholders $11,097,129.78. At the time of distribution, the gas company had available for dividends earnings or profits totaling $5,674,586.32. The footnote contains a tabular account of the arithmetic of what happened.[1] The decedent treated roughly half of what she received from the gas company as ordinary income for the year 1947. The Commissioner's deficiency assessment held her total receipts from the gas company to be taxable as ordinary income. Respondents were successful in the Tax Court, and the case comes here.

Forgetting for the moment the cash distribution, the case amounts to this, when reduced to its essentials. A corporation made a distribution in kind to its shareholders of property whose fair market value at the time of distribution exceeded its cost to the corporation and also exceeded the corporation's earnings

[1] Total earnings and profits available for 1947 dividends $5,674,586.32

Distribution charged out by Southern	
Cash $1.50 per share	$2,113,722.03
Property $6.375 per share cost	3,199,950.00
Total charged out by corporation per books	$5,313,672.03
Distributions received by stockholders	
Cash	$2,113,722.03
Property, at fair market value	8,983,407.75
Total received by stockholders	$11,097,129.78

or profits available for dividends, when considered apart from the property's appreciation in value. The earnings or profits were, however, sufficient to cover the cost to the corporation of the property distributed. In order to decide the tax effect on the distributees, therefore, we must determine whether a distribution in kind of appreciated property reduces the distributing corporation's earnings or profits by the fair market value of the property, without addition of the increment in value, as the Tax Court held, or whether it reduces earnings or profits only by the cost of the property. The two methods produce substantially different results. If earnings or profits, without addition of the increment caused by the appreciation in value, must be matched against the fair market value of the property, the distribution will be a dividend only to the extent of earnings or profits and the distributees will be taxed on that amount only, with the excess over earnings or profits going first to reduce the basis of the shares held by the distributees and any excess over basis being taxed as a capital gain under section 115(d).[2] This was the Tax Court's view. On the other hand, if earnings or profits, again without addition of the increment in value, must be matched against the cost of the property, the entire distribution will be a dividend and the distributees will be taxed upon the full fair market value as ordinary income.

The problem acquires its setting from the following provisions of the Internal Revenue Code. By section 22(a) " 'Gross income' includes gains, profits, and income derived from * * * dividends. * * *"[3] But section 22(a) does not define a "dividend." For that purpose, its subsection (e)[4] directs us to section 115. Section 115(a) defines a dividend as a corporate distribution to its shareholders "out of its earnings or profits. * * *" Section 115(b) provides a conclusive statutory presumption to the effect that every corporate distribution is "out of earnings or profits to the extent thereof. * * *" Finally, section 115(j) values a property dividend by providing that the property received "shall be included in gross income at its fair market value. * * *"[5]

The Tax Court said that the genesis of the problem was the Supreme Court's decision in *General Utilities Co.* v. *Helvering*, 296 U. S. 200 (1935). There General Utilities distributed to its shareholders property that had appreciated in value over its cost to the corporation. The Court held that General Utilities derived no taxable gain from the distribution. Because of procedural points involved and the sequence of the Commissioner's arguments before the Board of Tax Appeals, the Fourth Circuit, and the Supreme Court, the scope of the holding of the General Utilities case is uncertain.[6] There is no doubt, however, that the case has received judicial and administrative acceptance as standing for the proposition that a corporation does not realize income from the distribution of property which has appreciated in value over its cost.[7] We will so accept it for purposes of discussion here. Construing the General Utilities case as stated above, the Tax Court held

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[2] "(d) OTHER DISTRIBUTIONS FROM CAPITAL.
"If any distribution made by a corporation to its shareholders is not out of increase in value of property accrued before March 1, 1913, and is not a dividend, then the amount of such distribution shall be applied against and reduce the adjusted basis of the stock provided in section 113, and if in excess of such basis, such excess shall be taxable in the same manner as a gain from the sale or exchange of property. * * *" 26 U. S. C. sec. 115(d) (1952).

[3] 26 *id.* sec. 22(a).

[4] "(e) DISTRIBUTIONS BY CORPORATIONS.
"Distributions by corporations shall be taxable to the shareholders as provided in section 115." 26 *id.* sec. 22(e).

[5] "SEC. 115. DISTRIBUTIONS BY CORPORATIONS—(a) DEFINITION OF DIVIDEND.
"The term 'dividend' when used in this chapter * * * means any distribution made by a corporation to its shareholders, whether in money or in other property, (1) out of its earnings or profits accumulated after February 28, 1913, or (2) out of the earnings or profits of the taxable year (computed as of the close of the taxable year without diminution by reason of any distributions made during the taxable year), without regard to the amount of the earnings and profits at the time the distribution was made. * * *
"(b) SOURCE OF DISTRIBUTIONS.
"For the purposes of this chapter every distribution is made out of earnings or profits to the extent thereof, and from the most recently accumulated earnings or profits. * * *
"(j) VALUATION OF DIVIDEND.
"If the whole or any part of a dividend is paid to a shareholder in any medium other than money the property received other than money shall be included in gross income at its fair market value at the time as of which it becomes income to the shareholder." 26 *id.* sec. 115(a), (b), and (j).

[6] Paul, Ascertainment of "Earnings or Profits" for the Purpose of Determining Taxability of Corporate Distributions, 51 Harv. L. Rev. 40, 55–57 (1937).

[7] *Commissioner of Internal Revenue* v. *Wakefield*, 139 F. 2d 280 (C. A. 6, 1943); Platt Trust, 4 CCH T. C. M. 715 (1945), pet. for review dism'd, 154 F. 2d 1016 (C. A. 9, 1946); Hanan, 3 CCH T. C. M. 670 (1944); Koshland, 2 CCH T. C. M. 972 (1943). See also annotation in 7 A. L. R. 2d 750, 751 (1949).

that the so-called rule of that case should be applied in computing the amount of a corporation's earnings or profits available for dividends even where no question of the effect on its taxable net income was involved.[8] Therefore, the appreciation in value of the property held and distributed by the gas company here was not added to its earnings or profits. The result was that the distribution of the cash and property was a dividend and, thus, taxable to the distributees as ordinary income only to the extent of the gas company's earnings or profits.

The Commissioner's contention was that earnings covered the cost of the property distributed and, therefore, the distribution was "out of earnings or profits" under 115(a) and was backed by earnings or profits "to the extent" of cost under 115(b). The distribution was, therefore, a "dividend." Having been classified as a dividend under 115 (a) and (b), 115(j) then comes into operation and imposes a tax upon the distributees to the extent of the then fair market value of the property received. This argument was rejected by the Tax Court because it was said to destroy what was thought to be the proper correlation between taxability to the shareholder-distributees and the effect upon statutory earnings or profits of the corporation and because it was thought that to allow the Commissioner's argument to prevail would be to allow him to do indirectly what the Court in General Utilities prevented him from doing directly, i. e., write up the earnings or profits of the distributing corporation by the amount of the unrealized appreciation of the property distributed. We concede, of course, that the solution is not free from difficulty, but we think the Commissioner's theory has none of the effects attributed to it by the Tax Court and is the better of the two rules.

There is no statutory definition of "earnings or profits." The attempt to ascertain its meaning is usually made in a negative way. That is, there is general agreement that "earnings or profits" are not the same as taxable net income.[9] The General Utilities case has been accepted as another negative delineation of earnings or profits, in that it has been extended, as the Tax Court did here, as supporting the proposition that earnings or profits do not include the appreciation in value of the property distributed.[10] Furthermore, Section 115(*l*), which came into the Code in 1940, seems to support the rule that unrealized gains should not increase earnings or profits by providing that a realized but nonrecognized gain or loss shall not increase or decrease earnings or profits.[11] That section makes it clear that if a gain is not only nonrecognized but also not even realized, *a fortiori*, it should not be added to earnings or profits. Cf. *Commissioner of Internal Revenue* v. *Wheeler*, 324 U. S. 542 (1945), [Ct. D. 1637, C. B. 1945, 349]. But, if the appreciation in value of the property is an unrealized gain and, thus, may not be added to earnings or profits, we think it may not be subtracted either. Prior to distribution, the corporation carries the property on its books at its adjusted cost basis, since, as we have seen, the appreciation in value of the property in the absence of a closed transaction, does not become realized income. Of course, it is quite true that the increment in value is distributed by the corporation in the sense that it inheres in the property and leaves the corporation when the property does, but its distribution does not decrease earnings or profits because it never became part of earnings or profits. If the distribution of appreciated property were a realization of income by the corporation to the extent of the increment in value, simple arithmetic would require that the distribution would cause a simultaneous increase and decrease in the earnings or profits by the amount of the appreciation. That is, fair market value could be subtracted from earnings and profits only if fair market value (made up of cost, plus appreciation) had theretofore been added

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[8] National Carbon Co., 2 T. C. 57 (1943); Estate of Timken, 47 B. T. A. 494 (1942), aff'd, 141 F. 2d 625 (C. A. 6, 1944).

[9] *Commissioner of Internal Revenue* v. *Wheeler*, 324 U. S. 542, 546 (1945) [Ct. D. 1637, C. B. 1945, 349], U. S. Treas. Reg. § 29.115-3, Earnings or profits, 26 Code Fed. Regs. § 29.115-3 (1949). See also Albrecht, "Dividends" and "Earnings or Profits," 7 Tax. L. Rev. 157, 181–196 (1952); Rudick, "Dividends" and "Earnings or Profits" under the Income Tax Law: Corporate Nonliquidating Distribution, 89 U. of Pa. L. Rev. 865, 879–889 (1941); Paul. *supra* note 6.

[10] See *LaBell Iron Works* v. *United States*, 256 U. S. 377 (1921), [Ct. D. 12, C. B. 4, 373 (1921)]; *Chapment* v. *Anderson*, 11 F. Supp. 913 (S. D. N. L. (1935).

[11] "(*l*) Effect on earnings and profits of gain or loss and of receipt of tax-free distributions.

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"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 net income under the law applicable to the year in which such sale or disposition was made. * * *". 26 U. S. C. sec. 115(*l*) (1952).

to earnings and profits. The result is that cost is the only real variant and, therefore, the only real reduction in earnings or profits is to the extent of cost.

We think the correct approach to a case of a corporate distribution of appreciated property is dictated by the Code. Section 115 (a) and (b) define a dividend. For purposes of characterizing a distribution as a dividend *vel non*, i. e., whether it is out of earnings or profits, the sole relevant test is from the standpoint of the distributing corporation and from that standpoint fair market value is immaterial. The amount of a distribution, once it is determined that the distribution is a dividend, is governed by 115(j) and is measured solely from the standpoint of the distributees and with reference to fair market value, and for that purpose the earnings or profits of the corporation are immaterial.[12] Nor do we think this destroys any supposed correlation between taxability to distributees and effect on the corporation's earnings or profits. Indeed, there can be no correlation, in terms of *amounts* of money, for tax purposes, as between what the corporation distributes and what the shareholders receive, because, by hypothesis, the corporation does not, but the distributees do, realize income to the extent of the appreciation in value of the property distributed. The only correlation possible is that taxability to the distributees correspond with the source of the distributed property in the earnings and profits of the corporation. The Tax Court's insistence that there must always be an exact correlation between the amount of dollars by which a dividend in kind affects the earnings or profits of a corporation and the amount of dollars that are taxable in the hands of the stockholder receiving the dividend renders section 115(j) meaningless and makes of 115(a) and (b) the sections which not only determine the character and the source of the distribution but which value the distribution in the hands of the stockholder.

The following example, suggested to us by the Commissioner, shows that the result of the Tax Court's decision completely distorts the corporation's earnings or profits and its general financial picture. Assume that a corporation has $100,000 worth of capital and $12,000 of earnings or profits. It owns property which cost $10,000 but has now appreciated to $15,000. The property is distributed in kind to its shareholders. The General Utilities case is said to prevent a realization of income to the corporation of the $5,000 unearned increment and also to prevent increasing earnings or profits by the $5,000 appreciation. Now, if the $15,000 fair market value of the distributed property, which includes the $5,000 appreciation, is charged against earnings or profits, there results a $3,000 deficit in that account or a reduction of capital by that amount. Really, however, the corporation's investment in the property was all that it parted with from a tax standpoint. As a matter of fact, after the distribution, the corporation's capital is not only wholly intact but it has $2,000 of earnings or profits remaining and available for future dividends. If we return to the facts of our case, we find that the Tax Court's solution causes equally unrealistic results in the gas company's earnings or profits and financial picture. After the cash distribution the gas company had $3,560,864.29 of earnings or profits available for dividends. To reduce that amount by the fair market value of the distributed property ($8,983,407.75), not only consumes all of the earnings or profits but results in a deficit in that account in the amount of $5,422,543.46 or a reduction of capital in that amount, which is a book situation altogether at odds with the facts, because in reality capital not only was still intact but there were $360,914.29 of earnings or profits left. The Tax Court's decision not only unduly limits the amount which is taxable to the shareholders as a dividend by reason of the instant distribution but removes $360,914.29 of actual earnings or profits from future taxation as a dividend on any subsequent distribution by the gas company.

We hold that upon a corporate distribution of property that has appreciated over cost but whose cost is exceeded by earnings or profits, considered without addition of the property's appreciation in value, the proper reduction of earnings or profits is to the extent of cost. Taxwise, this means that in our case the entire distribution was a "dividend" and the distributees are taxable upon the full fair market value received. We think this does no violence either to section 115(*l*) of the Code or to the General Utilities case, but, on the contrary, is entirely consistent with both and with what we think is required by 115 (a), (b), and (j) in a case of this kind.

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[12] See Raum, Dividends in Kind: Their Tax Aspects, 63 Harv. L. Rev. 593, 609 (1950).

It must be conceded that, while we are not alone in our view, almost all the Tax Court cases have gone the other way.[13] In *R. D. Merrill Co.*, 4 T. C. 955, 959–963 (1945), a case of a distribution in kind of depreciated property, the Tax Court held that earnings or profits should be reduced by cost rather than the lower, fair market value. See *Beach Petroleum Corp.*, 5 CCH T. C. M. 638 (1946), *semble*, where fair market value exceeded cost. In *Reynolds Spring Co.* v. *Commissioner of Internal Revenue*, 181 F. 2d 638 (C. A. 6), cert. denied, 340 U. S. 821 (1950), another depreciated property distribution, cost rather than the lower, fair market value was used to reduce equity invested capital for purposes of the excess profits tax. *Cf. Charles Leich & Co.* v. *United States*, 210 F. 2d 901 (C. A. 7, 1954). The concurrence in *Guinness* v. *United States*, 73 F. Supp. 119, 132–134 (Ct. Cl. 1947), cert. denied, 334 U. S. 819 (1948), is in agreement with our theory and result in treating a distribution of appreciated property. The majority disposed of the case on the theory of *Commissioner of Internal Revenue* v. *Court Holding Co.*, 324 U. S. 331 (1945), [Ct. D 1636, C. B. 1945, 58], *Commissioner of Internal Revenue* v. *Wakefield*, 139 F. 2d 280 (C. A. 6, 1943), and *Binzel* v. *Commissioner of Internal Revenue*, 75 F. 2d 989 (C. A. 2), cert. denied, 296 U. S. 579 (1935, [Ct. D. 1079, C. B. XV-1, 217 (1936)], reach our result upon different principles.

No purpose would be served by an extended discussion of the cases since we have set out above the two major theories that have competed for acceptance as the solution to our problem. With variations of language, the decisions espouse one or the other. The Tax Court's opinion in this case presents one view as well as we think it can be presented. For the reasons stated we think the other view is the better one.

After this opinion was prepared but before it was filed, the Second Circuit reached the same result upon the same theory in a case involving the same corporate distribution as is involved here. *Commissioner of Internal Revenue* v. *Fannie Hirshon Trust*, 213 F. 2d. 523 (C. A. 2, decided May 17, 1954).

The judgment of the Tax Court will be reversed and the cause remanded for proceedings in accordance with this opinion.

SECTION 22(k).—GROSS INCOME: ALIMONY, ETC., INCOME

REGULATIONS 118, SECTION 39.22(k)-1: Alimony and separate maintenance payments; income to former wife.

Marital status where an individual is separated from spouse under an interlocutory decree of divorce. See Rev. Rul. 55-178, page 322.

SECTION 22(n).—GROSS INCOME: DEFINITION OF "ADJUSTED GROSS INCOME"

REGULATIONS 118, SECTION 39.22(n)-1: Adjusted gross income. Rev. Rul. 55-288

An arrangement whereby an employee is paid a salary with the understanding that he will pay his own expenses in the performance of his employment does not constitute a reimbursement or other expense allowance arrangement for the purposes of section 22(n)(3) of the Internal Revenue Code of 1939, in determining adjusted gross income. The arrangement contemplated by section 22(n)(3) of the 1939 Code exists only where the reimbursement or other expense allowance is identified either by making a separate payment or by spe-

[13] Nearly all of the cases are collected by Molloy, Some Tax Aspects of Corporate Distributions in Kind, 6 Tax L. Rev. 57 (1950).

cifically indicating the separate amounts where both wages and the expense allowance are combined in a single payment. In the absence of such an arrangement, the amount of expenses (other than for travel, meals and lodging while away from home) paid or incurred in connection with his employment may not be taken into account in determining adjusted gross income, but should be considered in arriving at net income unless the taxpayer claims the optional standard deduction.

REGULATIONS 118, SECTION 39.22(n)-1: Adjusted gross income. Rev. Rul. 55-315

The tax imposed by the State of Colorado upon the portion of the gross income of every person which is derived from the production or extraction of crude oil, natural gas, or both crude oil and natural gas from petroleum deposits located within the State, Chapter 84A, Paragraph 6 (1), of the Colorado Statutes, Annotated, as amended by the Laws of 1953, Sections 1-3, 352-354, is allowable under section 22(n) of the Internal Revenue Code of 1939 to the owner of an operating interest in oil and gas properties as a deduction attributable to a trade or business and to the owner of a royalty interest, such as a lessor or sublessor, as a deduction attributable to property held for the production of rents or royalties.

Advice has been requested whether the tax imposed by the State of Colorado upon the portion of the gross income of every person which is derived from the production or extraction of crude oil, natural gas, or both crude oil and natural gas from petroleum deposits located within the State is deductible in computing adjusted gross income under section 22(n) of the Internal Revenue Code of 1939.

Chapter 84A, Paragraph 6(1), of the Colorado Statutes annotated, as amended by the Laws of 1953, Sections 1-3, 352-354, provides that in addition to the tax imposed by subsections (2), (3), (4) and (5) there shall be levied, collected and paid for each taxable year ending on and after December 31, 1953, upon that portion of the gross income of every person which is derived from the production or extraction of crude oil, natural gas, or both crude oil and natural gas from petroleum deposits located within the State of Colorado a special income tax.

All State and local ad valorem property taxes imposed upon leaseholds, royalties and other interests in oil and gas deposits located within the State, except ad valorem taxes imposed upon drilling production, storage and transportation equipment and facilities, may be claimed as a credit against this special income tax. The tax is collected by withholding at the rate of 3 percent from payments made by every producer or first purchaser of oil or gas. The tax withheld may be claimed as a credit by the taxpayer on his Federal income tax return. This special gross income tax described above is not allowed as a credit against the general income tax of the State.

Section 22(n) of the Code provides in part as follows:

(n) DEFINITION OF "ADJUSTED GROSS INCOME".—As used in this chapter the term "adjusted gross income" means the gross income minus—

(1) TRADE AND BUSINESS DEDUCTIONS.—The deductions allowed by section 23 which are attributable to a trade or business carried on by the taxpayer. * * *;

* * * * * * *

(4) DEDUCTIONS ATTRIBUTABLE TO RENTS AND ROYALTIES.—The deductions (other than those provided in paragraph (1), (5), or (6)) allowed by section

23 which are attributable to property held for the production of rents or royalties;

Section 39.22(n)-1 of Regulations 118 provides that taxes are deductible in arriving at adjusted gross income only if they constitute expenditures directly attributable to the trade or business or to property from which rents or royalties are derived. Property taxes paid or incurred on real property used in the trade or business are deductible, but general state income taxes are not deductible in computing adjusted gross income, even though the taxpayer's income is derived from the conduct of a trade or business or from property held for the production of rents or royalties. However, the special Colorado income tax on gross income from oil and gas production applies only to income from the production or extraction of oil or gas from properties in that State. Such tax is, therefore, directly attributable to interest in oil and gas properties and is designed to complement State and local ad valorem taxation of such interests. To the extent that such ad valorem taxes are paid by the taxpayer they may be credited against his liability for this special income tax. The tax is not allowed as a credit against the general income tax imposed by the State. There is such a proximate connection between the tax and the property producing the income that the tax is, within the meaning of the regulations, directly attributable to the trade or business of the taxpayer or to property from which royalties are derived by the taxpayer. See *Robert J. Koshland, executor under the will of Corinne S. Koshland* v. *Commissioner*, 19 T. C. 860, affirmed per curiam, 216 Fed. (2d) 751, and I. T. 3829, C. B. 1946-2, 38.

Accordingly, the tax is allowable to the owner of an operating interest in oil and gas properties as a deduction attributable to a trade or business under section 22(n)(1) of the 1939 Code and to the owner of a royalty interest, such as a lessor or sublessor, as a deduction attributable to property held for the production of rents or royalties under section 22(n)(4) of the 1939 Code.

REGULATIONS 118, SECTION 39.22(n)-1: Adjusted gross income.

Tax attributable to a trade or business deductible in computing adjusted gross income. See Rev. Rul. 55-289, page 278.

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

REGULATIONS 118, SECTION 39.23(a)-1: Business expenses. Rev. Rul. 55-12

A penalty payment made by a taxpayer to his mortgagee to obtain a release from the mortgage on property used in his trade or business in order to secure a new loan from another source, constitutes a business expense within the meaning of section 23(a)(1) of the Internal Revenue Code of 1939 and is deductible by corporations as well as individuals. Under certain conditions the penalty payment would constitute a deductible nontrade or nonbusiness expense under section 23(a)(2) of the Code, but it does not represent

a payment of interest which would be deductible under section 23(b) of the Code.
Rev. Rul. 168, C. B. 1953-2, 19, amplified.

Further consideration has been given to Revenue Ruling 168, C. B. 1953-2, 19, for the purpose of clarifying the position of the Internal Revenue Service with respect thereto. That ruling holds that a penalty payment made by a taxpayer to his mortgagee to obtain a release from the mortgage on property used in his trade or business, in order to secure a new loan from another source, is deductible by the taxpayer in the year of payment or accrual, depending upon his method of reporting income.

The Internal Revenue Service has been asked to consider whether, in addition to qualifying as a deduction under section 23(a)(1) of the Internal Revenue Code of 1939, the penalty payment qualifies as a deduction under section 23(a)(2) of the Code and whether it may constitute a payment of interest which is deductible under section 23(b) of the Code.

Revenue Ruling 168, *supra*, relates specifically to what was there stated, namely, a mortgage on property used in a trade or business and a penalty payment made by the mortgagor to obtain a release from such mortgage in order to secure a new loan from another source. In that ruling it was held that the penalty payment was deductible under section 23(a)(1) of the Code regardless of whether the mortgagor is a corporation or an individual. It is immaterial whether the penalty payment referred to in the ruling was made pursuant to a prepayment provision in the original obligation or mortgage, or was the result of negotiations between the mortgagor and mortgagee subsequent to the loan agreement. In either case, the amount of the penalty is considered paid by the borrower to relieve himself of the obligation under the mortgage agreement in order to obtain a new loan from another source. Therefore, it is an expense of cancelling the old indebtedness. *Cf.* section 39.22(a)-17 of Regulations 118 and T. D. 4603, C. B. XIV-2, 58 (1935).

If the mortgage were on income producing property not used in a trade or business and if the conditions of section 39.23(a)-15 of Regulations 118 were met, the penalty payment would be an allowable deduction under section 23(a)(2) of the Code in computing net income.

If the mortgaged property were property held for the production of rents or royalties, the penalty payment should be taken into consideration in arriving at adjusted gross income. See section 22(n)(4) of the Code.

A penalty payment made under the conditions set forth in Revenue Ruling 168, *supra*, does not meet the definition of interest under section 23(b) of the Code. The United States Supreme Court has defined interest as the amount one has contracted to pay for the use of borrowed money. See *Pearl E. Deputy, et al.* v. *Pierre S. DuPont*, 308 U. S. 488, at 497, Ct. D. 1435, C. B. 1940-1, 118, citing *Old Colony Railroad Company* v. *Commissioner*, 284 U. S. 552, Ct. D. 456, C. B. XI-1, 274 (1932). The penalty payment here involved is a payment in addition to and disassociated from the payment of interest inasmuch as it is a payment made to obtain a release from the obligation which called for the payment of interest.

In order for a payment to be deductible as interest, it must be made for the use of borrowed money. A payment made for the privilege of prepaying an indebtedness is not one which can be said to be for the use of the borrowed money; it is in the nature of a penalty to gain release from a pre-existing contractual liability to make payments in the future. Such a payment cannot be classified as a payment of interest within the meaning of section 23(b) of the Code. This is true whether the payment is made pursuant to a prepayment clause in the original indebtedness agreement or through a negotiated release. Accordingly, it is held that the penalty payment under certain conditions would constitute a deductible nontrade or nonbusiness expense under section 23(a)(2) of the Code, but it does not represent a payment of interest which would be deductible under section 23(b) of the Code.

Revenue Ruling 168, *supra*, amplified.

REGULATIONS 118, SECTION 39.23(a)-1: Business expenses. Rev. Rul. 55-109

(Also Section 24(a); Regulations 118, Section 39.24(a)-1.)

Members of reserve components of the Armed Forces attending training drills under competent orders, with or without compensation, are regarded as engaged in a trade or business. Certain nonreimbursed transportation expenses incurred on trips (not extending overnight) made by reservists to attend such drills constitute ordinary and necessary business expenses under section 23(a)(1)(A) of the Internal Revenue Code of 1939 and may be deducted in computing net income, provided the optional standard deduction is not elected. Amounts expended by a reservist for the purchase and maintenance of uniforms, which he may wear only while performing duties as a reservist, are deductible for Federal income tax purposes as ordinary and necessary business expenses, except to the extent that nontaxable allowances are received for these costs.

Advice has been requested concerning the treatment, for Federal income tax purposes, of expenses incurred by a member of a reserve component of the Armed Forces for transportation in attending authorized training drills and for the purchase and maintenance of necessary uniforms.

In the instant case, the taxpayer, a member of a reserve unit of the Armed Forces, is required to attend authorized training drills under competent orders at a location which enables him to return to his residence each night after participating in such drills. The taxpayer receives basic pay for only one-half of the total number of drills prescribed for the taxable year, but does not receive any allowance or reimbursement for transportation expenses incurred in attending such drills. He is also required to purchase, maintain, and wear to such drills the uniforms designated by the particular branch of the Armed Forces to which he belongs.

Section 23(a)(1)(A) of the Internal Revenue Code of 1939 provides in part 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 * * * traveling expenses (including the entire amount ex-

pended for meals and lodging) while away from home in the pursuit of a trade or business * * *."

Section 48(d) of such Code provides that the term "trade or business" includes the performance of the functions of a public office. The Senate and Conference Committee Reports on the Revenue Bill of 1934, C. B. 1939-1 (Part 2), 586 at 608, and 627 at 630, respectively, stated that section 48(d) was declaratory of existing law. That provision has, therefore, been construed, not as automatically converting into a trade or business the functions of every so-called "public office" performed by a volunteer, but as recognizing that the functions of a public office which are in the nature of a trade or business should be treated as such, even though the incumbent thereof may serve without compensation, a factor which is ordinarily regarded as a prerequisite to the pursuit of a trade or business. Thus, full-time and many part-time military and civilian officers and employees of the Government are regarded as engaged in a trade or business, even though they are not compensated for their services. See *D. C. Jackling* v. *Commissioner*, 9 B. T. A. 312, acquiesence, C. B. VII-1, 16 (1928); I. T. 2721, C. B. XII-2, 38 (1933); G .C. M 23672, C. B. 1943, 66; and I. T. 4012, C. B. 1950-1, 33. Compare I. T. 3752, C. B. 1945, 81. Since it appears that a member of a reserve unit of the Armed Forces attending prescribed drills performs services which are ordinarily compensated and has rights, duties, and obligations which are in the nature of a trade or business, it is held that a reservist who attends drills under competent orders, with or without compensation, is engaged in a trade or business and may incur ordinary and necessary expenses within the scope of section 23(a)(1)(A) of the Code, even though he is not reimbursed therefor.

It is clear that a taxpayer may deduct his overnight traveling expenses (including the cost of meals and lodging) necessarily incurred while carrying on a trade or business at a minor or temporary post of duty situated at a distance from the general location of his principal or regular post of duty. *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); *Joseph H. Sherman, Jr., et ux.* v. *Commissioner*, 16 T. C. 332, acquiescence, C. B. 1951-2, 4; and *Harry F. Schurer* v. *Commissioner*, 3 T. C. 544, acquiescence, C. B. 1944, 24. That principle was extended in Revenue Ruling 190, C. B. 1953-2, 303, to permit taxpayers to deduct their transportation expenses (excluding the cost of meals and lodging) incurred on daily round trips to a minor or temporary post of duty situated beyond the metropolitan area which constitutes their principal or regular post of duty, even though such trips do not require them to be away overnight. Accordingly, it is held that where a member of a reserve unit of the Armed Forces is required to make trips (not extending overnight) between the city or general area which constitutes his principal or regular post of duty and the location of drills conducted away from such area, he may deduct his round-trip transportation expenses so incurred as ordinary and necessary business expenses under section 23(a)(1)(A) of the Code, provided free transportation between such locations is not furnished by the Armed Forces. This conclusion is applicable regardless of whether the tax-

payer attends such drills in the evening after his regular working hours or on an otherwise nonworking day.

The rules stated in the preceding paragraph (allowing deductions for overnight traveling expenses and daily transportation expenses while away from principal or regular post of duty) are not applicable to the daily commuting expenses of a taxpayer who is employed on different days at different locations within the same city or general area, because such a taxpayer is not away from his principal or regular post of duty, since that term is not limited to a particular office or building, but includes the entire city or general locality in which he is customarily employed. See *Williard I. Thompson* v. *Commissioner*, 15 T. C. 609; *Raymond E. Kershner* v. *Commissioner*, 14 T. C. 168; and Rev. Rul. 190, *supra*. Thus, it is held that a reservist may not deduct any part of his transportation expenses incurred in attending drills which are conducted within the city or general locality which constitutes his principal or regular post of duty unless he is also working at some other business location during that same day.

Where an employee having only *one* employer is required to work part of the same day at each of two different locations within the same city, it is clear that he must make a business trip which is directly attributable to the actual performance of his duties, and that his necessary transportation expenses in going from his first to his second place of employment would generally be deductible. If he has to return to his first place of employment during that same day, his return trip would also be directly connected with the business and his return transportation expenses would likewise be deductible. However, if at the end of his workday he goes home directly from his second place of employment, his trip would ordinarily be regarded as commuting and his transportation expenses would be nondeductible, at least in those situations where his transportation expenses in going from that location to his home do not exceed those from his headquarters office to his home.

Where an employee having *two* separate employers is required to work on the same day at a different location within the same city for each of his employers, it is recognized that his transportation expenses in going from his first to his second place of employment are not incurred in discharging the duties of either job or in carrying on the business of either employer. Compare *Commissioner* v. *J. N. Flowers*, 326 U. S. 465, Ct. D. 1659, C. B. 1946–1, 57. However, since both such positions constitute part of the employee's trade or business, local transportation expenses in getting from one place of employment to another constitute ordinary and necessary expenses incurred in carrying on his combined trade or business and in discharging his duties at both locations during that same day. This reasoning is in accord with the Brown, Powell, and Sherman cases, *supra*, to the extent they allow taxpayers who are carrying on two unrelated occupations at widely separated locations to deduct their overnight traveling expenses incurred in getting from one business location to the other, and with I. T. 3842, C. B. 1947–1, 11, to the extent it holds that a State legislator who is also engaged in some other trade or business at a distance from the State capital may deduct his transportation expenses incurred in making daily round trips between his two places

of business, provided such daily round trips are necessary for the purpose of discharging his duties at both locations. However, the deduction of local transportation expenses, especially in a dual-employer situation, would usually be limited to a one-way trip between his two local places of employment on the same day because the employee ordinarily would not have to report back to his first place of employment on that day.

Accordingly, it is held that when a reservist attends prescribed drills within the city or general locality which constitutes his principal or regular post of duty, and on that same day is working at some other business location therein, he may deduct his one-way transportation expenses in getting from one such business location to the other. Of course, if the taxpayer returns to his residence for dinner after his regular working hours and before attending the drill, he can deduct his actual transportation expenses only to the extent they do not exceed the transportation expenses he would have incurred had he gone directly from one such business location to the other.

The transportation expenses held to be deductible herein constitute ordinary and necessary business expenses, rather than traveling expenses "while away from home." Under the Internal Revenue Code of 1939, as amended, unreimbursed transportation expenses may be deducted by an employee only in computing net income and then only on condition that the taxpayer itemizes his deductions instead of electing the optional standard deduction.

With respect to the deductibility of the cost and maintenance of reservists' uniforms, such question is governed by section 39.24(a)-1 of Regulations 118, which provides in pertinent part as follows:

* * * The cost of equipment of an Army officer to the extent only that it is especially required by his profession and does not merely take the place of articles required in civilian life is deductible. Accordingly, the cost of a sword is an allowable deduction, but the cost of a uniform is not. * * *

The second sentence of the above-quoted regulation is intended to be explanatory of the tests for deductibility prescribed in the first sentence thereof, rather than to establish an inflexible rule that the cost of any military uniform is a nondeductible personal expense. In any case, therefore, where a uniform "does not merely take the place of articles required in civilian life," deduction of amounts expended in the purchase and maintenance of such a uniform would not be precluded by such regulation. In the case of a reservist who is required to wear his uniform when on active duty for training for temporary periods, when attending service school courses, or when attending training assemblies, and who is prohibited by military regulations from wearing his uniform except on such occasions, it is believed the uniform does not merely take the place of articles required in civilian life.

It is held, therefore, that amounts expended by reservists for the purchase and maintenance of uniforms required for such infrequent occasions as those set forth above, and allowed to be worn only on such occasions, are deductible for Federal income tax purposes as ordinary and necessary business expenses, except to the extent that nontaxable allowances are received for these costs. Such position does not represent any change in the views of the Internal Revenue Service with respect to the nondeductibility of the costs related to uniforms worn without restriction as to the occasion for such wear by members of the

Armed Forces on full-time active duty. In such cases, the uniform is considered to replace ordinary civilian clothing and does not meet the test of the above-quoted provision of the regulations.

REGULATIONS 118, SECTION 39.23(a)-1: Business expenses. Rev. Rul. 55-189

(Also Section 116(g).)

Where a member of a shipowners' protection and indemnity association, which association is exempt from Federal income tax to the extent provided in section 116(g) of the Internal Revenue Code of 1939, pays into the reserve fund of the association an amount considered necessary to provide the necessary insurance protection left void by the $100,000 deductible provision, with respect to each member vessel, in standard hull and machinery marine insurance policies carried with regular marine insurance carriers, such amount is deductible from the member's gross income as a business expense under section 23(a) of the Internal Revenue Code of 1939 to the extent it is ordinary and necessary.

Advice has been requested as to the deductibility of amounts paid into the reserve fund of a shipowners' protection and indemnity association by its members, for the purpose of providing the insurance protection left void by the $100,000 deductible provision in standard hull and machinery marine insurance policies carried with regular marine insurance carriers with respect to each vessel. Advice has also been requested as to whether such association, under the following circumstances, is exempt from Federal income taxation to the extent provided in section 116(g) of the Internal Revenue Code of 1939.

The owners of several vessels formed an association for the purpose of providing the insurance protection left void by the $100,000 deductible provision with respect to each vessel covered by standard hull and machinery marine insurance policies carried with regular marine insurance carriers. Each member pays annually into the reserve fund of the association $10x$ dollars for each vessel owned by such member, which amount is considered sufficient to provide the necessary insurance protection.

All monies coming into the association are used only to cover operating expenses of the association and losses sustained by the vessels not covered by the standard hull and machinery marine insurance policies carried with respect to each vessel. No profits, gains or dividends are distributed to the members of the association. None of the funds are to be directly or indirectly loaned, returned, discounted, hypothecated, pledged, given, assigned, advanced, or invested with or to any members of the association. The association is to continue indefinitely unless otherwise dissolved by a majority vote of those owners entitled to vote. Upon dissolution, all funds belonging to the association shall be given to charitable organizations. No members are to receive any benefit, direct or indirect, upon dissolution and distribution of the assets of the association.

Section 116(g) of the Code provides for the exclusion from gross income of "The receipts of shipowner's protection and indemnity associations not organized for profit, and no part of the net earnings of which inures to the benefit of any private shareholder; but such

corporation shall be subject as other persons to the tax upon their net income from interest, dividends, and rents."

Based upon the facts presented, it is held that the monies received by the association from its members shall not be included in its gross income under the authority of section 116(g) of the Code. However, the association shall be subject to tax upon its net income from interest, dividends, and rents.

With respect to the amounts paid by the members into the reserve fund of the association, such amounts are deductible as a business expense under section 23(a)(1) of the Code to the extent that they are ordinary and necessary. Prima facie, the amount deductible will be limited to that which would be payable to an independent insurance company for a similar type of coverage. However, in a particular case a deduction of higher amounts may be justified on a showing by the taxpayer that they are necessary to the maintenance of a proper reserve.

REGULATIONS 118, SECTION 39.23(a)-1: Business expenses. Rev. Rul. 55-193

(Also Sections 22(a), 22(b); Regulations 118, Sections 39.22(a)-3, 39.22(b)(1)-1, 39.22(b)(2)-5.)

Where an employer sponsors a nontrusteed pension and insurance plan for the benefit of his employees, funded by means of a contract with an insurance company which is the equivalent of a combination group term life insurance and group annuity contract, the life insurance premiums paid by the employer under the contract are deductible under section 23(a)(1)(A) of the Internal Revenue Code of 1939 by the employer as ordinary and necessary business expenses in the year paid and, as prescribed in the last sentence of section 39.22(a)-3 of Regulations 118, are not taxable to the employees. Insurance benefits under the contract paid beneficiaries by reason of the death of an employee prior to retirement are not taxable to the beneficiary in accordance with section 22(b)(1)(A) of the Code. Benefits derived from the annuity portion of the contract paid by reason of the death of an employee prior to retirement are taxable to the beneficiary to the same extent that they would have been taxable to the employee had he lived and received such benefits, in accordance with section 39.22(b)(2)-5 of Regulations 118, except that amounts paid as a death benefit in excess of that in which the employee had a nonforfeitable interest at the time of death will be excluded from gross income of the beneficiary in an amount not in excess of $5,000 as provided under section 22(b)(1)(B) of the Code.

Advice has been requested whether (1) a business deduction is allowed for life insurance premiums paid by an employer under a nontrusteed combination group insurance and group annuity contract, (2) such premiums are taxable to the employee, (3) insurance benefits paid under the insurance provisions of the group contract by reason of the death of an employee prior to retirement are taxable to the beneficiary, and (4) death benefits under the retirement annuity portion of the contract paid by reason of the death of an employee prior to retirement are taxable to the beneficiary.

An employer established a nontrusteed pension and insurance plan for the benefit of his employees under which annuity benefits are pro-

vided retired employees and insurance benefits are provided active employees. All benefits are funded under a single contract issued by a life insurance company. The employees do not contribute to the contract.

The retirement benefit features of the contract are similar to those generally found in group annuities. In addition, as in some group annuity contracts, a death benefit is paid from the accumulation of premiums paid for the retirement annuity benefit, upon the death of an employee prior to retirement, such death benefit being equal to the premiums paid by the employer for the annuity benefit, but not exceeding 56 times the monthly retirement annuity which would have commenced at normal retirement age if the employee had not died. This portion of the plan has been held to meet the requirements of section 165(a) (3), (4), (5), and (6) of the Internal Revenue Code of 1939.

The insurance portion of the contract provides benefits payable upon death of an eligible employee prior to retirement which consist of (a) one year term group insurance for employees not yet eligible for retirement annuity coverage; and, for employees covered by the annuity portion of the contract: (b) a lump-sum insurance benefit which, when added to the death benefit payable under the annuity portion of the contract, will be equal to 56 times the amount of the monthly retirement benefit expected at normal retirement age, and (c) a monthly income death benefit of one-half the monthly retirement benefit expected at normal retirement age, but not exceeding $100 per month. The benefit provided in (c) is available only for married male employees and runs from the date of death of such employee to what would have been his normal retirement date had he lived. The employee has the right to designate the beneficiary of any death benefits.

Under the contract for those employees eligible for retirement annuity coverage, separate level annual premiums are specified for each benefit, *i. e.*, the retirement annuity benefit and the insurance benefits indicated in (b) and (c) above. In this respect this contract differs from the group permanent forms of insurance and annuity contracts where the specified premium covers both annuity and insurance benefits. Moreover, the reserve maintained by the insurer for the annuity portion of the contract is the full actuarial reserve for such benefits, without adjustment on account of any deficiency in the reserve for the insurance benefits outlined in (b) and (c) above. (In connection with the insurance benefits in (b) and (c) above, "negative" reserves arise because a level premium is charged for a benefit which decreases in such a way that the annual cost of insurance protection decreases. The level premiums are insufficient to pay the insurance costs in earlier years, which results in a deficiency which is not made up until the end of the premium-paying period.) For state insurance department valuation purposes, a separate minimum reserve is maintained for the insurance benefits, part of such reserve being borrowed from the insurer's general surplus. It thus appears it would be possible to issue separate contracts for the insurance and annuity benefits without necessarily requiring any change in the premiums charged, in the reserve maintained, or in the benefits provided. In this respect also, the contract differs from the group per-

manent forms in which a single combined reserve is maintained for the insurance and annuity features with respect to active lives.

As noted above, after an employee becomes eligible for retirement annuity coverage, level annual premiums are charged for the insurance benefits in (b) and (c) above. Although in this respect the insurance benefits are more like group permanent insurance than the typical group (one-year term) insurance, the use of the level premium method in connection with the decreasing amounts of insurance produces negative reserves, so that there is no advance funding for these insurance benefits. Therefore, the only benefit which can be derived from the premiums paid for these insurance benefits consists of current insurance protection; thus, it is this feature that distinguishes typical group term insurance from group permanent insurance in which reserves are built up which may be used for continued insurance protection or some other benefit. In the present contract, benefits payable upon termination of employment prior to death or retirement, or upon termination of the plan, are derived solely from the reserve accumulated under the retirement annuity portion of the contract, and no portion of the reserve can be applied to continued insurance protection.

Upon termination of employment prior to retirement, a participant has the right to convert his term insurance coverage to individual permanent insurance, without evidence of insurability, the premium for this permanent insurance being that applicable to the class of risk to which the participant belongs and to the form and amount of the policy at his then current age. However, in accordance with Revenue Ruling 54–165, C. B. 1954–1, 17, the mere fact that an insurance contract permits conversion of term insurance to permanent types of insurance for which the employee pays the entire cost would not make the employer's premium payments for the term insurance includible in the employee's gross income if, in the absence of such a provision for conversion, such premiums would not be so includible.

On the basis of the foregoing considerations, it is held that the contract shall be considered as the equivalent of a combination of group term life insurance and group annuity contracts and not as a group permanent form. Accordingly, the tax consequences set forth in Mimeograph 6477, C. B. 1950–1, 16, with respect to group permanent life insurance, are not here applicable.

A deduction from gross income is provided in section 23(a)(1)(A) of the Code for all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered.

The last sentence of section 39.22(a)–3 of Regulations 118 prescribes that premiums paid by an employer on policies of group life insurance covering the lives of his employees, the beneficiaries of which are designated by the employees, are not income to the employees.

Section 22(b)(1)(A) of the Code provides that there shall be excluded from gross income and exempt from income tax, amounts received under a life insurance contract paid by reason of the death of the insured.

A $5,000 exclusion from gross income is provided in section 22(b)(1)(B) of the Code for amounts paid by or on behalf of an employer by reason of the death of an employee. Paragraph (d)(1)

of section 39.22(b)(1)-2 of Regulations 118 states in effect that such exclusion is limited to amounts which are specifically designated as a death payment with respect to which the deceased employee did not have a nonforfeitable right while living. See also Rev. Rul. 55-74, page 230, this Bulletin.

Under paragraph (c), section 39.22(b)(2)-5 of Regulations 118, if upon the death of a retired employee, the beneficiary of such employee is paid, in accordance with the terms of the annuity contract relating to the deceased employee, an annuity or other death benefit, the amounts received shall be included in the beneficiary's income to the extent they would have been included in the income of the deceased employee had he lived and received such payment, except to the extent the exclusion provided by section 22(b)(1)(B) is applicable. Similar tax treatment would apply to the death benefit under an annuity where the employee dies before retirement.

Accordingly, it is held that where an employer establishes a nontrusteed pension and insurance plan for the benefit of his employees, funded by means of a contract which is the equivalent of a combination group term life insurance and group annuity contract, the premiums paid for the insurance benefits under the contract by the employer are deductible by the employer under section 23(a)(1)(A) of the Code as ordinary and necessary business expenses in the year paid and, as prescribed in the last sentence of section 39.22(a)-3 of Regulations 118, are not taxable to the employees. Insurance benefits under the contract paid beneficiaries by reason of the death of an employee are not taxable to the beneficiary in accordance with section 22(b)(1)(A) of the Code. Benefits derived from the annuity portion of the contract paid by reason of the death of an employee prior to retirement, are taxable to the beneficiary in accordance with section 39.22(b)(2)-5 of Regulations 118 to the same extent they would have been taxable to the employee had he lived and received such benefits, except that any portion of such amounts paid as a death benefit in excess of that in which the employee had a nonforfeitable interest at the time of death will be excluded from gross income of the beneficiary in an amount not in excess of $5,000 as provided under section 22(b)(1)(B) of the Code.

REGULATIONS 118, SECTION 39.23(a)-1: Business expenses. Rev. Rul. 55-201

Amounts expended by National Guard officers to stimulate interest in their unit of the Guard, to maintain the strength of the unit at a high level, to build up morale, etc., which have not been authorized as a regular expense payable by the United States Army but which are paid out of the personal funds of the officers are held not to be necessary to the taxpayers' business as officers of the National Guard and as such are not deductible as ordinary and necessary business expenses under section 23(a)(1) of the Internal Revenue Code of 1939 in computing the net income of such officers. Where these expenditures are made in compliance with appropriate United States Army regulations respecting the making of contributions to company and other Guard unit funds, and where such expenses are incurred for exclusively public purposes, deductions therefor are allowable under section 23(o)(1) of the Code.

Advice has been requested whether expenses incurred by National Guard officers which benefit the United States National Guard, but

which are not authorized by the United States Army, are deductible in computing net income.

Some officers of a National Guard unit have been making voluntary expenditures out of their personal funds to benefit their unit of the National Guard of the United States. These expenditures include amounts spent for entertainment of prospective new members, headquarters supplies, advertising, building signs, equipment for the unit's dayroom, etc., and are designed to stimulate interest in the Guard, maintain the strength of the unit at a high level, and build up morale.

Section 23(a)(1) of the Internal Revenue Code of 1939 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. However, in the absence of any regulation of the National Guard of the United States or order from superior officers, the expenses referred to above are held not to be necessary to the taxpayers' business as officers of the National Guard of the United States.

Accordingly, such expenses incurred by National Guard officers which have not been authorized as a regular expense payable by the United States Army, but which are paid out of the personal funds of such officers, are not deductible as ordinary and necessary business expenses under section 23(a)(1) of the Code in computing the net income of such officers. To the extent expenses for the above-stated purposes are incurred in compliance with appropriate United States Army regulations respecting the making of contributions to a company or other Guard unit fund and to the extent it can be shown that such expenses are incurred for exclusively public purposes, deductions therefor are allowable in accordance with section 23 (o) (1) of the Code. Compare *W. W. Bercaw* v. *Commissioner*, 165 Fed. (2d) 521, the second issue, involving the purchase of an electric clock by an Army officer.

REGULATIONS 118, SECTION 39.23(a)-1: Business expenses. Rev. Rul. 55-250

Dues paid by members of the Armed Forces of the United States to an officers' or a noncommissioned officers' club are not so directly connected with the carrying on of their trade or business as to constitute an ordinary and necessary business expense deductible under section 23(a)(1)(A) of the Internal Revenue Code of 1939.

Advice has been requested whether dues paid by an officer of the Armed Forces of the United States to an officers' club are deductible for Federal income tax purposes as an ordinary and necessary business expense.

In the instant case, an officer maintains a membership in an officers' open mess, a social organization known as an officers' club. Although membership is on a voluntary basis, it has come to be regarded as customary among officers.

Section 23 of the Internal Revenue Code of 1939 provides in part as follows:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:
(a) EXPENSES.—

* * * * * * *

(A) In General.—All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business * * *.

Section 39.23(a)–1 of Regulations 118 provides in part that business expenses deductible from gross income include the ordinary and necessary expenditures directly connected with or pertaining to the taxpayer's trade or business. Section 48(d) of the Code provides that the term "trade or business" includes the performance of the functions of a public office. Military and civilian officers and employees of the Government have generally been regarded as engaged in a "trade or business" within the meaning of section 23(a)(1)(A) of the Code. See I. T. 4012, C. B. 1950–1, 33.

Whether amounts paid for club dues are deductible as an ordinary and necessary business expense must depend on a showing that such expense is directly connected with or pertaining to the carrying on of the taxpayer's trade or business. I. T. 1936, C. B. III–1, 122 (1924), holds that the benefits arising from membership in a club for cavalry officers of the National Guard, which employed stable men to care for the officers' mounts, did not justify the conclusion that the membership dues paid to the club represented an ordinary and necessary business expense, and such dues were held not deductible. In *Charles A. Harris et ux.* v. *Commissioner*, Tax Court Memorandum Opinion, entered January 28, 1953, it was held that Air Force Association dues paid by an Air Force officer were not deductible as a business expense.

In the case under consideration, the purpose and use of membership in an officers' club is not shown to be so connected with the performance of duty as a member of the Armed Forces as to justify the conclusion that membership dues paid to the club represent an ordinary and necessary business expense.

Accordingly, it is held that dues paid by members of the Armed Forces to an officers' club are not deductible under section 23(a)(1)-(A) of the Code. A similar conclusion results with respect to dues paid by enlisted personnel of the Armed Forces to a noncommissioned officers' club which is constituted and operated in the same manner as an officers' club.

REGULATIONS 118, SECTION 39.23(a)–1: Business expenses. Rev. Rul. 55–331

[(Also Sections 22(b), 23(x), 24(a); Regulations 118, Sections 39.23(x)–1, 39.24(a)–1.)

Premiums paid by an individual for his personal disability insurance do not constitute business expenses under section 23(a) of the Internal Revenue Code of 1939, but constitute personal expenses the deduction of which is prohibited by section 24(a)(1) of the Code. Further, such payments do not constitute medical expenses within the meaning of section 23(x) of the Code. However, any amounts received by such individual pursuant to the insurance contract are excludable from gross income under section 22(b)(5) of the Code as amounts received as compensation for personal injuries or sickness.

Advice has been requested whether premiums paid by a taxpayer for his personal disability insurance, under the following circumstances, are deductible from his gross income as a business expense under the provisions of section 23(a) of the Internal Revenue Code of 1939 or as a medical expense under section 23(x) of the Code.

The taxpayer purchased disability insurance which would, in part, replace income lost by reason of the loss of, or loss of the use of, a portion of the body vital to his profession. The contract provides that, in consideration of the premiums paid, if at any time during the period of the insurance the taxpayer shall sustain full loss or partial loss of that part or parts of the body insured, the underwriters will pay the assured, his executors, or administrators, compensation in accordance with the terms of the contract, but not exceeding an aggregate of a certain sum. The specific question presented is whether the premiums paid for such contract of insurance are deductible as a business expense under section 23(a) of the Code.

The applicable sections of the Code involved are as follows:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

(a) EXPENSES.—

(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, * * *.

* * * * * * *

(x) MEDICAL, DENTAL, ETC., EXPENSES.—Expenses paid during the taxable year, not compensated for by insurance or otherwise, for medical care of the taxpayer, his spouse, or a dependent * * *.

* * * * * * *

The term "medical care", as used in this subsection, shall include amounts paid for the diagnosis, cure, mitigation, treatment, or prevention of disease, or for the purpose of affecting any structure or function of the body (including amounts paid for accident or health insurance) * * *.

SEC. 24. ITEMS NOT DEDUCTIBLE.

(a) GENERAL RULE.—In computing net income no deduction shall in any case be allowed in respect of—

(1) Personal, living, or family expenses, except extraordinary medical expenses deductible under section 23(x);

SEC. 22. GROSS INCOME.

* * * * * * *

(b) EXCLUSIONS FROM GROSS INCOME.—The following items shall not be included in gross income and shall be exempt from taxation under this chapter:

* * * * * * *

(5) COMPENSATION FOR INJURIES OR SICKNESS.—Except in the case of amounts attributable to (and not an excess of) deductions allowed under section 23(x) in any prior taxable year, amounts received, through accident or health insurance or under workmen's compensation acts, as compensation for personal injuries or sickness, plus the amount of any damages received whether by suit or agreement on account of such injuries or sickness, * * *;

The statute clearly distinguishes between ordinary and necessary expenses of a trade or business and personal expenses, the former being deductible and the latter nondeductible. Section 23(a)(1) of the Code is not all inclusive, but the deduction of expenses under that section is limited to those referred to therein.

Since the benefits available to the taxpayer under the terms of the insurance contract indemnify him against loss of, or loss of the use

of, a portion of the body, it is held that the premiums paid for such coverage do not constitute a business expense within the meaning of section 23(a) of the Code, but constitute personal expenses the deduction of which is prohibited by section 24(a)(1) of the Code. Further, since the benefits available indemnify the taxpayer against specified losses or bodily injuries and do not, in any way, reimburse him for any medical expenses, the premiums paid for the coverage do not constitute a proper deduction under section 23(x) of the Code as an extraordinary medical expense. Compare Rev. Rul. 19, C. B. 1953-1, 59. However, any amounts received by the taxpayer pursuant to the insurance contract are excludable from gross income under the provisions of section 22(b)(5) of the Code.

REGULATIONS 118, SECTION 39.23(a)-1: Business expenses.

Deductibility of travel expenses in connection with promotional activities of a tax exempt organization. See Rev. Rul. 55-4, page 291.

REGULATIONS 118, SECTION 39.23(a)-1: Business expenses.

Expenses of wife who accompanies her husband on a business trip or to a business convention. See Rev. Rul. 55-57, page 315.

REGULATIONS 118, SECTION 39.23(a)-1: Business expenses.

Costs and expenses applicable to property held for sale in ordinary course of business contributed to an organization described in section 23(o) or section 23(q) of the Internal Revenue Code. See Rev. Rul. 55-138, page 223.

REGULATIONS 118, SECTION 39.23(a)-1: Business expenses.

Expenditures of amounts collected from lot owners by a real estate development company for fire and police protection and maintenance of its residential development. See Rev. Rul. 55-154, page 216.

REGULATIONS 118, SECTION 39.23(a)-1: Business expenses.

Protective articles of clothing worn by commercial fishermen. See Rev. Rul. 55-235, page 274.

REGULATIONS 118, SECTION 39.23(a)-1: Business expenses.

Deductibility of insurance policy premiums paid by a taxpayer for the purpose of reimbursing him for business overhead expenses in-

curred by him during prolonged periods of inability to work because of injury or sickness. See Rev. Rul. 55-264, page 11.

REGULATIONS 118, SECTION 39.23(a)-1: Trade or business expenses.

A contribution by a taxpayer in business for the purpose of bringing a national convention to locality. See Rev. Rul. 55-265, page 22.

REGULATIONS 118, SECTION 39.23(a)-1: Business expenses.

Expenses incurred by a teacher on sabbatical leave for study not required to maintain position. See Rev. Rul. 55-412, page 318.

REGULATIONS 118, SECTION 39.23(a)-2: Traveling expenses. (Also Section 39.23(a)-1.) Rev. Rul. 55-235

Crew members of a commercial fishing boat have their principal or regular post of duty at the home port where they ordinarily, or for an indefinite (as distinguished from a temporary) period, begin and end their fishing trips. Thus, they may deduct the reasonable and necessary expenses actually incurred by them for travel, meals, and lodging when on a business trip requiring their absence from such home port for a minimum period which lasts substantially longer than an ordinary day's work and during which their duties require them to obtain necessary sleep while away from such home port. See Rev. Rul. 54-497, C. B. 1954-2, 75. Expenditures incurred by commercial fishermen for protective clothing of a type not adaptable to general use, such as oil clothes, work gloves, and rubber boots, may be deducted in computing net income, provided the standard deduction is not claimed. See I. T. 3373, C. B. 1940-1, 28.

REGULATIONS 118, Section 39.23(a)-2: Traveling expenses. Rev. Rul. 55-236

The principles enunciated in Revenue Ruling 54-497, C. B. 1954-2, 75, and other rulings cited therein, concerning the deductibility and substantiation of traveling and related expenses incurred by railroad employees, are equally applicable to long line truck drivers who incur expenses for meals and lodging while away from their home terminal in the pursuit of their trade or business. Since a taxpayer's "home terminal" is not limited to a particular building or property, but includes the entire city or general locality which constitutes his principal or regular post of duty, the cost of meals purchased within such general area at the beginning or end of a long line truck driver's run represents a nondeductible living expense. See Revenue Ruling 55-109, page 261 of this Bulletin, and cases cited in the sixth paragraph thereof.

REGULATIONS 118, SECTION 39.23(a)-2: Traveling expenses.

Travel expenses incurred by a teacher on sabbatical leave for study not required to maintain position. See Rev. Rul. 55-412, page 318.

REGULATIONS 118, SECTION 39.23(a)-9: Pensions; compensation for injuries.

Deductibility of payments by an employer to the widow of a deceased employee. See Rev. Rul. 55-212, page 299

REGULATIONS 118, SECTION 39.23(a)-10: Rentals.

So-called rental payments to bank which purchased and holds legal title to automotive equipment which it leases to taxpayer. See Rev. Rul. 55-25, page 283.

REGULATIONS 118, SECTION 39.23(a)-15: Nontrade or nonbusiness expenses. Rev. Rul. 55-23

Where a subscriber to a sponsored investment plan pays a custody fee, as distinguished from a "creation" fee, to the sponsor and custodian of the plan for services rendered in making investments and keeping necessary records, the fee, pursuant to Revenue Ruling 3, C. B. 1953-1, 37, is deductible annually as a nonbusiness expense under section 23(a)(2) of the Internal Revenue Code of 1939 and the subscriber-taxpayer has no election to treat the fee as a capital expenditure.

REGULATIONS 118, SECTION 39.23(a)-15: Nontrade or nonbusiness expenses. Rev. Rul. 55-190

Attorney's fees and administration expenses paid or incurred by the fiduciary of an estate in connection with the administration of the estate, including expenses incurred in the determination, collection, or refund of any tax, are not deductible in the fiduciary's personal income tax return. However, expenses incurred during the administration of an estate which are paid by the executor or administrator in his capacity as the fiduciary of the decedent's estate are deductible under section 23(a)(2) of the Internal Revenue Code of 1939, in the estate's income tax return for the year in which the payment was made, provided such expenses are not claimed as a deduction in computing the net estate subject to the estate tax. See sections 39.23(a)-15(i) and 39.162-1 of Regulations 118, and I. T. 4018, C. B. 1951-1, 39.

REGULATIONS 118, SECTION 39.23(a)-15: Nontrade or nonbusiness expense. Rev. Rul. 55-221

Litigation expenses paid or incurred in a suit to have a residuary trust declared void do not constitute expenses proximately related to

the production or collection of income or to the management, conservation, or maintenance of property held for the production of income. Such expenses are classified as expenses of defending or perfecting title to property and are in the nature of capital expenditures. Accordingly, they are not deductible as nontrade or nonbusiness expenses under section 23(a)(2) of the Internal Revenue Code of 1939 insofar as they are allocable to recovery of property as distinguished from recovery of income.

SECTION 23(b).—DEDUCTIONS FROM GROSS INCOME: INTEREST

REGULATIONS 118, SECTION 39.23(b)-1: Interest. Rev. Rul. 55-389

Interest paid or accrued on debentures sold by a corporation to increase its working capital and to provide for refunding of indebtedness, and plant expansion, constitutes an allowable deduction within the meaning of section 23(b) of the Internal Revenue Code of 1939, notwithstanding the temporary or short-term investment of a substantial portion of the proceeds from the debentures in tax-exempt negotiable securities.

Advice has been requested whether interest paid or accrued on debentures sold by a corporation to increase its working capital and to provide for refunding of indebtedness, and plant expansion, constitutes an allowable deduction within the meaning of section 23(b) of the Internal Revenue Code of 1939 where a substantial portion of the proceeds of the indebtedness is temporarily invested in tax-exempt securities.

A sharp growth in sales volume and rapidly increasing demands on taxpayer's manufacturing facilities, as well as a material increase in its working capital requirements, necessitated an additional financing program. In this connection the taxpayer issued additional capital stock and sinking fund debentures. Through this financing the taxpayer proposed to provide additional capital for additional equipment, facilities and related services to manufacture its products.. The taxpayer also proposed to liquidate some of its debts. The balance of the monies received through this financing program was to be used for working capital and other corporate purposes.

The sale of the additional shares of stock and sinking fund debentures was consummated in April 1954, and a portion of the proceeds was applied for purposes of liquidating the taxpayer's debts, leaving a net balance for the purpose of planned expansion and working capital.

The taxpayer, being aware of the time required to complete the performance of construction contracts and to obtain delivery of machine tools, invested a substantial portion of the proceeds from the sales of debentures for a short but unspecified period of time in tax-exempt negotiable securities.

Section 23 of the 1939 Code provides that in computing net income there shall be allowed as deductions:

(b) INTEREST.—All interest paid or accrued within the taxable year on indebtedness, except on indebtedness incurred on continued to purchase or carry obligations (other than obligations of the United States issued after September 24, 1917, and originally subscribed for by the taxpayer) the interest upon which is wholly exempt from the taxes imposed by this chapter.

The indebtedness in question has been incurred for the purposes of refinancing other indebtedness, furnishing working capital, and contemplated plant expansion, rather than "to purchase or carry" tax-exempt securities. Accordingly if the borrowed funds so invested in the tax-exempt securities are expended for plant expansion during the years 1954 and 1955, it is held that the interest paid or accrued on the debentures will constitute an allowable deduction under section 23(b) of the Code, notwithstanding the temporary investment of such funds in tax-exempt securities. Compare S. R. 5128, C. B. IV-2, 156 (1925).

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

REGULATIONS 118, SECTION 39.23(c)-1: Taxes. Rev. Rul. 55-65

The two percent addition imposed by section 71.10(9)(c) of the Wisconsin Statutes (1953) on corporations, organized in the State of Wisconsin and licensed to do business therein, for failure to pay income tax in full on or before the 15th day of the third month following the close of the income year is a part of the tax and consequently is deductible under section 23(c) of the Internal Revenue Code of 1939.

The additions imposed by section 71.13(1) of the Wisconsin law to be added to the initial amount of income tax for delinquency in payment of the tax when due and under section 71.11(40) for failure to file an income tax return within the time prescribed by law are penalties and therefore are not deductible. See *Kossar & Co., Inc.* v. *Commissioner*, 16 B. T. A. 952.

REGULATIONS 118, SECTION 39.23(c)-1 Taxes. Rev. Rul. 55-139

The tax imposed by the State of Georgia by section 2 of the Georgia Retailers' and Consumers' Sales and Use Tax Act, Georgia Laws 1951, 360, approved on February 20, 1951, effective April 1, 1951, is a tax imposed upon the purchaser or consumer and is deductible under section 23(c)(1) of the Internal Revenue Code of 1939 regardless of whether or not it is imposed with respect to property used in a trade or business.

I. T. 4058, C. B. 1951-2, 22, modified.

Further consideration has been given I. T. 4058, C. B. 1951-2, 22, relating to the tax imposed by the State of Georgia under section 2 of the Georgia Retailers' and Consumers' Sales and Use Tax Act, Georgia Laws 1951, 360, approved on February 20, 1951, effective April 1, 1951. In I. T. 4058 it is held that such tax is deductible under section 23(c)(1) of the Internal Revenue Code of 1939 by persons who engage in the business of selling tangible personal property at retail in Georgia and by persons exercising the respective privileges set forth in the Act. If such persons are individuals, the deduction must be taken in computing adjusted gross income. In the case of such persons who are not individuals, the deduction is allowable in determining net income. Where taxpayers collect the tax from vendees they must include the total amounts so collected in their gross income for Federal income tax purposes. It is further held that to the extent that the tax is paid by the purchaser or consumer, other-

wise than in connection with his trade or business, it is deductible by the purchaser or consumer under section 23(c)(3) of the Code, except in the case of an individual who elects to take the optional standard deduction. In case the purchaser or consumer is an individual and the tax is paid in connection with his trade or business, the tax must be deducted in computing adjusted gross income.

The Act, *supra*, provides in part as follows:

> SEC. 12. Be it further enacted, by the authority aforesaid, that:
>
> (a) The privilege tax herein levied, measured by retail sales shall be collected by the dealer from the purchaser or consumer. Notwithstanding any other provision, it is the purpose and intent of this Act that the tax imposed hereunder is, in fact, a levy on the purchaser or consumer of the tangible personal property or services described in this Act, and the levy on dealers as specified is merely as agent of the State for collection of said tax. Therefore, notwithstanding any exemptions from taxes which any dealer may now or hereafter enjoy under the constitution or laws of this or any other State, or of the United States, such dealer shall collect the tax imposed hereunder from the purchaser or consumer and shall pay the same over to the State Revenue Commissioner as herein provided.

Section 23(c)(1) of the Code provides that in computing net income there shall be allowed as deductions taxes paid or accrued within the taxable year with certain exceptions not here material. Section 39.23(c)-1(a) of Regulations 118 provides that in general taxes are deductible only by the person upon whom they are imposed. Under section 23(c)(3) of the Code, retail sales taxes are deductible by the consumer when the burden of the tax is borne by the consumer even though the tax is not imposed upon the consumer but is imposed upon the dealer, unless the property upon which the tax is imposed is used by the consumer in connection with his trade or business.

From the phraseology of the Act, *supra*, "notwithstanding any other provisions * * *," it appears that the legislative intent and purpose was to impose a tax on the purchaser or consumer of the tangible personal property or services described in this Act, and that the levy on dealers as specified is merely as agent of the State for collection of the tax and to pay the same over to the State Revenue Commissioner.

Accordingly, it is held that the Georgia sales and use tax is imposed upon the purchaser or consumer and is paid by such taxpayer as a tax and is therefore deductible under section 23(c)(1) of the Code, regardless of whether or not it is imposed with respect to property used in a trade or business. Since the dealers are agents of the State for collection purposes, amounts collected by them as tax and paid to the State are not includible in their gross income for Federal income tax purposes. However, amounts retained by such agents as a fee for collecting the tax are includible in gross income.

I. T. 4058, C. B. 1951-2, 22, is modified to the extent that it is inconsistent with the views expressed herein.

REGULATIONS 118, SECTION 39.23(c)-1: TAXES (ALSO SECTION 22(n); REGULATIONS 118, SECTION 39.22(n)-1.) — Rev. Rul. 55-289

The tax imposed by the State of Mississippi, section 10174 of the Mississippi Code, as amended by House Bill No. 678, April 13, 1954,

Cumulative Supplement to Mississippi Code 1942 Annotated, Volume 7A recompiled, upon the sale, use, gift, possession or consumption of cigarettes, cigars and smoking tobacco, the impact or burden of which is declared to be upon "the vendee, user, consumer or possessor of cigarettes within the State of Mississippi" is deductible under section 23(c)(1) of the Internal Revenue Code of 1939 by the consumer or ultimate user to the extent that the amount of the tax is paid to the vendor by the vendee. However, in the case of an individual who elects to use the optional standard deduction, no deduction is allowable unless the tax is attributable to a trade or business carried on by him. If the tax is attributable to a trade or business carried on by the individual the amount of the tax is deductible from gross income in computing adjusted gross income within the meaning of section 22(n) of the Code, provided the trade or business does not consist of the performance of a service as an employee. Effective April 13, 1954, no deduction is allowable to the wholesaler and no portion of the price paid by the consumer or ultimate user for such products which represents the taxes thereon is includible in the gross income of the wholesaler.

REGULATIONS 118, SECTION 39.23(c)-1: Taxes.

Bonus required by the State of Pennsylvania to be paid on capital employed therein by organizations not created under the laws of that State. See Rev. Rul. 55-48, page 281.

REGULATIONS 118, SECTION 39.23(c)-1: Taxes.

Deductibility of real property taxes imposed by the State of Ohio, pursuant to section 5719.01 of the Revised Code of Ohio, effective October 13, 1953. See Rev. Rul. 55-152, page 67.

REGULATIONS 118, SECTION 39.23(c)-1: Taxes.

Tax imposed by State of Louisiana on cigarettes sold at wholesale or retail. See Rev. Rul. 55-326, page 24.

REGULATIONS 118, SECTION 39.23(c)-3: Taxes for local benefits.

Taxes assessed by Moffat Tunnel Improvement District of Colorado. See Rev. Rul. 55-284, page 25.

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

REGULATIONS 118, SECTION 39.23(e)-1: Losses by individuals. Rev. Rul. 55-274

(Also Sections 22(a), 23(f), Regulations 118, Sections 39.22(a)-1, 39.23(f)-1.)

For Federal income tax purposes, no gain is realized or loss sustained upon the redemption, prior to maturity, of 2½ percent Treasury

Bonds, Investment Series A-1965. Interest on such bonds is includible in gross income when received or accrued, depending on the taxpayer's method of accounting, and such interest accrues when it becomes payable and not until then. The difference between the amount received upon the redemption of such bonds prior to maturity and their face value constitutes a refund of a portion of the interest previously received and reported as gross income by the bondholder, and therefore it is deductible by him in the taxable year of redemption as an ordinary loss. Compare I. T. 3504, C. B. 1941-2, 93.

Regulations 118, Section 39.23(e)-1: Losses by individuals.

Adjustments of excessive accrual of interest on future payment funds held by Federal land banks. See Rev. Rul. 55-254, page 326.

Regulations 118, Section 39.23(e)-2: Voluntary removal of buildings. Rev. Rul. 55-110
(Also Section 23(f); Regulations 118, Section 39.23(f)-1.)

Where a taxpayer purchases property, with the intention of removing the old buildings thereon, and then either erecting a new building thereon or using the property without any additional improvements, no deductible loss or expense is sustained or incurred upon the removal of such old buildings. The removal costs constitute a part of the basis of the land acquired. Section 39.23(e)-2 of Regulations 118, and O. D. 1031, C. B. 5, 141 (1921). Further, the basis of such property must be reduced by the amounts of any payments received from the sale of the old buildings.

SECTION 23(f).—DEDUCTIONS FROM GROSS INCOME: LOSSES BY CORPORATIONS

Regulations 118, Section 39.23(f)-1: Losses by corporations.

Loss upon voluntary removal of buildings. See Rev. Rul. 55-110, page 280.

Regulations 118, Section 39.23(f)-1: Losses by corporations.

Interest "refunded" upon redemption, prior to maturity, of 2½ percent Treasury Bonds, Investment Series A-1965. See Rev. Rul. 55-274, page 279.

SECTION 23(g).—DEDUCTIONS FROM GROSS INCOME: CAPITAL LOSSES

REGULATIONS 118, SECTION 39.23(g)-1; Capital losses. Rev. Rul. 55-48

(Also Section 23(c), Section 39.23(c)-1.)

The bonus required by the State of Pennsylvania to be paid, in accordance with the provisions of the Pennsylvania law prior to its repeal on July 25, 1953, on capital employed or to be employed in that State by an organization not created or chartered under the laws of Pennsylvania and which was capitalized on the books of the organization, does not constitute an allowable deduction from gross income for Federal income tax purposes during such time as the organization remains in existence and the capital stock, or the equivalent thereof, remains outstanding.

Advice has been requested whether the bonus required by the State of Pennsylvania to be paid on capital employed in that State by an organization not created or chartered under the laws of Pennsylvania, and which was capitalized on the books of the organization, becomes deductible for Federal income tax purposes in 1953, the year in which the law providing for such payment was repealed, or in some later year.

I. T. 3210, C. B. 1938-2, 141, holds that the bonus required to be paid to the State of Pennsylvania, as provided for by section 1, Act of May 8, 1901, as amended, and found in Title 72, section 1851 of Purdon's Pennsylvania Statutes, Annotated, on capital employed or to be employed in that State by corporations, limited partnerships, or joint stock associations, not created or chartered under the laws of the State of Pennsylvania, was not a tax but a capital expenditure which was not deductible for Federal income tax purposes.

The Act of May 8, 1901, as amended, in respect of the bonus payment, was repealed by Public Law 149 by the Pennsylvania Legislature on July 25, 1953. See Purdon's Pennsylvania Statutes, Annotated, Title 72, Cumulative Annual Pocket-Part, page 26. The repealing provisions were not made retroactive, and, generally, became effective as of January 1, 1953. Public Law 149 contains the provision that every foreign corporation, as that term is defined in the Act, in respect of which a certificate has been issued to do business in the State of Pennsylvania, at the effective date, shall pay an excise tax upon the amount of any increase of capital actually employed wholly within that state; and, as to such corporations admitted to do business in that state after the effective date, the tax is payable upon the capital actually employed wholly within the state and upon any increase thereof.

Foreign corporations as defined by Public Law No. 149, *supra*, includes limited partnerships or joint stock associations chartered or created by or under the laws of any other state or of the United States or of any foreign country, which has been issued a certificate of authority by the State of Pennsylvania to do business within the State and which either has its principal or chief place of business located within the State, or has any part of its capital actually employed therein. It does not, however, include foreign insurance companies and foreign nonprofit corporations.

Inasmuch as the Act of May 8, 1901, *supra*, under which a bonus payment was required of an organization not created or chartered under the laws of Pennsylvania, was not invalidated and the amount of such payment is not refundable, the classification thereof as a capital expenditure would remain undisturbed.

Accordingly, it is held that the bonus, which was required to be paid to the State of Pennsylvania under its laws on capital employed or to be employed in that State by an organization not created or chartered under the laws of Pennsylvania, which payment properly was capitalized on the books of the organization, and the statute under which imposed not having been invalidated, even though repealed but without retroactive effect, is not recognizable as being worthless or deductible, for Federal income tax purposes, during such time as the organization continues in existence and its capital stock, or the equivalent thereof, remains outstanding.

Regulations 118, Section 39.23(g)-1: Capital losses. Rev. Rul. 55-66

(Also Section 23(k), Section 39.23(k)-1.)

Allocations to patrons in document form issued by a cooperative association in accordance with a preexisting agreement may take the form of certificates denoting an investment in the capital of the cooperative or of certificates of indebtedness of the cooperative. In such cases, it is considered that the patron has in effect received in money the face amount of the document and has either reinvested that amount in the capital of the association or allowed the association the use thereof. See Rev. Rul. 54–10, C. B. 1954–1, 24. The bylaws usually disclose the nature of the relationship between the association and its patrons, and hence, whether there has been an investment in capital of or a loan to the association. This relationship is reflected in the type of instrument which a patron receives. By showing whether there has been an investment in capital or a loan, the instrument will indicate whether a loss due to worthlessness upon dissolution or insolvency, of the cooperative which issued it, may be treated as a capital loss or as a bad debt.

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

Regulations 118, Section 39.23(k)-1: Bad debts.

Treatment of cooperative association allocations in document form upon dissolution or insolvency. See Rev. Rul. 55–66, above.

Regulations 118, Section 39.23(k)-5: Reserve for bad debts. Rev. Rul. 55-3

In the case of a bank having permission to use and using the reserve method of accounting for bad debts for Federal income tax purposes, the alternative method of computing additions to the reserve, as

provided in Revenue Ruling 54-148, C. B. 1954-1, 60, may be adopted at the option of the bank for any taxable year beginning after December 31, 1953, without obtaining further permission from the Commissioner.

REGULATIONS 118, SECTION 39.23(k)-5: Reserve for bad debts. Rev. Rul. 55-24

Where a bank, using either the moving average percentage of actual bad debt losses to loans in determining additions to its reserve for bad debts as provided in Mimeograph No. 6209, C. B. 1947-2, 26, or the average experience factor based on any 20 consecutive years of bad debt experience after 1927 as provided in Revenue Ruling 54-148, C. B. 1954-1, 60, has recovered during any of the 20 years used in computing either experience factor an amount of a loan charged off as a bad debt prior to the representative 20-year period, the amount of recovery should be taken into account for the year of recovery in determining the bank's moving average percentage or its average experience factor.

REGULATIONS 118, SECTION 39.23(k)-5: Reserve for bad debts.

Inclusion of certain preferred stock as part of total deposit or withdrawal accounts in the computation of the addition to the reserve for bad debts in the case of a building and loan association. See Rev. Rul. 55-391, page 306.

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

REGULATIONS 118, SECTION 39.23(l)-1: Depreciation. Rev. Rul 55-25

(Also Section 23(a), Section 39.23(a)-10; Section 24(a), (Section 39.24(a)-2.)

The taxpayer and a bank entered into a "Trust Agreement" providing that the latter as "trustee" would purchase and "lease" to the taxpayer certain automotive equipment. However, the trustee will hold only bare legal title to the vehicles and the taxpayer will have possession as well as all the rights and obligations relating thereto during their useful life and also any salvage realized upon their final disposition. The taxpayer will make stipulated payments termed "rent" to the trustee, which will be equal to the costs incurred by the bank in acquiring the vehicles as well as interest and incidental expenses. The agreement further provides that the taxpayer may at any time acquire full title to the vehicles by paying the balance of the costs then remaining unpaid. *Held*, that the taxpayer is virtual owner of the vehicles and is entitled to deduct depreciation thereon which should be spread over the useful life of the equipment rather than over the stated "lease" period. The payments termed "rent" in the agreement

constitute part payment for capital items and should be capitalized by the taxpayer insofar as they represent capital payments.

REGULATIONS 118, SECTION 39.23(l)-1: Depreciation. Rev. Rul. 55-89

The devisee of a lessor who is devised an interest in property on which a building had been constructed by a lessee without cost to the lessor, under a lease which extends beyond the useful life of the building, is not entitled to a depreciation allowance on the building.

Advice has been requested whether the devisee of a lessor, who has been devised property, or an interest in property, on which a building has been erected by the lessee without cost to the lessor under a long term lease which extends beyond the useful life of the building, is entitled to a depreciation allowance.

Section 23 of the Internal Revenue Code of 1939 provides for a deduction from gross income for—

(l) DEPRECIATION.—A reasonable allowance for the exhaustion, wear and tear (including a reasonable allowance for obsolescence)—
(1) of property used in the trade or business, or
(2) of property held for the production of income.

In the case of a lessor of property on which a building has been erected by the lessee without cost to such lessor, under a long term lease which extends beyond the useful life of the building, there is no basis for the allowance of depreciation to the lessor since the lessor has no investment or cost therein which is subject to exhaustion. Where the taxpayer acquires such property by a devise, the basis of the property so acquired, under section 113(a)(5) of the Code, is the fair market value of the property at the time of acquisition.

In cases involving the subject which were decided by the Tax Court prior to July 13, 1954, it was stated that the only reason the original lessor was not entitled to depreciation was that he had no basis (no investment or cost) upon which to compute depreciation; however, it was held that in the case of a devisee, a basis was acquired under section 113(a)(5) of the Code, which basis the devisee was entitled to depreciate. See *Mary Young Moore* v. *Commissioner*, 15 T. C. 906; *J. Charles Pearson, Jr.* v. *Commissioner*, 13 T. C. 851, and *Charles Bertram Currier* v. *Commissioner*, 7 T. C. 980.

The court held in the *First National Bank of Kansas City, Trustee (Williams Will)* v. *Nee*, 190 Fed. (2d) 61, that the lessor's testamentary trustee was not entitled, in the determination of income tax, to allowance for depreciation on its alleged interest in the building erected by the lessee on leased premises, on the grounds that the trustee had no interest in the building on the leased premises which was depreciable under the statutory definition; that the building was not "used in the trade or business" of the trustee, within the meaning of section 23(l)(1), nor was the building "held for the production of income" within the meaning of section 23(l)(2); that the lessor reserved and received, and her successors continued to receive, rent solely from the ground; that the building was designed to produce income, but not for the lessor or her successors; and since the lessee

paid for the building and was entitled to a credit against income for its depreciation.

On appeal, in *Commissioner* v. *Mary Young Moore*, 207 Fed. (2d) 265, certiorari denied 347 U. S. 942, the court reached the same conclusion as that reached in the First National Bank case. It stated that it is not the physical property itself, nor the title thereto, which alone entitles the owner to claim depreciation; that the statutory allowance is available to him whose interest in the wasting asset is such that he would suffer an economic loss resulting from the deterioration and physical exhaustion as it takes place; that the devisee inherits only an interest in the land and a reversionary interest in the building; and that ground rent, which arises out of the devisee's ownership of land, will come in for a period extending beyond the life of the building, so that the devisee will not suffer an economic loss as the building wears out.

On July 13, 1954, the court in *Albert L. Rowan* v. *Commissioner*, 22 T. C. 865, reconsidered its position and stated that it will no longer follow its decisions in the Moore, Pearson, and Currier cases, but will now follow the decisions in *Commissioner* v. *J. Charles Pearson, Jr.*, 188 Fed. (2d) 72, and *Commissioner* v. *Mary Young Moore*, 207 Fed. (2d) 265.

Accordingly, it is held that the devisee of a lessor who is devised property, or an interest in property, on which a building had been constructed by the lessee without cost to the lessor, under a lease which extends beyond the useful life of the building, is not entitled to a depreciation allowance on the building.

SECTION 23(m).—DEDUCTIONS FROM GROSS INCOME: DEPLETION

REGULATIONS 118, SECTION 39.23(m)-1: Depletion of mines, oil and gas wells, other natural deposits, and timber; depreciation of improvements. Rev. Rul. 55-13

In computing percentage depletion the gross selling price, where a prepayment discount is involved, may be used only in those cases where the discount is a cash discount, not a trade discount, and represents a fair interest rate.

The Internal Revenue Service has been requested to consider whether the gross sales price or the net sales price should be used in determining gross income for percentage depletion purposes. The question involves the same type of situation as was presented in the case of *Montreal Mining Company* v. *Commissioner*, 2 T. C. 688, acquiescence, C. B. 1944, 20 (appealed on other grounds to the United States Court of Appeals for the Sixth Circuit).

In that case, the taxpayer was engaged in mining and selling iron ore. Because of the taxpayer's location, its shipments to customers were restricted to the annual navigation season of the Great Lakes, which extends from April through about November 15. The taxpayer contracted with the customer to deliver specific tonnages of ore based on the particular customer's needs for an entire year. Such contracts usually provided for payment in 12 equal installments. The customer,

however, had the privilege of discounting any or all installments at a rate approximating the prevailing interest rate upon bank loans.

Subject to certain limitations not here pertinent, the allowance for depletion under section 23(m) of the Internal Revenue Code of 1939, in the case of a taxpayer in the mining industry, is based on a certain percentage "of the gross income from the property during the taxable year." In *Montreal Mining Co.* v. *Commissioner*, *supra*, the court ruled, in effect, that for purposes there pertinent the term "gross income from the property" was not synonymous with the concept of gross income as defined elsewhere in the Code. In fact, the court there stated that under the circumstances presented the term means the amount for which the petitioner sold its ore, an amount which it termed the "selling amount."

After reviewing the particular circumstances surrounding the adoption by the iron ore mining companies of the practice to extend cash discounts to customers, the court in the above-mentioned case distinguished between cash and trade discounts by stating, "It is clear that these discounts are cash discounts made to expedite payments for ore purchased by customers, not trade discounts arising out of market conditions and resulting in a flat rate of prices irrespective of the time of payment. * * * Moreover, there can be no question that they approximate a fair interest rate."

The court compared this principle with the practice of determining cost of inventories by a purchaser of merchandise, as provided by Article 22(c)-3 of Regulations 94 (now sec. 39.22(c)-3 of Regulations 118), wherein it is provided that cost means, in the case of merchandise purchased since the beginning of the taxable year, the invoice price less trade or other discounts, except strictly cash discounts approximating a fair interest rate, which may be deducted or not at the option of the taxpayer, provided a consistent course is followed. The court held that under the authority of these regulations it would appear that petitioner's customers, assuming they used inventories at cost, could treat the discounts in question either as income or a charge against cost, provided a consistent course is followed. On the basis of the foregoing the court reasoned that the petitioner, in keeping with its long and consistent accounting practice and that of the industry, is entitled to treat such discounts as business expenses of the nature of so-called "financial items which are properly deductible as ordinary and necessary expense."

In view of the above, it is the position of the Internal Revenue Service that in computing gross income from the property for purposes of section 23(m) of the Internal Revenue Code, where a prepayment discount is involved the gross selling price may be used only in those cases where the discount is a cash discount, not a trade discount, and represents a fair interest rate.

REGULATIONS 118, SECTION 39.23(m)-1: Depletion of mines, oil and gas wells, other natural deposits, and timber; depreciation of improvements. Rev. Rul. 55-35

The principles of G. C. M. 23623, C. B. 1943, 313, relating to the treatment, for Federal income tax purposes, of the assignment of

producing operating interests in oil and gas properties for cash, with retention of contingent production payments, are also to be applied with respect to the treatment of subleases of producing oil and gas properties where cash is received and the equipment is assigned. The excess of the adjusted basis of the equipment over the cash received is returnable only through depletion.

G. C. M. 23623, C. B. 1943, 313, modified.

The Internal Revenue Service has been asked whether, in view of the decision of the Supreme Court of the United States in *W. G. Choate* v. *Commissioner*, 324 U. S. 1, Ct. D. 1626, C. B. 1945, 343, the principles of G. C. M. 23623, C. B. 1943, 313, are to be applied with respect to the treatment of subleases of producing oil and gas properties with retention of an overriding royalty interest where the equipment is assigned under the following circumstances:

A has a producing leasehold with an adjusted leasehold basis of zero and an adjusted equipment basis of $250x$ dollars. A assigns a leasehold (or subleases) and assigns the equipment to B for a cash payment of $175x$ dollars and retains an overriding royalty of one-eighth (⅛). Following the decision in the Choate case, the cash is considered as payment for the equipment to the extent of its depreciated cost and the excess of cash, if any, over the depreciated cost represents a bonus or an advance royalty subject to percentage depletion in the hands of the sublessor. Where the depreciable cost of equipment exceeds cash, the excess amount is considered an additional cost of the royalty specified in the lease. As cost of the royalty, such excess would be returnable through depletion.

This policy is based on an extension of the principles stated in G. C. M. 23623, *supra*, in which it was held that in transactions involving assignments of producing oil and gas leases for cash with a retention of contingent oil and gas payments no less could be allowed, but the excess of the adjusted basis of equipment over cash received represented a part of the depletable basis of the retained economic interest (the contingent oil and gas payment). G. C. M. 23623 was issued prior to the decision in the Choate case, and expressed the view that the theory of a sale of equipment would not apply on those cases in which the assignor or sublessor retained a royalty interest throughout the productive life of the property as distinguished from those cases in which the transaction effected a sale.

It is sometimes argued that depreciation of the excess of the adjusted equipment cost over the cash received should be permitted over the life of the property instead of transferring such excess to depletable cost. The fallacy of permitting the return of the remaining basis in any way other than through depletion may be illustrated by a situation where A, in the foregoing example, transfers his lease and equipment without cash or other consideration other than the retention of a one-fourth (¼) overriding royalty. The stated argument would allow A in such a case to continue to deduct depreciation (it might be called amortization) despite the fact that he no longer owns the equipment. Furthermore, in such a case, since the overriding royalty has been increased in amount due to the fact that the property was equipped (the equipment having been assigned), and depletion is allowable on such increase, it is apparent that the allowance of depreciation in addition to depletion results in double deductions. This is less readily apparent, but nonetheless true, in the instance of an

assignment of the working interest with a retention of an economic interest (overriding royalty interest or contingent production payment) involving the receipt of cash in an amount less than the adjusted basis of the equipment on the property. See Revenue Ruling 54-548, C. B. 1954-2, 91, involving the treatment of royalty payments made for leased equipment.

Accordingly, the principles of G. C. M. 23623, *supra*, are also to be applied to cash payments made upon assignments or leases (or upon the subleasing) of producing oil and gas properties with a retention of an overriding royalty where equipment is assigned. The excess of the adjusted basis of equipment over cash received is returnable to the sublessor only as depletion.

G. C. M. 23623, C. B. 1943, 313, is modified accordingly.

REGULATIONS 118, SECTION 39.23(m)-1: Depletion of mines, oil and gas wells, other natural deposits, and timber. Rev. Rul. 55-251

A taxpayer who dredges sand and gravel from the bed of a navigable river under a permit from the Federal government which merely constitutes a waiver by the United States of any objection based on control by the United States over navigation, but which does not otherwise give to the taxpayer any legal right nor economic interest in the deposit, is not entitled to percentage depletion unless he has a depletable economic interest or legal right to the deposit independent of such Federal permit. Neither is depletion allowable on spoil banks built up during previous dredging operations.

Advice has been requested whether a deduction for depletion on sand and gravel dredged for commercial sale from the bed of navigable river is allowable for Federal income tax purposes under the following circumstances.

In the instant case the taxpayer dredges sand and gravel from several rivers and sells it to various industrial concerns in the area. The taxpayer pays no royalties for the sand and gravel which he removes and sells. The operation is carried on under a permit from the United States Army Engineers, but the taxpayer has no express permission of any kind from the State government to remove the sand and gravel. The permit from the Army Engineers states that it is understood that "this instrument does not give any property rights either in real estate or material, or any exclusive privileges * * * nor does it obviate the necessity of obtaining State assent to the work authorized. It merely expresses the assent of the Federal Government so far as concerns the public rights of navigation." The permit is merely a waiver by the United States of any objection based on control by the United States over navigation.

Section 39.23(m)-1 of Regulations 118 provides in part that the owner of an economic interest in mineral deposits or standing timber is allowed annual depletion deductions and that an economic interest is possessed in every case in which the taxpayer has acquired, by investment, any interest in mineral in place or standing timber and secures, by any form of legal relationship, income derived from the

severance and sale of the mineral or timber to which he must look for a return of his capital.

On the basis of the facts stated it does not appear that the taxpayer has any economic interest in the sand and gravel deposits. The permit granted by the United States does not give the taxpayer any property rights in the deposit, nor does it give the taxpayer a superior right in the deposits over anyone else. Of course, the mere fact that the taxpayer does not have an exclusive legal right in the deposits would not necessarily deprive it of depletion if it did have a nonrevocable legal right to remove the deposits and such right was a valuable right based upon a legal consideration. In extending percentage depletion to sand and gravel in the Revenue Act of 1951, it does not appear that Congress intended to alter the law respecting the type of interest that is depletable. See Senate Report No. 781 on the Revenue Act of 1951, C. B. 1951-2, 458, at 484.

Even if the taxpayer owned the land underlying the sand and gravel deposits, it would not necessarily follow that the taxpayer is entitled to depletion. This is based on the reasoning of the Supreme Court of the United States in *Lynch* v. *Alworth-Stephens Co.*, 267 U. S. 364, T. D. 3690, C. B. IV-1, 162 (1925), and *E. G. Palmer* v. *Bender*, 287 U. S. 551, Ct. D. 641, C. B. XII-1, 235 (1933), that depletion is available only to one whose interest is depleted by extraction of the mineral. In *J. Steve Anderson et al.* v. *Helvering*, 310 U. S. 404, Ct. D. 1456, C. B. 1940-1, 108, the Court stated that the deduction for depletion is intended as "compensation for the capital assets consumed in the production of income through the severence of minerals." The court added "the granting of an arbitrary deduction, in the interests of convenience, of a percentage of the gross income derived from the severance of oil and gas, merely emphasizes the underlying theory of the allowance as a tax-free return of the capital consumed in the production of gross income through severance." Also see *Helvering* v. *Bankline Oil Company*, 303 U. S. 362, Ct. D. 1323, C. B. 1938-1, 306. A taxpayer is not entitled to depletion if the value of his interest is not diminished by extraction of the mineral.

No information is given nor has there been any specific consideration whether the sand and gravel removed by the taxpayer from the river bed is replenished by the river within a relatively short period of time. However, if such is the case, the taxpayer's interest would not be exhausted by removal of the sand and gravel, and for that additional reason there would of course be no right to depletion.

In view of the above it is held that a taxpayer who dredges sand and gravel from the bed of a navigable river under a permit from the Federal government which merely constitutes a waiver by the United States of any objection based on control by the United States over navigation, but which does not otherwise give to the taxpayer any legal right nor economic interest in the deposit, is not entitled to percentage depletion unless he has a depletable economic interest or legal right to the deposit independent of such Federal permit. Neither is depletion allowable on spoil banks built up during previous dredging operations. Compare Rev. Rul. 4, C. B. 1953-1, 48.

REGULATIONS 118, SECTION 39.23(m)-1: Depletion of mines, oil and gas wells, other natural deposits, and timber; depreciation of improvements. Rev. Rul. 55-350

The taxpayer mines salt from underground deposits by hydraulic methods. It is brought to the surface in the form of artificial brine and used in that form as raw material for the manufacture of chemical products which are the first products marketed by the taxpayer. For electrolytic manufacturing purposes, salt produced in brine has the same value as crude rock salt at the mouth of the mine. *Held*, in computing "gross income from the property," for percentage depletion purposes, the market value of crude rock salt at the mouth of the mine should be ascertained either from direct sales of such material or by working back from sales of manufactured products. In order to arrive at the market value of crude rock salt by working back from sales of manufactured products, it is necessary to reduce the sales price by costs, expenses, and profits which are attributable to any processes subsequent to the completion of the mining processes. No opinion is expressed with respect to natural brine, this ruling being limited to natural salt deposits in solid form.

REGULATIONS 118, SECTION 39.23(m)-1: Depletion of mines, oil and gas wells, other than natural deposits, and timber; depreciation of improvements. Rev. Rul. 55-390

Where the main objective of mining granite or marble is the production of rough blocks, the mining process ends when the rough blocks of granite or marble produced at the quarry are shipped or transferred for sawing, shaping, and polishing. However, if the taxpayer incidentally produces and sells crushed granite or marble as a by-product of mining at the mine or quarry, amounts received for such production may be included in gross income subject to percentage depletion. When, because of subsequent operations, it is necessary to resort to the proportionate profits method (section 39.23(m)-1(e)(3) and section 39.23(m)-1(g) of Regulations 118) to determine the gross and net income from mining, any income from such byproducts incident to operations subsequent to mining must be included in determining the overall profits to be allocated to mining and nonmining activities.

REGULATIONS 118, SECTION 39.23(m)-1: Depletion of mines, oil and gas wells, other natural deposits, and timber; depreciation of improvements.

Depletion allowance with respect to income received from the sale of loam. See Rev. Rul. 55-11, page 212.

REGULATIONS 118, SECTION 39.23(m)-1: Depletion of mines, oil and gas wells, other natural deposits, and timber; depreciation of improvements.

Treatment of hauling and development allowances granted by the Atomic Energy Commission for percentage depletion purposes. See Rev. Rul. 55-47, page 239.

REGULATIONS 118, SECTION 39.23(m).-1: Depletion of mines, oil and gas wells, other natural deposits, and timber; depreciation of improvements.

Processes which are considered mining processes in the manufacture of lightweight aggregate from shale and slate. See Rev. Rul. 55-78, page 357.

REGULATIONS 118, SECTION 39.23(m)-1: Depletion of mines, oil and gas wells, other natural deposits, and timber; depreciation of improvement.

The decision in the case of *United States* v. *Cherokee Brick & Tile Company*, 218 Fed. (2d) 424, does not affect the position of the Service with respect to ordinary treatment processes in the case of brick and tile clay as set forth in Revenue Ruling 54-109, C. B. 1954-1, 62. See Rev. Rul. 55-244, page 73.

REGULATIONS 118, SECTION 39.23(m)-5: Computation of depletion based on percentage of income in case of certain mines or other natural deposits.

Percentage depletion of clay used in conjunction with shale in the manufacture of light weight aggregate. See Rev. Rul. 55-180, page 358.

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

REGULATIONS 118, SECTION 39.23(o)-1: Contributions or gifts by individuals. Rev. Rul. 55-4
(Also Section 23(a), Section 39.23(a)-1.

> A taxpayer who gives his services gratuitously to an association, contributions to which are deductible under section 23(o) of the Internal Revenue Code of 1939, and who incurs unreimbursed traveling expenses, including the cost of meals and lodging, while away from home in connection with the affairs of the association and at its direction, may deduct the amount of such unreimbursed expenses in computing his net income subject to the limitations provided by section 23(o) of the Code.

Advice has been requested whether a deduction may be taken under section 23(a)(1)(A) or section 23(o) of the Internal Revenue Code of 1939 by a taxpayer serving an association held to be exempt for

Federal income tax purposes for unreimbursed travel expenses in connection with the performance of his official duties.

In the instant case a taxpayer who gives his services gratuitously as an officer of an association, contributions to which are deductible under the provisions of section 23(o) of the Code, incurs unreimbursed traveling expenses, including cost of meals and lodging, while away from home in connection with the affairs of the association and at its direction.

Section 23(a)(1)(A) of the Code provides in part that a deduction is allowable for "traveling expenses (including the entire amount expended for meals and lodging) while away from home in the pursuit of a trade or business; * * *." The traveling expenses incurred by the taxpayer here under consideration, in connection with his activities on behalf of the association, do not represent expenses incurred in carrying on a trade or business and, therefore, are not deductible in computing his net income under that section of the Code.

Section 23(o) of the Code provides in part that in computing net income there shall be allowed as deductions:

> (o) CHARITABLE AND OTHER CONTRIBUTIONS.—In the case of an individual contributions or gifts payment of which is made within the taxable year to or for the use of:
>
> * * * * * * *
>
> (2) a corporation, trust, or community chest, fund, or foundation created or organized in the United States or in any possession thereof * * * organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, * * *;
>
> * * * * * * *
>
> to an amount which in all the above cases combined does not exceed 20 per centum of the taxpayer's adjusted gross income. * * *.

Accordingly, it is held that a taxpayer who gives his services gratuitously to an association, contributions to which are deductible under the provisions of section 23(o) of the Code, and who incurs unreimbursed traveling expenses, including the cost of meals and lodging, while away from home in connection with the affairs of the association and at its direction, may deduct the amount of such unreimbursed expenses in computing his net income subject to the limitation provided by section 23(o) of the Code.

REGULATIONS 118, SECTION 39.23(o)-1: Contributions or gifts by individuals. (Also Section 23(q); Regulations 118, Section 39.23(q)-1.) — Rev. Rul. 55-156

> Contributions made to a reserve officers' association are not deductible by the donors for Federal income tax purposes under the provisions of section 23(o) and (q) of the Internal Revenue Code of 1939.

Advice has been requested whether contributions made to a reserve officers' association are deductible by the donors for Federal income tax purposes under the provisions of section 23(o) of the Internal Revenue Code of 1939.

Section 23 of the Code, relating to deductions from gross income provides in part that in computing net income there shall be allowed as deductions:

(o) CHARITABLE AND OTHER CONTRIBUTIONS.—In the case of an individual, contributions or gifts payment of which is made within the taxable year to or for the use of:

* * * * * * *

(4) posts or organizations of war veterans, or auxiliary units or societies of any such posts or organizations, if such posts, organizations, units, or societies are organized in the United States or any of its possessions, and if no part of their net earnings inures to the benefit of any private shareholder or individual;

Section 23(q)(3) of the Code, which relates to the deductions of contributions made by corporations, contains wording substantially similar to that used in section 23(o)(4) of the Code.

Section 23(o)(4) of the Code refers to war veterans' organizations rather than to organizations of veterans of the military services generally and it is believed that these provisions are not broad enough to include reserve officers' organizations. That these organizations are not organizations of the same class is recognized in section 1701(a)(1)(B) of the Code, relating to admissions taxes, which specifically mentions reserve officers' organizations as well as organizations of war veterans.

The membership in the instant association is composed of persons who hold a current commission, or who formerly held a commission, in one of the military services of the United States. The constitution of the association provides that any person holding a commission in any of the civilian components of the Armed Forces of the United States shall be eligible for active membership. There is no requirement, however, that a member must be a war veteran, and the evidence does not show that the membership is made up entirely of war veterans, or is essentially a war veterans' organization.

It may be stated, however, that where an organization is essentially a war veterans' organization, the inclusion of a small minority of members who have served in an established branch of the armed forces but who have not served during a period of war will not preclude classification under the provisions of section 23(o)(4) of the Code.

Accordingly, it is held that contributions made to a reserve officers' association of the type here considered are not deductible by the donors for Federal income tax purposes under section 23 (o) and (q) of the Code.

REGULATIONS 118, SECTION 39.23(o)-1: Contributions or gifts by individuals. (Also Section 44(d); Regulations 118, Section 39.44-5.) Rev. Rul. 55-157

A taxpayer using the installment basis for the return of income derived from a sale of real property to an educational organization, contributions to which are deductible under section 23(o) of the Internal Revenue Code of 1939, is subject to Federal income tax as provided by section 44(d) of the Internal Revenue Code of 1939 with respect to installment notes due from such sale of real property when such notes are credited to the organization as gifts. However, the fair market value of each note as of the date it is credited as a

gift will constitute an allowable deduction to the extent provided by section 23(o) of the Code.

The taxpayer in the instant case sold a parcel of real estate to an educational organization, contributions to which are deductible under section 23(o) of the Internal Revenue Code of 1939. The terms of settlement provided for a cash payment amounting to less than 30 percent of the purchase price with the balance of the purchase price represented by twenty equal annual installment notes. The transaction as a whole did not amount in substance to a gift of the difference between the value of the real estate and the amount of the cash payment. The taxpayer elected to report the income derived from the sale on the installment basis prescribed in section 44 of the Code. Advice has been requested whether the taxpayer will be subject to Federal income tax as provided by section 44(d) of the Code if he makes a gift of each annual payment as it falls due and whether the credited payment will represent a contribution deductible to the extent provided by section 23(o) of the Code.

Under the provisions of section 44(d) of the Code, 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, in case of a distribution, transmission, or disposition otherwise than by sale or exchange, the fair market value of the obligation at the time of such distribution, transmission, or disposition. 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. See section 39.44–5 of Regulations 118.

Section 23(o) of the Code provides that in computing net income an individual taxpayer may take a deduction for the contribution or gift payment of which is made within the taxable year to or for the use of certain organizations to an amount which does not exceed 20 per centum of the taxpayer's adjusted gross income. If the contribution or gift is other than money, the basis for calculation of the amount thereof shall be the fair market value of the property at the time of the contribution or gift. Section 39.23(o)-1 of Regulations 118.

On the basis of the foregoing, it is held that the taxpayer is subject to Federal income tax as provided in section 44(d) of the Code with respect to the notes which are credited to the organization as gifts. The fair market value of each note as of the date credited as a gift will constitute an allowable deduction to the extent prescribed in section 23(o) of the Code.

REGULATIONS 118, SECTION 39.23(o)-1: Contributions or gifts by individuals. Rev. Rul. 55-192

That portion of membership dues earmarked for distribution to qualified charities, and paid by individual members to the treasurer of a social club, acting also as a duly constituted collecting agent for certain charitable organizations of the type set forth in section 23(o)

of the Internal Revenue Code of 1939, is deductible as a contribution by the donor members in computing their taxable net income in the manner and to the extent provided by section 23(o) of the 1939 Code.

Advice has been requested whether amounts paid as membership dues to a social club and distributed to qualified charities under the circumstances set forth below would constitute allowable deductions to the members within the meaning of section 23(o) of the Internal Revenue Code of 1939.

The rules of the instant club provide that each member shall pay dues of $100x$ dollars annually. Of this amount $30x$ dollars is in payment of two tickets to a dinner-dance and $70x$ dollars constitutes a direct contribution by the member to organizations, contributions to which are deductible under the provisions of section 23(o) of the Code. Checks in payment of dues are made payable to the treasurer of the club, who has been authorized both by the club and the donee organization to act as agent to receive members' contributions for such purposes.

Section 23(o) of the Code provides, in part, that in computing taxable net income there shall be allowed as deductions in the case of an individual "contributions or gifts payment of which is made within the taxable year to or for the use of * * * a corporation, trust, or community chest, fund or foundation * * * organized and operated exclusively for religious, charitable, scientific or educational purposes * * * ."

Section 39.23(o)-1 of Regulations 118 provides that a deduction is allowable under section 23(o) of the Code only with respect to contributions or gifts which are actually paid during the taxable year, regardless of when pledged and regardless of the method of accounting employed by the taxpayer in keeping his books or records.

Contributions made by members of the social club under the foregoing arrangement and paid over to organizations which are of the type set out in section 23(o) of the Code constitute allowable deductions to the members in computing their taxable net income in the manner and to the extent provided by that section. Contributions received by the treasurer who is also acting as agent of such donee organizations, will be deductible by the donors at the time such contributions are paid to him. However, if the treasurer has not been designated by the organization involved to act as its agent, he is considered to be the agent of the contributor. Accordingly, in that case such contributions are deductible only in the taxable year in which they are actually transferred to the donee organization.

REGULATIONS 118, SECTION 39.23 (o)-1: Contributions or gifts by individuals. Rev. Rul. 55-275

(Also Sections 811(c), 812(d); Regulations 105, Sections 81.17, 81.44.)

Method of reporting, for income, gift, and estate tax purposes, contributions of money and property made to an income participa-

tion fund of an organization exempt from Federal income tax under section 101(6) of the Internal Revenue Code of 1939, where payments from the net income of the fund, if any, are to be made to the contributors or to the contributors and their designated coparticipants during their lives.

An inquiry has been received relative to the method to be followed in reporting for income, gift, and estate tax purposes a donation of money or property under the following circumstances.

A corporation, contributions to which have been determined to be deductible under section 23(o) and section 23(q) of the Internal Revenue Code of 1939, issued income participation fund certificates, in the principal amount of $100x$ dollars outstanding at any one time, to certain individuals desirous of contributing to the fund but who wished to reserve the right to receive some income during their lives or the lives of themselves and a designated coparticipant. Under the plan, the donors contributed specified dollar amounts, or specifically valued property, to aid in retiring a debt incurred in the construction of a dormitory.

In return for such donation, the donor was issued a certificate in the form indicated and he will, from time to time, receive payments from the net income, if any, of the dormitory which is pledged to provide the payments to the contributors to the fund. Payments will be made to the holders of the certificates outstanding on each quarterly payment date up to the maximum specified annual percentages shown upon the face of the certificates. Each certificate shows the maximum return possible, determined by the age of the donor, or the younger of the donor and his coparticipant, at the time the certificate is issued.

Since the payments made to the donor are limited to a proportionate share of the aggregate income and since the plan in no way guarantees future payments in any amount to the donors, the payments would not constitute annuities for purposes of section 22(b)(2) of the Code or for gift tax or estate tax purposes. The effect of the agreements entered into by and between the corporation and the donor, whereby he alone or with another would receive income payments, is to create an irrevocable trust.

Section 23(o) of the Code provides for the allowance of contributions or gifts, payment of which is made within the taxable year "to or for the use of" charitable, educational, and other designated types of institutions and organizations.

The Internal Revenue Service has held that the phrase "for the use of" is intended to convey a meaning similar to that of "in trust for". See Rev. Rul. 194, C. B. 1953-2, 128. In I. T. 1776, C. B. II-2, 151 (1923), it was held, under the Revenue Act of 1921, that where a donor by written instrument gave a life estate in bonds to an individual and the remainder interest to a church, the cash value of the gift to the church was deductible. In I. T. 3707, C. B. 1945, 114, it was held that where a taxpayer creates an irrevocable trust, reserving the income to himself for life with remainder over at his death to a beneficiary which meets the requirements of section 23(o)(2) of the Code, the present value of the remainder interest is deductible by the taxpayer in his income tax return for the taxable year in which the property is

transferred in trust, subject to limitations prescribed in section 23(o) of the Code.

Therefore, it is held that under the agreements in the instant case, whereby the donor alone or the donor with another would receive income payments, a gift was made subject to a life estate or life estates. The amount to be allowed as a deduction in the year in which specified dollar amounts or specifically-valued property is transferred, is the present value of the remainder interest. See I. T. 3707, *supra*. The basis for calculating the amount of the gift of property, other than money, will be the fair market value of such property at the time of its transfer under the agreement.

With respect to a gift made after December 31, 1951, the value of the right retained by the donor is to be computed in accordance with Table I, section 86.19(f) of Gift Tax Regulations 108. The difference between the value of the property transferred and the value of the right retained by the donor is the value of the gift for gift tax purposes. If all the payments are to cease at the death of the donor, the entire value of the gift may be deducted on the gift tax return as a charitable gift. If, however, a survivorship right is involved, the value of the gift postponed until the death of the last to die of two persons will be furnished by the Internal Revenue Service, in connection with any completed transaction, upon the receipt of a request disclosing the name, address, age, and date of birth of the donor, and the name, address, age, and date of birth of the individual donee.

Since under the agreements the income is to be used in making the payments to the donor-beneficiaries and/or the coparticipants, the income is taxable to them.

Since the transfer is one in which the donor retained for his life the right to the income from the property within the meaning of section 811 (c) (1)(B) of the Internal Revenue Code, it should be reported in the estate tax return filed for his estate and a deduction therefor claimed under section 812(d) of the Code.

In the event the donation to the fund is in the form of property having a value in excess of its basis in the hands of the donor, the appreciation in the value of such property will not constitute taxable income to the donor. As stated hereinbefore, the basis of calculating the amount of the gift of property, other than money, will be the fair market value of such property as at the time of its transfer to the corporation under the agreement.

REGULATIONS 118, SECTION 39.23(o)-1: Contributions or gifts by individuals. Rev. Rul. 55-410

> The satisfaction of a pledge to an organization described in section 23(o) of the Internal Revenue Code of 1939 by means of a donation or gift of property which has either appreciated or depreciated in value does not give rise to a taxable gain or a deductible loss. Such contribution is deductible to the extent of the fair market value thereof at the time of the contribution or gift, to the extent provided by law.

Advice has been requested whether the satisfaction of a pledge made in terms of dollars to an organization described in section 23(o)

of the Internal Revenue Code of 1939, by the donation or gift of property which has either appreciated or depreciated in value will be considered a taxable event giving rise to a gain or loss for Federal income tax purposes.

Section 23(o) of the Code allows as a deduction in the case of an individual, subject to prescribed limitations, "contributions for gifts payment of which is made within the taxable year to or for the use of" certain specified organizations.

Section 39.23(o)-1 of Regulations 118 provides, in part, that a deduction is allowable under section 23(o) of the Code only with respect to contributions or gifts which are actually paid during the taxable year, regardless of when pledged and regardless of the method of accounting employed by the taxpayer in keeping his books and records. If the contribution or gift is in a medium other than money, the basis for calculating the amount of the gift is the fair market value of the property at the time of the contribution or gift.

It follows that for purposes of section 23(o) of the Code the event which gives rise to the deduction is the actual payment of money or the transfer of property. It would be inconsistent to treat such payment or transfer as a "contribution or gift" and at the same time as a satisfaction of a debt with the tax consequences which would ordinarily follow from the use of appreciated property or depreciated to pay a debt.

In view of the foregoing it is held that the satisfaction of a pledge to an organization described in section 23(o) of the Internal Revenue Code of 1939, by means of a donation or gift of property which has either appreciated or depreciated in value, does not give rise to a taxable gain or a deductible loss. Such contribution is deductible to the extent of the fair market value thereof at the time of the contribution or gift. With respect to the manner of handling contributions of agricultural or manufactured products or property held for sale in the ordinary course of business see Revenue Ruling 55–138, page 223 of this Bulletin.

REGULATIONS 118, SECTION 39.23(o)-1: Contributions or gifts by individuals.

Contributions of property held for sale in ordinary course of business to an organization described in section 23(o) of the Internal Revenue Code. See Rev. Rul. 55–138, page 223.

REGULATIONS 118, SECTION 39.23(o)-1: Contributions or gifts by individuals.

Deductibility of unreimbursed travel expenses in connection with the performance of services for an organization exempt under section 101(8) of the Internal Revenue Code of 1939. See Rev. Rul. 55-151, page 28.

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 23(a); Regulations 118, Section 39.23(a)-9.) Rev. Rul. 55-212

Regardless of whether an employer obligates himself to pay a pension to the widow of a deceased employee over a period of years or whether such payments are contingent upon some future happening, the employer may deduct in each taxable year, under section 23(p) of the Internal Revenue Code of 1939, only those amounts which are actually paid during the year, subject to the general tests of reasonableness.

Revenue Ruling 54-625, C. B. 1954-2, 85, is modified to the extent inconsistent herewith.

The Internal Revenue Service has reconsidered the position expressed in Revenue Ruling 54-625, C. B. 1954-2, 85, relating to the time when an employer may take a deduction for pension payments made to the widow of a deceased employee. Revenue Ruling 54-625, *supra*, states in part:

"Where a corporation on the accrual basis of accounting obliges itself to pay to the widow of a deceased employee, in periodic installments over a period of years, an additional amount to cover compensation for past services rendered by such employee, such amount is generally deductible under the provisions of section 23(a)(1)(A) of the Internal Revenue Code of 1939 as a business expense for the year in which such liability is incurred."

While this is a correct statement of the general principles underlying deductions by an accrual basis taxpayer under section 23(a) of the Code, it does not properly take into account the over-riding provisions of section 23(p) of the Code, which governs the deductibility of contributions of an employer to or under a stock bonus, pension, profit-sharing, or annuity plan and compensation paid or accrued on account of an employee under a plan or method of deferring the receipt of such compensation. Section 23(p)(1) of the Code provides that 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 shall not be deductible under section 23(a), but if they satisfy the conditions of section 23(a) they will be deductible to the extent provided in section 23(p). In addition to other limitations, section 23(p) requires that in order for a contribution or compensation to be deductible thereunder, it must be paid in the taxable year, with certain exceptions not pertinent here.

Section 23(p) of the Code, as well as Section 39.23(p)-1(c) 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 pays pensions to such of its retired employees and in such amounts as may be determined from time to time by the board of directors or responsible officers of the company, or 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). If an employer on the accrual basis defers paying any compensation to an employee until a later year or years under a method having the effect of a stock bonus, pension, profit-sharing, or annuity plan, or similar plan deferring the receipt of compensation, he shall not be allowed a deduction until the year in which the compensation is paid.

The above-stated provisions of the regulations carry out the statutory purpose of not allowing deductions for deferred compensation payments until such compensation is actually paid. While the provisions of the regulations referred to do not specifically mention widows' pensions, the same considerations which govern the deductibility of pensions to retired employees would also apply in the case of widows' pensions, since the basis of the deduction for a widow's pension is that it represents additional compensation of the employee, which has been deferred.

Accordingly, it is the position of the Internal Revenue Service that, regardless of whether an employer obligates himself to pay a pension to the widow of a deceased employee over a period of years or whether such payments are contingent upon some future happening, the employer may deduct in each taxable year under section 23(p) of the Code only those amounts which are actually paid during the year, subject to the general tests of reasonableness. Revenue Ruling 54-625, C. B. 1954-2, 85, is modified to the extent it is inconsistent herewith.

REGULATIONS 118, SECTION 39.23(p)-2: Information to be furnished by employer claiming deductions. Rev. Rul. 55-204

(Also Part I, Section 404.)

Each employer claiming deductions for contributions to an employees' trust or annuity plan, under section 23(p) of the Internal Revenue Code of 1939, on an industry-wide or area-wide basis negotiated by a labor union for the benefit of employees who are employed by one or more of the group of contributing employers, where the contributions are based on such determinable factors as man-hours worked or units produced, will not be required to furnish all of the information specified in section 39.23(p)-2 of Regulations 118 provided the plan trustees or an authorized association of the employers furnishes the required data for the entire group of participating employers.

Advice has been requested concerning the information necessary to be filed by an individual employer supporting deductions claimed under section 23(p) of the Internal Revenue Code of 1939 for contributions to an employee's trust or annuity plan on an industry-wide or area-wide basis negotiated by a labor union, when the trustees of the plan file the complete data required under section 39.23(p)-2 of Regulations 118 for all contributing employers.

Employers who claim deductions under section 23(p) of the Code are required to file the information specified in section 39.23(p)-2 of Regulations 118, to the extent applicable, by way of supporting the deductions claimed. Such information must be filed in the office of the District Director of Internal Revenue in which the employer files his tax returns. However, section 39.23(p)-2(e) of Regulations 118 authorizes the Commissioner to require any further information considered necessary to determine allowable deductions under section 23(p) of the Code or qualification under section 165(a) and to waive the filing of such information required by section 39.23(p)-2 of Regulations 118 which he finds unnecessary in a particular case. Pursuant to this authority, certain changes as noted below, will be made in the information required to be filed.

In the case of an employees' trust or annuity plan established on an industry-wide or area-wide basis and negotiated by a labor union for the benefit of employees who are employed by one or more of a group of contributing employers, in which the contributions of the employers are based on such determinable factors as man-hours worked or units produced, it will not be necessary for each individual employer to furnish all of the information required by section 39.23(p)-2 of Regulations 118 provided the plan trustees or an authorized association of the employers furnishes such data for the entire group of participating employers. In such cases, where it is desired to limit the information to be furnished by the several individual employers, the plan trustee or the association of employers should furnish once each year the information required by section 39.23(p)-2(a) of Regulations 118, as follows:

(1) the information listed under subparagraphs (1), (2), and (7), except that when such information has once been furnished, it need not be repeated unless a change in the facts makes a resubmission necessary; in which case, see subparagraph (b) of section 39.23(p)-2 of Regulations 118;

(2) the information listed under subparagraphs (4)(i) and (5) on an over-all basis for the entire plan, unless each participating employer furnishes such information with respect to his own employees; and

(3) the information required by subparagraphs (6) and (8).

If the information specified above is furnished by the trustees or the authorized association for the entire group of employers, each individual employer claiming a deduction under section 23(p) of the Code may limit the information he furnishes by attaching to his income tax return a statement showing:

(1) that the deduction claimed is for contributions under (name of plan) and that a favorable ruling with respect thereto was issued on (date), containing symbols (- - - -), and reference should also be made to this Revenue Ruling;

(2) the information required by subparagraph (9) of section 39.23(p)-2(a) of Regulations 118;

(3) that no other deductions are claimed under section 23(p) of the Code, except that if other deductions are claimed under this section, full information as called for under the above-cited section of Regulations 118 is to be furnished with respect to such other plans of deferred compensation; and

(4) that the plan trustees, or association of employers, have undertaken to furnish all other information required to be furnished under this Revenue Ruling.

Although this Revenue Ruling waives the requirement of filing certain information, it will not have the effect of precluding a District Director of Internal Revenue from requiring such additional information as is considered necessary to determine allowable deductions under section 23(p) of the Code or qualification under section 165(a) of the Code.

This Revenue Ruling is issued under the provisions of the Internal Revenue Code of 1939; however, it will also be effective under the Internal Revenue Code of 1954 to the extent that it will not be inconsistent with the provisions of regulations to be issued under section 404 of the 1954 Code.

REGULATIONS 118, SECTION 39.23(p)-7: Pension and annuity plans; limitations under section 23(p)(1)(A)(iii). (Also Section 22(a), Section 39.22(a)-1.) Rev. Rul. 55-14

Refunds of contributions of employees, by the insurer of an employees' annuity plan, do not constitute taxable income to the recipients. The aggregate amount paid by the employer to the insurer, as reimbursement for such refunds, will be deductible from taxable income of the employer over a ten-year period under section 23(p)(1)(A)(iii) of the Internal Revenue Code of 1939 as a supplementary cost of annuity credits.

Advice has been requested whether refunds of contributions of employees by the insurer of an employees' annuity plan constitute taxable income and whether an amount paid by the employer to the insurer as reimbursement for such refunds would be deductible from taxable income of the employer.

An employer, who had established an insured annuity plan, under which both the employer and the employees made contributions toward the funding of the benefits to be provided, now proposes to amend the plan to eliminate the requirement for employee contributions and to have the insurer return all contributions previously made by the employees to them and to reimburse the insurer for such refunds.

It is held that refunds made to employees under these circumstances would constitute return of premiums and therefore would not be taxable income to the recipients.

It is further held that the aggregate amount paid by the employer to the insurer, as reimbursement for the refunds to employees, would be considered as a supplementary cost of annuity credits and, as such, would be deductible from taxable income of the employer, under section 23(p)(1)(A)(iii) of the Internal Revenue Code of 1939, over a ten-year period, subject to applicable limitations of that section and to verification upon examination of tax returns involved.

REGULATIONS 118, SECTION 39.23(p)-7: Pension and annuity plans; limitations under section 23(p)(1)(a)(iii). Rev. Rul. 55-411

In computing deductions for contributions to an employees' pension or annuity plan, as provided by section 23(p)(1)(A)(iii) of the Internal Revenue Code of 1939, separate treatment shall be accorded past service costs which are attributable to substantial amendments to the plan just as though such costs were provided under distinct supplemental plans. Interest on unfunded portions thereof which tend to increase such costs may not be included in the 10 percent base while increases in cost due to unfavorable experience or underestimation of the costs or to a change in the insurance company annuity rates should be included in the 10 percent base.

Advice has been requested as to the proper method of determining allowable deductions under section 23(p)(1)(A)(iii) of the Internal Revenue Code of 1939 on account of an employer's contributions to its employees' pension plan under a group annuity contract where the cost of past service credits has been increased by a substantial amendment to the plan.

The employer established an employees' pension plan, as of January 1, 1941, with a group annuity contract providing past service benefits of 1 percent of average earnings during the 10 years preceding January 1, 1941, for each year of credited service prior to that date but not including service prior to 1930. The single premium cost to fund such benefits as of December 1, 1941 was 2,000x dollars. In 1946, the cost of past service benefits was increased by increasing the rate of past service credits from 1 to 1½ percent. Additional amendments made in 1947 further increased the past service costs as of that date by extending the past service credits to include service prior to 1930, and providing certain supplementary annuity credits with respect to service between 1941 and 1947. The single premium cost as of January 1, 1950, to fund the benefits as of that date was calculated actuarially at 5,000x dollars. The taxpayer had contributed and deducted 600x dollars of the original past service liability in 1941, and has since deducted up to the maximum limitations in each succeeding year. The question presented is whether the initial cost of 2,000x dollars may be included in the 10 percent base for purpose of computing limitations on deductions for the year 1950 and subsequent years.

Section 23(p)(1)(A)(iii) of the Internal Revenue Code provides a limitation on deductions with respect to past service and supplementary costs of:

* * * an amount equal to the normal cost of the plan * * * plus, if past service or other supplementary pension or annuity credits are provided by the plan, an amount not in excess of 10 per centum 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, * * * *except that in no case shall a deduction be allowed for any amount* * * * *paid in after such pension or annuity credits are completely funded or purchased.* [Italics supplied.]

It is the position of the Internal Revenue Service that where a plan is amended to provide for a substantial increase in benefits so that the amendment is similar to the establishment of a distinct supplemental plan, deductions with respect to the cost of the additional

benefits may thereafter be allowed only to the same extent as deductions would be allowed if the additional benefits were provided under a distinct plan.

Since the employer, in the instant case, contributed and deducted 600x dollars of the original past service liability in 1941 and has deducted the maximum limitation of 200x dollars in each succeeding year, it is apparent that the 1941 single premium cost of 2,000x dollars (plus interest on delayed installments thereof) was completely funded and deducted by 1949. Any remaining 10 percent base after that time should include only costs of past service and supplementary credits provided by the amendments in 1946 and 1947 as of the date they were included in the plan, and such costs should be included in the 10 percent base only until such time as each is completely funded.

Accordingly, it is held that the provisions of section 23(p)(1)(A) of the Code requires that separate treatment be accorded past service costs which are attributable to substantial amendments to an employees' pension or annuity plan, just as though they were provided under distinct supplemental plans. Interest on unfunded portions thereof which tend to increase such costs may not be included in the 10 percent base while, on the other hand, increases in cost due to unfavorable experience or underestimation of the costs or to a change in the insurance company annuity rates should be included in the 10 percent base.

Regulation 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).

Deductibility of payments by an employer to an escrow fund which may be used to pay pension benefits. See Rev. Rul. 55-310, page 45.

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.

Contributions of property held for sale in ordinary course of business to an organization described in section 23(q) of the Internal Revenue Code. See Rev. Rul. 55-138, page 223.

Regulations 118, Section 39.23(q)-1: Contributions or gifts by corporations.

Contributions to a reserve officers association. See Rev. Rul. 55-156, page 292.

SECTION 23(r).—DEDUCTIONS FROM GROSS INCOME: DIVIDENDS PAID BY BANKING CORPORATIONS

REGULATIONS 118, SECTION 39.23(r)-1: Dividends paid by mutual savings banks, building and loan associations, and cooperative banks. Rev. Rul. 55-177

For taxable years beginning after December 31, 1951, the entire amount retained by a domestic building and loan association as a fine, penalty, forfeiture or other fee, because of the withdrawal of a stockholder from the association prior to the maturity of his shares, is includible in the gross income of the association for the year in which the right to retain such amount is exercised, notwithstanding the fact that a portion of the amount retained is allocable to dividends credited to the stockholder's shares in certain prior years during which the association was not subject to Federal income taxation and no deduction was allowable for dividends credited to the stockholder's shares in such prior years.

Advice has been requested as to the treatment, for Federal income tax purposes, of amounts retained by a domestic building and loan association as a penalty because of the withdrawal of a stockholder from the association prior to the maturity of his shares, where the amounts retained are ratably from dividends credited to the taxpayer's shares in prior years and a portion of the amount so retained is allocable to years during which the association was not subject to Federal income taxation.

In the years 1950, 1951 and 1952 the *M* building and loan association credited to the shares of a stockholder dividends of $10x$ dollars per year, totalling $30x$ dollars. In 1953 the stockholder withdrew from the association and received $24x$ dollars in payment of the dividends credited for 1950, 1951 and 1952, the difference of $6x$ dollars being retained by the association as a penalty for withdrawal of the stockholder prior to the maturity of his shares.

The specific question presented is whether the full amount of the $6x$ dollars is includible in the gross income of the building and loan association for 1953, notwithstanding the fact that for the years 1950 and 1951 the association was not subject to Federal income taxation, or whether only $2x$ dollars should be included in the gross income of the association for 1953, since that is the amount retained allocable to dividends credited to the stockholder's shares in 1952 and for which the association obtained a tax benefit.

For taxable years beginning prior to January 1, 1952, domestic building and loan associations were not subject to Federal income taxation. However, section 313(h) of the Revenue Act of 1951 amended section 104(a) of the Internal Revenue Code of 1939, relating to the definition of a bank, to include within its definition domestic building and loan associations thus making them subject to Federal income tax within the limits prescribed in section 104(b) of the Code for taxable years beginning after December 31, 1951. Also, section 313(f) of the Revenue Act of 1951, effective for taxable years beginning after December 31, 1951, amended section 23(r) of the Code to provide as follows:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

* * * * * * *

(r) DIVIDENDS PAID BY BANKING CORPORATIONS.—

(1) In the case of mutual savings banks, cooperative banks, and domestic building and loan associations, amounts paid to, or credited to the accounts of, depositors or holders of accounts as dividends on their deposits or withdrawals accounts, if such amounts paid or credited are withdrawable on demand subject only to customary notice of intention to withdraw.

Section 39.23(r)-1(b) of Regulations 118 provides in the case of a building and loan association which operates in whole or in part as a serial association which issues shares subject to fines, penalties, forfeitures, or other withdrawal fees, there is deductible under section 23(r)(1) of the Code the total amount credited as dividends upon such shares. It is further provided that where the association has the right to retain or recover a portion of the total amount credited as earnings upon such shares as a fine, penalty or forfeiture, or other withdrawal fee there is includible in the gross income of the association for the taxable year in which the right is exercised amounts retained or recovered by the association pursuant to the exercise of such right.

Accordingly, it is held that for taxable years beginning after December 31, 1951, the entire amount (in the instant case 6x dollars) retained by a domestic building and loan association as a fine, penalty, forfeiture or other withdrawal fee, because of the withdrawal of a stockholder from the association prior to the maturity of his shares, is includible in the gross income of the association for the year in which the right to retain such amount is exercised, notwithstanding the fact that a portion of the amount retained is allocable to the dividends credited to the stockholder's shares in certain prior years during which the association was not subject to Federal income taxation and that no deduction was allowable for dividends credited to the stockholder's shares in such prior years.

REGULATIONS 118, SECTION 39.23(r)-1: Dividends paid by mutual savings banks, building and loan associations, and cooperative banks. (Also Section 23(k); Regulations 118, Section 39.23(k)-5.) Rev. Rul 55-391

Where it is shown that the actual relationship of the preferred stockholders of a building and loan association to the association is that of an ordinary depositor, the par value of preferred stock being withdrawable on demand subject only to the customary notice of intention to withdraw, the association is entitled to a deduction, under the provisions of section 23(r) of the Internal Revenue Code of 1939, for preferred stock dividends issued to and taxable to the holders of the preferred stock. Such dividends are deductible by the association in the taxable year in which the redeemable stock dividend is issued. Furthermore, the par value of the preferred stock outstanding on the books of the association at the end of the year constitutes a part of the "total deposits or withdrawable accounts" for the purpose of com-

puting the addition to the reserve for bad debts under section 23(k)(1) of the 1939 Code.

SECTION (23(x).—DEDUCTIONS FROM GROSS INCOME: MEDICAL, DENTAL, ETC., EXPENSE

REGULATIONS 118, SECTION 39.23(x)-1: Medical, dental, etc., expenses. Rev. Rul. 55-261
(Also Section 24(a); Regulations 118, Section 39.24(a)-1.)
(Also Part I, Section 213.)

Deductibility as medical expenses under section 23(x) of the Internal Revenue Code of 1939 of certain expenditures made by taxpayers for transportation, travel, special education, medical insurance, health institutes, air conditioning device, special construction and equipment, special clothing, food and beverages, and other hygienic articles for purposes of health.

Consideration is given herein to the deductibility under section 23(x) of the Internal Revenue Code of 1939 of certain expenditures made by taxpayers for purposes of health, and on which advice for Federal income tax purposes has been requested.

Section 23(x) of the Code provides in part as follows:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.
In computing net income there shall be allowed as deductions:

* * * * * * *

(x) MEDICAL, DENTAL, ETC., EXPENSES.—Expenses paid during the taxable year, not compensated for by insurance or otherwise, for medical care of the taxpayer, his spouse, or a dependent specified in section 25(b)(3)—

* * * * * * *

* * * The term "medical care," as used in this subsection, shall include amounts paid for the diagnosis, cure, mitigation, treatment, or prevention of disease, or for the purpose of affecting any structure or function of the body (including amounts paid for accident or health insurance). * * *

Section 39.23(x)-1 of Regulations 118 provides that allowable deductions under section 23(x) will be confined strictly to expenses incurred primarily for the prevention or alleviation of a physical or mental defect or illness. The taxpayer shall furnish the name and address of each person to whom payment for medical expenses was made and the amount and approximate date of the actual payment thereof. Claims for deductions must be substantiated, when requested by the Commissioner, by a statement from the individual or entity to which payment for medical expenses was made, showing the nature of the service rendered, the amount paid therefor, and the date of the actual payment thereof, and by such other information as the Commissioner may deem necessary.

In general, any expense paid primarily for the diagnosis, cure, mitigation, treatment, or prevention of disease is allowable as a medical expense deduction. Such expenses include payments for services rendered by physicians, surgeons, dentists, optometrists, chiropractors, osteopaths, qualified psychiatrists and psychologists, and authorized Christian Science practitioners. They also include amounts paid for hospitalization insurance, and for accident or health insurance premiums which provide indemnity for cost of medical care, but not for

indemnity solely for loss of earnings. See I. T. 3598, C. B. 1943, 157; Revenue Ruling 143, C. B. 1953-2, 129, and section 39.23(x)-1 of Regulations 118.

Amounts paid primarily for the purpose of affecting some structure or function of the body are allowable as a medical expense deduction. Such expenses include payments for obstetrical expenses, and X-ray or therapy treatments. Expenses paid primarily for the prevention or alleviation of a physical or mental defect or illness include payments for hospital expenses, nursing service (including nurses' board where paid by the taxpayer), medical, laboratory, surgical, dental and other diagnostic and healing services. Similarly, allowable deductions also include the cost of eyeglasses, hearing aids and component parts, a "seeing-eye" dog and its maintenance, artificial teeth and limbs. Ambulance hire essential to the rendition of medical services, and travel expense primarily for the prevention or alleviation of a physical or mental defect or illness, when such travel is not, in any sense, for vacation purposes, constitute allowable medical deductions. The deductibility of travel expense under the provisions of section 23(x) of the Code, however, must depend on the facts of each case and to the extent that such expense can be substantiated to the satisfaction of the Commissioner.

Medical expense, in order to be deductible under section 23(x) of the Code, subject to the limitations provided in that section, is therefore any expense paid and properly substantiated as being primarily for any of the purposes enumerated in section 23(x). Expenses of such a nature that the personal or other benefits realized are greater than the medical benefits realized will not generally qualify as allowable deductions.

The expenditures in question and the application of section 23(x) of the 1939 Code thereto are shown below.

1. *Hotel expenses incurred where daily visits are required to a medical clinic.*—Held deductible. Travel, meals and lodging incurred primarily for and essential to the rendition of medical services are deductible under section 23(x). See I. T. 3786, C. B. 1946-1, 75. (However, for years beginning with 1954 see section 213(e) of the Internal Revenue Code of 1954 and Committee Reports denying deduction for food and lodging except where incurred as part of a hospital bill.)

2. *Cost of trip to Florida solely for the benefit of a taxpayer's post-operative throat and lung condition.*—In this case, the taxpayer underwent an operation for the removal of the larynx. Since that operation, he breathes through an opening in his throat. His efforts to breathe during the winter at his residence in a northern climate produce spasms of coughing which rupture blood vessels in his lungs, causing considerable distress to him. He has found that he is entirely free of this condition when in Florida during the winter months. It is held that, on the basis of the particular facts in this case, the cost of a trip to Florida primarily for the alleviation of a physical defect, the cost of such trip fully substantiated to the satisfaction of an examining officer of the Internal Revenue Service, is deductible under the provisions of section 23(x) of the Code and of section 39.23(x)-1(d)(1) of Regulations 118. See I. T. 3786, *supra*, and *Commissioner* v. *Keever L. Stringham*, 183 Fed. (2d) 579. (See note at end of item "1.")

3. *Transportation expense of a physically disabled person to and from his place of employment.*—In this case, taxicab fares were paid by a physically handicapped victim of polio in commuting to and from his place of employment. The expense of such transportation is a personal expense not deductible for Federal income tax purposes. Compare *John C. Bruton* v. *Commissioner*, 9 T. C. 882; *Esther E. Ranstead* v. *Commissioner*, Tax Court Memorandum Opinion, entered January 31, 1951.

4. *Cost of special education or training of a deaf child.*—Section 39.23(x)-1(d)(1) of Regulations 118 provides, in part, that "allowable deductions under 23(x) will be confined strictly to expenses incurred primarily for the prevention or alleviation of a physical or mental defect or illness." Under this provision, it is held that the cost of special instruction or training, such as in speech and lip reading, designed to alleviate the loss of speech which is attributable to deafness and to compensate in part for the loss of the sense of hearing is deductible as a medical expense under section 23(x) of the Code. However, the cost of ordinary instruction which a child would require in any event is not a medical expense and is not deductible. See Commissioner v. Stringham.

5. *Cost of regular psychiatric therapy at a specially equipped treatment school.*—Due to severe emotional disturbances, a taxpayer's daughter is sent on the advice of a psychiatrist to a treatment school operating 12 months in the year, at which school she is under the care of a practicing psychiatrist and receives regular psychiatric therapy. Under such circumstances the amount paid for psychiatric care which is for the primary purpose of alleviating a mental illness is deductible as a medical expense under section 23(x) of the Code. As in situation 4 above, however, the cost of instruction or tuition at such school which does not represent medical care is not deductible.

6. *Personal counseling program for remedial reading.*—Taxpayer's son is attending a college for a personal counseling program for remedial reading. He is handled by a psychologist and is receiving individual instruction together with psychotherapy. If the psychotherapy is incidental to general supervisory counseling, the entire expense constitutes a personal expense the deduction of which is prohibited by section 24(a)(1) of the Code. However, if a claim for deduction of the cost of the psychotherapy can be substantiated, when requested by the Commissioner, as having been incurred primarily for the prevention or alleviation of a physical or mental defect or illness, as required in sections 39.23(x)-1(d)(1) and 39.23(x)-1(g) of Regulations 118, the cost thereof may be deducted as a medical expense. See Rev. Rul. 143, C. B. 1953-2, 129, and Rev. Rul. 54-457, C. B. 1954-2, 100.

7. *Single annual premium paid on an insurance policy covering both accidental injury and medical expense resulting therefrom.*—Taxpayer paid premiums on several policies of the type which provides for special indemnities in the case of various enumerated injuries (but not for loss of earnings) and, in addition to such indemnities, for payment by the insurance company of the expenses of treatment by a physician or surgeon, and hospital and nursing care required by such injuries. The premium of each policy is a single specified amount,

no allocation of each premium being shown with respect to each type of benefit available under the contract.

Section 23(x) of the Code provides that in computing net income there shall be allowed expenses, not compensated for by insurance or otherwise, for medical care of the taxpayer, his spouse, or his dependents, and that the term "medical care," as used in that section, shall include amounts paid for accident or health insurance. In *Robert O. Deming, Jr.* v. *Commissioner*, 9 T. C. 383, acquiescence C. B. 1948-1, 1, it was held that where the petitioner received payments under accidental insurance contracts, designated in part as indemnity for disability and in part as indemnity for hospitalization, etc., petitioner's medical expense was "compensated for by insurance" within the meaning of section 23(x) of the Code only to the extent that he received insurance payments specifically designated as indemnity payments for hospitalization, etc. Following the reasoning of this decision Revenue Ruling 19, C. B. 1953-1, 59, holds that "the amount of annual premium paid for accident and health insurance which *does not provide reimbursement to the insured for medical expense* does not constitute a proper deduction under section 23(x) of the Internal Revenue Code." (Emphasis supplied.) This language appearing in Revenue Ruling 19, *supra*, is not to be construed as meaning that the total premium paid for accident insurance which *does* provide in part for medical benefits is to be considered deductible entirely as a medical expense. Since only that portion of the policy covering benefits which reimburse the insured for medical expense reduces his otherwise allowable medical deductions under section 23(x), only that part of the premium paid by the taxpayer which is attributable to the medical benefits of such policy may be considered a deductible medical expense.

Accordingly, in the case of a single, specified premium paid annually or otherwise on a policy which provides for both accident indemnities and reimbursement for medical expense resulting from such accident, only that portion of the premium attributable to the medical benefits of the policy is deductible as medical expense under section 23(x) of the Code.

8. *Transportation expense to a doctor's office.*—Section 39.23(x)-1(d)(1) of Regulations 118 provides that travel primarily for and essential to the rendition of medical services is an allowable medical deduction. Transportation expense, as for example taxicab fares, paid for and properly substantiated as being primarily for the rendition of medical services constitutes an allowable medical deduction.

9. *Fees paid to health institutes.*—Ordinarily, fees paid to a health institute where the taxpayer takes exercise, rubdowns, etc., are held to be a personal expense, deduction for which is prohibited by section 24(a)(1) of the Code. However, fees paid to health institutes may be deductible as medical expense only when such treatments by such institutes are prescribed by a physician and are substantiated by a statement by the physician that the treatments are necessary for the alleviation of a physical or mental defect or illness of the individual receiving the treatments.

10. *Air conditioning device.*—Inquiries have been made as to the deductibility of the cost of an air conditioning device which has been installed in a room of the taxpayer's residence for the purpose of ef-

fecting relief from an allergy or for relieving difficulty in breathing due to a heart condition. It is held that the cost of an air conditioning device, plus the operating expenses, less any resale or salvage value, constitute an allowable deduction as a medical expense subject to prescribed limitations, provided that the need for it is substantiated by evidence submitted to show that the device is used primarily for the alleviation of a person's illness and provided further that the device does not become a permanent part of the dwelling and may be removed to other quarters.

11. *Oxygen equipment and oxygen for alleviation of illness.*—Amounts paid for oxygen equipment and oxygen used to alleviate difficulty in breathing due to a heart condition may be deducted as a medical expense subject to the limitations prescribed in section 23(x) of the Code.

12. *Construction of special room to accommodate an iron lung and associated equipment; operating costs for iron lung; change in home heating unit.*—In order to provide necessary care at home for a dependent stricken with polio, taxpayer built a special hospital room at his home to accommodate an iron lung, rocking bed, extra chest respirator and other equipment. During the dependent's confinement in the hospital room added expenses were involved, such as power for operation of the iron lung, special telephone setup, nursing service, etc. It was also necessary to make a complete change of the home heating unit.

With respect to the cost of construction of a special room at a dwelling, even though primarily for medical purposes, and with respect to the cost of altering a home heating unit, such costs are held to constitute expenditures for permanent improvements or betterments which increase the value of the property, and do not qualify as medical expenses under section 23(x) of the Code. See *John L. Seymour* v. *Commissioner*, 14 T. C. 1111 and Revenue Ruling 54-57, C. B. 1954-1, 67.

The expenses of operating an iron lung and of associated equipment necessary thereto, and the expense of nursing care during confinement in the special room are held to be expenses incurred primarily for the alleviation of a physical illness, and may be deducted as a medical expense subject to the limitations prescribed in section 23(x) of the Code.

13. *Cost of a small three-wheel motor vehicle commercially known as an "autoette" used by a totally disabled taxpayer.*—The taxpayer is rated by the Veterans' Administration as totally disabled; he can get around for short distances on crutches but is unable to drive a car or use public transportation.

The cost of a small three-wheel vehicle commercially known as an "autoette," acquired for transportation purposes, irrespective of the taxpayer's physical condition, does not represent an expense incurred primarily for the alleviation of a physical defect or illness as provided in section 39.23(x)-1(d)(2) of Regulations 118. Such an expense is a non-deductible personal expense under section 24(a)(1) of the Code. Compare *John C. Bruton* v. *Commissioner*, *supra*, and *Esther E. Ranstead* v. *Commissioner*, *supra*.

364050°—56——21

14. *Special mattress and plywood boards for the relief of an arthritic condition.*—Taxpayer's spouse has arthritis of the spine for which a special mattress and a certain thickness of plywood boards has been prescribed. Under such circumstances the expense of a special mattress and plywood boards prescribed for the relief of a physical disease or illness constitutes a medical deduction under section 23(x) of the Code.

15. *Cost of special food and beverages prescribed for specific ailments.*—Advice has been requested with respect to the deductibility as a medical expense of (1) whiskey prescribed by a physician for the relief of angina pain resulting from a coronary artery disease and (2) cost of special food prescribed by a physician for a taxpayer who is on an ulcer diet. Generally, the cost of special food or beverages does not qualify as a medical expense within the meaning of section 23(x) of the Code. However, in special cases, depending upon the particular facts presented, if the prescribed food or beverage is taken solely for the alleviation or treatment of an illness, is in no way a part of the nutritional needs of the patient, and a statement as to the particular facts and to the food or beverage prescribed is submitted by a physician, the cost of such food or beverage may be deducted as a medical expense. Where the special food or beverage is taken as a substitute for food or beverage normally consumed by a person and satisfies his nutritional requirements, the expense incurred is a personal expense within the meaning of section 24(a)(1) of the Code; but where it is prescribed by a physician for medicinal purposes and is in addition to the normal diet of the patient, the cost may qualify as a medicinal expense under section 23(x).

16. *Maternity clothing, antiseptic diaper service, wigs, toothpaste.*—Amounts expended for the preservation of general health or for the alleviation of physical or mental discomfort which is unrelated to some particular disease or defect are not expenses for medical care as defined in section 23(x) of the Code. Expenditures for maternity clothing, antiseptic diaper service, wigs, and toothpaste, are held to be personal expenses, the deduction of which is prohibited by section 24(a)(1) of the Code. *O. G. Russell* v. *Commissioner*, Tax Court Memorandum Opinion, entered November 6, 1953.

REGULATIONS 118, SECTION 39.23(x)-1: Medical, dental, etc., expenses.

Premiums paid for personal disability insurance. See Rev. Rul. 55-331, page 271.

SECTION 23(z).—DEDUCTIONS FROM GROSS INCOME: AMOUNTS REPRESENTING TAXES AND INTEREST PAID TO COOPERATIVE APARTMENT CORPORATION

REGULATIONS 118, SECTION 39.23(z)-1: Amounts representing taxes and interest paid to cooperative apartment corporation. Rev. Rul. 55-316

A nonstock corporation which sells perpetual use and equity contracts or proprietary leases to its members may constitute a

cooperative apartment corporation provided 80 percent of its gross income is derived from tenant-stockholders. Individual nominees of another corporation who own perpetual use and equity contracts or proprietary leases for the use of such corporation do not qualify as tenant-stockholders under section 23(z)(2)(B) of the Internal Revenue Code of 1939. Individual members who acquire perpetual use and equity contracts, whether or not held in the names of nominees, qualify as tenant-stockholders. Purchasers of perpetual use and equity contracts or proprietary leases who are tenant-stockholders are entitled to a deduction for their proportionate share of taxes and interest paid or incurred by the corporation.

Advice has been requested whether a nonstock corporation organized and operated in the manner described below will constitute a cooperative apartment corporation within the meaning of section 23(z) of the Internal Revenue Code of 1939. Advice has also been requested whether the purchasers of perpetual use and equity contracts or proprietary leases in such corporation are entitled to a deduction for their proportionate share of the taxes and interest paid or incurred by the corporation.

X corporation (hereinafter called "seller") formed a new corporation (hereinafter called "cooperative") as a nonstock corporation to be operated through a board of directors elected by the members. Seller owns an apartment house development consisting of furnished and unfurnished apartments, hotel rooms, lobbies, a dining room, garages, and stores. Cooperative will be granted a long-term lease (possibly 99 years with renewal options) of the ground and improved area on which the buildings stand, together with title to improvements thereon. Seller will reserve from the lease and the deed to improvements, (1) furniture in the furnished apartments and hotel rooms, (2) nonresidential areas, and (3) personalty used in connection with the operation of non-residential facilities.

The purchase price for the lease will be paid in cash and deferred purchase money notes secured by deeds of trust. The cash paid will be derived from sale by cooperative of perpetual use and equity contracts or proprietary leases to members of the cooperative. The contracts or leases will be purchased by present tenants or others for a principal sum. Any contracts or leases remaining unsold may be purchased by individual members of the cooperative for resale.

The use contracts or leases will entitle members to perpetual use and enjoyment of a designated apartment. Any purchasers of use contracts or leases, including nominees of seller, although entitled to occupy apartments for dwelling purposes, may lease apartments to others for dwelling purposes. The contracts or leases provide for payment to cooperative of "maintenance charges," in which will be included operating and maintenance expense, real estate taxes, interest and amortization under deeds of trust and ground lease rental.

Seller will also have the right to buy use contracts or leases, designating individual nominees as owners, and will have the right to require sale of use contracts or leases to other individuals by cooperative. Seller will pay for all services rendered by cooperative, and prorated amounts for taxes assessed against, and utilities used in, reserved parts of the real estate, the total of which will be substantially less than 20 percent of the annual gross income to be realized by cooperative.

Section 23 (z) of the Internal Revenue Code of 1939 provides as follows:

> (2) DEFINITION.—For the purposes of this subsection—
>
> (A) COOPERATIVE APARTMENT CORPORATION.—The term "cooperative apartment corporation" means a corporation—
>
> (i) having one and only one class of stock outstanding,
>
> (ii) all of the stockholders of which are entitled, solely by reason of their ownership of stock in the corporation, to occupy for dwelling purposes apartments in a building owned or leased by such corporation, and who are not entitled, either conditionally or unconditionally, except upon a complete or partial liquidation of the corporation, to receive any distribution not out of earnings and profits of the corporation, and
>
> (iii) 80 per centum or more of the gross income of which for the taxable year in which the taxes and interest described in paragraph (1) are paid or incurred is derived from tenant-stockholders.
>
> (B) TENANT-STOCKHOLDER.—The term "tenant-stockholder" means an individual who is a stockholder in a cooperative apartment corporation, and whose stock is fully paid-up in an amount not less than an amount shown to the satisfaction of the Commissioner as bearing a reasonable relationship to the portion of the value of the corporation's equity in the building and the land on which it is situated which is attributable to the apartment which such individual is entitled to occupy.

The case here under consideration involves a nonstock corporation. Unlike ordinary corporations, a nonstock corporation has no stockholders but in place thereof has members. In the absence of a contrary provision in the statute, charter, or by-laws, the rights of members of a nonstock corporation have been held to be the same as those of a shareholder in an ordinary corporation. *Baird* v. *Tyler et al.*, 39 S. E. (2d) 642; *Leeds* v. *Harrison*, 72 A (2d) 371. It has been held that the word "stockholder" as used in a statute relating to insurance companies meant, in the case of assessment companies, those who had agreed to become members of the association and pay assessments. *Sugg* v. *Farmers Mutual Insurance Association et al.*, 63 S. W. 226. In short, the terms "stock" and "stockholders" are not necessarily confined to their ordinary contemplation of a stock subscription list whereby certain sums are agreed to be paid as contributions to a fund intended to supply a capital stock for a company.

Section 3797(a)(7) of the Code defines the term "stock" to include the share in an association, joint-stock company, or insurance company, organizations in which the interest of a member may not be represented by "stock" in a strict sense. Similarly, the term "shareholder" is defined in section 3797(a)(8) to include a member in an association, joint-stock company, or insurance company.

Cooperative members in the instant case possess the normal and usual rights of stockholders, namely, a pro rata distribution of assets upon liquidation, participation in management by reason of electing the board of directors, and transferability of their interest. Furthermore, a nonstock cooperative apartment corporation which otherwise qualifies is in accord with the purpose of section 23(z) of the 1939 Code. The purpose of section 23(z) is to place the cooperative apartment owner in as favorable a position with respect to interest and taxes paid as the owner of a dwelling house. See Senate Report No. 1631 on the Revenue Bill of 1942, C. B. 1942–2, 504, at pages 546 and 577. Perpetual use of and equity in an apartment or the proprietary

lease of an apartment, coupled with membership in the corporation, is the equivalent for practical purposes of ownership of an apartment.

In view of the foregoing, it is held that provided the cooperative meets the 80 percent gross income requirement of section 23(z)(2) of the Internal Revenue Code of 1939, it will constitute a cooperative apartment corporation within the meaning of such section. It is further held that (1) individuals who hold perpetual use and equity contracts or proprietary leases as nominees for seller do not qualify as tenant-stockholders since the beneficial ownership is in a corporation, which cannot so qualify under section 23(z); and (2) individual members who acquire perpetual use and equity contracts or proprietary leases, whether or not held in the names of nominees, qualify as tenant-stockholders. Accordingly, the purchasers of perpetual use and equity contracts or proprietary leases who are tenant-stockholders in a cooperative will be allowed the deductions provided for by section 23(z)(1) of the 1939 Code.

SECTION 24(a).—ITEMS NOT DEDUCTIBLE: GENERAL RULE

REGULATIONS 118, SECTION 39.24(a)-1: Personal and family expenses. Rev. Rul. 55-57

(Also Section 23(a), Section 39.23(a)-1.)

> Amounts expended by a taxpayer for the purpose of having his wife accompany him on a business trip or to a business convention represent nondeductible personal expenses for Federal income tax purposes under the provisions of section 24(a)(1) of the Internal Revenue Code of 1939, unless it can be shown that the presence of the wife on such a trip has a bona fide business purpose.

Advice has been requested relative to the deductibility of amounts expended by a taxpayer for the travel expenses of his wife who accompanies him on a business trip or to a business convention.

Section 24(a)(1) of the Internal Revenue Code of 1939 provides that no deduction shall in any case be allowed in respect of personal, living, or family expenses, except extraordinary medical expenses.

Section 23(a)(1)(A) of the Code provides, in part, that in computing net income there shall be allowed as deductions all ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business. Traveling expenses (including meals and lodging) while away from home in the pursuit of a trade or business are specifically included.

Section 39.23(a)-2 of Regulations 118 provides as follows:

> (a) Traveling expenses, as ordinarily understood, include railroad fares and meals and lodging. If the trip is undertaken for other than business purposes, the railroad fares are personal expenses and the meals and lodging are living expenses. If the trip is solely on business, the reasonable and necessary traveling expenses, including railroad fares, meals, and lodging, are business expenses.

Such expenses must be directly attributable to the conduct of the business to be deductible.

Where a wife accompanies her husband on a business trip or to a business convention the Code and Regulations as cited above require a showing that her presence serves a bona fide business purpose, i.e. is not merely for her pleasure or vacation, but is directly attributable

to the husband's business and necessary to the conduct thereof. Otherwise, the portion of the expense of the trip attributable to the wife's travel constitutes a nondeductible personal or living expense within the provisions of section 24(a)(1) of the Code. The performance by a wife of some incidental service for her husband, such as the occasional typing of notes or similar service while accompanying him on such trips, does not establish that her presence is necessary to the conduct of his business.

The Tax Court of the United States (formerly the Board of Tax Appeals) has denied deductions for expenses of a wife who accompanied her husband on business trips in those cases where the wife's presence did not serve a bona fide business purpose. In the case of the *Appeals of George W. Megeath et al.*, 5 B. T. A. 1274, it was held that the portion of the traveling expenses incurred by the taxpayer incident to the transportation and maintenance of his wife who accompanied him on a business trip to Europe was personal in nature and not deductible.

In the case of *Axel S. Stokby* v. *Commissioner*, Tax Court memorandum opinion entered June 30, 1953, the court had many factors to consider before arriving at the decision that the expenses of the wife who accompanied the taxpayer on several business trips during the years under consideration were not deductible. There the taxpayer, in his unsuccessful attempt to establish that his wife was the proprietor of the business enterprise involved, introduced evidence that his wife signed some business checks, that her name appeared on certain business papers as proprietor, that she did spend some time at the place of business, that she did assist in entertaining customers and others important to the business life of the company, and that one of the South American suppliers of merchandise was arranged for through one of her acquaintances. The taxpayer and his wife made an extensive tour of the United States in 1943, a trip to Florida in 1944, a trip to Brazil and Uruguay in early 1945 and a trip to Denmark in the latter part of 1945. Although the taxpayer was continually contacting actual or potential customers and suppliers on these trips, he and his wife generally managed to include stops at resort cities or visits with relatives in their itineraries. The court found as a fact that the presence of the wife on the trips was not required or necessary for the business, and denied deduction of expenses therefor.

A contrary decision, however, was reached in the case of *John Charles Thomas et al.* v. *Commissioner*, Board of Tax Appeals memorandum decision entered March 14, 1939, where it was held that the expenses paid for transportation, board and lodging for the wife who accompanied her husband (the taxpayer) on trips which he made in pursuit of his trade or business, as a singer, were deductible. In that case the wife, who was herself trained as a singer, coached her husband in preparation for his singing roles, assisted in perfecting his pronunciation of certain foreign languages which he had to sing, in selecting appropriate costumes, obtaining publicity, planning itineraries, selecting programs for his concerts, and acted as his secretary and typist. On the basis of the information available, the Board found as a fact that the wife performed valuable services for her husband in connection with his business which required her to be

with him while traveling away from home and that the expenses incurred for her travel were ordinary and necessary business expenses.

On the basis of the foregoing discussion and cases cited for illustrative purposes, it is held that amounts expended by a taxpayer for the purpose of having his wife accompany him on a business trip or to a business convention represent nondeductible personal expenses for Federal income tax purposes under the provisions of section 24(a)(1) of the Code, unless it can be adequately shown that the wife's presence on the trip has a bona fide business purpose.

REGULATIONS 118, SECTION 39.24(a)-1: Personal and family expenses. Rev. Rul. 55-140

Expenses incurred by an employee in moving his family and household goods from one locality to another where he had accepted a new employment with another employer represent nondeductible expenses under section 24(a)(1) of the Internal Revenue Code of 1939 prohibiting the deduction of personal, living, or family expenses. Allowances or reimbursements for such expenses which are received from the new employer under the foregoing circumstances must be included in gross income. See Revenue Ruling 54-429, C. B. 1954-2, 53, for treatment of allowances or reimbursements for moving expenses of an employee who is transferred in the interest of his employer from one official station to another for permanent duty.

REGULATIONS 118, SECTION 39.24(a)-1: Personal and family expenses. Rev. Rul. 55-237

A taxpayer presently engaged in investing in independently produced pictures released in the United States proposes to make a trip to Europe to explore the general possibilities of making more favorable investments in films there. *Held*, expenditures incurred by the taxpayer in making a trip to Europe for such purposes, without an existing right or interest resulting in the production of income, do not constitute deductible expenses for Federal income tax purposes.

REGULATIONS 118, SECTION 39.24(a)-1: Personal and family expenses. Rev. Rul. 55-291

The taxpayer is president of a corporation engaged in the business of manufacturing machinery for use in the food and chemical processing industry. He was appointed as a lecturer on food technology at *X* college at a salary of $1 per year. The purpose of accepting such an appointment was to establish his reputation as a lecturer and writer on food technology to a point where instead of virtually contributing his services he would receive substantial personal income therefrom. With the above in view, the taxpayer incurred expenses in the development of outlets for the material used in his lectures through radio, television and magazine articles. In addition he appeared on radio and conducted radio interviews incurring certain expenses in connection therewith. *Held*, the expenses incurred by the

taxpayer for the purpose of increasing his prestige and establishing his professional reputation constitute personal expenses within the meaning of section 24(a)(1) of the Internal Revenue Code of 1939 and, therefore, are not deductible from gross income. Compare *Thomas H. Welch* v. *Helvering*, 290 U. S. 111, Ct. D. 755, C. B. XII-2, 112 (1933), *Manoel Cardozo* v. *Commissioner*, 17 T. C. 3, and *Frederick A. Purdy* v. *Commissioner*, 12 T. C. 888.

REGULATION 118, SECTION 39.24(a)-1: Personal and family expenses. (Also Section 23(a); Regulations 118, Sections 39.23(a)-1, 39.23(a)-2.) Rev. Rul. 55-412

Expenses incurred for travel and for study by a teacher on sabbatical leave constitute personal expenses under section 24(a) of the Internal Revenue Code of 1939, where such travel and study are not required to maintain the teaching position. Personal expenses are not deductible for Federal income tax purposes.

Advice has been requested as to the deductibility for Federal income tax purposes of expenses incurred by a teacher for travel and study in Europe while on sabbatical leave granted by the school in which he teaches.

Taxpayer is an instructor in a secondary private school. The school does not require any of its faculty to travel although it encourages instructors to take leave for study and travel which will result in improved teaching. The school continues to pay the instructor's salary during the period of leave but does not direct any of the instructor's plans nor does it require any report concerning such travel and study.

I. T. 4044, C. B. 1951-1, 16, holds that summer school expenses, including tuition, room rent, and cost of travel, incurred by a public school teacher who was required to attend summer school regularly in order to maintain her position were deductible as ordinary and necessary business expenses under section 23(a)(1)(A) of the Internal Revenue Code of 1939. In I. T. 3380, C. B. 1940-1, 29, traveling expenses incurred by teachers on sabbatical leave from their schools who received compensation while so engaged, which travel was required by the board of education, and who were required to report to the school relative to their travel, are similarly deductible.

Where, however, the expenses of travel and study were voluntarily assumed by a teacher for the purpose of increasing his prestige, to improve his reputation for scholarship and learning, and to better fit him for the duties he was employed to perform, such expenses were considered to be personal expenses, deduction for which is prohibited by section 24(a)(1) of the Code. See *Manoel Cardozo* v. *Commissioner*, 17 T. C. 3, and I. T. 4044, *supra*.

Accordingly, it is held that expenses incurred for travel and for study by a teacher while on sabbatical leave, during which period his salary from the school continues to be paid to him but the travel and study are not required by the school in order to maintain his position, are personal expenses under section 24(a)(1) of the Internal Revenue

Code of 1939, which are not deductible for Federal income tax purposes.

REGULATIONS 118, SECTION 39.24(a)-1: Personal and family expenses.

Expenses incurred by members of reserve components of the Armed Forces for cost and maintenance of uniforms. See Rev. Rul. 55-109, page 261.

REGULATIONS 118, SECTION 39.24(a)-1: Personal and family expenses.

Certain expenditures made by taxpayers for purposes of health. See Rev. Rul. 55-261, page 307.

REGULATIONS 118, SECTION 39.24(a)-1: Personal and family expenses.

Premiums paid for personal disability insurance. See Rev. Rul. 55-331, page 271.

REGULATIONS 118, SECTION 39.24(a)-2: Capital expenditures. Rev. Rul. 55-158

Amounts paid by a taxpayer for the preparation and filing of the affidavit relating to continued use required by section 8 of the Act of July 5, 1946, 60 Stat. 427, 431, 15 U. S. C. 1058, which act provides for the registration and protection of trade-marks, constitute capital expenditures made for the purpose of preventing cancellation of the registration of a trade-mark. Accordingly, such expenditures are not deductible for Federal income tax purposes. See section 39.24 (a)-2 of Regulations 118.

REGULATIONS 118, SECTION 39.24(a)-2: Capital expenditures. Rev. Rul. 55-252

Generally, direct costs incurred in connection with reforestation by planting are capital expenditures, recoverable through depletion as the timber subsequently becomes merchantable and is cut or sold. Compare Mim. 6030, C. B. 1946-2, 45; G. C. M. 6544, C. B. VIII-2, 118 (1929). Such planting costs include:

(a) preparation of the site, including any girdling or brush removal work to afford good growing conditions;
(b) cost of seedlings; and
(c) labor and tool expense, including depreciation of equipment used in planting such as trucks, tree planters, etc.

Indirect expenditures, such as interest paid on money borrowed to satisfy a State law requiring a deposit to guarantee natural reforestation over a specified period of years in lieu of planting, or a service

charge on a performance bond in lieu of a cash deposit, may be treated as current deductions for the year in which incurred or capitalized cumulatively in accordance with a proper election by the taxpayer under the provisions of section 39.24(a)-6 of Regulations 118.

REGULATIONS 118, SECTION 39.24(a)-2: Capital expenditures. Rev. Rul. 55-253

Expenditures incurred by a taxpayer for construction of a permanent roadway in connection with the development of a subdivision of rental property owned by him may not be deducted as an operating expense but is to be considered as an addition to capital investment within the meaning of section 24(a)(2) of the Internal Revenue Code of 1939.

REGULATIONS 118, SECTION 39.24(a)-2: Capital expenditures. Rev. Rul. 55-290

Expenditures incurred by a taxpayer in the original construction of greens on a golf course constitute capital expenditures to be added to the original cost of the land and are not subject to an allowance for depreciation. Subsequent operating expenses for sod, seed, soil and other sundry maintenance constitute ordinary and necessary business expenses which are deductible from gross income for Federal income tax purposes.

REGULATIONS 118, SECTION 39.24(a)-2: Capital expenditures. Rev. Rul. 55-332

Amounts paid to creditors of an insolvent corporation by a new corporation, having the same president as the former insolvent corporation, in order to obtain franchises to sell the creditors' products constitute capital expenditures which are not deductible as ordinary and necessary business expenses. See *Thomas H. Welch* v. *Helvering*, 63 Fed. (2d) 976, affirmed 290 U. S. 111, Ct. D. 755, C. B. XII-2, 112 (1933). Such payments are considered to be made to establish good will.

REGULATIONS 118, SECTION 39.24(a)-2: Capital expenditures.

So-called rental payments to bank which purchased and holds legal title to automotive equipment which it leases to taxpayer. See Rev. Rul. 55-25, page 283.

REGULATIONS 118, SECTION 39.24(a)-6: Taxes and carrying charges chargeable to capital account and treated as capital items. Rev. Rul. 55-118

Delay rentals paid or accrued in connection with non-producing oil and gas leases may, at the election of the taxpayer, be capitalized as carrying charges on unimproved and unproductive real property

under the provisions of section 39.24(a)-6 of Regulations 118, without regard to the manner in which that item on the same lease was handled for a prior year. Such item may be capitalized in respect of one nonproducing oil and gas lease, even though in the same taxable year a like treatment is not applied to other such leases owned.

Advice has been requested whether (1) delay rentals paid or accrued in connection with non-producing oil and gas leases may, at the taxpayer's election, be capitalized as carrying charges on unimproved and unproductive real property under the provisions of section 39.24(a)-6 of Regulations 118, (2) such election may be exercised with respect to a particular lease in a given year if such election was not exercised for the same lease in a prior year, and (3) such election must apply to all nonproducing leases in a given year.

In the instant case, the taxpayer (lessee) owns nonproducing oil and gas leases on acreage in various states and in Canada. During prior years, the taxpayer had deducted all delay rentals in determining taxable income. Beginning with the taxable year 1953, taxpayer desires to capitalize such delay rentals.

The provisions of paragraph (1) and sub-paragraph (1)(i) of section 39.24(a)-6(b) of Regulations 118, in the interpretation of section 24(a)(7) of the Internal Revenue Code of 1939, state that carrying charges on unimproved and unproductive real property may be capitalized at the election of the taxpayer, in the manner provided in section 39.24(a)-6(c) of the regulations.

Payment of a delay rental with respect to an undeveloped oil and gas lease extends the period in which the lessee may drill wells for the production of oil and gas. In G. C. M. 11197, C. B. XII-1, 238 (1933), it was held that delay rentals may be handled as carrying charges on unproductive property. In I. T. 3693, C. B. 1944, 272, it was held that a lessee's interest in an oil and gas lease constitutes an interest in real property, for Federal income tax purposes. Accordingly, undeveloped oil and gas leases are deemed to be unimproved and unproductive real property within the meaning of section 39.24(a)-6(b)(1)(i) of Regulations 118.

Section 39.24(a)-6(b)(2) of Regulations 118 contains the provisions that a taxpayer may elect to capitalize the carrying charges on one project even though he does not elect to capitalize carrying charges on other projects. An oil and gas lease is a separate property and thus is handled as a separate project. Compare G. C. M. 22106, C. B. 1941-1, 245, and G. C. M. 24094, C. B. 1944, 250.

In view of the foregoing, it is held that delay rentals paid or accrued in connection with nonproducing oil and gas leases may, at the election of the taxpayer, be capitalized as carrying charges on unimproved and unproductive real property within the purview of section 39.24(a)-6(b)(1) of Regulations 118. Under the provisions of section 39.24(a)-6(b)(3) of the regulations, an election may be exercised to capitalize delay rentals on a particular lease for a given year without regard to the manner in which carrying charges were handled in prior years with respect to the same lease. An election may be made to capitalize delay rentals in a given year with respect to a particular nonproducing oil and gas lease even though such an election is not exercised in that year with respect to other such leases.

SECTION 25.—CREDITS OF INDIVIDUALS AGAINST NET INCOME

REGULATIONS 118, SECTION 39.25-2: Credits of individuals for purpose of normal tax and surtax. (Also Sections 22(k), 51; Regulations 118, Sections 39.22(k)-1, 39.51-1.) Rev. Rul. 55-178

Consistent with the nonacquiescence, C. B. 1953-2, 8, in the decision in *Marriner S. Eccles* v. *Commissioner*, 19 T. C. 1049, affirmed, 208 Fed. (2d) 796, the Internal Revenue Service will continue to adhere to the position that an individual legally separated from his spouse under an interlocutory decree of divorce is legally separated under a decree of divorce or of separate maintenance within the meaning of section 25(b)(2)(B) of the Internal Revenue Code of 1939 and thus is not to be considered as married. Such conclusions are equally applicable to the nonacquiescence, C. B. 1953-2, 8, in *Alice Humphreys Evans* v. *Commissioner*, 19 T. C. 1102, affirmed, 211 Fed. (2d) 378.

Advice has been requested whether the decision in *Marriner S. Eccles* v. *Commissioner*, 19 T. C. 1049, affirmed, 208 Fed. (2d) 796, will affect the position of the Internal Revenue Service that for the purpose of section 25(b)(2)(B) of the Internal Revenue Code of 1939 a legal separation under an interlocutory decree of divorce is a legal separation under that section.

Section 25(b) of the Internal Revenue Code of 1939 relates to the exemptions allowable on a Federal income tax return, and paragraph (2)(B) thereof provides: "An individual legally separated from his spouse under a decree of divorce or of separate maintenance shall not be considered as married." It follows that if a wife is so separated from her husband, the husband cannot claim an exemption on his income tax return for her.

House of Representatives Report No. 1274, 80th Congress, C. B. 1948-1, 241, at 277, and Senate Report No. 1013, 80th Congress, C. B. 1948-1, 285, at 324, in considering section 25(b)(2) of the Code, state in part:

> The second rule is that an individual legally separated (although not absolutely divorced) from his spouse under a decree of divorce or of separate maintenance shall not be considered as married. Similar rules for the determination of status are provided in section 23(aa)(6) of the Code (as added by section 302(c) of the bill), relating to the standard deduction, and in section 51(b)(5) of the Code (as added by section 303 of the bill) relating to joint returns. A uniform construction of all these provisions is intended. The rule with respect to the marital status of an individual legally separated from his spouse under a decree of divorce or of separate maintenance is derived from a corresponding provision in section 22(k) of the Code, relating to the tax treatment of alimony and like payments.

In the Eccles case, The Tax Court of the United States held that the taxpayer and his wife who were legally separated under an interlocutory decree of divorce as of December 31, 1949, were for the purpose of section 51 of the Internal Revenue Code still husband and wife and thus entitled to file a joint return for the year 1949.

The Tax Court observed that an interlocutory decree of divorce was not a decree of divorce under State law since it did not effect a final divorce and was not a decree of separate maintenance as provided for

in the Utah statutes. However, it is the position of the Internal Revenue Service that the intent of Congress, by the phrase "decree of divorce or of separate maintenance," was to include any court decree (other than a decree of absolute divorce) which legally separates the parties and that local law is applicable only to discover whether there was such a decree and whether the decree had such effect upon the marital obligations of the parties as to amount to a "legal separation." Accordingly, it is the position of the Service that the court in the Eccles case was in error in holding that the parties, although legally separated, were still entitled to file a joint return under section 51 of the Code since under State law there was no "decree of divorce or of separate maintenance." See also I. T. 3761, C. B. 1945, 76.

The fact that the Government did not apply for certiorari in the Eccles case in no way represents an acceptance of the decision by the Internal Revenue Service. Consistent with the nonacquiescence in the Eccles case, C. B. 1953-2, 8, the Service will continue to hold that an individual legally separated from his spouse under an interlocutory decree of divorce is legally separated under a decree of divorce or of separate maintenance within the meaning of section 25(b)(2)(B) of the Code and thus is not to be considered as married, and an exemption claimed by the husband for his wife is not allowable.

The foregoing conclusions are equally applicable to the nonacquiescence, C. B. 1953-2, 8, in *Alice Humphreys Evans* v. *Commissioner*, 19 T. C. 1102, affirmed, 211 Fed. (2d) 378, so that the position of the Service continues to be that an interlocutory decree of divorce may effect a legal separation under a decree of divorce or of separate maintenance under section 22(k).

REGULATIONS 118, SECTION 39.25-2: Credits of individuals for purpose of normal tax and surtax. Rev. Rul. 55-413

> The adopting parents of a child born in a foreign country must look to the parentage of the child at the time of its birth in determining whether such child is a citizen for purposes of section 25(b)(3) of the Internal Revenue Code of 1939. A child born in a foreign country to a nonresident alien mother and a father who was a member of the Armed Forces of the United States who met the conditions prescribed by section 301(a)(7) of the Immigration and Nationality Act, was a citizen of the United States at birth. Therefore, a man and wife, citizens of the United States, who adopt such a child may claim the child as a dependent if the other requirements of section 25(b)(3) of the Code are met.

Advice has been requested whether a child, born in a foreign country, whose mother is a nonresident alien and whose father is a member of the Armed Forces of the United States, who is adopted by another member of the Armed Forces and his wife, qualifies as a dependent of such adopted parents under the provisions of section 25(b)(3) of the Internal Revenue Code of 1939.

In the instant case an officer in the United States Army and his wife, citizens of the United States, stationed in Germany, adopted the child of a German mother and a United States soldier, also a citizen of the United States. The child was adopted in March of the taxable year and has been supported by the army officer and his wife since that time.

Section 25(b) of the 1939 Code provides, in part, as follows:

(b) CREDITS FOR BOTH NORMAL TAX AND SURTAX.—
(1) CREDITS.—There shall be allowed for the purposes of both normal tax and the surtax, the following credits against net income:

* * * * * * *

(D) An exemption of $600 for each dependent whose gross income for the calendar year in which the taxable year of the taxpayer begins is less than $600, except that the exemption shall not be allowed in respect of a dependent who has made a joint return with his spouse under section 51 for the taxable year beginning in such calendar year.

* * * * * * *

(3) DEFINITION OF DEPENDENT.—As used in this chapter [chapter 1 of the Code] the term "dependent" means any of the following persons over half of whose support, for the calendar year in which the taxable year of the taxpayer begins, was received from the taxpayer:
(A) a son or daughter of the taxpayer * * *

* * * * * * *

* * * For the purposes of determining whether any of the foregoing relationships exist (1) a legally adopted child of a person * * *, shall be considered a child of such person by blood. 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. * * *

Legal adoption does not, of itself, confer upon a child the citizenship of the adopting parents. However, under the provisions of section 301(a)(7) of the Immigration and Nationality Act, 66 Stat. 163, 8 U. S. C. 1401 (formerly section 201(i) of the Nationality Act of 1940, as added by Act of July 31, 1946, 60 Stat. 721, 8 U. S. C. 601), a child is a citizen of the United States at birth if born outside the geographical limits of the United States and its outlying possessions of parents one of whom is an alien, and the other a citizen of the United States who, prior to the birth of such child, was physically present in the United States or its outlying possessions for a period or periods totaling not less than 10 years, at least 5 of which were after attaining the age of 14 years: *Provided*, that any periods of honorable service in the Armed Forces of the United States by such citizen parent may be included in computing the physical presence requirements of such paragraph.

Thus, in the instant case, the child acquired the status of a United States citizen by birth, not by adoption. See I. T. 3848, C. B. 1947-1, 30.

Accordingly, it is held that the adopting parents of a child born in a foreign country must look to the parentage of the child at the time of its birth in determining whether such child is a citizen for purposes of section 25(b)(3) of the Code. A child born in a foreign country to a nonresident alien mother and a father who was a member of the Armed Forces of the United States who met the conditions prescribed by section 301(a)(7) of the Immigration and Nationality Act, *supra*, was a citizen of the United States at birth. Therefore, a man and wife, citizens of the United States, who adopt such a child may claim the child as a dependent if the other requirements of section 25(b)(3) of the Code are met.

REGULATIONS 118, SECTION 39.25-2: Credits of individuals for purpose of normal tax and surtax.

A spouse cannot qualify as a dependent and no deduction is allowable for a spouse who has gross income in any amount. See Rev. Rul. 55-325, page 18.

PART IV.—ACCOUNTING 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. 55-205

The position of the Internal Revenue Service regarding the time for reporting, for federal income tax purposes, compensation resulting from termination of Government contracts has not been changed by virtue of the decision in *Apex Electrical Manufacturing Company* v. *Commissioner*, 202 Fed. (2d) 151, affirming 16 T. C. 1171, nonacquiescence C. B. 1951-2, 5.

Such position is generally stated in section 39.42-1 of Regulations 118 as follows:

> Except as otherwise stated in this paragraph, such items as claims for compensation under canceled Government contracts constitute income for the year in which they are allowed or their value is otherwise definitely determined, if the return is rendered on the accrual basis; or for the year in which received, if the return is rendered on the basis of cash receipts and disbursements. In the case of a termination of a war contract as defined by section 3 of the Contract Settlement Act of 1944, 58 Stat. 649, 41 U. S. C. 103 (or the termination of any other Government contract as to which the right to compensation is definitely fixed and the measure thereof is determinable with reasonable accuracy), if the return is rendered on a basis other than cash receipts and disbursements, compensation for the termination shall, unless a different method of reporting is prescribed or approved by the Commissioner, constitute income for the taxable year in which falls the effective date of the termination, except that if any part of the compensation is attributable to cost, expenses, or losses incurred in a subsequent year such part of the compensation shall be returned as income for the subsequent year.

Although general nonacceptance by the Service of the Apex decision is indicated by the Commissioner's nonacquiescence therein, it will be noted that the decision did not hold the counterpart of the above-quoted regulations in section 29.41-1 of Regulations 111 (as amended by T. D. 5405, C. B. 1944, 154) to be invalid. The decision disagreed rather with the Commissioner's determination in findings of pertinent facts (in that particular case) and in the application thereto of such regulations under Mimeograph 5897, C. B. 1945, 131.

REGULATIONS 118, SECTION 39.42-1: When included in gross income.

Interest on future payment funds held by a Federal land bank for its borrowers for future application on their indebtedness to the bank. See Rev. Rul. 55-254, page 326.

REGULATIONS 118, SECTION 39.42-1: When included in gross income.

Interest accrued, before reissuance, on Series E, United States savings bonds originally issued to coowners but later reissued to one of coowners. See Rev. Rul. 55-278, page 471.

REGULATIONS 118, SECTION 39.42-2: Income not reduced to possession. Rev. Rul. 55-254

(Also Section 39.42-1; Sections 22(a), 23(e); Regulations 118, Sections 39.22(a)-1, 39.23(e)-1.)

Interest allowed on future payment funds held by a Federal land bank for its borrowers for future application on their indebtedness to the Bank constitutes income for Federal income tax purposes to the borrower on the cash receipts basis as of the date of the disposition of the funds. Where the borrower is on the accrual basis, the interest is reportable as income annually as it is earned. If, upon final disposition, interest should be allowed at a different rate from that at which it was accrued, the difference in amount between that finally allowed and that formerly accrued will constitute either ordinary income under section 22(a) of the Internal Revenue Code of 1939, or an ordinary loss under section 23(e) of the Code, in the year of final disposition of the funds.

Advice has been requested whether interest allowed on future payment funds held by a Federal land bank for its borrowers for future application on their indebtedness to the bank, should be reported for Federal income tax purposes as income of the borrowers annually, or only when actually applied on their indebtedness, or when some other disposition of the interest is made.

In the instant case the borrower has two loans from a Federal land bank, each bearing a different interest rate, and a second mortgage land bank commissioner loan at a still higher interest rate. The land bank commissioner loan is serviced by the Federal land bank but is owned by the Federal Farm Mortgage Corporation. The interest allowance on the future payment funds cannot be finally determined until after the indebtedness to which such funds are applied and the interest rate on such indebtedness are both known.

The Federal Farm Loan Act, 12 U. S. C. 781, authorizes a Federal land bank to accept conditional payments from borrowers for subsequent credit upon their indebtedness to the bank, and to allow interest on such payments. Such section enumerates the powers, subject to the limitations and requirements of the statute, of Federal land banks generally. The eighteenth power provides that all conditional payments accepted shall be subject to such terms and conditions, not inconsistent with the provisions of the statute and with any rules or regulations prescribed for its efficient execution by the Farm Credit Administration, as may be agreed upon at the time of their acceptance. If a conditional payment is accepted for subsequent credit upon a first mortgage which is at the time or is thereafter pledged as collateral security for an issue of farm-loan bonds, all requirements, conditions, and limitations set forth in sections 897-899 of Title 12 shall apply to such payment the same as though it were a present payment on the principal of the mortgage

pledged as collateral security, and the Federal land bank shall forthwith notify the farm loan registrar of its receipt of such payment and account to him therefor. Every conditional payment accepted by a Federal land bank for subsequent credit upon indebtedness of a borrower shall be credited upon such indebtedness as the borrower may from time to time direct in accordance with the terms and conditions upon which the payment has been accepted. At the option of the bank, the payment may in any event be credited upon such indebtedness as and when it matures if it is not otherwise paid by the borrower at or before maturity. Any balance of conditional payments remaining uncredited, when the indebtedness on account of which they have been accepted has been paid in full, shall be refunded to the borrower.

The terms upon which a future payment fund is accepted are included in regulations issued by the Farm Credit Administration. These regulations, which have been made a part of Title 6 of the Code of Federal Regulations, Cumulative Pocket-Supplement for the year 1954, provide in part as follows:

SECTION 10.116 *Future payment funds as authorized by 12 U. S. C. 781, Eighteenth.* Future payments funds shall be held for subsequent credit upon indebtedness to the bank or the Corporation [Federal Farm Mortgage Corporation], except in cases of unusual circumstances where the release of the fund is justified. On future payment funds applied, interest shall be allowed to the date of application at the effective interest rate(s) applicable to the indebtedness in connection with which such funds are applied. On future payment funds released under unusual circumstances, interest shall be allowed to the date released at the effective interest rate(s) applicable to the indebtedness in connection with which such funds are held.

SECTION 10.121 *Unrelated loans.* In those cases in which a borrower has indebtedness to the bank, the Corporation [Federal Form Mortgage Corporation], or both which is not secured by the same or common real property, determination should be made by the bank, on the basis of the facts in each case, as to the indebtedness or the indebtednesses on which the future payment funds are to be accepted and held for subsequent credit. When future payment funds are accepted in these cases, they shall be subject to all the provisions of the regulations in this part governing future payment funds insofar as practicable.

SECTION 10.122 *Interest allowances:* Interest shall be allowed future payment funds in accordance with the following terms and conditions:

(a) The rate(s) at which interest is allowed the borrower on future payment funds applied shall be the rate(s) effective on those installment dates of the indebtedness to which the future payment funds are applied and which installment dates occurred during the period such future payment funds were held. As used in this part, "effective interest rate" means the rate actually charged the borrower on the indebtedness on which future payment funds are applied.

(b) If it is decided in unusual circumstances that the release of future payment funds held in connection with a borrower's indebtedness is justified, interest shall be allowed on such funds during the entire period that the funds were held. * * *.

(c) Interest shall be allowed on future payment funds from the date of acceptance of such funds to the date of their disposition and such interest shall be compounded as of the installment dates of the borrower's indebtedness which occurred during the period the future payment funds were held by the bank: *Provided*, That, at the option of the bank, interest need not be allowed upon any amount which has not been held for the credit of the borrower as unapplied future payment funds for a period up to 1 month: *And provided further*, That in any case where the aggregate interest credit does not exceed 25 cents, no allowance need be made.

(d) Interest allowed on future payment funds shall be credited to the borrower as of the date of disposition of the funds.

Section 39.42-1(a) of Regulations 118 states that, except as otherwise provided in Section 42, all gains, profits, and income shall be included in gross income for the taxable year in which received by the taxpayer unless they are included as of a different period in accordance with the approved method of accounting followed by him.

Section 39.42-2 of Regulations 118 provides as follows:

Income not reduced to possession.—Income which is credited to the account of or set apart for a taxpayer and which may be drawn upon by him at any time is subject to tax for the year during which so credited or set apart, although not then actually reduced to possession. To constitute receipt in such a case the income must be credited or set apart to the taxpayer without any substantial limitation or restriction as to the time or manner of payment or condition upon which payment is to be made, and must be made available to him so that it may be drawn at any time, and its receipt brought within his own control and disposition. A book entry, if made, should indicate an absolute transfer from one account to another. If a corporation contingently credits its employees with bonus stock, but the stock is not available to such employees until some future date, the mere crediting on the books of the corporation does not constitute receipt.

Since the interest allowance on future payment funds may be determined only after the indebtedness to which the funds are applied, and the interest rate on such indebtedness, are both known, such interest is not finally determinable and is not credited to the borrower until the date of the disposition of the funds. Therefore, until such disposition, since there can be no crediting of any amount of interest to the taxpayer prior to the disposition of the funds, there can be no constructive receipt of income. Accordingly, in the case of borrowers keeping their books and filing their returns on a cash receipts and disbursements basis, the interest paid or allowed on future payment funds constitutes income, for Federal income tax purposes, as of the date of the disposition of the funds.

When future payment funds are accepted by the bank to be applied against an indebtedness when it becomes due, the bank is required to accrue upon its books, on the due date of each installment thereof, its liability for interest on such funds at the rate actually charged the borrower on the unmatured portion of the indebtedness in connection with which the future payment funds are held. Therefore, a borrower employing the accrual method of accounting should accrue interest on such funds at the same rate, notwithstanding the possibility of an adjustment upon final disposition of the funds. See *Continental Tie and Lumber Co.* v. *United States*, 286 U. S. 290, Ct. D. 494, C. B. XI-1, 260 (1932).

In view of the foregoing, it is held that interest allowed on future payment funds held by a Federal land bank, for its borrowers, for future application on their indebtedness to the bank constitutes income, for Federal income tax purposes, to the borrower on the cash receipts and disbursements basis, as of the date of the disposition of the funds. Where the borrower is on the accrual basis, the interest is reportable as income annually as it is earned. If, upon final disposition, interest should be allowed at a different rate from that at which it was accrued, the difference in amount between that finally allowed and that formerly accrued will constitute either ordinary income under section 22(a) of the Internal Revenue Code, or an ordinary

loss under section 23(e) of the Code, in the year of final disposition of the funds.

REGULATIONS 118, SECTION 39.42-2: Income not reduced to possession. Rev. Rul. 55-317

No taxable income is realized by an employee of a city by reason of transferring to the city's new retirement system his accumulated contributions in the city's old retirement system (which was terminated in order that the employees could qualify for benefits under the Social Security Act, 49 Stat. 620, as amended, 42 U. S. C. 418) and the interest thereon. The aggregate of the employee's accumulated contributions so transferred without regard to the interest credited thereon plus any contributions to the new retirement system subsequent to such transfer will constitute the aggregate premiums or consideration paid for the annuity which will be paid from such system upon his ultimate retirement.

Advice has been requested relative to the taxability of interest on employees' contributions transferred from the old retirement system of a city to its newly created supplemental retirement system.

The facts surrounding the transfer are as follows:

Contributions were originally made by employees of the city and held in trust under the city's retirement system (old), established by an ordnance approved August 30, 1944. To permit the employees to qualify under the Social Security Act, 49 Stat. 620, as amended, 42 U. S. C. 418, the above ordinance and subsequent amendatory ordinances thereto were repealed and the system was terminated as of December 6, 1952. The ordinance for the repeal provided that the accumulated contributions of the members be set aside in "Fund A" or transferred to "Fund B" for disbursement on or before June 30, 1953. The employees became covered under the Social Security Act, as amended, on December 20, 1952. Effective December 22, 1952, the city's supplemental retirement system, adopted November 18, 1952, provided for retirement benefits supplemental to the benefits provided under the Social Security Act. Funds A and B were transferred to specified accounts of the supplemental retirement system. Forms A and B were utilized by the employees to direct the disposition of their accumulated contributions under the old retirement system.

By executing Form A, an employee authorizes the transfer and credit to his account in the supplemental retirement system his accumulated contributions in the old retirement system in an amount equal to the contributions that would have been based on the contribution rates provided in the supplemental retirement system less the sum necessary to back date social security to January 1, 1951 or to the date of his employment, whichever period is shorter, the remaining balance, if any, to be refunded to him. By signing Form A, the employee becomes a member of the supplemental retirement system and retains all credits for prior service with the city which were allowable under the old retirement system.

By executing Form B, an employee authorizes the return to him of all his accumulated contributions in the old retirement

system after deductions for back dating social security contributions to January 1, 1951, or to the date of his employment, whichever period is shortest. By signing Form B the employee becomes a member of the supplemental retirement system as a new member and forfeits all credits for prior service in the old retirement system earned prior to December 22, 1952. Participating in the supplemental retirement system as a new member and forfeiting all credits for prior service specifically mean that (a) the employee cannot retire and receive an ordinary disability retirement allowance until after he has completed 5 years' service as a member of the supplemental retirement system, (b) the employee's employment with the city before December 22, 1952, cannot be used to compute his retirement allowance if he retires at any time after December 22, 1952, and (c) in the event of his death, his beneficiary will not be eligible for a death benefit from the supplemental retirement system until the employee has completed 1 year of service as a member of that system, and not until he has completed 5 years will the maximum death benefit be payable.

Section 39.42-2 of Regulations 118, promulgated under section 42 of the Internal Revenue Code of 1939, provides in part that income which is credited to the account of or set apart for a taxpayer and which may be drawn upon by him at any time is subject to tax for the year during which so credited or set apart although not then actually reduced to possession. To constitute receipt in such a case, the income must be credited or set apart to the taxpayer without any substantial limitation or restriction as to the time or manner of payment or condition upon which payment is to be made and must be made available to him so that it may be drawn at any time, and its receipt brought within his own control and disposition.

In view of the provisions of the agreement evidenced by Form A and Form B, it is held that no taxable income is realized by an employee of the city by reason of transferring to the supplemental retirement system his accumulated contributions in the old retirement system and the interest thereon. The aggregate of the employee's accumulated contributions so transferred without regard to the interest credited thereon plus any contributions to the supplemental retirement system subsequent to such transfer will constitute the aggregate premiums or consideration paid for the annuity which will be paid from such system upon his ultimate retirement.

Where an employee receives a refund of his contributions, together with interest, the amount of the interest is includible in gross income in the year of receipt. O. D. 823, C. B. 4, 77 (1921).

SECTION 43.—PERIOD FOR WHICH DEDUCTIONS AND CREDITS TAKEN

REGULATIONS 118, SECTION 39.43-2: When charges deductible.

Accrual of real property taxes, imposed by section 5719.01 of the Revised Code of Ohio, effective October 13, 1953. See Rev. Rul. 55-152, page 67.

REGULATIONS 118, SECTION 39.43-2: When charges are deductible.

Accrual of vacation pay by taxpayers using accrual method of accounting. See Rev. Rul. 55-426, page 68.

SECTION 44.—INSTALLMENT BASIS

REGULATIONS 118, SECTION 39.44-1: Sale of personal property on installment plan.

Gain from sale of all rights, title, and interest in a distributorship agreement with a foreign manufacturer. See Rev. Rul. 55-374, page 370.

REGULATIONS 118, SECTION 39.44-5: Gain or loss upon disposition of installment obligations. Rev. Rul. 55-5

Real property was sold to the Y Corporation on the installment basis under a land contract with the balance to be paid over a number of years. The contract provided that upon payment of 50 percent of the purchase price and at the option of Y Corporation, a warranty deed of the premises would be delivered to Y Corporation in consideration of a promissory note secured by a real estate mortgage, for the balance of the purchase price, with installment payments to be made as set forth in the original contract of sale of said premises. The Y Corporation has complied with the terms of the original contract and a mortgage contract has been substituted for the land contract, containing the same terms and conditions for payment of the balance due as set forth in the land contract. *Held*, the substitution of the mortgage contract, in an amount equal to the unpaid balance of the purchase price, payable on the same terms and conditions of payment of the balance under the land contract, results in a change in the type of security only and does not constitute a satisfaction or disposition of an installment obligation giving rise to gain or loss under section 44(d) of the Internal Revenue Code of 1939.

REGULATIONS 118, SECTION 39.44-5: Gain or loss upon disposition of installment obligations. Rev. Rul. 55-292

Stock certificates issued by a building and loan association, in partial payment for notes sold to such association by a taxpayer reporting profits on the installment basis, represent income to the taxpayer in the year of the sale of the notes, even though pledged to the association as additional collateral for the notes.

Advice has been requested whether stock certificates issued by a building and loan association, in partial payment for notes sold to such association by a taxpayer reporting profits on the installment basis, represent income in the year in which issued, even though pledged to the association as additional collateral for the notes, or whether income is realized at the time the certificates are released from the collateral agreement.

The taxpayer is in the business of constructing houses on lots which are owned by purchasers of the houses. These houses are sold on credit and notes secured by mortgage are received for the construction and erection of the houses, payable in monthly installments over a period of approximately ten years. The profit with respect to construction of the houses is reported on the installment basis.

In order to finance construction, the taxpayer sold certain of the notes shortly after receiving them to a building and loan association. Because of the amount of the loan in respect to the value of the houses and lots, the association was not willing to pay the full purchase price of such notes in cash. It paid a certain amount in cash and the balance in stock of the association. Such stock was then pledged to the association as additional collateral for the notes. Under the terms of the collateral agreement, at such time as the makers of the notes have reduced their indebtedness to amounts on which the association would be justified in making mortgage loans, the stock will be released from the pledge and collateral agreement.

Section 42 of the Internal Revenue Code of 1939 provides in part as follows:

(a) GENERAL RULE.—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 44 of the Code provides in part as follows:

(d) GAIN OR LOSS UPON DISPOSITION OF INSTALLMENT OBLIGATIONS.—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 (1) in the case of satisfaction at other than a face value or a sale or exchange—the amount realized, or (2) in the case of a distribution, transmission, or disposition otherwise than by sale or exchange—the fair market value of the obligation at the time of such distribution, transmission, or disposition. * * *

In *Alworth-Washburn Co.* v. *Helvering*, 67 Fed. (2d) 694, Ct. D. 808, C. B. XIII-1, 208 (1935), the court held that where a corporation sold its assets in 1926, receiving less than one-fourth of the total purchase price in cash and the balance in notes, and in the following year discounted or sold the notes to a bank, being contingently liable as indorser, the transaction was closed in 1927 and the profit reflected in the notes discounted or sold constituted income in that year, and the corporation was not entitled to report the income in the subsequent years in which the notes were actually paid to the bank.

In *E. J. Gallagher Realty Co.* v. *Commissioner*, 4 B. T. A. 219, the taxpayer, engaged in the business of building and selling residential property, would sell houses for small down payments and finance the balance by mortgages given by the purchasers to building and loan associations. Such mortgages were for amounts in excess of those for which the building and loan associations made loans on similar property and, to protect themselves, the associations withheld such excess and required the taxpayer to execute bonds as security therefor. The associations retained the excess amount until such time as the purchasers had paid a sum equal to that amount; then the associations would pay over to the taxpayer the amount retained. It was the opinion of the United States Board of Tax Appeals (now The Tax Court of the United States) that the fact that a portion of the purchase price for

the property was assigned or left in the hands of the building associations to insure the mortgage payments by the purchasers, and that the actual payments to the taxpayer were deferred, did not justify the taxpayer, who was on the accrual basis of accounting, in excluding those amounts from income in the year of sale of the houses.

The collateral agreement, in the instant case, specifically provides that the taxpayer is the legal and equitable owner of certain savings shares of stock of the building and loan association. The agreement further provides that the pledge of such shares of stock as collateral shall in no wise affect or impair the ownership of pledgor in the shares, nor his rights, privileges or obligations as a shareholder in the association, except that the shares of stock shall be held as collateral security for the payment of the note.

Accordingly, it is held that the stock certificates issued by the building and loan association in partial payment for notes sold to such association by a taxpayer reporting profits on the installment basis constitute income in the year of the sale of the notes, even though such certificates are pledged to the association as additional collateral for the notes.

REGULATIONS 118, SECTION 39.44–5: Gain or loss upon disposition of installment obligations.

Cancellation of installment obligations of a charitable organization. See Rev. Rul. 55–157, page 293.

REGULATIONS 118, SECTION 39.44–5: Gain or loss upon disposition of installment obligations.

Gain or loss on installment obligations upon termination of a trust. See Rev. Rul. 55–159, page 391.

SECTION 46.—CHANGE OF ACCOUNTING PERIOD

REGULATIONS 118, SECTION 39.46-1(b)(4): Approval of change in accounting period. Rev. Rul. 55-111

Where a taxpayer desires to change his accounting period and under the provisions of section 39.46-1(b)(2) of Regulations 118 is required to obtain prior approval of the Commissioner, the taxpayer must file Form 1128, Application for Change in Accounting Period, on or before the 15th day following the close of the short taxable year. See section 39.46-1(b)(4) of Regulations 118. Form 1128 requires information as to the annualized net income for the short period. Where the net income for the short period cannot be definitely determined at the time the Form 1128 is filed, a reasonable estimate of such net income will be acceptable. The amount shown must be clearly identified as the best estimate available.

SECTION 47.—RETURNS FOR A PERIOD OF LESS THAN 12 MONTHS

REGULATIONS 118, SECTION 39.47-2: Returns for period of less than 12 months on account of a change in accounting period.

Change in parent corporation's accounting period to conform with that of its subsidiaries. See Rev. Rul. 55-80, page 387.

PART V.—RETURNS AND PAYMENT OF TAX

SECTION 51.—INDIVIDUAL RETURNS

REGULATIONS 118, SECTION 39.51-1: Individual returns.

Marital status where an individual is separated from spouse under an interlocutory decree of divorce. See Rev. Rul. 55-178, page 322.

REGULATIONS 118, SECTION 39.51-2: Form of return.

Election to file a joint return where the legal status of one spouse is that of a missing person. See Rev. Rul. 55-387, page 131.

SECTION 53.—TIME AND PLACE FOR FILING RETURNS

REGULATIONS 118, SECTION 39.53-1: Time for filing returns.

Extension of time for filing a short taxable year return of a subsidiary corporation. See Rev. Rul. 55-108, page 140.

REGULATIONS 118, SECTION 39.53-2: Extension of time for filing returns. Rev. Rul. 55-86[1]

> An extension of time until February 15, 1955, is granted to farmers on the calendar year basis for filing their 1954 income tax returns in lieu of declarations of estimated income tax and for paying the tax due thereon.

The purpose of this Revenue Ruling is to grant an extension of time to farmers for filing their 1954 individual income tax returns in lieu of declarations of estimated income tax and for paying the tax due thereon.

Under section 60(a) of the Internal Revenue Code of 1939, an individual whose estimated gross income from farming for the taxable year is at least two-thirds of the total estimated gross income from all sources for the taxable year is considered a farmer.

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[1] Originally issued as IR-Circular No. 55-10, dated January 31, 1955.

With respect to farmers, the time for filing a 1954 calendar year individual income tax return and for paying in full (without interest) the amount computed on the return as payable, in order that the return shall be considered a declaration or an amended declaration of estimated income tax, is hereby extended from January 31, 1955, to February 15, 1955.

SECTION 54.—RECORDS AND SPECIAL RETURNS

REGULATIONS 118, SECTION 39.54-1: Records and income tax forms.

Information returns in the case of Federal credit unions. See Rev. Rul. 55-133, page 138.

SECTION 55.—PUBLICITY OF RETURNS

REGULATIONS 118, SECTION 39.55-1: Inspection of returns. Rev. Rul. 55-238

Federal internal revenue laws neither require a taxpayer to allow State or local officials to inspect his copies of Federal tax returns and related documents nor protect him from such inspection. Where certain State statutes require the filing of copies of Federal tax returns in conjunction with the filing of local returns, it is held that such statutes do not violate the provisions of section 55(f) of the Internal Revenue Code of 1939. Section 55(b)(2) of such Code requires the Internal Revenue Service to permit any official, body, or commission, lawfully charged with the administration of any State tax law, to inspect any or all income returns filed with the Internal Revenue Service, if the inspection is for the purpose of such administration or for the purpose of obtaining information to be furnished to local taxing authorities.

T. D. 6133

TITLE 26—INTERNAL REVENUE, 1939.—CHAPTER I, SUBCHAPTER E, PART 458.—INSPECTION OF RETURNS

Inspection of certain returns by committees of Congress other than those enumerated in section 55(d) of 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. 458.324. INSPECTION OF RETURNS BY COMMITTEES OF CONGRESS OTHER THAN THOSE ENUMERATED IN SECTION 55(d) OF THE INTERNAL REVENUE CODE OF 1939.—(a)(1) Pursuant to the provisions of 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), any return with respect to income, excess-profits, declared value excess-profits, capital stock, estate, or gift tax imposed by the Internal Revenue Code of 1939 shall be open to inspection by any committee of the Congress, or any subcommittee of a committee of the Congress, specially authorized to

inspect such returns by an Executive order issued under the aforementioned statutory provisions on or after the date of the approval of this Treasury Decision. Such inspection shall be subject to the conditions and restrictions imposed by the Executive order and the rules and regulations hereinafter prescribed.

(2) Only such of the aforementioned returns as are specified in a resolution adopted by the committee in accordance with the rules of the appropriate house of the Congress then applicable to the reporting of a measure or recommendation from such committee shall be open to inspection. Such resolution shall set forth the names and addresses of the taxpayers whose returns it is necessary to inspect and the taxable periods covered by the returns. The inspection of returns authorized in this section may be made by the committee of the Congress, or the subcommittee of a committee of the Congress, authorized as provided in subparagraph (1) of this paragraph, acting directly as a committee or as a subcommittee, or by or through such examiners or agents as such committee or subcommittee may designate or appoint in its written request hereinafter mentioned. Upon written request by the chairman of such committee or of such subcommittee to the Secretary of the Treasury, giving the names and addresses of the taxpayers whose returns it is desired to inspect and the taxable periods covered by the returns and stating that the resolution hereinbefore mentioned with respect to the inspection of such returns has been duly adopted by such committee or by the committee under which such subcommittee functions, the Secretary or any officer or employee of the Department of the Treasury, with the approval of the Secretary, shall furnish such committee or subcommittee with any data relating to or contained in any such return or shall make such return available for inspection by such committee or subcommittee or by the examiners or agents designated or appointed by such committee or subcommittee. Such data shall be furnished, or such return shall be made available for inspection, in an office of the Internal Revenue Service. Any information thus obtained by such committee or subcommittee shall be held confidential: *Provided, however*, That any portion thereof relevant or pertinent to the purpose of the investigation may be submitted by the investigating committee to the appropriate house of the Congress.

(3) This section shall not be applicable to any committee authorized by section 55(d) of the Internal Revenue Code of 1939 to inspect returns.

(b) Because this Treasury Decision constitutes a general statement of policy and establishes a rule of Departmental practice and procedure, it is found that it is unnecessary to issue this Treasury Decision with notice and public procedure thereon under section 4(a) of the Administrative Procedure Act, approved June 11, 1945, or subject to the effective date limitation of section 4(c) of that Act.

(c) This Treasury Decision shall be effective upon its filing for publication in the Federal Register.

G. M. HUMPHREY,
Secretary of the Treasury.

Approved May 3, 1955,
DWIGHT D. EISENHOWER.

(Filed with the Division of the Federal Register May 3, 1955; 5:02 p. m.)

Inspection of certain returns by the Senate Committee on Government Operations. See Executive Order 10606, page 143.

Inspection of certain returns by the Committee on Government Operations, House of Representatives. See E. O. 10607, page 144.

SUBCHAPTER C.—SUPPLEMENTAL PROVISIONS

SUPPLEMENT A.—RATES OF TAX

SECTION 101.—EXEMPTIONS FROM TAX ON CORPORATIONS

REGULATIONS 118, SECTION 39.101(12)-1: Farmers' cooperative marketing and purchasing associations; requirements for exemption under section 101(12)(A). Rev. Rul. 55-141

> Where a farmers' marketing and/or purchasing association issues either a certificate of stock representing a patronage dividend or a check representing a dividend payable on its stock, the mailing of either of such instruments to the patron would constitute payment for Federal income tax purposes in the year of issue, and such refunds will be allowed as deductions from gross income where, in the ordinary handling of the mail, delivery cannot be made and the association holds the instrument subject to the claim of the rightful owner.
>
> The retention by a farmers' marketing and/or purchasing association of each patronage dividend payable in an amount less than one dollar and similar retentions of the cents payable in excess of whole dollar amounts do not constitute inequitable treatment of all patrons to an extent which would jeopardize the exempt status of such association under section 101(12)(A) of the Internal Revenue Code of 1939.

Advice has been requested whether the mailing by a farmers' marketing and/or purchasing association of a certificate of stock representing a patronage dividend due, or a check representing a dividend due on the association's stock, to the last known address of a patron constitutes payment for Federal income tax purposes, allowable as deductions from gross income, where such instruments are returned by the Post Office Department because of nondelivery and held by the association subject to claim of the rightful owner; also, whether the retention by a farmers' marketing and/or purchasing association of each patronage dividend payable in an amount less than one dollar and similar retentions of the cents payable in excess of whole dollar amounts constitute inequitable treatment of all patrons to an extent which would jeopardize the exempt status of such association under section 101(12)(A) of the Internal Revenue Code of 1939.

A farmers' marketing and/or purchasing association pays patronage dividends in shares of its capital stock. The certificates are mailed to patrons at their last known addresses and a few of such mailings are returned by postal authorities because of the inability to locate the addressee patrons. The shares are held by the association

subject to claim by the rightful owners until such time as the shares are called for redemption and payment. If the owner is not then located, the shares are canceled and a credit is made to an appropriate income account, as extraneous income to the association in the year of cancellation. Similar treatment is given to nondelivered dividend checks.

Moreover, in the allocation of patronage refunds all amounts of individual allocations in the amount of less than one dollar, and all cents in excess of even dollars due patrons entitled to more than one dollar, are set aside as a fund to defray the cost of maintaining patronage records and the allocation or distribution of patronage dividends. The aggregate of amounts so retained is subject to Federal income taxes as net proceeds realized which remain undistributed.

It is held that where either a certificate of stock representing a patronage dividend or a check representing a dividend payable on the capital stock of a farmers' marketing and/or purchasing association is properly prepared and placed in the mail at such time that in the ordinary handling of the mails it would be received by a patron within the period of time prescribed by section 101(12)(B) of the Code for making refunds, such action would constitute the payment of a patronage refund or a dividend on capital stock, allowable as a deduction from gross income even though such stock certificate or dividend check is later returned and held subject to the claim of the patron because the patron cannot be found by the Post Office Department. It is further held that the retention by a farmers' marketing and/or purchasing association of each patronage dividend payable in an amount less than one dollar and similar retentions of the cents payable in excess of whole dollar amounts do not constitute inequitable treatment of all patrons to an extent which would jeopardize the exempt status of such association under section 101(12)(A) of the Internal Revenue Code of 1939.

REGULATIONS 118, SECTION 39.101(12)-4: Patronage dividends, rebates, or refunds; treatment as to cooperative associations entitled to tax treatment under 101(12)(B). Rev. Rul. 55-26

Farmers' cooperative marketing and purchasing associations, whose bylaws set forth a definite pre-existing obligation of the association to make distribution to patrons of a portion of the net profits as patronage dividends, may have such dividends excluded from income for Federal income tax purposes regardless of whether the corporate name contains the word "cooperative."

SECTION 101(8).—EXEMPTIONS FROM TAX ON CORPORATIONS: CIVIC ORGANIZATIONS

REGULATIONS 118, SECTION 39.101(8)-1: Civic leagues and local asociations of employees.

Local association of employees operating a bus service for its members. See Rev. Rul. 55-311, page 72.

SECTION 109.—WESTERN HEMISPHERE TRADE CORPORATIONS

REGULATIONS 118, SECTION 39.109–1: Western Hemisphere trade corporations. Rev. Rul. 55–372

A Canadian or Mexican corporation is held to be a domestic corporation for purposes of qualifying as a Western Hemisphere trade corporation under section 109 of the Internal Revenue Code of 1939 if, as provided in section 141(g) of the Internal Revenue Code of 1939, it is organized and maintained solely for the purpose of complying with the laws of either country as to title and operation of property; and if it is so treated for purposes of section 141 of the Code by a domestic corporation owning or controlling, directly or indirectly, 100 percent of its capital stock. See section 39.141–1(e) of Regulations 118.

SECTION 112(a).—RECOGNITION OF GAIN OR LOSS: GENERAL RULE

REGULATIONS 118, SECTION 39.112(a)–1: Sales or exchanges. Rev. Rul. 55–77

Taxpayer and 5 others, as tenants in common, owned undivided interests in real property, including a building. The taxpayer desired to purchase the undivided interest of one of the other tenants in common, but no price could be agreed upon. In accordance with state law, a partition action was filed, thus forcing a sale of the property. The taxpayer, together with 4 of the other tenants in common, purchased the property at the partition sale. The local commissioner, appointed by the court to make such partition in pursuance of his judgment, distributed the proceeds of the sale among all of the tenants in common in accordance with their respective undivided interests immediately prior to the partition sale. The commissioner conveyed the entire title to the property to the taxpayer and the 4 tenants in common who joined him in submitting the joint bid at the sale. *Held*, under these circumstances, the partition proceedings constituted a nontaxable transaction for Federal income tax purposes. The taxpayer neither realized a taxable gain nor sustained a deductible loss on the sale of the undivided interest in the property which he owned immediately prior to the partition proceedings. The taxpayer still owns the interest which he owned prior to the sale; hence, he sold nothing. The effect of the sale was to establish a price at which the taxpayer could purchase the undivided interest of one of the other tenants in common. Compare *Mary L. Hunnicutt* v. *Commissioner*, 10 B. T. A. 1004, acquiescence, C. B. VII–2, 19 (1928).

REGULATIONS 118, SECTION 39.112(a)–1: Sales or exchanges. Rev. Rul. 55–142

Z Corporation owned certain adjoining real estate, evidenced by separate conveyances, acquired at various dates and from various sources. To accomplish consolidation of the property under a single deed, the property was transferred to a nominee and retransferred to

the Z Corporation, without consideration. The nominee was neither an employee, officer, director nor stockholder of the Z Corporation. *Held*, the transfer and retransfer of properties under such conditions does not give rise to a taxable gain or deductible loss to either party and the basis of the consolidated property remains unchanged.

REGULATIONS 118, SECTION 39.112(a)-1: Sales or exchanges. — Rev. Rul. 55-179

Where State law permits real property to be sold at public auction in an action brought by the holders of life or remainder interests, with the proceeds to be divided and distributed as the court may direct, and solely for the purpose of perfecting title to the property, a tract of land is put up for sale in such an action brought by all the current holders of such interests and "repurchased" by them at a price in which they share in proportion to their respective interests, the transaction does not constitute a sale or exchange for Federal income tax purposes to the extent that the parties merely "repurchase" their own interests and their shares of the proceeds of sale are redistributed to them.

REGULATIONS 118, SECTION 39.112(a)-1: Sales or exchanges.

Treatment of a sale by the sole stockholder of his stock in one corporation to another corporation also wholly owned by him. See Rev. Rul. 55-15, page 361.

SECTION 112(b).—RECOGNITION OF GAIN OR LOSS: EXCHANGES SOLELY IN KIND

REGULATIONS 118, SECTION 39.112(b)(5)-1: Transfer of property to corporation controlled by transferor. — Rev. Rul. 55-36

> Where a shareholder owning ⅙ of the capital stock of X Corporation organized a new corporation and transferred his shares in exchange for debenture bonds and stock of the new corporation and then donated his stock to a tax-exempt corporation which subsequently liquidated the new corporation, the consummated plan lacks substance and reality and the transfer by the shareholder of his stock to the new corporation is not a transaction within the purview of section 112(b)(5) of the Internal Revenue Code of 1939.

Advice has been requested with respect to the treatment for Federal income tax purposes of a consummated transaction involving an exempt corporation, a new corporation, and a certain shareholder of an old corporation.

The X Corporation has outstanding 300 shares of capital stock. An individual stockholder owned 50 shares of the corporation, having a value in excess of $3{,}000x$ dollars and had a basis to him for determining gain or loss of $1{,}000x$ dollars.

The shareholder proposed to make a substantial contribution to Y Corporation, an organization exempt for Federal income taxation. To that effect, the following plan was executed:

(1) As an individual, he organized a new corporation, Z, to which he transferred his shares of stock of X Corporation in exchange for debenture bonds having a face value in the amount of the value of the stock of X Corporation transferred to the Z Corporation, and stock of Z Corporation. The bonds would mature in 12 years and bear interest at the rate of 1 percent per annum. The stock issued by Z Corporation was without par value.

(2) The individual donated his stock in Z Corporation to Y Corporation.

(3) The Z Corporation, now a wholly-owned subsidiary of the Y Corporation, liquidated, and all of its assets (stock of X Corporation) were distributed to Y Corporation in exchange for the stock of Z Corporation. Y Corporation assumed the liability for the payment of the bonds issued by Z Corporation.

(4) X Corporation was then liquidated and the Y Corporation received a pro rata share of the assets of X in exchange for the stock of that corporation.

(5) The shareholder from time to time will donate to the Y Corporation such amounts of the bonds of the Z Corporation as he deems advisable.

It is stated the foregoing plan has been consummated in order that such donations will be made without income tax liability to the individual and in such a manner as to enable him to spread the donation over a number of years.

Section 112 of the Internal Revenue Code of 1939 provides, in part, as follows:

(b) EXCHANGES SOLELY IN KIND.—

* * * * * * *

(5) TRANSFER TO CORPORATION CONTROLLED BY TRANSFEROR.—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 of the corporation; * * *

* * * * * * *

(h) DEFINITION OF CONTROL.—As used in this section the term "control" means the ownership of stock possessing at least 80 per centum of the total combined voting power of all classes of stock entitled to vote and at least 80 per centum of the total number of shares of all other classes of stock of the corporation.

In the instant case the transaction served no corporate business purpose for the transfer of the stock of X Corporation to the Z Corporation. See *Evelyn F. Gregory* v. *Helvering*, 293 U. S. 465, Ct. D. 911, C. B. XIV-1, 193 (1935). The Z Corporation did not engage in the conduct of any trade or business and did not remain in existence, except for a brief time as was necessary to implement the donation of X Corporation's stock to the Y Corporation. Furthermore, the individual shareholder was not in control of the Z Corporation within the meaning of section 112(h). of such Code, since his ownership of the stock was only transitory and the object of the plan was to place control in the hands of the Y Corporation.

Accordingly, it is held that the consummated plan, insofar as it pertains to Z Corporation, was lacking in substance and reality, and that the transfer by the individual shareholder of his stock of the X Corporation to the Z Corporation was not a transfer to a corporation

controlled by the transferors within the meaning of section 112(b)(5) of the Internal Revenue Code of 1939.

Shares of stock exchanged in the same corporation pursuant to a reorganization. See Rev. Rul. 55-112, page 344.

Treatment to shareholders and the corporation as a result of a reorganization. See Rev. Rul. 55-305, page 345.

SECTION 112(f).—RECOGNITION OF GAIN OR LOSS: INVOLUNTARY CONVERSIONS

REGULATIONS 111, SECTION 29.112(f)-1: Reinvestment of proceeds of involuntary conversion. Rev. Rul. 55-170

A taxpayer who replaces requisitioned property in anticipation of receiving an award by construction of new facilities financed out of borrowed funds, and traces the condemnation proceeds into the purchased property, can obtain the benefits of section 112(f) of the Internal Revenue Code of 1939.

I. T. 3827, C. B. 1946-2, 57, modified.

Reconsideration has been given to the issue involved in I. T. 3827, C. B. 1946-2, 57, in the light of the decision in *Leon Strauss et al.* v. *Commissioner*, 22 T. C. 140, acquiescence, page 5, this Bulletin.

I. T. 3827, *supra*, holds that a taxpayer who replaces requisitioned property in anticipation of receiving an award by construction of new facilities financed out of his own funds or borrowed funds cannot obtain the benefits of section 112(f) of the Internal Revenue Code of 1939.[1] In reaching this conclusion it was determined that no distinction should be made between taxpayers using borrowed funds and taxpayers using their own funds.

In the Strauss case, the taxpayers, who were informed by the State of California that their property would probably be required for highway purposes, found suitable replacement property and, not having sufficient funds on hand to pay the full purchase price in cash as required by the sellers, arranged for a loan from their bank. They agreed with the bank that such loan was to be repaid from the condemnation proceeds. None of the proceeds of the loan were at any time under the control or in the possession of the petitioners, as a title company handled the purchase. The taxpayers opened a special account for the exclusive purpose of having a depository for the payment from the State, paid the loan, and reported only the unexpended balance of the proceeds from the sale as gain. Relying on I. T. 3827, *supra*, the Commissioner contended that the proceeds received from the State could be traced only to the borrowed funds and not directly into the replacement property.

The rules applicable where the disposition of the converted property occurred before January 1, 1951, are to be found in Regulations 111, sections 29.112(f)-1 and 29.112(f)-2. Section 29.112(f)-1 of such

[1] Since I. T. 3827 applies sec. 112(f) of the Code as it read prior to amendment by Public Law 251, *infra*, the conclusions stated therein, as modified by this Revenue Ruling, are effective only with respect to taxable years ending before January 1, 1951.

regulations provides, in part, that it is not sufficient for the taxpayer to show that, subsequent to the receipt of money from a condemnation award, he purchased other property similar or related in use, but he must trace the proceeds of the award into the payments for the property so purchased.

In *Twinboro Corporation* v. *Commissioner*, 149 Fed. (2d) 574, certiorari denied, 326 U. S. 754, upon which I. T. 3827, *supra*, in part, is based, the court held that where an owner of condemned property, in anticipation of the award, bought similar property with his own funds and recouped himself out of the award when received, he may not enjoy the benefits provided by section 112(f).

The court in the Strauss case held section 112(f) applicable, thus deciding that the award money which was used as repayment for the borrowed funds was "money which is forthwith in good faith under regulations prescribed by the Commissioner with the approval of the Secretary expended in the acquisition of other property similar or related." The court considered the argument that the award money can be traced only to the borrowed funds and not directly into the replacement property and stated that in the Twinboro case the court explicitly confined its decision to the question of anticipatory replacement by a taxpayer from his own funds and subsequent recoupment from the award proceeds.

The court stated that the legislative history in connection with the enactment of Public Law 251, 82d Cong., 65 Stat. 733, C. B. 1951-2,353, to amend section 112(f) of the Internal Revenue Code of 1939 (which eliminated the "tracing" requirements for taxable years beginning after 1950) reveals that Congress intended to extend the benefits of section 112(f) to instances where a taxpayer bought replacement property out of his own funds prior to receiving the award and later recouped himself and to cases where part of the award proceeds was used to pay off indebtedness on the converted property.

In the Strauss case the court pointed out that it was possible to trace with accuracy the amount of the condemnation proceeds directly into the property purchased and could see no justification for imposing more exacting standards of tracing condemnation proceedings where the purchase of replacement property has been made in anticipation of their receipt than where the purchase is made afterwards.

Accordingly, it is held that a taxpayer, who replaces requisitioned property in anticipation of receiving an award by construction of new facilities financed out of borrowed funds and traces the condemnation proceeds into the purchased property, can obtain the benefits of section 112(f) of the Code.

I. T. 3827, *supra*, is modified to the extent that it is inconsistent with the views expressed herein.

REGULATIONS 118, SECTION 39.112(f)-1: Involuntary conversion where disposition of the converted property occurred after December 31, 1950. — Rev. Rul. 55-351

The purchase by a corporation of an interest in a partnership within the time specified in section 112(f)(3)(B) of the Internal

Revenue Code of 1939, for purposes of replacing property involuntarily converted, is not a purchase of "other property similar or related in service or use to the property converted," within the meaning of section 112(f)(3)(A) of the 1939 Code, even though the partnership owns and operates property similar to the property converted.

SECTION 112(g).—RECOGNITION OF GAIN OR LOSS: DEFINITION OF REORGANIZATION

REGULATIONS 118, SECTION 39.112(g)-1: Purpose and scope of exception of reorganization exchanges. Rev. Rul. 55-112

(Also Sections 112(b), 113(a), 115(a); Regulations 118, Sections 39.113(a)-6, 39.115(a)-3.)

Six stockholders owning 54 percent of the common stock of a corporation (which had only common then outstanding) surrendered all of their common stock for newly issued nonvoting preferred stock of the same book value and same fair market value. After the exchange, none of the preferred stockholders was an officer, director, or employee of the corporation, and none of such stockholders had any direct or indirect economic interest in the affairs of the corporation except that evidenced by his preferred stock, *Held*, the transaction is a nontaxable reorganization (recapitalization) within the terms of section 112(g)(1)(E) of the Internal Revenue Code of 1939.

Advice has been requested with respect to the tax consequences, for Federal income tax purposes, of a change in the capital structure of *M* Corporation.

All the stock of the *M* Corporation (which had only common stock outstanding) was held by 5 men interested in its management and operation and by the wives of these individuals. Three of these men, due to ill-health and other reasons, desired to cease all activity in connection with the corporate business, while the other 2 desired to remain active in the business. The 2 who wished to remain active wanted complete control of the corporation and the others were willing to let them have such control.

Accordingly, all the interested parties agreed that the stockholders who did not wish to remain active would exchange their common stock for preferred stock. Therefore, the corporate charter was amended to authorize the issuance of nonvoting stock, preferred as to dividends and on liquidation, having no pre-emptive rights and redeemable at the option of the corporation. The 3 stockholders who desired to cease being active, and their wives, surrendered all their common stock (totalling 54 percent of all the stock) and received in exchange preferred stock of equal fair market value and of equal book value (such book value being determined by the corporation's basis for its assets for tax purposes). The corporation redeemed and cancelled all the common stock received by it in the exchange. After the transaction all the preferred stockholders owned no common stock, and were not officers, directors or employees of the corporation. None of the preferred stockholders was related by blood or marriage to any common stockholder, or to any officer, director or employee of the corporation, and no preferred stockholder had any economic

interest whatever in the affairs of the corporation except that evidenced by his preferred stock shares.

Section 112(a) of the Internal Revenue Code of 1939 provides, in effect, that upon the sale or exchange of property, the entire amount of the gain or loss resulting shall be recognized, unless the results of such exchanges are expressly exempted by the provisions of section 112(b) of such Code. Among the exchanges, the results of which are exempted, is an exchange in connection with a recapitalization (reorganization).

Section 112(b)(3) provides:

(b) EXCHANGES SOLELY IN KIND.—

* * * * * * *

(3) STOCK FOR STOCK ON REORGANIZATION.—No gain or loss shall be recognized if stock or securities in a corporation a party to a reorganization are, in pursuance of the plan of reorganization, exchanged solely for stock or securities in such corporation or in another corporation a party to the reorganization.

Section 39.112(g)-1(b) of Regulations 118 provides that 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 structures, 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 interests in property under modified corporate forms. The same subsection also provides that 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 transaction, are requisite to a reorganization under the Code.

Section 39.112(e) of Regulations 118 provides that a recapitalization and therefore a reorganization, takes place if, for example; a corporation issues preferred stock, previously authorized but unissued, for outstanding common stock.

Accordingly, the described transaction is a recapitalization as defined by section 112(g)(1)(E) of the Internal Revenue Code of 1939 and under section 112(b)(3) no gain or loss is recognized to the stockholders upon the exchanges by them of their common stock for new preferred stock. The basis of the preferred stock received by each shareholder is the same as the cost or other basis of the common stock surrendered by him. The exchanges of common stock for preferred stock have no effect upon the accumulated earnings and profits of *M* Corporation available for the distribution of dividends.

REGULATIONS 118, SECTION 39.112(g)-1: Purpose and scope of exception of reorganization exchanges. Rev. Rul. 55-305

(Also Sections 112(b), 115(a); Regulations 118, Section 39.115(a)-3.)

M, an Oregon corporation was engaged in warehouse operations serving farmers for profit. Due to competition of cooperative associations the corporation formed its own cooperative association under Oregon laws and effected a statutory merger by merging *M*

corporation into the cooperative association, the stock in the corporation being exchanged solely for stock in the cooperative. *Held*, the transaction constituted a nontaxable reorganization under section 112(g)(1)(A), section 112(b)(3) and section 112(b)(4) of the Internal Revenue Code of 1939.

Advice was requested with respect to the tax consequences for Federal income tax purposes of a consummated reorganization hereinafter described.

M, an Oregon corporation, was organized for profit by farmers to own and operate a warehouse for farmers. The capital stock consisted of 20 shares of common stock, par value $100 per share. The value of each share of such stock was $120x$ dollars based upon a pro rata share of the fair value of the net assets. As many of the stockholders of *M* corporation were members of other cooperative associations and as most of the warehouse facilities in the same area were operated by cooperative associations, it was desired to organize a new cooperative association with a capital structure consisting of 30 shares of common stock, par value $100 per share, and 250 shares of preferred stock, par value $100 per share. Both issues carried dividend rates of 5 percent, the dividends on the preferred being cumulative and any arrearages thereof being payable before any dividends on the common stock or patronage refunds are paid.

Pursuant to a merger agreement and plan of reorganization, a statutory merger under the laws of the State of Oregon was effected by merging *M* corporation into a new cooperative association. Under the plan, for each share of capital stock of *M*, the cooperative issued twelve shares of its capital stock as follows: Each stockholder of the corporation who was a producer of agricultural products upon surrender of stock of the corporation received for the first $\frac{1}{12}$ of each such share one share of common stock of the cooperative and one share of preferred stock of the cooperative for each additional $\frac{1}{12}$ share of common stock of the corporation. Each stockholder of the corporation, who was not a producer of agricultural products, received for each $\frac{1}{12}$ share of common stock of the corporation, one share of preferred stock of the cooperative. Each stockholder of the corporation who was a producer of agricultural products became a member of the cooperative with the right to vote as such a member, upon surrender of stock in the corporation in exchange for stock of the cooperative. Under the plan it was estimated that 80 percent of stockholders of the corporation were engaged in farming or were lessors of farming property and 20 percent were nonproducers of farming property. Therefore, each of the corporation's producer stockholders received at least one share of common stock of the cooperative as a result of the reorganization plan which qualified them as members. The amount of stock required for membership in the cooperative was one share of common stock. Each member had one vote. The holders of 4 shares of the corporation's stock who were nonproducers received 48 shares of preferred stock of the cooperative; and the holders of 16 shares of the corporation's stock who were producers received 176 shares of preferred stock and 16 shares of common stock of the cooperative.

Section 112 of the Internal Revenue Code provides in part as follows:

(b) EXCHANGES SOLELY IN KIND.—

* * * * * * *

(3) STOCK FOR STOCK ON REORGANIZATION.—No gain or loss shall be recognized if stock or securities in a corporation a party to a reorganization are, in pursuance of the plan of reorganization, exchanged solely for stock or securities in such corporation or in another corporation a party to the reorganization.

(4) SAME—GAIN OF CORPORATION.—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.

* * * * * * *

(g) DEFINITION OF REORGANIZATION.—As used in this section * * *

(1) The term "reorganization" means * * * (A) a statutory merger * * *.

Section 39.112(g)-2 of Regulations 118 states in part that the words "statutory merger" refer to a merger effected in pursuance of the corporation laws of the United States or a State or Territory or the District of Columbia. Section 39.112(g)-1 provides that in effect there must be substantial business reasons or exigencies for the reorganization; there must be continuity of the business enterprise under a modified corporate form; and there must be a continuity of interest on the part of the persons who were the owners of the enterprise prior to the reorganization. In the instant case the conditions with respect to these sections of the Code and the regulations thereunder were fully complied with.

Accordingly, it is held that the transaction constituted a statutory merger and, therefore, a reorganization under section 112(g)(1)(A) of the Internal Revenue Code. No gain or loss was recognized to *M* corporation, the cooperative, or the stockholders who exchanged their stock. The undistributed earnings and profits of *M* corporation are undiminished by the transaction for the purpose of determining the amount of earnings and profits of the cooperative available for distribution as dividends.

SECTION 112(n).—RECOGNITION OF GAIN OR LOSS: GAIN FROM SALE OR EXCHANGE OF RESIDENCE

REGULATIONS 118, SECTION 39.112(n)-1: Gain from sale or exchange of residence. Rev. Rul. 55-37

> Gain from the sale of a taxpayer's residence does not come within the purview of section 112(n) of the Internal Revenue Code of 1939 where the proceeds of the sale are reinvested in a home in which she has no legal interest, but to which her daughter, who contributed part of the purchase money, holds title. Any gain realized from the sale of the residence will be recognized and subject to Federal income tax under the capital gain provisions of the Code.

Advice has been requested whether gain from the sale of a taxpayer's old residence comes within the purview of section 112(n) of the Internal Revenue Code of 1939 where the new residence in which she invests the proceeds from the sale of her home is not purchased in her name.

The taxpayer sold her principal residence which she owned and the proceeds were used to build a new residence on land belonging to a college which employs her daughter. The daughter supports the

taxpayer and furnished the additional funds necessary over the amount received from the sale of the old residence in order to build the new residence. The taxpayer may occupy the new residence as long as she lives, but title thereto is necessarily held by the daughter as an employee of the college, which gave the daughter permission to erect the residence on its property. The residence will ultimately become the property of the college.

Section 112 of the Internal Revenue Code of 1939 provides in part as follows:

> (n) GAIN FROM SALE OR EXCHANGE OF RESIDENCE—
> (1) NONRECOGNITION OF GAIN.—If property (hereinafter in this subsection called "old residence") used by the taxpayer as his principal residence is sold by him and, within a period beginning one year prior to the date of such sale and ending one year after such date, property (hereinafter in this subsection called "new residence") is purchased and used by the taxpayer as his principal residence, gain (if any) from such sale shall be recognized only to the extent that the taxpayer's selling price of the old residence exceeds the taxpayer's cost of purchasing the new residence.

The purpose of section 112(n) of the Code is to defer recognition of all or a part of the gain realized from the sale of the "old residence" to a future taxable event. This is accomplished under section 112(n) by deducting from the basis of the "new residence" the nonrecognized gain realized from the sale of the "old residence," and using this adjusted basis in computing the taxable gain, if any, upon the subsequent sale or exchange of the "new residence."

The provisions of this law are applicable to any taxpayer selling a principal residence at a gain, and relief may be obtained only where the requirements of this section are met. There are no provisions in the law whereby the taxpayer may reinvest the proceeds from the sale of her home in the home of another taxpayer without recognition for Federal income tax purposes of the gain realized from such sale.

Accordingly, it is held that gain from the sale of a taxpayer's residence does not come within the purview of section 112(n) of the Internal Revenue Code where the proceeds of the sale are reinvested in a home in which she has no legal interest but to which her daughter holds title. Any gain realized from the sale of the residence will be recognized and subject to Federal income tax under the capital gain provisions of the Code.

REGULATIONS 118, SECTION 39.112(n)-1: Gain from sale or exchange of residence. Rev. Rul. 55-90

> Only the portion of the cost of construction with respect to a "new residence" attributable to a period beginning one year prior to the date of sale of the "old residence" and 18 months after such date may be included in the cost of the "new residence" for the purpose of determining the nonrecognized gain under the provisions of section 112 (n) of the Internal Revenue Code of 1939.

Advice has been requested relative to the nonrecognition of gain from the sale of a residence under the circumstances described below.

The taxpayer on July 21, 1951 secured a building permit to construct a new home on a lot which he had purchased as an investment Construction of the new residence was commenced in September, 1951. By July 23, 1952, the new house could have been occupied, but it was not entirely completed until September 22, 1953, and the taxpayer

moved into it immediately thereafter. The home which the taxpayer was occupying as his principal residence was sold on September 22, 1953.

Section 112(n)(1) of the Code relating to the nonrecognition of gain from a sale or exchange of a residence, provides in part that if property (therein called "old residence") used by the taxpayer as his principal residence is sold by him and, within a period beginning 1 year prior to the date of such sale and ending 1 year after such date, property (therein called "new residence") is purchased and used by the taxpayer as his principal residence, gain, if any, from such sale shall be recognized only to the extent that the taxpayer's selling price of the old residence exceeds the taxpayer's cost of purchasing the new residence.

Section 112(n)(2)(G) of the Code provides in part that in the case of a new residence "the construction of which was commenced" by the taxpayer prior to the expiration of 1 year after the date of the sale of the old residence, the period specified in paragraph (1), which includes a period of 1 year prior to date of sale and ending 1 year after such date, shall be considered as including a period of 18 months beginning with the date of the sale of the old residence.

Section 39.112(n)-1(b)(5) of Regulations 118 provides in part:

> The taxpayer's cost of purchasing the new residence includes only so much of such cost as is attributable to * * * construction * * * made within the * * * 30 month period of time * * *

The 30-month period of time begins 1 year prior to the date of the sale of the old residence and ends 18 months after such date. For the purposes of section 112(n) of the Code, the date of the sale of the old residence is the governing date.

In the instant case the construction of the residence was commenced in September 1951 and completed to the extent that the residence could have been occupied by July 23, 1952, but the new residence was not finally completed until September 22, 1953. In accordance with the above-stated regulations, in order for all of the costs attributable to the construction of the new residence to come within the provision of section 112(n) of the Code, it is necessary that the sale of the old residence take place within 1 year from the date of the beginning of the construction of the new residence and that such construction be completed within 18 months after the sale of the old residence. Since the old residence sold September 22, 1953, and construction of the new residence was completed on the same date, only so much of the cost as is attributable to the construction of the new residence during the period beginning September 22, 1952, and ending September 22, 1953, may be considered as the cost of purchasing the new residence for the purpose of section 112(n) of the Code. The costs which were incurred prior to September 22, 1952, may not be taken into account for this reason.

REGULATIONS 118, SECTION 39.112(n)-1: Gain from sale or exchange of residence. Rev. Rul. 55-222

> The sale of a family residence which was rented for a period of three years during a taxpayer's assignment in the Armed Forces does not come within the provisions of section 112(n)(1) of the Internal Revenue Code of 1939.

Advice has been requested whether the sale of a family residence which was rented for a period of 3 years during a taxpayer's asignment in the Armed Forces comes within the provisions of section 112(n)(1) of the Internal Revenue Code of 1939.

In the instant case an officer of the Armed Forces of the United States prior to his retirement owned with his wife a home and occupied it as a principal residence. Because of a change in his post of duty, the taxpayers were forced to give up their occupancy of the residence and rent it for a period of 3 years. The home was inherited and was regarded as the family residence. Upon retirement of the officer, the rented residence was sold and a new residence was built in another city, upon land which the taxpayers owned. Such new residence was then occupied as a principal residence.

Section 112(n)(1) of the Internal Revenue Code of 1939, relating to nonrecognition of gain from the sale or exchange of a residence, provides in part that if property (therein called "old residence") used by the taxpayer as his principal residence is sold by him and, within a period beginning 1 year prior to the date of such sale and ending 1 year after such date, property (therein called "new residence") is purchased and used by the taxpayer as his principal residence, gain, if any, from such sale shall be recognized only to the extent that the taxpayer's selling price of the old residence exceeds the taxpayer's cost of purchasing the new residence.

Section 39.112(n)-1(b)(1) of Regulations 118 provides in part as follows:

> Whether or not property is used by the taxpayer as his residence, and whether or not property is used by the taxpayer as his principal residence (in the case of a taxpayer using more than one property as a residence), depends upon all of the facts and circumstances in each individual case, including the bona fides of the taxpayer. The mere fact that property is, or has been, rented is not determinative that such property is not used by the taxpayer as his principal residence. For example, the taxpayer purchases his new residence before he sells his old residence, the fact that he temporarily rents out the new residence during the period before he vacates the old residence may not, in the light of all the facts and circumstances in the case, prevent the new residence from being considered as property used by the taxpayer as his principal residence.

In the instant case, the taxpayers were forced to give up the occupancy of their residence due to a change in the officer's post of duty. There was no intent at the time of their leaving the home that a new residence would be purchased as a replacement. The residence was not occupied by the taxpayers for a period of 3 years but was rented and the facts and circumstances in the case do not indicate that renting of the residence was a temporary arrangement entered into during a period made necessary by the purchase of a new residence. Accordingly, it is held that the provisions of section 112(n) of the Code are not applicable under the facts and circumstances herein present.

SECTION 113(a).—ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS: BASIS (UNADJUSTED) OF PROPERTY

REGULATIONS 118, SECTION 39.113(a)-1: Scope of basis for determining gain or loss. Rev. Rul. 55-27

> Pursuant to a reorganization under the supervision of the Bank Commissioner of the State in 1933 Y Bank received certificates of beneficial interest representing a certain amount of assets in the X

Bank. In a taxable transaction in 1937 Y exchanged the certificates for stock of X, claiming no deduction in its Federal corporate income tax return for the loss involved in such transaction. *Held*, the basis of the X stock received by Y is measured by the fair market value of such stock as of the effective date of the exchange.

Advice has been requested with respect to the basis for Federal income tax purposes of certain shares of stock of X Bank acquired by Y Bank under the circumstances set forth.

The X Bank was reorganized under the supervision of the Bank Commissioner of a certain State pursuant to a plan of reorganization during the year 1933. In the transaction Y Bank received certificates of beneficial interest issued by a new intermediary corporation organized under the plan of reorganization. The certificates represented 40 percent of the amount the Y Corporation had on deposit in X Bank when it was closed in 1933.

Pursuant to an agreement in 1937, the Y Bank exchanged the certificates of beneficial interest for certain shares of stock of the X Bank, the exchange being made on the basis of one share of stock of X Bank for each $30x$ dollars represented by such certificates. The stock had a fair market value of $10x$ dollars per share when received.

The question presented is whether the Y Corporation is permitted to use as the cost basis of the stock of X Bank ($30x$ dollars per share), rather than the fair market value of the stock when it was received ($10x$ dollars per share), if Y Corporation sells its stock now or in any future year, inasmuch as the Y Bank suffered a substantial loss in 1937 as reflected by its corporate income tax return for that year without taking into consideration the loss sustained upon the exchange.

In the instant case, the Internal Revenue Service held that the depositors of the X Bank did not sustain deductible losses in 1933 under the Revenue Act of 1932 upon receipt of the certificates of beneficial interest issued by the new corporation pursuant to the plan of the reorganization. It was held further that the holders of such certificates realized gain or loss upon the exchange in 1937 under section 112(a) of the Revenue Act of 1936 of their certificates for stock of the X Bank, measured by the difference between the cost basis of the certificates exchanged ($30x$ dollars per share) and the fair market value of the stock of the X Bank received ($10x$ dollars per share). Inasmuch as it has been held that the exchange represented a closed transaction which resulted in gain or loss to the certificate holders, the basis of the stock received in the exchange is measured by its fair market value ($10x$ dollars per share) as of the effective date of the exchange.

Accordingly, notwithstanding the fact that the Y Corporation did not deduct the loss in the year of the exchange because it would receive no tax benefit, the various Revenue Acts, the Internal Revenue Code of 1939, and the regulations promulgated thereunder, contain no provisions permitting Y Bank to use a cost basis of $30x$ dollars in the event of the sale of such stock.

REGULATIONS 118, SECTION 39.113(a)(2)-1: Property transmitted by gift after December 31, 1920.

Basis of property acquired by gift and, in part, by exchange for annuity contract. See Rev. Rul. 55-119, page 352.

REGULATIONS 118, SECTION 39.113(a)(5)-1: Basis of property acquired by bequest, devise, or inheritance. Rev. Rul. 55-293

Where the lifetime income beneficiary of a testamentary trust exercises during his lifetime a general power of appointment over the corpus of the trust and appoints the property to himself, the basis of the property for Federal income tax purposes shall be the same in the hands of the appointee as it was in the hands of the trustees, subject to adjustment as provided in section 113(b) of the Internal Revenue Code of 1939.

REGULATIONS 118, SECTION 39.113(a)(5)-1: Basis of property acquired by bequest, devise, or inheritance.

Basis of property distributed in partial liquidation of trust principal. See Rev. Rul. 55-117, page 233.

REGULATIONS 118, SECTION 39.113(a)(6)-1: Property acquired upon a tax-free exchange.

Basis of shares of common stock for preferred stock in exchange pursuant to a tax-free reorganization. See Rev. Rul. 55-112, page 344.

REGULATIONS 118, SECTION 39.113(a)(13)-1: Property contributed in kind by a partner to a partnership.

Gain or loss resulting from the merger of two common trust funds. See Rev. Rul. 55-299, page 402.

SECTION 113(b).—ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS: ADJUSTED BASIS

REGULATIONS 118, SECTION 39.113(b)(1)-1: Adjusted basis. Rev. Rul. 55-119
(Also Sections 113, 114; Regulations 118, Sections 39.113(a)(2)-1, 39.114-1.)

> Basis for computing the depreciation allowance and for determining gain or loss upon the disposition of property acquired in exchange for an annuity contract.
> O. D. 945, C. B. 4, 44 (1921), and S. M. 3141A, C. B. IV-2, 183 (1925), modified.

Advice has been requested relative to the basis for (1) computing depreciation and (2) determining gain or loss upon the subsequent sale or exchange of property received by a taxpayer in exchange for an agreement to make annuity payments to the annuitant (transferor of the property) for the remainder of the annuitant's life.

In O. D. 945, C. B. 4, 44 (1921), the taxpayer received certain land in exchange for a cash payment and his promise to support his mother

for the remainder of her life. O. D. 945, as modified by I. T. 2689, C. B. XII-1, 160 (1933), pursuant to the recommendation to that effect in G. C. M. 11655, C. B. XII-1, 159 (1933), holds that the basis for determining gain or loss on the sale of such land is the sum of the cash payment plus the discounted value of the support to be furnished. In S. M. 3141A, C. B. IV-2, 183 (1925), the taxpayer purchased her mother's life interest in property, giving as the consideration therefor her agreement to contribute to the support of her mother for the remainder of her mother's life. S. M. 3141A holds that the total of the payments made and to be made by the taxpayer under the contract will represent the cost of the property acquired.

Under the provisions of section 23(e) of the Internal Revenue Code of 1939, one of the requisites of a deductible loss is that such loss must actually be sustained during the taxable period for which the deduction therefor is sought and evidenced by a closed and completed transaction. See section 39.23(e)-1 of Regulations 118. A transaction in which a taxpayer who is not engaged in the business of writing annuity contracts receives property in exchange for his promise to make annuity payments to the transferor is not a closed and completed transaction until the death of the annuitant. It is not until the death of the annuitant that the fixed cost of the property so acquired may be determined. The annuitant having died and payments under the contract having terminated, the cost of the property, for Federal income tax purposes, is the total of the annuity payments made. See *Thomas H. Mastin* v. *Commissioner*, 28 Fed. (2d) 748; *Citizens National Bank of Kirksville, Mo.* v. *Commissioner*, 122 Fed. (2d) 1011, certiorari denied, 315 U. S. 822; and *D. Bruce Forrester* v. *Commissioner*, 4 T. C. 907. Of course, if the property acquired in exchange for an annuity contract is depreciable property, or if the property is sold prior to termination of the annuity payments, it is necessary to determine a basis upon which to compute a reasonable allowance for depreciation and upon which the gain or loss from the sale or exchange of the property may be determined.

In view of the foregoing and assuming an arm's-length transaction with no intent of a gift on the part of either party, where a taxpayer who is not engaged in the business of writing annuities receives property in exchange for his contract to make annuity payments, the following Federal income tax consequences will result, subject, however, to the provisions of section 24(b) of the Code of 1939, relating to the nondeductibility of certain losses from sales or exchanges of property:

1. The basis (unadjusted)[1] of the property for the purpose of computing the allowance for depreciation prior to the death of the annuitant shall be the value of the prospective payments under the annuity contract (computed as of the date of the transaction in accordance with Table I, section 86.19(f) of Regulations 108 with reference to the life expectancy of the annuitant) until such time as the annuity payments equal the value of the annuity contract at the date of the transaction. Any annuity payments made in excess of the value of the annuity contract at the date of the transaction should be added to the basis of the property

[1] When used in this ruling, the term "basis (unadjusted)" refers to the basis prior to the adjustment for depreciation, and does not contemplate capital additions or subtractions.

for depreciation purposes. However, upon the death of the annuitant, the basis (unadjusted) for computing any subsequent allowance for depreciation becomes the total of the annuity payments made under the contract. In the event depreciable and nondepreciable property is received, an allocation, for the purpose of computing the basis for the depreciable portion of the property, must be made on the basis of the ratio of the respective fair market values of the depreciable and nondepreciable properties at the time acquired.

2. Should disposition of the property occur after the death of the annuitant, the basis (unadjusted) for determining gain or loss shall be the total of the annuity payments made under the contract. See *D. Bruce Forrester* v. *Commissioner*, *supra.*

3. Should disposition of the property occur prior to the death of the annuitant, the basis (unadjusted) for determining gain shall be the total of the annuity payments made under the contract up to the date of disposition plus the value of the prospective payments remaining to be paid at the date of such disposition (computed in accordance with Table I, section 86.19(f) of Regulations 108 with reference to the life expectancy of the annuitant as of the date of disposition of the property). The basis (unadjusted) for determining loss shall be the total of the annuity payments actually made at the time of disposition. Compare section 39.23(e)-1, Regulations 118; *Thomas H. Mastin* v. *Commissioner*, *supra*, and *Citizens National Bank of Kirksville, Mo.* v. *Commissioner*, *supra.* Of course, a situation may arise where the selling price is less than the adjusted basis for gain and greater than the adjusted basis for loss. In such a case, neither gain nor loss would be recognized at the time of the sale.

Where disposition of property acquired in exchange for a promise to make annuity payments has occurred prior to the death of the annuitant, the taxpayer may realize a gain or loss, for Federal income tax purposes, as a result of events occurring subsequent to such disposition. Whether such events result in a recognized gain or a recognized loss is dependent upon the circumstances in each individual case. If the total of the annuity payments made under the contract (total of payments made before and after disposition of the property) exceeds the basis (unadjusted) of the property used in determining the gain or loss on the disposition, such excess is a loss in the year or years in which paid. In the case of a recognized loss, this will include all payments made after the date of disposition of the property. Where the selling price is such that neither gain nor loss is recognized upon disposition of the property, no loss is sustained until the total of the payments made under the annuity contract (total of payments made before and after disposition of the property) when decreased by depreciation allowed or allowable exceeds the selling price, at which time such excess is a loss in the year in which paid.

On the other hand, in the case of a recognized gain upon disposition of the property prior to the death of the annuitant, if the total of the annuity payments ultimately made is less than the basis (unadjusted) for computing such gain, the excess of such basis over the total of the annuity payments will constitute income in the year the annuitant dies. In the case of a recognized loss, there will be no gain as a result

of the annuitant's death. In case neither gain nor loss was recognized upon the disposition of the property, if the total annuity payments ultimately made (decreased by depreciation allowed or allowable during the period the property was held and adjusted for capital additions or subtractions) is less than the selling price, the excess of the selling price constitutes income in the year the annuitant dies.

The nature of any gain or loss, whether capital or ordinary, which is recognized as a result of events occurring subsequent to the sale of the property involved will depend upon the purpose for which the property was held. Compare *F. Donald Arrowsmith et al., executors of the last will and testament of Frederick R. Bauer, deceased, and Ruth R. Bauer et al.* v. *Commissioner*, 344 U. S. 6, Ct. D. 1752, C. B. 1952-2, 136.

The principles outlined above may be illustrated by the following examples:

(a) Assume the fair market value of the property received is $95,000 (land $15,000 and building $80,000) and the property is used in the taxpayer's trade or business or for the production of income. The remaining life of the building is 50 years and the estimated salvage value of the building at the end of that time is $15,000. The annuity contract provides for annual payments of $10,000 to the annuitant (transferor) for the remainder of his life. At the time of transaction the present value of the annuity contract is $94,785 (at age 69).

The annual depreciation would be computed for the period up to the date of the annuitant's death as follows:

$$\frac{\frac{\$80,000}{\$95,000}\times\$94,785-\$15,000}{50}=\$1,296.38$$

(b) If the annuitant should die at the end of the eighth year, the annual depreciation for subsequent taxable years would be computed as follows:

$$\frac{\frac{\$80,000}{\$95,000}\times\$80,000\,^{2}-\$15,000-\$10,371.04\,^{3}}{42\text{ (remaining life of building)}}=\$999.94$$

(c) Assuming the property was sold at the end of the ninth year and prior to the death of the annuitant, the recognized gain is computed as follows:

Selling price		$150,000.00
Basis:		
Annuity payments made (9×$10,000)	$90,000.00	
Plus: Value of prospective payments at date of sale (age 78)	63,705.00	
Unadjusted basis	$153,705.00	
Less: Depreciation (9×$1,296.38)	11,667.42	
Adjusted basis		142,037.58
Recognized gain		$7,962.42

Losses from annuity payment made after the property is disposed of would be recognized after the aggregate of the annuity payments

[2] Eight annuity payments made.
[3] Depreciation for 8 years at $1,296.38.

exceeds $153,705, *i. e.*, $6,295 of the 16th annual payment and all subsequent payments are losses in the year in which paid. However, if the 15th annual payment was the final payment made, there would be a recognized gain of $3,705 ($153,705 minus $150,000).

(d) Assuming all facts the same as in the preceding example, except that the selling price is $75,000, the recognized loss is computed as follows:

Selling price		$75,000.00
Unadjusted basis (9 annuity payments made)	$90,000.00	
Less: Depreciation (9 x $1,296.38)	11,667.42	
Adjusted basis		78,332.58
Recognized loss		$3,332.58

In this instance, each annuity payment made after the sale of the property would be recognized as a loss in the year paid.

(e) If the selling price were $105,000.00, no gain or loss would be recognized at the time the property is disposed of, since the selling price falls between the basis (adjusted), $142,037.58, for computing a recognized gain and the basis (adjusted), $78,332.58, for computing a recognized loss. In this situation, there would be a recognized loss of $3,332.58 on the 12th annuity payment (selling price, $105,000−(total payments, $120,000−depreciation, $11,667.42). The full amount of each succeeding payment would be a recognized loss in the year paid. If, however, the annuitant died after only 11 payments had been made, there would be a recognized gain in the year of the annuitant's death in the amount of $6,667.42 (selling price, $105,000−(total payments, $110,000−depreciation, $11,667.42)).

If, in fact, an element of gift is involved in connection with a transaction where property is acquired in exchange for an annuity contract, such fact must be considered by the recipient of the property in determining his basis for computing the depreciation allowance and for determining gain or loss upon subsequent disposition of such property. Under section 113(a)(2) of the Code the donee's basis for determining gain on the disposition of property received as a gift is the same as it would be in the hands of the donor, or the last preceding owner by whom it was not acquired by gift; the donee's basis for determining loss is the same as the basis for determining gain, or the fair market value of the property at the time of the gift, whichever is lower. The basis for depreciation is the same as the basis for computing gain. Section 114(a) of the Code. Thus, in determining the basis for gain, loss or depreciation the donee's basis of the portion of the property acquired by gift should be added to the basis computed under each of the above-stated rules relating to property received in exchange for an annuity contract only. In determining the basis for gain, loss or depreciation which is attributable to the portion of the property transferred as a gift, the donor's basis or the fair market value of the total property transferred, as the case may be, is reduced by the value of the prospective annuity payments to be made (computed as of the date of the transaction in accordance with Table I, section 86.19(f) of Regulations 108 with reference to the life expectancy of the annuitant). Where necessary, an allocation of the basis of the portion of the property received as a gift should be made between depreciable

and nondepreciable property based on the ratio of the total fair market values of such depreciable and nondepreciable property.

See Revenue Ruling 239, C. B. 1953-2, 53, as to the taxability of annuity payments received by an annuitant who has transferred real property in exchange for an annuity contract.

To the extent they are inconsistent with the foregoing, S. M. 3141A, C. B. IV-2, 183 (1925), is modified, and O. D. 945, C. B. 4, 44 (1921), as modified by I. T. 2689, C. B. XII-1, 160 (1933), is further modified.

SECTION 114.—BASIS FOR DEPRECIATION AND DEPLETION

REGULATIONS 118, SECTION 39.114-1: Basis for allowance of depreciation and depletion. — Rev. Rul. 55-67

Gypsum, in its natural state, is a mineral which may occur in rock-like masses but is very soft and rarely mined or used as stone for ordinary commercial purposes. It is not to be classified as "stone," as that term is used in section 114(b)(4)(A)(i) of the Internal Revenue Code of 1939 (as amended by section 319 of the Revenue Act of 1951) and section 39.23(m)-5(b) of Regulations 118, unless it is used, or sold for use, by the mine owner or operator as "stone" as defined in such regulations.

REGULATIONS 118, SECTION 39.114-1: Basis for allowance of depreciation and depletion. (Also Section 23(m); Regulations 118, Section 39.23(m)-1.) — Rev. Rul. 55-78

Processes which are included in the term "ordinary treatment processes" as set forth in section 39.23(m)-1(f) of Regulations 118, and section 114(b)(4)(B) of the Internal Revenue Code of 1939, with respect to the manufacture of lightweight aggregate from shale and slate.

Advice has been requested as to the processes in the manufacture of lightweight aggregate from shale and slate that are included under the term "ordinary treatment processes" as used in section 39.23(m)-1(f) of Regulations 118, and section 114(b)(4)(B) of the Internal Revenue Code of 1939.

The various treatment processes involved in the manufacture of such products are as follows:

(1) Removal of overburden
(2) Blasting with dynamite
(3) Loading on trucks
(4) Transportation to primary crusher
(5) Primary crushing
(6) Removal from primary crusher
(7) Firing in a rotary kiln
(8) Removal from kiln and cooling
(9) Crushing and screening
(10) Loading for shipment

It is held that the first six processes are "ordinary treatment processes" within the meaning of section 114(b)(4)(B) of the Code and section 39.23(m)-1(f) of Regulations 118. The furnacing, or heating in the rotary kilns, and all subsequent operations, are held to be nonmining processes.

As to the computation of the gross and net income from the property for percentage depletion purposes after the costs of mining and manufacturing have been segregated, see sections 39.23(m)-1 (e) and (g) of Regulations 118.

REGULATIONS 118, SECTION 39.114–1: Basis for allowance of depreciation and depletion. (Also Section 23(m); Regulations 118, Section 39.23(m)-5.) Rev. Rul. 55–180

Clay used in conjunction with shale in the manufacture of light weight aggregate does not qualify as brick and tile clay as defined in section 39.23(m)-5(b) of Regulations 118, and is not entitled to percentage depletion unless of a type of clay specifically identified in the Code and regulations as a clay for which a 15 percent rate of percentage allowance is provided. See section 114(b)(4)(A) of the Internal Revenue Code of 1939 and section 39.23(m)-5(b) of Regulations 118.

REGULATIONS 118, SECTION 39.114–1: Basis for allowance of depreciation and depletion.

Basis for determining depletion allowances with respect to income received from the sale of loam. See Rev. Rul. 55–11, page 212.

REGULATIONS 118, SECTION 39.114–1: Basis for allowance of depreciation and depletion.

Property acquired by a taxpayer, not engaged in the business of writing annuity contracts, in exchange for his contract to make annuity payments to the transferor. See Rev. Rul. 55–119, page 352.

REGULATIONS 118, SECTION 39.114–1: Basis for allowance of depreciation and depletion.

The decision in the case of *United States* v. *Cherokee Brick & Tile Company*, 218 Fed. (2d) 424, does not affect the position of the Service with respect to ordinary treatment processes in the case of brick and tile clay as set forth in Revenue Ruling 54–109, C. B. 1954–1, 62. See Rev. Rul. 55–244, page 73.

SECTION 115.—DISTRIBUTIONS BY CORPORATIONS

REGULATIONS 118, SECTION 39.115(a)-1: Dividends. Rev. Rul. 55-28

(Also Section 22(d), Section 39.22(d)-7; Section 718, Section 35.718-2, Regulations 112; Section 436, Section 40.436-1; Section 458, Section 40.458-4, Regulations 130.)

In determining the amount of earnings and profits available for dividends for a taxable year in which there was an involuntary liquidation of inventory, replacement of which was made in subsequent years, the earnings and profits for the year of liquidation, the year of replacement, and all intervening years must be adjusted to reflect any increase or decrease in income attributable to such replacement. In the determination of equity invested capital upon which the excess profits credit is based, accumulated earnings and profits as at the beginning of each year must be adjusted for the change in Federal income and excess profits tax liability for the preceding taxable year taking into consideration any adjustments required under section 22(d)(6) of the Internal Revenue Code of 1939. The accumulated earnings and profits in such cases, however, shall be reduced by the amount of the income and excess profits taxes determined without reduction for net operating loss or unused excess profits credit carrybacks.

Advice has been requested concerning the method to be used in computing the amount of earnings and profits available for dividend distribution where the involuntary liquidation and replacement provisions of section 22(d)(6) of the Internal Revenue Code of 1939 are applicable, and the effect to be given any increase or decrease in the Federal income and excess profits tax liability resulting from the replacement of inventories involuntarily liquidated. Advice is also requested as to what effect a net operating loss and/or an unused excess profits credit carryback will have upon the earnings and profits available for dividend distribution for a prior taxable year.

With regard to the replacement of an inventory involuntarily liquidated section 22(d)(6) of the 1939 Code provides, in part, as follows:

SEC. 22. GROSS INCOME.

* * * * * * *

(d) [Last-in first-out inventory method.]—

(6) INVOLUNTARY LIQUIDATION AND REPLACEMENT OF INVENTORY.—

(A) Adjustment of net income and resulting tax.—Years beginning prior to January 1, 1948.—If, for any taxable year beginning after December 31, 1940, and prior to January 1, 1948, the closing inventory of a taxpayer inventorying goods under the method provided in this subsection reflects a decrease from the opening inventory of such goods for such year, and if the taxpayer elects * * * to have the provisions of this paragraph apply, and if it [is] established * * * that such decrease is attributable to the involuntary liquidation of such inventory * * * and if the closing inventory of a subsequent taxable year, ending prior to January 1, 1953, reflects a replacement, in whole or in part, of the goods so previously liquidated, the net income of the taxpayer otherwise determined for the year of such involuntary liquidation shall be adjusted as follows:

(i) 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

(ii) 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.

This section of the Code and the regulations promulgated thereunder, affords taxpayers using the last-in first-out method of inventorying goods an opportunity, by election, to use replacement cost rather than actual cost for goods liquidated and, because of certain reasons therein outlined, not replaced at the close of the taxable year.

In commenting upon section 119 of the Revenue Act of 1942, which added section 22(d)(6) of the Code, the Senate Finance Committee stated, in report No. 1631, C. B. 1942-2, 504, at 567, as follows:

It is not intended that any adjustment should be made with respect to the closing inventory of the year of liquidation, or with respect to the opening or closing inventories of intervening years, as an incident to the ultimate replacement. It is intended, however, that the earnings and profits account for the year of liquidation and for all intervening years shall be adjusted in a manner consistent with the increase or decrease of net income provided for with respect to the year of liquidation. Any determination of earnings and profits available for dividend distribution, of the earnings and profits factor in invested capital, and of all related matters shall reflect the proposed adjustments.

Therefore, where the replacement of an inventory involuntarily liquidated is involved an adjustment of income shall be made in the year of liquidation notwithstanding that such adjustment is not determinable until the subsequent year in which the replacement is made.

Section 35.718-2 of Regulations 112, applicable to taxable year beginning after December 31, 1941 and prior to January 1, 1946 and section 40.458-4 of Regulations 130, applicable to taxable years ending after June 30, 1950 and beginning prior to January 1, 1954, provides in part that in the determination of equity invested capital, upon which the excess profits credit is based, accumulated earnings and profits at the beginning of the taxable year shall be decreased by the amount of Federal income and excess profits tax liability for the preceding taxable year.

With regard to the net operating loss and unused excess profits credit carrybacks, the Senate Report No. 1631, C. B. 1942-2, 504, 597, in commenting upon section 155 of the Revenue Act of 1942 which amended section 122 of the Internal Revenue Code, states in part as follows:

A taxpayer entitled to a carry-back of a net operating loss or unused excess profits credit (see section 204 of the bill) will not be able to determine the deduction on account of such carry-back until the close of the future taxable year in which he sustains the net operating loss or has an unused excess profits credit. He must therefore file his return and pay his tax without regard to such deduction, and must file a claim for refund at the close of the succeeding taxable year when he is able to determine the amount of such carry-back. * * *.

Therefore, where the carryback of a net operating loss or an unused excess profits credit is involved the adjustments will not be determinable until the close of the taxable year in which such adjustments arose.

Accordingly, it is held that in determining the amount of earnings and profits available for dividend distribution in a year in which there is an involuntary liquidation of inventory, replacement of which was made in a subsequent year, the earnings and profits for the year of liquidation, the year of replacement, and all intervening years must

be adjusted to reflect any increase or decrease in income attributable to such replacement as required by section 22(d)(6) of the Code.

It is further held that in computing invested capital under section 718, and excess profits credit under section 714 of the Code applicable to years beginning after December 31, 1941 and prior to January 1, 1946, or invested capital under section 437, and excess profits credit under section 436 of the Code applicable to taxable years ending after June 30, 1950 and beginning prior to January 1, 1954, accumulated earnings and profits must be decreased by the amount of accrued Federal income and excess profits tax liability for the preceding taxable year, computed on the basis of income as adjusted under section 22(d)(6) of the Code, and without benefit of any net operating loss or unused excess profits credit carryback. The accumulated earnings and profits to be included in invested capital should not reflect a net operating loss carryback, or the adjustments for taxes due to a net operating loss carryback or an unused excess profits credit carryback, prior to the beginning of the first taxable year subsequent to the end of the taxable year in which the net operating loss was sustained, or the year in which the unused excess profits credit carryback was determined. It follows that tax adjustments for such carrybacks will not be reflected in the amount of earnings and profits available for dividends in prior years.

SECTION 115(a).—DISTRIBUTIONS BY CORPORATIONS: DEFINITION OF DIVIDEND

REGULATIONS 118, SECTION 39.115(a)-1: Dividends. Rev. Rul. 55-15

(Also Section 112(a), Section 39.112(a)-1.)

> Where a sale was made by a sole stockholder of his stock in one corporation to another corporation wholly owned by him in order to eliminate administrative expense and to simplify dual operation, there was no economic reality to the transaction insofar as any relinquishment of the interest in the first corporation was concerned. Payments received from such sale represent a cash distribution to the taxpayer taxable as a dividend under section 115(a) of the Internal Revenue Code of 1939.

Advice has been requested whether a sale by the sole stockholder of the stock of M Corporation to N Corporation, also wholly owned by him, shall be treated as a bona fide sale realizing long-term capital gain or a distribution taxable as an ordinary dividend.

M Corporation was engaged in the business of owning and renting terminal buildings and transportation equipment. N Corporation was a motor freight common carrier. Most of the transportation terminal buildings and all of the transportation equipment owned by M Corporation were rented to N Corporation. Both corporations had substantial accumulated earnings and profits as indicated by their balance sheets. Both M Corporation and N Corporation were wholly owned by the same shareholder. In order to set up the business of N Corporation as an integrated operation thus eliminating administrative expenses and simplifying the dual operation, the sole shareholder sold his stock of M Corporation to N Corporation. The fair

market value of the assets of M Corporation was determined by an independent appraisal. Upon consummation of the plan, the initial payment in the first year did not exceed 30 percent of the approved selling price, and the remaining balance was to be paid in annual installments.

Section 115 of the Internal Revenue Code of 1939 relating to distributions by corporations provides in part:

(a) DEFINITION OF DIVIDEND.—The term "dividend" * * * means any distribution made by a corporation to its shareholders, whether in money or in other property, (1) out of its earnings or profits accumulated after Februay 28, 1913, or (2) out of the earnings or profits of the taxable year * * *.

In the instant case it is evident that there is no economic reality to the sale insofar as any relinquishment of interest by the sole shareholder in M Corporation is concerned. The shareholder received a cash distribution from N Corporation and, through the ownership of the stock of that corporation, he still retains effective control of the M Corporation, the stock interest which the shareholder was purporting to sell. Although it is a well settled principle that the taxpayer has the legal right to minimize his taxes by means which the law permits, the true nature of the transaction is not to be disguised by the mere formalism employed. Tax liabilities are measured by the reality of the transaction, not the mere form employed in bringing it about. See *Evelyn F. Gregory* v. *Helvering*, 293 U. S. 465, Ct. D. 911, C. B. XIV-1, 193 (1935), and *Commissioner* v. *Court Holding Co.*, 327 U. S. 331, Ct. D. 1636, C. B. 1945, 58.

Accordingly, it is held that the sale by the sole shareholder of his stock in M Corporation to another corporation wholly owned by him resulted in the distribution of a taxable dividend within the purview of section 115(a) of the Internal Revenue Code.

REGULATIONS 118, SECTION 39.115 (a)-1: Dividends.

A taxable distribution made by a corporation to its shareholders. See Rev. Rul. 55-373, page 363.

REGULATIONS 118, SECTION 39.115(a)-3: Effect on earnings or profits of certain tax-free exchanges and tax-free distributions.

The earnings and profits of a corporation pursuant to a recapitalization. See Rev.Rul. 55-112, page 344.

REGULATIONS 118, SECTION 39.115(a)-3: Effect on earnings or profits of certain tax-free exchanges and tax-free distributions.

Treatment of undistributed earnings and profits of corporations involved in a reorganization. Se Rev. Rul. 55-305, page 345.

SECTION 115(c).—DISTRIBUTIONS BY CORPORATIONS: DISTRIBUTIONS IN LIQUIDATION

REGULATIONS 118, SECTION 39.115(c)-1: Distributions in liquidation. Rev. Rul. 55-373

(Also Sections 115(a), 115(g); Regulations 118, Sections 39.115(a)-1, 39.115(g)-1.)

Where a contraction of its corporate business is due to a cancellation of its franchise to distribute certain products, a distribution by a corporation in complete cancellation and redemption of a portion of its capital stock, which does not exceed the net proceeds derived by the corporation from the bulk sales of its inventories, constitutes a distribution in partial liquidation within the meaning of section 115(c) and section 115(i) of the Internal Revenue Code of 1939. To the extent that the amount distributed exceeds the net proceeds from the bulk sale of inventories, such amount is taxable as a dividend under to provisions of section 115(a) and section 115(g) of the Code.

Advice has been requested with respect to the tax consequences for Federal income tax purposes of a partial liquidation of a corporation under the following circumstances.

A corporation was organized as an appliance distributor, principally under a franchise from a certain manufacturing corporation. The president of the distributor corporation and his family owned 60 percent and 40 percent, respectively, of such corporation's stock. The president died, and under the terms of his will, his widow and children are to receive, directly or in trust, substantially all of his estate.

After the death of the president the distributor corporation was served notice by the manufacturing corporation that under its policy the franchise for distributing its products would be canceled due to such death. This franchise had been the reason for the organization of the distributor corporation and the sales of the franchised products had constituted approximately 85 percent of its business. After the loss of its key franchise the corporation continued to operate a distributorship for other products for a trial period but its business was unprofitable. Accordingly, it was determined that the corporation would cease all of its prior operations and become a holding corporation for its real estate. All of its inventory, other than real estate, was disposed of in a series of bulk sales. The manufacturing corporation purchased all the inventories that were related to its line of products and the remainder of the inventories were sold in bulk to other purchasers. As a result of the foregoing measures the corporation was in an extremely liquid position.

After the appliance distributorship had been abandoned and the corporation became only a holding corporation for real estate, its capital and surplus were far in excess of the needs of the corporation. Accordingly, the stock held by the estate of the late president was purchased by the corporation at a price determined from the net worth of the corporation. The total redemption price was in excess of the net proceeds derived by the corporation from the bulk sales of its inventories.

Section 115 of the Internal Revenue Code of 1939 provides in part:

(a) DEFINITION OF DIVIDEND.—The term "dividend" when used in this chapter * * * means any distribution made by a corporation to its shareholders,

whether in money or in other property, (1) out of its earnings or profits accumulated after February 28, 1913, * * *.

* * * * * * *

(c) DISTRIBUTIONS IN LIQUIDATION.—Amounts distributed in complete liquidation of a corporation shall be treated as in full payment in exchange for the stock, and amounts distributed in partial liquidation of a corporation shall be treated as in part or full payment in exchange for the stock. The gain or loss to the distributee resulting from such exchange shall be determined under section 111, * * *.

* * * * * * *

(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 in redemption or cancellation of the stock, to the extent that it represents a distribution of earnings or profits accumulated after February 28, 1913, shall be treated as a taxable dividend.

* * * * * * *

(i) DEFINITION OF PARTIAL LIQUIDATION.—As used in this section the term "amount distributed in partial liquidation" means a distribution by a corporation in complete cancellation or redemption of a part of its stock, * * *."

It is held that to the extent the distribution by the corporation in complete cancellation and redemption of a portion of its capital stock does not exceed the net proceeds by the corporation from the bulk sales of its inventories, such distribution constitutes a distribution in partial liquidation within the meaning of section 115(c) and section 115(i) of the Revenue Code of 1939. To the extent that the amount distributed exceeds the net proceeds, such excess is taxable as a dividend under the provisions of section 115(a) and section 115(g) of the 1939 Code and section 115(g)-1 of Regulations 118. Since the individuals who at the time of the redemption owned 40 percent of the stock of the corporation are also the beneficiaries of the decedent's estate, this case is not controlled by the sentence in section 39.115(g)-1(a)(2) of Regulations 118 relating to the redemption of all of a particular shareholder's stock so that he ceases to be interested in the affairs of the corporation. See *Commissioner* v. *John T. Roberts, et al.*, 203 Fed. (2d) 304.

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. 55-91

(Also Section 117, Section 39.117(b)-1.)

Section 115(g)(3) of the Internal Revenue Code of 1939, relating to the redemption of stock to pay death taxes, applies to amounts distributed in redemption of stock acquired in a nontaxable reorganization under section 112(g)(1)(F) effecting a change only in the name, state of incorporation and the number of shares of the corporate entity where the value of the stock of the former corporaton was included in the gross estate of the decedent.

Any gain or loss realized by the estate upon the redemption of the stock will be treated as a capital gain or loss under sections 115(c) and 117 of the Internal Revenue Code of 1939.

Advice has been requested relative to the Federal income tax consequences of a redemption by N Corporation of a part of its stock owned by the estate of A.

Included in the gross estate of A were $120x$ shares of the stock of the M Corporation. The value of this stock exceeded 35 percent of the value of the total gross estate. The executors of the estate sold $38x$ shares of the stock to the M Corporation in order to obtain funds for the payment of estate and inheritance taxes. A later audit of the estate tax return resulted in the determination of a deficiency in estate tax of $115x$ dollars.

Pursuant to a plan of reorganization the M corporation incorporated the N Corporation under the laws of another State. Under the agreement between the two corporations, all the assets and liabilities of the M Corporation were transferred to the N Corporation in exchange for all of the issued and outstanding capital stock of N Corporation, which consisted of $10{,}000x$ shares. After the transfer, the M Corporation distributed $5x$ shares of N Corporation's stock in exchange for each of its $210x$ outstanding shares.

As a result of the reorganization, the estate of A received $410x$ shares of stock of the N Corporation in exchange for the remaining $83x$ shares of stock of the M Corporation that it owned.

The estate had no assets other than the stock of the N Corporation from which it could realize funds to pay the estate tax deficiency and interest thereon. Pursuant to an agreement the N Corporation redeemed a sufficient number of its shares of stock held by the estate of A for the estate to realize cash equal to, but not in excess of, the aggregate amount of the estate and inheritance taxes imposed upon the estate.

Section 115(g)(1) of the Internal Revenue Code of 1939 provides, in general, that 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 accumulated after February 28, 1913, shall be treated as a taxable dividend.

Section 115(g)(3) of the Code, with reference to the redemption of stock to pay death taxes, provides that the general rule in subsection 115(g) 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, as is distributed after such decedent's death and within the period of limitations for the assessment of estate tax 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 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.

The stock of the M Corporation was the stock the value of which was included in the gross estate of A for estate tax purposes. However, inasmuch as the stock of the N Corporation was received in a nontaxable reorganization which changed only the name of the M

Corporation, the state of incorporation, and the number of shares of the corporate entity, the stock of the N Corporation is in substance the same as the stock of the M Corporation, the value of which was included in the gross estate of the decedent.

Accordingly, it is held that, under the provisions of section 115(g)(3) of the Code, the redemption by the N Corporation, within the time limit prescribed, of shares of its stock held by the estate of A is not equivalent to the distribution of a taxable dividend, since the value of the stock of the M Corporation (now N Corporation), for estate tax purposes, comprised more than 35 per centum of the value of the gross estate of the decedent, and the amount of this distribution and previous distributions to the estate of A did not exceed the estate, inheritance, legacy, and succession taxes (including interest collected as a part of such taxes) imposed upon the estate of A.

Any gain or loss realized by the estate upon the redemption of the stock will be treated as a capital gain or loss under sections 115(c) and 117 of the Code.

REGULATIONS 118, SECTION 39.115(g)-1: Distribution in redemption or cancellation of stock taxable as a dividend.

Whether a distribution in connection with a cancellation or redemption of stock is essentially equivalent to a taxable dividend. See Rev. Rul. 55-373, page 363.

SECTION 115(j).—DISTRIBUTIONS BY CORPORATIONS: VALUATION OF DIVIDENDS

REGULATIONS 118, SECTION 39.115(j)-1: Dividends paid in property.

Corporate distribution in kind where the earnings and profits of the corporation are sufficient to cover the adjusted cost of the property distributed but are insufficient to cover its full market value at the time of distribution. See Ct. D. 1774, page 248; Ct. D. 1775, page 253.

SECTION 116.—EXCLUSIONS FROM GROSS INCOME

REGULATIONS 118, SECTION 39.116-1: Earned income from sources without the United States. Rev. Rul. 55-191

Where a United States citizen, a bona fide resident of a foreign country within the meaning of section 116(a) of the Internal Revenue Code of 1939, has expenses, losses or deductions which are neither allocable to his income from sources within the United States nor to his income from sources without the United States, as for example, real estate taxes on his personal residence abroad or medical expenses, such amounts are deductible without apportionment, subject to any applicable provisions or limitations provided in the Code with respect to such expenses, losses or deductions.

Advice has been requested relative to the deductions properly allocable or chargeable against amounts excluded from gross income by a United States citizen under the provisions of section 116(a) of the Internal Revenue Code of 1939, under the following circumstances.

The taxpayer, a citizen of the United States and a bona fide resident of a foreign country, within the meaning of section 116(a) of the Code, received gross income amounting to $50x$ dollars of which $25x$ dollars was earned abroad and excludable from his gross income under the provisions of section 116(a) of the Code. Deductions were claimed for real estate taxes paid on his personal residence abroad as well as personal and family medical expenses. The specific question presented is whether such expenses must be apportioned, as provided in section 119 of the Code, as between amounts properly excluded from and amounts properly included in gross income or whether such amounts are deductible without apportionment.

Section 39.116–1(a)(3) of Regulations 118 provides that there shall not be allowed as a deduction from gross income any items of expenses or losses or other deductions properly applicable to or chargeable against the amounts excluded from gross income under section 116(a) of the Code. The apportionment and allocation of such expenses, losses, or deductions as between income from sources within and income from sources without the United States shall be determined in accordance with the principles of section 119 of the Code and the regulations thereunder.

Thus, any expenses, losses, or deductions directly applicable to income exempt under section 116(a) of the Code cannot be claimed as deductions from gross income. The apportionment and allocation of such expenses, losses, or deductions in accordance with the principles of section 119 of the Code and the regulations thereunder would have to be made only in those cases where they cannot be identified as being attributable exclusively to either includible or excludable income but are attributable to both. See section 11.02, Rev. Rul. 55–171, page 80, this bulletin. For example, where State income taxes are paid on income part of which income is, for Federal income tax purposes, excludable from gross income under section 116(a) of the Code, the deduction for State income taxes under section 23(c) of the Code would be apportioned between the includible and excludable income in accordance with the principles of section 119 of the Code and the regulations thereunder. See *J. Haseltine Carstairs, Executor* v. *United States*, 75 Fed. Supp. 683. However, a salesman, a citizen of the United States, residing and traveling abroad, who properly excluded from gross income under section 116(a) of the Code income earned abroad, may not deduct in his Federal income tax return traveling and other expenses incurred by him in earning such excluded income. See section 11.02, Rev. Rul. 55–171, *supra*.

In the instant case the real estate taxes paid on the taxpayer's personal residence abroad as well as the medical expenses are attributable neither to reportable income nor to income excludable under section 116(a) of the Code. Accordingly, the real estate taxes on his personal residence abroad are deductible from gross income, under section 23(c) of the Code, without any apportionment and the medical expenses may, subject to the limitations of section 23(x) of the Code, be deducted from the taxpayer's gross income, also without apportion-

ment thereof, provided, in each instance, the taxpayer does not claim the optional standard deduction.

REGULATIONS 118, SECTION 39.116-1: Earned income from sources without the United States. Rev. Rul. 55-294

Treatment of pensions (including supplemental pensions) paid retired United States citizens by a domestic employer from current operating funds for service rendered as a bona fide resident of a foreign country.
I. T. 3472, C. B. 1941-1, 252, further modified.

A pension (including one which is only supplemental) paid from the current operating funds of a domestic employer direct to a retired United States citizen on account of or with respect to services rendered to the employer by the citizen while the latter was "a bona fide resident of a foreign country or countries" within the meaning of section 116(a)(1) of the Internal Revenue Code of 1939, as amended by section 321 of the Revenue Act of 1951, constitutes, in its entirety, "earned income" and "income from sources outside the United States" within the meaning of those terms as used in sections 116(a)(3) and 119(c), respectively, of the Code and is therefore wholly excludable from the gross income of the pensioner under the provisions of section 116(a)(1) of the Code.

However, where a pension paid from the current operating funds of an employer is partly with respect to services rendered by a United States citizen during a period when he was "a bona fide resident of a foreign country or countries," within the meaning of section 116(a)(1) of the Code, and partly with respect to services of the citizen not rendered during such a period (for example, services rendered in the United States), the amount of such pension payment to be excluded from the taxable income of the pensioner is that portion paid on account of the services of the citizen rendered during a period qualifying under section 116(a)(1) of the Code.

If the amount of the pension is governed solely by the length of service of the employee (for example, $100 per year for each year of service, regardless of salary), or if the pension is of the fixed benefit type (for example, 30 percent of average compensation over final 5 years of employment), the exempt portion thereof will be that proportion of each pension payment which the number of months of employment during the period qualifying under section 116(a) of the Code bears to the total number of months in the citizen's entire period of employment. The remainder of the pension is taxable income to the retired employee. See I. T. 3472, C. B. 1941-1, 252, as modified with respect to other matters by IR-Mim. 71, C. B. 1952-2, 170.

On the other hand, if the amount of the pension is determined in whole or in part by units of compensation actually paid to the employee from year to year during his period of total employment, the amount or portion of the pension excludable from the gross income of the employee for Federal income tax purposes will be governed, to the extent that the amount of the pension is so determined, by the relation of the total compensation actually paid to the employee with respect to his services rendered abroad during a period qualifying

under section 116(a) of the Code, to the total compensation actually paid to the employee on account of his entire period of employment. To the extent that it is inconsistent with the views expressed herein relative to pensions determined in whole or in part by units of compensation actually paid to an employee from year to year during his period of total employment, I. T. 3472, *supra*, is further modified.

The above principles apply whether or not the retired employee resumes residence in the United States on, during, or before retirement, but do not apply to amounts paid pursuant to a prefunded stock bonus, pension, annuity or profit-sharing plan. With respect to such plans, see IR-Mim. 71, C. B. 1952-2, 170.

REGULATIONS 118, SECTION 39.116-1; Earned income from sources without the United States.

The Ryukyu Islands, which include Okinawa, are a foreign country. See Rev. Rul. 55-6, page 409.

REGULATIONS 118, SECTION 39.116-1: Earned income from sources without the United States.

Income tax guide for United States citizens abroad. See Rev. Rul. 55-171, page 80.

REGULATIONS 118, SECTION 39.116-1: Earned income from sources without the United States.

Effect of community property laws on income excludable from gross income under the provisions of section 116(a) of the Internal Revenue Code of 1939. See Rev. Rul. 55-246, page 92.

REGULATIONS 118, SECTION 39.116-1: Earned income from sources without the United States.

Compensation received by a United States citizen, from kindergarten and nursery schools operated on United States bases or installations located in foreign countries which are operated on a permissive basis rather than under official instructions or regulations. See Rev. Rul. 55-384, page 94.

SECTION 116(g).—EXCLUSIONS FROM GROSS INCOME: SHIPOWNERS' PROTECTION AND INDEMNITY ASSOCIATIONS

Determination of the status, for Federal income tax purposes, of a shipowners' protection and indemnity association. See Rev. Rul. 55-189, page 265.

SECTION 117(a).—CAPITAL GAINS AND LOSSES: DEFINITIONS

REGULATIONS 118, SECTION 39.117(a)-1: Meaning of terms. Rev. Rul. 55-79

For Federal income tax purposes, the sale of a going business operated as a sole proprietorship does not constitute the sale of a single asset. Such a sale constitutes a sale of the individual assets comprising the business. For the purpose of determining whether the gain on the sale of a particular asset is to be included in gross income as an item of ordinary income or whether it is to be treated as gain from the sale of a capital asset, all of the individual assets sold must first be classified as to (1) capital assets as defined in section 117(a) of the Internal Revenue Code of 1939, (2) property used in trade or business as defined in section 117(j) of the Code, and (3) other property not coming within the provisions of section 117(a) or section 117(j) of the Code as, for example, stock in trade or inventory. For this purpose, records maintained with respect to the business, as well as intangible assets such as goodwill, constitute capital assets. See *Ensley Bank & Trust Co.* v. *United States*, 154 Fed. (2d) 968, certiorari denied, 329 U. S. 732. This is not intended to include records that are in fact inventory or stock in trade. The selling price must be allocated among all the assets sold according to the respective relative values thereof, for example, according to the ratio of the value of each individual asset to the sum total of the values of all the assets sold. See *C. D. Johnson Lumber Corp.* v. *Commissioner*, 12 T. C. 348, acquiescence, C. B. 1950-2, 3. Separate computations must be made of the gain or loss with respect to each asset sold, and the gain or loss in each case must be treated in accordance with the classification of such asset, as described above. See *Aaron F. Williams* v. *McGowan*, 152 Fed. (2d) 570; *Ernest A. Watson* v. *Commissioner*, 345 U. S. 544, Ct. D. 1760, C. B. 1953-1, 179.

REGULATIONS 118, SECTION 39.117(a)-1: Meaning of terms. Rev. Rul. 55-374

(Also Section 44; Regulations 118, Section 39.44-1.)

The sale of all of a taxpayer's rights and interest in a distributorship agreement with a foreign manufacturer constitutes the sale of a capital asset within the purview of section 117(a) of the Internal Revenue Code of 1939 and the gain realized is taxable as a long-term capital gain. Such sale qualifies as a casual sale of personalty on the installment basis within the purview of section 44(b) of the 1939 Code, where less than 30 percent of the sale price is received in the year of the sale.

Advice has been requested whether the sale of all of the taxpayer's rights and interest in a distributorship agreement with a foreign manufacturer constitutes the sale of a capital asset and whether such a sale qualifies as a casual sale of personalty on the installment basis under the provisions of section 44(b) of the Internal Revenue Code of 1939.

In the instant case the taxpayer, who is engaged in the business of acting as representative of foreign manufacturers, was appointed sole agent of a certain foreign company and its subsidiaries with respect to the sale and distribution of their products which were exported to the United States, its territories and possessions. Under powers granted in the agency agreement, the taxpayer appointed a domestic company as his distributor for such products. The agreement is for a term of 20 years unless terminated sooner under its provisions.

The taxpayer sold and assigned all of his rights, title and interest in the original agreement to his distributor. Approximately 10 percent of the agreed purchase price was paid upon execution of the sales agreements, and the balance thereof was paid in the following year. Under the sales agreement, the taxpayer warranted that the original agency agreement was in full force and effect; that he was not in default thereunder; that he had the right to assign all his rights, title and interest in and to such agreement; and, that the expiration date of his rights in and to the agreement remained the same after the assignment.

The purchaser agreed to assume all the obligations to be discharged under the original agreement. The sale covered only the rights of the taxpayer in the original agreement. It did not include any physical assets of his business, inventory, fixtures, or accounts receivable. The taxpayer was to continue his activities in the handling of other foreign products.

Section 117(a) of the Internal Revenue Code of 1939 does not exclude from the term "capital assets" a contract of the type herein concerned, which is sold by a taxpayer who is not, for Federal income tax purposes, a dealer in such contracts.

Section 44(b) of the Internal Revenue Code of 1939 provides in part that in the case of casual sales of personal property if the selling price exceeds $1,000, and the initial payments received in cash or other property, other than evidences of indebtedness of the purchaser, during the taxable period of the sale do not exceed 30 percent of the selling price, the gain realized from such sale may be reported on the installment basis.

Section 39.44–1 of Regulations 118 provides in part that under the installment basis there is reportable as income in any taxable year only that proportion of the installment payments actually received in that year which the gross profit realized or to be realized when payment is completed bears to the total contract price.

In the instant case, the selling price is in excess of $1,000, the initial payment is less than 30 percent of the selling price, and the assets have been held for a period of more than 6 months.

In view of the foregoing, it is held that (1) the sale of all of a taxpayer's rights and interest in a distributorship agreement with a foreign manufacturer constitutes the sale of a capital asset within the purview of section 117(a) of the Internal Revenue Code of 1939 and the gain realized is taxable as a long-term capital gain, and (2) such sale qualifies as a casual sale of personalty on the installment basis within the purview of section 44(b) of the 1939 Code, where less than 30 percent of the sale price is received in the year of the sale.

REGULATIONS 118, SECTION 39.117(b)-1: Deduction for long-term capital gains.

Gain or loss realized by an estate upon the redemption of stock of a corporation. See Rev. Rul. 55-91, page 364.

SECTION 117(f).—CAPITAL GAINS AND LOSSES: RETIREMENT OF BONDS, ETC.

Redemption of National Savings Bonds issued by the United States of Mexico. See Rev. Rul. 55-135, page 213.

Excess of the amount received over the price paid upon retirement of bonds. See Rev. Rul. 55-136, page 213.

SECTION 117(h).—CAPITAL GAINS AND LOSSES: DETERMINATION OF PERIOD FOR WHICH HELD

REGULATIONS 118, SECTION 39.117(h)-1: Determination of period for which capital assets are held. Rev. Rul. 55-68

A partnership is dissolved and its business is converted into a sole proprietorship where one of the partners purchases the partnership interests of all of the other partners. See *Nathan Blum et al.* v. *Commissioner*, 5 T. C. 702. Where a taxpayer purchases the partnership interests of all the other partners in a partnership of which he is a member he becomes the owner of the assets, by purchase as respects the fractional interest attributable to the purchased partnership interests, and, as respects the fraction attributable to his own partnership interest, by liquidation of his partnership interest through an in kind distribution which is an exchange within the meaning of section 117(h)(1) of the Internal Revenue Code of 1939. Accordingly, since in such case the bases of the distributed assets attributable to his partnership interest are determined with reference to section 113(a)(13) of the Code, the taxpayer shall compute the holding period for such property received in liquidation which is attributable to his partnership interest, from the time he acquired his partnership interest. With respect to the assets attributable to partnership interests which he acquired by purchase from the other partners, the holding period of such assets begins from the date on which such partnership interests were purchased. *George H. Thornley et ux.* v. *Commissioner*, 147 Fed. (2d) 416, and *Adam Kessler Jr.* v. *United States*, 124 Fed. (2d) 152.

REGULATIONS 118, SECTION 39.117(h)-1: Determination of period for which capital assets are held. Rev. Rul. 55-352

For the purposes of section 117(h) of the Internal Revenue Code of 1939 relating to the determination of the period for which property

is held, the holding period of timber, acquired by a corporation (transferee) in a nontaxable exchange under section 112(b)(5) of the Code and subsequently cut by such corporation under the elective treatment accorded the cutting of timber under section 117(k)(1) of the Code, includes the period during which such timber was held by the transferor. Compare G. C. M. 25301, C. B. 1947-2, 83.

REGULATIONS 118, SECTION 39.117(h)-1: Determination of period for which capital assets are held.

The holding period of securities acquired by a partnership for a member thereof. See Rev. Rul. 55-39, page 403.

SECTION 117(j).—CAPITAL GAINS AND LOSSES: GAINS AND LOSSES FROM INVOLUNTARY CONVERSIONS 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. Rev. Rul. 55-295

> For Federal income tax purposes, the rights to water, underlying land owned by and used in the taxpayer's trade or business, constitute an interest in "real property." Where the underlying water is used in taxpayer's trade or business and held in excess of 6 months it qualifies as "property used in trade or business" within the meaning of section 117(j) of the Internal Revenue Code of 1939 and any gain or loss on the sale of such water rights is subject to the treatment provided for in that section.

Advice has been requested whether, for Federal income tax purposes, certain water rights underlying land owned by and used together with the underlying water in the trade or business of the taxpayer constitute an interest in real property within the meaning of section 117(j) of the Internal Revenue Code of 1939 and are subject to the treatment provided for in that section.

Taxpayer owns in fee $500x$ acres of land held for more than 6 months which is used in the farming operations of the taxpayer. The taxpayer sold $50x$ acres of perpetual water rights underlying such property by deed at a price of $2x$ dollars per acre. Immediately prior to sale taxpayer used water underlying such 50 acres for irrigation purposes in connection with his farming operations. The deed provides that the taxpayer in consideration for a specified sum does grant, sell and convey to the purchasers all of the water rights in, to and under the land as described in said deed together with the right of ingress and egress for the purpose of exploring, prospecting, drilling for, producing and transporting water.

The grantee also acquires the right to construct, maintain and operate the necessary water wells, pumping plant, water collecting and flow pipe, both above and below the surface, the necessary communi-

cation and control circuits, together with the necessary electric power line and other electric facilities for furnishing power to the pumps and an easement over said land for the purpose of construction, installing, operating and mantaining the facilities.

The grantor reserves the right to use only so much of the water in, under and upon the premises as may be necessary to drill for and produce oil, gas and other minerals, and further reserves the right to use such water for the purpose of normal farming and ranching operations and domestic use but not for irrigation purposes.

Section 117(j) of the Internal Revenue Code of 1939 provides in effect, that gains and losses from transactions covered by that section shall be treated as gains and losses from the sale or exchange of capital assets held for more than 6 months if the aggregate of such gains exceeds the aggregate of such losses. If the aggregate of the gains does not exceed the aggregate of such losses, such gains and losses shall not be treated as gains and losses from the sale or exchange of capital assets.

The same principles can be applied in the instant cases as were applied in I. T. 3693, C. B. 1944, 272, wherein it is held that the interest of a lessee in oil and gas constitutes an interest in "real property" for Federal income tax purposes.

Accordingly, for Federal income tax purposes, the water rights constitute an interest in "real property." Where the underlying water is used in the taxpayer's trade or business and held in excess of 6 months it qualifies as "property used in trade or business" as defined in section 117(j) of the Internal Revenue Code of 1939, and any gain or loss on the sale of such water rights is subject to the treatment provided for in that section.

SECTION 119.—INCOME FROM SOURCES WITHIN UNITED STATES

Regulations 118, Section 39.119(a)-4: Rentals and royalties.

Payments for the right to use manufacturing "know-how." See Rev. Rul. 55-17, page 388.

SECTION 120.—UNLIMITED DEDUCTION FOR CHARITABLE AND OTHER CONTRIBUTIONS

Regulations 118, Section 39.120-1: Unlimited deductions for charitable and other contributions. Rev. Rul. 55-255

If an election is made on the final Federal income tax return of a particular year to have an overpayment of income tax for that year credited against the estimated tax for the succeeding year, and such overpayment is actually claimed and allowed for the succeeding year, the amount of such credit will constitute income tax paid in the succeeding year within the meaning of section 120 of the Internal Revenue Code of 1939 to the extent that the amount paid as estimated tax during such succeeding taxable year does not exceed the tax liability for that year.

Advice has been requested whether a credit by reason of an election made on a final income tax return to have an overpayment credited against estimated tax for the succeeding year will constitute income tax paid in such succeeding year within the meaning of section 120 of the Internal Revenue Code of 1939.

The taxpayer made contributions and gifts as described in section 23(o) of the Code which, when added to the income tax paid by him, equal 90 percent of his net income for each of the last 9 years. During the year 1953, he paid income tax in excess of his tax liability. He elected on his final income tax return to have the overpayment credited against his estimated tax for the succeeding year (1954). The amount of the overpayment, which was claimed and allowed for the succeeding year, does not exceed his succeeding year's income tax liability. If the credit against his estimated tax for the year 1954 constitutes income tax paid within the meaning of section 120 of the Code, he may be in a position to qualify for the unlimited deduction for charitable contributions.

Under the circumstances specified in section 120 of the Code, the 20 percent limitation imposed by section 23(o) of the Code on the deduction for charitable and other contributions is not applicable. Within the meaning of section 120 of the Code, in the case of a taxable year beginning after December 31, 1942, there shall be included in addition to the income, war-profits, and excess-profits taxes paid during such taxable year in respect of preceding taxable years, the amount of income tax paid during such taxable year in respect of such taxable year. For example, there shall be included the amount paid as estimated tax during the taxable year, to the extent such amount does not exceed the tax for such taxable year. See Regulations 118, section 39.120–1(b)(2).

Section 322(a)(3) of the Code provides in part as follows:

> The Commissioner is authorized to prescribe, with the approval of the Secretary, regulations providing for the crediting against the estimated tax for any taxable year of the amount determined by the taxpayer or the Commissioner to be an overpayment of the tax for a preceding taxable year.

The provisions of Regulations 118, section 39.322–3(a)(3), interpreting the above section of the Code further add 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.

Accordingly, it is held that if an election is made on the final Federal income tax return of a particular year to have an overpayment of income tax for that year credited against the estimated tax for the succeeding year, and such overpayment is actually claimed and allowed for the succeeding year, the amount of such credit will constitute income tax paid in the succeeding year within the meaning of section 120 of the Code to the extent that the amount paid as estimated tax during such succeeding taxable year does not exceed the tax liability for that year.

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REGULATIONS 118, SECTION 39.120-1: Unlimited deduction for charitable and other contributions.

Definition of the provision "income tax paid." See Rev. Rul. 55-308, page 30.

SECTION 122.—NET OPERATING LOSS DEDUCTION

REGULATION 111, SECTION 29.122-4: Computation of net operating loss carryovers and net operating loss carrybacks. Ct. D. 1785

EXCESS PROFITS TAX—INTERNAL REVENUE CODE—DECISION OF SUPREME COURT

1. NET OPERATING LOSS ADJUSTMENT FOR EXCESS PROFITS TAXES "PAID OR ACCRUED."

An accrual basis taxpayer cannot, in computing its net operating loss for 1946 to be carried back as a deduction against 1944 income, increase that operating loss by the amount of excess profits taxes paid in 1946 but which had accrued in 1945. Section 122(d)(6) of the Internal Revenue Code of 1939 does not grant a taxpayer an option to take deductions on a basis that is inconsistent with the method of accounting which it employs.

2. JUDGMENT REVERSED.

Judgment of the United States Court of Claims, 108 F. Supp. 109, 110 F. Supp. 600, reversed.

SUPREME COURT OF THE UNITED STATES

The United States, petitioner, v. *Olympic Radio and Television, Inc.*

On writ of certiorari to the United States Court of Claims

[May 23, 1955]

OPINION

Mr. Justice DOUGLAS delivered the opinion of the Court.

This suit was brought in the Court of Claims for a tax refund. The taxpayer, a New York corporation, kept its books and accounts on the accrual basis and filed its federal income tax returns on the same basis, using the calendar year. The taxpayer had a net operating loss of $310,872.60 for 1946. This loss was carried back and set off against the taxpayer's excess profits net income for 1944 and its excess profits tax for 1944 was adjusted accordingly. That carryback was authorized by the Internal Revenue Code of 1939, section 122; and it is not in controversy here.

The taxpayer reported an excess profits tax liability of $346,643.22 for 1945. In 1946 the taxpayer paid $263,272.80 in excess profits taxes for 1945. It contends that that amount, paid in 1946, should have been added to the net operating loss of $310,872.60 for that year and the sum of those figures, instead of $310,872.60, should have been carried back to 1944 as a net operating loss. If that should have been done, the United States would now owe the taxpayer the refund claimed.

The Court of Claims, by a divided vote, sustained the taxpayer's contention and held that in computing its net operating loss for 1946, the taxpayer was entitled to include the amount of excess profits tax paid in 1946 on account of its 1945 return. Judgment was accordingly entered for the taxpayer. 108 F. Supp. 109, 110 F. Supp. 600. The case is here on a petition for a writ of certiorari which we granted (348 U. S. 808), because of a conflict between the decision below and *Lewyt Corp.* v. *Commissioner*, 215 F. 2d 518, decided by the Court of Appeals for the Second Circuit.

Section 23(s) of the Internal Revenue Code provides that in computing net income "the net operating loss deduction computed under section 122" shall be allowed as a deduction. Section 122, as applicable here, provides a complicated formula for carrying net operating losses back for 2 preceding taxable years and over into the 2 succeeding taxable years, thus taking for the limited purpose of section 122 a 5-year period as the accounting unit. The part of section 122 of which the taxpayer seeks to take advantage is (b)(1) relating to the carryback.* By the express terms of section 122(b)(1) the carryback provisions are subject to the limitations contained in section 122 (d)(6), which provides in part, "There shall be allowed as a deduction the amount of tax imposed by Subchapter E of Chapter 2 paid or accrued within the taxable year. * * *" Subchapter E of Chapter 2 identifies the tax which may be used as a deduction as the Excess Profits Tax. But if it is to be used as a deduction, the tax must have been "paid or accrued" within the taxable year.

The controversy here revolves around the meaning of "paid or accrued." The years 1944 and 1945 were years of profit for the taxpayer. The years 1946 and 1947 were years of loss. The taxpayer kept its books and filed its returns on the accrual basis of accounting. Its 1945 excess profits tax therefore accrued in 1945, though it was paid in 1946. Yet the argument which prevailed below is that the tax paid in 1946 on account of the liability for 1945 could be used under section 122(d)(6) as a net operating loss for 1946. We take the other view and conclude that section 122(d)(6) does not grant a taxpayer an option to take deductions on a basis that is inconsistent with the method of accounting which it employs.

Section 41 states the general rule that net income shall be computed "in accordance with the method of accounting regularly employed in keeping the books" of the taxpayer.

Section 43 provides that deductions and credits may be taken "for the taxable year in which 'paid or accrued' or 'paid or incurred,' dependent upon the method of accounting upon the basis of which the net income is computed, unless in order to clearly reflect the income the deductions or credits should be taken as of a different period."

Section 48 provides, "When used in this chapter * * * (c) The terms * * * 'Paid or Accrued' shall be construed according to the method of accounting upon the basis of which the net income is computed under this Part." This provision of section 48 would itself seem to be conclusive of the question since section 122 is "in this chapter" to use the language of section 48. And section 48, together with section 41 and section 43, seem to indicate that the words "paid or accrued" have only one meaning throughout the chapter, not the changeable meaning which the taxpayer seeks to give them.

We deal here with a deduction which one obtains not as of right, but as of grace. *Deputy* v. *DuPont*, 308 U. S. 488, 493 [Ct. D. 1435, C. B. 1940–1, 118]. The taxpayer has the burden to show that it is within the provision allowing the deduction. But the effort here made, if successful, would cause "paid or accrued," as used in section 122(d)(6), to mean something different than it does in other sections of the same chapter; and that would fly in the face of the express command of section 48.

The Court of Claims recognized the force of this analysis, but concluded that Congress could not have meant what it said because, if so, this particular carryback provision would have little application. First, most corporations are on the accrual not the cash basis. Second, if an accrual taxpayer is limited in its deductions to excess profits taxes accrued within the taxable year, the provision has little value since there is "rarely a case when a taxpayer would be liable for any excess profits tax in a year in which it had sustained a net operating loss * * *." 108 F. Supp. 111. This taxpayer argues the inequity of the results which would follow from our construction of the Code. But as we have said before, "general equitable considerations" do not control the question of what deductions are permissible. *Deputy* v. *DuPont*, *supra*, 493. It may be that Congress granted less than some thought or less than was originally in-

*Section 122(b)(1) is entitled "Net operating loss carryback" and reads as follows:
"If for any taxable year beginning after December 31, 1941, the taxpayer has a net operating loss, such net operating loss shall be a net operating loss carryback for each of the 2 preceding taxable years, except that the carryback in the case of the 1st preceding taxable year shall be the excess, if any, of the amount of such net operating loss over the net income for the 2nd preceding taxable year computed (A) with the exceptions, additions, and limitations provided in subsection (d) (1), (2), (4), and (6), and (B) by determining the net operating loss deduction for such second preceding taxable year without regard to such net operating loss."

tended. We can only take the Code as we find it and give it as great an internal symmetry and consistency as its words permit. We would not be faithful to the statutory scheme, as revealed by the words employed, if we gave "paid or accrued" a different meaning for the purposes of section 122(d)(6) than it has in the other parts of the same chapter.

Our construction is in harmony with the general rule that a taxpayer on an accrual basis must take deductions in the year of accrual. See *Security Mills Co.* v. *Commissioner*, 321 U. S. 281 [Ct. D. 1603, C. B. 1944, 526.]

The fact that the construction we feel compelled to make favors the taxpayer on the cash basis and discriminates against the taxpayer on the accrual basis may suggest that changes in the law are desirable. But if they are to be made, Congress must make them.

Reversed.

Mr. Justice Harlan took no part in the consideration or decision of this case.

Regulations 111, Section 29.122-4: Computation of net operating loss carryovers and net operating loss carrybacks. Ct. D. 1786

EXCESS PROFITS TAX—INTERNAL REVENUE CODE—DECISION OF SUPREME COURT

1. Net Operating Loss Adjustment for Excess Profits Taxes "Paid or Accrued."

Under Sections 122(a) and 122(d)(6) of the Internal Revenue Code of 1939, in determining the amount of the net operating loss for 1946 to be carried back as a deduction against 1944 income, a taxpayer on the accrual basis cannot increase that operating loss by the amount of excess profits taxes which were paid in 1946 but which had accrued in 1945. *United States* v. *Olympic Radio and Television, Inc.* (Sup. Ct. Op. 5/23/55) followed.

Under Sections 122(b)(1) and 122(d)(6) of the Internal Revenue Code of 1939, in determining the amount of the net operating loss for 1946 to be carried back as a deduction against 1945 income, the excess profits tax to be offset against 1944 net income is the amount which taxpayer reported on its return where such amount is arrived at by proper application of recognized accounting principles on the accrual basis, and not the amount ultimately found to be due.

2. Decision Affirmed in Part and Reversed in Part.

Decision of the United States Court of Appeals for the Second Circuit, 215 F. 2d 518, affirmed in part and reversed in part.

Supreme Court of the United States

Lewyt Corporation (now known as Lewyt Manufacturing Corporation), petitioner, v. *Commissioner of Internal Revenue*

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

[May 23, 1955]

OPINION

Mr. Justice Douglas delivered the opinion of the Court.

This case is a companion case to *United States* v. *Olympic Radio & Television, Inc.*, just decided. The main point in the 2 cases is the same—whether a taxpayer on the accrual basis can, in computing its net operating loss for 1 year, deduct the amount of excess profits taxes which were paid in that year but had accrued in an earlier year.

The years 1944 and 1945 were years of profit for the taxpayer. For the years 1946 and 1947, the taxpayer incurred net operating losses which were allowed by the Commissioner as carryback deductions to the years 1944 and 1945. The taxpayer sought to augment its net operating loss for 1946 by the amount of excess profits taxes which it paid in 1946 on account of its 1945 excess profits tax liability. The Commissioner disallowed the deduction and the Tax Court sustained the Commissioner. 18 T. C. 1245. The Court of Appeals affirmed.

215 F. 2d 518. The case is here on a petition for certiorari which we granted (348 U. S. 895) to resolve the conflict with the *Olympic Radio* case. Our views, as expressed in the latter case, coincide with those of the Court of Appeals. Accordingly, we affirm that part of the judgment.

There is present in this case a point not involved in the *Olympic Radio* case. The question is whether the excess profits tax that may be offset against 1944 net income is the amount of excess profits tax reported for the year in question or the amount ultimately found to be due. The taxpayer claims it is the former; the Commissioner, the latter.

The question centers on section 122(b)(1) and section 122(d)(6). As we have seen in the *Olympic Radio* case, section 122(b)(1) directs that the net operating loss for a given year be carried back to the two preceding taxable years.* And section 122(d)(6) allows as a deduction "the amount of tax *imposed by* Subchapter E of Chapter 2 [*i. e.*, the excess profits tax] paid or *accrued* within the taxable year * * *." (Italics added.)

The taxpayer's net income for 1944, as shown by its return, was $827,852.99; and, as finally determined, was $584,866.81. The excess profits tax due according to its 1944 return was $625,561.59. The Commissioner, after allowing as a deduction a net operating loss carryback of $164,326.38 arising in 1946, and making other adjustments, ultimately determined the taxpayer's excess profits tax liability for 1944 to be $280,540.33. The Commissioner computed the net income for 1944 at $304,326.48, that is, $584,866.81 minus $280,540.33. Since the net operating loss of $164,326.38 was less than $304,326.48, there was no loss to be carried back to 1945, as section 122(b)(1) provides "* * * that the carryback in the case of the first preceding taxable year shall be the excess, if any, of the amount of such net operating loss over the net income for the second preceding taxable year * * *."

The taxpayer, however, contends that the excess profits tax "accrued" in 1944 is the tax shown on its return for that year, *viz.*, $625,561.59. If this larger amount is the correct figure, then the deduction allowed against 1944 income will be so great as to leave a carryback which can be deducted against 1945 income.

The controversy turns on the meaning of the clause in section 122(d)(6) which reads, "the amount of tax imposed by Subchapter E of Chapter 2 * * * accrued within the taxable year * * *." The Commissioner contends that the tax "imposed" is the tax ultimately determined to be due. The argument is that the taxpayer having once got back, through credit or refund, the difference between the amount of the tax "accrued" in 1944 and the amount finally determined to be due, no double benefit should be inferred. The double benefit, it is argued, should certainly be denied when the figure upon which it is based has no economic reality.

But the rule that general equitable considerations do not control the measure of deductions or tax benefits cuts both ways. It is as applicable to the Government as to the taxpayer. Congress may be strict or lavish in its allowance of deductions or tax benefits. The formula it writes may be arbitrary and harsh in its applications. But where the benefit claimed by the taxpayer is fairly within the statutory language and the construction sought is in harmony with the statute as an organic whole, the benefits will not be withheld from the taxpayer though they represent an unexpected windfall. See *Bullen* v. *Wisconsin*, 240 U. S. 625, 630.

When Congress wrote the word "imposed" into section 122(d)(6), it might have used it in one of two different senses—either to identify the tax; or to define the amount of the tax that is to be levied and collected. We think that Congress used "imposed" in the former sense.

In the first place, the deduction allowed by section 122(d)(6) is not the tax "imposed" by Subchapter E of Chapter 2. It is "the amount of tax imposed by Subchapter E of Chapter 2 * * * accrued within the taxable year." The word "imposed" when used in conjunction with "accrued" makes tolerably clear that "imposed" merely identifies or describes the tax that "accrued." That is

*Section 122(b)(1) provides:
"If for any taxable year beginning after December 31, 1941, the taxpayer has a net operating loss, such net operating loss shall be a net operating loss carryback for each of the 2 preceding taxable years, except that the carryback in the case of the 1st preceding taxable year shall be the excess, if any, of the amount of such net operating loss over the net income for the 2nd preceding taxable year computed (A) with the exceptions, additions, and limitations provided in subsection (d) (1), (2), (4), and (6), and (B) by determining the net operating loss deduction for such 2nd preceding taxable year without regard to such net operating loss."

to say, the sentence as a whole indicates that "imposed" is used merely by way of reference. It seems clear that Congress had that understanding. The Senate Finance Committee reported:

> "Section 122 of the Code, relating to computation of the net operating loss deduction allowed by section 23(s) of the Code, is amended so as to allow the excess profits tax paid or accrued within taxable years (subject to certain rules) as a deduction in computing net operating loss for, and net operating loss carryover and carryback from, such taxable years." S. Rep. No. 1631, 77th Cong., 2d Sess., p. 67. And see H. R. Rep. No. 2333, 77th Cong., 2d Sess., p. 65.

That indicates that the test of deductibility under section 122(d)(6) is whether the tax "accrued" within the taxable year.

Secondly, the general section dealing with deductions, section 23, allows deductions for taxes paid or accrued during the taxable year, with certain specified exceptions. Section 23(c). Some of the excepted taxes are identified by well-known names, *e. g.*, federal income taxes, estate, inheritance, legacy, succession, and gift taxes. See section 23(c)(1)(A), (D). Other taxes excepted are identified by reference to the taxes "imposed" by certain provisions of the law. Thus section 23(c)(1)(B) excepts "war-profits and excess profits taxes imposed by * * * Subchapter E of Chapter 2." The applicable Treasury Regulation indicates that the word "imposed" identifies the tax. It provides "Subject to the exception stated in this section * * * taxes imposed by the United States * * * are deductible from gross income for the year in which paid or accrued." 26 CFR section 39.23(c)-1.

Section 23 is especially relevant here, since the language of section 122(d)(6) was taken almost verbatim from section 23. That section as amended by the Revenue Act of 1941 had provided that, in computing net income, a deduction for taxes "paid or accrued within the taxable year" should be allowed.

As respects the excess profits tax, section 23(c)(2) provided:

> "For the purposes of this subsection, in the case of the excess profits tax *imposed* by Subchapter E of Chapter 2—
>
> "(A) The deduction shall be limited to the *tax imposed* for the taxable year * * *." (Italics added.)

It would seem that (A) would have limited the section 122(d)(6) adjustment to the tax finally paid. But (A) was omitted from section 122(d)(6). The word "imposed" as used in the quantitative sense was dropped, while the word "imposed" as used to identify the tax was retained.

Finally, the tax that "accrued" within a given year is not the tax finally determined to be due but the tax before ultimate adjustments are made. That is elementary in tax law. See *Security Flour Mills Co.* v. *Commissioner*, 321 U. S. 281, 284 [Ct. D. 1603, C. B. 1944, 526]. It would seem therefore that the concept "accrued" embodies the annual accounting principle. If, in case of a taxpayer on an accrual basis, events after the taxable year are taken into account, the word "accrued" would be effectively read out of section 122(d)(6) or given a varied meaning, contrary to our ruling in the *Olympic Radio* case.

It is true that the computations under section 122 are designed to spread losses over a 5-year period. But we are concerned with a technical concept that is being used as the basis of the formula for that reallocation. We find no justification for taking "accrued" as used in section 122(d)(6) to mean one thing in the setting of the *Olympic Radio* case and another in this situation.

Our conclusion is in accord with a line of related decisions. The whole tax scheme has been posited on the basis that the duty to pay is without regard to the deduction made available by the carryback. See *Manning* v. *Seeley Tube & Box Co.*, 338 U. S. 561, 567 [Ct. D. 1729, C. B. 1950-1 113]. Only recently we applied that principle to the excess profits tax. In *United States* v. *Koppers Co.*, 348 U. S. 254 [Ct. D. 1781, page 435, this Bulletin], we held that these taxes were payable in full the year when they were due and that interest was payable on the amounts so due, even though ultimately portions of the taxes were abated.

In short, the amount of tax accrued within the taxable year under section 122(d)(6) is to be determined in accord with the normal accounting concepts relevant to the accrual basis. That amount is not, of course, to be ascertained solely by reference to the figure set forth in the taxpayer's return, for that figure may be erroneously computed on the accrual basis. But when an amount is arrived at by proper application of recognized accounting principles on the accrual basis, the test of section 122(d)(6) has been met. Events and transactions of later years, irrelevant to a determination of income on the accrual

basis, do not warrant alteration of the figure computed under section 122(d)(6) for the year in question.

Affirmed in part and reversed in part.

Mr. Justice HARLAN took no part in the consideration or decision of this case.

SECTION 124A(b).—AMORTIZATION DEDUCTION: ELECTION OF AMORTIZATION

REGULATIONS 118, SECTION 39.124A (b)-1: Election of amortization. Rev. Rul. 55-223

> Where an emergency facility, as defined in section 124A(d) of the Internal Revenue Code of 1939, consists of two units, the use of one of the units, before completion of construction work common to both units, on an emergency basis for purposes other than those for which the facility was certified does not operate to constitute the unit in use a separate emergency facility.

Advice has been requested whether the use of one uncompleted unit of a two-unit emergency facility, as defined in section 124A(d)(1) of the Internal Revenue Code of 1939, on an emergency basis for purposes other than those for which the facility was certified will operate to constitute the unit in use a separate emergency facility.

The facility covered by the certificate of necessity consists of a power house building, two generating units, boiler plant equipment, fuel handling equipment, and other equipment essential to the generation of electric power by the two units. A substantial portion of the construction work is common to both generating units.

In December 1953, the first generating unit was placed in operation on an emergency basis, without all parts and controls thereof being completed, to furnish emergency electric power to meet requirements resulting from the influx of imported workers engaged in construction of another project and to furnish construction power to the project of which this unit was a part. On January 1, 1954, there was work uncompleted common to both units. The entire facility was completed in June 1954. The returns of the taxpayer are filed on a calendar year basis.

Based on the foregoing facts, it is held that the establishment of emergency power from one of the generating units before completion for purposes other than those certified, as stated herein, does not operate to constitute that generating unit a separate emergency facility completed prior to January 1, 1954, within the meaning of section 124A of the Code of 1939.

SECTION 125(a).—AMORTIZABLE BOND PREMIUM: GENERAL RULE

REGULATIONS 118, SECTION 39.125(a)-1: In general. Rev. Rul. 55-353

Where bonds of the type defined in section 125(d) of the Internal Revenue Code of 1939, the interest from which is wholly taxable, were sold by a taxpayer at a profit and immediately thereafter the same kind of bonds were purchased at a premium, the taxpayer may elect, with respect to the bonds so purchased, to make an adjustment

to the bases of the bonds for the amortizable bond premium. The amount of the amortization attributable to the taxable year constitutes an allowable deduction from gross income under section 39.125(a)-1(b)(1) of Regulations 118.

SECTION 127(a).—WAR LOSSES: CASES IN WHICH LOSS DEEMED SUSTAINED, AND TIME DEEMED SUSTAINED

REGULATIONS 111, SECTION 29.127(a)-3: Property in enemy countries and enemy controlled areas.

War losses sustained on property within or under the control of a country at war with the United States. See Rev. Rul. 55-239, below.

REGULATIONS 111, SECTION 29.127(a)-4: Investments referable to destroyed or seized property. Rev. Rul. 55-239

(Also Section 29.127(a)-3.)

Austrian I. B. A. 7 percent bonds and Dosave Aktien Railroad stock held by a taxpayer on December 11, 1941, are properties which are considered as having been destroyed or seized on that date (the date war with Germany was declared by the United States) within the meaning of section 127 of the Internal Revenue Code of 1939, relating to war losses, and the provisions of that section are applicable in respect of such losses, notwithstanding the fact that the securities were held on that date in a neutral country in the name of a nominee of the true owner.

SECTION 130.—LIMITATION ON DEDUCTIONS ALLOWABLE TO INDIVIDUALS IN CERTAIN CASES

REGULATIONS 118, SECTION 39.130-1: Limitation on deductions allowable to individuals in certain cases. Rev. Rul. 55-120

For the purposes of section 130 of the Internal Revenue Code of 1939 relating to the limitation on deductions allowable to individuals in certain cases, uranium exploration or mining ventures are considered a separate trade or business from that of oil and gas ventures, if, as a fact, it is shown that such ventures are separately conducted and are not closely related with each other. Compare Rev. Rul 55-121, below.

REGULATIONS 118, SECTION 39.130-1: Limitation on deductions allowable to individuals in certain cases. Rev. Rul. 55-121

Where several business activities emanate from a single commodity, such as oil and gas or a tract of land, it does not necessarily follow that such activities are one business for the purposes of

section 130 of the Internal Revenue Code of 1939 relating to the limitation on deductions allowable to individuals in certain cases. Where it is shown that such business activities are separately conducted and are not closely interrelated with each other they are considered as separate business activities for the purposes of section 130 of the Code.

Advice has been requested whether a taxpayer's gross income from the oil and gas business and his income from drilling oil and gas wells for others (contract drilling), whether from his individual, joint venture or partnership operation may, under the following circumstances, be considered as separate businesses for the purposes of section 130 of the Internal Revenue Code of 1939. Advice has been requested whether business activities emanating from a single parcel of land, such as the sale of standing timber, granting of leases for oil and gas minerals, operation of producing oil and gas wells and livestock and farming operations may be considered as separate business activities for the purpose of section 130 of the Code.

Taxpayer, an oil and gas producer, is a partner in a business engaged in contract drilling for others. He is also engaged, in his own individual capacity, in selling oil and gas. Each organization's operations is separately conducted. About 75 percent of the taxpayer's gross income is from the partnership's contract drilling operations for others, approximately 2 percent of which was done for the taxpayer individually, and the remainder of his gross income is primarily from oil and gas sales made on his own account.

The provisions of section 130 of the Code apply to a trade or business carried on by an individual. The activity of developing oil and gas properties and contract drilling activity are related in the sense that they deal with the same commodities—oil and gas. Standing alone, this fact does not make dissimilar business activities one "business" for the purpose of section 130 of the Code. Inherently, the activity of contract drilling is different from the activity of developing oil and gas properties. The first is a service activity in which the income from the business usually bears no relation to the mineral production from properties drilled. The second is a mining activity in which the income is directly proportional to mineral production.

The same would be true with respect to other business activities emanating from a single source. For example, a taxpayer owns a parcel of land and derives income therefrom under a contract for the sale of standing timber whereby the purchaser cuts and hauls the timber. The taxpayer also derives income from granting of leases to oil and gas minerals on such property as well as from producing oil and gas wells which he operates on a portion of the property. In addition he receives income from livestock and farming operations which he conducts on the property. Each of the operations is separately conducted and is related only in the sense that all of them emanate from the exploitation of a single piece of property belonging to the taxpayer.

However, the activities of contract drilling and of developing oil and gas properties are not so unrelated that they may never be carried on so as to constitute one business for the purpose of section 130 of the Code. Nor are the sales of standing timber, granting of leases to oil and gas minerals, operation of producing oil and gas wells, or livestock and farming operations so unrelated that two or more of such

activities may never constitute one business for the purpose of section 130 of the Code. However, whether such activities constitute one or more than one business depends upon whether they are in fact operated primarily as a single unit taking into consideration all pertinent factors. The same principles can be applied here as have been applied in determining whether losses in certain commodity transactions were to be considered losses incurred in taxpayer's regular trade or business or capital items. See G. C. M. 17322, C. B. XV-2, 151 (1936); *Kenneth S. Battelle et al.* v. *Commissioner*, 47 B. T. A. 117, acquiescence, C. B. 1942-2, 2; *Stewart Silk Corp.* v. *Commissioner*, 9 T. C. 174, acquiescence, C. B. 1948-1, 2.

In the instant case, the partnership activities of drilling oil and gas wells for others have no practical relationship to the oil and gas production of the taxpayer individually. The same is true with respect to the activities of selling standing timber, granting mineral leases, operation of producing oil and gas wells, and livestock and farming all conducted on a single parcel of land by the same individual, since each activity is separately conducted and not so interrelated to any other activity or activities so that it may be determined that one or more of such activities constitute one business.

Accordingly, where business activities emanate from a single commodity, such as oil and gas or a tract of land, it does not necessarily follow that such activities are one business for the purposes of section 130 of the Internal Revenue Code relating to the limitation on deductions allowable to individuals in certain cases. Where it is shown that such business activities are separately conducted and are not closely interrelated with each other, they are considered as separate business activities for the purpose of section 130 of the Code.

REGULATIONS 118, SECTION 39.130-1: Limitation on deductions allowable to individuals in certain cases. — Rev. Rul. 55-375

For the purpose of section 130 of the Internal Revenue Code of 1939, relating to the limitation on deductions allowable to individuals in certain cases, the short taxable year required to properly effect a change in accounting period constitutes a taxable year. In determining the excess of deductions over gross income from a business under section 130 of the Code, for the short taxable year, the actual amount of such excess and not any annualized amount shall be taken into account in determining the limitation of $50,000 described in section 130(a) of the Code.

SECTION 130A.—EMPLOYEE STOCK OPTIONS

REGULATIONS 118, SECTION 39.130A-2: Restricted stock option.

Ownership by employee of stock in corporation granting option for the purpose of applying the ten percent ownership rule. See Rev. Rul. 55-104, page 46.

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. 55-414

(Also Section 143; Regulations 118, Section 39.143-9.)

The United States follows the principle that trust income distributable to a nonresident alien beneficiary retains in his hands the same identity as to source and character as the income possessed in the hands of the fiduciary. United States income periodically paid to nonresident alien fiduciaries of a Canadian trust for distribution to beneficiaries residing in the United States, will be deductible by the trust and taxable to the beneficiaries, and each beneficiary shall be entitled to credit the tax withheld which is allocable to the income reportable by him, against the income tax computed on his return.

Advice has been requested whether United States citizens or resident beneficiaries would be entitled to credit for their pro rata share of United States income tax, withheld at the rate of 15 percent from United States interest and dividend income, paid to the trustees of a Canadian trust; whether income so received by the United States resident or citizen beneficiaries of the Canadian trust, would constitute Canadian income for the purpose of computing the allowable credit for Canadian taxes; and whether the beneficiaries who are citizens of the United States would be entitled to credit for the Canadian income tax withheld at the rate of 15 percent from the income distributed to them by the trustees.

The Canadian authorities hold that under their law such income loses its identity as income from United States sources and require that tax be withheld therefrom when distributed by the trustees to the beneficiaries in this country; whereas if the situation were reversed, the United States would follow the principle that trust income distributable to a nonresident alien beneficiary retains in his hands the same identity as to source and character as the income possessed in the hands of the fiduciary. See I. T. 3495, C. B. 1941-2, 195. Thus, a citizen or resident of Canada deriving dividend or interest income from sources within Canada through a trust in the United States would not be subjected to United States income tax on such income.

Under the provisions of section 39.143-9(b) of Regulations 118, tax withheld at the source upon fixed or determinable annual or periodical income paid to nonresident alien fiduciaries is deemed to have been paid by the persons ultimately liable for the tax upon such income.

Accordingly, it is held that income from United States sources which is paid to the trustees of a Canadian trust, who in turn distribute the income currently to beneficiaries residing in the United States, does not lose its character but will be deductible by the trust and taxable to the beneficiaries. Each beneficiary is entitled to credit the

portion of United States tax withheld which is allocable to the income reportable by him. Such income for the purpose of computing the allowable credit for Canadian taxes, constitutes income from United States sources rather than Canadian sources. The actual amount of tax paid to Canada by beneficiaries who are United States residents may be claimed as a credit under section 131(a) of the Internal Revenue Code of 1939, subject to the limitations of Code section 131(b). If the entire income received by a beneficiary consists of dividends and interest from United States sources which has passed through the hands of a Canadian trustee, the beneficiary will not be entitled to credit the Canadian tax on such income against his United States tax, since the numerator of the limiting fraction (which consists of income from within Canada) would be zero.

REGULATIONS 118, SECTION 39.131(a)-1: Analysis of credit for taxes. Rev. Rul. 55-296

The Government of Saudi Arabia by Royal Decree No. 17/2/28/3321, dated November 4, 1950, imposed a general income tax on incomes of individuals and corporations and applies to all persons except those specifically exempted. By Royal Decree No. 17/2/28/7634, dated December 27, 1950, the Government of Saudi Arabia imposed an additional tax on every company registered or required to be registered in accordance with the Decree for the Registration of Companies and engaged in the production of petroleum or other hydrocarbons in the Kingdom of Saudi Arabia. *Held*, both the general income tax and the additional tax imposed under the foregoing Decrees come within the United States concept of an income tax and are allowable as a credit against United States income tax under the provisions of section 131(a) of the Internal Revenue Code of 1939, subject to the limitations of section 131(b) of the Code.

REGULATIONS 118, SECTION 39.131(a)-2: Countries which do or do not satisfy the similar credit requirement. Rev. Rul. 55-16

The United Kingdom satisfies the similar credit requirement of section 131(a)(3) of the Internal Revenue Code of 1939 with respect to taxes paid or accrued during the taxable year to the United Kingdom. Accordingly, a British national residing in the United States is entitled to a credit against his United States income tax, subject to the limitations provided in section 131(b) of the Code, for income taxes paid to the United Kingdom provided he does not elect to use the optional standard deduction in computing his United States tax liability.

SECTION 131(h).—TAXES OF FOREIGN COUNTRIES AND POSSESSIONS OF UNITED STATES: CREDIT FOR TAXES IN LIEU OF INCOME, ETC., TAXES

REGULATIONS 118, SECTION 39.131(h)-1: Meaning of terms.

The Ryukyu Islands, which include Okinawa, are a foreign country. See Rev. Rul. 55-6, page 409.

SUPPLEMENT D.—RETURNS AND PAYMENT OF TAX

SECTION 141.—CONSOLIDATED RETURNS

REGULATIONS 129, SECTION 24.14: Accounting period of an affiliated group. (Also Section 24.32; Section 47, Regulations 118, Section 39.47-2.) Rev. Rul. 55-80

Where a parent corporation has been granted permission to change its accounting period from a fiscal to a calendar year basis to conform with that of its subsidiaries, the requirements of section 24.14(a) of Regulations 129 are considered to have been met. A consolidated return, including the income of the common parent and of the subsidiaries (computed as provided in section 24.32 of Regulations 129), is permitted to be filed for the short period. Each subsidiary is required to file a separate return for the period prior to the start of the short accounting period of the parent corporation. The consolidated net income is required to be annualized in accordance with the provisions of section 47(c) of the Internal Revenue Code of 1939.

SECTION 143.—WITHHOLDING OF TAX AT SOURCE

REGULATIONS 118, SECTION 39.143-1: Withholding tax at source.

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 Federal Republic of Germany, as affected by the income tax convention between the United States and the Federal Republic of Germany. See T. D. 6122, page 641.

REGULATIONS 118, SECTION 39.143-2: Fixed or determinable annual or periodical income.

Payments for the right to use manufacturing "know-how." See Rev. Rul. 55-17, page 388.

REGULATIONS 118, SECTION 39.143-3: Exemption from withholding.

Letters of notification of exemption from withholding tax filed by nonresident aliens pursuant to a tax convention. See Rev. Rul. 55-106, page 102.

REGULATIONS 118, SECTION 39.143–9: Return of income from which tax was withheld.

Income paid periodically to a nonresident alien fiduciary for distribution to resident beneficiaries. See Rev. Rul. 55–414, page 385.

SECTION 144.—PAYMENT OF CORPORATION INCOME TAX AT SOURCE

REGULATIONS 118, SECTION 39.144–1: Withholding in the case of nonresident foreign corporations. Rev. Rul. 55–17

(Also Section 143, Section 39.143–2; Section 119, Section 39.119(a)–4.

That portion of payments made by a domestic corporation to a nonresident foreign corporation, pursuant to a contract which provides for the right to use manufacturing "know-how" and personal services performed outside the United States in connection with the instruction of its employees with respect to such "know-how," which is applicable to the right to use the "know-how" is in the nature of royalty income and subject to withholding of tax at source under section 144 of the Internal Revenue Code of 1939. The portion of such payments applicable to the personal services is not income from sources within the United States and not subject to withholding of tax at source.

Advice has been requested whether payments made by a domestic corporation to a nonresident foreign corporation, for the use of technical knowledge and methods and instruction of its employees in certain techniques in connection with the production of certain chemicals, constitutes income from sources within the United States subject to withholding of tax at source under section 144 of the Internal Revenue Code of 1939.

In the instant case a nonresident foreign corporation, not engaged in trade or business within the United States, possessed certain techniques and methods, commonly referred to as "know-how," for the recovery and purification of certain chemicals, which a domestic corporation wished to apply to commercial production in the United States. A contract was entered into which licensed the domestic corporation to use the technical "know-how" and processes of the foreign corporation for a specified period of time. The foreign corporation would also provide instruction in certain techniques to the employees of the domestic corporation. The contract provided, among other things, that the domestic corporation would pay a specified amount upon execution of the contract; and, after commencement of production, quarterly installments at a rate based on production would be paid for the use of certain processes until a specified amount had been reached. Additional amounts would be paid for services of chemical engineers and similar experts in the country in which the foreign corporation is located.

Section 144 of the Code, relating to payment of corporation income tax at the source, provides in part as follows:

In the case of foreign corporations subject to taxation under this chapter [chapter 1 of the Code] not engaged in trade or business within the United States, there shall be deducted and withheld at the source in the same manner and

upon the same items of income as is provided in section 143 a tax equal to 30 per centum thereof. * * *

Section 39.143-2 of Regulations 118 provides that only fixed or determinable annual or periodical income is subject to withholding. The Internal Revenue Code specifically includes in such income, interest, dividends, rent, salaries, wages, premiums, annuities, compensations, remunerations, and emoluments. But other kinds of income are included, as, for instance, royalties.

The essence of the contract is the making available to the domestic corporation the technical knowledge, methods, experience, that is, the "know-how" of the foreign corporation. While manufacturing "know-how" is of a nonpatentable nature, it is something that its possessor can grant to another for a consideration. The right to use such "know-how" is not materially different from the right to use trade-marks, secret processes and formulae, and, if the right thereto is granted as part of a licensing agreement, it becomes, in effect, an integral part of the bundle of rights acquired under such agreement.

The payments made under the contract are applicable both to the specific rights therein granted, that is, the right to use the "know-how," and to services performed abroad in instructing and training the employees or technicians of the domestic corporation. Such payments should therefore be allocated between the license to use the "know-how" and the personal services. Since the personal services have only nominal value apart from the license to use such "know-how," all but a nominal sum should be allocated to the license.

In view of the above, it is held that the portion of such payments applicable to the rights granted under the contract is in the nature of royalty income, that is, fixed or determinable annual or periodical income from sources within the United States and subject to withholding of tax at source under section 144 of the Code. The portion of such payments applicable to the services performed abroad is not income from sources within the United States and therefore not subject to withholding of tax at source.

REGULATIONS 118, SECTION 39.144-1: Withholding in the case of nonresident foreign corporations.

Release of excess tax withheld, and exemption from, or reduction in rate of, withholding of tax at source in the case of German companies, as affected by the income tax convention between the United States and the Federal Republic of Germany. See T. D. 6122, page 641.

SUPPLEMENT E.—ESTATES AND TRUSTS

SECTION 162.—NET INCOME

REGULATIONS 118, SECTION 39.162-1: Income of estates and trusts. Rev. Rul. 55-38

Where the lifetime income beneficiary of a testamentary trust from time to time gives his written consent, pursuant to the terms of the will,

to pay a certain portion of the trust income to another individual, the amounts so paid will be taxable as income to the beneficiary inasmuch as he, in point of substance, has parted with no substantial interest in property other than the specified payments of income. See *Harrison* v. *Sarah H. Schaffner*, 312 U. S. 579, Ct. D. 1503, C. B. 1941-1, 321. However, in the case of an irrevocable assignment, valid under local law, of trust income for a period of not less than 10 years, such income will be taxable to the assignee, provided the facts are not such as would subject the lifetime income beneficiary (the assignor) to the tax on the income under the principles of section 39.22(a)-21 of Regulations 118, section 167 of the Internal Revenue Code of 1939, *Edward B. Douglas* v. *Willcuts*, 296 U. S. 1, Ct. D. 1041, C. B. XIV-2, 250 (1936), or I. T. 4007, C. B. 1950-1, 11. In such a case the position of the assignor is analagous to that of the grantor of a trust. Under such circumstances, because of the period and character of the assignment, the lifetime income beneficiary will be considered to have made a disposition of a substantial interest in the trust property. See *Edward T. Blair* v. *Commissioner*, 300 U. S. 5, Ct. D. 1205, C. B. 1937-1, 175.

REGULATIONS 118, SECTION 39.162-1: Income of estates and trusts. Rev Rul. 55-92

The terms of a will provide for a trust of the residue of the estate, the income to be paid to the testator's wife and daughter during their lives in the discretion of the trustees. However, the trustees have the power at any time to terminate the trust and pay over and deliver the whole of the income from or corpus of the trust estate within 5 years to certain designated charitable organizations in such proportion as the trustees in their uncontrolled judgment and discretion may determine. *Held*, that a donation to charity out of the gross income of the trust prior to a decision of the trustees to terminate the trust would not be pursuant to the terms of the will creating the trust. Accordingly, the trust estate would not be entitled to the charitable deduction authorized by section 162(a) of the Internal Revenue Code of 1939.

REGULATIONS 118, SECTION 39.162-1: Income of estates and trusts. Rev. Rul. 55-122

Where gifts of income to charity are not specifically provided for in a settlement agreement resulting from the contest of a will, any money received by charity will not be allowable as a charitable deduction under section 162(a) of the Internal Revenue Code of 1939.

Advice has been requested whether any amounts paid to certain charitable organizations pursuant to a settlement agreement resulting from the contest of a will would be allowable as a charitable deduction authorized by section 162(a) of the Internal Revenue Code of 1939.

In the instant case the decedent left two wills. The first will created a trust of the residuary estate for the benefit of a son for life with remainder interest of two-thirds to charity and one-third to grandchildren; the second left the bulk of the estate to certain persons other than the legatees named in the first will. From an order of the pro-

bate court admitting the second will to probate, several appeals were filed by the charities which contested the latter will relying on the first will, and by the heirs who contested both wills, claiming the decedent died intestate. Before judgments were rendered in these suits, a settlement agreement was reached whereby the second will would stand admitted to probate and would be administered as written in all respects, with the exception of the residue. With respect to the residue, the settlement agreement provides that all of the residue of the decedent's estate shall include the net income of the estate and shall be divided, paid over and distributed by the executor among the parties to the agreement. Pursuant to the agreement certain charitable organizations received substantial amounts in settlement of their claims.

The status of charities contesting the probated will was that of legatees under the prior will which they proffered as the decedent's last will. Such status commanded the settlement agreement and was recognized by it. See Rev. Rul. 145, C. B. 1953-2, 273. Accordingly, it is concluded that the settlement agreement takes the place of the will for the purpose of determining the deduction allowable under section 162(a) of the Internal Revenue Code of 1939.

However, since the settlement agreement merely provides that the residue of the estate shall include net income and does not specifically provide for gifts of income to charity, it is held that the charities are pecuniary legatees and any money received by them would not be allowable as a charitable deduction under section 162(a) of the 1939 Code because it was not received in satisfaction of a claim for income. Compare *Estate of Ralph R. Huesman* v. *Commissioner*, 198 Fed. (2d) 133.

REGULATIONS 118, SECTION 39.162-1: Income of estates and trusts. (Also Section 44; Regulations 118, Section 39.44-5.) — Rev. Rul. 55-159

A long-term capital gain was realized on the sale of property forming part of an inter vivos trust. The proceeds of the sale consisted of cash and installment obligations. The capital gain was reported on the installment basis on the fiduciary income tax return. At the termination of the trust the corpus and unpaid installment obligations were transferred to the beneficiary of the trust. *Held*, the distribution of the installment obligations to the beneficiary during the taxable year of the trust effected a "disposition" of such obligations and resulted in accelerating the capital gains tax thereon to the trust. Section 44(d) of the Internal Revenue Code of 1939. Capital gains on unpaid installment obligations distributed to a beneficiary at the termination of a trust are deductible by the trust and taxable to the beneficiary in the taxable year of distribution at the capital gains rate. See I. T. 2589, C. B. X-2, 156 (1931); G. C. M. 24702, C. B. 1945, 241; Rev. Rul. 24, C. B. 1953-1, 263; and *Carlisle* v. *Commissioner*, 165 Fed. (2d) 645. The gain is the difference between the basis of the obligation and the fair market value of the obligation at the time of distribution. The basis of the obligation is 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. See example 2, section 39.44–5 of Regulations 118.

REGULATIONS 118, SECTION 39.162–1: Income of estates and trusts.

Payments made out of a fund which has been set aside out of the net income of an irrevocable trust. See Rev. Rul. 55–286, page 75.

SECTION 165.—EMPLOYEES' TRUSTS

REGULATIONS 118, SECTION 39.165–1: Employees' trusts. Rev. Rul. 55–81

A pension plan of an employer will not fail to meet the requirements of section 165(a) of the Internal Revenue Code of 1939 merely because it covers only the employer's one employee.

Advice has been requested whether a pension plan of an employer for the benefit of his employees will meet the requirements of section 165(a) of the Internal Revenue Code of 1939 if it covers only the employer's one employee.

An employer provides a pension plan for the benefit of his employees at a time when he has but one employee. The pension plan otherwise meets all the requirements of section 165(a) of the Code and the one employee is covered by the plan. Provision for the coverage of additional employees is made in the plan when, and if, they are later employed.

Section 165(a) of the Code refers to a plan of an employer for the exclusive benefit of his employees. Other references in the Code and Regulations 118 pertaining thereto, concerning employees' trusts, are with regard to "employees." This is not considered significant. To attribute such significance to that section of the Code, so as to preclude the establishment by an employer of a plan for his one employee, would be placing a strained interpretation upon those parts of section 165(a) which refer to "employees."

It should be observed, however, that section 39.165–1(a)(4) of Regulations 118 provides in part that if a plan is so designed as to amount to a subterfuge for the distribution of profits to shareholders, even if other employees who are not shareholders are included under the plan, it will not qualify as a plan for the exclusive benefit of employees. All of the surrounding and attendant circumstances and the details of the plan will be indicative of whether it is a bona fide stock bonus, pension, or profit-sharing plan for the exclusive benefit of employees in general. The law is concerned not so much with the form of any plan as it is with its effects in operation. If, therefore, a plan covering only one employee at a particular time is not designed, or is not operated, as a means of siphoning profits to a shareholder-employee, or otherwise limiting participation to an employee within the enumerations with respect to which discrimination is prohibited, it may satisfy the requirement that it be for the exclusive benefit of employees in general.

Accordingly, it is held that where a pension plan meets all other requirements of section 165(a) of the Code, the mere fact that it covers, at a particular time, only the employer's one employee will not, for that reason alone, cause the plan to fail of qualification under that section.

REGULATIONS 118, SECTION 39.165-1: Employees' trusts in general.

Variations in distribution of benefits upon termination of pension plan meeting the requirements of section 165(a) of the Internal Revenue Code of 1939. See Rev. Rul. 55-60, page 37.

REGULATIONS 118, SECTION 39.165-2: Impossibility of diversion under the trust instrument. Rev. Rul. 55-297

An employee's rights under a pension or profit-sharing plan meeting the requirements of section 165(a) of the Internal Revenue Code of 1939 are matters covered by the terms of the plan and/or trust agreement and the provisions of local law. The enforcement of such rights is not a responsibility of, nor within the jurisdiction of, the Internal Revenue Service. The jurisdiction of the Internal Revenue Service with respect to pension, etc., plans is limited to determinations whether the plans meet the applicable requirements of the Internal Revenue Code, whether amounts claimed as deductions from gross income for contributions or payments to or under such plans are allowable, and as to the tax effect upon employees of such contributions to, and the distributions by or pursuant to, such plans or trusts.

Advice has been requested concerning the employee's rights under a pension plan, meeting the requirements of section 165(a) of the Internal Revenue Code of 1939, and the assistance that may be made available from the Internal Revenue Service in the enforcement of such employee's rights.

An employee participant in a pension plan, funded through a trust with a national bank as trustee, separated from the service of his employer and, under the provisions of the plan whereby every employee with 4 years of service who terminates his services prior to age 65 is entitled to a prescribed percentage of the employer's contributions on his behalf, was vested with a certain definite interest in the trust fund. It is claimed, however, that the employer, being unable to control the funds of the trust, demanded that the employee sign over to the employer the funds contributed by the employer because of the employee's separation from service.

An employee's rights under a pension, etc., plan are matters covered by the terms of the plan and/or trust agreement and the provisions of local law in regard thereto. The enforcement of such rights is neither a responsibility of, nor in any respect within the jurisdiction of, the Internal Revenue Service.

The jurisdiction of the Service with respect to pension, etc., plans is limited to determinations whether the plans meet the applicable requirements of the Code, whether amounts claimed as deductions from gross income for contributions or payments to or under such plans are allowable, and as to the tax effect upon employees of such

contributions to, and the distributions by or pursuant to, such plans or trusts. In making such determinations, consideration must be given to the actual operation of the plan, and in a case such as this it would of course be necessary to treat any assignment by the employee to the employer of the employee's vested interest in the trust fund as a reversion to the employer which is prohibited by section 165(a)(2) of the Code.

REGULATIONS 118. SECTION 39.165–4: Discrimination as to contributions or benefits.

Qualification of a pension or profit-sharing plan upon discontinuance of contributions. See Rev. Rul. 55–186, page 39.

REGULATIONS 118, SECTION 39.165–6: Taxability of beneficiary under a trust which meets the requirements of section 165(a). (Also Section 22(b); Regulations 118, Section 39.22(b)(2)–2.) Rev. Rul. 55–298

An employee-participant in a profit-sharing plan and trust, held to meet the requirements of section 165(a) of the Internal Revenue Code of 1939, will not be in receipt of gross income when annuity contracts (as distinguished from contracts containing an element of life insurance) are purchased in his behalf regardless of whether the employee has a vested interest at the time of purchase or the trustee has but limited control over the annuities. Such employee will be in receipt of taxable income when the contracts are surrendered.

Also, where, by reason of the termination of his service, a participant receives his "total distributions payable," which include his annuity contract, and surrenders his contract for its cash value during his taxable year in which the distribution is received, the "long term capital gain treatment" will be accorded such total distribution.

However, "long term capital gain treatment" may not be accorded the proceeds of the contract where the terminating employee defers the surrender of the annuity contract until a taxable year subsequent to the year of its distribution.

The above-stated principles are equally applicable to the beneficiary of a deceased employee, where the distribution has been made by reason of termination of services (i. e. his death while in the service of his employer).

Advice is requested (1) whether an employee is in receipt of gross income as a result of the purchase for him of an annuity contract (as distinguished from a contract containing an element of life insurance) by the trustees under a profit-sharing plan which meets the requirements of section 165(a) of the Internal Revenue Code of 1939, where the employee's rights under the contract are fully vested at the time of the purchase; (2) whether the "long term capital gain treatment" provided in section 165(b) of the Code is accorded where the contract is distributed to the employee (or his beneficiary) by reason of the termination of his services and, in a year subsequent to that in which such distribution is made, the contract is surrendered for its cash value; (3) whether such "long term capital gain treatment" is accorded if the contract is surrendered for its cash value in the year in which distributed to him (or his beneficiary); and (4) whether the

phrase "within one taxable year" contained in section 165(b) of the Code implies that the total distributions payable from a trust exempt under section 165(a) of the Code must be made in the year in which the employee's services are terminated in order to obtain the "long term capital gain treatment."

The profit-sharing plan of the *M* company has been held to meet the requirements of section 165(a) of the Code. Contributions to the trust by the employer are allocated among the participants in accordance with a nondiscriminatory formula and are used to pay premiums under a group annuity contract of the money purchase type, whereby paid-up deferred annuities are purchased for covered employees each year the company makes a contribution to the trust. The rights of each of the participants to the benefits provided for him under the contract are fully vested at the time of purchase (premium payment), except the right to surrender for cash in the event of termination of services within 10 years prior to normal retirement date. If termination of service occurs more than 10 years prior to normal retirement date, the paid-up deferred annuities provided for his benefit will be transferred to the participant, who may surrender them at any time for the cash surrender value thereof. The trustee has no power to cancel or surrender annuities once they are purchased, except he may surrender a participant's annuities for cash upon the participant's termination of service other than by retirement or death.

Section 39.165-6(a)(2) of Regulations 118 provides that, if a trust exempt under section 165(a) of the Code purchases an annuity contract for an employee and distributes it to the employee in a year for which the trust is exempt, the contract containing a cash surrender value which may be available to the employee by surrendering the contract, such cash surrender value will not be considered income to the employee unless and until the contract is surrendered.

Section 165(b) of the Code provides that if a trust exempt under section 165(a) of the Code pays to a distributee within one taxable year of the distributee the total distributions payable with respect to the employee, on account of the employee's separation from the service, the amount of such distribution, to the extent it exceeds the amounts contributed by the employee, shall be considered a gain from the sale or exchange of a capital asset held for more than 6 months.

Accordingly, where a trust, exempt under the provisions of section 165(a) of the Code, purchases an annuity contract (as distinguished from a contract containing an element of life insurance) for a participating employee, such employee is not in receipt of gross income by reason of such purchase, even though the employee has a vested interest in the contract at the time of purchase or the trustee has a limited control over the contract. Neither is the employee (or his beneficiary) in receipt of gross income in the taxable year in which such contract is distributed to him, by reason of such distribution, but is taxable when the contract is surrendered.

Since section 165(b) of the Code provides that the amounts distributed or made available to any distributee of a trust exempt under section 165(a) of the Code shall be taxable to him in the year in which so distributed or made available, and since the "long term capital gain treatment" is accorded only where the "total distributions pay-

able" are paid in one year by reason of the employee's separation from the service, such "long term capital gain treatment" is not applicable to a year subsequent to the year of distribution of the contract. Furthermore, the proceeds of the annuity contract surrendered in a year subsequent to its distribution by the trust are not paid "on account of the employee's separation from the service."

Where (1) the "total distributions payable," with respect to an employee participating in a trust exempt under section 165(a) of the Code, are distributed to a distributee (employee or his beneficiary) on account of the employee's separation from the service, (2) such "distributions payable" are in the form of an annuity contract, and (3) the distributee surrenders the annuity contract for its cash value during the taxable year in which the contract is distributed to him, then the deferment of taxation permitted by section 39.165–6(a)(2) of Regulations 118, is not applicable, but the distribution, represented by the proceeds of the annuity contract, is treated as a long term capital gain, since surrender of the contract during the year of its receipt from the trust has the same effect as a distribution by the trust in the form of cash.

REGULATIONS 118, SECTION 39.165–6: Taxability of beneficiary under a trust which meets the requirements of section 165(a). Rev. Rul. 55–354

A method of determining net unrealized appreciation, under section 165(b) of the Internal Revenue Code of 1939, on stock of a corporation which is distributed under an employees' savings plan, held to meet the requirements of section 165(a) of the Code, wherein the amounts of increase or decrease in the value of a participant's account at the time of conversion from one optional investment method to another are included in the total amount credited to the participant, is held to correctly reflect such "net unrealized appreciation" and the cost or other basis to the trust of the stock distributed, within the meaning of subparagraph (c) of section 39.165–6(b)(2)(ii) of Regulations 118.

Advice has been requested with regard to the method of determining the "net unrealized appreciation" within the meaning of that term as used in section 165(b) of the Internal Revenue Code of 1939, where common stock of the employer corporation is distributed to a participant under a profit-sharing plan designated as "an employees' savings plan" sponsored by the employer.

Under the provisions of an employees' saving plan, held to meet the requirements of section 165(a) of the Code as a qualified profit-sharing plan, each eligible employee is entitled to allot not more than 5 percent of his salary to be paid into the trust. For each participant the employer contributes an amount equal to 50 percent of the employee's allotment. Subject to certain limitations the sum of the employee's allotment and the employer's contribution is invested by the trustee, in accordance with the participant's direction in one or more of the following investment options, provided that if more than one option shall be designated, the total of a participant's allotments

and employer contributions shall be allocated in multiples of 10 percent but not less than 30 percent in any one option:

Option A.—An unsegregated fund invested solely in common stock of the employer held in the name of the trustee.

Option B.—An unsegregated fund invested in a diversified portfolio of stocks and other securities selected by and held in the name of the trustee.

Option C.—An unsegregated fund invested in United States Government securities selected by and held in the name of the trustee.

Option D.—United States Savings Bonds, Series E, registered in the name of the participant and held by the trustee.

A participant may change his investment direction on any plan anniversary date or concurrently with a conversion of investment. A participant has the right once in each plan year to convert all or a specified part of the funds in his account under any investment option or options to an investment in one or more of the other investment options. In effecting a conversion, the value of the converted part of a participant's account is converted into cash. Normally such conversions will be effected without sale of any securities, but in an unusual situation sale of securities might be necessary. The amount of cash is determined by multiplying the number of units credited to his account in the fund being converted by the value of each unit on the monthly value determination date following the date the trustee is advised. The number of units of the fund into which the investment is converted which are acquired depends upon the value of such units on the value determination date.

The value determination date is the last day of each calendar month on which business is transacted on the New York Stock Exchange. The total value of all the stock in the fund on that date including shares purchased with dividends, plus the amount of any uninvested cash, is divided by the total number of units theretofore credited to all participants. Each participant is credited with the number of units which his allotment and company contributions during that month will purchase on the basis of such unit value.

Section 165(b) of the Code relates to the taxability of the beneficiary in regard to amounts distributed by a trust meeting the requirements of section 165(a) of the Code and provides in part that

* * * if the total distributions payable with respect to any employee are paid to the distributee within one taxable year of the distributee on account of the employee's separation from the service, the amount of such distribution to the extent exceeding the amounts contributed by the employee, shall be considered a gain from the sale or exchange of a capital asset held for more than 6 months. Where such total distributions include securities of the employer corporation, there shall be excluded from such excess the net unrealized appreciation attributable to that part of the total distributions which consists of the securities of the employer corporation so distributed. The amount of such net unrealized appreciation and the resulting adjustment to basis of the securities of the employer corporation so distributed shall be determined in accordance with regulations which shall be prescribed by the Secretary. * * * In no event shall the amount actually distributed or made available to any distributee include net unrealized appreciation in securities of the employer corporation attributable to the amount contributed by the employee. Such net unrealized appreciation and the resulting adjustments to basis of such securities shall also be determined in accordance with regulations which shall be prescribed by the Secretary.

Under Regulations 118, subsection (b) (2) of section 39.165–6 provides that in determining the net unrealized appreciation in securities of the employer corporation distributed by the trust, reference will be made to the cost or other basis to the trust of such securities and to the market value of such securities at the time of distribution. In a distribution consisting in part of securities which have appreciated in value and in part of securities which have depreciated in value, the net unrealized appreciation shall be the net increase in value of all of the securities included in the distribution. Two or more distributions made by a trust to a distributee in a single taxable year of the distributee are treated as a single distribution.

Determination of the cost or other basis is made by whichever of the following rules is applicable:

(a) In the case of purchases earmarked for the account of a particular employee so that the cost or other basis is reflected in the employee's account, such cost or other basis is used.

(b) Where the trust allocates among the accounts of participating employees, at the close of each taxable year or other specified period, all securities acquired by the trust during the year (exclusive of securities unallocated under a plan providing for allocation in whole shares only) the cost or other basis shall be the average cost or other basis of all securities of the same type which were purchased or otherwise acquired by the trust during such allocation period. For determining the average cost in a subsequent allocation, the actual cost of securities unallocated at the close of a prior allocation period shall be the average cost or other basis of securities of the same type allocated as of the close of such prior allocation period.

(c) In a case where neither (a) nor (b) is applicable, if the trust fund or a specified portion thereof, is invested exclusively in one particular type of security of the employer corporation, and if during the period the distributee participated in the plan none of such securities has been sold except for the purpose of paying benefits under the trust or to enable the trustee to obtain funds with which to exercise rights which have accrued to the trust, the cost or other basis to the trust of all securities distributed to such distributee shall be the total amount credited to the account of such distributee (or such portion thereof as was available for investment in such securities) reduced by the amount available for investment but uninvested on the date of distribution. If at the time of distribution to a particular distributee a portion of the amount credited to his account is forfeited, appropriate adjustment shall be made with respect thereto in determining the cost or other basis to the trust of the securities distributed.

(d) In all other cases, the average cost (or other basis) to the trust is used.

Under the instant plan, no stock is earmarked for the account of a particular employee at the time of purchase by, or contribution to, the trust. The trust does not allocate the stock among the accounts of participating employees as of the close of any taxable year or any other specified period of time. No allocation of stock is made except

in connection with withdrawals. Thus, neither subparagraph (a) nor subparagraph (b) of section 39.165-6(b)(2)(ii) of Regulations 118 (as outlined in subparagraphs (a) and (b) of the next preceding paragraph) are applicable.

For purposes of determining net unrealized appreciation in securities of the employer corporation which are included in a total distribution under the plan, the credits to a participant's account shall include, in addition to all allotments and contributions, the net amount of the increase or decrease in the value of the converted part of the account at the time of the last prior conversion or reconversion of a part or all of the account from one option to another option. On this basis, the amount of any such net increase would be included in the total amount credited to the account of the distributee. This would mean that the amount of unrealized appreciation would be reduced by any increase in the value of the account existing at the time of conversion with an equivalent increase in the taxable amount.

The method of determining net unrealized appreciation in securities of the employer corporation which are included in a total distribution under the plan, and the amount of such distribution subject to tax at the time the distribution is made, is illustrated by the following example:

An employee with an annual salary of $3,600 allots 5 percent of his salary or $180 per year to the trust. The employer contributes an additional 50 percent of the employee's allotments or $90 per year. The employee elects Option A (common stock of the employer) and after 10 years of participation exercises the right to convert to Option B (diversified stocks). After further participation for a period of 3 years under Option B the employee exercised the right to reconvert to Option A. Upon completion of another 5 years of participation under Option A the employee retires and elects to receive the common stock of the employer. The amounts credited to the account of the employee at the times of conversion, reconversion and retirement are shown in the following tabulation:

	Value of employee's account		
	At time of conversion from Option A to Option B after 10 years of participation	At time of reconversion from Option B to Option A after 13 years of participation	At time of retirement after 18 years of participation
Employee's allotments	$1,800	$2,340	$3,240
Employer's contributions	900	1,170	1,620
Total	$2,700	$3,510	$4,860
Valuation at Value Determination Date	4,050	6,000	11,250
Increase in value	$1,350	$2,490	$6,390

The total value of the employee's account at the final value determination date represents 150 shares of the employer's common stock valued at $75 per share. In the determination of the net unrealized

appreciation in securities of the employer corporation at the time of retirement the following tabulation would be made:

Value of employee's account at time of distribution			$11,250
Less: Value of account at time of reconversion to Option A:			
Employee's allotments	$2,340		
Employer's contributions	1,170		
Increment realized as a result of such reconversion	2,490	$6,000	
Cost during final period of participation under Option A:			
Employees allotments	$900		
Employer's contributions	450	1,350	7,350
Amount of net unrealized appreciation			$3,900
Value of employee's account at time of distribution			$11,250
Less: Net unrealized appreciation		$3,900	
Total employee's allotments		3,240	7,140
Amount of distribution subject to tax			$4,110

Thus, the average cost or other basis of the stock, for purposes of determining gain or loss on any subsequent taxable transaction therein, would be $49.00 per share, determined by dividing the "cost" at the time of the distribution ($7,350) by the number (150) of shares distributed.

Accordingly, it is held that in an employees' savings plan which meets the requirements of section 165(a) of the Code, a method of determining net unrealized appreciation on stock of the employer corporation which is distributed to participants under the plan, wherein the amounts of increase or decrease in the value of a participant's account at the time of conversion from one optional investment method to another are included in the total amount credited to the participant, will correctly reflect such "net unrealized appreciation" and the cost or other basis to the trust of the stock distributed, within the meaning of subparagraph (c) of section 39.165-6(b)(2)(ii) of Regulations 118.

REGULATIONS 118, SECTION 39.165-6: Taxability of beneficiary under a trust which meets the requirements of section 165(a).

Distribution by an employees' trust of funds received as interest on tax-free securities. See Rev. Rul. 55-61, page 40.

REGULATIONS 118, SECTION 39.165-6: Taxability of beneficiary under a trust which meets the requirements of Section 165(a).

Tax consequences where a participant in an employees' profit-sharing trust may elect, in the case of financial necessity, to withdraw his vested interest with the consent of a committee. See Rev. Rul. 55-424, page 42.

SECTION 165(a).—EMPLOYEES' TRUSTS: EXEMPTION FROM TAX

REGULATIONS 118, SECTION 39.165-1(b): Employees' trusts: Affiliated corporations. Rev. Rul. 55-276

In the case of a pension plan maintained jointly by more than one employer, whether or not they are affiliated corporations, where employees covered by the plan may receive compensation from more than one of the participating employers, the discrimination prohibited by section 165(a) of the Internal Revenue Code of 1939 and the regulations promulgated thereunder will not result merely because the annual compensation used as a basis for determining an employee's eligibility for benefits in a pension plan is defined as the total annual compensation received by the employee from all employers participating in the plan. Such treatment is consistent with the principle set forth in PS No. 14, dated August 24, 1944, so long as there is a proper allocation of the costs of the resulting benefits among the participating employers.

Advice has been requested whether a pension plan maintained jointly by more than one employer (regardless of their affiliated status) will fail to qualify under section 165(a) of the Internal Revenue Code of 1939 if, in order to be eligible for benefits, the compensation of employees working for more than one of the participating employers is considered as the total compensation received from all such employers.

In an assumed case, the *X*, *Y*, and *Z* corporations are participants in a joint annuity contract. The contract provides an integrated $3,600 excess plan, *i. e.*, pension based on salary in excess of $3,600 per annum. Employees *A*, *B*, and *C* are employed by all three corporations receiving an annual salary of $3,000 from *X* corporation, $2,000 from *Y* corporation, and $1,000 from *Z* corporation.

In this case the question arises as to whether employees *A*, *B*, and *C* should be excluded from the plan, since they do not receive compensation in excess of $3,600 from any one of the contracting corporations, while all others employed at an annual salary of $6,000 by any one of the participating corporations would receive pension benefits based on their $2,400 excess salary.

The applicable portion of section 39.165-1(b) of Regulations 118, pertaining to affiliated corporations, states that a trust forming part of a plan of affiliated corporations for their employees may be exempt if all the requirements are otherwise satisfied.

PS No. 14 [August 24, 1944] provides, in part:

An employees' trust may be exempt from Federal income tax under section 165(a) of the Code even though several corporations make contributions thereto, and whether or not such corporations are members of an "affiliated group" as defined in section 141(d), provided all the requirements of section 165(a) of the Code, and the regulations promulgated thereunder, are otherwise satisfied with respect to each of the participating corporations and its employees, the provisions in regard to qualifying under section 165(a) as aforesaid, as well as the deduction provisions of section 23(p) of the Code, being applicable to each employer separately, regardless of the affiliated status of the participating group.

In the case of a pension plan maintained jointly by more than one employer, whether or not they are affiliated corporations, where employees covered by the plan may receive compensation from more than one of the participating employers, it is held that the discrimination prohibited by section 165(a) of the Code and the regulations promul-

gated thereunder will not result merely because the annual compensation used as a basis for determining an employee's eligibility or benefits in the plan is defined as the total of annual compensation received by that employee from all employers participating in the plan. Thus the above-described plan need not be considered discriminatory within the meaning of section 165(a) merely because for the purpose of determining eligibility and benefits of employees *A*, *B*, and *C* each employee's annual compensation is regarded as $6,000. Also, it is held that such treatment is consistent with the principle set forth in PS No. 14, so long as there is a proper allocation of the costs of the resulting benefits among the participating employers.

SECTION 169.—COMMON TRUST FUND

REGULATIONS 118, SECTION 39.169-2: Income of participants in common trust fund. (Also Section 113(a); Regulations 118, Section 39.113(a)(13)-1.) — Rev. Rul. 55-299

> No gain or loss is realized by the participants in two common trust funds or the funds themselves upon the merger of such funds, nor will there be any change in the bases of the assets in the portfolios of the common trust funds.

Advice has been requested whether the participants in two common trust funds or the funds themselves realized a gain or loss upon the merger of the two funds and whether there is a change in the bases of the assets in the portfolios of such funds as a result of the merger.

A bank operated two separate common trust funds. After the merger of the two funds the participants in each of the old funds held shares in the merged fund equal in value to the market value as of the date of merger of their shares in the original funds. There was no distribution of cash or securities to any participant remaining in the merged fund with the exception of such small cash adjustment as was necessary to eliminate fractional units.

A common trust fund is classified generally as a qualified form of "partnership" within the meaning of that term as defined by section 3797(a)(2) of the Internal Revenue Code of 1939. That is, such a fund is a partnership, though the special provisions of section 169 of the Code which vary the partnership provisions of the Code govern as to issues comprehended thereby. Since common trust funds are so treated for Federal income tax purposes, section 113(a)(13) of the Internal Revenue Code is applicable in determining gain or loss. This section provides:

> If the property was acquired, after February 28, 1913, by a partnership and the basis is not otherwise determined under any other paragraph of this subsection, 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. If the property was distributed in kind by a partnership to any partner, the basis of such property in the hands of the partner shall be such part of the basis in his hands of his partnership interest as is properly allocable to such property.

Under the above section, the merger is considered as having accomplished a dissolution of the two funds with each participant receiving its proportionate share of cash and undivided interest in the existing

funds as distribution in kind, and the formation of a new fund to which the participants in the old funds contribute such distributions in kind (except for cash received to eliminate fractional shares). For this purpose, the transfer by the trustees of the cash and assets of the two funds to the new fund is regarded as effecting such distributions of the respective funds followed by contributions to the new fund. Accordingly, no gain or loss is realized by the two funds or their participants and there is no change in bases of assets in the portfolios of the two funds by reason of the dissolution of such funds.

SUPPLEMENT F.—PARTNERSHIPS

SECTION 183.—COMPUTATION OF PARTNERSHIP INCOME

REGULATIONS 118, SECTION 39.183-1: Computation of partnership income. Rev. Rul. 55-39
(Also Section 117(h), Section 39.117(h)-1.)

> The investment by a partnership of a member's contributed capital in securities of his own choice, and for his own account, is in effect a withdrawal of such capital from the firm and an investment by him in the securities purchased, resulting in a reduction in the basis of his partnership interest. The basis of the securities to the member-taxpayer is the cost to the partnership, and the holding period of such securities shall be computed from the date they were acquired by the partnership.

Advice has been requested relative to the basis and holding period, for Federal income tax purposes, of securities purchased by a partnership for a member thereof under the following circumstances.

In the instant case, the taxpayer is a general partner of a firm, which consists of both limited and general partners. The limited partners are entitled to a fixed return on their respective capital contributions plus an additional contingent return, dependent upon net earnings. Except as modified by a special provision affecting the taxpayer in question, the general partners are entitled to "interest" at the rate of six percent on their respective capital accounts and thereafter the general partners share all gains and losses in specified but varying percentages. Some of the general partners receive salaries, and all of them are permitted to make certain withdrawals, including withdrawals for the purpose of paying Federal and State income taxes on their respective shares of the firm's profits.

By a special provision contained in the partnership agreement, as amended, the taxpayer may direct that the sum constituting his capital account be invested, in whole or in part, in securities of his selection, the purchase price being charged to his capital account, thereby reducing to that extent the amount upon which the "interest" allowable on his capital account is computed. Taxpayer's capital account will be credited with any dividends, interest or other distributions received by the firm as respects such securities. The increase or decrease in the value of such securities will be for his account. Such securities are to be sold at his request and the proceeds credited to his capital account. The agreement provides, also, that the securities so purchased "shall become and remain the property of the partnership and shall be deemed part of the capital" contributed by the taxpayer.

The taxable income accruing to the taxpayer upon any such securities, or by reason of the sale thereof "shall be deemed taxable income from the firm, or net capital gain from the firm" for purposes of ascertaining withdrawals permitted him for payment of Federal and State income taxes. Upon becoming entitled to a distribution of capital or to withdraw capital, upon termination of the partnership or upon retirement or otherwise, taxpayer or his estate is entitled to receive "any securities in his capital account" in kind.

The agreement further provides that securities purchased by the partnership for the taxpayer's account "shall become and remain the property of the partnership and shall be deemed part of the capital" contributed by the taxpayer. This and other language used in the agreement makes it plain that the securities would be treated as partnership property as respects the claims of creditors. Subjection of properties, other than partnership assets, to the claims of firm creditors is so commonly attained by specific agreement, by guaranty, by pledge, or by representations, that such subjection, as evidencing intent to convert property into partnership property, may be rebutted by provisions inconsistent with such intent. Where, as here, the agreement provides that certain property is acquired and held for the account of a particular partner, and all of the incidents of ownership, including the right to be credited with all income and profits therefrom and all rights of control, are in him, such property cannot qualify as jointly owned property.

In view of the foregoing, it is held that the securities become the property of the taxpayer at the time they are acquired for him by the partnership. When the partnership acquires the securities for the taxpayer, it in effect distributes cash to him in the amount of the cost of the securities purchased. A subsequent distribution of the securities to him is not a distribution of partnership property and has no Federal income tax consequences. Accordingly, for the purposes of determining basis and computing holding period, the taxpayer acquires the securities at the time they are purchased for his account, and at a cost equal to the purchase price.

Since the partnership agreement permits withdrawal of contributed capital without diminution of the taxpayer's participation rights in gains or losses, it is further held that withdrawals of contributed capital under the agreement are not in payment for or liquidation of part of his interest in the partnership. Accordingly, an investment of his contributed capital in securities of his own choice, and for his own account, is in effect a withdrawal of such capital from the firm and an investment by him in the securities purchased, resulting in a reduction in the basis of his partnership interest.

SECTION 187.—PARTNERSHIP RETURNS

REGULATIONS 118, SECTION 39.187-1: Partnership returns. Rev. Rul. 55-93

(Also Sections 1426, 1607; Regulations 128, Section 408.205; Regulations 107, Section 403.205.)

Interest in a partnership acquired by the decedent's widow and subsequently transferred to her son, resulting in another change in

membership, does not, in itself, terminate the partnership for Federal income tax or employment tax purposes.

Advice has been requested as to whether the transfer of a deceased partner's interest in a partnership by his widow terminates such partnership, for Federal income tax purposes under the provisions of the Internal Revenue Code of 1939 and for purposes of the Federal Insurance Contributions Act (subchapter A, chapter 9, Internal Revenue Code of 1939) and the Federal Unemployment Tax Act (subchapter C, chapter 9, Internal Revenue Code of 1939).

In the instant case A, the decedent, bequeathed to his widow his one-half interest in a partnership which he owned with B. The widow, for valuable consideration, transferred this interest to her son who continued in the partnership with B, the remaining partner.

Revenue Ruling 144, C. B. 1953–2, 212, and Revenue Ruling 54–31, C. B. 1954–1, 212, hold that a change in the membership of a partnership resulting from the death, withdrawal, substitution, or addition of a partner or a shift of interests among existing partners does not, in itself, effect a termination of a partnership for Federal income tax and employment tax purposes, respectively, where the business of the partnership or a substantial portion thereof is continued. That principle has been held to be applicable where the estate of the deceased partner continued the decedent's interest in a partnership which consisted of only two partners. See Rev. Rul. 54–55, C. B. 1954–1, 153. Revenue Ruling 54–484, C. B. 1954–2, 242, provides that this principle also applies to limited partnerships.

Under the facts in the instant case, it is evident that the transfer of the decedent's interest in the partnership by the widow to her son merely constituted another substitution in the partnership in accordance with Revenue Ruling 144, *supra*.

Accordingly, it is held that interest in a partnership acquired by the decedent's widow and subsequently transferred to her son resulting in another change in membership, does not, in itself, terminate the partnership for Federal income tax or employment tax purposes.

As in the cases of Revenue Rulings 144 and 54–31, *supra*, the Internal Revenue Service will not require this Revenue Ruling to be applied with respect to such a change in partnership interest which occurred prior to January 1, 1954. See Rev. Rul. 54–26, C. B. 1954–1, 153.

SUPPLEMENT G.—INSURANCE COMPANIES

SECTION 201.—LIFE INSURANCE COMPANIES

REGULATIONS 118, SECTION 39.201–3: Life insurance companies; definition. — Rev. Rul. 55–256

Y health and accident insurance company issued health and accident policies providing that such policies were renewable at the expiration of each term, except that if the insured had received total benefits under such a policy in an amount equal to x times the aggregate premiums paid since the date of its inception and the insured was not disabled at the expiration of the term, the company reserved the option not to renew the policy. As required by law, reserves in

addition to unearned premiums were maintained by the company to cover its renewal obligation. Such reserves were computed on an actuarial basis. *Held*, that such reserves may not be included in the "life insurance reserves" of the company under section 201(c)(2) of the Internal Revenue Code of 1939, since the policies are not noncancellable health and accident insurance contracts within the meaning of that section. See Regulations 118, section 39.201-3.

SECTION 204.—INSURANCE COMPANIES OTHER THAN LIFE OR MUTUAL

REGULATIONS 118, SECTION 39.204-3: Deductions. (Also Section 207; Regulations 118, Section 39.207-3.) Rev. Rul. 55-300

Insurance companies subject to the provisions of section 204 or section 207, except mutual fire insurance companies described in section 204(a)(1), are permitted deductions for dividends and similar distributions paid or declared to policyholders in their capacity as such. However, dividends to policyholders declared in an undetermined amount at the close of a taxable year measured by the excess of the earnings and profits of such year over an amount designated for surplus increments do not constitute "dividends and similar distributions paid or declared to policyholders" in that taxable year within the meaning of sections 39.204-3 or 39.207-3 of Regulations 118. Under those sections, the deduction is limited to the payment of a definite amount or a reasonably accurate estimate of the amount to be paid, depending on the accounting method used by the company. Accordingly, dividends declared in an undetermined amount are not deductible in determining such a company's income tax liability for the year in which the declaration was made either under section 204 or section 207.

SECTION 207.—MUTUAL INSURANCE COMPANIES OTHER THAN LIFE OR MARINE

REGULATIONS 118, SECTION 39.207-1: Tax on mutual insurance companies other than life or marine or fire insurance companies subject to the tax imposed by section 204. Rev. Rul. 55-240

In the absence of democratic ownership and control by the policy members, an insurance company may not qualify as a mutual insurance company taxable under the provisions of section 207 of the Internal Revenue Code of 1939.

Advice has been requested whether certain "mutual" insurance companies are in fact mutual insurance companies taxable under the provisions of section 207 of the Internal Revenue Code of 1939.

The companies in question, *X* and *L*, have heretofore filed Federal income tax returns as mutual fire and mutual liability companies, respectively. Each company has a paid-up guaranty capital represented by shares all of which have voting rights. There is no requirement that shareholders shall be policyholders, but there is a required

equal representation of the shareholders of each company with the policyholders on the boards of directors. The shareholders have the right to one vote for each share owned. The shareholders participate in the earnings of the companies through specified percentage returns on their contributions to the guaranty capital. Upon dissolution the shareholders would receive the par or face value as expressed in the certificates and any accrued interest due. Any balance or surplus funds would be the property of the policyholders whose policies were in force at the time of such liquidation. Neither company is exempt from tax under the provisions of section 101(11) of the Code.

Among the characteristics of a mutual insurance company is the right of all policyholders to be members to the exclusion of other persons and to choose the management. *Mutual Fire, Marine & Inland Insurance Co.* v. *Commissioner*, 8 T. C. 1212, 1217, acquiescence C. B. 1947–2, 3. In the case of *Keystone Automobile Club Casualty Company et al.* v. *Commissioner*, 122 Fed. (2d) 886, certiorari denied, 315 U. S. 814, the court recognized that democratic ownership and control is a fundamental characteristic of mutual insurance companies and found that there was a substantial departure from the fundamental principle of control where non-policyholders exceeding 20 percent of voting policyholders had the right to vote.

From a study of the above-mentioned court decisions and G. C. M. 6782, C. B. VIII–2, 209 (1929), and authorities referred to therein, it is found that the existence of paid-in guaranty capital represented by shares under certain conditions prevents the classification of insurance companies as mutual insurance companies inasmuch as it deprives such companies of the requisite democratic ownership and control by policyholders. In general, such conditions relate to the following:

(1) The control that the shareholders as a group exercise over the operations of the company.

(2) Voting rights of shareholders.

(3) Representation of shareholders on the board of directors.

(4) Rights of shareholders to participate in the earnings of the company to the extent of receiving a return on their capital investment and in the distribution of the company's assets in the event of dissolution.

In the instant case, the fact that the shareholders, who are not required to be policyholders have voting rights and representation on the boards of directors equal to those of the policyholders and also receive a return on their capital investment through participation in the earnings, is sufficient evidence that there is lacking the "fundamental characteristic of mutual or cooperative organizations—democratic ownership and control" emphasized by the court in the Keystone case. The fact that the shareholders do not share equally with policyholders in distributions in liquidation does not effect such determination. The fact that the companies have previously filed Federal income tax returns as mutual insurance companies does not preclude the Internal Revenue Service, as the result of a detailed examination of current income tax returns and study of the actual ownership and operation thereof, from subsequently holding such companies are not mutual insurance companies.

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Accordingly, it is held that in the absence of democratic ownership and control by the policy members an insurance company may not qualify as a mutual insurance company taxable under the provisions of section 207 of the Code. Thus, the insurance companies in the instant case would be subject to tax under the provisions of section 204 of the Code, as insurance companies other than life or mutual companies.

REGULATIONS 118, SECTION 39.207-3: Dividends to policyholders.

Deductibility of an undetermined amount representing a dividend declaration based on excess of earnings over surplus increment. See Rev. Rul. 55-300, 406.

SUPPLEMENT H.—NONRESIDENT ALIEN INDIVIDUALS

SECTION 211.—TAX ON NONRESIDENT ALIEN INDIVIDUALS

REGULATIONS 118, SECTION 39.211-7: Taxation of nonresident alien individuals.

Information requested by a United Kingdom bank in regard to a domestic corporation which withholds tax on dividends paid to United Kingdom stockholders. See Rev. Rul. 55-9, page 675.

SECTION 212.—GROSS INCOME

REGULATIONS 118, SECTION 39.212-2: Exclusion of earnings of foreign ships or aircraft from gross income.

Equivalent exemption requirement with respect to Venezuela. See Rev. Rul. 55-407, page 77.

SUPPLEMENT I.—FOREIGN CORPORATIONS

SECTION 231.—TAX ON FOREIGN CORPORATIONS

REGULATIONS 118, SECTION 39.231-1: Taxation of foreign corporations.

Canadian mutual investment company composed substantially of stockholders resident in the United States. See Rev. Rul. 55-182, page 77.

REGULATIONS 118, SECTION 231-3: Exclusion of earnings of foreign ships or aircraft from gross income.

Equivalent exemption requirement with respect to Venezuela. See Rev. Rul. 55-407, page 77.

SECTIONS 251(d).—INCOME FROM SOURCES WITHIN POSSESSIONS OF UNITED STATES: DEFINITION

REGULATIONS 118, SECTION 39.251(d)-1: Definitions. Rev. Rul. 55-6

(Also Section 116, Section 39.116-1; Section 131, Section 39.131(h)-1.)

The Ryukyu Islands, which include the island of Okinawa, do not constitute a possession of the United States within the meaning of section 251 of the Internal Revenue Code of 1939, but do constitute a foreign country under sections 116(a) and 131 of the Code. The Ryukyu Islands are within the geographical area covered by the terms of the Treaty of Peace with Japan and are not a part of the Territory of the Pacific Islands.

Revenue Ruling 199, C. B. 1953-2, 225, superseded.

A question has arisen as to the factual correctness of the holding in Revenue Ruling 199, C. B. 1953-2, 225, that Okinawa and the Ryukyu group to which it belongs are a part of the former Japanese mandated islands now known as the Territory of the Pacific Islands, which are administered by the United States under a trusteeship agreement between the United States and the Security Council of the United Nations. See I. T. 4080, C. B. 1952-1, 39.

Chapter II of the Treaty of Peace with Japan, U. S. C. C. & A. S. Vol. 2, 1951, p. 2730, which entered into effect on April 28, 1952 (Presidential Proclamation 2974, 17 Fed. Reg. 85, 3813 (1952)), is entitled "Territory" and provides in part as follows: "Article 2(d). Japan renounces all right, title and claim in connection with the League of Nations Mandate System, and accepts the action of the United Nations Security Council of April 2, 1947, extending the trusteeship system to the Pacific Islands formerly under mandate to Japan. * * * Article 3. Japan will concur in any proposal of the United States to the United Nations to place under its trusteeship system, with the United States as the sole administering authority, Nansei Shoto south of 29° north latitude (including the Ryukyu Islands and the Daito Islands), * * * Pending the making of such a proposal and affirmative action thereon, the United States will have the right to exercise all and any powers of administration, legislation and jurisdiction over the territory and inhabitants of these islands, including their territorial waters." Thus, the location of the Ryukyu Islands is fixed as being within the geographical area to which the terms of the Treaty of Peace apply and not a part of the Territory of the Pacific Islands.

The Internal Revenue Service has been advised that, in accordance with the terms of the Treaty of Peace with Japan, (1) the Ryukyu Islands are at present being administered by the Department of the Army, (2) no proposal to place these islands under a trusteeship has been made by the United States, and (3) it was intended that Japan retain "residual sovereignty" over these islands.

While the present powers of the United States over the Ryukyu Islands are generally no less extensive than if the United States had

in fact acquired full sovereignty over them, the fact remains that the United States does not have absolute authority over these islands. See *State of the Netherlands* v. *Federal Reserve Bank*, 201 Fed. (2d) 455, at 461.

Accordingly, it is held that the Ryukyu Islands, which include the island of Okinawa, do not constitute a possession of the United States within the meaning of section 251 of the Internal Revenue Code of 1939, but do constitute a foreign country for the purposes of sections 116(a) and 131 of the Code.

Revenue Ruling 199, *supra*, is hereby superseded.

SECTION 251(j).—INCOME FROM SOURCES WITHIN POSSESSIONS OF UNITED STATES: EMPLOYEES OF UNITED STATES

Compensation received by a United States citizen, from kindergarten and nursery schools operated on United States bases or installations located in possessions of the United States which are operated on a permissive basis rather than under official instructions or regulations. See Rev. Rul. 55-384, page 94.

SECTION 252.—CITIZENS OF POSSESSIONS OF UNITED STATES

REGULATIONS 118, SECTION 39.252-1: Status of citizens of United States possessions.

Salaries or wages paid to citizens of Guam. See Rev. Rul. 55-184, page 500.

SUPPLEMENT L.—ASSESSMENT AND COLLECTION OF DEFICIENCIES

SECTION 273.—JEOPARDY ASSESSMENTS

REGULATIONS 118, SECTION 39.273-1: Jeopardy assessments. T. D. 6121

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER A, PART 39.—INCOME TAX; TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1951

Regulations 118 amended to conform to Public Law 274 (83d Cong.), relating to the abatement of jeopardy assessments.

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

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

On August 12, 1954, a notice of proposed rule making with respect to amendment of Regulations 118 (26 CFR, pt. 39) to conform to Public Law 274 (83d Cong.) [C. B. 1953-2, 484], approved August

14, 1953, relating to the abatement of jeopardy assessments, was published in the Federal Register (19 F. R. 5088). Since no comments with respect to the rules proposed have been received, the amendments to Regulations 118 set forth below are hereby adopted:

PARAGRAPH 1. Section 39.273 is amended by adding at the end thereof the following:

(a) [k] *Abatement if Jeopardy Does Not Exist.*—The Secretary may abate the jeopardy assessment if he finds that jeopardy does not exist. Such abatement may not be made after a decision of The Tax Court of the United States in respect of the deficiency has been rendered, or, if no petition is filed with The Tax Court of the United States, after the expiration of the period for filing such petition. The period of limitation on the making of assessments and the beginning of distraint or a proceeding in court for collection, in respect of any deficiency, shall be determined as if the jeopardy assessment so abated had not been made, except that the running of such period shall in any event be suspended for the period from the date of such jeopardy assessment until the expiration of the tenth day after the day on which such jeopardy assessment is abated.

[Sec. 273, as amended by Pub. Law 274 (83d Cong.). Such Public Law added subsection (a) [k] and made such subsection applicable to all jeopardy assessments made, or in existence, on the date of enactment of such Act (August 14, 1953) and all jeopardy assessments made thereafter.]

PAR. 2. Section 39.273–1 is amended by adding at the end thereof the following:

(g) (1) The district director may abate a jeopardy assessment which existed on August 14, 1953, or which is made on or after such date, if it is shown to his satisfaction that jeopardy does not exist. An abatement may not be made under this paragraph after a decision of the Tax Court in respect of the deficiency has been rendered or, if no petition is filed with such Court, after the expiration of the period for filing such petition.

(2) The abatement of a jeopardy assessment, because jeopardy does not exist, will have the effect of abating any proceedings to collect the tax so assessed. The district director may then proceed to assess and collect a deficiency in the manner authorized by law as if the jeopardy assessment so abated had not existed. If a notice of deficiency had been sent to the taxpayer prior to the abatement of the jeopardy assessment, whether such notice was sent before or after the making of the assessment, the abatement of such assessment will not affect the validity of the notice or of any proceedings for redetermination based thereon. The period of limitation on the making of assessments and the beginning of distraint or a proceeding in court for collection in respect of any deficiency shall be determined as if the jeopardy assessment so abated had not been made, except that the running of such period shall in any event be suspended for the period from the date of such jeopardy assessment until the expiration of the 10th day after the date on which such jeopardy assessment is abated. The provisions of this subparagraph may be illustrated by the following example.

Example. On February 15, 1954, 28 days before the three-year statutory period of limitations on assessments would otherwise have expired, a jeopardy assessment was made in respect of a proposed deficiency. On April 2, 1954, before the mailing of the notice of deficiency provided for by section 273(b), this assessment was abated. By virtue of this subparagraph, the period of limitations for the making of an assessment did not expire prior to May 10, 1954, i. e., the 38th day after the date of the abatement. If the notice of deficiency provided for in section 273(b) had been sent prior to the abatement, the running of the statute of limitations on assessments would have been suspended pursuant to the provisions of section 277.

(3) Request for abatement of a jeopardy assessment, because jeopardy does not exist, should be filed with the district director and must state fully the reasons for the request and must be supported by such evidence as will enable the district director to determine that the collection of the deficiency is not in jeopardy. See section 273(c) and section 39.273-1(b) with respect to the abatement of jeopardy assessments which are excessive in amount.

(This Treasury Decision is issued under the authority contained in sections 62 and 3791 of the Internal Revenue Code of 1939 (53 Stat. 32, 467; 26 U. S. C. 62, 3791).)

JUSTIN F. WINKLE,
Acting Commissioner of Internal Revenue.

Approved January 27, 1955.

M. B. FOLSOM,
Acting Secretary of the Treasury.

(Filed with the Division of the Federal Register January 31, 1955, 8:52 a. m.)

SECTION 275.—PERIOD OF LIMITATION UPON ASSESSMENT AND COLLECTION

REGULATIONS 118, SECTION 39.275-2: Period of limitation upon collection of tax. Rev. Rul. 55-415

> For the purpose of section 275(c) of the Internal Revenue Code of 1939 "gross income" of a member of a partnership includes his proportionate share of the gross income of the partnership. Any partner's share of the gross income reported in the partnership information return is considered as having been returned by the taxpayer, as such information return is a return by or on behalf of each partner.

Advice has been requested whether the Internal Revenue Service will follow I. T. 3981, C. B. 1949-2, 78, and take the position in the application of section 275(c) of the Internal Revenue Code of 1939 that a partner's gross income includes his proportionate share of partnership gross income.

Section 275(c) of the 1939 Code provides as follows:

> OMISSION FROM GROSS INCOME.—If the taxpayer omits from gross income an amount properly includible therein which is in excess of 25 per centum of the amount of gross income stated in the return, the tax may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment, at any time within 5 years after the return was filed.

I. T. 3981, *supra*, holds that a partner's gross income for the purpose of section 251 of the Code includes his proportionate share of partnership gross income rather than his share of net income. In G. C. M. 26379, C. B. 1950-1, 58, it is held that, with stated qualifications, the sale of a partnership interest should be treated as the sale of a capital asset rather than a sale of the partner's undivided interest in each and every asset owned by the firm.

The courts have held that a partner is not bound by the net income shown in the partnership return but may offset his share of partnership items against corresponding individual items, and vice versa, indicating that they recognize that the partners at all times own a share interest in the gross income of the partnership. See *Emil Mosbacher* v. *United States*, 311 U. S. 619, and *Harry H. Neuberger* v. *Commissioner*, 311 U. S. 83, Ct. D. 1470, C. B. 1940-2, 228. The Neuberger case, in effect, affirmed *Zelda B. Jennings et al.* v. *Commissioner*, 110 Fed. (2d) 945, certiorari denied, 311 U. S. 704 and *John Craik* v. *United States*, 31 Fed. Supp. 132. The Jennings case held that a partner's share of the firm gambling gains offset his individual gambling losses under provisions allowing gambling losses only as offsets to gambling

gains. The Craik case held that a nonresident alien individual who was a member of partnerships operating in the United States but with income from sources without the United States was not taxable upon his share of such income from without the United States under section 213(c) of the Revenue Act of 1918, providing that "in the case of nonresident alien individuals gross income includes only the gross income from sources within the United States." It is well recognized that gross income, as earned, belongs to some taxable entity, and that a partnership is not a taxable entity. It logically follows that the partners should be considered as the owners of partnership gross income.

In *L. Glenn Switzer et al.* v. *Commissioner*, 20 T. C. 759, the court held that, for the purposes of section 275(c) of the Code, the gross income of the partners included their distributive share of the net income of the partnership. However, upon the petitioner's appeal to the United States Court of Appeals for the Ninth Circuit, the Commissioner conceded the issue and agreed that the partners' gross income should include their proportionate share of the partnership's gross income. Accordingly, the case was remanded to The Tax Court of the United States and on September 28, 1954, it vacated and set aside its decision with respect to this issue. In accordance with such concession, the position taken in I. T. 3981, *supra*, and the nonacquiescence, C. B. 1951-1, 4, in the *Estate of R. L. Langer et al.* v. *Commissioner*, 16 T. C. 41, it is held that for the purpose of section 275(c) of the Code "gross income" of a member of a partnership includes his proportionate share of the gross income of the partnership. See *Harry Landau et al.* v. *Commissioner*, 21 T. C. 414. Any partner's share of the gross income reported in the partnership information return should be considered as having been returned by the taxpayer as such information return is a return by or on behalf of each partner.

SUPPLEMENT M.—INTEREST AND ADDITIONS TO THE TAX

SECTION 294.—ADDITIONS TO THE TAX IN CASE OF NONPAYMENT

REGULATIONS 118, SECTION 39.294-1: Additions to the tax. Rev. Rul. 55-29

Additions to the tax imposed under section 294(d) of the Internal Revenue Code of 1939 should not be disturbed by the application of a relief provision such as a net operating loss carryback.

Advice has been requested whether the additions to the tax imposed under section 294(d) of the Internal Revenue Code of 1939 are affected by the application of a relief provision such as a net operating loss carryback.

In *John E. Manning* v. *Seeley Tube and Box Company*, 338 U. S. 561, Ct. D. 1729, C. B. 1950-1, 113, the court held that while a net operating loss carryback may serve to eliminate a deficiency for a previous year, the interest which had theretofore accrued on such deficiency was not eliminated. In holding that the Government was

entitled to interest, the court concluded that there was a real deficiency existing prior to the occurrence of the carryback loss and the right to interest is dependent upon the existence of a deficiency.

In G. C. M. 26455, C. B. 1950-1, 118, it is held that interest and penalties assessed and collected in connection with a Federal income tax liability should not be credited or refunded even though such tax liability is reduced or eliminated by net operating loss carrybacks. Revenue Ruling 173, C. B. 1953-2, 227, similarly holds that an ad valorem penalty (negligence, delinquency, or fraud) based upon the amount of a deficiency existing prior to the application of a relief provision such as a net operating loss carryback is to be imposed in connection with a Federal income tax liability, even though the tax as reported in the original return is equal to or in excess of the correct tax as finally determined after the application of such provision. These rulings follow the rationale of the Seeley Tube and Box Company case. As was pointed out in G. C. M. 26455, "The statutory pattern requiring prompt payment of taxes was the foundation of the opinion in the Seeley Tube and Box Company case. The requirement of prompt filing of returns is equally a statutory duty of a taxpayer. The carryback provisions of the Code do not modify that duty."

The filing of a declaration of estimated tax and the payment of installments of estimated tax declared are likewise statutory duties of a taxpayer. Section 294(d) of the Code imposes additions to tax in certain cases where the taxpayer has failed to perform such duties. It is believed the reasoning of the above-cited case and rulings is equally applicable to a case where additions to tax have been imposed by that section. Accordingly, it is held that the additions to the tax properly imposed under section 294(d) of the Code should not be disturbed by the application of a relief provision such as a net operating loss carryback.

REGULATIONS 118, SECTION 39.294-1: Additions to the tax. Rev. Rul. 55-224

> The additions to the tax provided by section 294(d)(1)(A) or (B) of the Internal Revenue Code of 1939 for failure to file a declaration or pay an installment of estimated tax, and by section 294 (d) (2) for substantial underestimation of estimated tax are both applicable where there has been a failure to file a declaration of estimated tax or failure to pay the tax and there has been a substantial underestimation of estimated tax.

Advice has been requested whether the decision in the case of *United States* v. *Claude E. Ridley, et al.*, 120 Fed. Supp. 530, will be followed in determining the additions to the tax under section 294(d) of the Internal Revenue Code of 1939 in cases where no declarations of estimated tax are filed.

Section 294(d)(1)(A) of the Code provides, in part, that

> In the case of a failure to make or file a declaration of estimated tax within the time prescribed * * * there shall be added to the tax 5 per centum of each installment due but unpaid, and in addition, with respect to each such installment due but unpaid, 1 per centum of the unpaid amount thereof for each month * * * during which such amounts remain unpaid. In no event shall the aggregate addition to the tax * * * exceed 10 per centum of the unpaid portion of such installment.

Section 294(d)(1)(B) of the Code provides, in part, that

* * * in the case of the failure to pay an installment of the estimated tax within the time prescribed * * * 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 * * * during which such amount remains unpaid. In no event shall the aggregate addition to the tax * * * exceed 10 per centum of the unpaid portion of such installment.

Section 294(d)(2) of the Code provides, in part that

If 80 per centum of the tax * * *, in the case of individuals * * *, exceeds the estimated tax * * *, there shall be added to the tax an amount equal to * * * 6 per centum of the amount by which such tax * * * exceeds the estimated tax * * *.

The taxpayer in the Ridley case had not filed a declaration of estimated tax and had not paid any installment of estimated tax. Among the penalties or additions to the tax asserted by the Commissioner were (1) 10 percent of the tax for failure to file a declaration of estimated tax as provided by section 294(d)(1)(A) of the Code and (2) 6 percent of the amount by which the tax exceeded the estimate (zero) for substantial underestimate of estimated tax as provided by section 294(d)(2) of the Code. The court held that the addition of 6 percent for substantial underestimate should not be added, stating that the greater addition to the tax imposed by section 294(d)(1)(A) for failure to file a declaration prohibited the assessment of the lesser addition to the tax for underestimating.

Section 39.294–1(a) of Regulations 118 states that section 294(d) provides for certain additions to the tax in the case of—

(1) Failure to file timely a declaration of estimated tax;
(2) Failure to pay within the time prescribed any installment of declared estimated tax; and
(3) Substantial underestimate of the estimated tax.

It has been the position of the Internal Revenue Service that where a declaration of estimated tax was not filed within the time prescribed and there is no showing of reasonable cause, the addition to the tax provided by section 294(d)(1)(A) is applicable. If in the same case a substantial underestimate of tax also occurs, the addition to the tax provided by section 294(d)(2) is also applicable. Section 39.294–1(b)(3)(i)(a) of Regulation 118 states that in the event of a failure to file the required declaration the amount of the estimated tax for the purposes of the addition to the tax imposed by section 294(d)(2) is zero.

This provision of the regulations has been upheld in several cases. For instance, in *G. E. Fuller et ux.* v. *Commissioner*, 20 T. C. 308, at page 316, the court states:

The failure of petitioners to file declarations of estimated tax within the time prescribed for each of these years necessarily resulted in a substantial understatement of estimated tax. We can not agree with petitioners' contention that because they filed no declaration of estimated tax under section 294(d)(1), they can not be held to have violated section 294(d)(2) for making a substantial underestimate of the estimated tax. The regulation provides that when a declaration of estimated tax is not filed, the amount of the estimated tax, for the purpose of the provisions of section 294(d)(2) shall be zero, and that is the basis used by respondent in computing the deficiency under this subsection. The petitioners attack the regulation as being void in that it distorted the will of Congress. The regulation is couched in the same language used by Congress in its

Conference Report [H. R. Report No. 510, 78th Cong. 1st Sess., C. B. 1943, 1351, at page 1372] on legislation covering this subject and follows the procedure therein prescribed. It therefore appears that the regulation actually reflects, rather than distorts, the will of Congress, and we uphold its validity.

For other cases supporting this position, see *Domenic DeFranco et ux.* v. *Commissioner*, Tax Court Memorandum Opinion, entered December 19, 1950; *J. Ray Cook* v. *Commissioner*, Tax Court Memorandum Opinion, entered June 30, 1952; and *J. D. Ledbetter* v. *Commissioner*, Tax Court Memorandum Opinion, entered March 31, 1953.

Accordingly, in any case in which there has been a failure to file a declaration of estimated tax or to pay an installment of estimated tax declared and where there also has been a substantial underestimation of estimated tax, it is still the position of the Internal Revenue Service that both the addition to the tax provided by section 294(d)(1)(A) or (B) of the Code for failure to file a declaration or pay an installment of estimated tax, and the addition to the tax provided by section 294(d)(2) for substantial underestimation of estimated tax are applicable.

SUPPLEMENT Q.—REGULATED INVESTMENT COMPANIES

SECTION 362.—TAX ON REGULATED INVESTMENT COMPANIES

REGULATIONS 118, SECTION 39.362-2: Method of taxation of regulated investment companies. Rev. Rul. 55-416

> For the purpose of the percentage requirement of section 362(b) of the Internal Revenue Code of 1939 relating to the method of taxation of regulated investment companies, payments to shareholders upon their redemption of their shares in an "open end" regulated investment company, representing their proportionate part of net income received or receivable up to the date of surrender of the shares, shall be included in determining whether the company has distributed to its shareholders as taxable dividends at least 90 percent of its net income for the taxable year.

Advice has been requested whether amounts paid to shareholders of a regulated investment company, representing their proportionate part of net income received or receivable up to the date of surrender of their shares for redemption, should be included in determining whether the company has distributed to its shareholders as taxable dividends at least 90 percent of its net income for the taxable year for the purpose of determining whether the company may obtain the benefits provided in section 362(b) of the Internal Revenue Code of 1939.

The trust agreement, under which the regulated investment company was created, provides that regular and extra cash dividends received and earned interest received in respect of the trust property become payable to the shareholders of record on particular dates. The agreement also provides that the distributions of profits realized on the sale of underlying assets may be distributed from time to time.

Under the agreement, shareholders may present their shares at any time for liquidation and redemption. Upon the surrender to the

trustee of a certificate for shares, the shareholders are entitled to receive in cash the value of their shares as determined under the agreement, such value representing their proportionate share of all the assets, including their share of dividends and interest received or receivable, less the deductions specified therein, to the date of surrender. The portions of the distributions so made to surrendering shareholders, representing their proportionate part of the net income (consisting of dividends and earned interest received or receivable), allocable to the surrendered shares to the date of surrender, are referred to as "equalization payments."

A regulated investment company as defined by section 361(a) of the 1939 Code may be taxable under Supplement Q of such Code. The requirements in order for it to be so taxed are (1) that it distribute during the taxable year to its shareholders as taxable dividends, other than capital gain dividends, an amount not less than 90 percent of its net income for the taxable year computed without regard to net long-term and net short-term capital gains and (2) that it comply for such year with all rules and regulations prescribed by the Commissioner, with the approval of the Secretary, relating to records required to be kept for the purpose of ascertaining the actual ownership of its outstanding stock. See section 362(a) of the Code and sections 39.362–2 and 39.362–3 of Regulations 118.

The shareholders of "open end" investment companies (companies which may issue new shares with practically no limitation) are entitled at any time, at their option, to surrender their shares for redemption. In the event such redemptions are extensive in any taxable year, the amount of the equalization payments to shareholders may exceed 10 percent of the net income for that year.

In *National Securities Series—Industrial Stock Series et al.* v. *Commissioner*, 13 T. C. 884, acquiescence, C. B. 1950–1, 4, the court held that the accumulated net earnings distributed by the taxpayers during the taxable year on the redemption of shares were not "preferential dividends" within the meaning of section 27(h) of the 1939 Code and that they were entitled to include such sums as dividends paid in determining their basic surtax credits under sections 362(b) and 27(b)(1) of the Code.

Although the factual situation in the instant case is somewhat different from that existing in the National Securities Series—Industrial Stock Series case, the principles laid down in the latter case are equally applicable. Accordingly, it is held that the amount of equalization payments to the redeeming shareholders, representing their proportionate part of net income received or receivable up to the date of surrender of their shares, may be included in determining whether a regulated investment company has distributed to its shareholders as taxable dividends at least 90 percent of its net income for its taxable year (computed without regard to net long-term and net short-term capital gains), so as to comply with the requirements of section 362(b) of the 1939 Code.

SUPPLEMENT R.—EXCHANGES AND DISTRIBUTIONS IN OBEDIENCE TO ORDERS OF SECURITIES AND EXCHANGE COMMISSION

SECTION 372.—BASIS FOR DETERMINING GAIN OR LOSS

REGULATIONS 118, SECTION 39.372-5: Basis of stock or securities acquired by shareholder upon tax-free distribution under Section 371(c). Rev. Rul. 55-355

A taxpayer, in one transaction, surrendered all of its $6 and $7 preferred stock in a registered public utility holding company and received common stock of three public utility subsidiary companies under the nontaxable provisions of section 371 of the Internal Revenue Code of 1939. Due to the manner of the exchange, the taxpayer is unable to identify which of the stock received was attributable to each type of preferred stock exchanged. *Held*, where identification is lacking, the "average" rule is applicable in determining the basis of the common stock received in the exchange.

Advice has been requested as to the method of determining the basis of three public utility subsidiary companies received in exchange for preferred stock of the parent public utility holding company.

The taxpayer acquired various blocks of $6 and $7 preferred stocks of a registered public utility holding company at various times and at different prices. Pursuant to a plan of liquidation of such company, approved by an order of the Securities and Exchange Commission, the taxpayer, in one transaction, surrendered all of its $6 and $7 preferred stock and received in exchange therefor common stocks of three public utility subsidiary companies of the liquidated company, plus cash dividend adjustments. The gain to the taxpayer on the exchange was not recognized except to the extent of cash received in accordance with the provisions of section 371(a) and 371(e)(1) of the Internal Revenue Code of 1939.

All the stock received by the taxpayer in the exchange was received simultaneously in one lot and was in the form of certificates representing, in each instance, 100 shares of stock, with any odd number of shares of any one of the companies being included in one certificate. There was no identification or designation as to which shares of the common stocks of the three public utility companies were attributable to any specific shares of the $6 or $7 preferred stock surrendered in the exchange.

The specific question presented is whether the taxpayer may compute an "average" basis for the common stock received upon the liquidation of the public utility company. It is fairly well settled that where identification is lacking, an average basis must be used for stock of another corporation received in a nontaxable exchange pursuant to a reorganization under section 112(g)(1) of the Code of 1939. See *Lyde R. Arrott* v. *Commissioner*, United States Board of Tax Appeals Memorandum Opinion, entered June 19, 1942, affirmed, 136 Fed. (2d) 449 and *Christian W. Von Gunten* v. *Commissioner*, 28 B. T. A. 702, affirmed, 76 Fed. (2) 670. In the instant case, although the stock was not acquired in a nontaxable exchange pursuant to a reorganization under section 112(g)(1) of the Code, the stock was

acquired in a tax-free exchange as a result of a liquidating distribution under the provisions of section 371 of the Code.

Accordingly, it is held that the tax basis of the shares of common stock received in the exchange should be determined by aggregating into one figure the respective bases of the various lots of the $6 and $7 preferred stock exchanged and, after appropriate adjustments, under section 372(a) of the Code, for cash received and gain recognized, allocating such figure to the common stocks in proportion to the total fair market value of the shares of each corporation on the effective date of the exchange. The amount thus allocated to the common stock of each company will be divided by the total number of shares of that company acquired in the exchange so that the basis of each share will be an "average" basis.

SUBCHAPTER D.—EXCESS PROFITS TAX

PART I.—RATE AND COMPUTATION OF TAX

SECTION 430.—IMPOSITION OF TAX

REGULATIONS 130, SECTION 40.430-2: Rate of tax. Rev. Rul. 55-94

> Where a corporation, which has undergone a "de facto" dissolution in 1936, is reactivated as of January 1, 1950, as a result of a nontaxable transaction under section 112(b)(5) of the Internal Revenue Code of 1939, such corporation is held to have "commenced business" as of the date of reactivation and is a "new" corporation within the meaning of section 430(e) of the Code.

Advice has been requested whether the date of commencement of business or the date of recommencement of business should be used in determining whether a corporation is a "new corporation" within the meaning of section 430(e) of the Internal Revenue Code of 1939.

The taxpayer was organized in 1914 with an authorized capital structure consisting of $25x$ shares of preferred stock and $75x$ shares of common stock. In 1936, its net assets were transferred to a partnership, the members of which were stockholders of the corporation. The stockholders' interest in the partnership was in the same proportion as their stock holdings in the corporation. Although the entire outstanding capital stock was cancelled, the corporation retained its charter. From 1936 to 1950 the corporation had no income and its only activities were the filing of annual statements and payment of State franchise taxes.

As of January 1, 1950, the corporation was reactivated and the partnership transferred its net assets to the corporation and dissolved. The corporation amended its charter to authorize $10x$ shares of common stock, which together with $600x$ dollars of debentures were issued in exchange for the partnership's net assets.

Section 430(e) of the Code provides in effect that in the case of a corporate taxpayer which "commenced business' after July 1, 1945, and whose fifth taxable year ends after June 30, 1950, excess profits

tax shall be levied at specified rates different from those imposed generally by section 430(a) of the Code.

Section 40.430-2(e)(3) of Regulations 130 provides that the "date the corporation commenced business shall be determined for purposes of section 430(e) and of (e) of this section under the rules provided in the regulations promulgated under section 445," which relates to the computation of average base period net income in the case of new corporations.

Section 40.445-1(a)(2) of Regulations 130 provides in part as follows:

> The words "commenced business" do not have the same meaning as "in existence." Ordinarily, a corporation commences business when it starts the business operations for which it was organized; a corporation comes into existence on the date of its incorporation. Mere organizational activities, such as incorporation or the issuance of capital stock, are not alone sufficient to show commencement of business. If the activities of the corporation have advanced to the extent necessary to establish the nature of its business operations, it will be deemed to have commenced business. For example, the acquisition of operating assets which are necessary to the type of business contemplated may constitute the commencement of business.

In I. T. 3871, C. B. 1947-2, 62, it was held that upon presentation of the facts to the "collector," a corporation which has ceased business operations, has retained no assets, and has no income, may be relieved from filing Federal income tax returns even though the corporation has not been formally dissolved. This conclusion was based on the fact that there was no specific provision in section 29.52-1 of Regulations 111 (now section 39.52-1 of Regulations 118) with respect to the necessity of filing a Federal income tax return in the case of a corporation which has ceased business operations but has not been formally dissolved. It was also observed that the above-mentioned section of the regulations provided that a corporation which has received a charter but has never perfected its organization, which has transacted no business and which has had no income, may be relieved of the necessity of making a return as long as it remains in an unorganized condition. The conclusion reached in I. T. 3871, *supra*, is further supported by reference to the decision in *Kamin Chevrolet Co.* v. *Commissioner*, 3 T. C. 1076, wherein it was held that the Commissioner acted properly in annualizing, pursuant to section 711(a) of the 1939 Code, the excess profits tax return filed for the calendar year 1940 by a corporation which on June 30, 1940, distributed all its assets, subject to liabilities, to its stockholders and discontinued its business, but did not surrender its charter. The court stated in effect that even conceding that under State law the corporation had a legal existence for the entire calendar year it did not follow that for purposes of income and excess profits tax dissolution may not occur prior to the date the charter is cancelled; that there may be a de facto dissolution even though there is not a de jure one; and that since the corporation had "no capital, no income and no expense" and was "a mere empty shell" there could be no doubt that there was a de facto dissolution as of the date of the liquidation.

Accordingly, assuming the reactivation of the corporation as of January 1, 1950, resulted from a nontaxable transaction under section 112(b)(5) of the 1939 Code, it is held that a "de facto" dissolution occurred in 1936; that the taxpayer terminated its business at that time; and that the corporation is deemed a new corporation which

"commenced business" as of the date of such reactivation, within the meaning of section 430(e) of the Code.

REGULATIONS 130, SECTION 40.430-2: Rate of tax.

Election in the computation of the excess profits tax. See Rev. Rul. 55-376, below.

SECTION 431.—DEFINITION OF ADJUSTED EXCESS PROFITS NET INCOME

REGULATIONS 130, SECTION 40.431-1: Definition of adjusted excess profits net income. (Also Sections 430, 433; Regulations 130, Sections 40.430-2, 40.433(a)-2.) — Rev. Rul. 55-376

> An adjustment shall be made for interest on borrowed capital under section 433(a)(1)(N) or (O) of the Internal Revenue Code of 1939 in those cases where (1) the total of the excess profits credit (allowed under section 434) and the unused excess profits credit adjustment (allowed under section 432) is less than $25,000 and therefore, such sum is, pursuant to section 431, increased to $25,000; and (2) where the taxpayer is a new corporation whose tax liability, computed under the alternative method set forth in section 430(e)(1), is less than under the other computations provided for in section 430.

Advice has been requested whether an adjustment should be made for interest on borrowed capital under section 433(a)(1)(N) or (O) of the Internal Revenue Code of 1939 in those cases where (1) the total of the excess profits credit (allowed under section 434) and the unused excess profits credit adjustment (allowed under section 432) is less than $25,000 and therefore, such sum is, pursuant to section 431, increased to $25,000; and (2) where the taxpayer is a new corporation whose tax liability, computed under the alternative method set forth in section 430(e)(1), is less than under the other computations provided for in section 430.

Section 430(a) imposes a tax upon the *adjusted excess profits net income* of every corporation. This adjusted excess profits net income is defined by section 431 as the excess profits net income (as defined in section 433(a)) minus the sum of the excess profits credit (allowed under section 434) and the unused excess profits credit adjustment (allowed under section 432); if the sum of the excess profits credit and the unused excess profits credit adjustment should be less than $25,000, section 431 provides that such sum is to be increased to $25,000. This contemplates an increase in the excess profits credit and the unused excess profits credit adjustment, and not a substitution of a new credit. Therefore, a corporation will, in each instance, have a credit allowed under section 434. Section 434 provides for an excess profits credit based on income (section 435) or a credit based on invested capital (section 436).

As indicated above, excess profits net income is computed under section 433(a). That section provides that excess profits net income is normal tax net income plus or minus certain adjustments set forth therein. Among these adjustments, is an adjustment for interest on

borrowed capital; the adjustment is made under section 433(a)(1)(N) if the excess profits credit is based on invested capital and under section 433(a)(1)(O) if the excess profits credit is based on income.

Section 430(a), in imposing a tax upon the adjusted excess profits net income of a corporation, provides for certain alternative computations. One of these, section 430(a)(1) is a computation based upon adjusted excess profits net income; the others, sections 430(a)(2)(A), (B) and (C), and section 430(a)(3), the latter of which incorporates by reference any computation under section 430(e) with respect to a new corporation using a computation based upon excess profits net income. The question presented here is whether a corporation whose adjusted excess profits net income is being subjected to tax, in making the alternative computation of tax under section 430(a)(2) or (3), upon its excess profits net income, or in computing its tax under any part of section 430(a), after subtracting the minimum of $25,000 allowed under section 431, must utilize the same excess profits net income that was used in computing the adjusted excess profits net income under section 431. It seems quite clear that it must. As stated above, section 430(a) imposes a tax upon *adjusted excess profits net income*, which must reflect an excess profits credit allowed under section 434 and hence an adjustment for interest on borrowed capital. It is then evident, that those alternative computations thereunder which are based upon *excess profits net income* are utilizing the same income subject to tax under the general rule enunciated therein but without any reduction as provided for in section 431.

Accordingly, it is held that an adjustment shall be made for interest on borrowed capital under section 433(a)(1)(N) or (O) of the Internal Revenue Code of 1939 in those cases where (1) the total of the excess profits credit (allowed under section 434) and the unused excess profits credit adjustment (allowed under section 432) is less than $25,000 and therefore, such sum is, pursuant to section 431, increased to $25,000 and; (2) where the taxpayer is a new corporation whose tax liability, computed under the alternative method set forth in section 430(e)(1), is less than under the other computations provided for in section 430.

SECTION 433.—EXCESS PROFITS NET INCOME

REGULATIONS 130, SECTION 40.433(a)-2: Computation of excess profits net income for the taxable year.

Adjustment for interest on borrowed capital. See Rev. Rul. 55-376, page 421.

SECTION 435(g).—NET CAPITAL ADDITION OR REDUCTION [EXCESS PROFITS CREDIT—BASED ON INCOME]

REGULATIONS 130, SECTION 40.435-7: Net capital addition or reduction. Rev. Rul. 55-392

In determining a net capital addition under section 435(g) of the Internal Revenue Code of 1939 for the purposes of the excess profits credit based on income, a distribution by a corporation of the stock

of a wholly-owned subsidiary as a dividend, which distribution reduces the corporation's inadmissible assets and does not provide funds used in increasing its operating assets, does not result in a net capital addition within the meaning of section 435(g)(9) of the Code.

Advice has been requested whether a corporation is entitled to a net capital addition for the purposes of computing its excess profits credit based on income where there has been a decrease in inadmissible assets in conjunction with an increase in operating assets, the decrease in inadmissibles resulting when stock in a wholly-owned subsidiary was distributed by the corporation to its controlling stockholders as a dividend.

In the instant case, the corporation distributed to its two controlling corporations as a dividend all of its stock in a wholly-owned subsidiary. The distribution resulted in a net decrease in inadmissible assets of the distributing corporation for the taxable year in the amount of $1.5x$ dollars. During the same taxable year, there was a net increase of $.3x$ dollars in the corporation's operating assets which came about by reasons other than the stock distribution, since no additional funds were obtained by the corporation as a result of the stock dividend.

Section 435(g)(9) of the Internal Revenue Code of 1939 provides that the excess of the decrease in inadmissible assets for the taxable year over the net capital reduction for the taxable year shall be considered the net capital addition (or shall be added to the net capital addition otherwise determined), subject to the exceptions and limitations provided in paragraph (10) of that section. One of the limitations in paragraph (10) is that such excess of the decrease in inadmissibles shall not be greater than the excess of the increase in operating assets for the taxable year over the net capital addition (determined without certain limitations that are not pertinent here) for that year.

The purpose of paragraph (9) of section 435(g) of the Code is that "reductions in inadmissible assets subsequent to the base period are to be allowed a credit as capital additions provided that the additional capital is invested in operating assets." Senate Report No. 781, 82d Cong., C. B. 1951–2, 458 at 515. Operating assets, as defined in paragraph (10) of section 435(g), *supra*, means property used in the taxpayer's trade or business, stock in trade or other property of a kind which would properly be includible in the inventory of the taxpayer, and property held by the taxpayer primarily for sale to customers in the ordinary course of the taxpayer's trade or business. It is apparent that the intent of section 435(g)(9) of the Code is that a capital addition under that section should result where additional funds were obtained from the disposal of inadmissible assets and such funds are used to finance expanding manufacturing operations, facilities, or inventories. While in some instances an increase in operating assets could come about by reasons other than by the sale of inadmissible assets, as, for example, from indebtedness incurred which constituted borrowed capital, a decrease in inadmissible assets for the purpose of section 435(g)(9) would not appear pertinent where no additional capital was made available to the taxpayer. In the instant case, no additional funds were obtained as a result of the

taxpayer distributing stock in a wholly-owned subsidiary as a dividend.

Accordingly, it is held that in determining a net capital addition under section 435(g) of the Code for the purposes of the excess profits credit based on income, a distribution by a corporation of the stock of a wholly-owned subsidiary as a dividend, which distribution reduces the corporation's inadmissible assets and does not provide funds used in increasing its operating assets, does not result in a net capital addition within the meaning of section 435(g)(9) of the Code.

SECTION 436.—EXCESS PROFITS CREDIT—BASED ON INVESTED CAPITAL

REGULATIONS 130, SECTION 40.436-1: Excess profits credit based on invested capital.

Accumulated earnings and profits for invested capital purposes shall reflect the increase or decrease in the Federal income and excess profits tax liability of the preceding year attributable to inventory replacements, but not to reflect any decrease because of net operating loss of unused excess profits carrybacks. See Rev. Rul. 55-28, page 359.

SECTION 456.—ABNORMALITIES IN INCOME IN TAXABLE PERIOD

REGULATIONS 130, SECTION 40.456-1: Abnormalities. Rev. Rul. 55-207

(Also Section 721; Regulations 112, Section 35.721-1.

A corporation had, in prior years, pledged cotton produced by it with the Commodity Credit Corporation as collateral for a loan. It defaulted upon this loan, whereupon its pledged cotton became, under the terms of the loan agreement, part of a producer's pool created and operated by the lender. The producer no longer had any right of redemption with respect to the cotton. It later received, pursuant to the terms of the loan agreement, its pro rata share of the proceeds remaining after satisfaction of the loans chargeable against the pooled cotton and the expenses incident to conducting the pool. *Held*, such amounts do not constitute abnormal income within the meaning of section 456(a) of the Internal Revenue Code of 1939. *Held further*, even if such amounts could be viewed as abnormal income under section 456(a) of the Code, such income could only be attributed to the year in which the taxpayer's right to receive the income became fixed.

Advice has been requested whether, for the purposes of section 456 of the Internal Revenue Code of 1939, the excess of the proceeds from the sale of pledged cotton over the amount of the producer's loan from the Commodity Credit Corporation constitutes abnormal income attributable to a year other than the year of accrual.

In 1949, the taxpayer, a corporation keeping its books on the accrual method of accounting and reporting its income on the basis of a fiscal year ending January 31st, obtained a loan of $15x$ dollars from the Commodity Credit Corporation, pledging as collateral its 1948 cotton crop. In July of 1949 the taxpayer defaulted in payment

of the loan and the cotton pledged as collateral for the loan was placed in a pool by the Commodity Credit Corporation. During its fiscal year ending January 31, 1951, the cotton was sold and the taxpayer received $3x$ dollars representing the proceeds of the sale, less payment of the loan and expenses. There is no showing that the sale at a price producing such proceeds was not the result of improved business conditions. The specific question presented is whether the $3x$ dollars represents abnormal income attributable to other years within the purview of section 456 of the Code.

Section 456(a) of the Code provides in part:

(a) DEFINITIONS.—For the purposes of this section—

(1) ABNORMAL INCOME.—The term "abnormal income" means income of any class described in paragraph (2) includible in the gross income of the taxpayer for any taxable year under this subchapter if it is abnormal for the taxpayer to derive income of such class, or, if the taxpayer normally derives income of such class but the amount of such income of such class includible in the gross income of the taxable year is in excess of 115 per centum of the average amount of the gross income of the same class for the four previous taxable years or, if the taxpayer was not in existence for four previous taxable years, the taxable years during which the taxpayer was in existence.

Section 456(a)(2) of the Code enumerates the separate classes of income. In this instance the type of income under consideration does not appear to fall within the classes (A) to (D) enumerated therein. However, it is provided that:

* * * The classification of income of any class not described in subparagraphs (A) to (D), inclusive, shall be subject to regulations prescribed by the Secretary.

Section 40.456-2(b) of Regulations 130 provides in part:

Other income, not within a class described in subparagraphs (A)-(D) of section 456(a)(2), to which section 456 is applicable may be grouped by the taxpayer, subject to approval by the Commissioner on the examination of the taxpayer's return, in such classes similar to those specified in subparagraphs (A)-(D) of section 456(a)(2) as are reasonable in a business of the type which the taxpayer conducts, and as are appropriate in the light of the taxpayer's business experience and accounting practice.

Section 456(b) of the Code provides in part:

(b) AMOUNT ATTRIBUTABLE TO OTHER YEARS.—The amount of the net abnormal income that is attributable to any previous or future taxable year or years shall be determined under regulations prescribed by the Secretary. * * *

Section 40.456-3 of Regulations 130 provides in part:

AMOUNT ATTRIBUTABLE TO OTHER YEARS.—(a) The mere fact that an item includible in gross income is of a class abnormal either in kind or in amount does not result in the exclusion of any part of such item from excess profits net income. It is necessary that the item be found attributable under these regulations in whole or in part to other taxable years. Only that portion of the item which is found to be attributable to other years may be excluded from the gross income of the taxpayer for the year for which the excess profits tax is being computed.

(b) Items of net abnormal income are to be attributed to other years in the light of the events in which such items had their origin, and only in such amounts as are reasonable in the light of such events. To the extent that any items of net abnormal income in the taxable year are the result of such factors as high prices, low operating costs, increased demand, or decreased competition, such items shall not be attributed to other taxable years. Thus, no portion of an item is to be attributed to other years if such item is of a class of income which is in excess of 115 percent of the average income of the same class for the four previous taxable years solely because of an improvement in business conditions. * * *

Thus, two conditions must be met before any income may be considered as abnormal within the meaning of section 456 of the Code, namely, (1) the income must be abnormal in kind or amount, and (2) such abnormal income must be attributable to other years.

The loan agreement with the Commodity Credit Corporation provides, so far as is pertinent here, (1) that all holders of the note shall look solely to the cotton for satisfaction of the loan, (2) that the Commodity Credit Corporation has the right, if it so desires, to purchase the pooled cotton, and (3) that the Commodity Credit Corporation is required to remit the net proceeds, if any, to the producer. From the above it is apparent that the title to the pooled cotton under the circumstances was in the producer and not the Commodity Credit Corporation. The proceeds from the sale belonged to the producer and constituted gross income. This gross income was the normal income of the producer.

The above is in accord with I. T. 4016, C. B. 1950-2, 29, in which it is held that advances received by cotton producers under similar loan agreements are loans and not proceeds from the sale of cotton, even though the producer may not be called upon to pay any deficiency which may exist after the sale of the pledged cotton, provided the producer reduces cotton acreage in accordance with an agreement with the Secretary of Agriculture and provided he has made no misrepresentation in connection with the loan. Advances may be loans even where there is absence of personal liability and the lender can look only to the pledged securities for repayment. Also, if the producer realizes an additional amount upon liquidation of the pool, such additional amount will constitute income for the taxable year in which his right to receive it becomes fixed, if he employs the accrual method of accounting.

In this instance the net proceeds of $3x$ dollars received from the sale of the producer's cotton, even if considered to be abnormal income, cannot be attributed to any year other than the fiscal year ending January 31, 1951, as to do so would be at variance with the regulations and the established accounting method of the taxpayer. See *Yuba Gardens, Inc.* v. *Commissioner*, 17 T. C. 334.

Accordingly, it is held that the $3x$ dollars does not constitute abnormal income within the meaning of section 456 of the Internal Revenue Code of 1939 but constitutes normal income which can only be attributed to the taxpayer's taxable year ended January 31, 1951.

REGULATIONS 130, SECTION 40.456-1: Abnormalities in income in taxable year. Rev. Rul. 55-377

For excess profits tax purposes, the increases in the redemption prices of noninterest-bearing obligations which are reported as income received in any taxable year by a corporation on the cash basis of accounting, pursuant to an election under section 42(b) of the Internal Revenue Code of 1939, constitute, to the extent of the income accrued up to the time of the election, a separate class of abnormal income attributable to the years in which the increases had their origin under section 456 of the 1939 Code.

Advice has been requested whether certain increases in redemption prices of noninterest-bearing obligations issued at a discount, under

the circumstances set forth below, constitute abnormal income attributable to other years within the meaning of section 456 of the Internal Revenue Code of 1939.

The corporation keeps its books and records and files its Federal income tax returns on the cash receipts and disbursements basis. Pursuant to an election under section 42(b) of the 1939 Code, the increases in the redemption prices of certain noninterest-bearing obligations occurring in the taxable year 1950 and prior years were treated as income received in 1950. The amount reported in 1950 was $100x$ dollars of which $75x$ dollars represented the accumulated increases in value of such obligations prior to 1950.

Section 42 of the 1939 Code provides in part:

* * * * * * *

(b) NONINTEREST-BEARING OBLIGATIONS ISSUED AT DISCOUNT.—If, in the case of a taxpayer owning any noninterest-bearing obligation issued at a discount and redeemable for fixed amounts increasing at stated intervals * * * the increase in the redemption price of such obligation occurring in the taxable year does not (under the method of accounting used in computing his net income) constitute income to him in such year, such taxpayer may, at his election made in his return for any taxable year beginning after December 31, 1940, treat such increase as income received in such taxable year. If any such election is made with respect to any such obligation, it shall apply also to all such obligations owned by the taxpayer at the beginning of the first taxable year to which it applies and to all such obligations thereafter acquired by him and shall be binding for all subsequent taxable years, unless upon application by the taxpayer the Commissioner permits him, subject to such conditions as the Commissioner deems necessary, to change to a different method. In the case of any such obligations owned by the taxpayer at the beginning of the first taxable year to which his election applies, the increase in the redemption price of such obligations occurring between the date of acquisition * * * and the first day of such taxable year shall also be treated as income received in such taxable year.

Section 456 of the 1939 Code provides in part:

(a) DEFINITIONS.—For the purposes of this section—

(1) ABNORMAL INCOME.—The term "abnormal income" means income of any class described in paragraph (2) includible in the gross income of the taxpayer for any taxable year under this subchapter if it is abnormal for the taxpayer to derive income of such class, * * *

(2) SEPARATE CLASSES OF INCOME.—Each of the following subparagraphs shall be held to describe a separate class of income:

* * * * * * *

(D) Income includible in gross income for the taxable year rather than for a different taxable year by reason of a change in the taxpayer's method of accounting.

* * * * * * *

(b) AMOUNT ATTRIBUTABLE TO OTHER YEARS.—The amount of the net abnormal income that is attributable to any previous * * * taxable year or years shall be determined under regulations prescribed by the Secretary. * * *

It is abnormal for a taxpayer to derive income of any class only if the taxpayer received no gross income of that class for the four previous taxable years. Section 40.456–1(a) of Regulations 130. In the instant case the taxpayer had no gross income coming within the class described in section 456(a)(2)(D) *supra*, in the 4 years preceding 1950.

Section 40.456–3 of Regulations 130 provides in part:

AMOUNT ATTRIBUTABLE TO OTHER YEARS.—(a) The mere fact that an item includible in gross income is of a class abnormal either in kind or amount does not result in the exclusion of any part of such item from excess profits net income.

It is necessary that the item be found attributable under these regulations in whole or in part to other taxable years. Only that portion of the item which is found to be attributable to other years may be excluded from the gross income of the taxpayer for the year for which the excess profits tax is being computed.

(b) Items of net abnormal income are to be attributed to other years in the light of the events in which such items had their origin, and only in such amounts as are reasonable in the light of such events * * *

In view of the above, it is held that the increases in redemption prices of the noninterest-bearing obligations, purchased by the taxpayer, accrued up to the time of the election under section 42(b) of the Internal Revenue Code of 1939 constitute a separate class of abnormal income within the meaning of section 456(a)(2)(D) of the Code and are attributable to the taxable years in which they had their origin. Accordingly, 75x dollars of the total increases is attributable to the years prior to 1950 and the balance to the taxable year 1950.

Section 40.456–9 of Regulations 130 provides that the class of income may include such items of income as are includible in gross income for the taxable year by reason of a change from the installment method to the straight accrual method of accounting, a change in inventory method, or a change from the reserve method to the specific charge-off method for the treatment of bad debts. This section also provides that the method of allocating items of net abnormal income includible in gross income for the taxable year rather than for a different year by reason of changes in accounting method, other than a change from the installment to the accrual method, is to be determined in each particular case upon consideration of all the facts in the case.

Section 42(b) of the 1939 Code was enacted by the Revenue Act of 1941. H. R. Report No. 1040, 77th Congress, C. B. 1941–2, 413, at page 445, in discussing the applicability of such section, stated in part:

* * * Therefore, with respect to such noninterest-bearing United States defense bonds, the effect of this section is to extend, at the election of the taxpayer, the accrual method to a taxpayer on the cash basis, but only for the limited purpose of reporting the increment in value of such bonds as it accrues.

Thus, it would appear that it was the intent of Congress that an election under section 42(b) of the 1939 Code be considered a change in the method of accounting for a limited purpose.

SECTION 458.—HISTORICAL INVESTED CAPITAL

REGULATIONS 130, SECTION 40.458–4: Determination of equity invested capital—Accumulated earnings and profits. Rev. Rul. 55–257

> For the purpose of computing equity invested capital under the provisions of section 458(d) of the Internal Revenue Code of 1939 accumulated earnings and profits may be determined by including therein, in the absence of a more accurate value, the cash surrender value of insurance policies carried by the taxpayer, as beneficiary, on the lives of its officers.

Advice has been requested whether, for the purpose of computing equity invested capital, accumulated earnings and profits should be determined by including therein the cash surrender value of insurance policies held by a corporation, as beneficiary, on the lives of its

officers or by including therein the total premiums paid by the corporation on such policies.

Under the provisions of section 24(a)(4) of the Internal Revenue Code of 1939 and the regulations promulgated thereunder, no portion of premiums paid on any life insurance policy covering the life of any officer or employee, or of any person financially interested in any trade or business carried on by the taxpayer, may be deducted by the taxpayer in computing net income when the taxpayer is directly or indirectly a beneficiary under such policy. To the extent that an asset is created by the payment of such premiums, the taxpayer may be considered to have a basis in the asset equal to the cash surrender value of the policy. This question was considered in *Century Wood Preserving Company* v. *Commissioner*, 69 Fed. (2d) 967, wherein the court said:

> The cost of an asset is the real question here. It is obvious that cost is not the total amount paid in as premiums, since continuing insurance protection is part of the consideration for the contract. The part of the premiums which represents annual insurance protection has been earned and used. The other part of the premium is an investment built up as a reserve until the policy is matured or surrendered. If it is surrendered, the holder is entitled to the cash surrender value from the insurer, or, roughly, the return of the equivalent of his investment after the cost of annual protection is deducted from the premiums.
>
> The petitioner in this case has made no effort to show the reserve carried by the insurer on these policies. But cost is approximately reflected by the cash surrender value of the policies * * *.

The question here presented was considered by the courts and the Internal Revenue Service under the World War I excess profits tax law which contained provisions relative to historical invested capital similar to those contained in section 458 of the Internal Revenue Code of 1939. It was held that amounts paid out of earnings by a taxpayer as premiums on insurance policies carried by the taxpayer on the lives of its officers in excess of that portion which is applicable to pure term insurance is the amount to be included in invested capital as earned surplus. See *E. J. Gallagher Realty Co.* v. *Commissioner*, 4 B. T. A. 219; *National Straw Works* v. *Commissioner* 47 Fed. (2d) 844; A. R. R. 229, C. B. 3, 354 (1920); O. D. 745, C. B. 3, 355 (1920).

However, in the case of *Lucas* v. *Kate Halloway Alexander et al.*, 279 U. S. 573, Ct. D. 76, C. B. VIII-2 273 (1929), the Supreme Court of the United States adopted the reserve value, *i. e.* the reserve carried by the insurer on the policies, in calculating the asset value of an insurance policy. But as a practical matter, in many cases the cash surrender value closely approximates the value of the taxpayer's investment. In such instances the slight difference in amounts involved may be disregarded in the interest of administrative convenience.

In view of the above, it is held that for the purpose of computing equity invested capital under section 458(d) of the Internal Revenue Code of 1939, accumulated earnings and profits may be determined by including therein, in the absence of a more accurate value, the cash surrender value of insurance policies carried by a taxpayer, as beneficiary, on the lives of its officers.

REGULATIONS 130, SECTION 40.458-4: Determination of equity invested capital—Accumulated earnings and profits.

Accumulated earnings and profits to reflect increase or decrease in Federal income and excess profits tax liability of preceding taxable year attributable to inventory replacement but not to reflect decrease because of net operating loss or unused excess profits credit carrybacks. See Rev. Rul. 55-28, page 359.

SUBCHAPTER E.—TAX ON SELF-EMPLOYMENT INCOME

SECTION 481.—DEFINITIONS

REGULATIONS 118, SECTION 39.481-1: Net earnings from self-employment. Rev. Rul. 55-30

"Salary" drawings received by a member of a partnership as compensation for services rendered to the partnership are includible in computing net earnings from self-employment for purposes of the Self-Employment Contributions Act where, by agreement of the partners, such payments are not chargeable against the working member's capital account regardless of whether the partnership sustains an operating loss, but are chargeable against the capital accounts of the remaining partners in the event of a partnership loss.

An inquiry has been received regarding the treatment for purposes of the Self-Employment Contributions Act (subchapter E, chapter 1, of the Internal Revenue Code of 1939) of payments made to the only working member of a partnership.

Pursuant to the partners' agreement all the members, including the working member, shared profits and losses equally; the working member received specified weekly amounts termed "salary" drawings whether or not the partnership operated at a profit; and in the event of a loss, such "salary" amounts were not charged against the working member's capital account but were deducted in equal portions from the capital accounts of the other two partners.

The Self-Employment Contributions Act imposes a tax upon self-employment income which, as provided in section 481(b), is based upon "net earnings from self-employment." The quoted term is defined in section 481(a), as follows:

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 chapter which are attributable to such trade or business, plus his distributive share (whether or not distributed) of the ordinary net income or loss, as computed under section 183, from any trade or business carried on by a partnership of which he is a member; except * * *. (The exceptions are not here material.)

It is clear that any portion of the partnership's net operating profit or loss credited or charged, respectively, to the working member's capital account would constitute "his distributive share * * * of the ordinary net income or loss * * * from any trade or business carried on by a partnership" within the scope of section 481(a) and,

hence, would have to be taken into account in computing his net earnings from self-employment.

Moreover, the working member's so-called "salary" drawings would also have to be treated as net earnings from self-employment. As that term is defined in section 481(a), it includes the "gross income derived by an individual from any trade or business carried on by such individual, less the deductions * * * attributable to such trade or business." With certain exceptions not material here, section 481(c) provides that the term "trade or business" as it is used with reference to self-employment income or net earnings from self-employment is to have the same meaning as when used in section 23 of the Code.

Inasmuch as partners are working for themselves and cannot be their own employees, amounts received by them as "salaries" cannot be treated as such for purposes of chapter 1 of the Code. Accordingly, under the Code such amounts are not properly deductible as operating expenses of the partnership and should not be so regarded in the computation of the partnership's income. Thus, if it should be determined that the amount of the so-called "salary" drawings received by the working member did not exceed the partnership's income, it is apparent that such payments would constitute withdrawals of partnership profits.

If, on the other hand, the amounts of the so-called "salary" drawings should exceed the partnership's income they would necessarily constitute withdrawals of capital insofar as the excess is concerned. Since in that case the "salary" drawings are to be charged to the capital accounts of the other two partners and not to the capital account of the working member, they would be taxable income to such working member and deductible by the partners to whose capital accounts they were charged. See, for example, *Augustine M. Lloyd*, 15 B. T. A. 82 acq., C. B. VIII–1, 27 (1929); G. C. M. 6582, C. B. VIII–2, 200 (1929). Inasmuch as these capital depletions are ordinary and necessary expenses incurred in carrying on the business of each of such partners and, as such, deductible by them in computing their respective net incomes, then the "salary" drawings should be regarded as "gross income derived by an individual from any trade or business carried on by such individual" within the scope of the definition of net earnings from self-employment quoted above.

There is further support for the conclusion that these "salary" drawings should be treated as net earnings from self-employment as that term is defined in section 481(a). While these drawings are not a distributive share of the partnership's net income, they are amounts received in lieu of such distributive share under a guarantee contract entered into as an incident to the partnership operation.

REGULATIONS 118, SECTION 39.481–1: Net earnings from self-employment. Rev. Rul. 55–49

Income derived by an individual from the sale of real estate originally purchased as unimproved land and subsequently divided into lots and turned over to a real estate firm to sell constitutes income from a "trade or business" and should be included in computing net earnings from self-employment for purposes of the Self-Employment Contributions Act.

The question has been presented whether income received by an individual from the sale, through a real estate agency, of subdivided and improved real estate originally purchased as unimproved land, is subject to the tax imposed under the Self-Employment Contributions Act (subchapter E, chapter 1, Internal Revenue Code of 1939.)

The taxpayer in the instant case purchased a large tract of land which, at the time of purchase, he had no intention of subdividing. A few years later, however, he subdivided the tract and spent considerable sums of money to improve the tract, involving clearing the land, paving streets, installing street lights, water mains, fire hydrants, etc. He constructed and sold several homes on the property but, in view of the expenses incurred in connection with the subdivision of the tract, these sales were at a loss to him. Accordingly, he discontinued the building project. Since 1950, his interest in the real estate project has been confined to sales of the remaining lots in the tract. These sales are conducted exclusively by a real estate firm and the taxpayer devotes none of his time to the actual selling of the lots, neither does he make frequent visits to the location of the tract.

Section 481 of the Self-Employment Contributions Act provides in part as follows:

(a) NET EARNINGS FROM SELF-EMPLOYMENT.—The term "net earnings from self-employment" means the gross income derived by an individual from any trade or business carried on by such individual, less the deductions allowed by this chapter [chapter 1] 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 23 [Internal Revenue Code of 1939] except that such term shall not include—* * * (the exceptions are not here material).

Section 39.481-1(b)(2), Regulations 118, provides, among other things, that the trade or business must be carried on by the individual, either personally or through agents or employees.

Whether an individual is engaged in a "trade or business" is dependent upon all the facts and circumstances in the particular case. As a general rule, a person who is engaged in an occupation or profession for profit and who is not regarded as an employee for purposes of the Federal Insurance Contributions Act taxes is engaged in a "trade or business."

In the instant case, there are several factors which lead to the conclusion that the taxpayer is engaged in the business of selling property. He personally subdivided the tract of land and spent considerable sums of money in doing so. Even though he discontinued the part of his venture related to the building of homes, he never abandoned his intention of selling the remaining lots. The fact that he chose to conduct those sales through a real estate agency is not sufficient to exclude his income from those sales from the term "net earnings from self-employment."

Accordingly, it is held that the income derived by the individual from the sale of real estate originally purchased as unimproved land and subsequently divided into lots and turned over to a real estate firm to sell constitutes income from a "trade or business" and should be included in computing net earnings from self-employment for purposes of the Self-Employment Contributions Act.

REGULATIONS 118, SECTION 39.481–1: Net earnings from self-employment.

Income earned by an individual who maintains telephone informational service to various automobile dealers for the purpose of enabling their salesmen to complete sales on specific models of cars. See Rev. Rul. 55–113, page 481.

REGULATIONS 118, SECTION 39.481–1: Net earnings from self-employment.

Income received by an independent contractor from sources without the United States. See Rev. Rul. 55–172, page 98.

REGULATIONS 118, SECTION 39.481–1: Net earnings from self-employment.

Royalties and other income received from writing books and giving public lectures as sideline activities of a full time university professor. See Rev. Rul. 55–385, page 100.

REGULATIONS 118, SECTION 39.481–3: Trade or business. Rev. Rul. 55–258

An individual who, in addition to part-time employment, enters various and unrelated prize contests in his own behalf, and does not advise or act for others in entering such contests, is not engaged in a "trade or business" for purposes of the Self-Employment Contributions Act. Accordingly, the value of the prizes won by the contestant although subject to normal income tax and surtax is not includible in computing net earnings from self-employment.

A question has been raised whether the value of prizes won by a contestant in prize contests may be included in computing net earnings from self-employment for purposes of the Self-Employment Contributions Act (subchapter E, chapter 1, Internal Revenue Code of 1939).

In the instant case, an individual who is employed only on a part-time basis due to a physical condition, devotes approximately five hours daily to entering various and unrelated prize contests as a hobby. As a result the individual has, on occasions, won several prizes both of cash and merchandise. He does not advise or act for others in entering such contests but acts solely in his own behalf.

Section 481 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 chapter [chapter 1] 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 23, * * *."

In the instant case, it is held that the activity engaged in by the individual with respect to entering various and unrelated prize con-

tests in his own behalf as a hobby does not constitute a "trade or business," as contemplated by section 481 (c) of the Act. Accordingly, the value of prizes won by a contestant under the circumstances described above, although subject to normal income tax and surtax, is not includible in computing net earnings from self-employment.

REGULATIONS 118, SECTION 39.481-3: Trade or business.

Individual engaged in private tutoring. See Rev. Rul. 55-206, page 485.

REGULATIONS 118, SECTION 39.481-3: Trade or business.

Income derived from the operation of a watch repair department within a jewelry store. See Rev. Rul. 55-248, page 117.

REGULATIONS 118, SECTION 39.481-3: Trade or business.

Sexton of a cemetery. See Rev. Rul. 55-328, page 98

CHAPTER 2.—ADDITIONAL INCOME TAXES

SUBCHAPTER A.—PERSONAL HOLDING COMPANIES

SECTION 501.—DEFINITION OF PERSONAL HOLDING COMPANY

REGULATIONS 118, SECTION 39.501-1: Definition of personal holding company. Rev. Rul. 55-417

A finance company, operating in a State which does not have any specific statute relating to or pertaining to finance companies, may nevertheless be exempt from personal holding company surtaxes under the provisions of section 501(b)(8) of the Internal Revenue Code of 1939 provided such company otherwise meets the provisions of such section.

SECTION 502.—PERSONAL HOLDING COMPANY INCOME

REGULATIONS 118, SECTION 39.502-1: Mineral, oil, or gas royalties. Rev. Rul. 55-194

In G. C. M. 22730, C. B. 1941-1, 214, and G. C. M. 24849, C. B. 1946-1, 66, it is established that payments collected on in-oil payment

rights, which payment rights are carved out of larger depletable interests in oil and gas in place, do not ordinarily qualify as royalty income.

In view of the foregoing, it is held that, for the purpose of determining personal holding company income, oil production payments collected on in-oil payment rights which were not originally granted or reserved in a leasing transaction do not qualify as mineral, oil, or gas royalties within the meaning of section 502(h) of the Internal Revenue Code of 1939.

SUBCHAPTER E.—EXCESS PROFITS TAX [REPEALED AFTER 1945]

PART I

SECTION 718.—EQUITY INVESTED CAPITAL

REGULATIONS 112, SECTION 35.718–2: Determination of daily equity invested capital—Accumulated earnings and profits.

Accumulated earnings and profits shall reflect the increase or decrease in the Federal income and excess profits tax liability of the preceding year attributable to inventory replacements. See Rev. Rul. 55–28, page 359.

SECTION 721.—ABNORMALITIES IN INCOME IN TAXABLE PERIOD

REGULATIONS 112, SECTION 35.721–1: Abnormalities in income in taxable year.

Amount received by taxpayer in excess of his loan from the Commodity Credit Corporation after sale of his inventory. See Rev. Rul. 55–207, page 424.

SECTION 722.—GENERAL RELIEF—CONSTRUCTIVE AVERAGE BASE PERIOD NET INCOME

REGULATIONS 112, SECTION 35.722–5: Application for relief under section 722. Ct. D. 1781

(Also Section 3771.)

EXCESS PROFITS TAX—INTERNAL REVENUE CODE—DECISION OF SUPREME COURT.

1. INTEREST ON DEFICIENCY—INTEREST NOT ABATED WHEN APPLICATION OF SECTION 722, 1939 CODE, ABATES DEFICIENCY.

Abatement of portions of deficiencies in excess profits taxes by reason of allowance of applications for relief under section 722 of the Internal Revenue Code of 1939 did not relieve taxpayers of liability for interest on such deficiencies from the original due dates of the taxes abated. Although the deficiency for 1940 determined without reference to section 722 had not been assessed, it was correctly and adequately assessed after it was partially abated.

2. JUDGMENT REVERSED AND JUDGMENT AFFIRMED.

Judgment of United States Court of Claims (117 F. Suppl. 181) reversed, and judgment of United States Court of Appeals for the Fifth Circuit (209 F. 2d 692) affirmed.

SUPREME COURT OF THE UNITED STATES

29. *The United States, petitioner,* v. *Koppers Company, Inc., successor on merger to Koppers United Company and subsidiaries*

On writ of certiorari to the United States Court of Claims

41. *Premier Oil Refining Company of Texas, petitioner,* v. *United States of America*

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

[January 31, 1955]

OPINION

Mr. Justice BURTON delivered the opinion of the Court.

The issue in these cases is whether, for the years 1940 through 1945, abatements of federal excess profits taxes, through application of I. R. C., section 722,[1] are retroactive. For the reasons hereafter stated, we hold that they are not and that they relieve taxpayers from the payment of interest on deficiencies in such taxes from the time of the abatement, rather than from the original due dates of the taxes abated.

In No. 29, *United States* v. *Koppers Co.*, the taxpayer, respondent therein,[2] reported and paid excess profits taxes of $6,512.76 for 1940, and $1,781,288.14 for 1941.[3] In computing these taxes, it used excess profits credits based upon invested capital.[4] In 1943 and 1945, it applied under section 722 for relief from all or part of these taxes, claiming that they were "excessive and discriminatory."[5] In accordance with the usual administrative practice, the Commissioner determined the amount of the excess profits taxes due without regard to the application for relief under section 722. In doing so, he found it necessary to proceed under I. R. C., section 713, using excess profits credits based upon the taxpayer's income, rather than upon its invested capital. As a result he found that the above taxes, as returned and paid by the taxpayer without reference to section 722, had been understated and that the following deficiencies existed as of their original due dates, March 15, 1941, and 1942:

	1940	*1941*
Excess profits tax under §§ 710(a) and 713	$466, 921. 67	$2, 208, 019. 09
Payments	6, 512. 76	1, 781, 288. 14
Deficiencies	460, 408. 91	426, 730. 95

[1] "SEC. 722. GENERAL RELIEF—CONSTRUCTIVE AVERAGE BASE PERIOD NET INCOME.

"(a) GENERAL RULE.—*In any case in which the taxpayer establishes that the tax computed under this subchapter* [as to excess profits tax, sections 710 *et seq.*] *(without the benefit of this section) results in an excessive and discriminatory tax and establishes what would be a fair and just amount representing normal earnings to be used as a constructive average base period net income* for the purposes of an excess profits tax based upon a comparison of normal earnings and earnings during an excess profits tax period, *the tax shall be determined by using such constructive average base period net income in lieu of the average base period net income* otherwise determined under this subchapter. * * *

* * * * * * *

"(d) APPLICATION FOR RELIEF UNDER THIS SECTION.—*The taxpayer shall compute its tax, file its return, and pay the tax shown on its return under this subchapter without the application of this section, except as provided in section 710(a)(5).* The benefits of this section shall not be allowed unless the taxpayer within the period of time prescribed by section 322 and subject to the limitations as to amount of credit or refund prescribed in such section makes application therefor in accordance with regulations prescribed by the Commissioner with the approval of the Secretary. If a constructive average base period net income has been determined under the provisions of this section for any taxable year, the Commissioner may, by regulations approved by the Secretary, prescribe the extent to which the limitations prescribed by this subsection may be waived for the purpose of determining the tax under this subchapter *for a subsequent taxable year.*" (Emphasis supplied.) 56 Stat. 914-915, as amended, 57 Stat. 601-602, 26 U. S. C. sec. 722(a)(d).

The above provisions of sec. 722(d) apply to taxable years beginning after December 31, 1939. 57 Stat. 602.

[2] Koppers Company, Inc., is, in fact, the successor to Koppers United Company and its subsidiaries, which filed consolidated excess profits tax returns for the years in question. For convenience, all of such corporations are referred to as the taxpayer.

[3] This tax was computed and paid pursuant to the Excess Profits Tax Act of 1940, 54 Stat. 975, as amended. See I. R. C., sec. 710 *et seq.* On November 8, 1945, these provisions became inapplicable to any calendar year beginning after 1945. 59 Stat. 568.

[4] Two methods of computation of the excess profits credit were authorized: the invested capital method under I. R. C., sec. 714, or the base period income method under I. R. C., sec. 713.

[5] By timely consents, the Commissioner and the taxpayer agreed that the amount of any income, excess profits, or war profits tax due for 1940 and 1941 could be assessed at any time on or before June 30, 1951.

The Commissioner computed interest, at 6 percent on the above deficiencies, amounting to $217,376.07 for 1940, and $230,504.86 for 1941.[6]

After extended investigations and negotiations conducted under authority of section 722, the Commissioner and the taxpayer agreed upon a "constructive average base period net income" which fixed the excess profits credits for the years in question and, as a result, the relief available under section 722. After this agreement was approved by the Excess Profits Tax Council of the Bureau of Internal Revenue, the Commissioner determined that the above-stated deficiencies, with the benefit of section 722, should be reduced to $260,554.39 for 1940, and to $95,749.33 for 1941. The taxpayer consented to the assessment of these deficiencies, with interest as provided by law. Whereupon, the Commissioner issued a formal determination of them and assessed them against the taxpayer. He also assessed the above-stated interest charges, based upon the full amount of the original deficiencies.

The taxpayer paid the deficiencies and interest so assessed but claimed refunds of $94,358.71 for 1940, and $178,784.48 for 1941. Those sums represented the interest on the abatements in its excess profits taxes made under section 722. When the Commissioner disallowed the claims, the taxpayer sued in the Court of Claims to recover their amounts. With one judge dissenting, that court deducted a set-off and rendered judgment in favor of the taxpayer for $270,216.34. 126 Ct. Cl. 847, 117 F. Supp. 181. To resolve the resulting conflict with *United States* v. *Premier Oil Co.*, 209 F. 2d 692, we granted certiorari, 347 U. S. 965.

In No. 41, *Premier Oil Co.* v. *United States*, the taxpayer, petitioner therein, paid the excess profits taxes shown on its original returns in the following amounts: for 1943, $564,167.70 (adjusted to $560,484.84); for 1944, $353,292.15 (adjusted to $313,639.13); and for 1945, $45,679.67. Thereafter, several deductions which the taxpayer had made from its income were disallowed, resulting, in 1948, in the following deficiencies in its payment of its excess profits and income taxes as of their original due dates:

Deficiencies without the application of section 722

	1943	*1944*	*1945*
Deficiencies in excess profits tax, under §§ 710(a) and 713	$78, 359. 80	$55, 529. 92	$190, 785. 32
Deficiencies in income tax	9, 060. 07	9, 178. 01	(90. 00)
Total deficiencies	87, 419. 87	64, 707. 93	190, 695. 32

The Commissioner computed interest, at 6 percent, on the above excess profits tax deficiencies as follows:

For 1943—on $78,359.80, March 15, 1944, to June 23, 1948	$20, 084. 79
For 1944—on $55,529.92, March 15, 1945, to June 23, 1948	10, 901. 36
For 1945—on $190,785.32, March 15, 1946, to June 19, 1948	25, 869.26
	56, 855. 41

In the meantime, the taxpayer had applied for relief under section 722, seeking acceptance of a "constructive average base period net income" of $357,000 for each of the years at issue. The Excess Profits Tax Council approved that figure as a credit in lieu of $93,150.36 for each of the years 1943 and 1944, and of $116,437.95 for 1945. This credit so far reduced the taxpayer's taxable excess profits as to abate its excess profits tax deficiencies for 1943 and 1944 entirely, and that for 1945 to $366.52.[7] Accordingly, the Commissioner's assessment of the remainder of the taxpayer's deficiencies in excess profits taxes was for only $366.52. However, as in the *Koppers* case, *supra*, he assessed against the taxpayer the full amount of the interest charges based upon the original deficiencies.

The taxpayer paid the deficiency and interest so assessed but claimed refunds totaling $56,855.41. That sum represented the interest on the abatements in its excess profits taxes made under section 722. When the Commissioner disallowed

[6] The interest on the 1940 tax ran from March 15, 1941, to January 28, 1949, which was treated as the date of its payment; that on the 1941 tax ran from March 15, 1942, to March 16, 1951, which was 30 days after the filing of a waiver consenting to the assessment and collection of the deficiencies finally determined. See I. R. C., sec. 292(a), *infra*, note 12.

[7] Abatement of excess profits tax deficiencies under section 722.

	1943	*1944*	*1945*
Deficiencies without application of § 722	$78, 359. 80	$55, 529. 92	$190, 785. 32
(Decreases) under § 722	(175, 307. 78	(175, 174. 49)	(190, 418. 80)
Resulting (credits) and deficiency	(96, 947. 98)	(119, 644. 57)	366. 52

By reducing that part of the taxpayer's income that was subject to excess profits taxes, this application of section 722 automatically left more of the taxpayer's income subject to the normal tax and surtax. Those increases in the taxpayer's income taxes and their consequences are not before us.

those claims, the taxpayer brought the instant action to recover their amounts, in the United States District Court for the Northern District of Texas, under 28 U. S. C. section 1346(a)(1). That court rendered judgment for the taxpayer.[8] 107 F. Supp. 837. The Court of Appeals reversed. 209 F. 2d 692. We granted certiorari to resolve the conflict with *United States* v. *Koppers Co.*, *supra*. 347 U. S. 987.[9]

As the underlying issue is the same in each case and for each year, we shall discuss it in relation to the 1940 taxes in the *Koppers* case. There, the taxpayer, under the usual procedure, computed and paid the excess profits tax of $6,512.76 shown on its return for 1940. In due course the Commissioner, without the application of section 722, determined that the payment should have been $466,921.67, and, therefore, that a deficiency of $460,408.91 was due the United States, with interest from March 15, 1941. I. R. C., sections 53(a), 56(a). If the taxpayer had made no application for relief under section 722, there is no doubt that such interest would have remained due the United States until paid and that, when paid, it would not have been refundable. The same would have been true if the taxpayer's application for relief under section 722 had been finally denied. The taxpayer contends, however, that, because the Commissioner has abated the taxpayer's deficiency from $460,408.91 to $260,554.39 under section 722, such reduction is necessarily retroactive to March 15, 1941, and that the taxpayer, accordingly, is entitled to a refund of the interest on the sum abated. The Commissioner, on the other hand, contends that the determination under section 722 is not retroactive but is a current abatement effective when made.

Congress could have prescribed either treatment but did not expressly specify either. Our answer is determined from our consideration of the statutory scheme as a whole, the related provisions of the statute, the legislative history of section 722 and the administrative interpretation that has been given the statute.

1. The Statutory Scheme as a Whole.

The excess profits tax was a device initiated by Congress, late in 1940, in great part for the quick collection of large sums needed by the Government in a national emergency. Congress sought to obtain those funds from abnormally high corporate profits while such profits were available. To that end, it prescribed computations of unusual profits and required prompt payment of the taxes on them.[10]

From the beginning the statute also provided, in section 722, a means of subsequent adjustment of the tax in special instances where the normal computation of the tax was found to result in inequity. The adjustment could be made only after administrative action and, pending its consideration, it did not eliminate the tax return or the tax payment otherwise required. Until 1942, it did not permit even the postponement of the payment of any part of the standard tax. Indeed, the full payment of that tax soon was made an express condition of the application for adjustment. I. R. C., section 722 (d). In 1943, Congress stated that if overpayments for either of the taxable years 1940 or 1941 were found to be attributable to section 722, no interest on such overpayments was to be paid the taxpayer.[11] At least to that extent, Congress expressly recognized that the funds paid as excess profits taxes, when due and without the benefit of section 722, were funds owed to and usable by the Government.

The significance of this statutory scheme further appears when it is applied to the instant case. If the instant taxpayer had paid its required tax in 1941, the Government would have received an additional $460,408.91 at that time. Accordingly, it would have had the use of that money, without charge, during the crucial war years. Correspondingly, the taxpayer would have been without that money during the same period. Instead, the taxpayer, in fact, retained the funds for its own use and now contends that it need not compensate the Government for such use of a substantial part of it.

[8] The original judgment for $56,855.41 was modified to $52,292.40 to reflect several adjustments, including the deduction of $49.72, representing interest on the unabated deficiency of $366.52 upon which the taxpayer conceded that interest was chargeable.

[9] The grant was limited to the following question stated in the petition:

"Where a deficiency in excess profits tax, based on the income and credits as shown in the taxpayer's return, would have existed except for the subsequent application of Section 722 of the Internal Revenue Code, is the taxpayer liable for interest on the amount of such deficiency (hereinafter called the 'potential deficiency') which would have existed had it not been extinguished by the application of Section 722?" 347 U. S., at 988.

[10] I. R. C., sec. 713—on the basis of income, or I. R. C., sec. 714—on the basis of invested capital. I. R. C., sec. 721, authorized standard allowances for specified abnormalities. No return by the taxpayer under I. R. C., sec. 722, was permissible.

[11] I. R. C., sec. 3771(g), *infra*, note 15, discussed at 12-13, *infra*.

While in the instant case the taxpayer did not underpay any amount actually shown on its return, as contemplated by I. R. C., section 294(a), it understated its tax and thus withheld the amount in question. The detriment to the Government and benefit to the taxpayer was the same—the use of $460,408.91 for 8 years. The above distinction, emphasized by the taxpayer, may have helped it in initiating its application for relief under section 722(d) because it could establish that, at least, it had paid "the tax shown on its return." The distinction, however, supplies no ground for different results once the deficiencies have been determined. We find no implication that a self-serving error in the understatement of its tax on its tax return entitles the taxpayer to a greater ultimate tax advantage than does a self-serving error of the same size in the underpayment of the same tax. *A fortiori* we find nothing to justify a greater tax advantage to any taxpayer that underpays its correct tax, over one that pays such tax in full when due.

2. THE INTEREST HERE IN CONTROVERSY IS ATTRIBUTABLE TO I. R. C., SECTION 292(a).[12]

The interest here in controversy was due under section 292(a) from March 15, 1941, until paid. Accordingly, to obtain a refund of it, the taxpayer must sustain the proposition that the tax relief granted under section 722 is necessarily retroactive, extinguishing the deficiency as of the original due date of the tax and thus eliminating the interest charges for the corresponding period. To that end, the taxpayer emphasizes the statement in section 722(a) that, as a condition of securing the application of section 722, a taxpayer must establish that the usual procedure "results in an excessive and discriminatory tax" and also must establish "what would be a fair and just amount representing normal earnings to be used as a constructive average base period net income." Once the taxpayer has done that, "the tax shall be determined by using such constructive average base period net income in lieu of the average base period net income otherwise determined under this subchapter." Standing alone, this directive language is elastic. It can be read consistently either with the interpretation that the new computation replaces and abates the old one currently, when the new one is determined and assessed, or that it retroactively replaces the old tax from its original due date. It leaves the issue open for disposition by the effect of other clauses relating more specifically to the issue. For the reasons hereafter stated, we read it as looking forward, rather than backward.[13]

3. I. R. C., SECTION 710 (a)(5),[14] PERMITS A TAXPAYER, SEEKING RELIEF UNDER SECTION 722, TO DEFER A PART OF ITS EXISTING EXCESS PROFITS TAXES WHERE ITS ADJUSTED EXCESS PROFITS NET INCOME EXCEEDS 50 PERCENT OF ITS NORMAL TAX NET INCOME.

In 1942, Congress added section 710(a)(5), conditionally authorizing partial deferment of the tax in cases where a taxpayer claimed benefits under section

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[12] "SEC. 292. INTEREST ON DEFICIENCIES.
"(a) GENERAL RULE.—Interest upon the amount determined as a deficiency shall be assessed at the same time as the deficiency, shall be paid upon notice and demand from the collector, and shall be collected as a part of the tax, at the rate of 6 per centum per annum from the date prescribed for the payment of the tax (or, if the tax is paid in installments, from the date prescribed for the payment of the first installment) to the date the deficiency is assessed, or, in the case of a waiver under section 272(d), to the thirtieth day after the filing of such waiver or to the date the deficiency is assessed whichever is the earlier." 53 Stat. 88, as amended, 57 Stat. 602, 26 U. S. C. section 292(a).

[13] Section 722(d) looks forward when it provides that if a constructive base period net income has been determined under sec. 722 for any taxable year, the Commissioner may, by regulations approved by the Secretary, permit waivers of the section's limitations for the purpose of determining excess profits taxes for a subsequent taxable year. Even this effect is not automatic, whereas it might have been expected to be so if the adjustment were a retroactive correction of the standard excess profits credit.

[14] "SEC. 710. IMPOSITION OF TAX.
"(a) * * *

* * * * * * *

"(5) DEFERMENT OF PAYMENT IN CASE OF ABNORMALITY.—If the adjusted excess profits net income (computed without reference to section 722) for the taxable year of a taxpayer which claims on its return, in accordance with regulations prescribed by the Commissioner with the approval of the Secretary, the benefits of section 722, is in excess of 50 per centum of its normal tax net income for such year, computed without the credit provided in section 26(e) (relating to adjusted excess profits net income), the amount of tax payable at the time prescribed for payment may be reduced by an amount equal to 33 per centum of the amount of the reduction in the tax so claimed. For the purposes of section 271, if the tax payable is the tax so reduced, the tax so reduced shall be considered the amount shown on the return." 54 Stat. 975, as

Footnote 14 continued on the following page.

722. The condition was that the taxpayer's "adjusted excess profits net income (computed without reference to section 722)" must exceed 50 percent of the taxpayer's normal tax net income for the year. Even then, deferment was limited to 33 percent of the benefit claimed under section 722. If a taxpayer, without this amendment, could have successfully deferred payment and avoided interest charges by following the course taken in the instant cases, it could, by understatement of its tax, have deferred, without incurring interest charges, the payment of a corresponding part of its tax pending relief. If so, there would have been little need for section 710(a)(5). The 1942 amendment, by its restrictions, fairly meant that, under all other circumstances, the existing taxes were to be paid when due, or be subjected to interest during their delinquency under section 292(a).

4. THE DENIAL OF INTEREST ON REFUNDS IS PRESCRIBED BY I. R. C., SECTION 3771(g).[15]

Although section 3771(g) was not enacted until 1943, it was then made applicable to taxable years before, as well as after, January 1, 1942. It denied all interest on refunds attributable to section 722 where the refunds related to the taxable years 1940 or 1941. It also denied interest on refunds relating to taxable years beginning after January 1, 1942, but limited such denials to the first year after the filing of an application for relief under section 722, or to periods prior to September 16, 1945 (2 years after the effective date of the amendment), whichever was the later.[16]

In cases where the Government has authorized refunds of excess profits taxes overpaid to it by reason of the abatement of taxes attributable to section 722, section 3771(g) expressly precludes the payment of interest by the Government upon the amounts abated. This treats the Government as entitled to the use of the abated amounts between the time of their overpayment and that of their abatement. Equity demands a comparable result in the case of underpayments. Where unpaid taxes are abated by reason of section 722, the taxpayer then receives a release from its existing obligation to pay the amount abated. However, the Government having been entitled, up to that time, to collect and use the sum abated, the Government should receive interest, on the abated sum, for the period during which the Government was entitled to have its use. This is the natural counterpart of the Government's freedom from paying interest on refunded overpayments.

5. THE LEGISLATIVE HISTORY OF SECTION 722.

The excess profits tax was initiated in 1940. 54 Stat. 975 *et seq.* It provided for prompt payment of large taxes computed on income reflecting unusual profits, Computation of the tax on the basis of the taxpayer's prior income or invested capital was prescribed in sections 713 and 714. A stand-

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amended, 56 Stat. 917, but see also, later amendment indicated by 26 U. S. C. section 710(a)(5).

The Senate Committee on Finance Report accompanying the Revenue Act of 1942, 56 Stat. 798, stated:

"Although it is believed advisable to require a taxpayer seeking relief under section 722 to compute and pay its tax without the benefit of such section, there are some cases in which it would be inequitable to compel the taxpayer to pay the entire amount of such tax. Section 710(a) is therefore amended to provide * * * [as above quoted]." S. Rep. No. 1631, 77th Cong., 2d Sess. 205.

[15] "SEC. 3771. INTEREST ON OVERPAYMENTS.

* * * * * * *

"(g) CLAIMS BASED UPON RELIEF UNDER SECTION 722.—If any part of an overpayment for a taxable year beginning prior to January 1, 1942, is determined by the Commissioner to be attributable to the final determination of an application for relief or benefit under section 722 for any taxable year, no interest shall be allowed or paid with respect to such part of the overpayment. If any part of an overpayment for a taxable year beginning after December 31, 1941, is determined by the Commissioner to be attributable to the final determination of an application for relief or benefit under section 722 for any taxable year, no interest shall be allowed or paid with respect to such part of the overpayment for any period prior to one year after the filing of such application, or September 16, 1945, whichever is the later." 53 Stat. 465, as amended, 57 Stat. 602, 26 U. S. C. sec. 3771(g).

[16] The same Act added I. R. C., sec. 292(b), containing comparable provisions prohibiting the assessment of interest upon deficiencies attributable to the final determination of an application for relief under sec. 722. 53 Stat. 88, as amended, 57 Stat. 602, 26 U. S. C. sec. 292(b). This applied, for example, to deficiencies in the payment of ordinary income taxes resulting from an abatement under sec. 722 of excess profits taxes. Such an abatement automatically would leave a larger portion of a corporation's taxable income subject to the normal income tax and surtax. This increase, however, was not made retroactive any more than the decrease in the excess profits tax which caused it was made retroactive. Congress thus appropriately charged no interest on the resulting deficiency just as it had allowed none on the related overpayment.

ardized treatment of abnormalities was provided in section 721. In addition, section 722 authorized the Commissioner "to make such adjustments as may be necessary to adjust abnormalities affecting income or capital." 54 Stat. 986. The procedure under section 722 was formalized by the Excess Profits Tax Amendments of 1941, 55 Stat. 23–25, and put in its final form by the Revenue Act of 1942, 56 Stat. 914–917, as amended, 57 Stat. 601–602. The technical and discretionary nature of the adjustment was emphasized by the provision that the determination of most computations under section 722 was reviewable only by a special division of the Tax Court constituted for the occasion and by no other court or agency. 55 Stat. 26, as amended, 56 Stat. 917, 59 Stat. 295, 673, 26 U. S. C. section 732. A taxpayer never was permitted to file a return of its own under section 722. S. Rep. No. 75, 77th Cong., 1st Sess. 13; H. R. Rep. No. 146, 77th Cong., 1st Sess. 13.

The statute has been interpreted as authorizing a procedure that is in the nature of a claim for a refund preceded by long investigations of complicated special circumstances, and followed by extended negotiations between the Commissioner and taxpayer to develop a mutually satisfactory "constructive average base period net income." This interpretation leaves the usual procedure under section 710 *et seq.* complete in itself but subject, upon application, to ultimate adjustment in instances accepted by the Commissioner under section 722.[17] We find no statement of a purpose that section 722 shall relieve taxpayers from penalties or interest charges due either to their defaults in paying, or their errors in computing, their taxes. On the contrary, it has been suggested that Congress considered relief under section 722 to be in the nature of a favor and as not relieving the taxpayer of its duty to pay the original tax when due.[18]

The regulations do not deal specifically with the issue before us but, from their beginning, in Treasury Regulations 109, they have been consistent with the interpretation given the Act by the Government. See section 30.722-5, as added by T. D. 5264, 1943 Cum. Bull. 761, as amended, T. D. 5393, 1944 Cum. Bull. 415. In addition to the practice of the Commissioner in the instant cases, there is in the record of the *Premier Oil Co.* case an undisputed affidavit by a Treasury Department reviewer to the effect that the policy followed was the administrative policy of the Bureau:

> "It is the policy of the Bureau of Internal Revenue in those cases where all or any part of a tax deficiency has been extinguished by application of the relief provisions of Section 722 of the Internal Revenue Code not to assess the extinguished portion of such deficiency. *However, interest has been computed and assessed on the extinguished portion of the deficiency* from the due date of the return to the thirtieth day after the agreement, Form 874, is filed or date of assessment, whichever is the earlier. (Emphasis supplied.)

While *Manning* v. *Seeley Tube & Box Co.*, 338 U. S. 561 [Ct. D. 1729, C. B. 1950-1, 113], relates to the carryback provisions of the Internal Revenue Code, it is

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[17] When Congress, in a later Act, authorized deferment of payments of comparable taxes pending determinations of applications for relief, it did so unequivocally. The relief provisions in the Excess Profits Tax Act of 1950, 64 Stat. 1137, adding I. R. C., secs. 430–472, prescribed formulas for determining a substitute average base period net income, secs. 442–446, and permitted the taxpayer to adjust its base period net income at the time the return was filed, sec. 447(e). See S. Rep. No. 2679, 81st Cong., 2d Sess. 17–21, discussing the general relationship between these provisions and the experience gained under sec. 722 now before us.

[18] See legislative history outlined in *American Coast Line* v. *Commissioner*, 159 F. 2d 665 [Ct. D. 1690, C. B. 1947-2, 129] and *Pohatcong Hosiery Mills* v. *Commissioner*, 162 F. 2d 146 [Ct. D. 1693, C. B. 1947-2, 122].

"* * * there is no doubt a difference between a tax, conceded to be due in the corporation's own return, and a tax assessed against it in invitum. This argument might perhaps be persuasive, if the denial of 'benefits' under section 722 were regarded as a constituent factor of the tax itself, as for example are the conditions detailed in section 721. We do not so regard section 722: on the contrary it was a favor; it presupposed that, even after taking into account the ameliatory conditions of section 721, the tax was due unless ex gratia the blow was softened; it was a tempering of the wind to the shorn lamb." Circuit Judge Learned Hand, for the court, 159 F. 2d, at 668. See also, *Ideal Packing Co.* v. *Commissioner*, 9 T. C. 346, 349; *Uni-Term Stevedoring Co.* v. *Commissioner*, 3 T. C. 917, 918.

"In each instance the section [722] provided that a hypothetical base period earnings credit be 'tailor made' for the particular taxpayer and that certain assumptions be made in connection with the case. Each case was a problem in research, and the legal or tax result generally was intertwined with complicated accounting and economic problems. Almost every factor which had any influence on the particular business was pertinent to the case and the time and expense involved in reconstructing the average base period earnings credit were tremendous." S. Rep. No. 2679, 81st Cong., 2d Sess. 17.

thoroughly consistent in principle with the above discussion. There the Court upheld the collection of interest on a deficiency which later was extinguished by carrying back a loss which occurred in a subsequent year. It treated the carryback as a current adjustment of the tax previously determined, characterizing it as an "abatement" at 565. It recognizes I. R. C., section 3771(e), as a help to the interpretation of the statute, much as we recognize I. R. C., section 3771(g), as a help here. See 567-568. The Court also there announced that "In the absence of a clear legislative expression to the contrary, the question of who properly should possess the right of use of the money owed the Government for the period it is owed must be answered in favor of the Government." Id., at 566.[19]

While the deficiency for 1940 in the amount of $460,508.91 was properly determined without reference to section 722 and treated as a deficiency for that year by the Commissioner, it was not separately assessed as much. This was not necessary because, at the time of its determination and before its assessment, it was abated to $260,554.39. The latter sum, with interest in the amount of $217,376.07 computed on the whole deficiency of $460,408.91, was correctly and adequately assessed and paid.[20]

For the foregoing reasons, we conclude that the Government, in each case, is entitled to retain the interest now in controversy. Therefore, in No. 29, the judgment of the Court of Claims is reversed and, in No. 41, the judgment of the Court of Appeals is affirmed.

No. 29—Reversed.

No. 41—Affirmed.

Mr. Justice REED and Mr. Justice DOUGLAS dissent.

CHAPTER 3.—ESTATE TAX

SUBCHAPTER A.—BASIC ESTATE TAX

PART II.—ESTATES OF CITIZENS OR RESIDENTS OF THE UNITED STATES

SUBPART I.—COMPUTATION OF TAX

SECTION 811.—GROSS ESTATE

REGULATIONS 105, SECTION 81.10: Valuation of property. (Also Section 81.13.) — Rev. Rul. 55-301

United States Savings Bonds of Series G and Series K will be redeemed at par (principal amount) before maturity after 6 months from the issue date upon the death of an owner or coowner, if a natural person, at the option of the persons entitled to the bonds. Where such bonds are redeemed prior to maturity the interest thereon ceases at the end of the interest period next preceding the date of redemption. See sections 315.23(c) and 315.21(d) of Treasury Department Circular No. 530, Seventh Revision, dated May 21, 1952. Accordingly, the par value (principal amount) of United States Savings Bonds of Series G or K owned by a decedent at the time of his death constitutes the value at which the bonds are includible in his gross estate for Federal estate tax purposes. Where the owner of such

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[19] See also, *Standard Roofing & Material Co.* v. *United States*, 199 F. 2d 607; *Rodgers* v. *United States*, 123 Ct. Cl. 779, 108 F. Supp. 727; *Cumberland Portland Cement Co.* v. *United States*, 101 F. Supp. 577, aff'd, 202 F. 2d 152.

[20] See *Rodgers* v. *United States, supra*; *Cumberland Portland Cement Co.* v. *United States, supra.*

bonds dies between interest payment dates no amount is includible in his gross estate as accrued interest from the last interest payment date to the date of death.

REGULATIONS 105, SECTION 81.10: Valuation of property.

Valuation of jewelry, furs and related articles of personal property in Federal gift tax returns. See Rev. Rul. 55-71, page 110.

SECTION 811(a).—GROSS ESTATE: DECEDENT'S INTEREST

REGULATIONS 105, SECTION 81.13: Property of decedent at time of death. Rev. Rul. 55-123

The right of a decedent's estate to receive payment for legal services performed by the decedent on a contingent fee basis constitutes an interest in property, the value of which is includible in his gross estate for Federal estate tax purposes.

Advice has been requested whether the right of the executor of the decedent's estate to receive payment for legal services performed by the decedent on a contingent fee basis constitutes an interest in property within the meaning of section 811(a) of the Internal Revenue Code of 1939.

The decedent, an attorney, was engaged in the handling of negligence cases in the State of New York on a contingent fee basis. As the result of a disposition of some of the cases in the client's favor after decedent's death, the executor received certain payments during the year following decedent's death. The executor elected to have the property of the estate valued in accordance with section 811(j) of the Internal Revenue Code of 1939.

As a general rule, the executor or administrator of the estate of a deceased attorney is entitled to recover the reasonable value of the services rendered by the deceased on a contingent fee basis upon the subsequent termination of the litigation in the client's favor. The general rule is stated in section 175, American Jurisprudence, Vol. 5, as follows:

> In the case of the disability or death of an attorney employed on a contingent basis before final adjudication or settlement has been obtained, he or his estate, as the case may be, will be allowed to recover the reasonable value of the services rendered by him upon the subsequent successful termination of the litigation in the client's favor.

A leading case on the subject is the New York case of *Sargent* v. *N. Y. Central & H. R. R. Co. et al.*, 209 N. Y. 360, 103 N. E. 164. In that case an attorney had entered into a contingent fee contract with his client to prosecute the latter's claim for damages against a railroad company. The attorney died before the case was concluded and the railroad company thereafter settled the case. The administrator of the deceased attorney's estate brought suit against the railroad company to enforce the attorney's charging lien which had attached to the client's cause of action at the time it was filed. In New York a

decedent attorney's estate not only has the contingent right of *quantum meruit* to rely on, but there is also a lien upon the cause of action under paragraph 475 of the Judiciary Law of the State of New York. In holding that the attorney's estate was entitled to recover the reasonable value of the decedent's services and that the railroad company was liable therefor under the attorney's charging lien, the court said:

> If a lawyer dies, before he has prosecuted to judgment or settlement, litigation which he has undertaken to conduct for a certain compensation, his contract is at an end, because both parties must be supposed to contemplate the continuance of his ability to perform as a condition of the contract, * * * and the compensation agreed upon cannot be recovered by his representative under the agreement, because he did not, and his representative cannot, carry out his agreement.
>
> The extent of the recovery permitted his representative is the full reasonable value of the services rendered under the contract, not exceeding, however, the sum or the rate fixed by it.

See also *In re Lake's Estate*, 123 N. Y. S. 2d 307 (1953), which involved a similar situation where the court in reliance upon the Sargent case said that "* * * under these circumstances, the extent of the recovery permitted to his representative is the full reasonable value of the services rendered under the contract, not exceeding, however, the sum or rate fixed by it." The case of *In re Coleman*, 87 Fed. (2d) 753, is considered distinguishable from the instant case as it did not involve recovery for legal services on a *quantum meruit* basis.

In the *Estate of G. Percy McGlue* v. *Commissioner*, 41 B. T. A. 1199, the United States Board of Tax Appeals (now the Tax Court of the United States) said that the term "property" as used in the estate tax statute "embraces all choses in action, including claims for compensation for services performed." Compare *Edward F. McClennen* v. *Commissioner*, 131 Fed. (2d) 165, and *Bank of California* v. *Commissioner*, 133 Fed. (2d) 428.

In the instant case, the decedent's right to receive payment for services rendered in cases completed in his lifetime was fixed by contract. After the decedent's death, his personal representatives had a right to recover on a *quantum meruit* basis the reasonable value of the services rendered by him on a contingent fee basis in the cases in which settlements or judgments were obtained after his death. This right of the personal representatives is a chose in action, a species of personal property.

A determination of the fair market value as of the date of decedent's death, or other applicable valuation date, of the right of the personal representatives of a deceased attorney to recover for services rendered on a contingent fee basis in cases remaining unsettled as of such date may present a difficult problem, but it is possible to fairly appraise or estimate the value of such right. Compare *Helvering* v. *Safe Deposit & Trust Company of Baltimore*, 316 U. S. 56, Ct. D. 1552, C. B. 1942–1, 246.

In the instant case the executor elected to have the property of the estate valued in accordance with section 811(j) of the Internal Revenue Code of 1939; that is, one year after the date of death or as of the date of sale, exchange, or other disposition in the interim. The amount realized by the estate during the year following the decedent's death for his services constitutes a disposition of the claim for compensation and the amount received therefor represents the fair market value of the property as of the date of such disposition. In

view of the foregoing, it is held that the fair market value as of the applicable valuation date of the right of the executor to receive compensation for legal services performed by the decedent on a contingent fee basis is includible in his gross estate as an interest in property within the purview of section 811(a) of the Internal Revenue Code of 1939.

Since the contrary position expressed by the United States Board of Tax Appeals in the case of the *Estate of Joe Crail* v. *Commissioner*, B. T. A. Memorandum Opinion entered June 30, 1942, is not considered to be a proper interpretation of the law on this issue, the Internal Revenue Service will not follow that case in the disposition of other cases involving the same issue.

REGULATIONS 105, SECTION 81.13: Property of decedent at time of death. Rev. Rul. 55–418

The value of all real estate owned by an Osage Indian at the date of his death is includible in his gross estate for Federal estate tax purposes except the value of a homestead allotment consisting of either agricultural and grazing lands, not exceeding a total of 160 acres, or village, town, or city property not exceeding in cost $5,000.

Advice has been requested whether for Federal estate tax purposes there is a limitation on the homestead allotment of a deceased Osage Indian not having a certificate of competency.

Homestead allotments of Osage Indians are exempt from Federal taxation under the following statutes:

Act of June 28, 1906, 34 Stat. 539–541.

* * * Each member of said tribe shall be permitted to designate which of his three selections shall be a homestead, and his certificate of allotment and deed shall designate the same as a homestead, and the same shall be inalienable and non-taxable until otherwise provided by Act of Congress. * * *

Act of March 2, 1929, 45 Stat. 1478–1479.

* * * Homestead allotments of Osage Indians not having a certificate of competency shall remain exempt from taxation while the title remains in the original allottee of one-half or more of Osage Indian blood and in his unallotted heirs or devisees of one-half or more of Osage Indian blood until January 1, 1959; *Provided*, That the tax-exempt land of any such Indian allottee, heir, or devisee shall not at any time exceed one hundred and sixty acres. * * *

Act of June 24, 1938, 52 Stat. 1034–1036.

* * * Homestead allotments of Osage Indians not having a certificate of competency shall remain exempt from taxation while the title remains in the original allottee of one-half or more of Osage Indian blood and in his unallotted heirs or devisees of one-half or more of Osage Indian blood until January 1, 1984: *Provided*, That the tax-exempt land of any such Indian allottee, heir, or devisee shall not at any time exceed one hundred and sixty acres. * * *

The Act of June 20, 1936, 49 Stat. 1542, which applied to Indians generally, including Osage Indians, provided, in part, as follows:

SEC. 2. All lands the title to which is now held by an Indian subject to restrictions against alienation or encumbrance except with the consent or approval of the Secretary of the Interior, heretofore purchased out of trust or restricted funds of said Indian, are hereby declared to be instrumentalities of the Federal Government and shall be nontaxable until otherwise directed by Congress.

Section 2 of the Act of June 20, 1936, *supra*, was amended by the Act of May 19, 1937, 50 Stat. 188, to read as follows:

All homesteads, heretofore purchased out of the trust or restricted funds of individual Indians, are hereby declared to be instrumentalities of the Federal Government and shall be nontaxable until otherwise directed by Congress: Provided, That the title to such homesteads shall be held subject to restrictions against alienation or encumbrance except with the approval of the Secretary of the Interior: And provided further, That the Indian owner or owners shall select, with the approval of the Secretary of the Interior, *either* the agricultural and grazing lands, not exceeding a total of one hundred and sixty acres, *or* the village, town, or city property, not exceeding in cost $5,000, to be designated as a homestead. [Italics supplied.]

Under the foregoing statutes relating specifically to the Osage Indians, it is clear that the homestead resulting from the designation of allotted lands is limited to 160 acres. The provisions and the legislative history of section 2 of the Act of June 20, 1936, as amended, indicate no purpose to permit the designation by any Indian of a second homestead in lands purchased out of trust or restricted funds while at the same time the Indian purchaser retains a duly designated homestead in allotted or previously purchased land. Where land purchased out of trust or restricted funds of individual Indians is properly selected as a homestead, however, it may under that section consist either of agricultural and grazing land not exceeding 160 acres, or village, town, or city property not exceeding in cost $5,000.

In view of the foregoing, it is held that the value of all real estate owned by an Osage Indian at the date of his death is includible in his gross estate for Federal estate tax purposes except the value of a homestead either in allotted lands or in lands purchased out of trust or restricted funds, in accordance with the limitations stated in the preceding paragraph. Compare Rev. Rul. 54–168, C. B. 1954–1, 182.

Regulations 105, Section 81.13: Property of decedent at time of death.

Lump sum payment to the widow or widower of the deceased or to any person entitled thereto under Title II of the Social Security Act. See Rev. Rul. 55–87, page 112.

SECTION 811(c).—GROSS ESTATE: TRANSFER 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.

Reporting transfer to income participation fund of charitable organization. See Rev. Rul. 55–275, page 295.

Regulations 105, Section 81.18: Transfers with possession or enjoyment retained. Rev. Rul. 55–302

Where a decedent purchased a single premium joint life and survivorship annuity contract from an insurance company subsequent to March 3, 1931, the value of the survivors annuity or, if

the survivor annuitant predeceased the decedent, the present worth of refund payments due under the contract is includible in the decedents gross estate under section 811(c) of the Internal Revenue Code of 1939.

Advice has been requested whether the value of a single premium joint life and survivorship annuity contract purchased by a decedent from an insurance company subsequent to March 3, 1931, is includible in his gross estate in view of the decision in *Estate of Mary L. Pruyn* v. *Commissioner*, 184 Fed. (2d) 971.

Where subsequent to March 3, 1931, a decedent has purchased an annuity payable to himself for life and thereafter to a survivor annuitant for life, the value of the survivor's annuity based on replacement cost is includible in the decedent's gross estate under section 811(c) of the Internal Revenue Code of 1939. See *Commissioner* v. *C. F. Clise et al.*, 122 Fed. (2d) 998, cert. denied 315 U. S. 821; *Commissioner* v. *Estate of A. M. Wilder*, 118 Fed. (2d) 281, cert. denied 314 U. S. 634. However, where the survivor annuitant of a joint life and survivorship annuity policy predeceases the decedent, the present worth of the refund payments due under the contract is includible in the decedent's gross estate under section 811(c) of the Code.

A similar annuity contract was considered in *Estate of Mary L. Pruyn* v. *Commissioner*, *supra*. In that case it was held that the value of the annuity contract was not includible in the decedent's gross estate. There, however, the annuity was purchased prior to March 4, 1931, and, therefore, was nontaxable under the provisions of section 7 of the Technical Changes Act of 1949, 63 Stat. 891, 26 U. S. C. 811(c), C. B. 1949-2, 275, at 279. In this connection, see *Estate of John M. Goetchius* v. *Commissioner*, 17 T. C. 495.

In view of the foregoing, it is held that where the decedent purchased a single premium joint life and survivorship annuity policy from an insurance company subsequent to March 3, 1931, the value of the survivor's annuity or, if the survivor annuitant predeceased the decedent, the present worth of refund payments due under the contract is includible in the decedent's gross estate under section 811(c) of the Internal Revenue Code of 1939.

REGULATIONS 105, SECTION 81.18: Transfers with possession or enjoyment retained. Rev. Rul. 55-378

Where the decedent transferred substantially all of his property into a trust account for the benefit of his children, reserving the right to withdraw from the income or the principal, if necessary, a specified annuity or an amount equal to his living expenses, the transfer was not a bona fide sale for an adequate and full consideration in money or money's worth for the purposes of section 811(c)(1)(B) of the Internal Revenue Code of 1939, and the value of the property transferred is includible in his gross estate for Federal estate tax purposes.

Advice has been requested whether the value of certain property transferred by the decedent is includible in his gross estate for Federal estate tax purposes under the following circumstances:

On April 1, 1931, the decedent transferred substantially all of his property valued at approximately $100,000 into a trust account for the

benefit of his children, reserving the right to withdraw from the income or the principal of the account $2,500 a year or all of his living expenses. From the time of the transfer to the date of decedent's death his children paid all of his living expenses which amounted to more than the net income from the property.

Section 811 of the Internal Revenue Code of 1939 provides, in part, as follows:

> The value of the gross estate of the decedent shall be determined by including the value at the time of his death of all property, real or personal, tangible or intangible, wherever situated, except real property situated outside of the United States—
>
> * * * * * * *
>
> (c) TRANSFERS IN CONTEMPLATION OF, OR TAKING EFFECT AT, DEATH.—
>
> (1) GENERAL RULE.—To the extent of any interest therein of which the decedent has at any time made a transfer (except in case of a bona fide sale for an adequate and full consideration in money or money's worth), by trust or otherwise—
>
> * * * * * * *
>
> (B) under which he has retained for his life or for any period not ascertainable without reference to his death or for any period which does not in fact end before his death (i) the possession or enjoyment of, or the right to the income from, the property, or (ii) the right, either alone or in conjunction with any person, to designate the persons who shall possess or enjoy the property or the income therefrom; * * *

The decedent did not transfer the property to his children absolutely in consideration of their agreement to pay him $2,500 a year or all of his living expenses but instead he transferred the property into a trust account reserving the right to receive $2,500 a year or all of his living expenses out of the transferred property. Accordingly, it is held that the transfer was not a bona fide sale for an adequate and full consideration in money or money's worth and is includible in decedent's gross estate under section 811(c)(1)(B) of the Internal Revenue Code of 1939 as a transfer under which he retained the possession or enjoyment of, or the right to the income from, the property.

SECTION 811(d).—GROSS ESTATE: REVOCABLE TRANSFERS

REGULATIONS 105, SECTION 81.20: Transfers with power to change the enjoyment. — Rev. Rul. 55-393

Where the terms of an inter vivos trust created by the decedent were subject to change or amendment by the trustee with the consent of the adult beneficiary, or beneficiaries, then entitled to receive the trust income, and the decedent reserved the right to remove the trustee at any time and appoint another or successor trustee (including himself), the enjoyment of the transferred property was subject at date of decedent's death to change through the exercise of a power by him alone or in conjunction with others to alter, amend, revoke, or terminate within the meaning of section 811(d) of the Internal Revenue Code of 1939. Accordingly, the value of the property transferred to the trust is includible in his gross estate. See *Estate of Paul Loughridge* v. *Commissioner*, 183 Fed. (2d) 294, certiorari denied, 340 U. S. 830. However, where the only right reserved to the decedent was

the right to appoint a new or successor trustee (himself) in the event of the resignation or disqualification of the original trustee, and such contingency did not occur during decedent's lifetime, the enjoyment of the transferred property was not subject at date of decedent's death to change through the exercise of a power by him alone or in conjunction with others to alter, amend, revoke, or terminate. Under such circumstances, the value of the property transferred would not be includible in his gross estate. See *Estate of O. G. Jennings* v. *Smith*, 161 Fed. (2d) 74.

SECTION 811(j).—GROSS ESTATE: OPTIONAL VALUATION

REGULATIONS 105, SECTION 81.11: Optional valuation date. Rev. Rul. 55-333

Section 811(j) of the Internal Revenue Code of 1939 does not limit the application thereof to the estates of decedents which have decreased in value during the 1-year period following the date of death. Therefore, where an estate has increased in value during that period of time and the executor has elected, on a return timely filed, to have the estate valued in accordance with the provisions of section 811(j), all property included in the gross estate which has not been distributed, sold, exchanged, or otherwise disposed of within 1 year after the decedent's death shall be valued as of the date 1 year after the decedent's death. Property distributed, sold, exchanged, or otherwise disposed of within 1 year after the decedent's death shall be valued as of the date of such distribution, sale, exchange, or other disposition.

REGULATIONS 105, SECTION 81.11: Optional valuation date. Rev. Rul. 55-379

The increase in value of a policy of insurance, such as one owned by a decedent who was not the insured, which increase is attributable to the payment of premiums, or any interest earned, during the year following date of death is deemed to be "excluded property" within the meaning of section 81.11 of Regulations 105 in determining the value of the policy under the provisions of section 811(j) of the Internal Revenue Code of 1939.

SECTION 812(b).—NET ESTATE: EXPENSES, LOSSES, INDEBTEDNESS AND TAXES

REGULATIONS 105, SECTION 81.37: Taxes. Rev. Rul. 55-334

The decedent made gifts to third party donees during the year in which he died. The executors of his estate and his surviving spouse, who made no gifts during the year, consented to treat the gifts as having been made one-half by each spouse and filed Federal gift tax returns, each of which disclosed a tax liability. The executors of the estate paid the entire gift tax liability. *Held*, the entire tax due

with respect to the gifts made by the decedent and paid by his executors is deductible under section 812(b) of the Internal Revenue Code of 1939 as a tax accrued prior to the decedent's death, constituting an enforceable obligation of the decedent existing at the time of death, notwithstanding the provisions of section 1000(f) of the 1939 Code to the effect that the liability for the tax of each spouse, as thus computed, shall be joint and several.

SECTION 812(d).—NET ESTATE: TRANSFERS FOR PUBLIC, CHARITABLE, AND RELIGIOUS USES

REGULATIONS 105, SECTION 81.44: Tranfers for public, charitable, religious, etc., uses. (Also Section 81.46.) Ct. D. 1777

ESTATE TAX—INTERNAL REVENUE CODE—DECISION OF SUPREME COURT

1. NET ESTATE—TRANSFERS FOR CHARITABLE, ETC. USES—CONDITIONAL BEQUESTS.

In determining the net estate for Federal estate tax purposes, decedent's estate is not entitled to a deduction under Section 812(d) of the Internal Revenue Code of 1939 on account of a charitable bequest that is to take effect only if decedent's divorced and childless 27-year-old daughter dies without descendants surviving her and her mother.

2. Judgment reversed.

Judgment of the United States Court of Appeals for the Second Circuit (207 F. 2d 600), affirming in part decision of Tax Court of United States (18 T. C. 836), reversed.

SUPREME COURT OF THE UNITED STATES

Commissioner of Internal Revenue, petitioner, v. *estate of Louis Sternberger, the Chase National Bank of the City of New York, executor*

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

[January 10, 1955]

OPINION

Mr. Justice BURTON delivered the opinion of the Court.

The issue here is whether, in determining a net estate for Federal estate tax purposes, a deduction may be made on account of a charitable bequest that is to take effect only if decedent's childless 27-year-old daughter dies without descendants surviving her and her mother. For the reasons hereafter stated, we hold that it may not.

Louis Sternberger died testate June 25, 1947. His Federal estate tax return discloses a gross estate of $2,406,541.71 and, for the additional estate tax, a net estate of $2,064,346.55. It includes assets owned by him at his death and others held by the Chase National Bank, respondent herein, under a revocable trust created by him. As the revocable trust makes provisions for charity that are, for our purposes, identical with those in the will, this opinion applies to both dispositions.

The will places the residuary estate in trust during the joint lives of decedent's wife and daughter and for the life of the survivor of them. Upon the death of such survivor, the principal of the trust fund is payable to the then living descendants of the daughter. However, if there are no such descendants, one-half of the residue goes to certain collateral relatives of decedent and the other half to certain charitable corporations. If none of the designated relatives are living, the entire residue goes to the charitable corporations.[1]

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[1] These provisions appear more fully in *Estate of Sternberger* v. *Commissioner*, 18 T. C. 836, 837–838.

At decedent's death, his wife and daughter survived him. His wife was then 62 and his daughter 27. The latter married in 1942, was divorced in 1944, had not remarried and had not had a child.

In the estate tax return, decedent's executor, respondent herein, deducted $179,154.19 from the gross estate as the present value of the conditional bequest to charity of one-half of the residue. Respondent claimed no deduction for the more remote charitable bequest of the other half of the residue. The Commissioner of Internal Revenue disallowed the deduction and determined a tax deficiency on that ground. The Tax Court reversed the Commissioner. 18 T. C. 836. The Court of Appeals for the Second Circuit affirmed the Tax Court, 207 F. 2d 600, on the authority of *Meierhof* v. *Higgins*, 129 F. 2d 1002. To resolve the resulting conflict with the Court of Appeals for the First Circuit in *Newton Trust Co.* v. *Commissioner*, 160 F. 2d 175, we granted certiorari, 347 U. S. 932.

The controlling provisions of the Revenue Code are in substantially the same terms as when they were first enacted in 1919 [2] and are as follows:

> SEC. 812. NET ESTATE.
>
> For the purpose of the tax the value of the net estate shall be determined * * * by deducting from the value of the gross estate—
>
> * * * * * * *
>
> (d) TRANSFERS FOR PUBLIC, CHARITABLE, AND RELIGIOUS USES.—The amount of all bequests, legacies, devises, or transfers * * * to or for the use of any corporation organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes * * *. I. R. C.

The Commissioner concedes that the corporations named in the will qualify as charitable corporations under the statute. There is no doubt, therefore, that if the bequest to them had been immediate and unconditional, its value would be deductible. The question before us is what, if any, charitable deduction may be made despite (1) the deferment of the effective date of the charitable bequest until the deaths of both decedent's wife and daughter and (2) the conditioning of the bequest upon a lack of decendants of decedent's daughter surviving at that time. We find the answer in the Treasury Regulations, which are of long standing and strengthened by reenactments of I. R. C. section 812(d), since their promulgation.[3]

1. *Section 81.44 of Treasury Regulations 105 would permit the deduction of the present value of the bequest if it were an outright bequest, merely deferred until the deaths of decedent's wife and daughter.*

In their earliest form, the predecessors of these regulations, in 1919, recognized, in plain language, the propriety of the deduction of the present value of a deferred, but assured, bequest to charity.[4] Section 81.44 (d) of Treasury Regulations 105 does so with inescapable specificity:

> "Sec. 81.44. TRANSFERS FOR PUBLIC, CHARITABLE, RELIGIOUS, ETC., USES * * *
>
> * * * * * * *
>
> (d) If a trust is created for both a charitable and a private purpose, deduction may be taken of the value of the beneficial interest in favor of the former only

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[2] Originally sec. 403(a)(3) of the Revenue Act of 1918, 40 Stat. 1098. See also, Griswold. Cases and Materials on Federal Taxation (3d ed.), 679 *et seq.*; 1 Paul, Federal Estate and Gift Taxation, 638, *et seq.*

[3] Its latest reenactment is in sec. 2055(a) of the Internal Revenue Code of 1954, 68A Stat. 390. The purpose of the deduction is to encourage gifts to the named uses. *Edwards* v. *Slocum*, 264 U. S. 61, 63; Geo. Wash. L. Rev. 198, 201; 28 Va. L. Rev. 387–388. Like other tax deductions, however, it must rest on more than a doubt or ambiguity. See *United States* v. *Stewart*, 311 U. S. 60 71 [Ct. D. 1466, C. B. 1940–2, 199]. and also *Commissioner* v. *Jacobson*, 336 U. S. 28, 49 [Ct. D. 1712, C. B. 1949–1, 40].

Section 408(a) of the Revenue Act of 1942, 56 Stat. 949, added to I. R. C., sec. 812(d), the so-called "disclaimer provision," whereby, under certain conditions, the renunciation of a private bequest which effectuates a gift to charity earns a charitable deduction from the decedent's gross estate.

[4] "ART. 53. Public, charitable, and similar bequests.— * * * It does not prevent deduction * * * that the property placed in trust is also subject to another trust for a private purpose. Thus, where money or property is placed in trust to pay the income to an individual during life, and then to pay or deliver the same to a charitable corporation, or apply the principal to a charitable purpose, the charitable bequest or devise forms the basis for a deduction. The amount of the deduction, in such case, is the value, at the date of the decedent's death, of the remainder interest in the money or property which is devised or bequeathed to charity. For the manner of determining the value of such remainder interest, see Article 20." 21 T. D. 783–784.

Article 20 prescribed methods of determining the present worth of a remainder subject to a single life interest.

insofar as such interest is presently ascertainable, and hence severable from the interest in favor of the private use. Section 81.10 indicates the principles to be applied in the computation of the present worth of deferred uses, but such computation will not be made by the Commissioner on behalf of the executor. *Thus, if money or property is placed in trust to pay the income to an individual during his life, or for a term of years, and then to pay or deliver the principal to the charitable corporation, or to apply it to a charitable purpose, the present value of the remainder is deductible.* To determine the present value of such remainder, use the appropriate factor in column 3 of Table A or B of section 81.10. *If the present worth of a remainder bequeathed for a charitable use is dependent upon the termination of more than one life, or in any other manner rendering inapplicable Table A or B of section 81.10, the claim for the deduction must be supported by a full statement, in duplicate, of the computation of the present worth made, in accordance with the principle set forth in section 81.10, by one skilled in actuarial computations.*" (Emphasis supplied.) 26 CFR.

The very explicitness of the above provisions emphasizes their restriction to "the computation of the present worth" of *assured* bequests such as are the subject of each of the illustrations and cross references in the section. The statute restricts charitable deductions to bequests to corporations "organized and *operated exclusively* for * * * charitable * * * purposes."[5] (Emphasis supplied.) Likewise, the above section of the regulations requires that the deductible value of "the beneficial interest in favor of" the designated charitable purpose be "severable from the interest in favor of the private use." There is no suggestion in the statute or in section 81.44 of a deduction of funds other than those later to be used exclusively for charitable purposes.

2. Section 81.46 of Treasury Regulations 105 permits no deduction for a conditional bequest to charity "unless the possibility that charity will not take is so remote as to be negligible."

Here, also, the regulations in their earliest form, in 1919, were unequivocally restrictive.[6] It was only after court decisions had demonstrated the need for doing so[7] that the restrictions were restated so as expressly to permit deductions of bequest assured in fact but conditional in form.

Section 81.46 now provides expressly that no deduction is allowable for a conditional bequest to charity "unless the possibility that charity will not take is so remote as to be negligible." The whole section is significant:

"SEC. 8146. CONDITIONAL BEQUESTS.—(a) *If as of the date of decedent's death the transfer to charity is dependent upon the performance of some act or the happening of a precedent event in order that it might become effective, no deduction is allowable unless the possibility that charity will not take is so remote as to be negligible.* If an estate or interest has passed to or is vested in charity at the time of decedent's death and such right or interest would be defeated by the performance of some act or the happening of some event which appeared to have been highly improbable at the time of decedent's death, the deduction is allowable.

"(b) If the legatee, devisee, donee, or trustee is empowered to divert the property or fund, in whole or in part, to a use or purpose which would have rendered it, to the extent that it is subject to such power, not deductible had it been directly so bequeathed, devised, or given by the decedent, deduction will be limited to that portion, if any, of the property or fund which is exempt from an exercise of such power." (Emphasis supplied.) 26 CFR.

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[5] Congressional insistence upon the actual use of the funds *exclusively* for charitable purposes appears in the following provisions describing the bequests that are deductible: "The amount of all bequests * * * to or for the use of any corporation organized and *operated exclusively* for religious, charitable, scientific, literary, or educational purposes * * * *no part of the net earnings of which inures to the benefit of any private stockholder or individual* * * * or to a trustee or trustees, or a fraternal society, order, or association operating under the lodge system, but *only if* such contributions or gifts are to be *used* * * * *exclusively* for religious, charitable, scientific, literary, or educational purposes * * *." (Emphasis supplied.) I. R. C., sec. 812(d).

[6] "ART. 56. Conditional bequests.—Where the bequest, legacy, devise, or gift is dependent upon the performance of some act, or the happening of some event, in order to become effective it is necessary that the performance of the act or the occurrence of the event shall have taken place before the deduction can be allowed. Where, by the terms of the bequest, devise or gift, it is subject to be defeated by a subsequent act or event, no deduction will be allowed." 21 T. D. 785.

[7] *United States* v. *Provident Trust Co.*, 291 U. S. 272. See also, *Hoagland* v. *Kavanagh*, 36 F. Supp. 875; *Ninth Bank & Trust Co.* v. *United States*, 15 F. Supp. 951.

Sections 81.44 and 81.46 fully implement section 812(d) of the code. In their early forms they were obviously mutually exclusive and easily reconcilable. The predecessor of section 81.46 confined charitable deductions to outright, unconditional bequests to charity. It expressly excluded deductions for charitable bequests that were subject to conditions, either precedent or subsequent. While it encouraged assured bequests to charity, it offered no deductions for bequests that might never reach charity. Subsequent amendments have clarified and not changed that principle. Section 81.46(a) today yields to no condition unless the possibility that charity will not take is "negligible" or "highly improbable." Section 81.46(b) is equally strict. It relates to provisions whereby funds may be diverted in whole or in part to noncharitable uses, and it limits the tax deduction to that portion of each fund that cannot be so diverted. Where the principal of a bequest to charity thus may be invaded for private purposes, it is only the ascertainable and assured balance of the bequest to charity that is recognized for a tax deduction.

Respondent concedes that the chance that charity will not take is much more than negligible. Therefore, if section 81.46(a) applies to the instant case, no charitable deduction is permissible.

Respondent claims, however, that section 81.44 covers this case. In doing so, it reads sections 81.44 and 81.46 together and, instead of confining them to their mutually exclusive subjects, makes them overlap. It applies section 81.44 to some deferred *conditional* bequests. It does so in any case where it can compute, on approved actuarial standards, the degree of possibility that charity will receive the conditional bequest. Respondent then computes the present value of a corresponding percentage of the entire deferred bequest. In short, respondent claims an immediate tax deduction equal to the present value of whatever fraction of the bequest corresponds, actuarially, to the chance that charity may benefit from it.

This Court considered a somewhat comparable proposal in 1928. In *Humes* v. *United States*, 276 U. S. 487, a taxpayer sought a charitable deduction based on a bequest to charity that was conditional upon the death of decedent's 15-year-old niece, without issue, before reaching the age of 40. To sustain the proposal, the taxpayer sought to establish actuarially a measure of the chance that charity would receive the bequest and to find authority in the Revenue Code for the deduction of the present value of a corresponding percentage of the bequest. Speaking through Mr. Justice Brandeis, this Court found the actuarial computation inadequate. It, however, did not drop the matter there. It made the following statement:

"One may guess, or gamble on, or even insure against any future event. The Solicitor General tells us that Lloyds of London will insure against having twins. But the fundamental question in the case at bar, is not whether this contingent interest can be insured against or its value guessed at, but what construction shall be given to a statute. Did Congress in providing for the determination of the net estate taxable, intend that a deduction should be made for a contingency, the *actual* value of which cannot be determined from any known data? Neither taxpayer, nor revenue officer—*even if equipped with all the aid which the actuarial art can supply*—could do more than guess at the value of this contigency. *It is clear that Congress did not intend that a deduction should be made for a contingent gift of that character.*" (Emphasis supplied.) *Id.*, at 494.

Since the above was written, there have been advances in the actuarial art. Today, actuarial estimates are employed more widely than they were then. The computations now before us illustrate that advance. They do not, however, lessen the necessity for statutory authorization for such a tax deduction. The scope of the authority required by respondent can best be appreciated if examined in the revealing light of the specific circumstances of the present case.

The Tax Court and the Court of Appeals have approved respondent's actuarial computations as fairly reflecting the present value of one-half of a two-million-dollar residue, reduced in proportion to the chance that charity will receive it. In making this estimate, respondent has computed the present value of the deferred bequest on the basis of 4 percent interest compounded annually and has used the following actuarial tables:

1. To determine the joint life expectancy of decedent's wife and daughter, the Combined Experience Mortality Table prescribed in section 81.10 of the estate tax regulations.

2. To estimate the probability of remarriage of the daughter, the American Remarriage Table, published by the Casualty Actuarial Society.

3. To estimate the chance of a first child being born to decedent's daughter, a specially devised table which has been found by the Tax Court to have been prepared in accordance with accepted actuarial principles upon data derived from statistics published by the Bureau of the Census.[8]

On the basis of these tables, the Tax Court finds that the present value of the charitable remainder at the death of decedent is .18384 on the dollar if computed solely on the chances of his daughter's remarriage; .24094 on the dollar if computed on the chance that of legitimate descendant of his daughter will survive her; and .24058 on the dollar if computed on the chance that any legitimate or illegitimate descendant of his daughter will survive her. It is this last estimate that respondent seeks to apply here.

If respondent is successful, it means the allowance of an immediate and irrevocable deduction of over $175,000 from the gross estate of decedent, although respondent admits there is a real possibility that charity will receive nothing. The bequest, in fact, offers to the daughter an inducement of about $2,000,000 to remarry and leave a descendant. To the extent that this inducement reduces the actuarially computed average probability that charity will receive this bequest, it further demonstrates the inappropriateness of authorizing charitable tax deductions based upon highly conditional bequests to charity.

An even clearer illustration of the effect of respondent's interpretation of the code readily suggests itself. If decedent had here conditioned his bequest to charity solely on the death of his daughter before remarriage, the Remarriage Table would then fix the present value of the charitable remainder at .18384 on the dollar. The taxpayer would at once receive a substantial charitable deduction on that basis. The daughter, however, would have a $2,000,000 inducement to remarry. If she did so, her action would cancel the possibility that charity would receive anything from the bequest, but it would not cancel the tax deduction already allowed to the estate. To whatever extent any person can defeat the fulfillment of any condition upon which a benefit to charity depends, to that extent the actuarial estimate that such benefit will reach charity is less dependable. The allowance of such a tax reduction as is here sought would open a door to easy abuse. The result might well be not so much to encourage gifts inuring to the benefit of charity as to encourage the writing of conditions into bequests which would assure charitable tax deductions without assuring benefits to charity.

We find no suggestion of authority for such a deduction in section 812(d). That section remains substantially the same as it was when *Humes* v. *United States*, *supra*, 276 U. S. 487, was decided. We also find no authorization for the deduction either in section 81.46 or section 81.44 of the regulations, as thus far discussed. This relegates respondent to the following works now in section 81.44(d):

"If the present worth of a remainder bequeathed for a charitable use is dependent upon the termination of more than one life, or *in any other manner rendering inapplicable Table A or B of section 81.10*, the claim for the deduction must be supported by a full statement, in duplicate, of the computation of the present worth made, in accordance with the principle set forth in section 81.10, by one skilled in actuarial computations." (Emphasis supplied.)

In view of the statutory emphasis upon outright bequests and the long-standing exclusion of conditional bequests by section 81.46 of the regulations (and its predecessors), we do not regard the above sentence as now invading the domain of section 81.46 by extending the deduction to conditional bequests in a manner

[8] Despite the conclusions of the Tax Court and the Court of Appeals to the contrary, the Government contends here that the proposed actuarial value of the conditional remainder to charity does not support the deduction. We do not reach that issue, but the facts material to it are as follows: The Remarriage Table is based on a study of American experience conducted by a Committee of the Casualty Actuarial Society, 19 Proceedings of the Casualty Actuarial Society (1933), 279–349. The table is based solely upon the remarriage experience of widows who, through the deaths of their husbands, become beneficiaries under workmen's compensation laws in states where they lose compensation benefits upon remarriage. The reports relied upon cover experience for policy years 1921 to 1929, inclusive. See *id.*, at 286–288. See also, Myers, Further Remarriage Experience 36 Proceedings of the Casualty Actuarial Society (1949), 72 *et seq.* The specially devised table as to the probability of issue is based upon statistics, for white women in 47 states and the District of Columbia, indicating the degree of probability that such women, after they are 27 years old, will marry and have first-born children. See the following Bureau of the Census publications for 1940; Vital Statistics of the United States, Pt. II, 89; Nativity and Parentage of the White Population—General Characteristics 110; Types of Families 9. The instant computation assumes that such a child will survive its mother. 18 T. C. 836, 837–838.

readily open to abuse. We regard the sentence as restricted to computations of deferred, but assured, bequests. Section 81.10(i) now deals at length with the valuation of remainders and reversionary interests and gives many examples of such computations. Every example, however, is one of the valuation of an assured bequest. The additional language in section 81.44(d), quoted above, does not authorize the deduction, and section 81.46 prohibits it. Such specific and established administrative interpretation of the statute is valid and "should not be overruled except for weighty reasons." *Commissioner* v. *South Texas Co.*, 333 U. S. 496, 501. [Ct. D. 1697, C. B. 1948-1, 82.]

This Court has not specifically faced the issue now before us since *Humes* v. *United States, supra*, but we see no reason to retreat from the views there stated. This Court finds no statutory authority for the deduction from a gross estate of any percentage of a conditional bequest to charity where there is no assurance that charity will receive the bequest or some determinable part of it. Where the amount of a bequest to charity has not been determinable, the deduction properly has been denied. *Henslee* v. *Union Planters Bank*, 335 U. S. 595, 598–600; *Merchants Bank* v. *Commissioner*, 320 U. S. 256, 259–263; and see *Robinette* v. *Helvering*, 318 U. S. 184, 189. Where the amount has been determinable, the deduction has, with equal propriety, been allowed where the designated charity has been sure to benefit from it. *United States* v. *Provident Trust Co.*, 291 U. S. 272; *Ithaca Trust Co.* v. *United States*, 279 U. S. 151 [Ct. D. 61, G. B. VIII-1, 313 (1929)].

Some of the lower courts have squarely met the instant problem and denied the deduction. For example, the deduction was denied in the First Circuit where the court found that "it is not certain that the charity will take 50 percent of the corpus; only that it has a 50–50 chance of getting all or nothing." *Newton Trust Co.* v. *Commissioner*, 160 F. 2d 175, 181. See also, *Graff* v. *Smith*, 100 F. Supp. 42; *Hoagland* v. *Kavanagh*, 36 F. Supp. 875; *Wood* v. *United States*, 20 F. Supp. 197. The administrative practice, as evidenced here by the action of the Commissioner, has been to deny the deduction. See further, Paul, Federal Estate and Gift Taxation (1946 Supp.), 426–427.

The judgment of the Court of Appeals, accordingly, is reversed and the cause remanded for action in conformity with this opinion.

Reversed.

REGULATIONS 105, SECTION 81.44: Transfers for public, charitable, religious, etc., uses.

Deduction for transfer to income participation fund of charitable organization. See Rev. Rul. 55-275, page 295.

REGULATIONS 105, SECTION 81.46: Conditional bequests. Rev. Rul. 55-335

Amounts distributed by the executor of an estate as charitable bequests, where the organizations and the amount to be distributed to each are not fixed by the will, are not deductible from the decedent's gross estate under section 812(b) of the Internal Revenue Code of 1939 for Federal estate tax purposes.

Advice has been requested relative to the treatment for Federal estate tax purposes of amounts distributed by the executor of an estate as charitable bequests in carrying out the terms of a will.

In the instant case the decedent left a will bequeathing all of his real and personal property to his mother and brother. Each was to have a one-half share of the estate and in the event that either predeceased him the survivor was to have the full estate. The brother was designated sole executor under the will.

The will further contained a provision that the mother and brother make suitable charitable gifts out of his estate; the amount of the

gifts and the institutions to which such gifts are made was left solely within their judgment.

In compliance with the wishes of the testator, the executor distributed certain gifts to charitable organizations.

Section 812 of the Internal Revenue Code of 1939 provides, in part, as follows:

> For the purpose of the tax the value of the net estate shall be determined, in the case of a citizen or resident of the United States by deducting from the value of the gross estate—
>
> * * * * * * *
>
> (d) TRANSFERS FOR PUBLIC, CHARITABLE AND RELIGIOUS USES.—The amount of all bequests, legacies, devises, or transfers * * * to or for the use of the United States, any State, Territory, any political subdivision thereof, or the District of Columbia, for exclusively public purposes, or to or for the use of any corporation organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, * * *.

Since the charitable organizations and the amount distributed to each were not fixed by the will, it is apparent that the amount which any charity might receive was so uncertain that it could not have been stated in definite terms of money. Under such circumstances the charitable deduction is not allowable. *Daniel W. Norris et al.* v. *Commissioner*, 134 Fed. (2d) 796, cert. denied 320 U. S. 756. *Charles F. Delbridge, Exr. (Est. of G. M. Roehm)* v. *United States*, 89 Fed. Supp. 845. *Charles L. Burdick et al.* v. *Commissioner*, 117 Fed. (2d) 972, cert. denied 314 U. S. 631.

In accordance with the foregoing, it is held that amounts distributed by the executor of an estate as charitable bequests, where the organizations and the amount to be given to each are not fixed by the will, are not deductible from the decedent's gross estate under section 812(d) of the Internal Revenue Code of 1939 for Federal estate tax purposes.

REGULATIONS 105, SECTION 81.46: Conditional bequests.

Charitable bequest to take effect upon death of decedent's wife and daughter without descendants. See Ct. D. 1777, page 450.

SECTION 812(e).—NET ESTATE: BEQUESTS, ETC., TO SURVIVING SPOUSE

REGULATIONS 105, SECTION 81.47a: Requests, etc., to surviving spouse. Rev. Rul. 55-277

> Where a policy of insurance contains a provision that the proceeds are to be retained by the insurance company and interest thereon paid monthly to the surviving spouse during her life with the right in the wife, exercisable by her alone and in all events, to direct the insurance company to pay the entire proceeds at her death to her executors, administrators or assigns, the surviving spouse possesses a power of appointment within the meaning of section 812 (e) (1) (G) of the Internal Revenue Code of 1939. Accordingly, the proceeds of the policy qualify for the marital deduction under section 812(e) of the Code.

Advice has been requested concerning the estate tax marital deduction provisions of section 812(e) of the Internal Revenue Code of 1939

as applied to the proceeds of life insurance under the circumstances set forth below.

In the instant case a policy of insurance provides that the proceeds of the policy were to be retained by the insurance company and interest thereon paid monthly to the surviving spouse during her life. The wife was given the right, exercisable by her alone and in all events, to direct the insurance company to pay the entire proceeds of the policy at her death to her executors, administrators or assigns. The specific question is whether the spouse possessed a power of appointment within the meaning of section 812(e)(1)(G) of the Internal Revenue Code qualifying the proceeds of the policy for the marital deduction under section 812 (e) of the Code.

Section 812(e)(1)(G) of the Internal Revenue Code provides as follows:

> (G) Life Insurance or Annuity Payments With Power of Appointment in Surviving Spouse.—In the case of an interest in property passing from the decedent consisting of proceeds under a life insurance, endowment, or annuity contract, if under the terms of the contract such proceeds are payable in installments or are held by the insurer subject to an agreement to pay interest thereon (whether the proceeds, upon the termination of any interest payments, are payable in a lump sum or in annual or more frequent installments), and such installment or interest payments are payable annually or at more frequent intervals, commencing not later than thirteen months after the decedent's death, and all amounts payable during the life of the surviving spouse are payable only to such spouse, and such spouse has the power to appoint all amounts payable under such contract (exercisable in favor of such surviving spouse, *or of the estate of such surviving spouse*, or in favor of either, whether or not in each case the power is exercisable in favor of others), with no power in any other person to appoint to any person other than the surviving spouse any part of the amounts payable under such contract—
>
> (i) such proceeds shall, for the purposes of subparagraph (A), be considered as passing to the surviving spouse, and
>
> (ii) no part of such proceeds shall, for the purposes of subparagraph (B) (i), be considered as passing to any person other than the surviving spouse.
>
> This subparagraph shall be applicable only if, under the terms of the contract, such power in the surviving spouse to appoint, whether exercisable by will or during life, is exercisable by such spouse alone and in all events. [Italics supplied.]

The provisions contained in the policy to the effect that the surviving spouse had the right to direct payment of the proceeds to her "executors, administrators or assigns" is a power to appoint to "the estate of such surviving spouse" within the meaning of section 812(e)(1)(G) of the Code, *supra*. Accordingly, it is held that since the wife is entitled to the income for life and the right, exercisable by her alone and in all events to direct the insurance company to pay the entire proceeds of the policy at her death to her executors, administrators or assigns, the insurance qualifies for the marital deduction under section 812(e) of the Code. Compare Rev. Rul. 54–553, C. B. 1954–2, 303.

The decision in *Second National Bank of Danville, Illinois, Trustee u/w/t Will of Helen L. Abdill* v. *Dallman*, 209 Fed. (2d) 321, which would require a conclusion contrary to that reached herein, will not be accepted by the Internal Revenue Service as a precedent in the disposition of other cases involving similar fact situations.

REGULATIONS 105, SECTION 81.47a: Bequests, etc., to surviving spouse. Rev. Rul. 55-394

A testamentary trust created by the decedent in favor of his surviving spouse provides that she is to receive the entire income from the trust property, payable in quarterly installments, until January 1, 1958, or until her death, whichever is earlier. If she is alive on the stipulated date, the corpus is to be paid over to her in fee simple absolute. In the event of the spouse's death prior to the expiration of the trust term, the corpus is to be paid over to the executor of her estate provided she shall so direct in her last will in accordance with the general and unconditional power of appointment conferred upon her by the decedent. Should she fail to exercise the power, the property is to be added to another trust created by the decedent in favor of beneficiaries other than his wife. *Held*, the payment of the corpus of the trust to the surviving spouse prior to her death is not deemed to be a termination of the general power of appointment within the meaning of section 81.47a(c) of Estate Tax Regulations 105 nor does the naming of takers in default of the exercise of her power of appointment over the corpus of the trust fail to satisfy the condition, contained in such section, that the surviving spouse must be able to appoint to herself or her estate. Since no interest in the trust property is considered as having passed from the decedent to any person other than his surviving spouse, the trust in question qualifies for the marital deduction under the provisions of section 812(e) of the Internal Revenue Code of 1939.

REGULATIONS 105, SECTION 81.47a: Bequests, etc., to surviving spouse. Rev. Rul. 55-395

Decedent bequeathed the residue of his estate in trust and provided that the trustee shall use the net income therefrom for the care, maintenance and support of his widow in such fashion and state as she may desire, with the power in the trustee, in the event such income should be insufficient to meet her desires or demands, to sell trust assets from time to time and use the proceeds for the purposes aforesaid. The trustee was directed to convert the remainder of the trust assets into cash following the death of the widow and to distribute the proceeds of the sale and any accumulations of the trust to certain designated beneficiaries. *Held*, since the terms of the trust did not confer upon decedent's surviving spouse the power, exercisable by her alone and in all events, to appoint the entire corpus or a specific portion thereof free of trust as required by section 812(e)(1)(F) of the Internal Revenue Code of 1939, and as others were named to take so much of the property as may remain upon her death, the interest passing to such spouse was a terminable one within the meaning of section 812(e)(1)(B) of the 1939 Code, no portion of the value of which qualifies for the estate tax marital deduction.

REGULATIONS 105, SECTION 81.47a: Bequests, etc., to surviving spouse. Rev. Rul. 55-419

Property exempted from execution under local laws which is set off absolutely to a widow from her deceased husband's estate con-

stitutes an interest in property acquired by inheritance within the meaning of section 812(e)(3) of the Internal Revenue Code of 1939. Accordingly, the value of such property qualifies for the marital deduction authorized by section 812(e) of the 1939 Code.

Advice has been requested whether property exempted from execution under local laws which is set off absolutely to the widow from her deceased husband's estate qualifies for the marital deduction authorized by section 812(e) of the Internal Revenue Code of 1939.

Section 812(e) of the Internal Revenue Code of 1939 provides, in part, as follows:

(e) BEQUESTS, ETC., TO SURVIVING SPOUSE.—

* * * * * * *

(3) DEFINITION.—For the purposes of this subsection, an interest in property shall be considered as passing from the decedent to any person if and only if—

(A) such interest is bequeathed or devised to such person by the decedent; or

(B) such interest is inherited by such person from the decedent; or

(C) such interest is the dower or curtesy interest (or statutory interest in lieu thereof) of such person as surviving spouse of the decedent; * * *.

The particular State statute involved in the instant case provides in effect that when the deceased leaves a widow, all personal property which in his hands as head of a family would be exempt from execution, after being inventoried and appraised, shall be set apart to her as her property, and be exempt in her hands as in the hands of the decedent.

Whether exempt property set off to a widow by local statute constitutes an interest in property passing from the decedent to his surviving spouse depends upon an interpretation of the word "inherited."

In the case of *Munro L. Lyeth* v. *Hoey*, 305 U. S. 188, Ct. D. 1370, C. B. 1938-2, 208, the question involved was whether property received by an heir under an agreement compromising and settling his contest of the decedent's will is property acquired by "inheritance" within the meaning of the Revenue Act of 1932. The Court said:

* * * the question whether what the heir has thus received has been "acquired by inheritance" within the meaning of the Federal statute necessarily is a Federal question. * * * Congress established its own criteria and the State law may control only when the Federal taxing act by express language or necessary implication makes its operation dependent upon state law. * * *

In re McHugh, 75 Fed. Supp. 676, affirmed 168 Fed. (2d) 350, the question involved was whether money received by a bankrupt pursuant to the Federal Employees Liability Act for the death of his son was an inheritance within the terms of the National Bankruptcy Act. The court said:

The term "bequest" and "devise" refer to the acquisition of property by will * * *. Inheritance is a word of broader significance. Any means by which a relation succeeds to the property of an ancestor may properly be termed an inheritance. It includes all the methods by which a child or relation takes property from another at his death, except by devise, and includes as well succession as descent. *Cf.* 1 Bouv. Law Dict., Rawles' Third Revision, page 1568.

Since the exempt property involved in the instant case actually passes to the surviving spouse by operation of law so as to give her a vested interest therein, it is clear that such property comes within the meaning of the term inheritance as defined in the case of *In re McHugh, supra.*

In view of the foregoing, it is held that property exempted from execution under local laws which is set off absolutely to a widow from her deceased husband's estate constitutes an interest in property acquired by inheritance within the meaning of section 812(e)(3) of the Internal Revenue Code of 1939. Accordingly, the value of such property qualifies for the marital deduction authorized by section 812(e) of the 1939 Code.

REGULATIONS 105, SECTION 81.47d: Limitation on amount of marital deduction. Rev. Rul. 55-225

Where the executor of an estate elects to claim certain expenses of administration as deductions from the gross income of the estate under section 23(a) of the Internal Revenue Code of 1939 rather than as deductions from the decedent's gross estate under section 812(b) of the 1939 Code, the value of the decedent's "adjusted gross estate," for the purposes 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 actually claimed and allowed under section 812(b) of the Code as distinguished from those which would merely be allowable under this section.

Advice has been requested whether certain expenses of administration otherwise allowable as deductions from the decedent's gross estate under section 812(b) of the Internal Revenue Code of 1939 will have the effect of increasing the "adjusted gross estate" for the purpose of determining the 50 percent limitation on the amount allowable as a marital deduction should the decedent's executor elect to claim such expenses as deductions for Federal income tax purposes under section 23(a) of the Code.

Section 812(e)(1)(H) of the Internal Revenue Code of 1939 provides that the amount allowable as a marital deduction shall not exceed 50 per centum of the value of the adjusted gross estate.

Under the general rule provided by section 812(e)(2)(A) of the Code, the value of the 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 section 812(b) of the Code. This provision was designed to prevent a double deduction with respect to any item, that is, a deduction under both subsection (b) and subsection (e) of section 812 of the Code. There is, however, no provision in either the law or the regulations stating that the aggregate amount of all deductions authorized by section 812(b) of the Code, irrespective of whether claimed or allowed for the purpose of the estate tax, must be subtracted from the value of the decedent's gross estate for the purpose of determining the value of the adjusted gross estate and the 50 percent limitation on the amount allowable as a marital deduction.

The amount of the marital deduction allowable in any case, however, cannot exceed the *net value* to the surviving spouse of the property interests which passed to her from the decedent, and which qualify for the deduction, or 50 percent of the value of the adjusted gross es-

tate, whichever is the lesser. Amounts paid as attorney's fees and executor's commissions, or as other expenses of administration allowable as deductions under section 812(b) of the Code, may in no event be considered as interests in property which passed from the decedent to his surviving spouse. Thus, while an election on the part of the decedent's executor to take amounts paid as expenses of administering the estate as deductions from the gross income of the estate under section 23(a) of the Code, rather than as deductions from the gross estate as authorized by section 812(b) of the Code, would have the effect of increasing the adjusted gross estate for the purpose of arriving at the maximum amount allowable as a marital deduction, such expenses are, nevertheless, to be taken into account in determining the net value, for the purpose of the deduction, of the interest in or share of the estate which passed from the decedent to his surviving spouse. In other words, where the value of the property interests which passed to the surviving spouse, reduced by that portion of the administration expenses properly chargeable thereto, and in respect to which no deduction is taken by the estate for the purpose of the estate tax, is less than 50 percent of the adjusted gross estate computed without regard to such expenses, the amount of the marital deduction cannot exceed the value of the property interests which passed to such spouse, as thus reduced.

In view of the foregoing, it is held that where the executor of an estate elects to claim certain expenses of administration as deductions from the gross income of the estate under section 23(a) of the Internal Revenue Code of 1939 rather than as deductions from the decedent's gross estate under section 812(b) of the Code, the 50 percent limitation on the amount allowable as a marital deduction is determined by subtracting from the entire value of the gross estate the aggregate amount of the deductions actually claimed and allowed under section 812(b) of the Code.

SECTION 813(b).—CREDITS AGAINST TAX: ESTATE, SUCCESSION, LEGACY, AND INHERITANCE TAXES

REGULATIONS 105, SECTION 81.9: Credit for death taxes. Rev. Rul. 55-69

> Where an allowance of credit for State inheritance taxes is made after a final determination of the Federal estate tax liability, the refund attributable to the allowance of such credit does not bear interest.

Advice has been requested whether a refund of Federal estate tax due under the facts hereinafter set out bears interest in view of the following provisions of section 813(b) of the Internal Revenue Code of 1939:

SEC. 813. CREDITS AGAINST TAX.

* * * * * * *

(b) ESTATE, SUCCESSION, LEGACY, AND INHERITANCE TAXES.—The tax imposed by section 810 or 860 shall be credited with the amount of any estate, inheritance, legacy, or succession taxes, actually paid to any State * * *.

* * * * * * *

Refund based on the credit may * * * be made if claim therefor is filed within the period above provided. Any such refund shall be made without interest.

The facts of the present case are as follows:

The executor of the estate filed a Federal estate tax return showing a gross tax liability of $65,700, credit for State inheritance tax of $3,920, and a net tax liability of $61,780 which was assessed and paid. Upon audit of the return, an additional deduction of $10,000 was allowed for administration expenses which reduced the gross tax liability to $62,700. As the evidence in support of the credit claimed for State inheritance taxes was not submitted, the audit resulted in a deficiency of $920. A statutory notice was subsequently issued determining a deficiency of $920. As a petition was not filed with The Tax Court of the United States, the deficiency was duly assessed and paid. Thereafter, the executor filed a timely claim for refund of $3,600 and submitted therewith evidence which entitled the estate to a credit of $3,600 for State inheritance taxes paid, resulting in an overpayment of $3,600.

It is clear from the foregoing that proof of the payment of the State inheritance taxes, which was a prerequisite to the allowance of the credit for such taxes, was not furnished until after the determination of the estate's Federal estate tax liability. Accordingly, the refund then found due was based on the allowance of the credit for State inheritance taxes and the refund, under section 813(b) of the 1939 Code does not bear interest.

The conclusion so reached is supported by the decision of the United States Court of Appeals for the Second Circuit in *Guaranty Trust Co. of New York* (as executor of the estate of *Grayson M. P. Murphy*) v. *United States*, 192 Fed. 2d 164, in which a refund of Federal estate taxes resulting from the allowance of a credit for New York estate taxes, under circumstances similar to the circumstances of the present case, was held not to bear interest. The court's decision is in part as follows:

* * * It was not until the New York estate taxes were actually paid that the taxpayer became entitled to a credit, and hence to a refund. Until then the estate was the Government's debtor. If the executor had never proved payment of the New York taxes it would never have been entitled to any refund. Therefore, we think it plain that the refund was "based on a credit" and so within both the literal words and the policy of section 813(b), which expressly forbids the payment of interest on any such refund.

Accordingly, it is held that where an allowance of credit for State inheritance taxes is made after a final determination of the Federal estate tax liability, the refund attributable to the allowance of such credit does not bear interest.

REGULATIONS 105, SECTION 81.9: Credit for death taxes. Rev. Rul. 55-380

Where credit for state inheritance taxes is not claimed on the Federal estate tax return any communication relative to the allowance or submission of evidence in support of such credit received within four years after the filing of the estate tax return, if clearly

indicating an intent to claim the credit, may be considered as a claim for credit within the statutory period provided by section 813(b) of the Internal Revenue Code of 1939. It is not necessary that the evidence in support of the credit claimed be filed within the statutory period; the submission of evidence showing that the inheritance taxes were actually paid within four years after the filing of the return will satisfy the statutory requirement.

Advice has been requested whether an estate is entitled to credit for state inheritance taxes under the following circumstances.

For reasons not material herein the schedule of the Federal estate tax return for showing the computation of tax was not filled in and therefore no credit for state inheritance taxes was claimed in the return. Subsequent to the filing of the return the Internal Revenue Service was advised that the documentary evidence in support of the credit would be filed as soon as the inheritance taxes were determined. The Service was later requested to grant an extension of time within which to file the credit evidence. The correspondence was received within 4 years after the filing of the return. The documentary evidence in support of credit was submitted more than 4 years after the filing of the return but it showed that state inheritance taxes were paid to the state prior to the expiration of the statutory period.

Section 813(b) of the Internal Revenue Code of 1939 provides, in part, as follows:

* * * The tax imposed by section 810 or 860 shall be credited with the amount of any estate, inheritance, legacy, or succession taxes actually paid to any State or territory or the District of Columbia, or any possession of the United States, in respect of any property included in the gross estate (not including any such taxes paid with respect to the estate of a person other than the decedent). The credit allowed by this subsection shall not exceed 80 per centum of the tax imposed by section 810 or 860 * * * *and shall include only such taxes as were actually paid and credit therefor claimed within four years after the filing of the return* required by section 821 or 864 * * *. [Italics supplied.]

Generally, where an estate is subject to the basic estate tax, credit for inheritance taxes is claimed on the return and such claim is considered as a claim for the credit within the meaning of section 813(b), although the inheritance taxes had not been determined or paid at the time the estate tax return was filed.

However, where credit for state inheritance taxes is not claimed on the Federal estate tax return, correspondence indicating an intent to claim credit received within 4 years after the filing of the return may be considered as a claim for credit within the statutory period. It is not necessary that the evidence in support of the credit claimed be filed within the statutory period; the submission of evidence showing that the inheritance taxes were actually paid within 4 years after the filing of the return will satisfy the statutory requirement.

Under the circumstances in this case it is held that the estate has complied with the statutory requirements. Accordingly, the estate is entitled to credit for state inheritance taxes. However, any overpayment of the tax which may result from allowance of the credit may not be refunded unless a claim for refund thereof on Form 843 was filed within the period provided by section 813(b) of the Internal Revenue Code of 1939.

SECTION 813(c).—CREDITS AGAINST TAX: PAID TO FOREIGN COUNTRIES

REGULATIONS 105, SECTION 81.9: Credit for death taxes. (Also Section 936(c); Regulations 105, Section 81.9.) Rev. Rul. 55-381

The credit provisions of the United States-Canadian Death Tax Convention, C. B. 1954–2, 633, pertain only to the Dominion succession duties and are not applicable to taxes imposed by any of the provinces of Canada. The Province of Ontario, Canada, does not meet the reciprocal credit requirement of the foreign death tax credit provisions in sections 813(c) and 936(c) of the Internal Revenue Code of 1939, in the case of an estate of a deceased citizen of Canada who at the time of death was domiciled in the United States, for the reason that the Province of Ontario does not allow credit against its succession duty for estate tax paid to the United States on property situated in the United States nor exempt such property from its succession duties in the case of a deceased citizen of the United States who at time of death was domiciled in Ontario. Accordingly, the estate of a deceased citizen of Canada who at time of death was domiciled in the United States will not be entitled to the credit provided by sections 813(c) and 936(c) of the Code for any estate, inheritance, legacy, or succession duties paid to the Province of Ontario.

SUBPART II.—RETURNS AND PAYMENT OF TAX

SECTION 827(b).—LIEN FOR TAX: LIABILITY OF TRANSFEREE, ETC.

REGULATIONS 105, SECTION 81.62: Transfer certificates. Rev. Rul. 55-160

A bank in possession of property standing in the name of a nonresident decedent and his wife as joint tenants, with right of survivorship, is not relieved from Federal estate tax liability and the necessity of obtaining a transfer certificate should an executor or administrator be appointed, qualified, and acting within the United States.

Advice has been requested whether a bank in possession of property standing in the name of a nonresident decedent and his wife as joint tenants, with right of survivorship, will be relieved from Federal estate tax liability and the necessity of obtaining a transfer certificate after the appointment of an executor or administrator, qualified and acting within the United States.

A bank located in the United States has in its possession a bank deposit standing in the name of a nonresident decedent and his wife as joint tenants, with right of survivorship. The bank will not consent to a withdrawal of any part of the deposit until it has been presented with a transfer certificate or until after an executor or administrator has been appointed and qualified in the United States. The bank is concerned whether the appointment of an executor or admin-

istrator in this country prior to the removal of any part of the fund would relieve it of liability for Federal estate taxes.

Section 81.62 of Estate Tax Regulations 105 provides in part that certificates permitting the transfer of property of nonresident decedents without liability will be issued when the tax imposed upon the estate, if any, has been fully discharged or provided for. It further provides that this requirement shall not apply if there is an executor or administrator appointed, qualified, and acting within the United States. This latter provision refers to property in the possession or control of such executor or administrator.

Property held in joint tenancy with the right of survivorship does not form a part of the probate assets of a decedent's estate. Title to such property passes direct to the surviving coowner by operation of law. Since the surviving coowner is regarded as the absolute owner, it is clear that funds on deposit with a bank which are held in joint tenancy with the right of survivorship would not come into the possession or control of an executor or administrator. Under such circumstances, a bank in possession of property standing in the name of a nonresident decedent and his wife as joint tenants, with right of survivorship, can insure avoidance of Federal estate tax liability only by demanding and receiving a transfer certificate prior to the removal of the funds by the surviving coowner.

PART III.—ESTATES OF NONRESIDENTS NOT CITIZENS OF THE UNITED STATES

SECTION 863.—PROPERTY WITHOUT THE UNITED STATES

REGULATIONS 105, SECTION 81.50: Situs of property. Rev. Rul. 55-143

The decedent, a nonresident alien not engaged in business in the United States at the time of his death, died possessed of certain funds which he had placed in a safe-deposit box rented in his name from a bank located in the United States. *Held*, the words "moneys deposited" as used in section 863(b) of the Internal Revenue Code of 1939 apply to so-called general deposits with a bank where the relationship of debtor and creditor between the bank and the depositor exists with respect to such deposits. Since the funds in the safe-deposit box on the date of decedent's death do not represent moneys deposited with a person carrying on the banking business within the meaning of section 863(b) of the Code, they are includible, for Federal estate tax purposes, in the decedent's gross estate situated in the United States. See G. C. M. 22419, C. B. 1940-2, 288.

REGULATIONS 105, SECTION 81.50: Situs of property.

Situs of participating units of a common trust fund. See Rev. Rul. 55-163, page 674.

PART IV.—SUPPLEMENTAL PROVISIONS

SUPPLEMENT A.—ASSESSMENT AND COLLECTION OF DEFICIENCIES

SECTION 872.—JEOPARDY ASSESSMENTS

REGULATIONS 105, SECTION 81.74: Assessments. T. D. 6126
(Also Section 81.92; Sections 1013, 1014; Regulations 108, Sections 86.43, 86.44.)

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER B, PART 81 AND PART 86

Regulations 105 and Regulations 108 amended to conform to Public Law 274 (83d Cong.), relating to the abatement of jeopardy assessments.

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

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

On October 7, 1954, a notice of proposed rulemaking with respect to amendment of Regulations 105 (26 CFR (1939), pt. 81) and Regulations 108 (26 CFR (1939), pt. 86) to conform to Public Law 274 (83d Cong.) [C. B. 1953-2, 484], approved August 14, 1953, relating to the abatement of jeopardy assessments, was published in the Federal Register (19 F. R. 6478). Since no comments with respect to the rules proposed have been received, the amendments to Regulations 105 and Regulations 108 set forth below are hereby adopted:

PARAGRAPH 1. There is inserted immediately after section 872 and before section 874 of the Internal Revenue Code which precede section 81.74 of Regulations 105 and preceding section 86.43 of Regulations 108 the following:

PUBLIC LAW 274 (83d CONG.) [APPROVED AUGUST 14, 1953]

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That * * *

* * * * * * *

(b) Sections 872 and 1013 (relating to the abatement of jeopardy assessments of estate and gift taxes, respectively) are hereby amended by adding at the end of each of such sections the following new subsection:

"(j) ABATEMENT IF JEOPARDY DOES NOT EXIST.—The Secretary may abate the jeopardy assessment if he finds that jeopardy does not exist. Such abatement may not be made after a decision of The Tax Court of the United States in respect of the deficiency has been rendered or, if no petition is filed with The Tax Court of the United States, after the expiration of the period for filing such petition. The period of limitation on the making of assessments and the beginning of distraint or a proceeding in court for collection, in respect of any deficiency, shall be determined as if the jeopardy assessment so abated had not been made, except that the running of such period shall in any event be suspended for the period from the date of such jeopardy assessment until the expiration of the tenth day after the day on which such jeopardy assessment is abated."

(c) The amendments made by this Act shall be applicable to jeopardy assessments made or in existence on the date of enactment of this Act or which are thereafter made.

PAR. 2. Section 81.74 of Regulations 105, as amended by Treasury Decision 6034 [C. B. 1953-2, 278], approved July 29, 1953, is further amended as follows:

(A) By changing the heading thereof to read as follows: "ASSESSMENTS.—(a) *In general.*"

(B) By adding at the end of the first paragraph of (a) the following:

For abatement of jeopardy assessments where jeopardy does not exist, see paragraph (b).

(C) By adding at the end of such section the following:

(b) *Abatement of jeopardy assessments where jeopardy does not exist.*—(1) The District Director may abate a jeopardy assessment which existed on August 14, 1953, or which is made on or after such date, if it is shown to his satisfaction that jeopardy does not exist. An abatement may not be made under this paragraph after a decision of the Tax Court in respect of the deficiency has been rendered, or, if no petition is filed with such Court, after the expiration of the period for filing such petition.

(2) The abatement of a jeopardy assessment, because jeopardy does not exist, will have the effect of abating any proceedings to collect the tax so assessed. The District Director may then proceed to assess and collect a deficiency in the manner authorized by law as if the jeopardy assessment so abated had not existed. If a notice of deficiency had been sent to the taxpayer prior to the abatement of the jeopardy assessment, whether such notice was sent before or after the making of the assessment, the abatement of such assessment will not affect the validity of the notice or of any proceedings for redetermination based thereon. The period of limitation on the making of assessments and the beginning of distraint or a proceeding in court for collection in respect of any deficiency shall be determined as if the jeopardy assessment so abated had not been made, except that the running of such period shall in any event be suspended for the period from the date of such jeopardy assessment until the expiration of the 10th day after the date on which such jeopardy assessment is abated. The provisions of this paragraph may be illustrated by the following example.

Example. On February 15, 1954, 28 days before the 3-year statutory period of limitations on assessments would otherwise have expired, a jeopardy assessment was made in respect of a proposed deficiency. On April 2, 1954, before the mailing of the notice of deficiency provided for by section 872(b), this assessment was abated. By virtue of this paragraph, the period of limitations for the making of an assessment did not expire prior to May 10, 1954, i. e., the 38th day after the date of the abatement. If the notice of deficiency provided for in section 872(b) had been sent prior to the abatement, the running of the statute of limitations on assessments would have been suspended pursuant to the provisions of section 875.

(3) Request for abatement of a jeopardy assessment, because jeopardy does not exist, should be filed with the District Director and must state fully the reasons for the request and must be supported by such evidence as will enable the District Director to determine that the collection of the deficiency is not in jeopardy. See section 872(c) and the first paragraph of section 81.74(a) with respect to the abatement of jeopardy assessments which are excessive in amount.

PAR. 3. Section 81.92 of Regulations 105 is amended by adding at the end thereof the following:

See, however, section 81.74 with respect to requests for the abatement of jeopardy assessments.

PAR. 4. Section 86.43 of Regulations 108, as amended by Treasury Decision 5503 [C. B. 1946-1,156], approved March 20, 1946, is further amended as follows:

(A) By changing the heading thereof to read as follows: "JEOPARDY ASSESSMENTS.—(a) *In general.*"

(B) By adding at the end of the second paragraph of (a) the following:

For abatement of jeopardy assessments where jeopardy does not exist, see paragraph (b).

(C) By adding at the end of such section the following:

(b) *Abatement of jeopardy assessments where jeopardy does not exist.*—(1) The District Director may abate a jeopardy assessment which existed on August 14, 1953, or which is made on or after such date, if it is shown to his satisfaction that jeopardy does not exist. An abatement may not be made under this paragraph after a decision of the Tax Court in respect of the deficiency has been rendered or, if no petition is filed with such Court, after the expiration of the period for filing such petition.

(2) The abatement of a jeopardy assessment, because jeopardy does not exist, will have the effect of abating any proceedings to collect the tax so assessed. The District Director may then proceed to assess and collect a deficiency in the manner authorized by law as if the jeopardy assessment so abated had not existed. If a notice of deficiency had been sent to the taxpayer prior to the abatement of the jeopardy assessment, whether such notice was sent before or after the making of the assessment, the abatement of such assessment will not affect the validity of the notice or of any proceedings for redetermination based thereon. The period of limitation on the making of assessments and the beginning of distraint or a proceeding in court for collection in respect of any deficiency shall be determined as if the jeopardy assessment so abated had not been made, except that the running of such period shall in any event be suspended for the period from the date of such jeopardy assessment until the expiration of the tenth day after the date on which such jeopardy assessment is abated. The provisions of this paragraph may be illustrated by the following example.

Example. On February 15, 1954, 28 days before the 3-year statutory period of limitations on assessments would otherwise have expired, a jeopardy assessment was made in respect of a proposed deficiency. On April 2, 1954, before the mailing of the notice of deficiency provided for by section 1013(b), this assessment was abated. By virtue of this paragraph, the period of limitations for the making of an assessment did not expire prior to May 10, 1954, i. e., the 38th day after the date of the abatement. If the notice of deficiency provided for in section 1013(b) had been sent prior to the abatement, the running of the statute of limitations on assessments would have been suspended pursuant to the provisions of section 1017.

(3) Request for abatement of a jeopardy assessment, because jeopardy does not exist, should be filed with the District Director and must state fully the reasons for the request and must be supported by such evidence as will enable the District Director to determine that the collection of the deficiency is not in jeopardy. See section 1013(c) and the second paragraph of section 86.43(a) with respect to the abatement of jeopardy assessments which are excessive in amount.

PAR. 5. Section 86.44 of Regulations 108 is amended by adding to the end thereof the following:

See, however, section 86.43 with respect to requests for the abatement of jeopardy assessments.

(This Treasury Decision is issued under the authority contained in secs. 1029 and 3791 of the Internal Revenue Code of 1939 (53 Stat. 157, 467; 26 U. S. C. 1029, 3791).)

JUSTIN F. WINKLE,
Acting Commissioner.

Approved March 14, 1955.

M. B. FOLSOM,
Acting Secretary of the Treasury.

(Filed with the Division of the Federal Register March 16, 1955, 8:50 a. m.)

REGULATIONS 105, SECTION 81.92: Claim for abatement.

Delegation of authority to District Directors of Internal Revenue relative to the abatement of jeopardy assessments of estate and gift taxes. See T. D. 6126, page 466.

SUPPLEMENT D.—REFUNDS

SECTION 910.—PERIOD OF LIMITATION FOR FILING CLAIMS

REGULATIONS 105, SECTION 81.96: Claim for refund. Rev. Rul. 55-226
(Also Section 3775.)

The Internal Revenue Service is without authority to apply a barred overpayment of Federal estate tax against outstanding assessments of income tax due by a decedent for years preceding his death.

Advice has been requested whether the representatives of an estate are entitled to recoup an overpayment of Federal estate tax which is barred from refund against outstanding assessments of income tax owed by the decedent for years prior to his death.

A claim for refund of Federal estate tax based on the allowance of additional deductions from the decedent's gross estate for Federal and state income taxes owed by the decedent for years prior to his death was filed more than 3 years after the payment of the Federal estate tax. The representatives of the estate contend that under the doctrine of recoupment which was applied by the Supreme Court of the United States in *Ernest M. Bull* v. *United States*, 295 U. S. 247, Ct. D. 969, CB XIV-1, 310 (1935), the estate is entitled to recoup the barred overpayment of estate tax against an unpaid income tax assessment.

In the Bull case the barred over-assessment of estate tax and the deficiency in income tax arose out of decedent's share of the income of a partnership of which he had been a member, earned by the partnership after his death. First, the right to receive the income was included in the decedent's gross estate for Federal estate tax purposes at a value equal to the amount of such income, and, second, the income was included as taxable income of his estate. The item in controversy was one and the same, partnership income received after death.

The decision of the Court in the Bull case, and its decision in the case of *Robert G. Stone et al.* v. *White*, 301 U. S. 532, Ct. D. 1232, C. B. 1937-1, 224, which also dealt with the allowance of barred tax claims by way of recoupment, were discussed by the Supreme Court of the United States in its decision in *Rothensies* v. *The Electric Storage Battery Company*, 329 U. S. 296, Ct. D. 1679, C. B. 1947-1, 109, in which the Court further considered the doctrine of recoupment in Federal tax cases and outlined the scope of that doctrine in such cases.

In the Electric Storage Battery Company case the Court concluded that in Federal tax cases application of the doctrine of recoupment is limited to situations where a single transaction or taxable event has been subjected to two taxes on inconsistent legal theories. In such case the tax erroneously paid may be recouped against the tax correctly due. The Court said that in both cases (Bull v. United States and Stone v. White) a single transaction constituted the taxable event claimed upon and the one considered in recoupment; that in both, the single transaction or taxable event had been subjected to two taxes on inconsistent legal theories; and that what was mistakenly paid was recouped against what was correctly due. The Court also observed that there is no statutory warrant for allowing barred refund claims by way of recoupment or otherwise.

The present case is not one in which a single transaction or taxable event has been subjected to two taxes upon inconsistent legal theories. The liability of the decedent for income taxes on income received for years prior to his death and the excess estate tax paid by his estate by reason of his failure to pay such taxes during his lifetime, may not, under the decisions of the Supreme Court of the United States, be considered as a single transaction or taxable event which was subjected to two taxes upon inconsistent legal theories.

In view of the foregoing, it is held that the Internal Revenue Service is without authority to apply a barred overpayment of Federal estate tax against outstanding assessments of income tax due by a decedent for years preceding his death.

SUBCHAPTER B.—ADDITIONAL ESTATE TAX

SECTION 936(c).—CREDITS AGAINST TAX: ESTATE, ETC., TAXES PAID TO FOREIGN COUNTRIES

REGULATIONS 105, SECTION 81.9: Credit for death taxes.

Credit for succession duties paid to the Province of Ontario. See Rev. Rul. 55-381, 464.

CHAPTER 4—GIFT TAX

SECTION 1000.—IMPOSTION OF TAX

REGULATIONS 108, SECTION 86.2: Transfers reached.

Gift of an annuity to a taxpayer's spouse. See Rev. Rul. 55-388, page 233.

REGULATIONS 108, SECTION 86.3a: Gift of husband or wife to third party after April 2, 1948. Rev. Rul. 55-241

A husband and wife who entered into a prenuptial agreement under which each spouse waived all marital rights in the property of the

other will not be denied the gift-splitting privilege provided by section 1000(f) of the Internal Revenue Code of 1939 if they have signified their consent to treat all gifts made by them to third party donees as having been made one-half by each spouse and if they are otherwise qualified to apply that privilege with respect to the gifts in question.

SECTION 1003(b).—NET GIFTS: EXCLUSIONS FROM GIFTS

REGULATIONS 108, SECTION 86.10: Total amount of gifts. Rev. Rul. 55-303

Where a gift is made in trust the terms of which provide that the trustee is to pay the income to three designated beneficiaries for their lives in such portions as he in his sole discretion shall determine, with remainder over to others, it is held that the value of the right to the income to be distributed to a particular beneficiary is not susceptible of determination. Under such circumstances, no exclusion is allowable under section 1003(b)(3) of the Internal Revenue Code of 1939 with respect to the gifts made of the right to receive income from the property transferred. See *Helvering* v. *Mary M. Hutchings*, 312 U. S. 393, Ct. D. 1493, C. B. 1941-1, 438; *Welch* v. *Paine et al.*, 130 Fed. (2d) 990; *United States* v. *Arthur Pelzer*, 312 U. S. 399, Ct. D. 1495, C. B. 1941-1, 441; and *Fondren et al.* v. *Commissioner*, 324 U. S. 18, Ct. D. 1627, C. B. 1945, 421.

REGULATIONS 108, SECTION 86.10: Total amount of gifts.

Transfer or assignment of a policy of insurance to a donee as absolute owner. See Rev. Rul. 55-408, page 113.

SECTION 1005.—GIFTS MADE IN PROPERTY

REGULATIONS 108, SECTION 86.19: Valuation of property. Rev. Rul. 55-278
(Also Section 42; Regulations 118, Section 39.42-1.)

Series E United States savings bonds registered in the names of *A* and *B* in the alternative as coowners, which *A* had purchased in 1948 entirely with his own funds, were reissued in 1953 in the name of *B* alone in order to effect a gift to him of *A*'s coownership therein. *Held*, (1) the redemption value of the bonds at the time reissued is the proper value to be used by *A* with respect to such gift for Federal gift tax purposes; and (2) the interest (increment in value) that had accrued (as earned) on the bonds before their reissue is all includible in *A*'s gross income, for Federal income tax purposes, for his taxable year or period wherein he made such gift, except such interest as he has properly returned as income previously.

Advice has been requested relative to the proper value to be used by *A*, for Federal gift tax purposes, where Series E United States

savings bonds registered in the names of *A* and his son *B* in the alternative as coowners, which *A* had purchased in 1948 entirely with his own funds, were reissued in 1953 in the name of *B* alone in order to effect a gift to him of *A*'s coownership therein. Advice has also been requested regarding to whom and when the interest (increment in value) that had accrued (as earned) on the bonds before their reissue is taxable, for Federal income tax purposes. *A* and *B* are domiciled in a State which does not have community property laws.

Section 1005 of the Internal Revenue Code of 1939 provides that "If the gift is made in property, the value thereof at the date of the gift shall be considered the amount of the gift," and section 86.17 of Regulations 108 provides similarly. Section 86.19 of Regulations 108 provides, in part, that "The value at the date of the gift in the case of * * * bonds, within the meaning of the statute, is the fair market value per * * * bond on such date." However, since Series E United States savings bonds are generally nonnegotiable and nontransferable, they are nonmarketable and, accordingly, have no particular "market" value. Although ownership therein is transferable by death and by reissue in certain cases (U. S. Savings Bond Regulations, Department Circular No. 530, 7th Rev., dated May 21, 1952), their only definitely indicated or ascertainable value is the amount at which they are redeemable by the United States Treasury. In Mim. 5109, C. B. 1940–2, 283, and Mim. 5202, C. B. 1941–2, 241, it was held, *inter alia:*

> If "John Jones" purchases with his separate funds savings bonds and has them registered in his name and that of another individual in the alternative as coowners, for example, "John Jones or Mrs. Ella S. Jones," there is no gift for Federal gift tax purposes, unless and until he during his lifetime gratuitously permits "Mrs. Ella S. Jones" to redeem them and retain the proceeds as her separate property, in which event a gift of the then redemption value of the bonds would be made. Of course, such bonds if not previously redeemed would on the death of "John Jones" be includible in his gross estate for estate tax purposes at their full redemption value.

In other words, such a coownership in Series E United States savings bonds as is here involved does not constitute a tenancy by the entirety (see sections 86.2(a)(6) and 86.19(h) of Regulations 108), tenancy in common, joint tenancy (see section 86.2(a)(5) of Regulations 108), nor ownership similar to a joint bank account (see section 86.2(a)(4) of Regulations 108). *A* acquired full beneficial ownership of the bonds at time of purchase. This beneficial ownership would not be extinguished during *A*'s lifetime until (1) *A* surrenders the bonds to *B* and gratuitously permits him to cash them and retain the proceeds or (2) the bonds are reissued in *B*'s name alone. In the meanwhile, for all practical purposes *B* has only the hope or expectancy that either event ((1) or (2)) might occur. Therefore, it is held that the proper value to be used by *A*, for Federal gift tax purposes, with respect to his gift to *B* of his coownership in such bonds which he had purchased entirely with his own funds is their redemption value at the time they were reissued. The redemption values of such bonds during their original terms generally are indicated in tables on the bonds. The redemption values after the original maturities of Series E bonds issued prior to May 1, 1942, are indicated in table B in Department Circular 653 (3rd Rev.) dated April 29, 1952, a copy of which may be obtained from any Federal Reserve Bank, or the Bureau of the Public Debt, Washington 25, D. C. The redemption values after the original

maturities of Series E bonds issued on or after May 1, 1942, are indicated in tables A and C of that Circular.

In Revenue Ruling 54–143, C. B. 1954–1, 12, it was held, *inter alia*, that, where the purchase price of such a savings bond registered in the names of a husband and his wife in the alternative as coowners was contributed in part by each spouse and the bond is reissued in the names of the husband and their daughter in the alternative as coowners, any interest (increment in value) that had accrued (as earned) on the bond before its reissue is income, for Federal income tax purposes, of the wife in proportion to her contribution to the purchase price. Consistently, it is held that the interest (increment in value) that had accrued (as earned) on the bonds in the instant case before their reissue is all income of *A*. As indicated in section 39.42–6 of Regulations 118, and section 29.42–6 of Regulations 111, such interest (increment in value) does not accrue ratably between the dates on which the redemption values increase, but, as outlined in Revenue Ruling 54–143, *supra*, the increments occur (become earned) only in specific (fixed) amounts at the end of certain periods.

In Revenue Ruling 54–143, *supra*, however, no question was presented or resolved regarding *when* the interest (increment in value) held therein to be income of the wife was returnable by her, for Federal income tax purposes, if she had not already returned it as income on the accrual basis or pursuant to election under Code section 42(b). Although references were made in that Revenue Ruling to established general rules relative to when interest (increment in value) on such savings bonds is returnable under certain circumstances ordinarily involved, none included transfer of coownership in such bonds by reissue and realization of earned interest (increment in value) thereon by thus effecting a gift of it. The references were made for general information and because the rules apparently were, or would be, applicable to the interest income of the husband (who continued as original coowner), of the daughter (after she became coowner instead of the wife), and of the wife (to the extent she may already have properly returned it), and also to interest earned on a coowned bond held in the Revenue Ruling to be all income of one coowner, where he had purchased the bond entirely with his funds, even though he gratuitously permits the other coowner to redeem it and retain the entire proceeds. It is held that the interest (increment in value) that had accrued (as earned) on the bonds in the instant case before their reissue is all includible in *A*'s gross income for his taxable year or period wherein he thus made a gift of it, except such interest as he has properly returned as income previously. *A* realized the benefit of such interest when he made the gift thereof, since it was then already earned and he could have realized its benefit in cash payment by obtaining redemption of the bonds but chose instead to realize its benefit in a gift thereof to *B* by causing the bonds to be reissued in the latter's name alone. See *Helvering* v. *Paul R. G. Horst*, 311 U. S. 112, Ct. D. 1472, C. B. 1940–2, 206. See, generally, I. T. 3357, C. B. 1940–1; 11; *International Freighting Corporation, Inc.* v. *Commissioner*, 135 Fed. (2d) 310, affirming 45 B. T. A. 716; and *Isidore Brown, et ux.*, v. *Commissioner*, 22 T. C. 147, affirmed 220 Fed. (2d) 12. Compare I. T. 3011, C. B. XV–2, 132 (1936); and I. T. 3097, C. B. 1937–2, 219.

The above holding is applicable where the reissue occurs during the extended maturity period of Series E bonds as well as where it oc-

curs during their original term. See Code section 42(d), as added by section 2 of Public Law 12, 82d Cong., 66 Stat. 26, 26 U. S. C. 42, C. B. 1951-1, 182.

REGULATIONS 108, SECTION 86.19: Valuation of property.

Valuation of jewelry, furs, and related articles of personal property in Federal gift tax returns. See Rev. Rul. 55-71, page 110.

SECTION 1013.—JEOPARDY ASSESSMENTS

REGULATIONS 108, SECTION 86.43: Jeopardy assessments.

Delegation of authority to District Directors of Internal Revenue relative to the abatement of jeopardy assessments of estate and gift taxes. See T. D. 6126, page 466.

SECTION 1014.—CLAIMS IN ABATEMENT

REGULATIONS 108, SECTION 86.44: Claims in abatement.

Delegation of authority to District Directors of Internal Revenue relative to the abatement of jeopardy assessments of estate and gift taxes. See T. D. 6126, page 466.

CHAPTER 9.—EMPLOYMENT TAXES

SUBCHAPTER A.—EMPLOYMENT BY OTHERS THAN CARRIERS

PART III.—GENERAL PROVISIONS

SECTION 1420(e).—COLLECTION AND PAYMENT OF TAXES: FEDERAL SERVICE

REGULATIONS 128, SECTION 408.203: Employment after December 31, 1950.

Services performed for wholly owned instrumentality of the United States. See Rev. Rul. 55-96, page 488.

SECTION 1426.—DEFINITIONS

REGULATIONS 128, SECTION 408.203: Employment after December 31, 1950.

Salaries or wages paid to citizens of Guam. See Rev. Rul. 55-184, page 500.

REGULATIONS 128, SECTION 408.204: Who are employees. Rev. Rul. 55-18

An individual entered into a contract with the owner of a mobile diner to operate the diner for 50 percent of the net profits. Under the terms of the contract, the operator selects the site for operation of the diner; determines the hours it will be open to the public; and purchases all food, supplies and beverages to be sold as well as the gasoline and oil necessary for moving the diner. *Held*, the operator is not an employee of the owner of the mobile diner for Federal employment tax purposes.

An opinion has been requested whether an individual who operates a mobile diner for the owner thereof is an employee of the owner for purposes of the Federal Insurance Contributions Act (subchapter A, chapter 9, Internal Revenue Code of 1939).

The owner of a mobile diner entered into a contract with an individual to operate the diner for fifty percent of the net profits. Under the terms of the contract the owner agrees to equip the diner; keep it in proper operating condition; assume all expenses for such items as mechanical repair or replacement, tires, tubes, painting, insurance and State license; keep complete records of all business transacted between the parties; and make such records open to inspection by the operator. The operator agrees to purchase all food supplies and beverages to be sold in the diner; sustain the loss for all food spoilage; pay for the gasoline and oil necessary for operation of the diner; take the diner from the owner's place of business; and, mainly for the purpose of preventing vandalism, return it when he has terminated operations for the day. The operator is free to locate the diner at any location which he deems preferable and he determines the hours he will keep it open to serve the public.

Section 1426(d) of the Federal Insurance Contributions Act, as amended, provides 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. Section 408.204(c) of Regulations 128 relating to the definition of the term "employee," for Federal employment tax purposes, provides that generally the 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 also as to the details and means by which that result is accomplished. That is, an employee is subject to the will and control of the employer not only as to what shall be done but how it shall be done. If an individual 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, he is an independent contractor. An individual performing services as an independent contractor is not, as to such services, an employee under the usual common law rules.

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 the instant case the owner of the diner is interested only in the results obtained by the operator and does not in any manner direct or control him as to the details and means by which that result is accomplished. The fifty percent net profits retained by the owner are considered in the nature of a rental

fee for the use of the diner. Accordingly, it is held that the operator is not an employee of the owner of the diner for Federal employment tax purposes.

REGULATIONS 128, SECTION 408.204: Who are employees. Rev. Rul. 55-31

Guides to be used in determining the status of traveling or city salesmen under section 1426(d)(3)(D) of the Federal Insurance Contributions Act.

1. Mimeograph 6583, C. B. 1951-1, 97, in part, outlines the general application of the provisions of the Federal Insurance Contributions Act (subchapter A, chapter 9, of the Internal Revenue Code of 1939) in the cases of traveling or city salesmen.

2. Paragraph 6 of Mimeograph 6583 sets forth the conditions under which a traveling or city salesman (other than an agent-driver or commission driver) who is not an employee under the usual common-law rules, is considered an employee under section 1426(d)(3)(D) of the Act, with respect to services performed after 1950.

3. The purpose of this Revenue Ruling is to supplement paragraph 6 of the Mimeograph by providing a definition or general interpretation of certain terms appearing therein, and by giving examples of factual situations for purposes of section 1426(d)(3)(D) of the Act:

(a) *Full-time basis.*—A traveling or city salesman whose entire or principal business activity is the solicitation of orders primarily for one principal from wholesalers, retailers, contractors, or operators of hotels, restaurants, or other similar establishments for merchandise for resale or supplies for use in their business operations. Generally, a traveling or city salesman will be presumed to meet the "principal business activity" test in any calender quarter in which he devotes 80 percent or more of his working time and attention to the solicitation of orders for one principal from wholesalers and/or the other customers specified for merchandise for resale or supplies of the requisite character.

(b) *Wholesalers.*—Those who buy merchandise or commodities in comparatively large quantities and sell such merchandise or commodities to jobbers, retailers, etc., as distinguished from the ultimate consumers, in smaller quantities for the purpose of resale. Wholesalers do not process the merchandise in any way that would cause it to lose its identity. It is the character of their selling, not their buying, which characterizes these as wholesalers.

(c) *Retailers.*—Those who sell merchandise or commodities to the ultimate consumers, usually in small parcels or quantities. For purposes of this definition, a merchant will not lose his classification as a retailer merely because he may perform a service function, or a processing or manufacturing operation, with respect to the merchandise or commodity which he sells. The distinguishing feature of a retailer is the fact that he sells to the ultimate consumers.

(d) *Contractors.*—Those who, for a fixed price, undertake the performance of work on an independent basis usually on a large scale, whether for the public, a company, or an individual, such

as, construction contractors and certain service organizations. These include, among others, electrical, plumbing, painting, building, highway, window washing, wall cleaning and delivery service contractors.

(e) *Operators of hotels, restaurants or other similar establishments.*—The phrase "other similar establishments" refers solely to establishments similar to hotels and restaurants and usually is limited to establishments whose primary function is the furnishing of food and/or lodging.

(f) *Merchandise for resale.*—Goods, wares, and commodities, which ordinarily are the objects of trade and commerce, whether at wholesale or retail, and which are purchased for the purpose of selling to others in substantially the same form as acquired. This term includes tangible materials which do not lose their identity between the time of purchase and the time of sale while in the hands of the vendor.

(g) *Supplies for use in the customers' business operations.*—Means principally articles consumed in conducting or promoting the customers' businesses. Generally the term "supplies" includes all tangible items which are not "merchandise for resale" or capital items. Services, such as radio time, advertising space, etc., are intangible items and not within the definition. However, calendars, advertising novelties, etc., used by the advertiser in his business constitute "supplies."

4. The following types of customers usually are not included in those designated in section 1426(d)(3)(D) of the Act: manufacturers, schools, hospitals, churches, and institutions, municipalities and State and Federal governments. However, an entity which is not included in the type of customers specifically designated may, through a unit of its organization, carry on a clearly identifiable and separate business which is in the included category. For example, where an entity, such as a college, university or other school, is engaged principally in activities not in connection with retail distribution of commodities, but through a unit of its organization, such as a bookstore, carries on a clearly identifiable and separate business, such separate unit, as such, is a "retailer" within the meaning of section 1426(d)(3)(D).

5. The following examples, in each of which it has been established that the salesman is not an "employee" under the usual common law rules, illustrate the application of the above terms in determining the status of traveling or city salesmen under the statutory test provided in section 1426(d)(3)(D) of the Act. (In each such case the salesman solicits orders regularly and exclusively for one principal, transmits the orders to such principal, operates under an arrangement whereby substantially all of the services are performed by him personally, and has no substantial investment in facilities (other than transportation facilities) used in the performance of his services.)

Example 1. The salesman performs sales services for a company engaged in publishing catalogs and plans for home designs. He solicits orders for the catalogs exclusively from lumber dealers. The catalogs are purchased by the lumber dealers either for resale purposes or for free distribution to their customers. The lumber dealers are "wholesalers" or "retailers" within the meaning of those terms as used in section 1426(d)(3)(D) of the Act. The catalogs for resale consti-

tute "merchandise for resale" and those purchased for free distribution constitute "supplies for use in the customers' business operations." The salesman meets the statutory test provided in such section 1426(d)(3)(D) and is an employee of the company for purposes of the taxes imposed by the Act.

Example 2. The employer is a wholesale distributor of automotive parts and a rubberseal compound to be inserted in automobile or truck tire tubes. The salesman spends all of his working time in soliciting orders for the distributor's products from retail automobile dealers, operators of gasoline service stations and repair shops, and automobile fleet owners. Some of the dealers have shops at which only ordinary repair work incident to the sale of automobiles is performed. The operators of the other repair shops are engaged primarily in repairing automobiles and tires and sell no automotive parts other than those installed by them and no rubberseal compound except that inserted in their customers' tire tubes.

The automotive parts and rubberseal compound constitute "merchandise for resale" or "supplies for use in the customers' business operations" within the meaning of section 1426(d)(3)(D) of the Act. The operators of gasoline service stations and the retail automobile dealers (including dealers who in conjunction with their salesrooms operate repair shops at which only ordinary repair work incident to the sale of automobiles is performed) are "retailers" within the meaning of such section. The operator of an automotive repair shop or garage who conducts a retail unit separate from his regular business, or separately identified, likewise is with respect to such unit a "retailer." However, generally the operator of a repair shop or garage who has no such unit is not a "retailer" or other customer of the type specified in section 1426(d)(3)(D). The automobile or truck fleet owners who operate delivery service businesses and contract with merchants to deliver packages or the owners of trucks used in fulfilling hauling contracts are "contractors" within the meaning of section 1426(d)(3)(D). However, the owner of a fleet of taxicabs or limousines used for transporting passengers or the owner of automobiles or trucks rented for driving by the renters thereof is not deemed to be a "contractor."

Inasmuch as the salesman solicits orders from some customers who are not retailers, contractors or others of the types specified in section 1426(d)(3)(D), it is clear that his "entire business activity" is not the solicitation of orders from the requisite types of customers. Then it is necessary to determine whether his "principal business activity" is the solicitation of orders for one principal from the requisite types of customers. The salesman estimates that he devotes 80 percent of his working time to soliciting orders for the distributor from the requisite types of customers in each calendar quarter and that these activities are the principal source of his income. It is concluded that the salesman meets the statutory test provided in section 1426(d)(3)(D), and is an employee of the distributor for purposes of the taxes imposed by the Act.

Example 3. The salesman performs sales services for a company which is engaged in the sale of new and used trucks and trailers. He solicits orders exclusively from trucking firms who purchase the vehicles for use in fulfilling hauling contracts. Although the truck-

ing firms are "contractors" within the meaning of section 1426 (d) (3) (D) of the Act, the trucks and trailers purchased by them are capital investments of the customers and are not "merchandise for resale" or "supplies for use in the customers' business operations." Accordingly, the salesman does not meet all the requirements of the statutory test contemplated by section 1426(d) (3) (D), *supra*, and is not an employee of the company for purposes of the Act.

Example 4. The salesman solicits orders on behalf of a company which is engaged in the manufacture of novelty jewelry. The orders for such jewelry are solicited from college bookstores, jewelry stores, newstands, drug stores, curio shops, automobile dealers, and military supply stores, including Army and Air Force post exchanges and Navy ship service stores. The products are purchased for resale by all of the customers other than the automobile dealers. Those purchased by the automobile dealers are for free distribution to their customers for advertising purposes. The college bookstores, as separate units of the college, are "retailers" within the meaning of section 1426 (d) (3) (D) of the Act. The military supply stores, including Army and Air Force post exchanges and Navy ship service stores, and the operators of jewelry stores, newstands, drug stores, curio shops and automobile dealers also are "retailers" within the meaning of such section. The novelty jewelry purchased for resale constitutes "merchandise for resale" and that purchased for free distribution constitutes "supplies for use in the customers' business operations" within the meaning of section 1426(d) (3) (D). Since the salesman's entire business activity is the solicitation of orders for one principal for the requisite types of items from customers specified in section 1426(d) (3) (D) and he meets other conditions in such section, he is an employee for purposes of the Act.

Example 5. The salesman performs sales services for a company which is in the business of selling and servicing sound and projection equipment. He calls principally on schools to interest them in better teaching methods by the use of audio-visual equipment and to sell such equipment. He also solicits orders from churches. Since he solicits orders principally or exclusively from schools and churches which, as such, are not the types of customers designated in section 1426(d) (3) (D) of the Act, he is not an employee of the company for purposes of the taxes imposed by the Act.

Example 6. The salesman performs sales services for a firm which is engaged in selling advertising on menus, folders, etc. He solicits orders for the advertising from wholesalers, retailers, contractors, and operators of restaurants, hotels, motels and similar establishments. The solicitation of orders for advertising for inclusion on menus, folders, etc., which are not made available to the advertiser involved, but are furnished to other customers of the salesman or his principal for use or distribution, does not constitute the solicitation of orders of the type contemplated by section 1426(d) (3) (D) of the Act. However, the solicitation of orders for advertising on menus, folders, or advertising specialties from wholesalers, retailers, contractors, or from operators of hotels, motels, restaurants or other similar establishments, which are used by such customers for use in their business operations (including good will novelties distributed by or on behalf of the ad-

vertiser) constitute the solicitation of orders for "supplies for use in the customers' business operations."

Although all of the customers are of the types specified in section 1426(d)(3)(D) of the Act, none of the orders are for "merchandise for resale" by the customers from whom such orders are solicited and only part of the orders are for "supplies for use in the customers' business operations." The salesman estimates that he devotes 60 percent of his time during each calendar quarter to soliciting orders for the firm from customers for advertising for inclusion on menus, folders, etc., which are not made available to the advertiser involved and, therefore, are not "supplies for use in the customers' business operations." It is concluded that the salesman does not meet all the requirements of the statutory test contemplated by section 1426(d)(3)(D), and is not an employee of the firm for purposes of the taxes imposed by the Act.

REGULATIONS 128, SECTION 408.204: Who are employees. Rev. Rul. 55-95

Individuals are selected by the M Community Service, Inc., to perform services as "homemakers" in private homes. The Service requires the individuals to keep daily records and retains the right to control the individuals in the performance of their services. *Held*, the individuals are employees of the Service for Federal employment tax purposes.

The question has been presented whether individuals who are selected and placed in private homes by the M Community Service, Inc., a casework agency, for the purpose of performing services as "homemakers" are the employees of such Service for purposes of the Federal Insurance Contributions Act (subchapter A, chapter 9, Internal Revenue Code of 1939.)

It is the purpose of the "homemaker" service to place individuals, carefully chosen for their homemaking skills and ability to get along with people, in a home where their presence is needed to maintain the home as a unit, and to keep it functioning during the temporary incapacity or unavoidable absence of the mother. The service is also available to adults overcome by short illnesses, infirmities of old age, or otherwise. The service is furnished free of charge when needed, through the relief funds of various charitable agencies. Some families, however, pay part or all of the cost of the service if they are able to do so.

In the beginning, the Service placed an advertisement in the newspaper for individuals who wished to register as homemakers. The individuals interested in the type of work involved now apply for registration. The individuals are required to fill out application forms and give character and health references. A determination of whether a prospective homemaker has the necessary qualifications for an assignment is based on such character and health references and by trial on the job. The Service maintains a register of homemakers and requires them to keep a daily record of hours worked, which is then used by the Service in computing their remuneration. The Service

pays the individuals by check from its own funds immediately upon completion of each assignment, without regard to whether it will be reimbursed by the family for whom the services were performed.

Section 1426(d)(2) of the Act provides, in part, that the term "employee" means any individual who under the common law rules applicable in determining the employer-employee relationship has the status of an employee. See section 408.204(c), Regulations 128, relating to common law employees.

It is concluded that the M Community Service, Inc., retains the right to exercise such direction and control over the homemakers in the performance of their services as is necessary to constitute an employer-employee relationship. Accordingly, it is held that individuals selected and placed in private homes by the M Community Service, Inc., to perform services as "homemakers" are employees of that Service for Federal employment tax purposes.

REGULATIONS 128, SECTION 408.204: Who are employees. Rev. Rul. 55-113

(Also Section 481; Regulations 118, Section 39.481-1.)

An individual and a group of automobile dealers entered into an agreement whereby the individual maintains a central telephone service in his home and keeps a complete listing of the daily car inventory of each dealer for the purpose of enabling a salesman of a participating dealer to complete a sale of a specific model of car not in the particular dealer's stock. The individual is neither supervised nor issued instructions concerning the manner of performing his services. He may delegate the work to a substitute of his own choosing without the consent of the dealers, and he receives a regular monthly fee for the service plus telephone expenses. *Held*, the individual is not an employee of the automobile dealers for Federal employment tax purposes.

Inquiry has been made whether an individual, who furnishes certain telephone informational service to various automobile dealers in the area, is the employee of such dealers for purposes of the Federal Insurance Contributions Act (subchapter A, chapter 9, Internal Revenue Code of 1939).

In the instant case, an individual and a group of automobile dealers entered into an oral agreement whereby the individual agrees to maintain a central telephone bureau in his home for the dealers. By calling each of the dealers every day, he is able to keep a complete listing of the daily inventory of each, thus enabling a salesman of any dealer to complete his sale with a customer for a particular model or color of car not in the dealer's own stock, through purchase from another participating dealer. For these services the individual receives a regular monthly fee, plus telephone expenses. The dealers furnish no equipment or office supplies, do not supervise or issue instructions in the work, and do not require that the services be performed personally. The individual may regulate his own hours, but of necessity works during the normal working hours of the firms. One of the dealers acts as a collection agent for the group, without fee, paying

the individual's monthly fee and telephone expenses, as well as collecting the prorated share of expenses from each participating dealer.

Section 1426(d) of the Federal Insurance Contributions Act, as amended, 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. See section 408.204(c), Regulations 128, relating to common law employees.

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 shown that the automobile dealers do not exercise or have the right to exercise control over the individual in the performance of his services sufficient to establish an employer-employee relationship under the usual common law rules. Accordingly, it is held that the individual in the instant case is not the employee of the automobile dealers for Federal employment tax purposes. However, he is engaged in self-employment with respect to this activity and the net earnings he receives are subject to the provisions of the Self-Employment Contributions Act (subchapter E, chapter 9, Internal Revenue Code of 1939).

REGULATIONS 128, SECTION 408.204: Who are employees. Rev. Rul. 55-124

A retail furniture and electrical appliance company conducted an extensive advertising campaign to promote the sale of its merchandise. It engaged a salesman on a commission basis to call on prospects whose names it furnished him. It supplied him with business cards, order books, merchandise catalogues, and demonstrator models of some of its appliances. It provided him a telephone service at its headquarters and otherwise made those headquarters available to him in connection with his sales activities. At times, he waited on customers coming into the company's store. *Held*, the salesman is an employee of the company for Federal employment tax purposes.

An opinion has been requested relative to the status, for Federal Insurance Contributions Act purposes (subchapter A, chapter 9, Internal Revenue Code of 1939), of an individual who performs sales services for a retail furniture and electrical appliance company.

The company in the instant case is engaged in the retail sale of furniture and electrical appliances. It conducted an extensive advertising campaign to promote the sale of its merchandise and engaged a salesman on a commission basis to call on prospective customers whose names it furnished him. It supplied him with business cards, order books, merchandise catalogues, and demonstrator models of some of its appliances. It provided him a telephone service at its headquarters and otherwise made those headquarters available to him in connection with his selling activities. At times, he waited on customers coming into the company's store. Although he was not required to observe regular working hours, he used the company's facilities as his sales headquarters. He was required to check with local banks, etc., to obtain information regarding the credit ratings of the customers to whom he sold the company's merchandise. At the

end of each day, he reported the sales consummated during the day. Based upon these reports, the company paid him his commissions on a weekly basis.

Section 1426(d) of the Federal Insurance Contributions Act provides 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 employer-employee relationship under the usual common law rules are found in section 408.204(c), Regulations 128.

Whether a person is an independent contractor or an employee is largely a question of fact to be determined upon the particular facts of each case. In the instant case the nature of the services performed permit a greater freedom from employer control than is usually present in the case of services of a different character. However, the company has authority over the salesman in the performance of his services as shown by the fact that he is furnished with the names of prospects on whom he is expected to call, that he is furnished with necessary facilities, that he uses the company's office as his headquarters, and that he also performs sales services in the company's store. Accordingly, it is held that the company exercises or has the right to exercise such control over the individual in the performance of his services as is necessary to establish the relationship of employer and employee under the usual common law rules for Federal employment tax purposes.

REGULATIONS 128, SECTION 408.204: Who are employees. Rev. Rul. 55-144

An individual is employed by a dealer in used automobiles to drive automobiles to an auction company located in a city distant from the dealer's place of business. The dealer instructs the individual with respect to the price at which the cars are to be sold at auction, requires the individual to "protect that price," pays all expenses of the trip, and remunerates the individual on the basis of a stated amount for each car sold. *Held*, the individual is an employee of the dealer for Federal employment tax purposes.

An opinion has been requested whether an individual employed by a used car dealer to drive automobiles to an auction company located in a city distant from the dealer's place of business and to "protect the price" at which the car is to be sold is an employee of the dealer for purposes of the Federal Insurance Contributions Act (subchapter A, chapter 9, Internal Revenue Code of 1939).

In the instant case, a dealer in used automobiles employed an individual under the terms of an oral agreement to drive automobiles to an auction company located in a city distant from the dealer's place of business. The dealer places a price on the car to be sold at auction and requires the individual to "protect the price." The auction company generally mails the check in payment for the car direct to the dealer. The dealer pays all expenses incurred by the individual in connection with the trip and remunerates him on the basis of a stated amount for each car sold. The individual also drives automobiles to the dealer's place of business from locations out of the city, for which he receives a stated sum. All services are performed

in the name of the dealer. The individual's services may be terminated by the dealer for any or no reason. The individual also performs similar services for another used car dealer.

Section 1426(d) of the Act provides, in part, 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 to be used in determining the employer-employee relationship under the usual common law rules are found in section 408.204(c) of Regulations 128.

Whether a person is an independent contractor or an employee is largely a question of fact to be determined upon the particular facts of each case. In the instant case the individual performs personal services for the dealer and the dealer exercises, or has the right to exercise, such control over the individual in the performance of his services as is necessary to establish an employer-employee relationship. The fact that the individual performs services for another principal does not negative the existence of an employer-employee relationship. See S. S. T. 24, C. B. XV-2, 406 (1936). Accordingly, it is held that the individual is an employee of the dealer for Federal employment tax purposes.

REGULATIONS 128, SECTION 408.204: Who are employees. Rev. Rul. 55-195

Under his last will and testament a decedent bequeathed all of his property to his three children as trustees. The estate consists of certain business property which had been operated by the decedent as a sole proprietorship. The will provides that the trustees shall, in their discretion, carry on the businesses that the decedent was conducting at the time of his death, with authority to employ a manager of such businesses and such other employees as they deem necessary. The will also provides that in case a difference of opinion should exist among the trustees with regard to any of the trust affairs, the opinion and determination of any two shall be controlling. The trustees elected to engage each of their number to perform services in connection with the operation of the businesses of the trust which are outside the scope of their official duties as trustees.

A ruling published as Em. T. 444, C. B. 1943, 1070, holds that a sole fiduciary should not be considered an employee of the estate, either as to his official duties or any services performed outside the scope of his official duties, since the essentials of employment are lacking. However, such ruling also holds that where two or more fiduciaries engage one of their number to perform services for the estate which are specifically recognized as being outside the scope of the fiduciary's official duties he may, as to such special services, be an employee provided the requisite control exists.

Accordingly, inasmuch as each of the instant trustees is subject to the supervision of his cotrustees in the performance of his special services, it is held that with respect to such services each trustee is an employee of the trust for purposes of the Federal Insurance Contributions Act (subchapter A, chapter 9, Internal Revenue Code of 1939).

REGULATIONS 128, SECTION 408.204: Who are employees. (Also Section 481; Regulations 118, Section 39.481–3.) Rev. Rul. 55–206

An individual, who is engaged in the business of private tutoring and is self-employed with respect to such activity, is also engaged part-time by the *X* Board of Education to perform services as a substitute teacher in the public schools. As a substitute teacher, the individual is required to observe regular school hours and is subject to the rules and regulations prescribed by the *X* Board of Education. *Held*, with respect to her services as a substitute teacher, the individual is an employee of the *X* Board of Education for Federal employment tax purposes.

A ruling has been requested relative to the status for purposes of the Federal Insurance Contributions Act (subchapter A, chapter 9, Internal Revenue Code of 1939) and the Self-Employment Contributions Act (subchapter E, chapter 1, Internal Revenue Code of 1939) of an individual who is engaged in the business of private tutoring and is employed part-time by the *X* Board of Education to perform services as a substitute teacher in the public schools.

In the instant case the individual is engaged in private tutoring and is self-employed with respect to such services. She also performs services as a substitute teacher in the public schools. While performing services as a substitute teacher, she is engaged in the regular activities of the school, is subject to its rules and regulations, and is required to conform to regular school hours. Such services are performed in the public school buildings.

Section 1426(d) of the Federal Insurance Contributions Act provides 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. Section 408.204(c) of Regulations 128 relating to the definition of the term "employee" for Federal Insurance Contributions Act purposes, provides that generally the 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 also as to the details and means by which that result is accomplished.

The tax under the Self-Employment Contributions Act is imposed upon "self-employment income" which in turn is based upon "net earnings from self-employment." It is necessary for an individual to carry on a "trade or business," either as an individual or as a member of a partnership, in order for him to have "net earnings from self-employment." The performance of services by an individual as an "employee" as defined in the Federal Insurance Contributions Act, with an exception not here material, does not constitute a "trade or business."

In the instant case, the individual who holds herself out to the public as a private tutor and is carrying on such business for the purpose of livelihood or profit is self-employed with respect to such activities, and the income derived therefrom should be considered in determining "net earnings from self-employment." However, with respect to the individual's services as a substitute teacher in the public schools she is not engaged in an independent calling, but is subject to direction

and control by the *X* Board of Education necessary to establish the legal relationship of employer and employee for Federal employment tax purposes. See S. S. T. 341, C. B. 1938–2, 297. Therefore, the portion of the individual's income attributable to substitute teaching in the public schools does not constitute earnings from self-employment for Federal self-employment tax purposes.

REGULATIONS 128, SECTION 408.204: Who are employees. Rev. Rul. 55-279

An individual engaged as a telephone solicitor of orders for a company's products, calls persons and firms listed in the telephone directory. She uses a telephone, other office facilities, and supplies furnished by the company. The company gives her instructions regarding the general conversation and "sales talk" with the prospective customers. She devotes several hours daily to the work, performs the services personally, and is remunerated on a commission on sales basis. *Held*, she is an employee of the company for Federal employment tax purposes.

Another telephone solicitor engaged by the company solicits orders for its products from her own home on a part-time basis. She performs the services at her convenience, without supervision, pays all expenses incurred in connection with her selling activities, and is paid on a commission on sales basis. *Held*, she is not an employee of the company for Federal employment tax purposes.

The Internal Revenue Service has been requested to determine the status, under the Federal Insurance Contributions Act (subchapter A, chapter 9, Internal Revenue Code of 1939) of individuals engaged to perform services as telephone solicitors for a company in connection with the sale of its products under the two situations shown below.

Case 1.

In the first case, a person is engaged by the company to perform services as a telephone solicitor in connection with obtaining orders for its products. Her duties are to telephone certain individuals and institutions designated by the company and to enter the necessary information on an order blank when a sale is made. She is furnished a telephone, and other office facilities, and supplies by the company. No period of training was required due to the type of services performed. However, the company suggests the general conversation and "sales talk" to be used with the prospective customers. The telephone calls are made at times optional to the solicitor, but she is expected to devote from 4 to 8 hours of her time each day to the performance of these services. She operates under the name of the company. The company does not allow her a drawing account or require her to produce a minimum volume of sales. Her services may be terminated at any time.

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.

Although detailed direction and control are not exercised by the company over the performance of services by the telephone solicitor, it is evident that the company has the right of direction and control

and, in fact, exercises all the control which is necessary and practicable for the accomplishment of its purposes. This conclusion is based upon a consideration of the impracticability of detailed and continuous supervision due to the nature of the services performed; the fact that the solicitor is furnished the names of prospective customers to be called; that she is furnished, outside her home, the facilities and supplies necessary for her work; and, that she is required to spend a considerable amount of time each day on the company's premises. Accordingly, it is held that the relationship of employer and employee for Federal employment tax purposes exists between the company and this telephone solicitor.

Case 2.

The company also engages another telephone solicitor to call householders for the purpose of obtaining orders for its products. In order to avoid duplication of calls made by the other solicitor this solicitor is assigned certain pages of the telephone directory from which to make her calls. She operates from her own home, performs the services on a part-time basis, without supervision, and pays all expenses incurred in connection with her selling activities. She does not submit reports, other than sales orders; does not deliver the products sold or collect any payment therefor; and is not required to devote any certain amount of time to the work, perform any services on the company's premises, or produce a minimum volume of sales. She is paid a commission on each sale made by her and is not allowed a drawing account or any advance against anticipated earnings.

Applying the rules contained in section 408.204(c), *supra*, it is held that the company does not exercise or have the right to exercise the control necessary to establish the relationship of employer and employee for Federal employment tax purposes between itself and this particular telephone solicitor.

REGULATIONS 128, SECTION 408.204: Who are employees.

An individual performing services for an organization as an organizer of "forum-type dinner clubs." See Rev. Rul. 55-233, page 116.

REGULATIONS 128, SECTION 408.204: Who are employees.

Individual conducting a watch repair department within a jewelry store. See Rev. Rul. 55-248, page 117.

REGULATIONS 128, SECTION 408.204: Who are employees.

Individual performing services as sexton of a cemetery. See Rev. Rul. 55-328, page 98.

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REGULATIONS 128, SECTION 408.204: Who are employees.

Individual repairing automobile bodies and fenders on regular salary or percentage basis. See Rev. Rul. 55-370, page 122.

REGULATIONS 128, SECTION 408.205: Who are employers.

Change in membership of partnership where the business thereof was continued. See Rev. Rul. 55-93, page 404.

REGULATIONS 128, SECTION 408.213: United States and instrumentalities thereof. (Also Section 1420(e), Section 408.203.) Rev. Rul. 55-96

> Commissions and foundations established under the Fulbright Act, are wholly owned instrumentalities of the United States for Federal tax purposes. Services performed in the employ of such commissions and foundations come within the classification of services excepted from "employment" under section 1426(b)(7)(B) of the Federal Insurance Contributions Act. However with respect to such services performed on and after January 1, 1951, the determination as to whether an individual is performing services which constitute "employment" is to be made under section 1420(e) of the Act by the head of the Government agency involved.

Advice has been requested whether services performed by a teacher in Thailand for an educational foundation established and operating under the Fulbright Act are excepted from "employment" under the Federal Insurance Contributions Act (subchapter A, chapter 9, Internal Revenue Code of 1939).

The Fulbright Act, Act of August 1, 1946, 60 Stat. 754, 50 U. S. C. 1641, authorizes the State Department to enter into agreements with foreign governments to provide for an educational exchange program. This statute contemplates that its provisions will be carried out by the formation of educational foundations operating in the foreign countries concerned. Such foundations will receive foreign currencies, or credits therefor, held or available for expenditure by the United States or any agency thereof, and not required by law or agreement to be used for any other purpose, and will use such funds for the purpose, among others, of financing studies, research, instruction, and other educational activities of or for American citizens in schools and institutions of higher learning located in countries other than the United States.

It is concluded that commissions and foundations established under the Fulbright Act are wholly owned instrumentalities of the United States for Federal tax purposes. Since these commissions and foundations are not corporations it is the opinion of the Internal Revenue Service that services performed in the employ of such commissions and foundations come within the classification of services excepted from "employment" by section 1426(b)(7)(B) of the Federal Insurance Contributions Act. However, section 1420(e) of the Act

provides, with respect to services performed on and after January 1, 1951, in the employ of the United States or a wholly owned instrumentality thereof, that (1) the determination as to whether an individual has performed services which constitute "employment" as defined in section 1426 of the Act, (2) the determination of the amount of remuneration for such services which constitutes "wages" as defined in such section, and (3) the return and payment of the taxes imposed by the Act, shall be made by the head of the Federal agency or instrumentality having control of such services or by such agents as he may designate.

REGULATIONS 128, SECTION 408.214: States and their political subdivisions and instrumentalities.

Civilian employees of State National Guard. See Rev. Rul. 55-247, page 117.

REGULATIONS 128, SECTION 408.214: States and their political subdivisions and instrumentalities.

Social security coverage for employees of a State instrumentality exempt under section 101(6) of the Internal Revenue Code. See Rev. Rul. 55-310, page 45.

REGULATIONS 128, SECTION 408.215: Ministers of churches and members of religious orders. Rev. Rul. 55-242

Ordained ministers serving on the faculties of theological seminaries as teachers and administrators are performing services in the exercise of their ministry and such services are excepted from employment under section 1426(b)(9)(A) of the Federal Insurance Contributions Act.

Advice has been requested whether services performed by ordained ministers as teachers and administrators on the faculties of theological seminaries are excepted from "employment" under section 1426(b)(9)(A) of the Federal Insurance Contributions Act (subchapter A, chapter 9, Internal Revenue Code of 1939).

In the instant case a theological seminary, which is a nonprofit, charitable, religious, and educational institution of learning, exempt from Federal income tax under section 101(6) of the Code, was organized for the purpose of training and educating ministers. Ordained ministers are engaged by the seminary to serve on its faculty as teachers and administrators under oral agreements which provide only that the minister will receive such rights, privileges, and benefits as the seminary's policies provide for one holding that specific position.

Section 1426(b) of the Federal Insurance Contributions Act excludes from the definition of "employment" for the purposes of that Act:

(9)(A) Service 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; * * *.

Regulations 128, issued pursuant to the Act, provides in section 408.215 that 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, are excepted from employment. The duties of ministers include the ministration of sacerdotal functions and the conduct of religious worship, and the control, conduct, and maintenance of religious organizations (including the religious boards, societies, and other integral agencies of such organizations), under the authority of a religious body constituting a church or church denomination.

Theological seminaries are religious institutions of learning, their purpose being to train and educate ministers in the propagation of the religious principles and ideals of various church denominations. It is concluded that ordained ministers serving on the faculties of theological seminaries as teachers and administrators are performing services in the exercise of their ministry and that such services are excepted from "employment" under section 1426(b)(9)(A) of the Act. In the event that a theological seminary that is exempt from Federal income tax under section 101(6) of the Code waives its exemption from the taxes imposed under the Federal Insurance Contributions Act, the remuneration paid to the ministers serving on its faculty as teachers and administrators will nevertheless not constitute wages for purposes of the taxes imposed under such Act. See T. D. 5823, C. B. 1951-1, 89.

REGULATIONS 128, SECTION 408.215: Ministers of churches and members of religious orders. Rev. Rul. 55-243

Services performed by ordained, commissioned, or licensed ministers, as heads of religious departments, or as teachers and administrators, whose specific duties involve no ecclesiastical functions, on the faculty of a college which is not under the authority of a religious body constituting a church or church denomination are not excepted from "employment" under section 1426(b)(9)(A) of the Federal Insurance Contributions Act.

Services performed by an ordained, commissioned, or licensed minister as a "Chaplain and Professor of Religion" at the college are excepted from "employment" under such section.

Advice has been requested whether services performed by ordained, commissioned, or licensed ministers as heads of religious departments or as teachers and administrators on the faculty of a college are excepted from "employment" under section 1426(b)(9)(A) of the Federal Insurance Contributions Act (subchapter A, chapter 9, Internal Revenue Code of 1939). Similar advice has also been requested relative to services performed by an ordained, commissioned, or licensed minister as "Chaplain and Professor of Religion" at the college.

Section 1426(b) of the Federal Insurance Contributions Act contains the following exception from the term "employment," for purposes of the taxes imposed under the Act;

(9)(A) Service 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; * * *

Revenue Ruling 55-242, page 489, this Bulletin, relates to services performed by ordained ministers as teachers and administrators on

faculties of theological seminaries under oral agreements which provide only that they will receive such rights, privileges, and benefits as the seminary's policies provide for one holding that specific position and holds that such services are excepted from "employment" under section 1426(b)(9)(A) of the Act. This result is based upon the conclusion that theological seminaries are religious institutions of learning, dedicated to the training and education of ministers in the propagation of religious principles and ideals, and, hence, that the services performed by ministers as teachers and administrators at such seminaries fall within the scope of section 408.215 of Regulations 128, which provides:

> Ministers of churches and members of religious orders. 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, are excepted from employment. The duties of ministers include the ministration of sacerdotal functions and the conduct of religious worship, and the control, conduct, and maintenance of religious organizations (including the religious boards, societies, and other integral agencies of such organizations), under the authority of a religious body constituting a church or church denomination.

The Internal Revenue Service holds generally that services performed by ordained ministers as heads of religious departments and as teachers and administrators on the faculty of a college or university which, although not basically a religious institution, is an integral agency of a religious organization under the authority of a religious body constituting a church or church denomination, are in the exercise of their ministry and are excepted from "employment" under section 1426(b)(9)(A) of the Federal Insurance Contributions Act. However, in the instant case the Service has accepted as facts the representations which support a conclusion that although the college is an institution of the *M* state convention such convention is not a religious body constituting a church denomination. Therefore, it is held that services performed by ordained ministers as heads of religious departments as distinguished from schools of theology, and as teachers and administrators on the faculty of the college whose specific duties involve no ecclesiastical functions, such as the conduct of religious worship, are not excepted from "employment" under the provisions of section 1426(b)(9)(A) of the Federal Insurance Contributions Act.

An ordained minister is engaged by the college primarily as a chaplain and serves as "Chaplain and Professor of Religion" with a specification of duties embracing the ministration of sacerdotal functions and the conduct of religious worship. He is responsible for planning the chapel programs each Sunday and on one other day in each week and is required to preach at approximately one-half of the Sunday services. He is also responsible for the religious counseling of students and for supervising generally all religious activities on the campus. He devotes approximately one-half of his time to teaching, including a course in religion.

Mimeograph 6633, C. B. 1951-1, 106 (which prescribes rules to determine whether the services of a duly ordained minister of a church are performed "in the exercise of his ministry" within the meaning of section 1426(b)(9)(A) of the Federal Insurance Contributions Act), provides, in subparagraph (a), paragraph 5, that services in the conduct of religious worship or in the ministration of sacerdotal

functions are "in the exercise of the ministry" whether or not they are performed for a religious organization.

Since the duties imposed upon the instant chaplain, i. e., the teaching of religion and the performance of admittedly ecclesiastical services considered in their entirety are not susceptible of segregation into two separate and distinct categories, section 1426(c) of the Federal Insurance Contributions Act, which relates to included and excluded services is not applicable. Accordingly, it is held that services performed as "Chaplain and Professor of Religion", in the circumstances stated are performed in the exercise of the ministry within the contemplation of Mimeograph 6633, *supra*, and are therefore excepted from employment under section 1426(b)(9)(A) of the Federal Insurance Contributions Act.

REGULATIONS 128, SECTION 408.226: Wages. (Also Sections 1607, 1621; Regulations 107, Section 403.227; Regulations 120, Section 406.207.) Rev. Rul. 55-196

Where an agreement between a traveling salesman employed on a straight commission basis and his employer provides that some part of the salesman's gross commissions be considered (a) an allowance toward bona fide ordinary and necessary expenses to be incurred in the business of the employer, or (b) a reimbursement for such expenses previously incurred by the salesman in such business, the difference between the gross commissions and the allowance or reimbursement for expenses constitutes the wages to be reported for Federal employment and withholding tax purposes, provided proper identification is made at the time of payment.

An inquiry has been made regarding the proper method of determining the amount of wages, for purposes of the Federal Insurance Contributions Act, the Federal Unemployment Tax Act, and Collection of Income Tax at Source on Wages (subchs. A, C, and D, respectively, ch. 9, Internal Revenue Code of 1939) of a traveling salesman employed on a straight commission basis who pays, out of his gross commissions, the expenses incurred by him in connection with services performed for his employer.

Subject to certain exceptions and limitations not here material, the term "wages" is defined in sections 1426(a) and 1607(b) of the Federal Insurance Contributions Act and the Federal Unemployment Tax Act, respectively, to mean "all remuneration for employment, including the cash value of all remuneration paid in any medium other than cash; * * *."

Section 408.226(a) of Regulations 128, relating to the definition of the term "wages" for purposes of the Federal Insurance Contributions Act, provides, among other things, that amounts paid specifically, either as advances or reimbursements, for traveling or other bona fide ordinary and necessary expenses incurred or reasonably expected to be incurred in the business of the employer are not wages. Traveling and other reimbursed expenses must be identified either by making a separate payment or by specifically indicating the separate amounts where both wages and expense allowances are combined in a single payment. Section 403.227(a) of Regulations 107, as amended, relating to the tax imposed under the Federal Unemployment Tax Act contains like provisions. See T. D. 5805, C. B. 1950-2, 112. Also,

the corresponding provisions of section 1621(a) of the Code and section 406.207(c) of Regulations 120, relating to the collection of income tax at source on wages, are substantially the same as the above-cited provisions pertaining to the Federal Insurance Contributions Act and the Federal Unemployment Tax Act.

Applying the provisions of law and regulations cited above, it is held that the wages of a traveling salesman, who is paid on a straight commission basis, are the gross commissions paid to him minus any amounts paid specifically as advances or reimbursements for traveling and other bona fide ordinary and necessary expenses incurred in the business of his employer. Generally, where the employer's liability to the traveling salesman is limited to the gross commissions earned, no payment or portion thereof is considered to be an advance or reimbursement for expenses. However, if under the arrangements between the traveling salesman and his employer there exists an express or implied agreement or understanding that some part of the traveling salesman's gross commissions is to be considered either (a) an allowance toward expenses to be incurred in the business of the employer, or (b) a reimbursement for expenses previously incurred by the traveling salesman in the business of the employer, the difference between the gross commissions and the allowances or reimbursements for expenses constitutes the wages to be reported as subject to the Federal employment taxes and to income tax withholding under section 1622 of the Code provided, of course, proper identification is made at the time of payment.

A provision in an oral or written contract of employment or in a collateral agreement, to the effect that any payments made or advanced against earned commissions are first to be applied to reimburse the traveling salesman for traveling or other bona fide ordinary and necessary expenses, will satisfy the first requirement of the regulations. It is further necessary, however, that the portion thereof which represents reimbursement for expenses be properly identified at the time of payment. Where both requirements are met, the portion which represents reimbursement for expenses does not constitute wages and should be deducted from the traveling salesman's gross commissions in computing his wages subject to the taxes imposed by the Federal Insurance Contributions Act, the Federal Unemployment Tax Act, and for purposes of the Collection of Income Tax at Source on Wages.

The ruling contained herein is in accord with Mimeograph 6547, C.B. 1950-2, 113.

REGULATIONS 128, SECTION 408.226: Wages. (Also Sections 1607, 1621; Regulations 107, Section 403.227; Regulations 120, Section 406.207.) Rev. Rul. 55-197

Payments made by a company to its employee under an account separate and distinct from his earned commissions account, in satisfaction of bills submitted by him to the company for reimbursement of amounts actually expended by him in conducting its business, do not constitute "wages" for Federal employment tax purposes.

An inquiry has been received as to the extent of liability for purposes of the Federal Insurance Contributions Act, Federal Unem-

ployment Tax Act, and Collection of Income Tax at Source on Wages (subchapters A, C, and D, respectively, chapter 9, Internal Revenue Code of 1939) of a company with respect to amounts paid to one of its employees as reimbursements for expenses incurred in conducting company business.

An individual performed various services as an employee of a company for more than 20 years during which he was paid first on a salary basis and later on a salary and commission basis. This arrangement was changed by an agreement between the company and the employee under which his salary was discontinued and his earnings were computed on a commission basis. Under the agreement, upon the submission of expense accounts by the employee, the company reimbursed him for expenses actually incurred in its business up to a certain maximum each month. Separate and distinct expense accounts were maintained by the company and the amounts of reimbursed expenses were deducted from the commissions earned by the employee. The agreement provided that in the event the earned commissions did not equal the reimbursed expenses, the difference would become due and payable to the company. However, at a later date the company agreed that in this particular case if the employee's commissions were not sufficient to absorb the expenses, or if his sales were only nominal, the expenses would be "written off" and no refund from the employee would be required.

The facts in the instant case are distinguishable from those supporting the conclusion reached in S. S. T. 68, *supra*.[1] In the instant case the employment agreement did not provide for "advances" against unearned commissions or otherwise and the company did not make such advances. Instead, the employment agreement provided that the employee would bill the company for amounts, subject to maximum limitations, actually expended in its behalf, that the company would reimburse the employee only to the extent of his billing, and that his earned commissions would constitute a separate and distinct account. The employee was to receive commissions only to the extent that they exceed the amount of expenses which he incurred on behalf of the company and submitted bills to it for reimbursement. These provisions were adhered to by the company and the employee.

Actually, during the taxable year in question the employee's commissions totaled $12x$ dollars and the reimbursed expenses totaled $27x$ dollars. The commissions did not equal or exceed the reimbursed expenses at any time, and the total amount received from the company during the year was $27x$ dollars. The services of the employee for the company were terminated during the year in question. The company made no attempt to collect any portion of the difference between the commissions and the reimbursed expenses.

The provisions of law and regulations relating to the exclusion from "wages" of traveling and other bona fide ordinary and necessary expenses are found in Revenue Ruling 55-196, page 492 of this Bulletin.

The attention of the Internal Revenue Service has been directed to a ruling published as S. S. T. 68, C. B. 1937-1, 355. In that ruling it is held that advance payments made after December 31, 1936, to

[1] Although the conclusions in this Revenue Ruling may be regarded as reaching the same result as the conclusions of S. S. T. 316, C. B. 1938-2, 275 and S. S. T. 379, C. B. 1939-2, 293, both of which distinguished S. S. T. 68, *supra*, the fact that there were no advances in the instant case distinguishes it from both of these rulings.

salesmen of a company who have drawing accounts against unearned salary, commissions, or other remuneration for services to be performed in "employment" constitute "wages" at the time of payment for purposes of the taxes imposed under the Social Security Act. Under the facts in that case, such advances are charged to their drawing accounts and any advances in excess of the earned commissions are carried as accounts due from the salesmen involved. In the event a salesman's services are terminated, the excess is charged to profit and loss.

Applying the law and regulations cited and the principles set forth in Revenue Ruling 55–196, *supra*, it is held that the payments representing reimbursements for expenses, made by the company upon the basis of a separate and distinct account and properly identified at the time of payment as being reimbursements for expenses, do not constitute "wages" and are not subject to the Federal employment taxes or to income tax withholding under section 1622 of the Code.

REGULATIONS 128, SECTION 408.226: Wages.

Wages paid under the Fair Labor Standards Act. See Rev. Rul. 55–203, page 114.

REGULATIONS 128, SECTION 408.226: Wages.

Cash value of awards earned by employee salesmen. See Rev. Rul. 55–232, page 115.

SECTION 1430.—OTHER LAWS APPLICABLE

REGULATIONS 128, SECTION 408.606: Place and time for filing returns.
(Also Section 408.607.)

Date for filing return and making deposit of tax when due date therefor falls on Saturday, Sunday, or legal holiday. See Rev. Rul. 55–83, page 523.

SUBCHAPTER B.—EMPLOYMENT BY CARRIERS

PART I.—TAX ON EMPLOYERS

SECTION 1501.—DEDUCTION OF TAX FROM COMPENSATION

REGULATIONS 114, SECTION 411.303: Collection of, and liability for, employees' tax. Rev. Rul. 55–202

The liability of employers for the employee tax under the Railroad Retirement Tax Act, based on increased taxable compensation earned for the period from July 1, 1954, to August 30, 1954, inclu-

sive, is limited to the extent that the employer had under his control at any time subsequent to August 30, 1954, compensation earned at any time by the employee.

Advice has been requested with respect to the liability of the employer for the deduction of the employees' share of the tax based on the increase in the amount of taxable compensation of those workers who were employed subsequent to June 30, 1954, but who left the service of the employer prior to August 31, 1954, the date on which the Act of August 31, 1954, Public Law 746, 83d Cong., 68 Stat. 1038, C. B. 1954–2, 602, was approved. Public Law 746, which amended the Railroad Retirement Tax Act (subch. B, ch. 9, Internal Revenue Code of 1939), increased the amount of compensation per calendar month which is subject to employer tax and employee tax. The amendment applies to compensation earned in July 1954 and subsequent months, regardless of when such compensation is paid.

For each month prior to July 1954, the taxes apply to the compensation, not in excess of $300, earned in any such month by an employee. For July 1954 and each month thereafter, the taxes apply to compensation, not in excess of $350, earned in any such month.

The increase in the taxes based on the increase in the amount of taxable compensation imposed by Public Law 746 is retroactive to July 1, 1954. Section 1501 of the Railroad Retirement Tax Act, as amended by section 202 of Public Law 746, requires the employer to deduct the employee tax, based on the increased taxable compensation, from compensation as and when paid and makes the employer liable for payment of the tax. It cannot have been intended to impose a liability on an employer for the deduction or payment of the tax, based on the increased taxable compensation, with respect to compensation paid to his employees prior to the approval of Public Law 746, that is, during the period July 1, 1954, to August 30, 1954, unless the employer had in his control subsequent to August 30, 1954, amounts of the employees' compensation from which the increased deduction could be made.

Accordingly, it is held that with respect to the increased taxable compensation earned by an employee for the period from July 1, 1954, to August 30, 1954, inclusive, the employer shall be liable for the employee tax only to the extent that the employer had under his control at any time subsequent to August 30, 1954, amounts of compensation earned at any time by the employee.

SUBCHAPTER C.—TAX ON EMPLOYERS OF EIGHT OR MORE

SECTION 1607.—DEFINITIONS

REGULATIONS 107, SECTION 403.205: Who are employers. Rev. Rul. 55-19

Circumstances under which a person may be regarded as an employer within the meaning of section 1607(a) of the Federal Unemployment Tax Act, and accordingly liable for the tax imposed under that Act.

Inquiries have been received regarding the method to be used in arriving at a weekly count of employees for purposes of determining

liability of an employer under section 1607(a) of the Federal Unemployment Tax Act (subchapter C, chapter 9, Internal Revenue Code of 1939) under certain conditions, particularly where part-time employees are involved.

Section 1607(a) of the Act provides that the term "employer" does not include any person unless on each of some 20 days during the taxable year, each day being in a different calendar week, the total number of individuals who were employed by him in employment for some portion of the day (whether or not at the same moment of time) was eight or more.

The following questions and answers illustrate the application of the foregoing provisions of the Act.

Question 1. Are employees considered to be in the employ of an employer during the entire week where, because of the long daily hours of employment, the employees are granted 1 or 2 days of absence each week and substitutes replace the absent regular employees?

Answer. The regular employees should be considered to be in the employ of the employer during the entire week. The basis of this conclusion is that the employer-employee relationship which exists between the parties does not terminate by reason of their absence from duty for 1 or 2 days during the week. If the employer-employee relationship exists, it is immaterial that the employee performs no physical service for the employer on certain days of the week. S. S. T. 330, C. B. 1938-2, 331.

Question 2(a). Is the number of positions in an enterprise a factor to be considered in determining the number of workers within a week? For example, suppose that an employer had regularly employed seven individuals over a period of weeks, then had to replace an employee who resigned.

Answer. The number of positions in an employer's organization is not a factor to be considered in determining the number of individuals in his employ for purposes of the Federal Unemployment Tax Act.

Question 2(b). Assuming that the employee had 3 weeks of accrued vacation time, and the replacement employee began his services on the morning following the resigned employee's last day of actual work, would both of those individuals be counted as being "in employment" during the 3-week vacation period?

Answer. An employee who resigns and has vacation time for which he receives his regular compensation is considered as being in the employ of the employer during the vacation period. The employee who replaced him is also "in employment" and both employees should be counted in determining the employer's liability under the Act. As previously indicated, it is immaterial whether the employee actually performs physical services for his employer, provided an employment relationship exists between the parties.

Question 2(c). If there were no vacation period involved, and the former employee left at the end of a working day in the middle of a week, would both workers be counted as being "in employment" to make a count of eight employees for the week, even though there were never more than seven on any 1 day?

Answer. This question is answered in the negative. Since the employment relationship was terminated as of the end of the employee's

last working day, there was no day in the calendar week on which the employer had more than seven individuals in his employ.

Question 3(a). Is the method or frequency of payment considered to be a factor in determining whether or not an employee is "regular" or "permanent?"

Answer. The basis on which compensation is paid, in and of itself, is not a factor to be considered in determining whether a person had the requisite number of employees for the prescribed period to qualify as an employer under the Act.

Question 3(b). Would a worker who is paid on a daily basis always be construed to be "in employment" on only a day-to-day basis?

Answer. The existence of an employment relationship is the controlling factor. Whether or not an employment relationship, once established, continues depends upon the intention of the parties with respect to its continuation. For example, if the agreement between the parties contemplates the performance of services on 1 day each week, the employment relation continues and the employee should be counted in determining liability under the Act even though he is paid at the end of each day. On the other hand, where an employee works 1 day and the understanding between the parties is to the effect that the employer will communicate with the employee if and when his services are needed and that employee will work if not otherwise engaged, the employment relationship is terminated at the end of the day he worked. In the latter instance, the employee should be counted in the employ of this employer only on the days he actually performs services for him.

Question 4. Would a worker who is hired for a 5-day week and paid every Friday be construed to be "in employment" on Saturday and Sunday even though the employer has no legal right to require services of the worker on those days?

Answer. This worker should be treated as being in the employ of the employer on each of the 7 days of a week until the employer-employee relationship has been definitely terminated. If other employees are employed for the 6th and 7th days of the week, they should be counted as additional employees to those employed on a 5-day week basis.

Question 5. In determining whether an employee is "regular" or "permanent," is any significance attached to the number of days per week that he customarily performs services? For example, would a man who has for years worked only 3 days in each week be construed to be "in employment" on the remaining 4 days of each week?

Answer. It is not necessary to determine whether an employee is "regular" or "permanent" since the term "employer," as defined in the Act, includes every person who employs eight or more employees in employment for the prescribed period. An employee who has worked for an employer only 3 days in each week for a number of years is considered to be "in employment" on the remaining days of each week.

Question 6. Where an employer could not get full-time employees in his area he had to permit housewives to work half days 3 days per week. Because of this situation, he pays part-time salaries to 12 people each week, even though there are never more than 3 employees in his shop at any one time, nor more than 6 on any one day. What

number of employees should be recorded for each week in this situation?

Answer. If the employees are engaged with the understanding that they will perform services for the employer each week, the employer would have 12 individuals in his employ on each day of the week until the employer-employee relationship is terminated.

REGULATIONS 107, SECTION 403.205: Who are employers.

Change in membership of partnership where the business thereof was continued. See Rev. Rul. 55-93, page 404.

REGULATIONS 107, SECTION 403.227: Wages.

Reimbursement or advances for traveling and other expenses. See Rev. Rul. 55-196, page 492.

REGULATIONS 107, SECTION 403.227: Wages.

Reimbursement for traveling and other expenses. See Rev. Rul. 55-197, page 493.

REGULATIONS 107, SECTION 403.228(a)(2): Wages paid by predecessor attributed to successor. Rev. Rul. 55-7

A partnership composed of A, B, and C, an employer of eight or more individuals, was in business during the first 2 months of a calendar year. C died on the first of March and D became a member of the partnership on the second of March. A, B, and D acquired all the assets previously belonging to A, B, and C, and immediately after the acquisition employed all the individuals who were previously employed by A, B and C, and continued the business in its entirety until the first of July. Since the acquisition was made under circumstances which come within the ambit of Revenue Ruling 54-31, C. B. 1954-1, 212, 11, there was one employing entity during the first 6 months of the calendar year which qualified as an "employer" within the meaning of section 1607(a) of the Federal Unemployment Tax Act (subchapter C, chapter 9, Internal Revenue Code of 1939). Corporation N succeeded Partnership ABD on July 1, acquiring all the assets of the partnership and employing all of its employees for the balance of the year. Section 403.228(a)(2) of Regulations 107, as amended, provides in part that wages paid by a predecessor shall not be considered as having been paid by a successor unless both the predecessor and the successor are employers as defined in section 1607(a) of the Act for the calendar year in which the acquisition occurs. Generally, an employer is one who has eight or more employees on at least 1 day of each of 20 calendar weeks during the calendar year. See T. D. 5905, C. B. 1952-1, 173, 185. *Held*, for purposes of the application of the $3,000 limitation on wages provided by section 1607(b)(1) of the Act, as amended, remuneration paid by A, B, and C

and A, B, and D may be considered as having been paid by Corporation N.

The employing entity, which was originally composed of A, B and C and later of A, B and D is required to file one return, Form 940, Annual Federal Tax Return of Employers, reporting therein the remuneration and taxable wages paid by both groups during the calendar year. Corporation N is an "employer" and should include in line 2 of Schedule B of its return, Form 940, the remuneration which it paid during the calendar year to the former employees of A, B, C, and D after applying the $3,000 limitation on wages provided by section 1607(b)(1) of the Federal Unemployment Tax Act. For example, assume that there were 10 employees of A, B, C, and D, all of whom were also employed by Corporation N as the successor employer. The 10 employees each received remuneration of $2,500 from A, B, C and D, and $2,500 from Corporation N, or a total of $5,000 during the year. Assuming there were no other employees of Corporation N during the year, the amount of $25,000 (10 x $2,500) would be entered on line 1, Schedule B, of the Form 940 filed by the corporation. The number 10 would be entered in the first column on line 2 and the amount of $20,000 ($2,000 the amount in excess of $3,000 paid to each of the 10 employees by the predecessor and successor employers) in the second column thereon.

In Revenue Ruling 54–313, C. B. 1954–2, 371, it is held that the M Corporation may not take into consideration the remuneration paid by its predecessor for purposes of the $3,000 limitation on wages provided by section 1607(b)(1) of the Federal Unemployment Tax Act. In that case the predecessor was not an employer within the meaning of section 1607(a) of the Act. In the instant case the predecessor is considered to be one entity which qualifies as an "employer," as contemplated by Revenue Ruling 54–31, *supra*.

SUBCHAPTER D.—COLLECTION OF INCOME TAX AT SOURCE ON WAGES

SECTION 1621.—DEFINITIONS

REGULATIONS 120, SECTION 406.207: Wages. (Also Sections 252, 1426; Regulations 118, Section 39.252-1; Regulations 128, Section 408.203.) Rev. Rul. 55-184

Wages paid to a citizen of Guam, who is a citizen of the United States only by virtue of collective naturalization under the Organic Act of Guam, by the United States or any agency thereof for services performed in Guam are not subject to withholding of United States income tax or the taxes imposed under the Federal Insurance Contributions Act.

An inquiry has been received whether wages paid by the United States or an agency thereof to a citizen of Guam, who is a citizen of the United States only by virtue of collective naturalization under the Organic Act of Guam, *infra*, for services performed in Guam are subject to the Collection of Income Tax at Source on Wages or

the taxes imposed under the Federal Insurance Contributions Act (subchapters D and A, respectively, chapter 9, Internal Revenue Code of 1939).

Section 31 of the Organic Act of Guam, 64 Stat. 384, C. B. 1950–2, 214, which was placed in operation as of January 1, 1951, by Executive Order 10211, C. B. 1951–1, 155, provides as follows:

> The income-tax laws in force in the United States of America and those which may hereafter be enacted shall be held to be likewise in force in Guam.

Section 30 of the Organic Act of Guam provides as follows:

> All customs duties and Federal income taxes derived from Guam, the proceeds of all taxes collected under the internal-revenue laws of the United States on articles produced in Guam and transported to the United States, its Territories, or possessions, or consumed in Guam, and the proceeds of any other taxes which may be levied by the Congress on the inhabitants of Guam, and all quarantine, passport, immigration, and naturalization fees collected in Guam shall be covered into the treasury of Guam and held in account for the government of Guam, and shall be expended for the benefit and government of Guam in accordance with the annual budgets.

In developing procedures for determining economically the amounts to which the Government of Guam is entitled under the provision of law cited, without requiring taxpayers to report separately their incomes derived from Guam and from other sources, it has been found necessary to require all departments and agencies of the United States Government having employees stationed in Guam to report the United States income tax withheld from the salaries and wages of such employees to the United States Commissioner of Internal Revenue. Amounts of tax so withheld and reported are in due course credited against the employees' liability to the Government of Guam.

The Commissioner of Revenue for Guam will administer section 30, *supra*, as it relates to the income tax liabilities of individuals, other than civilian and military personnel of the United States Government, who derive their incomes from Guam.

In Revenue Ruling 56, C. B. 1953–1, 303, it is held that a citizen of Guam, who is a citizen of the United States only by virtue of collective naturalization under the Organic Act of Guam, is a citizen of a possession of the United States for the purpose of section 252 of the Internal Revenue Code of 1939 and is subject to Federal income tax only upon income derived from sources within the United States. Such citizen is also subject to income tax imposed by the Government of Guam by reason of the dual system of taxation created by the Organic Act of Guam. See I. T. 4046, C. B. 1951–1, 57.

Section 251 of the Internal Revenue Code of 1939 relates to income from sources within possessions of the United States. Subsection (j) of such section, added by the Revenue Act of 1950, provides as follows:

> EMPLOYEES OF UNITED STATES.—For the purposes of this section, amounts paid for services performed by a *citizen of the United States* as an employee of the United States or any agency thereof shall be deemed to be derived from sources within the United States. [Italics supplied.]

Section 252 of the Code provides in part:

> (a) Any individual who is a citizen of any possession of the United States (but not otherwise a citizen of the United States) and who is not a resident of the United States, shall be subject to taxation under this chapter only as to income derived from sources within the United States, and in such case the tax shall be computed and paid in the same manner and subject to the same conditions as in the case of other persons who are taxable only as to income derived from such sources. * * *

Under the provisions of section 251(j), *supra*, amounts paid for services performed in Guam by a *citizen of the United States*, as an employee of the United States or any agency thereof, are deemed to be derived from sources within the United States and are subject to the withholding of United States income tax. The exception, from the term "wages," of remuneration for services performed by a citizen of the United States within a possession of the United States under the conditions provided by section 1621(a)(8)(B) of the Code is not applicable to remuneration paid to employees of the United States or an agency thereof. However, citizens of Guam, who are citizens of the United States only by virtue of collective naturalization under the Organic Act of Guam, do not come within the purview of section 251(j) of the Code, but are subject to United States income tax under section 252 of the Code only on income derived from sources within the United States. Such persons are treated for the purpose of the tax as if they were nonresident alien individuals. Since the term "United States" does not include the Island of Guam, salaries or wages paid to employees of the United States or any agency thereof who are citizens of Guam, not otherwise citizens of the United States, for services performed in Guam (except in the remote circumstances that such an individual is a bona fide resident of the United States), are not received from sources within the United States and are not subject to the withholding of United States income tax. Such salaries or wages, however, are subject to the withholding of income tax for the Government of Guam by reason of section 31 of the Organic Act of Guam which renders applicable to Guam the income tax laws in force in the United States.

A nonresident alien individual or, as in this instance, a citizen of Guam, not otherwise a citizen of the United States, who derives no income from sources within the United States, has no income tax liability to the United States and thus has a legally enforceable claim against the United States for refund of any income tax withheld upon his income and erroneously paid over to the United States, provided, of course, the tax has not been adjusted by the agency or credited against the citizen's liability to Guam.

The taxes imposed by the Federal Insurance Contributions Act are applicable to all "wages" for "employment," as those terms are defined in the Act. Section 1426(b) of the Act includes in the definition of "employment" any service, of whatever nature (with certain exceptions not here material), performed after 1950 outside the United States by a citizen of the United States as an employee for an American employer. Citizens of Guam not otherwise citizens of the United States are not considered to be citizens of the United States for purposes of section 1426(b), and the taxes imposed by such Act are not applicable to the remuneration paid to them for services performed in Guam.

REGULATIONS 120, SECTION 406.207: Wages.

Regulations 120 amended to provide rules for withholding during 1954 and 1955 on payments which are subject to section 105(d) of the Internal Revenue Code of 1954 relating to wage continuation plans. See T. D. 6128, page 123.

REGULATIONS 120, SECTION 406.207: Wages.

Amounts paid to member of the "uniformed services" under the provisions of the Career Compensation Act of 1949, 63 Stat. 802. See Rev. Rul. 55-88, page 241.

REGULATIONS 120, SECTION 406.207: Wages.

Reimbursement or advances for traveling and other expenses. See Rev. Rul. 55-196, page 492.

REGULATIONS 120, SECTION 406.207: Wages.

Reimbursement for traveling and other expenses. See Rev. Rul. 55-197, page 493.

REGULATIONS 120, SECTION 406.207: Wages.

Cash value of awards earned by employee salesmen. See Rev. Rul. 55-232, page 115.

SECTION 1622.—INCOME TAX COLLECTED AT SOURCE

REGULATIONS 120, SECTION 406.300: Statutory provisions; determination of tax.

Wages paid under the Fair Labor Standards Act. See Rev. Rul. 55-203, page 114.

SECTION 1627.—OTHER LAWS APPLICABLE

REGULATIONS 120, SECTION 406.605: Place and time for filing returns.
(Also Section 406.606.)

Date for filing return and making deposit of tax when due date therefor falls on Saturday, Sunday, or legal holiday. See Rev. Rul. 55-83, page 523.

SUBCHAPTER E.—GENERAL PROVISIONS

SECTION 1633.—RECEIPTS FOR EMPLOYEES

REGULATIONS 120, SECTION 406.501: Receipts for employees — Rev. Rul. 55-145

An employer who is required under the provisions of section 1633 of the Internal Revenue Code of 1939 to furnish a Form W-2, Withholding Tax Statement, to an employee shall, in addition to preparing

the statement, make a reasonable effort to deliver such statement to the employee at the time required by section 1633 of the Code or the regulations prescribed thereunder. The mailing of the statement to an absent employee's last known address will be considered a sufficient compliance with the law and regulations.

An employer required to furnish a Form W-2, Withholding Tax Statement, to an employee, who willfully fails to furnish such statement at the time prescribed therefor by the law and regulations, is subject to the penalty provided by section 1634 of the Code.

Advice has been requested whether an employer who prepares a Form W-2, Withholding Tax Statement, for an employee within the time required by section 1633 of the Internal Revenue Code of 1939 and holds the statement available to an absent employee, without making an effort to deliver it to the employee, has fulfilled the requirements of section 1633 of the Code.

Section 1633(a) of the Code provides, in part, that:

Every person required to deduct and withhold from an employee a tax under section 1400 or 1622, * * * shall *furnish* to each such employee in respect of the remuneration paid by such person to such employee during the calendar year, on or before January 31 of the succeeding year, or, if his employment is terminated before the close of such calendar year, on the day on which the last payment of remuneration is made, a written statement showing the following: (1) the name of such person, (2) the name of the employee * * *, (3) the total amount of wages as defined in section 1621(a), (4) the total amount deducted and withheld as tax under section 1622, (5) the total amount of wages as defined in section 1426(a), and (6) the total amount deducted and withheld as tax under section 1400. * * * [Italics supplied.]

Paragraph (c), section 406.501, Regulations 120, provides, in general, that for good cause shown upon application by the employer the District Director of Internal Revenue may grant an extension of time within which to furnish the Form W-2, Withholding Tax Statement to employees. Upon termination of employment during a calendar year, an extension of time, not exceeding 30 days, is granted an employer to furnish the statement. In the case of intermittent or interrupted employment where there is reasonable expectation on the part of both employer and employee of further employment, there is no requirement that a written statement be immediately furnished the employee; but when such expectation ceases to exist, the statement must be furnished within 30 days from that time.

Paragraph (d), section 406.501, Regulations 120, provides, in part, that the tax return copy and the employee's copy of each withholding statement on Form W-2 for the calendar year, which the employer is required to furnish to the employee and which after *reasonable effort* he is unable to deliver to the employee, shall be transmitted to the District Director with the return on Form 941 filed by the employer for the first calendar quarter of the next succeeding calendar year or with the employer's final return if filed at an earlier date.

Section 1634 of the Code provides in part:

(b) * * * any person required under the provisions of section 1633 to furnish a statement who willfully furnishes a false or fraudulent statement, or who willfully fails to furnish a statement in the manner, at the time, and showing the information required under section 1633, or regulations prescribed thereunder shall for each failure be subject to a civil penalty of $50.

The questions which have been presented and the answers thereto are as follows:

Question 1. An employee is absent from work on account of a strike for several weeks before the close of the calendar year. No agreement has been made as to the termination of the employee's services and it is expected that he will return to work when the strike is settled. Is the employer required to furnish the employee a Form W–2, Withholding Tax Statement, before January 31, of the succeeding year?

Answer: In the case of interrupted employment by reason of a strike or otherwise, where there is a reasonable expectation on the part of both the employer and the employee of further employment in the calendar year, there is no requirement that a withholding statement on Form W–2 be immediately furnished the employee. When such expectation ceases to exist, the statement must be furnished within 30 days from that time. However, if the individual's services have not been terminated before the close of the calendar year, the withholding statement on Form W–2 must be furnished to him on or before January 31 of the succeeding year, unless an extension of time is granted by the District Director, regardless of whether he is present at or absent from work.

Question 2. An employee, whose services have not been terminated, is absent from work for an extended period from the close of a calendar year to after January 31 of the succeeding year. Does the employer satisfy the requirements of section 1633 of the Code by preparing a Form W–2, Withholding Tax Statement, on or before January 31 of the year succeeding the year during which remuneration was paid for employment and holding such statement available to the employee at the place of employment?

Answer: The employer, in addition to preparing the statement on or before January 31 of the succeeding year, should make a reasonable effort to deliver such statement to the employee on or before that date or within any extension of time granted by the District Director. The mailing of the Form W–2, Withholding Tax Statement, to the employee's last known address will be considered a sufficient compliance with the law and regulations.

Question 3. An employee without obtaining permission from his employer is absent from work for several weeks during a calendar year. The employer does not expect to reinstate the employee in the event he returns to work. Does the employer satisfy the requirements of section 1633 of the Code by preparing a Form W–2, Withholding Tax Statement, and holding the statement at his place of business until it is called for by the employee?

Answer: The employer should mail the Form W–2, Withholding Tax Statement, to the employee at the time of mailing his final check for past services rendered. If no remuneration is due the employee, the statement should be mailed to the employee within 30 days from the date when the expectation of further employment ceases to exist or within an extension of time granted by the District Director. The mere preparation of the Form W–2 by the employer and holding it at his place of business until the employee calls for it are not sufficient compliance with the law and regulations.

An employer required to furnish a Form W-2, Withholding Tax Statement, to an employee, who willfully fails to furnish such statement to the employee at the time prescribed therefor by the law and regulations, is subject to the penalty provided by section 1634 of the Code.

CHAPTER 10.—ADMISSIONS AND DUES

SUBCHAPTER A.—ADMISSIONS

SECTION 1700.—TAX

REGULATIONS 43, SECTION 101.2: Meaning of "admission." Rev. Rul. 55-50

A company sells booklets containing coupons which are honored for admissions to certain places of entertainment. Such booklets also contain coupons which may be exchanged for the use of recreational facilities, such as golf courses and bowling alleys. The monetary value of the coupons contained in a booklet is greatly in excess of the nominal amount for which the booklet is sold. Such booklets are published by the company as a general advertising and promotional service for the persons participating in the plan, and the company retains the total amount received from their sale as remuneration for its advertising and promotional service. *Held*, since the person granting the admission does not receive any part of the amount paid for the booklets containing the coupons, no part of such amount represents an amount paid for admission within the meaning of section 1700 of the Internal Revenue Code of 1939, and, accordingly, is not subject to the tax imposed by that section.

SECTION 1701.—EXEMPTIONS FROM TAX

REGULATIONS 43, SECTION 101.15: Exemptions from tax. Rev. Rul. 55-70

The determination of whether membership fees paid to a charitable organization constitute contributions toward the support of the organization within the meaning of section 1701(a)(1)(A)(iii) of the Internal Revenue Code of 1939 depends upon the character, objectives, and activities of the organization and the rights and privileges afforded the members. Goods donated to a charitable organization constitute contributions toward the support of the organization within the meaning of section 1701(a)(1)(A)(iii) of the Code.

Advice has been requested whether membership fees paid to a charitable organization, and goods donated to the organization, constitute contributions toward the support of the organization within

the meaning of section 1701(a)(1)(A)(iii) of the Internal Revenue Code of 1939.

Section 1701(a)(1)(A)(iii) of the Code provides for exemption from tax on admissions with respect to any admissions all the proceeds of which inure to a corporation or any community chest, fund, or foundation organized and operated exclusively for charitable purposes, exempt under section 101(6) of the Code, if such corporation or organization is primarily supported by contributions from the general public.

The use of the term "organization" in the statute implies a group or body with a more or less definite structure, operating under some form of rules and regulations, and having members. Membership in such an organization normally carries with it certain rights and privileges, such as the right to vote, hold office, etc. A determination as to how an amount may be characterized when paid to an organization for membership therein, that is, whether as dues or as a contribution, depends upon the facts involved. The basic factors to be considered are the character and objectives of the organization, the activities conducted by it, and the nature of the rights and privileges conferred on the members.

Where membership in an organization of the type contemplated by section 1701(a)(1)(A)(iii) of the Code is merely nominal and carries no rights or privileges, the fee paid for such membership is held to be a contribution toward the support of the organization. Where membership in such an organization carries with it some rights and privileges, a determination whether the fees paid by members are for services, privileges, or facilities to be enjoyed by them, or whether such fees are in reality contributions, must be based, as indicated above, upon a consideration of all the facts.

If the rights and privileges of membership are incidental to making the organization function according to its charitable purposes, and the benefit to be derived by a member is the personal satisfaction of being of service to others and furthering the charitable cause in which the members share an interest in common, then the membership fee is considered a contribution toward the support of the organization.

As an illustration of the foregoing, a children's convalescent home provides free nursing care and rest-home facilities for children recuperating from serious illnesses. Memberships from the general public are solicited and, based upon the amounts paid, are called contributing, associate, donor, or patron memberships. All members have the right to attend the annual meeting and vote for officers of the organization. The officers select a board of directors in whose hands are lodged the actual control and responsibility for running the home. Members are requested, but are not required, to put in a number of hours of service at the home serving as nurses aides, feeding children, reading to them, etc. All members are expected to help in the fund-raising activities of the organization and in securing members. Twice a year the organization holds a social function to which the members and their guests are invited. These social functions have a threefold purpose; first, they serve as an expression of gratitude to the members from the organization; secondly, they serve to attract new members; and thirdly, they tend to weld the members in

a more tightly-knit group for better service and heightened morale.

For a period of 1 month each year the organization conducts a rummage sale of clothing, books, odds and ends, etc. The articles sold are donated by members, friends, or others interested in the charitable purposes and activities of the organization. The members run the store during the time the sale is being conducted, caring for the stock and handling all transactions. All the proceeds after expenses are turned over to the organization.

In another situation an organization may have the same general purposes and activities as the one just described, the only difference being that the rights to vote and hold office are restricted to the donor and patron members (those paying the highest amounts of membership fees).

Upon consideration of the facts as recited above, it is held that the amounts paid as membership fees to either of the foregoing described organizations constitute contributions to the support of the organizations within the meaning of section 1701(a)(1)(A)(iii) of the Code. It is further held that goods donated to the organizations are contributions toward their support for purposes of that section. The amount of the contributions will be measured by the fair market values of the donated goods. In the case of the rummage sale, the selling price of an article may, for such purpose, be accepted as representing its fair market value.

On the other hand, membership fees are considered to be paid as dues, rather than as membership fees, where the organization is one which holds itself out as furnishing certain facilities and services to its members for their own benefit, and membership in the organization is acquired in order to secure the right to enjoy the facilities and services offered. In such event, the amount paid is held not to be a contribution for purposes of section 1701(a)(1)(A)(iii) of the Code.

Accordingly, those membership fees which are considered to be contributions, as well as the fair market value of donated goods, may be considered as contributions in determining whether a charitable organization, which otherwise qualifies for exemption from the tax on admissions, is primarily supported by contributions from the general public within the meaning of section 1701 (a)(1)(A)(iii) of the Code.

REGULATIONS 43, SECTION 101.15: Exemptions from tax. Rev. Rul. 55-161

An entire opera, as well as arias from operas, when presented by a civic or community membership association comes within the meaning of the term "concerts" as used in section 1701(c) of the Internal Revenue Code of 1939. Accordingly, the exemption from tax on admissions to concerts provided by that section applies to amounts paid for admission to such presentations, provided no part of the net earnings therefrom inures to the benefit of any member of the association. However, the exemption provided by that section does not extend to plays or shows presented by such an association. See also Rev. Rul. 245, C. B. 1953-2, 337.

SUBCHAPTER B.—DUES

SECTION 1710.—TAX

REGULATIONS 43, SECTION 101.22: Meaning of dues or membership fees. Rev. Rul. 55-318

> Charges made by a social, athletic, or sporting club or organization to its members for use of any social, athletic, or sporting privilege or facility for a period of more than six days, come within the meaning of the term "dues" as defined by section 1712 of the Internal Revenue Code of 1939, and such charges are subject to the tax on dues imposed by section 1710(a)(1) of such Code.

Advice has been requested with respect to the application of the tax on dues imposed by section 1710 of the Internal Revenue Code of 1939 to charges made by a social, athletic, or sporting club or organization to its members for the use of any social, athletic, or sporting privilege or facility for a period of more than 6 days.

In the instant case a beach club operated for social purposes owns a strip of ocean beach and provides and maintains certain bathing facilities for the exclusive use of its members and guests. Among the facilities provided are lockers and bathhouses which a member may rent on a seasonal or on a daily basis as an accommodation for his guests. However, the rental of such facilities is optional. Members may come to the club in bathing suits and swim in the ocean or use the swimming pool without renting lockers or bathhouses.

Section 1710(a)(1) of the Code imposes a tax equivalent to 20 percent of any amount paid as dues or membership fees to any social, athletic, or sporting club or organization, if the dues or fees of an active resident annual member are in excess of $10 per year. Section 1712(a) defines the term "dues" to include any charge for social privileges or facilities, or for golf, tennis, polo, swimming, or other athletic or sporting privileges or facilities for any period of more than 6 days.

Revenue Ruling 177, C. B. 1953-2, 341, which relates to the application of the tax on dues to payments by members of a beach club for the use of cabins or cabanas, holds that since members of the club obtain bathing and swimming privileges only by payment of charges for cabins or cabanas, such payments constitute charges for bathing and swimming privileges within the meaning of section 1712(a) of the Code and are subject to the tax on dues. That ruling is predicated upon facts in a particular case where members of the club, in order to obtain bathing and swimming privileges, are required to pay charges for the use of cabins or cabanas for the summer season. However, the ruling does not limit the application of the tax on dues to payments for the use of such privileges or facilities in situations where members are required to avail themselves of the privileges or facilities afforded. That a member may have the option to decide whether he will avail himself of any or all of the activities, facilities or privileges is not the controlling factor with respect to the application of the tax. The test is whether the charge confers the right to participate in or use the activities, facilities, or privileges involved for a period of more than 6 days.

It is held that any charge made by a social, athletic, or sporting club or organization to any of its members for the use of any social, athletic, or sporting privilege or facility, for a period of more than six days, irrespective of whether the members have the option to decide whether they will avail themselves of such privilege or facility, comes within the meaning of the term "dues" as defined by section 1712(a) of the Code. Accordingly, since the charges for lockers and bathhouses are charges for the use of athletic or sporting privileges or facilities, such charges are subject to the tax on dues imposed by section 1710(a)(1) of the Code.

Inasmuch as those clubs, whose operations come within the ambit of Revenue Ruling 177, *supra*, have relied upon it as a basis for not subjecting the optional payments here involved to the tax imposed by section 1710(a)(1) of the 1939 Code, it is further held that, 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, the position stated in this Revenue Ruling will not be applied retroactively, except that any tax which has been paid will not be refunded.

REGULATIONS 43, SECTION 101.22: Meaning of dues or membership fees.

Life memberships granted by a club to widows of members. See Rev. Rul. 55-199, page 511.

REGULATIONS 43, SECTION 101.29: Life membership. Rev. Rul. 55-198

Application of the tax on life memberships imposed by section 1710(a)(3) of the Internal Revenue Code of 1939 to certain classes of honorary memberships.

Advice has been requested concerning the liability of a club for the collection of tax on life memberships imposed by section 1710(a)(3) of the Internal Revenue Code of 1939 with respect to certain classes of honorary memberships.

In the instant case a club which qualifies as a social, athletic, or sporting club within the meaning of section 1710(a) of the Code has, in addition to active resident annual memberships, the following classes of non-dues-paying honorary memberships which entitle persons granted such memberships the use of the facilities of the club:

(a) *Political and judicial memberships.*—Public officers, such as judges of various courts and local, county and State officials, are granted honorary memberships for a period covering their tenure in public office. Such an honorary membership automatically terminates upon the expiration of the term of public office of each holder.

(b) *Ministerial memberships.*—Various local ministers are from time to time granted honorary memberships, which they retain as long as they continue in their ministerial positions in local churches.

(c) *Special memberships.*—Outstanding athletic or public figures are from time to time granted honorary memberships. These memberships are for the most part automatically renewed annually. The board of governors of the club selects those few whose memberships are to be terminated.

(d) *Honorary membership after 40 years of club membership.*—This class includes all members who have been active resident annual members of the club for a period of 40 years or more.

(e) *Honorary membership granted the widow of a member.*—Upon the death of a member an honorary membership is granted to his widow, which entitles her and her children to the facilities of the club for the duration of her widowhood.

All honorary memberships described above are granted by the club for periods of indefinite duration, with the exception of those granted to public officers who are elected or appointed to office for a specific period of time.

Section 1710(a)(3) of the Code provides in part that in the case of life memberships there shall be levied a tax equivalent to the tax upon the amount paid by active resident annual members for dues or membership fees other than assessments. Section 101.29 of Regulations 43 provides in part that if a person is a life member, whether he is a resident or nonresident, he must pay a tax equivalent to the tax on dues or membership fees paid by active resident annual members of the club.

In order to come within the meaning of "life membership" it is not necessary that honorary memberships be termed such by the club, nor must there be a specific provision that the memberships are to continue for life. For the purpose of the tax an honorary member of a club who is entitled to the use of the facilities of the club for a period of indefinite duration is considered to be a life member. The right to vote and hold office is not a prerequisite for taxable life membership.

On the other hand, honorary memberships which are granted for a definite period of time and are in fact terminated at the expiration of that period, and not renewed, are not considered life memberships and are not subject to tax provided no dues or membership fees are paid. The fact that the club may retain the right to terminate honorary memberships at any time would not, of itself, constitute them memberships for a definite period of time.

Accordingly, it is held that all honorary members of the club are "life members" for purposes of the tax, with the exception of those public officers who are elected for periods of definite duration, and whose honorary membership is automatically terminated at the end of their tenure of public office.

This ruling is equally applicable under the provisions of section 4241(a)(3) of the Internal Revenue Code of 1954.

Earlier rulings of the Internal Revenue Service relating to widow and ministerial memberships have not been consistent with the position set forth herein; therefore, under the authority contained in section 7805(b) of the 1954 Code, this Revenue Ruling will not be applied to such memberships prior to May 1, 1955, but will be effective as of that date.

REGULATIONS 43, SECTION 101.29: Life membership. (Also Section 101.22.) Rev. Rul. 55–199

Basis for computing the tax imposed by section 1710(a)(3) of the Internal Revenue Code of 1939 on life memberships granted by a club to widows of members when such memberships do not carry with them the full club privileges afforded male members.

Advice has been requested as to the basis for computing the tax on life memberships granted to widows of members by a club which

qualifies as a social, athletic, or sporting club within the meaning of section 1710 of the Internal Revenue Code of 1939. Such life members are entitled to the rights of dues paying female members who do not enjoy the full club privileges afforded male members. The dues or membership fees paid for female membership is less than those paid for male membership.

Section 1710(a)(3) of the Code imposes on life memberships a tax equivalent to the tax upon the amount paid by active resident annual members for dues and membership fees other than assessments.

Section 101.22 of Regulations 43 defines an active resident annual member as one who is not a life member but who enjoys full club privileges as distinguished from the privileges enjoyed by a person holding a nonresident membership, an associate membership or other partial or restricted membership.

It is held that since the male members of the club are the ones who enjoy the full club privileges such members are considered the active resident annual members of the club within the meaning of the law and regulations. Accordingly, the life memberships granted by the club to widows of members are taxable to the extent of the tax on the dues or fees paid by the male members of the club even though such life memberships carry with them only the limited privileges granted female members of the club.

CHAPTER 11.—DOCUMENTS, OTHER INSTRUMENTS, AND PLAYING CARDS [INCLUDING STAMP TAXES]

SUBCHAPTER A.—RATE AND PAYMENT OF TAX

SECTION 1801.—CORPORATE SECURITIES

REGULATIONS 71, SECTION 113.54: Renewals. Rev. Rul. 55-97

A corporation executed its bond secured by a mortgage on real property, and subsequently conveyed the mortgaged property to its straw man who on the same day entered into an agreement with the mortgagee to extend the maturity date of the bond. Immediately thereafter the straw man reconveyed the mortgaged property to the corporate mortgagor. *Held*, the undertaking renewed is a corporate obligation subject to the documentary stamp tax imposed by section 1801 of the Internal Revenue Code of 1939, inasmuch as the corporation continues to be required to pay the debt as a condition to its continued ownership and use of the property, and if the debt is not paid in accordance with the terms of the instrument, it must satisfy the obligation to the extent of its property securing the debt. The general charge on the corporation is changed in substance by the straw man renewal to a charge on specific corporate property. However, the corporate character of the obligation is not changed for the reason that the corporation must either pay its debt or surrender its property securing such payment. This fact renders the obligation an undertaking to pay out of a specified fund or source and such undertaking

is sufficient to warrant imposition of the tax. Accordingly, the extension of the bond constitutes a renewal thereof within the meaning of section 1801 of the Code.

REGULATIONS 71, SECTION 113.54: Renewals. Rev. Rul. 55–185

A corporate owner of real estate executes a mortgage bond and subsequently sells the mortgaged property to an individual. The individual owner later enters into an extension and modification agreement with the mortgagee, wherein the owner agrees to pay the indebtedness and to comply with the terms of the corporate bond and mortgage. The form of agreement contains a clause which provides that, in consideration of the assumption by the individual of the payment of the corporate bond renewed, the mortgagee agrees that it will not institute any action, suit, claim or demand, in law or in equity, against the original corporate obligor, on account of the original corporate obligor's personal liability to repay the indebtedness evidenced by the bond. *Held*, such agreement does not of itself unequivocally or unqualifiedly release the corporation from its liability under the bond so as to exempt the renewal from the stamp tax as imposed by section 1801 of the Internal Revenue Code of 1939. However, if, under the law of any State in which the form of extension agreement is used, or pursuant to the decisions of the courts in such States, the clause in question effects a release or discharge of the corporate obligor from all liability on the bond, the renewal would not be subject to the stamp tax. See G. C. M. 22, 207, C. B. 1940–2, 325, with respect to conveyances in New York and New Jersey between a corporation and its nominee, straw man, or other type of agent.

SECTION 1802.—CAPITAL STOCK (AND SIMILAR INTERESTS)

REGULATIONS 71, SECTION 113.33: Sales and transfers subject to tax. Rev. Rul. 55–259

> Transfers of the stock of a domestic corporation are subject to the documentary stamp tax imposed by section 1802(b) of the Internal Revenue Code of 1939 when recorded on duplicate stock records maintained by the corporation at its head office in this country, even though the transaction between transferor and transferee is effected outside the United States and is recorded in stock transfer books maintained outside the United States.

Advice has been requested with respect to the applicability of the transfer tax imposed by section 1802(b) of the Internal Revenue Code of 1939 to transactions in stock of a domestic corporation which take place outside the United States between nonresidents of the United States, are recorded on transfer books maintained outside the United States, and are subsequently recorded on duplicate stock records maintained by the corporation at its head office in this country.

The stock in question is listed on stock exchanges in several foreign cities, and independent stock transfer agents and registrars are established by the corporation of those cities. All transfers made by such agents are reported to the corporation's head office in this country

which keeps duplicate stock records and quarterly compiles a complete stockholders' list.

Section 1802(a) of the Code imposes a tax upon each original issue of shares or certificates of stock, or of profits, or of interest in property or accumulations by any corporation.

Section 1802(b) of the Code imposes a tax on all sales, or agreements to sell, or memoranda of sales or deliveries of, or transfers of legal title to any of the shares or certificates mentioned or described in section 1802(a) of the Code.

Section 113.33(k) of Regulations 71 provides that the transfer of stock on the books of a domestic corporation, regardless of where the sale is made or the stock certificate delivered, is subject to tax.

Accordingly, it is held that transfers of the stock of a domestic corporation are subject to the documentary stamp tax imposed by section 1802(b) of the Code when recorded on duplicate stock records maintained by the corporation at its head office in this country, even though the transaction between transferor and transferee is effected outside the United States and is recorded in stock transfer books maintained outside the United States.

REGULATIONS 71, SECTION 113.35: Specific exemptions provided in Section 1802 (b). Rev. Rul. 55-51

A transfer tax is not incurred, except the tax on the sale, where an odd-lot dealer acting as a principal transfers stock from his name to himself as custodian under a written custodian agreement with the owner of the shares, provided the requisite exemption certificate is furnished.

Advice has been requested with respect to the application of the documentary stamp tax imposed by section 1802(b) of the Internal Revenue Code of 1939 when stock is transferred from the name of an odd-lot dealer, acting as principal, to himself as custodian under a written custodian agreement with the owner of the stock.

In the instant case, a monthly investment plan for buying listed stocks on a pay-as-you-go basis is operated by odd-lot firms in cooperation with representative commission brokerage firms of the New York Stock Exchange for the purpose of providing small investors a method of buying stock at minimum cost in accordance with their current available funds. An investor or participant in the plan determines his own program, within certain prescribed limits, and incurs only the customary commission rates for all regular services afforded by the plan. The shares or fractional shares purchased for the investor become his exclusive property immediately and are at all times thereafter subject to his unqualified disposition and control. An individual desiring to acquire stocks pursuant to the method offered by the plan executes an instrument known as a "Purchase Order" which evidences his intention to invest a stated amount monthly or quarterly in a named stock listed on the Stock Exchange and sets forth the terms of the agreement including precise instructions by the participant relating to pertinent matters affecting the operation of the plan. The investor's remittances are deposited in a specially authorized bank account. The odd-lot dealer then sells to the Exchange member, for the account of the customer, such shares, or fractions thereof, of the

designated stock as the remittance permits, after deducting regular commissions. The shares and fractions are credited to the account of the customer and held by the odd-lot dealer as custodian for the investor. The remittances by the investor and the stock acquisitions for his account continue to be made and to accumulate in accordance with the terms of the Purchase Order, the stock being delivered pursuant to the investor's directions.

Section 1802(b) of the Code imposes a stamp tax on all sales or transfers of legal title to any shares or certificates of stock, with certain exceptions, which include the provision that the tax shall not be imposed upon deliveries or transfers of shares or certificates from the owner to a custodian if under a written agreement between the parties the shares or certificates are to be held or disposed of by such custodian for, and subject at all times to the instructions of, the owner; or from such custodian to such owner.

Section 113.35(f) of Regulations 71 provides that such an exemption shall not be granted in any case unless the delivery or transfer of stock to or by a custodian is accompanied by an exemption certificate, as provided for in section 113.35(i) of those regulations.

The sale of the stock by the odd-lot dealer to the investor through the latter's member broker is taxable under section 1802(b) of the Code. The shares thus purchased could be delivered to the customer without incurring a transfer tax. Such shares could then be transferred by the owner to his custodian without incurring a transfer tax, providing the requisite exemption certificate is affixed. Since the direct or short-cut transfer of the shares from the odd-lot dealer in his capacity as seller to himself in his capacity as custodian does not involve the short-cutting of a taxable transfer, no tax will be due on such direct transfer if the necessary exemption certificate is furnished.

Accordingly, a transfer tax is not incurred, except the tax on the sale, where an odd-lot dealer acting as a principal transfers stock from his name to himself as custodian under a written custodian agreement with the owner of the shares, provided the requisite exemption certificate is furnished.

SECTION 1807.—PLAYING CARDS

REGULATIONS 66, ARTICLE 19: Imported playing cards. T. D. 6123

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER C, PART 305.—TAX ON PLAYING CARDS

Regulations 66 amended to conform to section 321 of the Tariff Act of 1930, as amended by section 13 of the Customs Simplification Act of 1953, relating to administrative exemptions.

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

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

Section 321 of the Tariff Act of 1930, as amended by section 13 of the Customs Simplification Act of 1953 (67 Stat. 515; 19 U. S. C. 1321), authorizes the Secretary, under such regulations as he shall

prescribe, to admit, free of customs duty and internal revenue tax, certain imported articles not exceeding $10 in value. The Customs Regulations (19 CFR 8.3 and 9.6) prescribe the circumstances under which such articles may be imported free of customs duty and internal revenue tax. In order to conform Regulations 66 (26 CFR Pt. 305), as made applicable to the Internal Revenue Code of 1939 by Treasury Decision 4885 [C. B. 1939-1 (Part I), 396], approved February 11, 1939 (26 CFR, Cum. Supp., note, p. 5876), to section 321 of the Tariff Act of 1930, as amended by section 13 of the Customs Simplification Act of 1953, the first sentence of article 19 (a) of such regulations, as amended by Treasury Decision 5080 [C. B. 1941-2, 312], approved October 3, 1941 (26 CFR 305.19(a)), is further amended to read as follows:

Except as set forth in the Customs Regulations (19 CFR 8.3 and 9.6), relating to certain importations on and after September 7, 1953, of articles not exceeding $10 in value, playing cards imported from foreign countries on and after October 1, 1941, must be tax-paid at the rate of 13 cents per pack of not more than 54 cards.

Because this Treasury Decision merely makes reference to the applicable sections of the Customs Regulations which permit the importation of certain playing cards free of duty and internal-revenue tax, it is found that it is unnecessary to issue this Treasury Decision with notice and public procedure thereon under section 4(a) of the Administrative Procedure Act, approved June 11, 1946, or subject to the effective date limitation of said section 4(c) of said Act.

(This Treasury Decision is issued under the authority contained in sec. 321 of the Tariff Act of 1930, as amended (67 Stat. 515; 19 U. S. C. 1321), sections 1836 and 3791 of the Internal Revenue Code of 1939 (53 Stat. 204, 467; 26 U. S. C. 1836, 3791).)

O. Gordon Delk,
Acting Commissioner of Internal Revenue.

Approved February 1, 1955.

M. B. Folsom,
Acting Secretary of the Treasury.

(Filed with the Division of the Federal Register February 4, 1955, 8:47 A. M.)

CHAPTER 15.—TOBACCO, SNUFF, CIGARS, AND CIGARETTES

SUBCHAPTER A.—RATE AND PAYMENT OF TAX

SECTION 2000(c).—RATE OF TAX: CIGARS AND CIGARETTES

Regulations 8, Article 72: Rates of tax on cigars and cigarettes—Date effective—When tax accrues. Rev. Rul. 55-20

The principal market of a cigar is the locality in which the bulk of such cigars are sold. If the cigars are sold singly at retail in that

locality for more than one price, the tax to be paid shall be based upon the retail price at which the majority of the cigars are there so sold. Where cigars are manufactured or imported to retail in full packages or boxes only, or in lots of two or three cigars, for a certain price and the cigars are not sold in their principal market in any other manner so that there is no ordinary retail price for a single cigar in such market, the price of a single cigar shall be the price of the package or lot divided by the number of cigars therein.

Advice has been requested as to the proper basis for determining the tax rate on cigars weighing more than 3 pounds per thousand.

In the case here involved, a cigar manufacturer, producing only one type or grade of cigars, confined his sales in the first year of manufacture primarily to sales of individual cigars to friends and neighbors at x cents each. However, sales by the manufacturer in subsequent years were made in box lots of 50 cigars at $50x$ cents per box. The cigars in the box lots so purchased from the manufacturer were then sold singly to consumers at $2x$ and $3x$ cents per cigar.

Section 2000(c) of the Internal Revenue Code of 1939 provides that in determining the retail price of cigars for tax purposes regard shall be had to the ordinary retail price of a single cigar in its principal market. This method of determining the proper tax rate is applied in the case of cigars weighing more than 3 pounds per thousand. The law does not attempt to fix the price at which the cigars shall retail. It imposes a tax on such cigars sold or removed for consumption or sale by the manufacturer or importer thereof, based upon the price at which the cigars are manufactured to retail, with the term "retail" involving the "ordinary retail price of a single cigar in its principal market."

Article 72 of Regulations 8, 26 C. F. R. Part 140, provides that where there is more than one price for the same cigar in its principal market, the tax to be paid will be determined according to the price at which the majority are sold therein.

The price at which cigars are manufactured or imported to be sold at retail is a question of fact. The best evidence of that fact is the price at which the cigars are actually sold at retail in their principal market, that being the one the manufacturer or importer has chiefly in view. The principal market of a cigar is regarded as the locality where the bulk of such cigars are sold. If the cigars are sold singly at retail in that locality for more than one price, the tax to be paid shall be based on the retail price at which the majority of the cigars are there so sold. Where cigars are manufactured or imported to retail only in full packages or boxes, or in lots of two or three cigars for a certain price, and the cigars are never sold in their principal market in any other manner so that there is no established retail price for a single cigar in such market, the price of a single cigar is the price of the package or lot divided by the number of cigars contained therein.

In the instant case, the rate of tax for the first year in which sales were made should be determined upon the basis of the price at which the manufacturer made single sales of the cigars (x cents). The basis for determining the proper tax rate for subsequent years should be the price at which the majority of the cigars were sold singly to the consumers (either $2x$ cents or $3x$ cents) and not the rate at which they were sold in box lots by the manufacturer, divided by 50.

CHAPTER 19.—RETAILERS' EXCISE TAXES

SECTION 2400.—TAX ON JEWELRY, ETC.

REGULATIONS 51, SECTION 320.30: Scope of tax. Rev. Rul. 55-125

An article of jewelry which is sold in an unassembled condition but complete as to all component parts to an ultimate consumer who merely cements or otherwise assembles the parts into an article of jewelry is subject to the tax imposed by section 2400 of the Internal Revenue Code of 1939. The sale of unassembled jewelry articles to a person for resale, as such, or for assembling into completed articles of jewelry for sale, is not a taxable sale at retail. The person who assembles such jewelry articles and sells the completed articles to the ultimate consumer is liable for the tax. Where jewelry articles are sold for resale purposes, the character of the sale must be established in accordance with the provisions of section 320.23 of Regulations 51, relating to the filing of a "retailers' exemption certificate" or equivalent proof to substantiate the nontaxable sale for resale purposes.

SECTION 2402.—TAX ON TOILET PREPARATIONS

REGULATIONS 51, SECTION 320.50: Scope of tax. Rev. Rul. 55-8

> Sales of creams or lotions which are recommended solely for use in softening or lubricating the beard preparatory to shaving are not subject to the tax on toilet articles imposed by section 2402 of the Internal Revenue Code of 1939.

Advice has been requested concerning the application of the tax on toilet preparations imposed by section 2402 of the Internal Revenue Code of 1939 to the sale of creams or lotions intended for use in softening or lubricating the beard preparatory to shaving including preparations similarly intended for use before using an electric razor.

Section 2402 of the Code imposes a tax on the sale of articles or preparations intended to be used for toilet purpose. Section 320.50 of Regulations 51 includes as taxable any article advertised or held out for toilet purposes regardless of the name by which it may be known or distinguished. After shaving lotions are included among examples of toilet preparations subject to tax.

It is held that creams or lotions intended for use in softening or lubricating the beard preparatory to shaving, including preparations similarly intended for use before using an electric razor, are not considered toilet preparations within the meaning of section 2402 of the Code and sales thereof are not subject to the tax. However, if the labels, leaflets, or other advertising relating to such shaving preparations include any recommendations for their use as an after shaving cream or lotion, skin conditioner or for other toilet purposes they are considered toilet preparations within the meaning of section 2402 of the Code and sales thereof are subject to the tax imposed by that section.

CHAPTER 27.—OCCUPATIONAL TAXES

SUBCHAPTER A.—SPECIAL PROVISIONS

PART IX.—COIN-OPERATED AMUSEMENT AND GAMING DEVICES

SECTION 3267.—TAX ON COIN-OPERATED AMUSEMENT AND GAMING DEVICES

REGULATIONS 59, SECTION 323.1: Meaning of terms. Rev. Rul. 55-336

Where gum or candy vending machines are operated by the insertion of a 1-cent coin and the only articles occasionally dispensed by the machines along with the gum or candy are toy charms of negligible value, such machines constitute bona fide vending machines which are specifically excluded from the special tax imposed by section 3267 of the Internal Revenue Code of 1939.

Advice has been requested concerning the application of the special tax on coin-operated amusement and gaming devices, imposed by section 3267 of the Internal Revenue Code of 1939, to the maintenance for use of the following described devices.

The devices are coin-operated machines, each having a glass bowl containing balls of chewing gum or candy with which are mixed toy charms of negligible value. Upon the insertion of a 1-cent coin a machine dispenses a ball of gum, or candy, and occasionally toy charms.

Under the provisions of section 3267 of the Code, every person who maintains for use or permits the use of, on any place or premises occupied by him, a coin-operated amusement or gaming device is liable for a special tax of $10 a year with respect to each amusement device and $250 a year with respect to each gaming device. That section defines an amusement device as any amusement or music machine operated by means of the insertion of a coin, token, or similar object. Gaming devices are defined as so called "slot" machines which operate by means of insertion of a coin, token, or similar object and which, by application of the element of chance, may deliver, or entitle the person playing or operating the machine to receive cash, premiums, merchandise, or tokens. Bona fide vending machines in which are not incorporated gaming or amusement features are specifically excluded from the tax.

With respect to vending machines which have incorporated gaming features, section 3267 of the Code provides that such a machine operated by means of the insertion of a 1-cent coin, which, when it dispenses a prize, never dispenses a prize of a retail value of, or entitles a person to receive a prize of a retail value of, more than 5 cents, and if the only prize dispensed is merchandise and not cash or tokens, shall be classified as a coin-operated amusement device.

It is held that where gum or candy vending machines are operated by the insertion of a 1-cent coin and the only articles occasionally dispensed by the machines along with the gum or candy are toy charms of negligible value, such machines constitute bona fide vending machines which are specifically excluded from the special tax imposed by section 3267 of the Code. Individual charms which cost less than

1 cent to the person who maintains the machines for use are regarded to be of such insignificant value that they do not come within the category of prizes within the scope of the law.

CHAPTER 27A.—WAGERING TAXES

SUBCHAPTER A.—TAX ON WAGERS

SECTION 3285.—TAX

REGULATIONS 132, SECTION 325.21: Scope of tax. (Also Section 3290; Regulations 132, Section 325.41.) Rev. Rul. 55-82

In accordance with the principles outlined in Revenue Ruling 54–405, C. B. 1954–2, 401, the operation of non-coin-operated clay machines and non-coin-operated pinball machines, where prizes are awarded to successful players, constitutes the operation of a lottery conducted for profit and is subject to the wagering taxes imposed by sections 3285 and 3290 of the Internal Revenue Code of 1939. For the purpose of this ruling the redeeming of free games won in connection with the operation of such machines is considered to be the awarding of prizes.

SUBCHAPTER B.—OCCUPATIONAL TAX

SECTION 3290.—TAX

REGULATIONS 132, SECTION 325.41: Person liable for tax. (Also Section 3291; Regulations 132, Section 325.50.) Ct. D. 1782

OCCUPATIONAL TAXES—INTERNAL REVENUE CODE—DECISION OF SUPREME COURT

1. WAGERING TAX—CONSTITUTIONALITY.

The occupational tax on the business of accepting wagers, imposed by section 3290 of the Internal Revenue Code of 1939, is constitutional in its application to the District of Columbia. The statute neither violates the privilege against self-incrimination nor contravenes the ban against unlawful search and seizure.

2. JUDGMENT AFFIRMED.

Judgment of the United States Court of Appeals for the District of Columbia, 214 F. 2d 853, affirmed.

SUPREME COURT OF THE UNITED STATES

Frank Lewis, Petitioner v. *United States of America*

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

[March 14, 1955]

OPINION

MR. JUSTICE MINTON delivered the opinion of the Court.

An information was filed in the Municipal Court of the District of Columbia charging the petitioner with violation of 26 U. S. C. section 3290 in that he

engaged in the business of accepting wagers without paying the occupational tax imposed by that section. The Municipal Court sustained a motion to dismiss the information. The Municipal Court of Appeals for the District reversed, and the Circuit Court of Appeals affirmed the Municipal Court of Appeals. 214 F. 2d 853. We granted certiorari. 348 U. S. 810.

The questions presented in this case are: Does the Act, as applied to the petitioner in the District of Columbia, constitute a valid exercise of the taxing power or is it a penalty under the guise of a tax? Secondly, does it violate the Fifth Amendment's prohibition as to compulsory self-incrimination? Thirdly, does it contravene the Fourth Amendment's ban against unreasonable search and seizure? The first two questions were categorically answered in the negative, and the validity and constitutionality of the Act upheld by us in *United States* v. *Kahriger*, 345 U. S. 22 [Ct. D. 1755, C. B. 1953-1, 456]; the third question is not substantially different from the second and is also controlled by *Kahriger*. The only material factual difference between that case and the instant case is that in *Kahriger* the violation occurred in a United States district of a State, namely, Pennsylvania, while in the instant case the violation is charged to have taken place in the District of Columbia.

The statute, 26 U. S. C. section 3290, provides:

> "A special tax of $50 per year shall be paid by each person who is liable for tax under subchapter A or who is engaged in receiving wagers for or on behalf of any person so liable."

Another section, 26 U. S. C. section 3271, reads:

> "Payment of tax—(a) Condition precedent to doing business.
> "No person shall be engaged in or carry on any trade or business mentioned in this chapter until he has paid a special tax therefor in the manner provided in this chapter."

Subchapter A, referred to in section 3290, provides in section 3285:

> "(a) Wagers.
> "There shall be imposed on wagers, as defined in subsection (b), an excise tax equal to ten per centum of the amount thereof."

These provisions must be read together, and when we do, it seems clear that payment of the special $50 tax is to be made prior to engaging in the business of accepting wagers.

We held in *Kahriger* that this statute was a constitutional exercise of the taxing power and was not a penalty under the guise of a tax. 345 U. S., at 24–32. It is argued that that case involved wagering in a State, where such activity is not a violation of federal law, that the instant case arises in the District of Columbia, where wagering is by federal law a crime, D. C. Code (1951), section 22-1501 *et seq.*, and that this statute as applied to petitioner in the District of Columbia is a penalty in the guise of a tax. The short answer to this argument is that this Court has long held that the Federal Government may tax what it also forbids. *United States* v. *Stafoff*, 260 U. S. 477.

Secondly, it is contended by petitioner that the Act in question is unconstitutional because compliance compels self-incrimination in contravention of the Fifth Amendment. The Fifth Amendment provides that one cannot be *compelled*, in a criminal case, to be a witness against himself. It is a shield that prevents one from being convicted out of his own mouth by anything short of voluntary statements.

Petitioner maintains that the taxes imposed are retrospective in application. It is argued that he must be liable for the tax under subchapter A in the sense that he must have already wagered before he is required to take out the occupational tax, and that to require him to do so compels admission that he has gambled. We do not so read the statute. The Act does not mean one must first have made a wager as defined in subchapter A and therefore incurred liability to pay the tax levied therein before liability for the occupational tax attaches. The Act is wholly prospective and by its terms did not become applicable until November 1, 1951, more than 10 days after its enactment on October 20, 1951. See compiler's note to 26 U. S. C. section 3285. The statute simply designates a class that *is liable* to pay the ten percent tax when a wager or wagers are made. Payment of the $50 tax here under consideration is a registration fee that must be paid before engaging in the business of wagering.

We said in *Kahriger, supra*, at 32–33: "Under the registration provisions of the wagering tax, appellee is not compelled to confess to acts already committed, he is merely informed by the statute that in order to engage in the business of wa-

gering in the future he must fulfill certain conditions." The condition here important was that petitioner must first pay the $50 tax, but that did not give him any license to engage in an unlawful business. *License Tax Cases*, 5 Wall. 462, 471. It only warned that if he proposed to carry on this particular business he must pay the tax.

If petitioner desires to engage in an unlawful business, he does so only on his own volition. The fact that he may elect to pay the tax and make the prescribed disclosures required by the Act is a matter of his choice. There is nothing compulsory about it, and, consequently, there is nothing violative of the Fifth Amendment. If he does not pay the occupational tax, proceeds to accept wagers, and is prosecuted therefor, as in this case, he cannot be compelled to testify and may claim his privilege. The only compulsion under the Act is that requiring the decision which would-be gamblers must make at the threshold. They may have to give up gambling, but there is no constitutional right to gamble. If they elect to wager, though it be unlawful, they must pay the tax.

And, finally, the petitioner argues that to require him to pay the tax and exhibit the stamp in his place of business, as required by 26 U. S. C. section 3293 of the Act, is to furnish probable cause for the issuance of a search warrant. This is just another facet of the Fifth Amendment argument, but the ready answer is that the petitioner has no stamp. If he does not purchase a stamp even though he wagers, which is this case, it is difficult to see how such failure would give probable cause for the issuance of a search warrant. His complaint is that if he had one he might get in trouble. Since petitioner is without a stamp, he is not in a position to raise the question as to what might happen to him if he had one.

The judgment is affirmed.

REGULATIONS 132, SECTION 325.41: Persons liable for tax.

Application of the occupational wagering tax to an operator of certain non-coin-operated machines and to persons who receive wagers for or on behalf of the operator of such machines. See Rev. Rul. 55-82, page 520.

SECTION 3291.—REGISTRATION

REGULATIONS 132, SECTION 325.50: Registry, return, and payment of tax.

Constitutionality of the wagering tax as applied to a petitioner in the District of Columbia. See Ct. D. 1782, page 520.

CHAPTER 28.—PROVISIONS COMMON TO MISCELLANEOUS TAXES

SUBCHAPTER A.—GENERAL PROVISIONS

PART I.—STAMPS, MARKS, AND BRANDS

SECTION 3304.—REDEMPTION OF STAMPS

REGULATIONS 71, SECTION 113.159: Claims for redemption. Rev. Rul. 55-396

For the purpose of establishing a claim for refund of the amount paid for documentary stamps that have been purchased and errone-

ously affixed to a document, it is necessary that such stamps be submitted with the claim or that they be endorsed by an internal revenue officer who shall write on the face of the stamps "claim for refund filed." Where a document with the stamps affixed has been lost and it is impossible to endorse them in the approved manner, a refund of the amount paid for the stamps is not allowable.

Advice has been requested whether a claim may be allowed for the refund of the amount paid for documentary stamps which had been erroneously attached to a deed that has been lost.

Section 3304(a) of the Internal Revenue Code of 1939 authorizes the Commissioner, subject to regulations prescribed by the Secretary, and upon receipt of satisfactory proof of the facts, to make allowances for or redeem stamps that may have been spoiled, destroyed, or rendered useless or unfit for the purpose intended, or for which the owner may have no use, or which through mistake may have been improperly or unnecessarily used, or where the rates or duties represented thereby have been excessive in amount, paid in error, or in any manner wrongfully collected.

Section 3304(b) of the Code prescribes the method and conditions of allowance and provides, as an alternative to giving other stamps in lieu of the stamps redeemed, for the refunding of the amount or value of the stamps.

Section 113.159 of Regulations 71 provides that the stamps involved in a claim shall be submitted therewith, or if it is impracticable to remove the stamps from the instruments to which they are attached, the instruments should be presented to an internal revenue officer who shall 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.

Accordingly, it is held that in order to establish a claim for refund of the amount paid for documentary stamps that have been purchased and erroneously affixed to a document, it is necessary that such stamps be submitted with the claim or that they be endorsed by an internal revenue officer who shall write on the face of the stamps "claim for refund filed." Where a document with the stamps affixed has been lost and it is impossible to endorse them in the approved manner, a refund of the amount paid for the stamps is not allowable.

PART II.—ASSESSMENT, COLLECTION, AND REFUND

SECTION 3310.—RETURN AND PAYMENT OF TAX

T. D. 6025, SECTION 477.3: Filing of excise tax returns. Rev. Rul. 55-83

(Also Section 477.4; Sections 1430, 1627; Regulations 128, Sections 408.606, 408.607; Regulations 120, Sections 406.605, 406.606.)

Where the due date for filing Quarterly Federal Excise Tax Return, Form 720, or Employers' Quarterly Federal Tax Return, Form 941, falls on a Saturday, Sunday, or legal holiday, the filing of the

return will be considered timely if made on the next succeeding business day.

Where the due date for making a deposit of excise tax accompanied by the Depositary Receipt for Federal Excise Taxes, Form 537, or of Federal Insurance Contribution Act taxes and net income tax withheld on wages accompanied by Federal Depositary Receipt, Form 450, for the first two months of a calendar quarter falls on a Saturday, Sunday or legal holiday, the making of the deposit will be considered timely if made on the next succeeding business day.

Where the due date for making a deposit for the last month of the calendar quarter falls on a Saturday, Sunday or legal holiday, the making of the deposit will be considered timely if made on the next succeeding business day. As to this deposit, however, the regulations provide also that it must be made in ample time to enable the depositary to return the validated receipt to the taxpayer to be attached to and filed with the taxpayer's return at the time fixed for filing the return.

SECTION 3313.—PERIOD OF LIMITATION UPON REFUNDS AND CREDITS

Allowability of credit claimed for manufacturers' excise tax which exceeds total tax reported on return, with the credit balance being taken on subsequent returns filed after expiration of the four-year period of limitation. See Rev. Rul. 55-53, page 528.

CHAPTER 29.—MANUFACTURERS' EXCISE AND IMPORT TAXES

SUBCHAPTER A.—MANUFACTURERS' EXCISE TAXES

SECTION 3403.—TAX ON AUTOMOBILES, ETC.

REGULATIONS 46, SECTION 316.4: Who is a manufacturer. Rev. Rul. 55-98

(Also Section 316.55; Section 3444, Section 316.7.)

In the "reconditioning" of a used generator, which requires the replacement of the armature with one that has been rewound by the person restoring the generator to useful condition for sale, a manufacturing or "rebuilding" operation is performed on the armature only, and the tax is computed upon the established selling price of the armature component.

Revenue Ruling 54-329, C. B. 1954-2, 405, amplified.

Advice has been requested concerning the method of determining the tax due when a "rebuilt" armature is used in "reconditioning" a generator for sale (including exchange).

An automobile shop operates a generator exchange service. A generator accepted in an exchange is disassembled and cleaned, the armature is rewound or replaced with a previously rewound armature,

and the generator is then reassembled, repainted, and placed in stock for subsequent exchange. The exchange price of such a generator is $10, while the established exchange price of a rewound armature is $1.50.

In the instant case the rewinding of the armature constitutes a "rebuilding" operation on a part which is then used as a component in the "reconditioning" of the generator. The tax should be based, therefore, upon the established selling price of such a "rebuilt" armature, namely $1.50, excluding the value of a like part accepted in exchange.

Revenue Ruling 54-329, C. B. 1954-2, 405, amplified.

REGULATIONS 46, SECTION 316.54: Credit for taxes on tires, inner tubes, automobile radio or television receiving sets. — Rev. Rul. 55-397

The credit allowable under section 3403(e) of the Internal Revenue Code of 1939 in respect of the tax-paid tires, tubes, automobile radio or television receiving sets sold on or in connection with the sale of chassis, bodies or vehicles taxable under section 3403(a) or (b) of the Internal Revenue Code of 1939, is not granted to the person who qualifies as the manufacturer, producer, or importer of the tires, tubes or sets, nor is it a credit of the tax paid by such manufacturer, etc., with respect to the sale or use of the tires, tubes, or sets. Instead, such credit is granted to the person qualifying as the manufacturer, etc., of the taxable automotive chassis, body or vehicle and is (in effect) an adjustment in computing the tax to be paid with respect to the sale of the chassis, body or vehicle. For these reasons, the restrictions and conditions expressed in section 3443(d) of such Code do not apply to the credit authorized by section 3403(e).

REGULATIONS 46, SECTION 316.55: Definition of parts or accessories. — Rev. Rul. 55-260

Conventional (belt-driven) compressors and condensing units which are primarily adapted for use in commercial refrigeration, but which may be modified for use in taxable automotive vehicles, are not automobile parts or accessories within the meaning of section 3403(c) of the Internal Revenue Code of 1939 and are therefore not subject to the tax imposed by that section of the Code.

REGULATIONS 46, SECTION 316.55: Definition of parts or accessories. — Rev. Rul. 55-304

High pressure and low pressure pencil gauges used principally by service stations and garages in servicing customers' tires are articles susceptible of general use and are not considered automobile parts or accessories within the meaning of section 3403(c) of the Internal Revenue Code of 1939. Accordingly, sales of such articles are not subject to the manufacturers' excise tax imposed by that section.

REGULATIONS 46, SECTION 316.55: Definition of parts or accessories.

Determination of the tax base where rewound armature is used in the reconditioning of a used generator. See Rev. Rul. 55-98, page 524.

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. Rev. Rul. 55-320

> Premium subminiature tubes, designed for use in military equipment, such as computers, guided missiles, sono-buoys, radar bomb sights, fuel control for jet engines, etc., are held not suitable for use on or in connection with, or as component parts of radio or television receiving sets, phonographs, or combinations of any of the foregoing, and are, therefore, not subject to the tax imposed by section 3404(b) of the Internal Revenue Code of 1939.

Advice has been requested whether certain premium subminiature tubes are subject to the tax imposed by section 3404(b) of the Internal Revenue Code of 1939.

These tubes, which are highly engineered and expensive, were designed for use in military equipment which is subject to considerable jar or concussion, and in which space is an important factor, such as computers, guided missiles, sono-buoys, radar bomb sights, fuel control for jet engines, etc. They may be used in equipment which transmits and/or receives code, facsimile, teletype, instrument landing signals or navigational signals, and as an incident to the primary purpose this equipment might be used for voice reception. These tubes are equipped with lead wires, instead of the base which is attached to conventional receiving tubes, so that they may be soldered into the circuits of military equipment. For such tubes to be usable in conventional circuits in commercial radio or television receiving sets, it would be necessary to add, at substantial expense, a base or adapter to the tubes. Due to their high price, dictated by the requirements of extremely small size combined with long life, ruggedness, and other features of design, they are not used in non-military type radio or television receiving sets.

Section 3404(b) of the Code imposes a tax on the sale by the manufacturer, producer, or importer of tubes which are suitable for use on or in connection with, or as component parts of, radio and television receiving sets, phonographs, or combinations of any of the foregoing.

The taxability of the tubes in the instant case depends upon whether they are "suitable for use" in radio or television receiving sets. "Suitable" has been defined as "fitting, convenient, appropriate or proper." The test of the suitableness of an article for a certain purpose is not whether it is commonly used therefor, but whether it possesses actual, practical commercial fitness for that purpose. While

it is recognized that from a theoretical standpoint these tubes could by adaptation be used in radio or television receiving sets, it would seem from the facts presented that it would be commercially impractical to do so.

Accordingly, it is held that the premium subminiature tubes described above are not suitable for use on or in connection with, or as component parts of, radio and television receiving sets, phonographs, or combinations of any of the foregoing, and are, therefore, not subject to the tax imposed by section 3404(b) of the Code.

REGULATIONS 46, SECTION 316.61A: Specific exemption of certain communication receivers, etc., and component parts. (Also Sections 3443, 3444; Regulations 46, Sections 316.204, 316.7.) Rev. Rul. 55–420

Oscilloscope analyzers designed for detecting variations of aircraft engine performance are considered detection receivers of the commercial, military, or marine type for the purpose of relief from tax on components named in section 3404(b) of the Internal Revenue Code of 1939 which are contained in such receivers sold to the United States.

Advice has been requested whether aircraft engine analyzers constitute communication, detection, or navigation receivers of the type used in commercial, military, or marine installations for purposes of tax exemption, credit or refund with respect to articles named in section 340(b) of the Internal Revenue Code of 1939 which are used in such receivers manufactured for sale to the United States.

In the instant case oscilloscope type analyzers are connected to aircraft engines in such a manner as to detect certain engine performance characteristics and relay electrical impulses to a receiving mechanism which converts these impulses into visible signals. These signals are shown as electronic wave patterns on the fluorescent screen of a picture tube. Variations of the electronic wave patterns indicate variations of, or from, normal engine performance. These analyzers are produced in accordance with military specifications for sale to the United States Navy.

Sections 3404(b), 3443(a)(1)(B) and 3444(b) of the Code provide exemption, credit or refund of tax on articles of the type taxable under section 3404(b) of the Code which are used as material in the manufacture or production of, or as a component part of, communication, detection, or navigation receivers of the type used in commercial, military, or marine installations if such receivers are to be sold to the United States for its exclusive use.

It is held that oscilloscope analyzers designed for detecting variations of aircraft engine performance are considered detection receivers of the commercial, military, or marine type for the purpose of relief from tax on components named in section 3404(b) of the Code which are contained in such receivers sold to the United States.

SECTION 3406.—EXCISE TAXES IMPOSED BY THE REVENUE ACT OF 1941

REGULATIONS 46, SECTION 316.110: Scope of tax. Rev. Rul. 55-52

Electric incinerators, designed for use in homes, which, by a burning process, dispose of paper, trash, rags and other combustible household wastes including garbage, are not considered electric garbage disposal units of the household type within the meaning of section 3406(a)(3) of the Internal Revenue Code of 1939 and are, therefore, not subject to the tax imposed by that section.

REGULATIONS 46, SECTION 316.110: Scope of tax. Rev. Rul. 55-146

An electric belt-driven fan which is designed for use as an exhaust or intake ventilating fan to be operated as an independent unit and which has a blade diameter of less than 40 inches, is considered to be of the "household type," unless it has other features of construction by which it may be identified definitely as being primarily adapted for commercial or industrial use. Therefore, such fans are subject to the manufacturers' excise tax imposed by section 3406(a)(3) of the Internal Revenue Code of 1939.

SUBCHAPTER C.—GENERAL ADMINISTRATIVE PROVISIONS

SECTION 3443.—CREDITS AND REFUNDS

REGULATIONS 46, SECTION 316.204: Credits and refunds. Rev. Rul. 55-53
(Also Section 3313.)

When received by a district director of internal revenue, a Quarterly Federal Excise Tax Return, Form 720, showing a credit for manufacturers' excise tax previously paid, is recognized as a claim for the entire amount of the credit shown even though such amount may exceed the total tax reported on the return. The credit balance may be taken on returns for subsequent periods regardless of whether the subsequent returns are filed before or after expiration of the 4-year period of limitation on credits and refunds under section 3313 of the Internal Revenue Code of 1939. The conditions to be met are (1) the return first showing the credit balance must be filed within the statutory period for claiming credit and (2) the full amount of the credit must be supported by the evidence otherwise required by regulations relating to credits and refunds which includes compliance with section 3443(a)(3)(B) or 3443(d) of the Code.

REGULATIONS 46, SECTION 316.204: Credits and refunds.

Allowability of a credit or refund to a manufacturer in the amount of any tax paid on components used by him in the production of

receivers sold to the United States for its exclusive use. See Rev. Rul. 55-420, page 527.

SECTION 3444.—USE BY MANUFACTURER, PRODUCER, OR IMPORTER

REGULATIONS 46, SECTION 316.7: Tax on use by manufacturer, producer, or importer.

The use of a rewound armature in the restoration of a used generator constitutes the taxable use of a manufactured article. See Rev. Rul. 55-98, page 524.

REGULATIONS 46, SECTION 316.7: Tax on use by manufacturer, producer, or importer.

Liability for tax on the use of an article by a manufacturer, producer, or importer. See Rev. Rul. 55-420, page 527.

CHAPTER 30.—TRANSPORTATION AND COMMUNICATION

SUBCHAPTER B.—TELEGRAPH, TELEPHONE, RADIO, AND CABLE FACILITIES

SECTION 3465.—IMPOSITION AND RATE OF TAX

REGULATIONS 42, SECTION 130.31: Scope of tax. Rev. Rul. 55-280
(Also Section 130.37.)

Information services, such as stock and commodity quotations, furnished to subscribers where delivery is effected by messenger or telephone, even where such services are furnished by a telegraph company do not constitute telegraph messages within the meaning of section 3465(a)(1)(B) of the Internal Revenue Code of 1939; or a leased wire service within the meaning of section 3465(a)(2)(A) of the Code; or a wire and equipment service within the meaning of section 3465(a)(2)(B) of the Code, and the amounts paid by the subscribers are not subject to the taxes imposed by those sections. However, where delivery of the information is effected by a tie-line furnished by the telegraph company the service constitutes a wire and equipment service within the meaning of section 3465(a)(2)(B) of the Code, and the amount paid by the subscribers is subject to the 8 percent tax imposed by that section.

REGULATIONS 42, SECTION 130.37: Scope of tax.

Application of the tax imposed by section 3465 of the Internal Revenue Code of 1939 with respect to leased wire service, and wire

and equipment service where delivery of information is effected by messenger or telephone. See Rev. Rul. 55-280, page 529.

REGULATIONS 42, SECTION 130.38: Rate and application of tax. Rev. Rul. 55-208

An automatic transmitter which reads a perforated tape containing converted confirmation notices of stock market transactions and transmits such information, through a leased teletype circuit, to a receiving-only page teletypewriter which prints the information on sprocket-fed multiple-copy form paper, provides a communication service of the kind contemplated by section 3465(a)(2)(A) of the Internal Revenue Code of 1939. The amounts paid for the lease of the transmission facilities and for the lease of the circuit for such transmission are subject to the tax imposed by that section on amounts paid for leased wire, teletypewriter, and talking circuit special services.

Advice has been requested concerning the application of the tax imposed by section 3465(a)(2)(A) of the Internal Revenue Code of 1939, on leased wire, teletypewriter and talking circuit special services to amounts paid for the lease of circuits and facilities for the following described transmissions.

A firm of brokers in securities and commodities with branch and field offices throughout the United States leases several types of wire facilities to meet its various needs. The leased facilities include teletype circuits connecting the branch and field offices with the main office, automatic tape transmitters located in the main office, and receiving-only page teletypewriters located in the branch or field offices. Throughout the business day orders for the purchase or sale of securities or commodities are placed in the branch or field offices. Each order is executed in the main office and a message is sent to the branch or field office where the order originated and that office notifies the customer of the completion of his order. Each day after the close of the security and commodity markets a punch card record is prepared in the main office for each transaction. These cards show the identification of the branch office, the date, account number, name of security, number of shares, whether purchase or sale, exchange symbol, price per share, commission, taxes, and dollar extent of the transaction. The cards are segregated according to branch or field office and the data shown on the cards for each particular office are converted into a continuous perforated teletypewriter tape. The perforated tape is then run through an automatic tape transmitter connected by teletype circuit with a receiving-only page teletypewriter, located in the branch or field office, which prints the confirmation notices on sprocket-fed multiple-copy form paper.

Section 3465(a)(2)(A) of the Code imposes a tax upon the amount paid for leased wire, teletypewriter, or talking circuit special service, except where such service is used exclusively in rendering wire and equipment service which is taxable at a lower rate under section 3465(a)(2)(B) of the Code.

Section 130.38 of Regulations 42 states that, in general, leased wire, teletypewriter, or talking circuit special service, taxable under section 3465(a)(2)(A) of the Code, relates to private line service where channels, equipment and other facilities are furnished to enable users

to communicate between specified locations continuously or for specified periods. The communications may be telephonic, in Morse or similar code, or may be reproduced at the terminating end in the form of a typewritten page or tape, or picture or facsimile.

Accordingly, it must be concluded that the automatic tape transmitter and receiving-only page teletypewriter when connected by a teletype circuit provide a communication service of the kind contemplated by section 3465(a)(2)(A) of the Code. Therefore, amounts paid for the lease of the transmission facilities and for the circuits for such transmission are subject to the tax imposed by that section on leased wire, teletypewriter, and talking circuit special services.

REGULATIONS 42, SECTION 130.42: Coin-operated telephones. Rev. Rul. 55-99

Under the provisions of section 3465(a)(3) of the Internal Revenue Code of 1939 no tax is imposed with respect to charges of 24 cents or less paid by the insertion of coins in coin-operated telephones available to the public, except that where such coin-operated telephone service is furnished for a guaranteed amount the tax applies to the amount paid under the guarantee plus any fixed monthly or periodic charge. *Held*, that the tax applies to the full amount of such guarantee whether it is paid out of receipts from the coin box of the telephone or from funds of the subscriber (guarantor). For example, if a subscriber guarantees a minimum deposit of 20 cents per day, and if at the end of a 60-day period it is determined that only $9.75 has been deposited in the coin box, the tax is based upon any periodic service charge plus the guaranteed amount of $12, even though only $2.25 of the guaranteed amount is paid from the subscriber's own funds.

SUBCHAPTER C.—TRANSPORTATION OF PERSONS

SECTION 3469.—TAX ON TRANSPORTATION OF PERSONS, ETC.

REGULATIONS 42, SECTION 130.53: Payments for transportation subject to tax. Rev. Rul. 55-84

A girl scout troop chartered a bus to transport its members to a camp and for sightseeing in a city en route to the camp. The amount paid for the charter of the bus represented a per capita charge of more than 35 cents for each person actually transported. *Held*, an amount paid by the girl scout troop for chartering the bus is subject to the tax on the transportation of persons; exemption is not granted just because an organization is educational, religious, etc.

REGULATIONS 42, SECTION 130.54: Payments not subject to tax. Rev. Rul. 55-209

The tax on the transportation of persons imposed by section 3469 of the Internal Revenue Code of 1939 does not apply to amounts

paid by residents of Canada to a travel agency in that country for transportation between points in the United States when such transportation is a part of a package tour which begins and ends in Canada. Method of establishing nontaxable character of such payments is outlined.

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 amounts paid outside the United States under the following circumstances for transportation between points within the United States, and, if the tax does not apply, further advice has been requested as to the evidence required to establish the nontaxable character of such payments.

In the instant case a Canadian travel agency sells to residents of Canada a package tour which begins and ends in Canada and includes transportation between points in the United States. The travel agency does not issue a prepaid order, exchange order, or similar order for the United States portion of the tour, but transmits to the United States carrier a bank draft for the purchase of a ticket for such portion of the tour.

In accordance with the provisions of section 3469 of the Code the tax is imposed upon amounts paid without the United States on or after November 1, 1950, for the transportation of persons on or after such date, by rail, motor vehicle, water, or air which begins and ends in the United States.

Section 130.54(b) (1) of Regulations 42 provides, in part, that the tax does not apply to a payment made outside the United States for transportation which begins or ends outside the United States. For purposes of the preceding sentence, a payment made outside the United States for transportation between two or more points within the United States (such transportation being referred to as "the United States portion"), which is part of transportation from or to a point outside the United States, is a payment for transportation which begins or ends outside the United States, where it is definitely established at the time of making payment for the United States portion that such portion is purchased for use in making the journey from or to a point outside the United States. The Internal Revenue Service has not approved the use of any form or exemption certificate to establish the nontaxable character of such payment. However, section 130.54(b) (3) and (4) of the Regulations prescribe specific provisions for the establishment of the nontaxable character of a payment made outside the United States for the United States portion in those cases where a prepaid order, exchange order, or similar order for the United States portion is issued outside the United States and the ticket is issued within the United States pursuant to such order.

It is held that since the transportation sold in Canada by the travel agency is part of a package tour which begins and ends outside the United States, the amount paid to the travel agency for the United States portion of the tour is not subject to tax. Since in this case no prepaid order, exchange order, or similar order is issued, but instead a bank draft is transmitted to the United States carrier in payment for the ticket which is issued within the United States, it is held further that to establish the nontaxable character of the payment

made to the Canadian travel agency for the United States portion of the tour, it will be necessary for the travel agency to transmit to the United States carrier with the bank draft a statement (1) certifying that the ticket is being purchased by the agency for use by the passenger in conjunction with connecting transportation from a point outside the United States and (2) showing (a) the origin and destination of the connecting transportation, (b) the identity of the carrier furnishing the connecting transportation, and (c) the serial number of the ticket covering such connecting transportation. The United States carrier should retain the statement in its records as evidence that the ticket issued by it was purchased for use in conjunction with the connecting transportation from a point outside the United States. The United States carrier also should inscribe on the ticket issued by it the information specified in (a), (b), and (c) above and, in addition, the name of the Canadian travel agency from which the payment for the ticket was received.

REGULATIONS 42, SECTION 130.54: Payments not subject to tax.

Applicability of the tax on the transportation of persons to a payment made in Canada by a resident of the United States for a trip which begins and ends outside of the United States. See Rev. Rul. 55-409, page 126.

REGULATIONS 42, SECTION 130.58: Motor vehicles with seating capacity of less than ten. Rev. Rul. 55-54

A vehicle propelled by a gasoline motor and designed to travel on ice and snow surfaces by means of skis and endless chain-type tracks is used for the transportation of persons. The vehicle is used primarily to transport persons engaged in repairing power lines and to rescue persons lost in the snow and it is not operated between definite points or with any degree of regularity. The seating capacity of the vehicle is 4 persons, including the driver, but when additional seating space is needed a trailer with a seating capacity of 10 persons is attached to the vehicle. *Held*, the vehicle constitutes a "motor vehicle" within the meaning of section 3469(a) of the Internal Revenue Code of 1939. However, since the vehicle is not operated on an established line and in view of the specific provision of the statute that the tax does not apply to transportation by motor vehicles having a seating capacity of less than 10 adult passengers, including the driver, when not operated on an established line, the tax does not apply to amounts paid for transportation in the vehicle when operated without the trailer. On the other hand, amounts paid for transportation in the vehicle when operated with the trailer attached are subject to tax since in such case the seating capacity of the vehicle is not less than 10 adult passengers, including the driver. This is so on the assumption that the amounts so paid represent a per capita charge of more than thirty-five cents for each person actually transported.

REGULATIONS 42, SECTION 130.59: Charges not exceeding 35 cents. Rev. Rul. 55-147

An amount paid to a truck owner for transporting agricultural workers from a concentration point to a farm and return is subject to the tax imposed by section 3469(a) of the Internal Revenue Code of 1939 where payment for the round trip represents a per capita charge of more than 35 cents for each worker transported. The per capita charge is determined by dividing the total payment for a round trip by the number of workers actually transported.

Advice has been requested concerning whether the amount paid to a truck owner for transporting agricultural workers from a cencentration point to a farm and return is subject to the tax on the transportation of persons imposed by section 3469 of the Internal Revenue Code of 1939.

In the instant case a truck owner is paid $20 for transporting agricultural workers, ranging in number from 20 to 60, from a concentration point to a farm and return.

Section 3469(a) of the Code imposes a tax upon amounts paid for the transportation of persons by rail, motor vehicle, water, or air, but section 3469(b) provides that the tax shall not apply to amounts paid for transportation which do not exceed 35 cents.

Section 130.59 of Regulations 42 provides that an amount of more than 35 cents paid for round trip transportation is exempt from the tax, if the regular one-way single fare of like class between the terminal points of the round trip does not exceed 35 cents. However, that section also provides that an amount paid for the charter of a car, train, motor vehicle, aircraft, or boat is exempt from the tax, if the payment represents a per capita charge of 35 cents or less for each person actually transported. It will be noted that the first provision applies only to situations where there is an established fare for one-way transportation between the terminal points of a trip, as in the case of regular scheduled trips, and would not apply to charter trips since the charges for such trips are not based on an established fare for one-way transportation. The separate provision concerning the application of the exemption in the case of charter trips furthermore makes no reference to a single one-way trip, indicating that charter trips are not placed in the same category as regular scheduled trips.

It is held, therefore, that an amount paid to a truck owner for transporting agricultural workers from a concentration point to a farm and return is subject to the tax imposed by section 3469(a) of the Code where payment for the round trip represents a per capita charge of more than 35 cents for each worker transported. The per capita charge is determined by dividing the total payment for a round trip by the number of workers actually transported.

REGULATIONS 42, SECTION 130.64: Transportation outside the northern portion of the Western Hemisphere. Rev. Rul. 55-337

Section 3469(a) of the Internal Revenue Code of 1939 provides that the tax on transportation of persons shall not apply to the amount

paid for 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. A steamship company sold tickets for a cruise that began and ended in New York but did not include a stop at any other port in the United States, Canada, or Mexico. The payments for the tickets were not subject to the tax on transportation of persons for the reason that the cruise itinerary included a call at the port of La Guaira, Venezuela, a point outside the northern portion of the Western Hemisphere, as defined in section 3469(a) of the Code. However, due to engine trouble which developed during the cruise the vessel was forced to omit the call at the South American port. *Held*, where tickets for a cruise are sold on a tax-exempt basis by reason of the fact that the cruise itinerary includes a call at a port outside the northern portion of the Western Hemisphere and an emergency arises during the course of the cruise which makes it impossible for the vessel to make the scheduled stop at such port, the exempt status of the payments originally made for the tickets is not nullified by the omission of such stop, and the steamship company is not required to collect the tax on the payments made by the passengers for the cruise.

SUBCHAPTER E.—TRANSPORTATION OF PROPERTY

SECTION 3475.—TRANSPORTATION OF PROPERTY

REGULATIONS 113, SECTION 143.1: Meaning of terms. Rev. Rul. 55-398

In response to an inquiry from an association of funeral directors and embalmers, it is held that a funeral director who, as a part of the mortuary services provided by him, transports a corpse in his own hearse or ambulance from one city to another, or who occasionally performs such transportation for another funeral director, is not considered to be a person engaged in the business of transporting property for hire within the meaning of section 3475 of the Internal Revenue Code of 1939. Accordingly, amounts paid to a funeral director for such transportation are not subject to tax.

REGULATIONS 113, SECTION 143.1: Meaning of terms.

Applicability of the tax, imposed by section 3475 of the Internal Revenue Code of 1939, to the delivery by a truck owner of commodities purchased by him from a company where the persons to whom delivery is made have previously ordered such commodities from the company. See Rev. Rul. 55-421, page 539.

REGULATIONS 113, SECTION 143.1: Meaning of terms. **Rev. Rul. 55-126**

> **An amount paid to a household goods carrier for packing and unpacking clothing, which includes the use of dispensable wardrobe cartons, is not subject to tax, provided the packing and unpacking services are performed before and after the transportation movement and the charge therefor is billed separately from the charge for the transportation movement.**

Advice has been requested whether the tax on the transportation of property imposed by section 3475 of the Internal Revenue Code of 1939 is applicable to amounts paid for certain services performed in connection with the transportation of household goods.

In the instant case, a carrier, which furnishes packing and unpacking services, uses almost exclusively in packing articles of clothing dispensable wardrobe cartons that are made of cardboard. The charge for these wardrobe cartons is set forth in the carrier's tariff under the item covering the rates for packing and unpacking services. This item provides that the rates include (1) packing, unpacking and the use of packing containers and materials, or (2) packing and the packing containers and materials in the event that such packing containers and materials are retained by the shipper or consignee. In other words, the charge covers packing and unpacking services, but if the shipper or consignee does not wish to take advantage of the unpacking service, in lieu thereof he may retain the packing materials, including the wardrobe carton.

Section 3475 of the Code imposes a tax upon the amount paid within or without the United States, to a person engaged in the business of transporting property for hire, for the transportation of property by rail, motor vehicle, water or air from one point in the United States to another, with certain exceptions not here applicable.

Section 143.1(d) of Regulations 113 provides that the term "transportation" means 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 and that, in general, the term also includes accessorial services furnished in connection with any such movement.

M. T. 15, C. B. 1943, 1158, holds that amounts paid for certain services, including wardrobe service, when furnished in connection with the transportation of household goods by the carrier which performs the transportation movement, are subject to the tax whether the charge for such services is included in, or is billed separately from, the charge for the transportation movement proper. Such a charge for wardrobe service is a charge for the use, during the transportation movement, of a permanent type of wardrobe box which is retained by the carrier as a part of his transportation equipment. M. T. 15 also holds that amounts paid for packing and unpacking, or crating and uncrating, occurring before and after a transportation movement, are not taxable if the charges therefor are billed separately.

It is held that the charge made by the carrier in the instant case for (1) packing, unpacking, and the use of wardrobe cartons, or (2) packing and the wardrobe cartons which are retained by the shipper or consignee, is a charge for packing and unpacking, and not a charge for wardrobe service, within the meaning of M. T. 15. Accordingly,

such charge is not subject to tax, provided the packing and unpacking services are performed before and after the transportation movement, and provided the charge therefor is billed separately from the charge for the transportation movement.

REGULATIONS 113, SECTION 143.13: Application of tax. Rev. Rul. 55–55

The tax on the transportation of property imposed by section 3475 of the Internal Revenue Code of 1939 applies to amounts paid to a port terminal operator for the towing of logs in a log reload operation.

Advice has been requested whether the tax on the transportation of property imposed by section 3475 of the Internal Revenue Code of 1939 applies to amounts paid to a port terminal operator for the towing of logs from the places of storage to the dock where they are loaded onto rail cars.

In the instant case *M* corporation operates a port terminal for inbound and outbound ocean cargo and rail shipments. One of its operations is a log reload which involves the loading of logs from rafts in the water to railroad log flats and gondola cars for shipment to lumber yards and pulp mills. The rafts of logs are delivered from logging companies by tugboats to the port and are moored at various tie-up places in the river where they are stored until the reload can place them on the cars. When the logs are brought from the storage places to the dock, *M* corporation orders a tugboat to move the rafts from the tie-up places to the reload boom and pays the tugboat operator for the towing services. The *M* corporation bills the various logging companies for the amount of the towage charges plus 20 percent of such charges.

Under the provisions of section 3475 of the Code the tax applies to amounts paid to a person engaged in the business of transporting property for hire, including amounts paid to a freight forwarder, express company, or similar person, but not including amounts paid by a freight forwarder, express company, or similar person for transportation with respect to which a tax has previously been paid under this section.

Section 143.1(d) of Regulations 113 provides that the term "transportation" means 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, as well as towing, ferrying, switching, etc. In general, it includes accessorial services furnished in connection with a transportation movement such as loading, unloading, and similar services.

The term "person engaged in the business of transporting property for hire," for the purpose of the tax imposed by section 3475(a) of the Code, includes not only a carrier who actually transports the property but also a person who holds himself out to the public as one who for compensation sells, provides, procures, furnishes, or arranges for the transportation of property. See Rev. Rul. 54–54, C. B. 1954–1, 273.

It is held that to the extent *M* corporation furnishes the reload service which includes towing of the logs, *M* corporation is a person en-

gaged in the business of transporting property for hire within the meaning of section 3475(a) of the Code. Accordingly, the tax applies to amounts paid to *M* corporation by the logging companies for the towing of the logs and for any accessorial services, such as loading and unloading, furnished in connection therewith. However, the tax does not apply to the amounts paid by *M* corporation to the tugboat operators for towing with respect to which the tax is payable to such corporation.

REGULATIONS 113, SECTION 143.13: Application of tax. Rev. Rul. 55-148

Highway use taxes, such as ton-mile, weight-distance, axle-mile and similar taxes or tolls, are imposed by several states upon carriers by motor vehicle, and in some instances an amount approximating such expense items incurred by the carrier is billed to shippers separate from the transportation charge proper. *Held*, such amounts constitute a part of the total transportation charges subject to the tax imposed by section 3475 of the Internal Revenue Code of 1939, even though they may be billed separately.

REGULATIONS 113, SECTION 143.13: Application of tax. Rev. Rul. 55-281

> Liability for payment of tax on the transportation of property, imposed by section 3475 of the Internal Revenue Code of 1939, falls upon the person making, or having immediate control of making, any payment of taxable transportation charges to a person engaged in the business of transporting property for hire.

Advice has been requested concerning the person or persons liable under the following circumstances for the payment of tax on the transportation of property imposed by section 3475 of the Internal Revenue Code of 1939.

In the instant case a processing company entered into a contract with growers of the commodity which it processes concerning the growing, harvesting, and delivery of the commodity. Under the contract a grower agrees to bear the cost of transportation of the commodity to the company's processing plant, the transportation charges to be paid directly by the grower or charged against the grower's account if paid by the company. Under the agreement the company, in making any transportation arrangements or payments for transportation, acts solely as the agent of the grower. The hauling of the commodity is performed by persons engaged in the business of transporting property for hire.

Section 3475(a) of the Code imposes a tax upon amounts paid for the transportation of property to a person engaged in the business of transporting property for hire. Section 3475(c) of the Code provides that the tax shall be paid by the person making the taxable transportation payment and that each person receiving payment for taxable transportation shall collect the tax from the person making such payment.

Pursuant to the provisions of law stated above and the regulations relating thereto, liability for payment of the transportation tax falls

upon the person making, or having immediate control of making, any payment of taxable transportation charges to a person engaged in the business of transporting property for hire. The tax is payable at the time payment is made of the transportation charges and a person liable for payment of the tax by reason of making a taxable transportation payment may not, by separate agreement, avoid his responsibility for making payment of the tax concurrently with making the payment for transportation services. The determination of liability for payment of transportation tax is not dependent upon the terms of a contract, such as the one in the instant case, where the effect of the terms thereof would shift the responsibility for payment of the transportation tax, at the time it is due, to a person other than the person making, or having immediate control of making, the taxable payment to the carrier.

Accordingly, it is held that under the circumstances described the processing company, when making a payment to a carrier for hauling a commodity, incurs liability for payment of the transportation tax concurrently with the payment of the taxable transportation charges. Similarly, a grower, when making payment to a carrier for transportation, becomes liable for payment of the tax. Any problem of reimbursement between a grower and the company, when the company makes payment of the transportation charges and the tax on behalf of a grower, is a matter to be settled between the grower and the company.

REGULATIONS 113, SECTION 143.13: Application of tax. (Also Section 143.1.) — Rev. Rul. 55-421

Applicability of the transportation of property tax, imposed by section 3475 of the Internal Revenue Code of 1939, to the delivery by a truck owner of commodities purchased by him from a company where the persons to whom delivery is made have previously ordered such commodities from the company.

Advice has been requested whether certain amounts received by a truck owner for the "back-haul" of commodities under the following circumstances are subject to the tax on the transportation of property imposed by section 3475 of the Internal Revenue Code of 1939.

In the instant case certain truck owners, such as farmers, grain and feed dealers, and stock and produce dealers, haul their products or wares from their homes or places of business to market in their trucks. In order to avoid returning with empty trucks they enter into arrangements with the salesmen of *M* company whose plant is located near the truck owners' market, for the delivery of commodities, orders for which have been obtained by the salesmen from customers located near the truck owners' homes or places of business. Under the arrangements the truck owners purchase the commodities at *M* company's plant at the f. o. b. plant list price, transport them to the customers' premises, and sell them to the salesmen's customers at the delivered price previously agreed upon between the salesmen and the customers. This delivered price represents the f. o. b. plant list price of the commodity plus the amount for which the salesman believed that he could obtain transportation of the order by one of these truck

owners. The truck owner assumes no significant risk due to possible changes in the price of the commodity purchased. Furthermore, the truck owner does not perform any service from which he could gain a profit except the service of transportation.

The tax imposed by section 3475 of the Code applies to amounts paid for the transportation of property to a person engaged in the business of transporting for hire. Section 143.1 of Regulations 113 states that such a person includes a common carrier, contract carrier, or other person transporting property for hire wholly or in part by rail, motor vehicle, water or air. The tax is payable by the person making the taxable transportation payment and is collectible by the person receiving such payment. In general, where the delivery activities of a wholesale or retail merchant are carried on with his own trucks and are merely incidental to his business of selling merchandise, the merchant is not regarded as a person engaged in the business of transporting property for hire even though a separate charge for the delivery is made to the customer. Mim. 5447, C. B. 1942–2, 280. However, where the truck owner does not have the usual indices of a merchant except the ownership of the commodities carried, and where his sole remuneration is based on a charge for transportation, the truck owner is considered to be engaged in the business of tranporting property for hire. Compare with Rev. Rul. 54–463, C. B. 1954–2, 424.

It is held that under the circumstances described the amount paid to the truck owner by the customer of *M* company in excess of the purchase price of the commodity paid by the truck owner constitutes an amount paid by the customer for transportation to a person engaged in the business of transporting property for hire within the meaning of section 3475 of the Code and is subject to the tax imposed by that section. The truck owner should collect the tax at the time the transportation charges are paid to him.

REGULATIONS 113, SECTION 143.21: Post Office Department. Rev. Rul. 55-21

The tax on the transportation of property imposed by section 3475 of the Internal Revenue Code of 1939 does not apply to amounts paid to a carrier by the Post Office Department for the transportation of United States mail.

Advice has been requested by a motor carrier whether it must collect the tax on the transportation of property imposed by section 3475 of the Internal Revenue Code of 1939 with respect to amounts paid to it by the Post Office Department for the transportation of United States mail.

Under the provisions of section 3475(a) of the Code, a tax is imposed 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. Such tax shall apply only to amounts paid to a person engaged in the business of transporting property for hire, including amounts paid to a freight forwarder, express company, or similar person, but not including amounts paid by a freight forwarder, express company, or similar person for transportation with respect to

which a tax has previously been paid under that section. Section 3475(b) of the Code provides that the tax shall not apply to amounts paid to the Post Office Department for the transportation of property.

Amounts paid to the Post Office Department for the transportation of mail are considered to be amounts paid to a "freight forwarder, express company, or similar person," within the meaning of section 3475(a) of the Code, and if it were not for the specific exemption provided by section 3475(b) of the Code such amounts would be subject to the tax on the transportation of property.

Since payments to the Post Office Department are exempt from the tax, such payments are considered the equivalent of payments *with respect to which a tax has previously been paid* for the purpose of determining the liability of the Post Office Department for tax on its payments to a motor carrier for transporting mail.

Therefore, when the United States Post Office Department in its capacity as "freight forwarder, express company, or similar person," collects from the sender or addressee the full charges for the transportation of the mail, any amounts paid by the Post Office Department to other persons for transportation services rendered by them in connection with the transportation or delivery of such mail are not subject to the tax on the transportation of property imposed by section 3475 of the Code.

REGULATIONS 113, SECTION 143.24: States, Territories, etc. Rev. Rul. 55-162

> Amounts paid for the transportation of construction materials consigned to a State or political subdivision of a State, including an agency or instrumentality thereof, in care of a contractor, for incorporation into a State project are exempt from tax on the transportation of property imposed by section 3475 of the Internal Revenue Code of 1939, if such materials are so consigned pursuant to instructions issued by the State or political subdivision thereof authorizing such procedure.

Advice has been requested whether the tax on the transportation of property imposed by section 3475 of the Internal Revenue Code of 1939 applies to amounts paid for the transportation of construction materials consigned to a State Highway Commission, a State Department of Public Works, a State Public Housing Authority, or any other agency or instrumentality of a State, in care of a contractor, for incorporation into a State project.

Under the provisions of section 3475(b) of the Code, amounts paid for the transportation of property to or from the government of a State, Territory of the United States, or political subdivision thereof, or the District of Columbia, are exempt from the tax.

Section 143.24 of Regulations 113 provides that where the shipping papers show the consignor or consignee to be a State, Territory or political subdivision thereof, or the District of Columbia, or an agency or instrumentality of any of the foregoing, such papers may be accepted by the carrier as proof of the exempt character of the shipment. No certificate of exemption is required.

It is held that the exemption provided by section 3475(b) of the Code applies to amounts paid for the transportation of construction

materials to be incorporated into a State project, where such materials are consigned to a State or political subdivision of a State, including an agency or instrumentality thereof, in care of a contractor. In such cases, the shipping papers must clearly show that the property is consigned to the State or political subdivision. However, before a contractor may take advantage of this exemption and have construction materials consigned to a State or political subdivision, in care of himself, it will be necessary for the particular State or political subdivision to issue appropriate instructions authorizing such procedure.

The exemption provided by section 3475(b) of the Code does not apply with respect to shipments of fuel, lubricants, spare parts and items of construction equipment belonging to the contractor and which will not be incorporated in the construction project and which will not become the property of the State or political subdivision thereof.

REGULATIONS 113, SECTION 143.31: Continuity of movement. Rev. Rul. 55-183

If wheat, which is purchased at interior points for exportation, comes to rest at a seaport elevator and is processed for a business purpose, such processing constitutes a "break" in the continuity of the movement of the wheat. The movement of the wheat prior to this processing is domestic in character and subject to the tax imposed by section 3475 of the Internal Revenue Code of 1939 on the transportation of property.

Advice has been requested whether the tax on the transportation of property, imposed by section 3475 of the Internal Revenue Code of 1939, applies to amounts paid for the transportation of wheat from interior points in the United States to a grain company's elevator at a port of exportation, where, before being exported, the wheat comes to rest and is processed in the following manner.

In the instant case the contracts between the grain company and its foreign customers specify the grade of wheat to be exported. The company purchases wheat from farmers, cooperatives, or country dealers for delivery to its elevator. This wheat consists of several classes and subclasses, each of which is further broken down into several grades based upon weight and other factors. In addition, it may be of a "special" grade, such as, smutty, tough, weevily, ergoty, treated, or garlicky. The seller's price to the company is based upon the current price for the best grade of the specific class, but is subject to discounts and charges according to variations in grade. Although the "special" grades may not be separately marketable, they are valuable to the company for use in blending with higher grades of wheat for supplying foreign demands.

As the wheat is received at the elevator it is sorted into bins according to class, subclass, and grade. By means of a graduated slot or opening at the bottom of each bin and a system of conveyor belts, or other arrangements, the wheat in the various bins can be drawn out and blended. When an export order is to be filled, predetermined proportions of the wheat are drawn from the different bins and blended to produce a composite which will conform to the particular grade called for in the contract. As a part of this operation, wheat which because of its condition has been given a special grade and

which therefore might not be merchantable, or would be subjected to discount, is appropriately treated by washing or cleaning so that it can be blended with higher graded wheat. Through this blending process it is possible for the company to produce a composite which can be sold for a price greater than that which could be obtained if the various classes and grades were sold in separate lots.

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. In accordance with Subpart E of Regulations 113 the tax does not apply to an amount paid for the transportation of property in the course of exportation to a foreign destination, or shipment to a possession of the United States. The test of the export character of a shipment is the continuity of movement from the point of origin in the United States to its foreign destination. The mere fact that grain or other property transported by one of the means enumerated in section 3475 of the Code is finally exported does not necessarily mean that it was continuously in the course of exportation after it was started on its movement from its place of origin. Section 143.31 of Regulations 113 provides that in case a break occurs in the movement of property shipped for export, which is not the fault of transportation, and the property comes to rest in transit prior to exportation, that part of the amount paid for the transportation which pertains to the movement from the point of origin to the point where the break occurs is taxable. A "break" may be said to occur wherever the property is stopped for a business purpose, such as grading, cleaning, mixing, sorting, or manufacture, and not merely in accommodation to the means of transportation.

In the instant case, the operations conducted at the elevator, considered in their entirety, cannot be regarded as a mere storage of wheat with incidental services pending the arrival of shipping accommodations. Rather, the operations are such that they constitute the conduct of a domestic processing plant at which various classes and grades of wheat are received and subjected to blending and other forms of processing in the production of the particular class and grade of wheat destined for export. Under these circumstances the stoppage of the wheat in the grain company's elevator is not merely in accommodation to the means of transportation but is essentially for a business purpose and therefore this stoppage constitutes a "break" in the continuity of the movement from the interior points of origin. Accordingly, all movements of the wheat prior to this stoppage are domestic in character and the amounts paid for such transportation are subject to the tax on the transportation of property imposed by section 3475 of the Code. See G. C. M. 22580, C. B. 1941–1, 459.

REGULATIONS 113, SECTION 143.31: Continuity of movement. Rev. Rul. 55-338

Where cartons of goods shipped from an inland manufacturing plant pursuant to an export contract are stopped at a port to be overpacked to meet export packing specifications or while a foreign customer obtains the necessary export license or exchanges foreign cur-

rency for American dollars to pay for the goods, the stoppage of the goods is not for a business purpose within the meaning of section 143.31 of Regulations 113 and does not constitute a "break" in the continuity of the export movement of the goods. Accordingly, the tax on the transportation of property imposed by section 3475 of the Internal Revenue Code of 1939 will not apply to the amount paid for the transportation of the goods from the inland manufacturing plant to the port, provided the person paying the transportation charges establishes exemption from payment of the tax in accordance with the applicable provisions of Subpart E of Regulations 113. Compare Rev. Rul. 55-183, page 542, this bulletin.

CHAPTER 34.—INFORMATION AND RETURNS

SUBCHAPTER A.—DISCOVERY OF TAX LIABILITY

SECTION 3603.—NOTICE REQUIRING RECORDS, STATEMENTS, AND SPECIAL RETURNS

REGULATIONS 120, SECTION 406.607: Records.

Regulations 120 amended to provide rules for withholding during 1954 and 1955 on payments subject to section 105(d) of the Internal Revenue Code of 1954 relating to wage continuation plans. See T. D. 6128, page 123.

CHAPTER 36.—COLLECTION

SUBCHAPTER B.—LIEN FOR TAXES

SECTION 3670.—PROPERTY SUBJECT TO LIEN

Rev. Rul. 55-210

Where a taxpayer has an unqualified fixed right, under a trust or a contract, or through a chose in action, to receive periodic payments or distributions of property, a Federal lien for unpaid tax attaches to the taxpayer's entire right, and a notice of levy based on such lien is effective to reach, in addition to payments or deductions then due, any subsequent payments or distributions that will become due thereunder.

Advice has been requested whether a levy reaches only such property or money as may be due or owing the taxpayer at the time of the service of a notice of levy for Federal taxes.

Section 3670 of the Internal Revenue Code of 1939 provides:

If any person liable to pay any tax neglects or refuses to pay the same after demand, the amount * * * shall be a lien in favor of the United States upon all property and rights to property, whether real or personal, belonging to such person.

Section 3692 of the Code provides that if the person liable to pay any tax neglects or refuses to pay the same within ten days after notice and demand the collector may levy:

* * * upon all property and rights to property, except such as are exempt by the preceding section, belonging to such person, or on which the lien provided in section 3670 exists, for the payment of the sum due, * * *

Section 3710(a) of the Code provides:

* * * Any person in possession of property, or rights to property, subject to distraint, upon which a levy has been made, shall, upon demand by the collector or deputy collector making such levy, surrender such property or rights to such collector or deputy, unless such property or right is, at the time of such demand, subject to an attachment or execution under any judicial process.

The lien arising under section 3670 applies to property owned by the delinquent at any time during the life of the lien. See *Glass City Bank of Jeanette, Pa.* v. *United States*, 326 U. S. 265, Ct. D. 1651, C. B. 1945, 330.

It has been held that a notice of levy does not attach to a taxpayer's right to money that is contingent upon the performance of future services. See *United States* v. *Long Island Drug Company, et al.*, 115 Fed. (2d) 983. The court in that case said that the indebtedness of a third party to a taxpayer is subject to levy, but not an indebtedness that is contingent upon the performance of future services. Compare *United States* v. *Warren Railroad Co., et al.*, 127 Fed. (2d) 134, 137.

It has been held that a notice of levy served upon a trustee of a spendthrift trust attaches to distributions by the trustee to the beneficiary even though such distributions are not due at the time the levy is served. *United States* v. *Charles O. Canfield, et al.*, 29 Fed. Supp. 734, appeal dismissed sub. nom. *Security First National Bank of Los Angeles* v. *United States*, 113 Fed. (2d) 491. Compare *In re Rosenberg's Will*, 199 N. E. 206, Ct. D. 1069, C. B. XV-1, 258 (1936); *M. Israel Schwarz, et al.* v. *United States*, 191 Fed. (2d) 618.

Upon the basis of the above cited opinions it is the position of the Internal Revenue Service that where a taxpayer has an unqualified fixed right, under a trust or a contract, or through a chose in action, to receive periodic payments or distributions of property, a Federal lien for unpaid tax attaches to the taxpayer's entire right, and a notice of levy based on such lien is effective to reach, in addition to payments or distributions then due, any subsequent payments or distributions that will become due thereunder, at the time such payments or distributions become due.

SECTION 3672.—VALIDITY AGAINST MORTGAGEES, PLEDGEES, PURCHASERS, AND JUDGMENT CREDITORS

(Also Part I, Section 6323.) Ct. D. 1776

INCOME WITHHOLDING AND SOCIAL SECURITY TAXES—INTERNAL REVENUE CODE OF 1939—DECISION OF COURT.

1. INCOME WITHHOLDING AND SOCIAL SECURITY TAXES—LIENS—PRIORITY—BANKRUPTCY.

A trustee in bankruptcy is not a judgment creditor within the meaning of section 3672(a) of the Internal Revenue Code of 1939 and, therefore, the lien for federal taxes is valid even though notice thereof had not been filed prior to bankruptcy.

2. ORDER REVERSED.

Order of Referee in Bankruptcy dated June 17, 1953, reversed and cause remanded for further proceedings.

UNITED STATES DISTRICT COURT FOR THE NORTHERN DISTRICT OF ALABAMA
SOUTHERN DIVISION

In The Matter of Ben Green, Bankrupt

[September 30, 1954]

OPINION

LYNNE, District Judge: Here for review on his certificate is an order of honorable Stephen B. Coleman, Referee in Bankruptcy, dated June 17, 1954, pertaining to the distribution of funds of the bankrupt estate to apply on recorded tax liens in favor of State Department of Industrial Relations of Alabama. Insisting that the referee erred in avoiding its lien for taxes, established by 26 U. S. C. A. 3670, the United States stands squarely on the position that a trustee in bankruptcy is not a judgment creditor within the meaning of 26 U. S. C. A. 3672(*a*). Without attempting either to review or to analyze the opinions of both trial and appellate courts which are in irreconcilable conflict, this court is of the opinion that the United States is right in its contention.

Judicial gloss placed upon the words "judgment creditor" as employed by Congress in Section 3672 conclusively establishes that such words were used "in the usual, conventional sense of a judgment of a court of record." *United States* vs. *Gilbert Associates*, 345 U. S. 361, at page 364 [Ct. D. 1757, C. B. 1953–1, 474]. See concurring opinion of Mr. Justice Jackson in *United States* vs. *Security Trust and Savings Bank*, 340 U. S. 47, at page 52 [Ct. D. 1736, C. B. 1950–2, 151].

Concededly, neither of these cases was dealing with bankruptcy. If the trustee in bankruptcy in the instant proceeding (wherein there is no conventional judgment creditor to whose rights the trustee would succeed by operation of Section 70(c) of the Act) is endowed with the status of a judgment creditor, it must be because of the provisions of Section 70(c) of the Bankruptcy Act [11 U. S. C. A. 110(c)], which read as follows:

The trustee may have the benefit of all defenses available to the bankrupt as against third persons, including statutes of limitation, statutes of frauds, usury, and other personal defenses; and a waiver of any such defense by the bankrupt after bankruptcy shall not bind the trustee. The trustee, as to all property, whether or not coming into possession or control of the court, upon which a creditor of the bankrupt could have obtained a lien by legal or equitable proceedings at the date of bankruptcy, shall be deemed vested as of such date with all the rights, remedies, and powers of a creditor then holding a lien thereon by such proceedings, whether or not such a creditor actually exists.

No one may doubt the authority of Congress to constitute a trustee in bankruptcy a judgment creditor with reference to federal tax laws. Clear and appropriate language to that end might have been included in Section 70(c) of the Act, but obviously was not. Or, Congress might have added trustees in bankruptcy to the categories of persons described in 26 U. S. C. A. 3672(a), as against whom the lien created by 26 U. S. C. A. 3670 is invalid until notice thereof has been filed by the collector as required by law, but it did not. Nor did it include the trustee in bankruptcy in the corresponding section 6323 of the Internal Revenue Code of 1954, 68A Sta. 779.

Nothing herein is intended to say that a trustee in bankruptcy does not occupy the fictitious position of judgment creditor in opposing the claims of conditional vendors and other creditors holding improperly filed or unfiled instruments of security. The holding here is circumscribed by the point for review and is confined to the proposition that a bankruptcy trustee is not a "judgment creditor" within the purview of 26 U. S. C. A. 3672.

Sociological and economic problems of tremendous scope immediately suggest themselves if this position be sound. However, they address themselves to Congress, and to the legislative process is committed the task of deciding whether in many bankruptcy cases all of the assets of the estate are to be distributed to federal and state taxing authorities to the exclusion of practically all other creditors, including wage earners (where real estate is involved).

An order will be entered remanding this cause to the Referee in Bankruptcy for further proceedings herein not inconsistent with this opinion.

Ct. D. 1778

INCOME TAXES—INTERNAL REVENUE CODE—DECISION OF SUPREME COURT

1. FEDERAL TAX LIEN—PRIORITY OVER ATTACHMENT LIEN—EFFECT OF STATE LAW.

A lien for Federal income taxes filed after the taxpayer's property had been attached by a creditor but before the latter had recovered judgment against the taxpayer was superior to the attachment lien. Although under Ohio law an attachment lien is designated "an execution in advance" the priority of the lien of the United States for unpaid taxes is a Federal question and the Federal courts are not bound by a State's characterization of its liens.

2. JUDGMENT REVERSED.

Judgment of United States Court of Appeals for the Sixth Circuit (209 F. 2d 258), affirming 109 F. Supp. 943, reversed.

SUPREME COURT OF THE UNITED STATES

United States of America, petitioner, v. *Michael P. Acri, Dollar Savings & Trust Company, the Dollar Savings & Trust Company of Youngstown, Ohio, guardian of the estate of Michael P. Acri, and Edward Oravitz, administrator of the estate of John Oravec, a. k. a., Oravitz, deceased*

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

[January 10, 1955]

OPINION

Mr. Justice MINTON delivered the opinion of the Court.

This case involves the relative priority between an attachment lien and the liens of the United States for unpaid taxes. The district court found the attachment lien prior to the liens of the United States, and the Court of Appeals affirmed without opinion. We granted certiorari, 347 U. S. 973.

On August 11, 1948, the United States filed suit in the District Court for the Northern District of Ohio to collect unpaid income taxes for the years 1942–1946 against one Acri and his wife. Acri was at the time in the penitentiary for the murder of one Oravec, whose personal representative, Oravitz, had, on August 6, 1947, in Mahoning County, Ohio, filed an action against Acri for wrongful death. On the same date, certain cash and bonds of Acri, which were in his safety deposit box in the Dollar Savings and Trust Company, were attached by Oravitz. The box was not opened until September 11, 1948, after the bank had been made guardian of Acri, at which time an inventory was filed. The personal representative, Oravitz, and the bank, as guardian of Acri, were made parties to the Government's suit.

On January 19, 1949, the personal representative of the murdered man recovered judgment against Acri in the sum of $18,500. In the meantime, on November 18, 1947, after the issuance of the writ of attachment, but more than a year before the judgment in the main action for wrongful death, the assessment lists for unpaid income taxes of Acri and his wife for the years 1942–1946 were received in the office of the Collector of Internal Revenue. On November 19, 1947, demand for payment was mailed to Acri. On November 21, 1947, a notice of the tax liens was filed in the office of the Recorder in Mahoning County, Ohio, which is the residence of the defendants and the location of the Acris' property, and the place where the action for wrongful death was begun. Notice and levy of the tax liens were served upon the Dollar Bank. It was stipulated that the only question involved was the relative priority of the attachment lien of the personal representative and the tax liens of the United States.

The issue here is identical with that in *United States* v. *Security Trust Co.*, 340 U. S. 47 [Ct. D. 1736, C. B. 1950–2, 151]. There the question was stated as follows:

"The question presented here is whether a tax lien of the United States is prior in right to an attachment lien where the Federal tax lien was recorded subsequent to the date of the attachment lien but prior to the date the attaching creditor obtained judgment."

Our answer here is the same as in the *Security Trust Company* case and for the same reasons.

The relative priority of the lien of the United States for unpaid taxes is as we said in *United States* v. *Waddill Co.*, 323 U. S. 353, 356, 357 [Ct. D. 1624, C. B. 1945, 459]; *Illinois* v. *Campbell*, 329 U. S. 362, 371; *United States v. Security Trust Co.*, 340 U. S. 47, 49, always a Federal question to be determined finally by the Federal Courts. The State's characterization of its liens, while good for all State purposes, does not necessarily bind this Court. *United States* v. *Waddill Co.*, 323 U. S. 353, at 357; *United States* v. *Gilbert Associates*, 345 U. S. 361 [Ct. D. 1757, C. B. 1953-1, 474]. Therefore, the fact that the Ohio courts had designated an attachment lien "an execution in advance," *Rempe & Son* v. *Ravens*, 68 Ohio St. 113, 67 N. E. 282, and treated it as a perfected lien at the time of attachment, does not bind this Court. We must look at the circumstances as we did in the *Waddill* case, where the Virginia court had held a landlord's lien was fixed, specific, and not inchoate. This Court, after examining the facts, found otherwise. In *Gilbert Associates*, the New Hampshire court had held that the assessment of a tax was a judgment and the United States' lien for taxes was not valid against the tax assessment made by the town within the meaning of section 3672 of the Internal Revenue Code.* We held that although New Hampshire might treat its tax assessments as judgments for State purposes, the assessment of the tax was not a judgment within the meaning of section 3672. We hold here that the attachment lien in Ohio is for Federal tax purposes an inchoate lien because at the time the attachment issued the fact and the amount of the lien were contingent upon the outcome of the suit for damages.

In argument it was pointed out that the statute of California involved in the *Security Trust* case was different because California courts had held an attachment lien to be inchoate and a mere notice of a more perfect lien to come, while Ohio courts had held it to be an execution in advance and a lien perfected as of the time of attachment. This distinction is immaterial for purposes of Federal law. This case is not to be distinguished from *United States* v. *Security Trust Co.*, 340 U. S. 47, and the judgment is Reversed.

Ct. D. 1779

FEDERAL TAXES—INTERNAL REVENUE CODE—DECISION OF SUPREME COURT

1. FEDERAL TAX LIEN—PRIORITY OVER LANDLORD'S DISTRESS FOR RENT UNDER LAWS OF SOUTH CAROLINA.

Where the landlord on April 7, 1952, filed request for distress warrant against taxpayer for unpaid rents and a receiver was appointed on April 8, 1952, the tax lien filed by the United States on April 10, 1952, was superior to the landlord's distress lien. The landlord's lien was not a mortgage, pledge, or judgment lien and the landlord was not a purchaser. Moreover, the distress lien was not perfected at the time the Government's lien was filed, since under South Carolina law taxpayer had 5 days in which to put up bond and free the property from the lien of distress.

2. JUDGMENT REVERSED.

Judgment of the Supreme Court of the State of South Carolina (78 S. E. 2d 277) reversed.

SUPREME COURT OF THE UNITED STATES

United States of America, petitioner, v. *R. P. Scovil, et al.*

On writ of certiorari to the Supreme Court of the State of South Carolina

[January 10, 1955]

OPINION

Mr. Justice MINTON delivered the opinion of the Court.

This case involves the relative priority of a landlord's distress for rent under the laws of South Carolina and a lien for unpaid taxes due the United States. The landlord, herein referred to as respondent, on April 7, 1952, filed in the Court of Common Pleas for Greenville County, South Carolina, an affidavit setting forth that the Roy Bass Motor Company was indebted to him for rent and requesting a

*"Such lien shall not be valid as against any mortgagee, pledgee, purchaser, or judgment creditor until notice thereof has been filed by the collector * * *" etc.

distress warrant which issued. The master's report shows only that the landlord for past due rent "proceeded on the 7th day of April 1952, to distress upon the assets of said corporation for said rent in arrears." The record does not disclose what was actually done in the distress proceedings. South Carolina Code Annotated, 1952, section 41–151, provides when the affidavit of a landlord is filed the magistrate may issue his distress warrant naming the amount due with costs and deliver the warrant to an officer for service. The officer shall forthwith demand payment [sec. 41–153], and if not paid, he shall distrain sufficient property on the rented premises to pay the amount, giving a list of property distrained together with a copy of the distress warrant to the tenant. The distress must be reasonable as to amount of property distrained on penalty of action for damages [sec. 41–158, 159]. The tenant has 5 days in which to put up bond and free the property from the lien of distraint [sec. 41–160].

The next day, April 8, 1952, a receiver was appointed for the corporate taxpayer-tenant as an insolvent. All of the assets of the corporation passed to the receiver who sold them and realized therefrom the fund over which this contest is waged.

For nonpayment of taxes due, the Collector of Internal Revenue received the proper assessment lists in his office on March 19, 1951, May 24, 1951, August 29, 1951, December 3, 1951, February 23, 1952, and February 28, 1952, and notice of these liens thereafter was filed in the proper office in Greenville County, South Carolina, on April 10, 1952. Section 3671 of the Internal Revenue Code provides that the lien for such unpaid taxes attaches when the assessment lists are received by the Collector. Therefore, long before the landlord obtained a distress warrant the Government's liens for taxes had attached.

The Supreme Court of South Carolina held that since the distress warrant was perfected before the receiver was appointed the landlord's distress lien was superior to the United States' priority created by section 3466, Revised Statutes, 31 U. S. C. section 191. 224 S. C. 233, 78 S. E. 2d 277. However, we find it unnecessary to pass upon the effect of that section. We hold that the Government must prevail because of its liens under section 3670, Internal Revenue Code.

The landlord had a lien other than a mortgage, pledge, or judgment lien. As to all other liens, such as the distress lien in the instant case, section 3672 of the Internal Revenue Code affords no protection. *United States* v. *Security Trust Co.*, 340 U. S. 47, 51 (concurring opinion) [Ct. D. 1736, C. B. 1950–2, 151]. Cf. *United States* v. *Gilbert Associates, Inc.*, 345 U. S. 361, 362–365 [Ct. D. 1757, C. B. 1953–1, 474]. Moreover, the distress lien was not perfected in the Federal sense at the time the Government's liens were filed. Such perfection is, of course, a matter of Federal law. *United States* v. *Waddill Co.*, 323 U. S. 353 [Ct. D. 1624, C. B. 1945, 459]; *Illinois* v. *Campbell*, 329 U. S. 362, 371. The 5-day period specified by section 41–160 of the South Carolina Code had not elapsed. During this time the tenant-taxpayer could have reacquired any interest the landlord may have had in his property by posting bond as provided by the Code. Therefore, such a lien was only a caveat of a more perfect lien to come, as we have so often held in other cases. *United States* v. *Security Trust Co., supra; United States* v. *Gilbert Associates, Inc., supra; United States* v. *Waddill Co., supra*, at 357–359; *New York* v. *Maclay*, 288 U. S. 290.

It was decided in the trial court and argued here that the landlord was a purchaser within the meaning of section 3672 of the Internal Revenue Code and, therefore, that the Government lien was invalid as to him. A purchaser within the meaning of section 3672 usually means one who acquires title for a valuable consideration in the manner of vendor and vendee. Obviously, the landlord was not a purchaser.

The judgment is Reversed.

Ct. D. 1780

FEDERAL TAXES—INTERNAL REVENUE CODE—DECISION OF SUPREME COURT

1. FEDERAL TAX LIEN—PRIORITY OVER GARNISHMENT LIEN—INSURANCE PROCEEDS.

The lien of a writ of garnishment filed on behalf of a litigating creditor of taxpayer for the purpose of attaching insurance proceeds agreed to be paid was not superior to a federal tax lien filed subsequent to attachment but prior to entry of judgment in state court.

Garnishee insurance company's right under Texas Rules of Civil Procedure to reasonable attorney's fees incurred in connection with suit is also subordinate to tax lien.

2. CASES FOLLOWED.

United States v. *Michael P. Acri, et al.* (U. S. Sup. Ct. decided January 10, 1955) and *United States* v. *Security Trust Co.*, 340 U. S. 47, followed.

3. JUDGMENT REVERSED.

Judgment of United States Court of Appeals for the Fifth Circuit (209 F. 2d 684), affirming decision of District Court (107 F. Supp. 405), reversed.

SUPREME COURT OF THE UNITED STATES

United States of America, intervenor, petitioner, v. the Liverpool and London and Globe Insurance Company, Ltd., and Sunnyland Wholesale Furniture Company

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

[January 10, 1955]

OPINION

Mr. Justice MINTON delivered the opinion of the Court.

This is a case involving priority of Federal tax liens and a lien of garnishment.

On March 8, 1952, fire destroyed certain property of Adams, engaged in a furniture business in Temple, Bell County, Texas. Respondent insurance company and another were insurers. The insurance companies agreed on the amount of the loss, and they were to share the payment equally. Before the insurance money was paid, a creditor of Adams, the Sunnyland Wholesale Furniture Company, on April 8, 1952, sued Adams on an open account. At the same time a writ of garnishment was issued and served upon the Liverpool & London & Globe Insurance Company, attaching the insurance funds due and owing Adams. On April 21, 1952, the assessment lists covering the unpaid Federal taxes of Adams and his wife for 1948 and 1950 were received in the office of the Collector of Internal Revenue for Texas. On April 26, 1952, notice of tax lien was filed in the office of the county clerk of Bell County, Texas, in favor of the United States for $10,417.57, with interest. Notice of the tax lien with warrants of distraint and notice of levy were served on the respondent insurance company. On June 20, 1952, judgment was entered against Adams in favor of Sunnyland for $2,516.70, with interest and costs. When the garnishee, the respondent insurance company, answered, it named the United States an additional party defendant and requested a determination of priorities of the garnishor and the United States, and asked for reasonable attorney's fees. The amendment was allowed, and the United States was served with process to appear in the state court. On petition of the United States the interpleader action was removed to the Northern District of Texas, and the United States was dismissed as a party defendant and permitted to file its complaint for foreclosure of its tax lien. The respondent insurance company paid $7,500.39 into the registry of the court and asked for an attorney's fee of $500. The district court held the lien of the garnishor superior to the liens of the United States for taxes and allowed the garnishee $500 for attorney's fees. The court of appeals affirmed, one judge dissenting.

The question of priorities is identical with that of *Acri*, No. 33, this day decided, and *United States* v. *Security Trust Co.*, 340 U. S. 47 [Ct. D. 1736, C. B. 1950–2, 151]. On the authority of those cases we hold the tax liens of the United States superior to the lien of the garnishor.

As to the attorney's fee allowed the garnishee insurance company, Rule 677, Vernon's Texas Rules of Civil Procedure, provides:

"Where the garnishee is discharged upon his answer, the costs of the proceeding, including a reasonable compensation to the garnishee, shall be taxed against the plaintiff; where the answer of the garnishee has not been controverted and the garnishee is held thereon, such costs shall be taxed against the defendant and included in the execution provided for in this section; where the answer is contested, the costs shall abide the issue of such contest."

The district court evidently found there was no contest between the insurance company and the other parties, and that the insurance company should be discharged with costs and allowance of a reasonable attorney's fee of $500. It, therefore, ordered the clerk to issue a check to the insurance company, payable out of the funds paid into the court by it.

If the garnishment lien is not prior to the Government liens, and we have held that it is not, certainly fees allowed in that proceeding are not prior to the Government liens, and the authorization of the payment of the attorney's fees prior to the Government liens was error. The costs and fees should be adjudged against the defendant, as provided by Rule 677.

The judgment is Reversed.

State of New Hampshire designates offices in which District Directors of Internal Revenue may file tax liens and certificates of release or discharge. See Rev. Rul. 55–134, page 196.

SUBCHAPTER C.—DISTRAINT

PART III.—GENERAL PROVISIONS

SECTION 3710.—SURRENDER OF PROPERTY SUBJECT TO DISTRAINT

(Also Part I, Section 6331; 26 CFR 301.6331–1.) Rev. Rul. 55–227

A notice of levy may be served on an instrumentality of a State to reach the accrued wages due an employee of that instrumentality in order to obtain satisfaction of his unpaid Federal taxes. I. T. 2405, C. B. VII–1, 72 (1928), modified.

Advice has been requested whether State and local governments and their agencies and instrumentalities are subject to levy and to the provisions of section 3710 of the Internal Revenue Code of 1939 for amounts owed as accrued salaries to their employees who are delinquent in the payment of their Federal taxes and for amounts owed as pensions to former employees with delinquent Federal taxes.

The statutes governing the collection of Federal taxes are broad and comprehensive. Section 3670 of the Code provides that, if any person liable to pay any tax neglects or refuses to pay the same after demand, the amount of the tax shall be a lien upon all property and rights to property, whether real or personal, belonging to such person. Section 3690 of the Code authorizes the Director to collect taxes by distraint and sale of the goods, chattels, or effects, including stocks, securities, bank accounts, and evidences of debt, of the person delinquent. Section 3691 lists the property exempt from seizure. Section 3692 empowers the Director to levy upon all property and rights to property, except such as are exempt by the preceding section, belonging to such person, or on which the lien provided in section 3670 exists. Subsection (a) of section 3710 imposes upon any person in possession of property, or rights to property, subject to distraint, a duty to surrender such property to the collector or his deputy upon proper levy and demand. Subsection (b) of section 3710 provides a penalty for violation of the above requirement in a sum equal to the

value of the property or rights not so surrendered, but not to exceed the amount of the taxes including penalties, interest and costs from date of levy. Subsection (c) of section 3710 provides that the term "person" as used in this section includes an officer or employee of a corporation or a member or employee of a partnership, who as such officer, employee, or member is under a duty to perform the act in respect of which the violation occurs. Section 3797(a)(1) provides that the term "person" when used in the Code shall be construed to mean and include an individual, a trust, estate, partnership, company, or corporation.

It has been held that a debt owed by a State to a taxpayer is property against which a Federal tax lien may be foreclosed. *United States* v. *Warren C. Graham et al.*, 96 Fed. Supp. 318, affirmed *State of California et al.* v. *United States*, 195 Fed. (2d) 530, certiorari denied, 344 U. S. 831. The Federal tax lien is a continuing lien applicable to after-acquired property. *Glass City Bank of Jeannette, Pa.* v. *United States*, 326 U. S. 265, Ct. D. 1651, C. B. 1945, 330.

I. T. 1557, C. B. II–1, 172 (1923), holds that the accrued salary of an employee held by an employer is an evidence of debt within the purview of the Federal collection statute (now section 3690 of the Internal Revenue Code of 1939) and may be levied upon the same as any other simple contract debt, such as a bank deposit. Accrued wages and other debts are subject to levy and distraint under section 3690. See *United States* v. *Long Island Drug Co.*, 115 Fed. (2d) 983; *Margaret R. Cannon et al.* v. *Nicholas*, 80 Fed. (2d) 934, Ct. D. 1113, C. B. XV–1, 313 (1935); *United States* v. *Ocean Accident & Guarantee Corp.*, 76 Fed. Supp. 277; and *Lucius Antrum* v. *United States et al.* U. S. D. C. for the District of Conn., decided December 14, 1953.

I. T. 2405, C. B. VII–1, 72 (1928), holds in part that I. T. 1557, *supra*, refers to salaries paid by private persons or corporations and that the analogy (of accrued wages to bank deposits) should not be extended to include salaries paid by a State or municipality operating public utilities and that accrued salaries of officers and employees of State operated public utilities may not be levied upon for unpaid taxes. In view of later court decisions that ruling has been regarded as obsolete for some years, but heretofore it has not been expressly revoked.

Where salaries or wages have accrued and funds appropriated for their payment are in the hands or possession of the appropriate State disbursing officials, the right to such funds then belongs to the employees and they may sue for and recover them. This right, being one to property, is expressly made subject to levy by the provisions of section 3692 of the Code, an overriding Federal law. The final act of payment to the employee is purely administrative and ministerial, and therefore a levy by the District Director of Internal Revenue under such circumstances constitutes no interference with sovereignty or with the performance of any executive governmental function. Pending payment, the State or its instrumentality is merely a custodian of the money due to the employee-taxpayer. The interference contention was raised in opposition to the taxation of State employees salaries in *Helvering* v. *Philip L. Gerhardt et al.*, 304 U. S. 405, Ct. D. 1343, C. B. 1938–1, 246. In that case the Court held that the wages and salaries of State employees are not exempt from

Federal income taxation. If not exempt from being taxed, they are not exempt from being subject to levy, for the lesser act of collecting an unpaid tax out of the debt due the taxpayer by distraint or levy, if necessary, is a related power and likewise does not interfere with sovereignty or the governmental function, but is a proper exercise of the enforcement provisions of the Federal revenue laws imposing the taxes. The constitutional power given to the Federal government is to lay and *collect* taxes.

The question whether section 3710 of the Code is applicable depends upon whether a State or local government, or its agency or instrumentiality, is a "person" in possession of property or rights to property of the taxpayer, within the meaning of that section. Closely related questions were considered and decided in *United States* v. *Warren C. Graham et al., supra*, where the State contended that it was not a "person" within the meaning of section 3678 (b) of the Code, and hence could not be made a party defendant to an action to enforce the Federal tax lien upon an indebtedness of the State to the taxpayer for certain rentals, and that the indebtedness was not property or a right to property of the delinquent taxpayer in the possession of the State. The Court, whose grounds and reasons were adopted in the opinion by the Court of Appeals for the Ninth Circuit, in its opinion stated in part as follows:

* * * With this contention I cannot agree. Nothing in the Internal Revenue Code, its legislative history, or the policy behind the administration of the law persuades me that Congress meant to exclude the state from those who could be made a party to this proceeding. The Supreme Court has shown no particular disposition when considering the meaning of the word "person" in Congressional Acts to exclude the states. *State of Georgia* v. *Evans*, 316 U. S. 159, 62 S. Ct. 972, 86 L. Ed. 1346, construing a section of the Sherman Act, 15 U. S. C. A. paragraph 1–7, 15 note. See also *State of California* v. *U. S. D. C.*, 46 F. Supp. 474, 477–478, three-judge court construing the Merchant Marine Act, 46 U. S. C. A. paragraph 866 et seq. In *State of Ohio* v. *Helvering*, 292 U. S. 360, 370, 54 S. Ct. 725, 78 L. Ed. 1307, the Supreme Court set forth numerous instances in which a State has been held to be a person within the meaning of some statute. Ultimately the question is usually wrapped up in the legislative environment of the act. There is nothing in the language of this act to indicate a narrow construction was to be placed upon the meaning of the word "person".

* * * * * * *

The contention that there is no property against which the plaintiff's tax liens may be foreclosed is without support. "Congress intended to subject all of a taxpayer's property, except that specifically exempt to the payment of taxes. "Property" is a word of very broad meaning and when used without qualification may reasonably be construed to include obligations, rights and other intangibles, as well as physical things. "Property" within the tax laws should not be given a narrow or technical meaning." *Citizens State Bank, Barstow, Texas* v. *Vidal*, 10 Cir. 114 Fed. (2d) 380, 382. Communications between state officials acting in their official capacity reveal that they considered that the state owed the taxpayer a specific sum of money. The uncontroverted evidence shows that the state entered into an agreement with the taxpayer as a result of which the state became indebted to the taxpayer. The debt of the state to the taxpayer comes within the purview of the tax lien. Sec. 3670, 3678, Title 26 U. S. C. A.

In *State of Ohio* v. *Helvering, et al., supra*, cited in the quotation, the Court found no merit in the contention that the State was not embraced within the meaning of the word "person" as used in a Federal statute which levied a tax upon every person who sells or offers for sale foreign or domestic distilled spirits, and which defined "person" to mean and include a partnership, association, company, or

corporation, as well as a natural person. See also *United States* v. *City of New York*, 82 Fed. (2) 242, 245.

Accordingly, it is held that State and local governments and their agencies and instrumentalities are subject to levy and to the provisions of section 3710 of the Code for amounts owed as accrued salaries to their employees who are delinquent in the payment of their Federal taxes and for amounts owed as pensions to former employees with delinquent Federal taxes.

To the extent that I. T. 2405, *supra*, holds that accrued salaries of officers and employees of State or municipally operated public utilities may not be levied upon for unpaid taxes, it is revoked.

This ruling, which is based on application of the provisions of the Internal Revenue Code of 1939, has equal application under the provisions of the Internal Revenue Code of 1954. See sections 6321, 6331, 6332, and 6334 of the Internal Revenue Code of 1954. See also regulations promulgated under section 6331 at section 301.6331–1(4)(ii) which provide: "Accrued salaries, wages, or other compensation of any officer, employee, or elected or appointed official of a State or Territory, or of any agency, instrumentality, or political subdivision thereof are also subject to levy to enforce collection of any Federal tax." T. D. 6119, page 145, this Bulletin.

SUBCHAPTER E.—SUITS BY UNITED STATES

SECTION 3740.—AUTHORIZATION TO COMMENCE SUIT

Ct. D. 1773

INCOME TAX—INTERNAL REVENUE CODE—DECISION OF SUPREME COURT

1. INCOME TAX EVASION—INDICTMENT—VALIDITY OF INDICTMENT SECURED BY DISTRICT ATTORNEY WITHOUT SANCTION BY ATTORNEY GENERAL'S OFFICE—EXECUTIVE ORDER 6166—POWER OF GRAND JURY.

Failure of the Attorney General to direct that a suit for recovery of income taxes or penalty be commenced does not bar prosecution for filing false and fraudulent income tax returns. Section 5 of Executive Order 6166, transferring to the Department of Justice responsibility for prosecuting federal offenses, and a Justice Department Circular, directing how this responsibility should be exercised, do not bar a District Attorney, on his own initiative, from presenting a tax evasion case to the grand jury, nor do they curtail power of grand jury to consider and investigate alleged crimes within its jurisdiction.

2. CRIMINAL PROCEEDINGS—26 U. S. C., SECTION 3740.

Section 3740, Internal Revenue Code of 1939 applies only to civil suits and not to criminal proceedings.

3. WITHDRAWAL OF PLEA OF NOLO CONTENDERE AFTER SENTENCE.

Petitioner may not, after sentence, withdraw a plea of nolo contendere to correct manifest injustice on the ground that the court misled petitioner and government counsel made promises of leniency or probation, where the evidence, without a doubt, refutes petitioner's claim and where no exception was taken to any statement prior to sentence.

4. JUDGMENT AFFIRMED.

Judgment of the United States Court of Appeals for the Tenth Circuit (212 F. 2d 125) affirmed.

SUPREME COURT OF THE UNITED STATES

Odom Farrell Sullivan, petitioner, v. *United States of America*

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

[December 6, 1954]

OPINION

Mr. Justice MINTON delivered the opinion of the Court.

Upon pleas of *nolo contendere* the petitioner was found guilty of violating the income tax laws by making and filing false and fraudulent returns. The District Court sentenced him to three years' imprisonment and fined him $13,000. The Court of Appeals affirmed, 212 F. 2d 125, and we granted certiorari, 347 U. S. 1010.

On February 28, 1952, a duly constituted grand jury for the District of Kansas indicted the petitioner on four counts for false and fraudulent statements in his individual tax returns and on two counts in another indictment for false and fraudulent returns of the Central Theatre Co., a corporation of which he was president. To these indictments the petitioner entered pleas of not guilty. He later withdrew these pleas, and to two counts of the indictment on his individual returns and to one count on the corporation returns, he entered pleas of *nolo contendere.* The other counts were dismissed.

Before the pleas of *nolo contendere* were entered, petitioner had filed motions to dismiss the indictments because the evidence upon which they were based was presented to the grand jury by the District Attorney without direction to do so by the Attorney General's office. These motions were overruled after argument and time for briefing. This presents the first question, namely, were the indictments faulty because, without sanction by the Attorney General's office, the District Attorney offered evidence to the grand jury upon which the indictments were returned? It is first contended by petitioner that pursuant to 26 U. S. C. section 3740,[1] the indictments could not be returned without authorization by that office. We agree with the Court of Appeals that this section applies only to civil suits and not to criminal proceedings. In the absence of words in their context requiring a different conclusion, the phrase "suits for recovery" ordinarily means civil suits and not criminal prosecutions. *Hepner* v. *United States,* 213 U. S. 103, 105–109; *Stockwell* v. *United States,* 13 Wall. 531, 542–543. One "recovers" in a civil action but prosecutes and punishes in a criminal proceeding.

The further contention is made that section 5 of Executive Order No. 6166,[2] and Circular Letter No. 2431 of the Department of Justice[3] required approval from the Attorney General's office before any evidence could be presented to the grand jury and that such direction was not given. It is admitted that no authorization was received from the Attorney General's office to present the evidence to the grand jury in the instant case; nor does the record reveal clearly that an emergency existed. Apparently none was reported to the Department of Justice as required by Circular Letter No. 2431.

Prior to Executive Order No. 6166, prosecutions for the violation of internal revenue laws were often referred directly to United States District Attorneys for presentation to grand juries. The purpose of section 5 of Executive Order No. 6166, among other things, was to transfer responsibility for the prosecution of criminal proceedings and suits by or against the United States in civil matters to the Department of Justice.

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[1] "No suit for the recovery of taxes, or of any fine, penalty, or forfeiture, shall be commenced unless the Commissioner authorizes or sanctions the proceedings and the Attorney General directs that the suit be commenced."

[2] "The functions of prosecuting in the courts of the United States claims and demands by, and offenses against, the Government of the United States and of defending claims and demands against the Government, and of supervising the work of United States attorneys, marshals, and clerks in connection therewith, now exercised by any agency or officer, are transferred to the Department of Justice.

"As to any case referred to the Department of Justice for prosecution or defense in the courts, the function of decision whether and in what manner to prosecute, or to defend, or to compromise, or to appeal, or to abandon prosecution or defense, now exercised by any agency or officer, is transferred to the Department of Justice.

"For the exercise of such of his functions as are not transferred to the Department of Justice by the foregoing two paragraphs, the Solicitor of the Treasury is transferred from the Department of Justice to the Treasury Department.

"Nothing in this section shall be construed to affect the function of any agency or officer with respect to cases at any stage prior to reference to the Department of Justice for prosecution or defense." Promulgated June 10, 1933, 5 U. S. C. secs. 124–132.

[3] "In accordance therewith, all United States Attorneys are directed to present evidence to a grand jury concerning violations of revenue laws of the United States only when authorized to do so by this office, unless an emergency calls for immediate action, in which event a full report should promptly be submitted." August 10, 1933.

It was not the purpose of the Executive Order to direct how the responsibility should be exercised but to fix it in the Department of Justice. How that responsibility was to be discharged was a matter for the Department. To make the system uniform, Circular Letter No. 2431 was sent to all District Attorneys. It was never promulgated as a regulation of the Department and published in the Federal Register. It was simply a housekeeping provision of the Department and was not intended to curtail or limit the well-recognized power of the grand jury to consider and investigate any alleged crime within its jurisdiction. See *United States* v. *Thompson*, 251 U. S. 407, 413–415; *Blair* v. *United States*, 250 U. S. 273, 282; *Hale* v. *Henkel*, 201 U. S. 43, 61–66; *Frisbie* v. *United States*, 157 U. S. 160–163.

Therefore, it is not contended that, aside from the Executive Order and the departmental letter, a grand jury may not consider evidence of crime known to the grand jurors or revealed by their investigation. It is only urged that the Executive Order and the departmental letter limited the action of the grand jury in respect to cases concerning violations of internal revenue laws. We hold the Order and the letter had no such restrictive effect, and the grand jury in this case was free to consider the evidence put before it by Government counsel without authorization from the Attorney General's office in Washington. The evidence was presented by the District Attorney who was a representative of the Department of Justice, notwithstanding that he failed to comply with the departmental directive. For this he is answerable to the Department, but his action before the grand jury was not subject to attack by one indicted by the grand jury on such evidence. The motions to dismiss were properly overruled.

Three days after judgment had been pronounced finding the petitioner guilty under his pleas of *nolo contendere* and sentences passed, the petitioner filed a motion asking for leave to withdraw his pleas. Later he filed an amended motion to withdraw the pleas and a petition for probation. In his motion to withdraw the pleas he gave the following reasons, (1) because of manifest injustice, (2) because he had entered his pleas under the mistaken belief, induced by the acts and statements of Government counsel, that he would be placed on probation, and (3) because of misconduct of the District Attorney. The District Court, after hearing argument, denied the motion and the petition for probation and filed its findings of fact, although there apparently was no request for them.[4] Under Rule 32(d)[5] a defendant may, after sentence, withdraw a plea of *nolo contendere* to correct manifest injustice. It is this provision that petitioner relies upon. He claims he was somehow misled by Government counsel to believe that if he entered the pleas of *nolo contendere* he would receive probation. By the court's findings, which, in light of the evidence, raise not a doubt, it is settled that the court in no way misled the petitioner and that Government counsel made no promises of leniency or probation.[6]

Petitioner argues that the United States Attorney misled him because his statement to the court during the hearing for probation was stronger than petitioner and his counsel expected. No exception was taken to anything the District attorney said, nor was any complaint made about such statement until after sentence was pronounced. We have read this statement and the affidavits of both counsel. The statement was factual, dispassionate and fair. The petitioner has failed to show any "manifest injustice" as required by Rule 32(d). During all of the proceedings from arraignment to denial of petition for probation, petitioner was represented by able and experienced counsel. In our opinion they were not and could not have been misled by the action and statements of Government counsel. The judgment is

Affirmed.

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[4] See Rule 23(c), Fed. Rules Crim. Proc.

[5] "*Withdrawal of Plea of Guilty.* A motion to withdraw a plea of guilty or of nolo contendere may be made only before sentence is imposed or imposition of sentence is suspended; but to correct manifest injustice the court after sentence may set aside the judgment of conviction and permit the defendant to withdraw his plea." Rule 32(d), Fed. Rules Crim. Proc.

[6] "At the June 23 hearing, the court specifically inquired of defendant's counsel as to whether any remark or statement made by the court to defendant's counsel had influenced them in advising the defendant to enter the pleas above mentioned. The court was assured by defendant's counsel and now finds that no statement of the court made to defendant's counsel or in the presence of defendant influenced the defendant's entrance of his pleas of nolo contendere.

"The court further finds that no promise of probation or lenience was made, either to the defendant personally or to his counsel by the United States Attorney or his assistant who handled the prosecution for the Government." Findings 9 and 10, R. 91–92.

CHAPTER 37.—ABATEMENTS, CREDITS, AND REFUNDS

SECTION 3770.—AUTHORITY TO MAKE ABATEMENTS, CREDITS, AND REFUNDS

Rev. Rul. 55-32

To the extent provided by section 3770(a) of the Internal Revenue Code of 1939, a claim for refund of Federal taxes paid erroneously by a trustee in bankruptcy in violation of the general priority provisions of section 64-A(2) of the Bankruptcy Act, 30 Stat. 544, as amended, will be considered and processed without requiring further action by the trustee and/or bankruptcy court.

SECTION 3771.—INTEREST ON OVERPAYMENTS

Rev. Rul. 55-339

Tax paid on Form 1040-C, U. S. Departing Alien Income Tax Return, is an advance payment of tax. Interest due on an overpayment of such tax as determined by a subsequently filed final return for the year, will run from the due date of the final return and not from the actual date of payment of the tax.

An individual income tax return was filed by an alien taxpayer when he departed from the United States. The return was prepared on Form 1040-C, United States Departing Alien Income Tax Return, and the tax was paid. Subsequently, a final return for the taxable year was filed and it was found that an overpayment of tax had been made at the time of filing Form 1040-C. Claim for refund was filed alleging interest was due on the overpayment from the date of payment of the tax.

Advice has been requested whether the payment of tax made at the time of the filing of a United States Departing Alien Income Tax Return on Form 1040-C, will cause interest on an overpayment of the tax to run from the date of such payment or whether it will commence to run on the due date of the final return for that year.

Section 3771(b) of the Internal Revenue Code of 1939 provides for the allowance of interest at the rate of 6 percent per annum on any overpayment in respect of any internal revenue tax commencing "from the date of the overpayment." Section 322(b)(4) provides that advance payments of tax shall be deemed to have been made not earlier than the last day prescribed by law for filing the return or paying the tax determined without regard to any extension of time.

Under section 146 of the Internal Revenue Code of 1939, and the regulations promulgated in connection therewith, an alien intending to depart from the United States is required to obtain a Certificate of Compliance and, unless he is not in default in making returns or paying his tax or has otherwise made satisfactory arrangements to secure such payment, to execute and file a return on Form 1040-C for the current taxable period. However, the tax payable at that time, on the basis of the return so filed, is only in an approximate amount, determined as nearly as may be, up to and including the date of his in-

tended departure. Regulations 118, section 39.146-1(b). The departing alien is still required to file a return for the full taxable year. G. C. M. 17195, C. B. XV-2, 107, at 110 (1936); *Ludwig Littauer & Co.* v. *Commissioner*, 37 B.T. A. 840.

It is held that the tax paid on Form 1040-C, United States Departing Alien Income Tax Return, is an advance payment of tax. Interest due on an overpayment of such tax as determined by a subsequently filed final return for the year, will run from the due date of the final return and not from the date of actual payment of the tax.

Allowability of interest on refunds of manufacturers' excise taxes erroneously or mistakenly paid by retail dealers. See Rev. Rul. 55-272, page 199.

SECTION 3771(g).—INTEREST ON OVERPAYMENTS: CLAIMS BASED UPON RELIEF UNDER SECTION 722

Interest on deficiencies in abated taxes through application of section 722 of the Internal Revenue Code of 1939 is not abatable. See Ct. D. 1781, page 435.

SECTION 3775.—CREDITS AFTER PERIODS OF LIMITATION

Credit or recoupment of barred overpayment of Federal estate tax against deficiencies in income tax. See Rev. Rul. 55-226, page 469.

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)-4: Final disposition of claim for refund as a determination. — Rev. Rul. 55-340

Section 3801(a)(1)(C)(ii) of the Internal Revenue Code of 1939 provides in effect that a disallowed claim for refund (other than one disallowed by reason of offsetting items) is not finally disposed of until the expiration of the 2-year statutory period allowed by section 3772 of the Code for instituting suit on the claim (unless suit is instituted prior to the expiration of such period). A taxpayer may not waive his right to institute suit, with respect to a disallowed claim, in order to expedite the treatment of the action taken on the claim as a determination under section 3801 of the Code. However, the necessity of waiting for the expiration of the 2-year period of limitation provided in section 3772 of the Code may be avoided in such cases as are

described in the regulations by the use of a closing agreement to effect a determination. See section 39.3801(a)(1)-4(c), (d) and (e) of Regulations 118.

SECTION 3804.—TIME FOR PERFORMING CERTAIN ACTS POSTPONED BY REASON OF WAR

Rev. Rul. 55-127

The period of time required to be disregarded under section 3804(f) of the Internal Revenue Code of 1939 with respect to individuals serving in or in support of the Armed Forces of the United States in the Korean combat zone, as defined in Executive Order 10195, C. B. 1951-1, 6, is applicable in the case of a joint return of an individual and his wife, but is not applicable to a separate return of the wife should she elect to file on that basis. The filing of a separate return by the wife for the taxable year does not preclude the filing of a joint return subsequently by the husband and wife for such taxable year within the time prescribed by law for the filing of a return by the husband. See section 472.301, T. D. 5279, C. B. 1943, 952. Thus, even though the wife files a short Form 1040, Individual Income Tax Return, or a 1040A, Employee's Optional U. S. Income Tax Return, an election to file a joint return or a separate long Form 1040 may be made on or before the postponed due date for the filing of a return by the husband. A joint return filed by the wife, under a proper power of attorney is a binding election; but, if no authorization has been conferred upon the wife such election is not binding upon the husband. When filing individual income tax returns under section 3804(f) of the Code, a statement, indicating the dates on which combat service, or hospitalization as the result of combat service, commenced and terminated, should be attached to each return.

Rev. Rul. 55-382

The decision in *George W. Carnrick* v. *Commissioner*, 9 T. C. 756, acquiescence, C. B. 1948-1, 1, holding that a deficiency notice had been timely mailed under circumstances stated therein, is not considered by the Internal Revenue Service to be in conflict with its position with respect to the period of time to be disregarded under section 3804 of the Internal Revenue Code of 1939 for the purpose of determining the due date for filing returns of income.

Advice has been requested relative to the method of computing the period of time to be disregarded by members of the Armed Forces of the United States under section 3804 of the Internal Revenue Code of 1939 with particular reference (1) to the period of time to be disregarded in determining the period of limitation on assessment and collection, and (2) to the period of time to be disregarded for the purpose of determining the due date for filing returns of income.

Section 3804 provides that in the case of certain individuals outside of the Americas after December 6, 1941, the period of time beginning and ending as of the dates therein mentioned "shall be disregarded in determining, under the internal revenue laws, in respect of any tax liability" of such individuals, whether the various acts enumerated in

that section were performed within the time prescribed by law. Among the acts so enumerated are those which are required to be performed within a period of limitation reckoned from the happening of an event and others which are required to be performed on or before certain fixed dates.

In *George W. Carnrick* v. *Commissioner*, 9 T. C. 756, acquiescence, C. B. 1948–1, 1, the Tax Court of the United States considered the timeliness, under section 3804(a) of the Code, of a notice of deficiency in 1941 taxes mailed in August 1945 to a taxpayer whose 1941 return was filed on March 16, 1942, and who, from February 1944 to February 1945, as a member of the Armed Forces of the United States, was continuously outside the Americas and in the European theatre of operations. In holding that the deficiency notice had been timely mailed to the taxpayer, the court stated in part as follows:

* * * Since the petitioner's return was filed on March 16, 1942, the statute of limitations would ordinarily have expired on March 16, 1945. However, by reason of section 3804(a) of the Code, the statute was tolled when petitioner embarked for the United Kingdom in February 1944, after the statute had run for less than two years. Under the provisions of that section, the period of time during which petitioner was continuously outside the Americas, and the next 90 days thereafter, are to be disregarded in determining whether the respondent sent the notice of deficiency within the prescribed time. Petitioner returned to this country in February 1945. Thereafter, the statute of limitations still had more than a year to run. Notice of deficiency was sent in August 1945, and so there can be no question but that its mailing was timely. * * *

The position taken by the Tax Court that, in cases where periods of time are to be disregarded under subsection (a) of section 3804 of the Code, in determining the time within which a notice of deficiency may be issued, there should be taken into account the period of time otherwise remaining as of the date of the taxpayer's departure from the continental United States, for the issuance of the notice of deficiency, is in harmony with the example given in section 472.203(c) of Treasury Decision 5279, C. B. 1943, 952, at page 968. That example holds that where, in the case of a member of the military forces, a period of time is to be disregarded under section 3804 in determining whether a petition was timely filed with the Tax Court, there should be taken into account the period otherwise remaining for the filing of such petition (under sec. 272 of the Code) as of the date of the taxpayer's departure from the continental United States:

EXAMPLE. On April 1, 1943, the Commissioner duly mailed to A, a member of the military forces of the United States, a notice of deficiency in respect of A's income tax for the taxable year beginning on January 1, 1941. Under the provisions of section 272, A has 90 days after the notice is mailed within which to file a petition with The Tax Court of the United States for a redetermination of the deficiency. A leaves the continental United States on May 1, 1943, and serves on active duty outside the continental United States until he returns thereto on April 30, 1944. A does not again serve outside the continental United States until after October 14, 1944. Under the provisions of this section the last day on which A may timely file a petition with The Tax Court of the United States for a redetermination of the deficiency is October 14, 1944. This date is determined as follows: the day on which the notice of deficiency was mailed, that is April 1, 1943, is excluded and the day of A's departure from the continental United States, that is, May 1, 1943, is included in determining that portion of the 90-day period which had expired on A's departure from the continental United States, which is 30 days; the period of time which is disregarded commences at the first moment of May 2, 1943, the day following A's departure from the continental United States, and terminates at the last moment of August 15, 1944, the 15th day of the fourth month following the month in which A ceases to serve out-

side the continental United States; and the 60th day thereafter (the 90 days for filing a petition with The Tax Court less 30 days thereof which had expired on A's departure from the continental United States) is October 14, 1944.

A similar position was taken in the example given in section 472.503 (a) of Treasury Decision 5279, C. B. 1943, 952, at page 971, regarding the time to be disregarded in the filing of a petition with the Tax Court, under section 3804, by *A*, a civilian, to whom the Commissioner had mailed a notice of deficiency in respect of his 1941 income taxes on February 1, 1943, and who had left the Americas for England on March 1, 1943, and had returned to the Americas on March 31, 1944.

In the same example it was held that if *A* (the civilian) makes his Federal income tax return for 1942 on a calendar year basis, "the due date for filing his income tax return for such taxable year", under section 3804, "is June 29, 1944 (the ninetieth day after *A*'s return to the Americas". It will be observed that there was not added to the time to be disregarded the period between March 1, 1943, when *A* left the Americas, and March 15, 1943, the date on which he would have been required to file his return for 1942 under section 53(a) of the Code.

The same rule would apply in determining the due date for filing an income tax return by a member of the military forces, under similiar circumstances.

The decision in the Carnrick case relating to the period of time to be disregarded under section 3804 of the Code, in determining whether a notice of deficiency was timely mailed to a member of the military forces of the United States, is not considered by the Internal Revenue Service to be in conflict with its position relating to the due date of a Federal income tax return where, by reason of the taxpayer's absence from the Americas, a period of time is to be disregarded under section 3804 in determining whether a return was timely filed.

SECTION 3806.—MITIGATION OF EFFECT OF RENEGOTIATION OF WAR CONTRACTS OR DISALLOWANCE OF REIMBURSEMENT

Effect of Vinson Act on contracts and subcontracts subject to or exempted from renegotiation under the Renegotiation Act of 1951, as amended and extended. See Rev. Rul. 55-173, page 104.

FEDERAL FIREARMS ACT

SECTION 1

REGULATIONS 131, SECTION 315.2: Definitions. Rev. Rul. 55-358

Section 1(3) of the Federal Firearms Act, 15 U. S. C. 901(3), defines a firearm as any weapon, by whatever name known, which is designed to expel a projectile or projectiles by the action of an explosive and a firearm muffler or firearm silencer, or any part or parts of such weapon. *Held*, a pistol or revolver grip, whether of standard

or custom design, is a component part of a firearm, as distinguished from accessories or attachments thereto, and therefore is a "firearm" within the purview of section 1(3) of the Act. While a dealer, defined in section 1(5) of the Act, 15 U. S. C. 901(5), may manufacture *special* stocks, etc., a license as a manufacturer is required to lawfully engage in the manufacture or importation of pistol or revolver grips in quantity lots for purposes of sale or distribution.

REGULATIONS 131, SECTION 315.40: General. Rev. Rul. 55-342
(Also Part I, Section 4181.)

A dealer who engages in the business of assembling firearms from component parts in quantity lots for purposes of sale or distribution in interstate or foreign commerce must procure a license as a manufacturer of firearms, pursuant to the provisions of the Federal Firearms Act. Liability to the manufacturer's excise tax imposed under section 4181 of the Internal Revenue Code of 1954 would be incurred on the subsequent sale of the firearms so produced.

Advice has been requested whether it is necessary to obtain a manufacturer's license in order to assemble rifles.

Section 1 of the Federal Firearms Act, 52 Stat. 1250, 15 U. S. C. 901, provides in part that the term "manufacturer" includes a person engaged in the business of manufacturing firearms, etc., for purposes of sale or distribution. It also provides that a "dealer" may repair or fit special barrels, stocks, trigger mechanisms or breech mechanisms to firearms.

The latter provision permits a licensed dealer to engage in such activity on an individual item basis but, in effect, precludes a dealer from engaging in the business of assembling firearms from component parts in quantity lots for purposes of sale or distribution in interstate or foreign commerce. Accordingly, in order to assemble firearms for such purposes, a license as a manufacturer of firearms must first be procured in accordance with the Federal Firearms Act. Also, liability for the manufacturer's excise tax, imposed under section 4181 of the Internal Revenue Code of 1954, is incurred on the subsequent sale of the firearms so produced from the component parts.

SECTION 1(3)

REGULATIONS 131, SECTION 315.27: Firearm. Rev. Rul. 55-175
(Also Sections 315.71, 315.72.)

A "barrel action" comprised of the barrel with front and rear sights; front and rear stock bands; receiver with complete bolt, trigger action, magazine, etc., assembled, is a firearm as defined by the Federal Firearms Act.

Advice has been requested whether "barrel actions" as described herein are firearms as defined by the Federal Firearms Act or whether they are considered parts with no records required to be kept nor excise taxes paid.

Section 1(3) of the Federal Firearms Act, 15 U. S. C. 901(3), defines a firearm as any weapon, by whatever name known, which is

designed to expel a projectile or projectiles by the action of an explosive and a firearm muffler or firearm silencer, or any part or parts of such weapon. Sections 315.71 and 315.72 of Regulations 131 require manufacturers and dealers to maintain complete and adequate records of all firearms manufactured or sold, including firearms in an unassembled condition, but not including parts of firearms.

It is held that a barrel action comprised of the barrel with front and rear sights; front and rear stock bands; receiver with complete bolt, trigger action, magazine, etc., is a weapon, complete except for the stock, which is capable of expelling a projectile or projectiles by the action of an explosive. Accordingly, component parts when considered as an assembled or unassembled unit, constitute firearms within the purview of section 1(3) of the Federal Firearms Act as distinguished from "parts of firearms" as contemplated by sections 315.71 and 315.72 of Regulations 131. However, the provisions of section 4181 of the Internal Revenue Code of 1954, are not applicable to the sale thereof.

SECTION 3

REGULATIONS 131, SECTION 315.40: General.

Referral of orders for firearms to manufacturers by licensed dealers. See Rev. Rul. 55–33, page 128.

REGULATIONS 131, SECTION 315.71: Manufacturers' records.

Classification of "barrel actions" under the Federal Firearms Act. See Rev. Rul. 55–175, page 562.

REGULATIONS 131, SECTION 315.72: Dealers' records.

Classification of "barrel actions" under the Federal Firearms Act. See Rev. Rul. 55–175, page 562.

PART III

ALCOHOL TAX RULINGS AND DECISIONS

SUBPART A.—RULINGS AND DECISIONS UNDER THE INTERNAL REVENUE CODE OF 1954

Rulings and decisions published in Part III, Subpart A, of the Internal Revenue Bulletin are based on the application of provisions of the Internal Revenue Code of 1954 and, unless otherwise noted therein, are published without consideration as to any application of the provisions of the Internal Revenue Code of 1939, the Federal Alcohol Administration Act, or 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

Rev. Rul. 55-100

Internal revenue distilled spirits bottle strip stamps (red, green and blue) will, on and after January 1, 1955, be furnished to qualified persons without cost. Under the provisions of section 5008 of the Internal Revenue Code of 1954, the charge of one cent each (one-fourth cent in the case of the denomination of less than one-half pint) for strip stamps, which was imposed under the Internal Revenue Code of 1939, is eliminated.

On and after January 1, 1955, strip stamps will be issued without charge on the basis of orders, properly approved, on Form 403, "Order for Bottle Stamps—Bottled-in-Bond Strips," and Form 428, "Order for Bottle Stamps—Other than Bottling-in-Bond Strips." The money value strip stamps heretofore provided will be devaluated and will continue to be issued after January 1, 1955, but without charge. It is contemplated that in the future the prefix symbol indicating the internal revenue collection district will be omitted from the symbols appearing on the strip stamps, but each stamp, except the strip stamps of less than one-half pint denomination, will bear a serial number.

The issuance of strip stamps without charge will make it unnecessary for owners of such stamps to present unusable stamps to District Directors for exchange. Such stamps will be turned over to the storekeeper-gauger for destruction.

Claims for redemption of strip stamps purchased on or before December 31, 1954, will be filed with the appropriate Assistant Regional Commissioner, Alcohol and Tobacco Tax, by the owners thereof. Such claims should be accompanied by the stamps, unless the stamps were reissued pursuant to a verified inventory, and an inventory of the stamps. Inventories of stamps held by domestic bottlers will be verified by storekeeper-gaugers at the premises and the stamps reissued to the bottlers for use on and after January 1, 1955. Stamps held in this country by importers will be surrendered to the appropriate Assistant Regional Commissioner, Alcohol and Tobacco Tax, for verification of inventory and, where desired, for reissuance. Stamps held abroad by importers or their agents or foreign suppliers may be surrendered for verification of inventories and reissuance, to such internal revenue or customs officers on duty abroad, as may be designated to perform this task by the Commissioner of Internal Revenue and the Commissioner of Customs. Claims of the type herein referred to will be processed in the regular manner for payment. Attention is invited to the regulations which provide that the redemption of this kind of stamp may be made only in quantities of the money value of $5 or more and where claim is filed within 2 years from the date of issue of the stamps.

SECTION 5009.—STAMPS FOR DISTILLED SPIRITS WITHDRAWN FOR EXPORTATION

Procedure for handling stamps to be affixed to packages and casks of distilled spirits and alcohol intended for export, under the Internal Revenue Code of 1954. See Rev. Rul. 55-102, page 569.

SUBPART C.—WINES

SECTION 5041.—IMPOSITION AND RATE OF TAX

(Also Section 5051.) Rev. Rul. 55-101

Under the provisions of the Internal Revenue Code of 1954, and the regulations promulgated pursuant thereto, the method of payment of internal revenue excise taxes on beer and wine imposed by sections 5051 and 5041 of the Code of 1954 will be by tax returns instead of by stamps. See 26, the Beer Regulations, CFR Part 245, and the Wine Regulations, 26 CFR Part 240, effective January 1, 1955. Under such regulations, the sale of beer and wine stamps was discontinued as of the close of business on December 31, 1954.

Form 2034, "Beer Tax Return," provides spaces for showing the name and address of the brewery and for the date and signature of the person executing the return, as well as the "capacity" in which

he signs. There are five lines at the top of the form for entering the amounts of the total taxes due from Schedule A, plus adjustments, gross tax, minus adjustments, and tax to be paid with the return. Schedule A provides for showing the total barrels of keg beer and bottled beer, as well as the amount of tax, which is the same amount to be entered on line 1 at the top of the form. Schedules B and C will be used for reflecting information on adjustments which will increase or decrease the amount of tax due the Government. At the top of the return form, space has been provided for showing the "Serial No." of the return which, for each taxpayer, will begin with "1" on January 1 of each calendar year.

Form 2050, "Wine Tax Return," provides space at the top for showing the name of the taxpayer, the operating bonded name of the winery or wine cellar and the number and address thereof. Immediately below, five spaces are provided for showing the total tax from Schedule A, adjustments from Schedule B, total, less credit adjustments from Schedule C, and the amount of tax to be paid with the return. Spaces are then indicated for the signature of the individual signing the return, the capacity in which he signs, and the date. Schedule A provides for information showing the computation of the tax, and Schedules B and C provide spaces for indicating the plus and minus adjustments. There is also provided at the top of the form a space for showing the serial number of the return. Such serial number will begin with "1" for each taxpayer on the first day of each calendar year.

Form 2052, "Prepayment of Wine Tax," has been adopted as the form for use of wineries and wine cellars in connection with the prepayment of the wine tax. Such form is self-explanatory and will be serially numbered in the same manner as Form 2050.

The beer tax return, Form 2034, will be prepared in quadruplicate and will be submitted, with the accompanying remittance, to the District Director of Internal Revenue not later than the close of the business day next succeeding that on which the tax liability is incurred, except that Form 2034 need not be prepared nor the remittance of the tax made until the total gross tax (for one or more days) reaches $100. However, regardless of the amount of gross tax, Form 2034, with remittance, will be prepared and filed covering the last day or days of the next preceding month, even though the amount of tax due is less than $100. The time for filing the wine tax return, Form 2050, is the same, except that the tax due will be allowed to accumulate until the total for successive days is $10 instead of $100.

The original and one copy of Form 2034 or Form 2050, with remittance in full for the net amount of tax, will be mailed or delivered to the District Director of Internal Revenue. One copy of the return will be retained by the taxpayer, and the remaining copy, in the case of brewers, will be transmitted to the Assistant Regional Commissioner, Alcohol and Tobacco Tax, with Form 103, "Brewer's Monthly Report of Operations," not later than the 10th day of the succeeding month. The tax may be paid by cash, or by check or money order made payable to the "District Director of Internal Revenue." The Wine Regulations provide that where the proprietor of a bonded winery or a bonded wine cellar desires to remove wine subject to tax in an amount in excess of his tax deferral bond coverage, Form 2052 will be used

and filed in duplicate with the District Director of Internal Revenue, accompanied by an appropriate remittance.

Beer and wine stamps which were not used and which were in the hands of brewers and proprietors of wine cellars and wineries at the close of business on December 31, 1954, may be submitted for redemption on Form 843 to the Assistant Regional Commissioner, Alcohol and Tobacco Tax. (See the Miscellaneous Regulations Relating to Liquor, 26 CFR Part 170.)

Copies of the several forms which are discussed in this Revenue Ruling are available from the offices of the Assistant Regional Commissioner, Alcohol and Tobacco Tax.

SUBPART D.—BEER

SECTION 5051.—IMPOSITION AND RATE OF TAX

Procedure for handling beer tax returns under the Internal Revenue Code of 1954, and the disposition of unused beer stamps. See Rev. Rul. 55-101, page 566.

SECTION 5053.—EXEMPTIONS

26 CFR 245.291: Reciprocating foreign countries.

Costa Rica added to list of reciprocating foreign countries. See Rev. Rul. 55-362, page 577.

SECTION 5057.—REFUND AND CREDIT OF TAX, OR RELIEF FROM LIABILITY

26 CFR 245.253: Beer lost or destroyed by fire, casualty, or act of God. — Rev. Rul. 55-343

Section 5057(b) of the Internal Revenue Code of 1954 and section 245.253 of the Beer Regulations permit the refund of tax or allowance of credit for the tax paid on beer lost as a result of breakage before the transfer of title thereto to any other person. Sections 245.254 and 245.255 of the regulations establish the procedure for the filing of claims for refund or credit, respectively, and require that claims under section 5057 of the Code must be filed within 6 months from the date of the loss. *Held*, due to the frequency of losses of beer as a result of breakage, brewers should file claims on a monthly basis for refund of tax or for allowance of credit for the tax paid on beer so lost before title to the beer has been transferred to another person. The daily summary record of the removal of bottled beer, required by section 245.351 of the Beer Regulations, must be kept by the brewer showing the quantities of beer lost by breakage after removal but while still owned by the brewer.

SUBPART E.—GENERAL PROVISIONS

SECTION 5061.—METHOD OF COLLECTING TAX

(Also Section 5009.) Rev. Rul. 55-102

Section 5061 of the Internal Revenue Code of 1954 provides that the taxes on distilled spirits and on other products shall be paid by return, with the proviso that the taxes shall continue to be paid by stamp until the Secretary or his delegate shall, by regulations, provide for the payment of the taxes by return. The regulations provide for extending the use of the existing distilled spirits excise tax stamps to cover packages of distilled spirits, and also provide that storekeeper-gaugers will issue wholesale liquor dealer's stamps in appropriate instances, thereby eliminating the further use of the distilled spirits coupon stamps for taxpaying distilled spirits.

Under the regulations issued pursuant to section 5009 of the Internal Revenue Code of 1954, the five and ten cent stamps affixed to packages and casks of distilled spirits intended for export will be furnished by District Directors of Internal Revenue without charge, upon receipt of Form 206, "Distilled Spirits for Exportation, Free of Tax," properly executed and accompanied by Form 1520, "Report of Spirits Gauged," or Form 1456, "Alcohol for Export," properly executed and accompanied by Form 1440, "Report of Alcohol Gauged." The stamps now being used will continue to be issued until such time as new stamps may be provided.

SECTION 5062.—REFUND AND DRAWBACK IN CASE OF EXPORTATION

REGULATIONS 28, SECTION 176.11a: Reciprocating foreign countries.

Costa Rica added to list of reciprocating foreign countries. See Rev. Rul. 55-362, page 577.

SUBCHAPTER B.—DISTILLERIES

PART I.—ESTABLISHMENT

SECTION 5173.—DISTILLERY FIXTURES AND EQUIPMENT

26 CFR 235.129: Bottling tanks. Rev. Rul. 55-56

Section 235.129 of the Rectification of Spirits and Wines Regulations provides in part that outlet pipe connections on bottling tanks must be equipped with check valves. This requirement applies to pipelines attached to bottling tanks installed at rectifying plants prior to existing regulations as well as those installed subsequent thereto.

SECTION 5193.—DRAWING, GAUGING, AND MARKING OF DISTILLED SPIRITS

26 CFR 225.415: To change kind of cooperage. Rev. Rul. 55-40

Neutral grain spirits of 190 degrees of proof may be received at an internal revenue bonded warehouse, reduced in proof to 111 degrees of proof in bulk gauging tanks in the regauge room of the warehouse, and drawn off into reused wooden barrels for the purpose of improving the quality of the spirits.

Advice has been requested whether it is permissible to receive neutral grain spirits at an internal revenue bonded warehouse at 190 degrees of proof, dump such spirits into bulk gauging tanks in the regauge room in order to reduce the proof thereof to 111 degrees and draw the spirits off into reused wooden barrels, and, if so, what serial numbers should be placed on the packages.

Section 225.415 to section 225.417, regulations relating to the warehousing of distilled spirits, make provision for the transfer of spirits from one kind of cooperage to another and establish the procedure to be followed relative thereto. Section 225.408 provides in part that spirits in warehouse storage tanks which were produced at 190 degrees or more of proof may be reduced in such storage tanks to not less than 111 degrees of proof prior to being drawn into packages. Section 225.411 of the regulations provides that all packages filled from warehouse storage or gauging tanks shall be serially numbered, separately from packages filled at the distillery, beginning with number 1, preceded by the letter "T," as T-1, T-2, etc.

While the regulations do not specifically provide for the proposed procedure, it is held that the use of bulk gauging tanks for such transfer, dumping, reducing in proof and filling of packages with distilled spirits, in accordance with the applicable provisions of Regulations 10, as indicated above, constitutes substantial compliance therewith and may be permitted, upon proper request, by the Assistant Regional Commissioner, Alcohol and Tobacco Tax. Such operations may be performed only at such times as there are no regauge activities being conducted and when the services of a storekeeper-gauger are available for necessary supervision. The packages in which the spirits are placed after reduction in proof should be serially numbered in accordance with Section 225.411.

SECTION 5194.—TRANSFER OF SPIRITS AT REGISTERED DISTILLERIES

26 CFR 225.124: Pipelines. Rev. Rul. 55-359
(Also 26 CFR 225.581; 235.383.)

Distilled spirits may be taxpaid in two or more bulk gauging tanks of an internal revenue bonded warehouse for transfer by pipeline to a rectifying plant for perfecting blends at such plant.

Advice has been requested whether distilled spirits may be taxpaid in excess of the amount required for a blend, a partial transfer by pipeline made to the rectifying plant processing tank, and the rem-

nants remaining in the gauging tanks subsequently transferred to a separate processing tank.

Section 225.581 of the Regulations relating to the Warehousing of Distilled Spirits provides in part that when spirits have been gauged or regauged for taxpayment they must be promptly taxpaid and removed from the warehouse. Section 225.124, relative to pipeline transfers, requires that the pipelines must be so arranged as to permit complete drainage or emptying after each transfer of spirits.

Section 235.383 of the Regulations relating to the Rectification of Spirits and Wines, covering the receipt of spirits at a rectifying plant by pipeline, by reference to section 235.382, requires the rectifier to give notice on Form 122, Rectifier's Notice of Dumping and Rectification, to the internal revenue officer assigned to the rectifying plant immediately upon the transfer of spirits into processing tanks.

In order to utilize the maximum gauging tank facilities in the instant case, the proprietor desires to taxpay in excess of the amount of spirits needed for each batch of spirits to be blended at the rectifying plant. The exact amount of each type of spirits required in a blend would be transferred from the warehouse gauging tank to a processing tank at the rectifying plant. The gallonage remaining in the gauging tank would be retained temporarily. After the required amount of each type of spirits had been transferred, the pipeline would be cleared by air. Subsequently, the remnants remaining in each tank would be pumped to another processing tank and the pipeline again cleared by air. This procedure would be continued until all desired batches of blended spirits had been completed in the rectifying plant and all remnants had been transferred to the processing tank containing remnants only.

It is held that distilled spirits may be taxpaid in two or more bulk gauging tanks of an internal revenue bonded warehouse in excess of the actual needs for perfecting blends at a rectifying plant and the remnants of such spirits left in the warehouse tanks temporarily after the initial quantities needed have been withdrawn. However, the withdrawal of the total quantity of spirits from each tank must be completed expeditiously and within a 24-hour period in substantial compliance with section 225.124 and section 225.581. Also, Forms 122 must be prepared after the receipt of the last deposit and the last remnant in the respective processing tanks for each batch completed in the rectifying plant, in substantial compliance with section 235.383.

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26 CFR 225.581: Immediate removal upon taxpayment.

Taxpayment of distilled spirits in two or more bulk gauging tanks of an internal revenue bonded warehouse in excess of the actual needs for perfecting blends at a rectifying plant. See Rev. Rul. 55-359, page 570.

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26 CFR 235.383: Receipt by pipeline.

Taxpayment of distilled spirits in two or more bulk gauging tanks of an internal revenue bonded warehouse in excess of the actual needs for perfecting blends at a rectifying plant. See Rev. Rul. 55-359, page 570.

PART III.—GENERAL PROVISIONS RELATING TO DISTILLERIES AND DISTILLED SPIRITS

SECTION 5212.—PREVENTION AND DETECTION OF FRAUD

26 CFR 182.526: Withdrawal for taxfree use or for export. (Also 5555; 182.643.) — Rev. Rul. 55-321

Section 182.526 of the Industrial Alcohol Regulations requires in part that when alcohol is withdrawn free of tax from an industrial alcohol plant or a bonded warehouse for scientific purposes, use of hospitals, etc., there shall be stenciled on the Government head of each package or side of each case the purpose of withdrawal, such as "Hospital Use," "Scientific Purposes," etc. *Held*, in cases where the withdrawal permit, Form 1450, Alcohol for Use by States, Municipalities, Hospitals, Colleges, Scientific Institutions, Etc., does not show the specific purpose for which taxfree alcohol is withdrawn, it will be sufficient to show on the package and on Form 1440, Report of Alcohol Gauged, the purpose of withdrawal as "Scientific," or an appropriate abbreviation thereof.

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26 CFR 225.640: Refilling, gauging, and marking packages of taxpaid spirits withdrawn from a gauging tank. (Also Federal Alcohol Administration Act, Section 5(e); FAA Regulations No. 5, Section 21.) — Rev. Rul. 55-399

Procedure with respect to the marking and branding of wholesale liquor dealer packages containing straight whisky taxpaid at the end of 8 years and consolidated in the original packages which are then coated with paraffin, and the subsequent labeling of such spirits when bottled.

Advice has been requested whether homogeneous straight whisky, which is taxpaid at 8 years of age and consolidated in the original containers as wholesale liquor dealer packages, may still be designated according to the original class and type if the wholesale liquor dealer packages are coated on the outside with paraffin. If so, further advice has been requested concerning the markings and brands to be placed on the wholesale liquor dealer packages.

Section 21, Class 2 (b), (c), and (d) of Regulations No. 5 provides that whisky bottled on or after July 1, 1938, and aged in charred new oak cooperage for not less than 24 calendar months may be designated "straight whisky" if a distillate from fermented mash of grain distilled at not more than 160 degrees of proof and withdrawn from the cistern room of the distillery at not more than 110 degrees and not less than 80 degrees proof, whether or not such proof is further reduced prior to bottling to not less than 80 degrees proof; and further as "straight rye whisky" or "straight bourbon whisky" if distilled from a fermented mash of grain of which not less than 51 percent is rye grain or corn grain, respectively, and aged in charred new oak cooperage. The regulations define "age" in the case of American type

whisky, other than the various types of corn whisky, as that period during which, after distillation and before bottling, distilled spirits have been kept in charred new oak containers. Section 39(a)(2) of the regulations requires that the age of any of the types of straight whisky be stated substantially as follows: "This whisky is (*years and/or months*) old."

Whisky produced and aged in accordance with the standards referred to and which is bulk gauged solely for taxpayment and return (consolidated) to the original packages for bottling at a later date, would be considered as having remained in the original oak containers from the date of deposit in the warehouse. Therefore, the classification of the spirits and the privilege of claiming age thereon would remain unchanged. However, the provision in the regulations for claiming age contemplates the storage of the spirits in standard oak containers under normal conditions. Therefore, and in accordance with the required age statement in the case of straight whisky, age may be claimed only for the time the whisky in question was stored in the warehouse in standard oak containers under normal conditions. Since no age may be claimed on whisky for the period of its storage in cooperage coated with paraffin, the maximum age to be shown on the labels when the whisky is bottled may not be in excess of 8 years.

The wholesale liquor dealer packages should be marked as indicated in the applicable sections of the Regulations relating to the Warehousing of Distilled Spirits, particularly sections 225.640 and 225.641. If the original barrels to be used for repackaging the taxpaid whisky are coated with paraffin, such treatment would make the barrels comparable to paraffin lined barrels from the standpoint of claiming age and the "kind of cooperage" should be marked on the barrels as "PAR." If the original barrels to be used for repackaging the taxpaid whisky marked "C" are not so treated, the kind of cooperage to be shown on the barrel may be designated as "C" in accordance with the intent of section 225.640 of the regulations.

SECTION 5217.—EXEMPTIONS RELATING TO NATIONAL EMERGENCY TRANSFERS

26 CFR 220.554: Vodka. Rev. Rul. 55-114
(Also Treasury Decision 5864, Section 171.195.)

> Spirits, including alcohol, transferred to a registered distillery pursuant to Treasury Decision 5864, C. B. 1951-2, 248, may not be redistilled or otherwise used in the production of vodka at a registered distillery.

Advice has been requested whether alcohol transferred from an industrial alcohol plant or an industrial alcohol bonded warehouse to an internal revenue bonded warehouse and redesignated as neutral spirits, pursuant to the provisions of Treasury Decision 5864, C. B. 1951-2, 248, may be transferred to a registered distillery for the manufacture of vodka.

For the purpose of assuring availability of adequate supplies of alcohol at 160° of proof or more for Government use in case of a national emergency, section 3183 of the Internal Revenue Code of 1939 and Treasury Decision 5864, issued pursuant thereto, authorize, among other things, the transfer of alcohol from an industrial alcohol

plant or an industrial alcohol bonded warehouse to a distillery or internal revenue bonded warehouse for redistillation or storage or any other purpose deemed necessary for the national defense, with the privilege of withdrawal therefrom, *if of a proof of 160° or more*, for any taxfree purpose authorized by sections 3100 to 3126, inclusive, of the Internal Revenue Code of 1939 (sections 5301 through 5320 of the Internal Revenue Code of 1954) or for any purpose authorized for like spirits produced at a distillery. These provisions were incorporated in section 5217 of the Internal Revenue Code of 1954.

Section 220.554 of the Distilled Spirits Regulations (formerly section 183.533 of Regulations 4) provides in part that neutral spirits *which are reduced to not more than 110° of proof* and after such reduction in proof are so treated by one of the methods set forth in the regulations so as to be without distinctive character, aroma, or taste shall be branded "Vodka." This provision is based on section 21(a) of of the Federal Alcohol Administration Regulations No. 5, relating to the labeling and advertising of distilled spirits, which prescribes a standard of identity for "Vodka" in like language. Thus, although "Vodka" may be produced at a registered distillery, the regulations above cited require withdrawal at not more than 110° of proof and so conflict with the requirement that alcohol if transferred to a registered distillery or an internal revenue bonded warehouse and removed for beverage purposes be withdrawn at a proof of 160° or more.

Therefore, there is no authority for transferring alcohol from an industrial alcohol plant or industrial alcohol bonded warehouse to an internal revenue bonded warehouse for later transfer to a registered distillery for redistillation and ultimate removal from bond as "Vodka" even though the alcohol is redesignated as "neutral spirits" in the internal revenue bonded warehouse under section 171.233 of Treasury Decision 5864.

However, alcohol or neutral spirits transferred to internal revenue bonded warehouses from industrial alcohol plants and industrial alcohol bonded warehouses pursuant to Treasury Decision 5864 may be withdrawn, if 160° of proof or more, taxpaid and then transferred to a rectifying plant for the production of "Vodka." See Rev. Rul. 54–336, C. B. 1954–2, 557.

TREASURY DECISION 5864, SECTION 171.195: Authorized removals.

Production of vodka from spirits transferred pursuant to Treasury Decision 5864, C. B. 1951–2, 248. See Rev. Rul. 55–114, page 36.

SUBCHAPTER C.—INTERNAL REVENUE BONDED WAREHOUSES

PART II.—OPERATIONS

SECTION 5241.—SUPERVISION OF OPERATIONS

26 CFR 225.352: Keys to proprietor's locks. Rev. Rul. 55–360

The proprietor of an internal revenue bonded warehouse may affix his locks to any doors between interior parts of a warehouse building

or to any of the outside doors of an individual building, provided that as many keys to each of the proprietor's locks are furnished to the Assistant Regional Commissioner, Alcohol and Tobacco Tax, as may be required. Where the outside doors of a building are to be secured with proprietor's locks, such locks should be affixed in such a manner that the Government lock can be independently affixed and removed.

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26 CFR 225.355: Warehouse to be kept locked. Rev. Rul. 55-115

Section 225.355 of the Warehousing Distilled Spirits regulations, which relates to the locking of internal revenue bonded warehouses, provides in part that where the distilled spirits or other property is in imminent danger of loss by fire, flood, or other casualty or where the safety of the proprietor or his employees is endangered, and it is impracticable to first obtain authorization from the storekeeper-gauger in charge or the Assistant Regional Commissioner, Alcohol and Tobacco Tax, city or State fire or police officials or the proprietor of the warehouse may remove seals or locks for the purpose of preventing loss of property or of avoiding danger to the safety of personnel.

In order to advise the plant proprietor and public or private fire or police organizations relative to the breaking of such locks, the following statement may be placed on or near warehouse doors in the form of signs or warnings:

IN THE EVENT OF SERIOUS EMERGENCY

IF ENTRANCE IS NECESSARY TO PREVENT OR COMBAT FIRE, FLOOD, OR OTHER DISASTER, THE LOCKS ON THIS WAREHOUSE MAY BE BROKEN BY MEMBERS OF PUBLIC OR PRIVATE FIRE OR POLICE ORGANIZATIONS, OR THE PROPRIETOR. WHEN SUCH ENTRANCE BY FORCE IS MADE, THE PROPRIETOR MUST NOTIFY THE STOREKEEPER-GAUGER WITHOUT DELAY, AND MAINTAIN STRICT GUARD UNTIL HIS ARRIVAL.

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26 CFR 225.357: Admittance of proprietor. Rev. Rul. 55-361
(Also 26 CFR 225.359.)

Although the gauging of spirits at an internal revenue bonded warehouse is prohibited under ordinary circumstances except for official purposes, the provisions of section 225.357 of the Regulations relating to the Warehousing of Distilled Spirits for access to the spirits for "other legitimate purposes" is interpreted as permitting the taking of gross and net weights and proofs of spirits in specific instances, such as loss or quality studies, etc., with the approval of the Assistant Regional Commissioner, Alcohol and Tobacco Tax, where the data obtained would be of interest to the Government as well as to the proprietor.

Advice has been requested regarding the regauge of experimental packages of distilled spirits at the end of the experiments conducted in an internal revenue bonded warehouse for the purpose of determining the rate of loss sustained during storage.

The commercial gauging of spirits remaining in storage is prohibited by section 225.359 of the Regulations relating to the Warehousing of Distilled Spirits, which provides, "Spirits shall not be gauged except as required for official purposes." Section 225.357 of the regula-

tions makes provision for the proprietor of an internal revenue bonded warehouse to have admittance, in the presence of a storekeeper-gauger, to the warehouse and the spirits therein for the purpose of repairing cooperage, taking necessary measures to prevent waste of the spirits by leakage or for other legitimate purposes.

The gauging of spirits in the manner prescribed in the regulations, in specific instances such as loss or quality studies, etc., with the approval of the Assistant Regional Commissioner, Alcohol and Tobacco Tax, where the data obtained would be of interest to the Government as well as to the proprietor, comes within the scope of "other legitimate purposes" and therefore is not in violation of section 225.359 of the regulations. This work should be done at a time or times when a storekeeper-gauger is available for the required supervision.

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26 CFR 225.359: Commercial gauging.

Gauging of spirits in specific instances, such as loss or quality studies with the approval of the Assistant Regional Commissioner, Alcohol and Tobacco Tax. See Rev. Rul. 55-361, page 575.

SECTION 5247.—WITHDRAWAL OF SPIRITS FOR EXPORTATION

26 CFR 182.594: Export bonds. Rev. Rul. 55-116

An exporter may execute one bond, Form 1495, Continuing Export Bond (Alcohol Withdrawn Tax-Free for Exportation) covering exportations from more than one industrial alcohol bonded warehouse operated in the same internal revenue region.

Advice has been requested whether one continuing export bond on Form 1495 may be executed covering exportations from more than one industrial alcohol bonded warehouse in lieu of a separate export bond for each such industrial alcohol bonded warehouse.

Section 182.594 of the Industrial Alcohol Regulations provides in part that a continuing bond, Form 1495, may be filed by the exporter to cover exportations of alcohol from an industrial alcohol bonded warehouse from time to time and that the penal sum of the bond shall be sufficient to cover the tax at the distilled spirits rate on the maximum quantity of alcohol that may remain unaccounted for at any one time but not in excess of $200,000 or less than $1,000.

There is no provision in the regulations which would prohibit the filing of one bond by an exporter to cover withdrawals for exportation of alcohol from more than one industrial alcohol bonded warehouse. Accordingly, one bond, Form 1495, may be executed by an exporter covering exportations from more than one industrial alcohol bonded warehouse operated in the same internal revenue region. The penal sum of the bond must cover the tax on the maximum quantity of alcohol that may remain unaccounted for at any one time so that the total tax on such quantity of alcohol does not exceed the maximum amount stated in the bond. Also, consent of surety must be filed specifying any additional warehouses from which withdrawals will be made.

SECTION 5248.—WITHDRAWAL OF SPIRITS WITHOUT PAYMENT OF TAX

26 CFR 182.630b: Reciprocating foreign countries. Rev. Rul. 55-362 [1]
(Also 5362, 5053, 5062; 26 CFR 225.861, 240.691, 245.291; Regulations 28, Section 176.11a.)

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 Costa Rica 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. 1954-1, 32, is hereby modified to include Costa Rica.

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 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	Norway
Bahama Islands	Ecuador	Peru
Belgium	France	Sweden
Bermuda	Israel	Switzerland
Brazil	Italy	United Kingdom
Canada	Japan	
Costa Rica	The Netherlands	

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26 CFR 225.861: Reciprocating foreign countries.

Costa Rica added to list of reciprocating foreign countries. See Rev. Rul. 55-362, above.

SUBCHAPTER D.—RECTIFYING PLANTS

PART II.—OPERATION

SECTION 5281.—REGULATION OF BUSINESS OF RECTIFIER

26 CFR 235.345: Form 27-B Supplemental. Rev. Rul. 55-176
(Also Part III-C, Section 5 (e); FAA Regulations No. 5, Section 22.)

A small percentage of recovered spirits (not neutral) may be used, within the 2½ percent limitation permitted for harmless coloring, flavoring, and blending materials prescribed in section 22 of Regulations No. 5, in a blend of straight whisky and neutral spirits. The basic blend must consist of the prescribed percentages of straight whisky and neutral spirits within the limitations of the approved formula, Form 27-B Supplemental, Formula and Process for Rectified Products," covering such blend. However, neutral spirits as such

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[1] Further modified by Revenue Ruling 55-741, I. R. B. 1955-51, to include the Federal Republic of Germany.

may not be used as a part of the 2½ percent permitted for coloring, flavoring and blending materials. See Rev. Rul. 54–350, C. B. 1954–2, 458. Neutral spirits which have been reduced in proof to less than 190° and stored in reused cooperage, as for example, for a period of from 2 to 4 years are still classed as "neutral spirits" within the intent of Revenue Ruling 54–350, *supra*, and, accordingly, may not be used as a part of the 2½ percent permitted for coloring, flavoring, and blending materials.

SUBCHAPTER E.—INDUSTRIAL ALCOHOL PLANTS, BONDED WAREHOUSES, DENATURING PLANTS, AND DENATURATION

PART I.—INDUSTRIAL ALCOHOL PLANTS, BONDED WAREHOUSES, AND DENATURING PLANTS

SECTION 5301.—ESTABLISHMENT OF INDUSTRIAL ALCOHOL PLANTS

26 CFR 182.7: Industrial Alcohol Plants: Restrictions. T. D. 6117

(Also Sections 5302, 5303; 26 CFR 182.514, 182.715.)

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER E, PART 182.—INDUSTRIAL ALCOHOL

Miscellaneous amendments

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 November 17, 1954, a notice of proposed rulemaking with respect to part 182 of title 26 (1939) of the Code of Federal Regulations was published in the Federal Register (19 F. R. 7408). The purposes of the amendments were stated as (a) to implement the provisions of the Internal Revenue Code of 1954 (1) by permitting the conduct of other businesses on the industrial alcohol plant premises, (2) by deleting the restriction that industrial alcohol plants may not be located within 600 feet of a vinegar plant using the vaporizing process, (3) by deleting the restriction that ether may not be produced on industrial alcohol plant premises, (4) by deleting the requirement that signs at industrial alcohol plants, bonded warehouses, and denaturing plants be painted in oil colors or gilded, (5) by deleting the requirement for a special application to build a fence around an industrial alcohol plant, bonded warehouse, or denaturing plant, (6) by requiring the registry of only those stills set up for distillation, redistillation, or recovery of alcohol or rum, (7) by changing the retention period for wholesale liquor dealer records from 4 to 2 years, (8) by deleting the requirement that export stamps be paid for, and (9) by permitting the recovery of denatured rum, and (b) to implement administrative decisions relative to individual sureties, the approval of Forms 1614 and 1696 by the storekeeper-gauger, the methods of taxpayment of

alcohol, tank truck shipments, the transfer of instructions to employees from regulations to internal management documents, the use of Form 92, the date of submission of reports by permittees, the elimination of Form 129, and the removal of regulatory provisions relative to ethyl acetate. No data, views, or arguments pertaining thereto having been received within the period of 15 days from the date of publication of said notice; accordingly, part 182 of title 26 of the Code of Federal Regulations is amended as follows:

PARAGRAPH 1. Wherever the term "supervisor" or "district supervisor" appears in the sections of the regulations revised by this Treasury decision, such term is hereby amended to read "assistant regional commissioner".

PAR. 2. Subsection 182.6(n) and §§ 182.36, 182.37, 182.138, 182.189, 182.190, 182.191, 182.192, 182.193, 182.194, 182.195, 182.196, 182.283, 182.408j, 182.564, 182.572, 182.573, 182.574, 182.574q, 182.574r, 182.574t, 182.837, 182.838, 182.839, 182.840, 182.841, 182.842, 182.843, 182.844, 182.929, and 182.930 are revoked.

PAR. 3. Section 182.1 is redesignated as section 182.3 and new sections 182.1 and 182.2 to read as follows are inserted:

SEC. 182.1. PRODUCTION AND DISPOSITION OF INDUSTRIAL ALCOHOL.—These regulations, Regulations 3 and appendix, Industrial Alcohol (26 CFR pt. 182), contain the precedural and substantive requirements 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 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 from abroad. These regulations also cover the issuance of permits covering the production of alcohol and denatured alcohol, the sale of specially denatured alcohol, and the withdrawal, transportation, and use of specially denatured and tax-free alcohol.

SEC. 182.2. FORMS PRESCRIBED.—The Director, Alcohol and Tobacco Tax Division, is authorized to prescribe all forms required by this part, including bonds, applications, reports, returns, and records. Information called for shall be furnished in accordance with the instructions on the forms or issued in respect thereto.

PAR. 4. Section 182.6, as amended by Treasury Decision 5801 [C. B. 1950–2, 154], approved August 11, 1950, is further amended by adding to the end thereof the following two new paragraphs:

(a–10) "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.

(a–11) "Director, Alcohol and Tobacco Tax Division" shall mean the Director, Alcohol and Tobacco Tax Division, Internal Revenue Service, Treasury Department, Washington, D. C.

PAR. 5. Section 182.7 is amended to read as follows:

SEC. 182.7. INDUSTRIAL ALCOHOL PLANTS; RESTRICTIONS.—Industrial alcohol plants may not be located in any dwelling house, or in any shed, yard, or inclosure connected with any dwelling house, or on board of any vessel or boat, or on any premises where beer, wines, vinegar, solvents, or proprietary antifreezes or articles manufactured with denatured alcohol are manufactured or produced, or where sugars or sirups are refined, or where liquors of any description are retailed, or where any other business is carried on: *Provided*, That industrial alcohol plant premises may be used for the conduct of other businesses by the proprietor of the industrial alcohol plant not involving the production of alco-

holic beverages but which (1) utilize materials, equipment, or processes similar to or interchangeable with those used for the production of alcohol, (2) involve the use of byproducts or wastage from the production of alcohol, or (3) utilize portions of premises or equipment not required in the production of alcohol for entirely dissimilar businesses such as general storage or mechanical repair work: *And provided further*, That the Director, Alcohol and Tobacco Tax Division, shall find, upon application made to him in each case, that such use will not jeopardize the revenue and will not unduly increase administrative supervision.

PAR. 6. Section 182.35 is amended by deleting from the section the following: ", painted in oil colors or gilded,".

PAR. 7. Section 182.47 is amended by deleting from the first sentence of the section the following: "painted in oil colors or gilded,".

PAR. 8. Section 182.48 is amended to read as follows:

SEC. 182.48. FENCES OR WALLS AND GATES.—The provisions of section 182.38 relating to fences or walls (and gates therein) around the premises of an industrial alcohol plant are hereby extended to and made applicable to bonded warehouses.

PAR. 9. Section 182.55 is amended by deleting from the first sentence of the section the following: ", painted in oil colors or gilded,".

PAR. 10. Section 182.56 is amended to read as follows:

SEC. 182.56. FENCES OR WALLS AND GATES.—The provisions of section 182.38 relating to fences or walls and gates around the premises of an industrial alcohol plant are hereby extended to and made applicable to denaturing plants.

PAR. 11. Section 182.134 is amended to read as follows:

SEC. 182.134. REGISTRY OF STILLS.—Every person having in his possession or custody, or under his control, any still or distilling apparatus set up for distillation, redistillation, or recovery of alcohol or rum must register such still or distilling apparatus on Form 26, in triplicate, with the assistant regional commissioner of the region in which such equipment is located as soon as it is set up. Form 26 must be verified by a written declaration that such registration is made under the penalties of perjury. The assistant regional commissioner will, on approving the registration of a still on Form 26, retain one copy, forward one copy to the Director, Alcohol and Tobacco Tax Division, and return the remaining copy to the plant proprietor. The proprietor will retain his copy at his plant premises available for inspection by internal revenue officers.

PAR. 12. Section 182.185 is amended to read as follows:

SEC. 182.185. SURETY OR SECURITY.—The bonds required by this part shall be given with corporate surety or collateral security.

PAR. 13. Section 182.186, as amended by Treasury Decision 6074 [C. B. 1954–2, 481], approved June 28, 1954, is further amended to read as follows:

SEC. 182.186. CORPORATE SURETY.—Surety bonds may be given only with surety companies holding certificates of authority from the Secretary of the Treasury as acceptable sureties on Federal bonds, subject to the limitations prescribed by the Secretary in Treasury Department Form 356—Revised, and subject to such amendments as may be issued from time to time.

PAR. 14. Section 182.197 is amended by deleting the following from the single sentence of the section: ", whether individual or corporate,".

PAR. 15. Section 182.199, as amended by Treasury Decision 5801, is further amended by deleting the fourth and fifth sentences of the section and inserting in lieu thereof the following sentence: "The consent may be executed for the surety company by an agent or attorney in fact duly authorized so to do by power of attorney filed by the surety with the appropriate assistant regional commissioner, or the consent may be executed by the home office officials of such surety."

PAR. 16. Section 182.204 is amended as follows:

(A) By deleting the words "these regulations" in the first sentence of the section and substituting in lieu thereof the words "this part".

(B) By deleting the word "Commissioner" in the second and fifth sentence of the section and substituting in lieu thereof the following: "Director, Alcohol and Tobacco Tax Division".

(C) By deleting the third sentence of the section and substituting in lieu thereof the following sentence: "A new bond shall be required immediately in case of the insolvency of a corporate surety."

PAR. 17. Section 182.260(e) is amended to read as follows:

(e) *Registry of stills.*—Register the stills set up for the distillation, redistillation, or recovery of alcohol or rum, if any, on Form 26, in triplicate, in accordance with section 182.134.

PAR. 18. Section 182.261(a)(3) is amended to read as follows:

(3) *Registry of stills.*—Register the stills set up for the distillation, redistillation, or recovery of alcohol or rum, if any, on Form 26, in triplicate, in accordance with section 182.134.

PAR. 19. Section 182.262(b)(3), as amended by Treasury Decision 6115 [C. B. 1954–2, 511], approved December 8, 1954, is further amended to read as follows:

(3) *Registry of stills.*—If the business is to be permanently discontinued, file Form 26, in triplicate, in accordance with section 182.432 for those stills set up for the distillation, redistillation, or recovery of alcohol or rum.

PAR. 20. Section 182.279a, as added by Treasury Decision 6048, [C. B. 1953–2, 356], approved November 5, 1953, is further amended by deleting the first sentence of the introductory paragraph and substituting in lieu thereof the following sentence: "An industrial alcohol plant may be operated alternately for the production of alcohol under this part, the production of distilled spirits under part 183 of this title, or the production of brandy under part 184 of this title: *Provided*, That such operation as an industrial alcohol plant, registered distillery, or fruit distillery is for a period of 24 hours, or multiples thereof, concurrent with the calendar day, or days, as the case may be."

PAR. 21. Section 182.279c(a), as added by Treasury Decision 6048, is further amended as follows:

(A) By deleting the first sentence of the section and inserting in lieu thereof the following sentence: "File Form 1696 with the storekeeper-gauger in charge giving notice of intention to suspend operations."

(B) By deleting the words "Assistant Regional Commissioner" in the fourth sentence of the section and substituting in lieu thereof the following words: "storekeeper-gauger in charge".

PAR. 22. Section 182.279d(a), as added by Treasury Decision 6048, is further amended by deleting the first sentence of the section and substituting in lieu thereof the following sentence: "File Form 1696 with the storekeeper-gauger in charge for authority to resume operations."

PAR. 23. Section 182.279e, as added by Treasury Decision 6048, is further amended by striking from the section the words "Assistant Regional Commissioner" and substituting in lieu thereof the words "storekeeper-gauger in charge".

PAR. 24. Section 182.408i, as amended by Treasury Decision 5788, [C. B. 1950–1, 151], approved May 19, 1950, is further amended to read as follows:

SEC. 182.408i. GAUGING OF PACKAGES.—Whenever the proprietor desires to withdraw alcohol in packages on payment of tax, he shall correctly weigh and proof the alcohol and determine the exact contents of each package in proof gallons. He shall prepare Form 1440, in quadruplicate, giving the details of the gauge.

PAR. 25. Section 182.408k, as added by Treasury Decision 5788, is further amended to read as follows:

SEC. 182.408k. TAXPAYMENT AND REMOVAL OF ALCOHOL.—The tax on alcohol to be removed in packages will be paid by the proprietor by use of distilled spirits excise tax stamps prescribed by section 182.574h, procured in accordance with sections 182.574h–182.574j, and used in accordance with the applicable provisions of section 182.568a. A wholesale liquor dealer's stamp for attachment to the package will be procured by the proprietor in accordance with sections 182.574o and 182.574p. After receipt of the wholesale liquor dealer's stamp the proprietor will stamp and mark the packages as provided in sections 182.525, 182.527, and 182.528 after which he will immediately remove the alcohol from the premises or to his taxpaid storeroom, if one has been provided. When the alcohol has been removed the storekeeper-gauger will retain 1 copy of Form 1440, forward 1 copy to the assistant regional commissioner, and return 2 copies to the proprietor who will retain 1 copy in accordance with section 182.455b, and, if he so desires, furnish the remaining copy to the vendee.

PAR. 26. By amending the undesignated centerhead immediately preceding section 182.432 to read as follows: "*Registry of Stills*".

PAR. 27. Section 182.432, as amended by Treasury Decision 5711, is further amended to read as follows:

SEC. 182.432. REGISTRY ON FORM 26.—Every still set up for the distillation, redistillation, or recovery of alcohol or rum must be registered on Form 26, in triplicate, in accordance with section 182.134. The temporary suspension of a plant does not necessitate reregistration of the stills. The operation of a plant by alternating proprietors, where no permanent change in ownership occurs, does not require reregistration of the stills by the proprietors. When there is a change in location or use or a bona fide change in ownership of a still, the still must be registered to reflect the change.

PAR. 28. Section 182.441, as amended by Treasury Decision 5773 [C. B. 1950–1, 199], approved February 13, 1950, is further amended to read as follows:

SEC. 182.441. TRANSFER AGREEMENT, FORM 1614.—Where the outgoing proprietor and his successor so arrange for the transfer of distilling materials the outgoing proprietor will file with the storekeeper-gauger in charge 4 copies of Form 1614 duly executed by himself and the successor. The storekeeper-gauger will, upon approval, furnish 1 copy to the transferor, 1 copy to the transferee, and 2 copies to the assistant regional commissioner, 1 for the file of the transferor and 1 for the file of the transferee.

PAR. 29. Section 182.514, as amended by Treasury Decision 6074, approved June 28, 1954, is further amended as follows:

(A) By deleting the sixteenth sentence.

(B) By deleting the word "load" in the seventeenth sentence and substituting in lieu thereof the word "compartment".

PAR. 30. Section 182.525 is amended to read as follows:

SEC. 182.525. STAMP NUMBERS.—When alcohol is withdrawn taxpaid, or taxfree for export, transfer to a customs manufacturing bonded warehouse, or for use on vessels and aircraft, the serial number of the wholesale liquor dealer's or export stamp and the date of withdrawal shall be marked on the package or case immediately below such stamp.

PAR. 31. Section 182.527 is amended as follows:

(A) Paragraph (a), as amended by Treasury Decision 5711, is further amended by deleting from the paragraph the word "Taxpaid" and substituting in lieu thereof the following: "Wholesale liquor dealer's".

(B) Paragraph (b), as amended by Treasury Decision 6074, is further amended to read as follows:

(b) *Cancellation.*—Wholesale liquor dealer's and export stamps, after being affixed, will be immediately canceled by the proprietor by stenciling or stamping thereon at least five fine parallel waved lines, long enough to extend beyond the top and bottom of the stamp. Such stencil or stamp shall be provided by the proprietor.

PAR. 32. Section 182.528, as amended by Treasury Decision 5711, is further amended as follows:

(A) Figure 1 is amended by adding a decimal and the number "1" after the number "95" to cause the proof gallons to appear as 95.1.

(B) Figure 2 is amended by deleting the word "taxpaid" above the word "stamp" in the outline representing the stamp and before the word "stamp" immediately below the outline representing the stamp and substituting in lieu thereof "W. L. D." and by adding a decimal and the number "1" after the number "95" to cause the proof gallons to appear as 95.1.

(C) Figure 3 is amended by adding a decimal and the number "1" after the number "95" to cause the proof gallons to appear as 95.1.

(D) Figure 4 is amended by adding a decimal and the number "1" after the number "95" to cause the proof gallons to appear as 95.1.

(E) Figure 5 is amended by deleting the word "taxpaid" above the word "stamp" in the outline representing the stamp and before the word "stamp" immediately below the outline representing the stamp and substituting in lieu thereof "W. L. D." and by deleting the number "42" and substituting in lieu thereof the number "46".

(F) Figure 6 is amended by deleting the word "taxpaid" above the word "stamp" in the outline representing the stamp and before the word "stamp" immediately below the outline representing the stamp and substituting in lieu thereof "W. L. D.".

(G) Figure 7 is amended by deleting the word "taxpaid" above the word "stamp" in the outline representing the stamp and before the word "stamp" immediately below the outline representing the stamp and substituting in lieu thereof "W. L. D." and by adding a decimal and the number "1" after the number "95" to cause the proof gallons to appear as 95.1.

PAR. 33. Section 182.563 is amended as follows:

(A) By amending the second sentence to read as follows: "He shall prepare Form 1440, in quadruplicate, giving the details of the gauge."

(B) By deleting the fourth sentence.

PAR. 34. Section 182.565, as amended by Treasury Decision 5801, is further amended to read as follows:

SEC. 182.565. TAXPAYMENT AND REMOVAL OF ALCOHOL.—The tax on alcohol to be removed in packages and cases will be paid by the proprietor by use of distilled spirits excise tax stamps prescribed by section 182.574b, procured in accordance with sections 182.574h–182.574j, and used in accordance with the applicable provisions of section 182.568a. A wholesale liquor dealer's stamp for attachment to the package or case will be procured by the proprietor in accordance with sections 182.574o and 182.574p. After receipt of the wholesale liquor dealer's

stamp, the proprietor will stamp and mark the packages or cases as provided in sections 182.525, 182.527, and 182.528 after which he will immediately remove the alcohol from the premises or to his taxpaid storeroom, if one has been provided. When the alcohol has been removed the storekeeper-gauger will retain 1 copy of Form 1440, forward 1 copy to the assistant regional commissioner, and return 2 copies to the proprietor, who will retain 1 copy as a permanent record as provided in section 182.643(h) and, if he so desires, furnish the remaining copy to the vendee.

PAR. 35. Section 182.566, as amended by Treasury Decision 5801, is further amended to read as follows:

SEC. 182.566. GAUGING OF ALCOHOL.—Whenever the proprietor desires to withdraw alcohol for taxpayment and removal in tank cars or tank trucks, the alcohol will be run into a weighing tank, where it will be gauged and then run into such conveyances. The proprietor shall prepare Form 1440, in quadruplicate for intraregion shipments and in quintuplicate for interregion shipments, giving the details of the gauge. In case the alcohol is to be taxpaid by use of a certificate of taxpayment, the proprietor shall submit all copies to the storekeeper-gauger for examination. If the forms are in proper order, the storekeeper-gauger will retain one copy and return the other copies to the proprietor. In case the alcohol is to be taxpaid by use of distilled spirits excise tax stamps, the proprietor shall proceed in accordance with section 182.568a.

PAR. 36. Section 182.568a, as amended by Treasury Decision 5919 [C. B. 1952–2, 306], approved July 16, 1952, is further amended to read as follows:

SEC. 182.568a. USE OF DISTILLED SPIRITS EXCISE TAX STAMPS.—Where alcohol is to be taxpaid by use of distilled spirits excise tax stamps, the proprietor will cancel the necessary number of stamps in the exact amount of the tax due by perforation as prescribed herein, or by legibly writing or stamping on each stamp with indelible (india) ink, his name, the registry number of the warehouse, and the date of Form 1440; for example, "John Doe Industries, Incorporated, Industrial Alcohol Bonded Warehouse No. 63, New Jersey, Form 1440 June 1, 1954." Prior to use in taxpayment, the proprietor, if he so desires, may partially precancel the stamps to the extent of showing his name and registry number only. The date of Form 1440 must not be entered on the stamp in advance of actual use in taxpayment. The assistant regional commissioner may, in his discretion, approve a suitable abbreviation of the required information for cancellation, including the initials for the name of the proprietor, if adequate for identification; for example, "J. D. Ind. Inc. IABW63–NJ–1440–6–1–54." The proprietor's cancellation must be made on the lower portion of the stamp below the figures and words indicating the denomination of the stamp. If the proprietor's cancellation is made by perforation, each letter and figure of the cancellation must be not less than one-fourth of an inch in height and of proportionate width and suitably spaced for legibility and distinctness, and must be clearly and sharply outlined either (a) by perforation through the substance of the stamp, and not merely puncturing it, each perforation to be not less than one thirty-second of an inch in width or diameter; or (b) by perforations in the form of incisions through the stamp of at least one thirty-second of an inch in width, cutting out the form of the letters and figures from the substance of the stamp, which letters and figures must be of the size, spacing, and distinctness as above specified. The proprietor will then attach the canceled distilled spirits excise tax stamps to one copy of Form 1440 and submit all copies of that form to the storekeeper-gauger. The storekeeper-gauger, if the forms are in order and the canceled stamps are in the proper amount of the tax shown due on the Form 1440, will then further cancel and deface the stamps by cutting a hole one-half inch square in the upper right hand corner, and wholly within the border, of each stamp and will execute a certificate on all copies of Form 1440 (using the certificate of the District Director, properly modified) certifying to the receipt and further cancellation of stamps in the amount of tax due. The canceled distilled spirits excise tax stamps will be securely attached to a copy of Form 1440 by means of a staple, eyelet, or similar device. Such copy of Form 1440 will be attached to the board on the weighing tank and remain thereon until the alcohol covered by such stamps has been removed. A wholesale liquor dealer's stamp for attachment to the container will be procured by the proprietor in accordance with sections 182.574o and 182.574p.

PAR. 37. Section 182.571, as amended by Treasury Decision 6090 [C. B. 1954–2, 492], approved August 13, 1954, is further amended by adding at the end thereof the following two new sentences: "Where alcohol is taxpaid by use of distilled spirits excise tax stamps and a wholesale liquor dealer's stamp is issued, the storekeeper-gauger will retain a copy of Form 1440. In the case of tank truck or tank car shipments taxpaid by the use of distilled spirits excise tax stamps and shipped to a vendee in another region, a copy of Form 1440 shall be forwarded to the assistant regional commissioner of the region in which the vendee is located."

PAR. 38. By amending the undesignated centerhead immediately preceding § 182.574h to read as follows: "*Distilled Spirits Excise Tax Stamps for Removals in Packages, Tank Cars, or Tank Trucks and by Pipelines.*"

PAR. 39. Section 182.574h, as amended by Treasury Decision 5919, is further amended as follows:

(A) By inserting between the first and second sentence of the section the following new sentence: "The tax on alcohol removed in packages must be paid by such stamps."

(B) By deleting the word "collector" in the second sentence and substituting in lieu thereof the words "District Director".

(C) By deleting the word "collectors" in the fourth sentence and substituting in lieu thereof the words "District Director".

PAR. 40. Section 182.574l, as amended by Treasury Decision 5919, is further amended to read as follows:

SEC. 182.574l. REDEMPTION OF DISTILLED SPIRITS EXCISE TAX STAMPS.—The assistant regional commissioner may redeem distilled spirits excise tax stamps that 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.

PAR. 41. Section 182.574m, as amended by Treasury Decision 6075 [C. B. 1954–2, 447], approved June 28, 1954, is further amended as follows:

(A) By amending the headnote to read as follows: "*Claim to Assistant Regional Commissioner*".

(B) By deleting the first sentence and substituting in lieu thereof the following sentence: "Proprietors desiring to have distilled spirits excise tax stamps redeemed under the provisions of section 182.574l must make claim on Form 843 to the assistant regional commissioner within 3 years after the purchase of such stamps."

PAR. 42. By amending the undesignated centerhead immediately preceding section 182.574o to read as follows: "*Wholesale Liquor Dealer's Stamps for Packages, Tank Cars, and Tank Trucks*".

PAR. 43. Section 182.574o, as amended by Treasury Decision 5919, is further amended to read as follows:

SEC. 182.575o. APPLICATION FOR STAMPS.—Where alcohol, taxpaid by use of distilled spirits excise tax stamps, is to be removed in packages, tank cars, or tank trucks, the proprietor will make a request for wholesale liquor dealer's stamps on Form 1440 at the time he submits the forms and distilled spirits excise tax stamps in accordance with section 182.568a.

PAR. 44. Section 182.574p, as amended by Treasury Decision 5919, is further amended to read as follows:

SEC. 182.574p. ISSUANCE OF WHOLESALE LIQUOR DEALER'S STAMPS.—On receipt of Forms 1440 bearing application for wholesale liquor dealer's stamps, the

storekeeper-gauger will issue the stamps and enter the serial number of each stamp and a notation that the stamps were issued on all copies of Form 1440. The copy of Form 1440 retained by the storekeeper-gauger in the case of tax-payment where a wholesale liquor dealer's stamp is issued shall be placed in a permanent file as authority for issuance of the stamp. When issuing the stamps, the storekeeper-gauger will enter on each stamp all the information called for and affix his signature to the stamp in the space provided therefor. The storekeeper-gauger may enter his signature by means of facsimile stamp, provided care is taken to use only such ink as will neither fade nor blur. Where an appreciable number of wholesale liquor dealer's stamps will be used, the proprietor must provide the storekeeper-gauger in charge with suitable rubber stamps for the insertion of information common to all wholesale liquor dealer's stamps to be used by him.

PAR. 45. Section 182.590 is amended to read as follows:

SEC. 182.590. EXPORT STAMPS REQUIRED.—Every package of alcohol intended for exportation must have an export stamp affixed thereto at the time of its removal from the bonded warehouse. Such stamps shall be obtained by the proprietor of the warehouse from the District Director of the internal revenue district in which the warehouse is located.

PAR. 46. Section 182.591 is amended to read as follows:

SEC. 182.591. FORMS TO BE SENT TO THE DISTRICT DIRECTOR.—The proprietor of the warehouse will forward all copies of Form 1456, with Form 1440 attached, to the District Director for the necessary number of export stamps.

PAR. 47. Section 182.592 is amended to read as follows:

SEC. 182.592. ACTION BY DISTRICT DIRECTOR.—The District Director will (a) issue the necessary number of export stamps, (b) enter the kind and serial numbers of the stamps on all copies of Form 1440, and (c) retain 1 copy of each form (1456 and 1440) and return 3 copies, with the export stamps, to the proprietor of the warehouse.

PAR. 48. Section 182.648, paragraph (b) of which was amended by Treasury Decision 5714 [C. B. 1949–2, 177], approved August 2, 1949, and paragraph (c) of which was amended by Treasury Decision 5314 [C. B. 1944, 686], approved January 5, 1944, is further amended as follows:

(A) By deleting the word "four" immediately preceding the word "years" in the third sentence of paragraph (b) and substituting in lieu thereof the word "two".

(B) By deleting the word "Investigator" from the clause "the transcripts shall be so filed with the Investigator in Charge" in the first sentence of paragraph (c) and substituting in lieu thereof the word "supervisor".

(C) By deleting the word "four" immediately preceding the word "years" in the seventh sentence of paragraph (c) and substituting in lieu thereof the word "two".

(D) By deleting in the seventh sentence of the section the words "the Commissioner or".

PAR. 49. Section 182.669, as amended by Treasury Decision 5788, is further amended as follows:

(A) By deleting the following from the first sentence of the section: "'Report of Tax-Free Alcohol',".

(B) By deleting the word "Government" in the fifth sentence of the section and substituting in lieu thereof the words "internal revenue".

PAR. 50. Section 182.715 is amended by deleting the words "Forms 129 and" from the first sentence of the section and substituting in lieu the word "Form".

PAR. 51. Section 182.731, as amended by Treasury Decision 5568 [C. B. 1947–2, 227], approved July 3, 1947, is further amended as follows:

(A) By deleting the sixth sentence.

(B) By deleting the word "load" in the seventh sentence and substituting in lieu thereof the word "compartment".

PAR. 52. By amending the undesignated centerhead immediately preceding section 182.780 to read as follows: "*Registry of Stills*".

PAR. 53. Section 182.780, as amended by Treasury Decision 5711, is further amended to read as follows:

SEC. 182.780. REGISTRY ON FORM 26.—Every denaturer having in his possession or custody, or under his control, stills set up for the redistillation or recovery of alcohol or rum, must register such stills with the assistant regional commissioner of the region in which the equipment is located on Form 26, as provided by section 182.134.

PAR. 54. Section 182.781, as amended by Treasury Decision 6090, is further amended by deleting the form number "129" from the fifth sentence of the section.

PAR. 55. Section 182.787, the introductory paragraph of which, as amended by Treasury Decision 6032 [C. B. 1953–2, 362], approved July 23, 1953, is further amended as follows:

(A) By amending the headnote to read as follows: "*Forms 1468–A, B, C, D, E, and F*".

(B) By deleting the number "129" and the word "and" following the word "Forms" in the first sentence of the section.

(C) By amending paragraph (a), previously unamended, to read as follows:

(a) *Denaturants.*—The quantities of denaturants used in each denaturization will be entered on Form 1468–B, according to formula. At the close of the month, the quantities of denaturants received and used or removed during the month will be summarized and entered on Form 1468–C; denaturants received being summarized and entered according to kind, and denaturants used being summarized from Form 1468–B and entered according to both kind and formula.

(D) By deleting in the first sentence of paragraph (e), as amended by Treasury Decision 6090, the form number "129" and the word "and" following the word "Forms".

(E) By deleting in the first sentence of paragraph (f), as amended by Treasury Decision 5544 [C. B. 1946–2, 202], approved September 10, 1946, the form number "129" and the word "and" following the word "Forms".

(F) By deleting in the first sentence of paragraph (f), the word "Government" and substituting in lieu thereof the words "internal revenue".

PAR. 56. By deleting the undesignated centerhead immediately preceding section 182.837.

PAR. 57. Section 182.874, as amended by Treasury Decision 6032, is further amended as follows:

(A) By deleting the words "the regulations in" between the word "by" and the word "this" in the second sentence of the section.

(B) By deleting the fifth sentence of the section.

PAR. 58. By amending the undesignated centerhead immediately preceding section 182.878 to read as follows: "*Sale, Use, and Recovery of Denatured Rum*".

PAR. 59. Section 182.879, as amended by Treasury Decision 5801, is further amended to read as follows:

SEC. 182.879. DEALERS IN AND USERS OF DENATURED RUM.—The provisions of this part relating to specially denatured alcohol will apply, insofar as applicable, to the procurement and sale by bonded dealers, and the procurement, use, and recovery by manufacturers, of denatured rum, except that dealers shall make deliveries in accordance with part 216 of this title.

PAR. 60. Section 182.880 is amended to read as follows:

SEC. 182.880. FORMS, RECORDS, AND REPORTS.—The same forms, records, and reports as are prescribed in this part concerning the procurement and sale by bonded dealers, and the procurement, use, and recovery by manufacturers of specially denatured alcohol, shall apply to and be used, insofar as applicable, after making proper modification, in each instance in connection with the procurement and sale by bonded dealers, and the procurement, use, and recovery by manufacturers, of denatured rum: *Provided*, That bonds on Form 653–A or 582–A will be used in lieu of bonds on Forms 1475 or 1480, in connection with application for permit as a bonded dealer in denatured rum, or with application by a manufacturer to use and recover denatured rum. The penal sums of bonds on Forms 653–A and 582–A will be computed as provided in this part with respect to bonds, Forms 1475 and 1480. Where a user desires to recover denatured rum and the terms of his bond do not cover such operation, consent of surety must be filed on Form 1533 extending the terms of his bond, Form 582–A.

PAR. 61. Section 182.881 is amended as follows:

(A) By entering at the head of the list of form numbers and descriptions the following: "26 Registry of stills".

(B) By deleting the following three items from the list of form numbers and descriptions: "597 Notice of shipment of specially denatured rum (in lieu of Form 1473), 1430 Order to show cause why permit should not be revoked, copy of complaint attached, and 1430–A Order to show cause why permit should not be revoked".

PAR. 62. Section 182.882 is amended to read as follows:

SEC. 182.882. SALE, USE, OR RECOVERY OF BOTH SPECIALLY DENATURED ALCOHOL AND DENATURED RUM.—Where it is desired to procure and sell, use, or recover both specially denatured alcohol and denatured rum, separate applications for permits and separate bonds shall be filed and separate permits procured for the specially denatured alcohol and for the denatured rum. Separate records shall be kept and separate reports made for the specially denatured alcohol and for the denatured rum so received and sold, used, or recovered.

Because these amendments are needful for the enforcement of the applicable provisions of the Internal Revenue Code effective January 1, 1955, it is hereby found that it is contrary to the public interest to issue this Treasury Decision subject to the effective date limitation of section 4(c) of the Administrative Procedure Act, approved June 11, 1946.

This Treasury Decision shall be effective on January 1, 1955.

(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 December 28, 1954.

M. B. FOLSOM,
Acting Secretary of the Treasury.

(Filed with the Division of the Federal Register December 30, 1954, 8:54 a. m.)

SECTION 5302.—ESTABLISHMENT OF INDUSTRIAL ALCOHOL BONDED WAREHOUSE

26 CFR 182.514: Tank trucks.

26 CFR Part 182 amended. See T. D. 6117, page 578.

SECTION 5303.—ESTABLISHMENT OF INDUSTRIAL ALCOHOL DENATURING PLANTS

26 CFR 182.707: Denaturants not required to be tested. Rev. Rul. 55-128

> The National Formulary (N. F.) and United States Pharmacopoeia (U. S. P.) substances, including solids, liquids, essential oils and aromatic materials; Chemically Pure (C. P.) or Commercially Pure materials; and imitation essential oils and aromatic substances, denaturing grade, approved by the National Office from time to time for use in lieu of the natural oils, are denaturants which may be used at a denaturing plant without previous testing and approval by a duly authorized chemist, as provided in section 182.707 of the Industrial Alcohol Regulations.

Advice has been requested as to the types of denaturants which may be used at a denaturing plant without previous testing and approval by a duly authorized chemist.

Section 182.707 of the Industrial Alcohol Regulations provides that where a chemically or commercially pure salt or solid or a U. S. P. or N. F. essential oil, or an essential oil approved by the Commissioner, is used as a denaturing material, the same need not be submitted for testing except when the Commissioner shall so direct, provided the material is delivered to the storekeeper-gauger in the original sealed package of a reputable manufacturer of chemicals, bearing a label descriptive of its contents placed thereon by the manufacturer.

The N. F. and U. S. P. substances include solids, liquids, essential oils, and aromatic materials.

Chemically Pure (C. P.) or Commercially Pure materials include denaturants whose descriptions in the specially denatured alcohol formulas are given, as follows:

1. Formaldehyde solution containing 37 percent formaldehyde (N. F. or methanol-free).
2. Soap, dried and granulated or powdered.
3. 100 percent acetaldehyde (C. P. or Commercially Pure).
4. Hard soap, good toilet grade.
5. Methyl violet (Commercially Pure).
6. Oil of Citronella (natural oil), Oil of Mustard, Volatile (natural or synthetic).
7. White or orange shellac, arsenic and rosin-free (a commercial grade).
8. Safrol (pure aromatic).

Imitation essential oils and aromatic substances, denaturing grade, which have been approved by the National Office for use in lieu of the natural oils, are as follows:

Manufacturer	*Method of identification*	*Label requirements*
	OIL OF BERGAMOT	
P. R. Dreyer, Inc., New York, N. Y.	Imitation Oil of Bergamot, D. G., Dreyer.	Esters as Linalyl Acetate—36–38%, and Essential Oils, Isolates and Aromatics—62–64%.
General Drug Company, New York, N. Y.	Synthetic Oil of Bergamot, No. 3630, Modified, D. G., General Drug.	Linalyl Esters—36% minimum, and Essential Oils, Aromatics and Isolates—64% maximum.
P. R. Dreyer, Inc., New York, N. Y.	Imitation Oil of Bergamot, No. 10, D. G. Dreyer.	Esters as Linalyl Acetate—36% minimum, and Essential Oils, Aromatics, and Isolates—64% maximum.
P. R. Dreyer, Inc., New York, N. Y.	Imitation Oil of Bergamot, No. 15, D. G. Dreyer.	Esters as Linalyl Acetate—36% minimum, and Essential Oils, Aromatics, and Isolates—64% maximum.
P. R. Dreyer, Inc., New York, N. Y.	Imitation Oil of Bergamot, No. 20, D. G., Dreyer.	Esters as Linalyl Acetate—36% minimum, and Essential Oils, Aromatics, and Isolates—64% maximum.
Polak's Frutal Works, Inc., Long Island City, N. Y.	Imitation Oil of Bergamot, D. G., Polak's.	Esters as Linalyl Acetate—36% minimum, and Essential Oil, Isolates, and Aromatics—64% maximum.
Dodge and Olcott Co., New York, N. Y.	Synthetic Oil Bergamot, No. 185, D. G., D. & O.	Esters as Linalyl Acetate—36% minimum, and Essential Oil, Isolates, and Aromatics—64% maximum.
Florasynth Laboratories, New York, N. Y.	Oil Bergamot Synthetic No. 90, D. G., Florasynth.	Esters as Linalyl Acetate—36% Minimum, and Essential Oil, Isolates and Aromatics—64% maximum.
	OIL OF CASSIA	
P. R. Dreyer, Inc., New York, N. Y.	Imitation Oil of Cassia, D. G., Dreyer.	Cinnamic Aldehyde—80% minimum, and Essential Oils, Aromatics, and Isolates—20% maximum.
Fritzsche Brothers, Inc., New York, N. Y.	Imitation Oil of Cassia, D. G., Fritzsche.	Cinnamic Aldehyde—80% minimum, and Essential Oils, Aromatics, and Isolates—20% maximum.
Dodge and Olcott Co., New York, N. Y.	Synthetic Oil of Cassia, No. 173, D. G., D. & O.	Cinnamic Aldehyde—80% minimum, and Essential Oil, Isolates and Aromatics—20% maximum.
Magnus, Mabee and Reynard, Inc., New York, N. Y.	Cinnamic Aldehyde N. F., D. G., MM&R.	
Magnus, Mabee and Reynard, Inc., New York, N. Y.	Imitation Cassia Oil, D. G., MM&R.	Cinnamic Aldehyde—80% minimum.
Florasynth Laboratories, New York, N. Y.	Oil Cassia Imitation, No. 175, D. G., Florasynth.	Cinnamic Aldehyde—80% minimum.
Norda Essential Oil and Chemical Co., New York, N. Y.	Imitation Oil of Cassia, D. G., Norda.	Cinnamic Aldehyde—80% minimum, and Essential Oils, Isolates and Other Aromatics—20% maximum.

Manufacturer	*Method of identification*	*Label requirements*
	OIL OF CASSIA—Continued	
H. C. Ryland, Inc., New York, N. Y.	Imitation Oil of Cassia, D. G., Ryland.	
Ungerer and Company, Inc., New York, N. Y.	Imitation Oil of Cassia, D. G., Ungerer.	Cinnamic Aldehyde—93%.
Dodge and Olcott Co., New York, N. Y.	Oil Cinnamon (Cassia) Terpeneless, D. G., D. & O.	
Schimmel & Co., Inc., New York, N. Y.	Oil Imitation Cassia S-4845, D. G., Schimmel.	Cinnamic Aldehyde—96% minimum.
Ungerer and Company, Inc., New York, N. Y.	Imitation Oil of Cassia, D. G., Ungerer.	Cinnamic Aldehyde—80% minimum.
The Givaudan Corporation, Delewanna, N. J.	Imitation Oil of Cassia, D. G., Givaudan.	Cinnamic Aldehyde—95% minimum.
Felton Chemical Company, Inc., Brooklyn, N. Y.	Imitation Oil of Cassia, No. 242, D. G., Felton.	Cinnamic Aldehyde—80% minimum.
	OIL OF CLOVES	
Dodge and Olcott Co., New York, N. Y.	Oil Clove Terpeneless, D. G., D. & O.	
	REFINED COAL TAR CONCENTRATE	
Wright, Layman & Umney, Ltd., Southwark, S. E., London, England.	Refined Coal Tar Concentrate, D. G., Wright, Layman & Umney, Ltd., 66 Park Street, Southwark, S. E. 1.	
	ISOTHYMOL	
Givaudan-Delawanna, Delawanna, N. J.	Isothymol, D. G., Givaudan-Delawanna.	
	OIL OF LAVENDER	
P. R. Dreyer, Inc., New York, N. Y.	Imitation Oil Lavender Flowers, D. G., Dreyer.	Esters as Linalyl Acetate—30% minimum, and Essential Oils, Isolates, and Aromatics—70% maximum.
Lautier Fils, New York, N. Y.	Oil of Lavender, Synthetic No. 32-A, D. G., Lautier Fils.	Esters as Linalyl Acetate—32.3% minimum, and Essential Oils, Isolates, and Aromatics—67.7% maximum.
General Drug Co., New York, N. Y.	Synthetic Oil of Lavender No. 3938, Modified, D. G., Gen. Drug.	Linalyl Esters—30% minimum, and Essential Oils, Aromatics, and Isolates—70% maximum.
Tombarel Products, Corp., New York, N. Y.	Oil of Lavender, Artificial No. 2441, D. G., Tombarel.	Linalyl Esters—30% minimum, and Essential Oil, Aromatics, and Isolates—70% maximum.
Lautier Fils, New York, N. Y.	Oil Lavender Synthetic No. 3234, D. G., Lautier Fils.	Esters as Linalyl Acetate—30% minimum, and Essential Oils, Aromatics, and Isolates—70% maximum.
P. R. Dreyer, Inc., New York, N. Y.	Imitation Oil of Lavender No. 10, D. G., Dreyer.	Esters as Linalyl Acetate—30% minimum, and Essential Oils, Aromatics, and Isolates—70% maximum.

Manufacturer	Method of identification	Label requirements
	OIL OF LAVENDER—Continued	
P. R. Dreyer, Inc., New York, N. Y.	Imitation Oil of Lavender No. 15, D. G., Dreyer.	Esters as Linalyl Acetate—30% minimum, and Essential Oils, Aromatics, and Isolates—70% maximum.
P. R. Dreyer, Inc., New York, N. Y.	Imitation Oil of Lavender No. 20, D. G., Dreyer.	Esters as Linalyl Acetate—30% minimum, and Essential Oils, Aromatics, and Isolates—70% maximum.
Givaudan-Delawanna, N. Y.	Oil of Lavender, Synthetic No. 2706, D. G., Givaudan-Delawanna.	Esters as Linalyl Acetate—32% minimum, and Essential Oils, Aromatics, and Isolates—68% maximum.
Fritzsche Bros., New York, N. Y.	Oil of Lavender, Imitation No. 14224, D. G., Fritzsche.	Esters as Linalyl Acetate—32% minimum, and Essential Oils, Aromatics, and Isolates—68% maximum.
Ungerer & Company, New York, N. Y.	Imitation Oil of Lavender, D. G., Ungerer.	Esters as Linalyl Acetate—30% minimum, and Essential Oils, Isolates, and Aromatics—70% maximum.
Ungerer & Company, New York, N. Y.	Imitation Oil of Lavender No. 122, D. G., Ungerer.	Esters as Linalyl Acetate—30% minimum, and Essential Oils, Isolates, and Aromatics—70% maximum.
Polak's Frutal Works, Inc., Long Island City, N. Y.	Imitation Oil of Lavender, D. G., Polak's.	Esters as Linalyl Acetate—30% minimum, and Essential Oil, Isolates, and Aromatics—70% maximum.
Fritzsche Bros., New York, N. Y.	Oil of Lavender, Synthetic No. 14539, D. G., Fritzsche.	Esters as Linalyl Acetate—30% minimum, and Essential Oils, Isolates, and Aromatics—70% maximum.
Magnus, Mabee and Reynard, Inc., New York, N. Y.	Imitation Lavender Oil No. 30, D. G., MM&R.	Esters as Linalyl Acetate—30% minimum, and Essential Oils, Isolates, and Aromatics—70% maximum.
Dodge and Olcott Co., New York, N. Y.	Synthetic Oil Lavender No. 186, D. G., D. & O.	Esters as Linalyl Acetate—30% minimum, and Essential Oil, Isolates, and Aromatics—70% maximum.
Florasynth Laboratories, New York, N. Y.	Oil Lavender Synthetic No. 50, D. G., Florasynth.	Esters as Linalyl Acetate—30% minimum, and Essential Oil, Isolates, and Aromatics—70% maximum.
Florasynth Laboratories, New York, N. Y.	Oil Lavender Synthetic No. 14550, D. G., Florasynth.	Esters as Linalyl Acetate—30% minimum, and Essential Oil, Isolates, and Aromatics—70% maximum.
Naugatuck Aromatics (Division of U. S. Rubber Co.), New York, N. Y.	Artificial Oil of Lavender No. C–1, D. G., Naugatuck.	Esters as Linalyl Acetate—57% minimum.
Felton Chemical Company, Inc., Brooklyn, N. Y.	Oil of Lavender, Imitation T. G. S., D. G., Felton.	Esters as Linalyl Acetate—30% minimum, and Essential Oils, Isolates, and Aromatics—70% maximum.
Norda Essential Oil and Chemical Company, Inc., New York, N. Y.	Oil Lavender Imitation, D. G., not U. S. P., Norda.	Esters as Linalyl Acetate—30% minimum, and Essential Oils, Isolates, and Aromatics—70% maximum.
S. B. Penick and Company, New York, N. Y.	Imitation Oil of Lavender, D. G., Penick.	Esters as Linalyl Acetate—30% minimum, and Essential Oil, Isolates, and Aromatics—70% maximum.

Manufacturer	*Method of identification*	*Label requirements*
	OIL OF LAVENDER—Continued	
Orbis Products Corporation, New York, N. Y.	Imitation Oil of Lavender AC, D. G., Orbis.	Esters as Linalyl Acetate—30% minimum, and Essential Oil, Isolates, and Aromatics—70% maximum.
Felton Chemical Company, Inc., Brooklyn, N. Y.	Imitation Oil of Lavender, D. A. No. 947, D. G., Felton.	Esters as Linalyl Acetate—30% minimum, and Essential Oil, Isolates, and Aromatics—70% maximum.
Naugatuck Aromatics (Division of U. S. Rubber Co.), New York, N. Y.	Oil of Lavender, Artificial, CSC No. 848, D. G., Naugatuck.	Esters as Linalyl Acetate—30% minimum, and Essential Oil, Isolates, and Aromatics—70% maximum.
The Givaudan Corporation, Delawanna, N. J.	Synthetic Lavender Perfume Oil, GD-D-67611, D. G., Givaudan-Delawanna	Esters as Linalyl Acetate—30% minimum, and Essential Oil, Isolates, and Aromatics—70% maximum.
Polak's Frutal Works, Middletown, N. Y.,	Oil Lavender Technical, Synthetic, D. G., Polak's.	Esters Calculated as Linalyl Acetate—53% minimum.
Polak's Frutal Works, Middletown, N. Y.	Oil Lavender Solvio, Synthetic, D. G., Polak's.	Esters Calculated as Linalyl Acetate—53% minimum.
Verona Chemical Company, Newark, N. J.	Oil of Lavender, Technical, D. G., Verona.	Esters as Linalyl Acetate—30% minimum, and Essential Oils, Aromatics, and Isolates—70% maximum.
The Givaudan Corporation, Delawanna, N. J.	Oil Lavender Imitation DEN, D. G., GD.	Esters as Linalyl Acetate—30% minimum, and Essential Oil, Isolates, and Aromatics—70% maximum.
The Givaudan Corporation, Delawanna, N. J.	Oil of Lavender Imitation No. 195, D. G., Givaudan.	Esters Calculated as Linalyl Acetate 50% minimum.
The Givaudan Corporation, Delawanna, N. J.	Oil of Lavender Imitation No. 151, D. G., Givaudan.	Esters Calculated as Linalyl Acetate 69% minimum.
Florasynth Laboratories, New York, N.Y.	Initation Lavender Oil No. 9742 D. G., Florasynth.	Esters Calculated as Linalyl Acetate—30% minimum and Essential Oils, Aromatics, and Isolates—70% maximum.
Dodge & Olcott, Inc., New York, N. Y.	Oil of Lavender Imitation No. 1955, D. G., D. & O.	Esters as Linalyl Acetate—30% minimum, and Essential Oils, Aromatics and, Isolates—70% maximum.
	MENTHOL	
Fries Brothers, New York, N. Y.	Synthetic Menthol (homo meta menthol), D. G., Fries Bros.	
Givaudan-Delawanna, N. Y.	Racemic Menthol, D. G., Givaudan-Delawanna.	
A. Maschmeijer, Jr., Inc., New York, N. Y.	Racemic Menthol, D. G., Maschmeijer.	
Mann Fine Chemicals, Inc., New York, N. Y.	Mentholone, D. G., Mann.	
	OIL OF NEROLI	
Roure-DuPont, Inc., New York, N. Y.	Oil, Neroli Synthetic R-D, D. G.	Esters as Linalyl Acetate—38.50% minimum.

Manufacturer	*Method of identification*	*Label requirements*
	OIL OF PINE	
Hercules Powder Co., Wilmington, Del.	Oil of Pine, Yarmor No. 302, Hercules.	
Magnus, Mabee & Reynard, Inc., New York, N. Y.	Oil of Dwarf Pine Needles, Synthetic, D. G., MM&R.	
Magnus, Mabee & Reynard, Inc., New York, N. Y.	Imitation Dwarf Pine Needle Oil, D. G., MM&R.	
P. R. Dreyer, Incorporated, New York, N. Y.	Oil of Pinus Sylvestris, D. G., Dreyer.	
P. R. Dreyer, Incorporated, New York, N. Y.	Oil of Fir Needles Siberian, D. G., Dreyer.	
Schimmel & Co., Inc., New York, N. Y.	Oil Imitation Fir Needles Siberian S-4846, D. G., Schimmel.	Essential Oils—65%, and Aromatics—35%.

Applicants for the use of specially denatured alcohol desiring to use any of the alternate denaturants listed above must file proper application on Form 1479-A, Formula and Preparation Made with Specially Denatured Alcohol. The alternate denaturant desired should be properly identified at line 4 of the form by use of the description thereof shown in column two, "Method of Identification," of the above list. The denaturants should be furnished to the storekeeper-gauger at the denaturing plant in original packages properly labeled to identify the company manufacturing the denaturant and to show the specifications for such denaturant, if any, as indicated in column three, "Label Requirements," of the list.

All denaturants for which detailed tests and specifications are given in the Appendix to the Industrial Alcohol Regulations must be approved by an authorized chemist before use. Substances such as stronger Ammonia Water, U. S. P., and other denaturants that are U. S. P. or N. F., C. P. or Commercially Pure, do not need the Commissioner's permission for use provided such substances as received conform to section 182.707 of the Industrial Alcohol Regulations. However, the storekeeper-gauger at the denaturing plant has the responsibility for the acceptance or rejection of any denaturing material and may, at his discretion, request the testing of substances of which he is uncertain.

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26 CFR 182.715: Furnishing approved denaturants.

26 CFR Part 182 amended. See T. D. 6117, page 578.

PART II.—DENATURATION

SECTION 5331.—WITHDRAWAL FROM BOND FREE OF TAX

26 CFR 182.847: Containers. Rev. Rul. 55-181

Section 182.847(c) of the Industrial Alcohol Regulations provides that bona fide agents of producers of proprietary solvents and lacquer

thinners may receive such products in railroad tank cars or in tank trucks and may transfer such products to packages for sale to others, such packages if more than 5 gallons capacity to be furnished by the producer. The provision requiring the manufacturer to furnish the drums for packaging proprietary solvents and lacquer thinners by his agent is for the purpose of insuring adequate identification of such manufacturer, and is not construed as prohibiting the purchase, with the consent of the producer, of such packages by the agent. Accordingly, it is held that bona fide agents of producers may purchase containers of more than 5 gallons capacity, with the consent of the producer, for the packaging of proprietary solvents and lacquer thinners, provided the symbol and serial number of the producer is embossed thereon.

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26 CFR Section 182.866: Storage, use, and records. Rev. Rul. 55-129

A specially denatured alcohol permittee using specially denatured alcohol and isopropyl alcohol on the same premises, but who uses the specially denatured alcohol only for laboratory purposes, is not required to maintain the records prescribed in section 182.866 of the Industrial Alcohol Regulations.

Advice has been requested whether a permittee who uses both specially denatured alcohol and isopropyl alcohol on the same premises is required to maintain the records of such use if the specially denatured alcohol is used on such premises only for laboratory testing.

Section 182.866 of the Industrial Alcohol Regulations provides in part that if a manufacturer holding a permit to use specially denatured alcohol also uses isopropyl alcohol on the same premises, he must keep a manufacturing record at such premises, available for inspection by internal revenue officers, showing the information specified in that section.

In the instant case, specially denatured alcohol is used exclusively in laboratory analysis and not for manufacturing purposes. Accordingly, it is held that the prescribed records need not be maintained by a specially denatured alcohol permittee who also uses isopropyl alcohol at the same premises if the specially denatured alcohol is used exclusively for laboratory testing and not for manufacturing purposes.

SUBCHAPTER F.—BONDED AND TAXPAID WINE PREMISES

PART II.—OPERATIONS

SECTION 5361.—BONDED WINE CELLAR OPERATIONS

26 CFR 240.132: Commercial fruit products and by-products. (Also 26 CFR 240.890.) Rev. Rul. 55-363

Section 240.132 of the Wine Regulations provides that the proprietor of a bonded wine cellar may, under the provisions of sections 240.890 to 240.892, inclusive, prepare for market and store commercial fruit

products and by-products not taxable as wine. Section 240.890 limits such activities to those in which fruit or fruit juice is the principal material used in production. Therefore, flavoring syrup for soft drinks, in which fruit or fruit juice is not the principal material, may not be prepared, stored, etc., on bonded wine cellar premises. However, the Internal Revenue Service will not object to a winemaker curtailing his bonded winery or bonded wine cellar premises (for example, during the off-season) in order that the bottling room may be used temporarily for the preparation and bottling of such products.

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26 CFR 240.481: Classes of wine other than standard wine. Rev. Rul. 45-322

Section 240.481 of the Wine Regulations includes among the classes of wine which are not standard wine, but which may be produced or stored on bonded wine cellar premises, standard type blending sherry, or similar wine products not for beverage use, produced as provided in section 240.485. *Held*, a salted wine which contains not in excess of 21 percent alcohol by volume and not less than 1.5 grams of salt per 100 cubic centimeters is a wine product, not for beverage use, under section 240.485. Such a product may be produced, stored and handled on standard wine premises under authority of section 240.481 upon approval of formula on Form 698-Supplemental, Formulas and Process for Wine.

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26 CFR 240.890. Application.

Flavoring syrup for soft drinks in which fruit or fruit juice is not the principal material may not be prepared, stored, etc., on bonded wine cellar premises. See Rev. Rul. 55-363, page 595.

SECTION 5362.—REMOVALS OF WINE FROM BONDED PREMISES

26 CFR 240.691: Reciprocating foreign countries.

Costa Rica added to list of reciprocating foreign countries. See Rev. Rul. 55-362, page 577.

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26 CFR 240.741: Application. Rev. Rul. 55-213
(Also 5372; 26 CFR 240.746; Federal Alcohol Administration Act, Section 5(e); FAA Regulations No. 4, Section 30.)

> Samples of wine may not be removed by the proprietor of a bonded wine cellar tax-free for distribution by his salesmen to prospective purchasers. Such samples must be taxpaid and must be labeled in accordance with the requirements of section 30 of Regulations No. 4.

Advice has been requested whether samples of wine may be removed tax-free by the proprietor of a bonded wine cellar for salesmen to pass

out to prospective purchasers. In the event such samples must be taxpaid, advice was also requested regarding the labeling thereof.

Section 5362 of the Internal Revenue Code of 1954 provides in part that wine may be removed from bonded wine cellar premises, without liability for tax being incurred by reason of such removal, for use by or for the account of the proprietor or his agents for analysis or testing, organoleptically or otherwise. Section 240.741 of the Wine Regulations authorizes a proprietor to remove samples of wine for analysis or testing by a laboratory.

Section 5372 of the Code authorizes the utilization of wine *in any bonded wine cellar* for testing, tasting, or sampling, free of tax. Pursuant to this authorization, section 240.746 of the Wine Regulations provides for the testing, tasting, or sampling of tax-free wine by prospective purchasers only on the bonded wine cellar premises.

There is no provision in the law or regulations for the removal of tax-free wine samples for salesmen to pass out to prospective purchasers. Accordingly, wine removed for that purpose must be taxpaid and must be labeled in accordance with the requirements of section 30 of Regulations No. 4.

SECTION 5368.—GAUGING, MARKING, AND STAMPING

26 CFR 240.579: Labeling bottled wine. Rev. Rul. 55-344

Section 240.579 of the Wine Regulations provides in part that when wine is bottled by the producer or proprietor of a bonded wine cellar under an authorized trade name, such trade name may be stated on the label as the name of the proprietor. Section 240.192 permits the use of two or more authorized trade names simultaneously or alternately for bottling or packaging of wine. A proprietor bottling wine of his own production, under an authorized trade name, may use on the label the phrase "Produced and bottled by" where the use of such phrase is consistent with provisions of Regulations No. 4 issued pursuant to the Federal Alcohol Administration Act.

SECTION 5372.—SAMPLING

26 CFR 240.746: For tasting and testing.

Samples of wine for distribution by salesmen of a bonded wine cellar proprietor to prospective purchasers. See Rev. Rul. 55-213, page 596.

PART III.—CELLAR TREATMENT AND CLASSIFICATION OF WINE

SECTION 5381.—NATURAL WINE

26 CFR 240.489: Spoiled wine. Rev. Rul. 55-214
(Also Federal Alcohol Administration Act, Section 5(e); FAA Regulations No. 4, Section 21.)

A wine made within the limitations for natural wine, which has become substandard by reason of the development of excessive

volatile acidity, may be blended on bonded wine cellar premises with another natural wine made from the same kind of fruit for the purpose of correcting the substandard condition. The resulting blend may be marketed as a standard wine if the volatile acidity is within the limitations prescribed by section 21 of Regulations No. 4. Also, wine which has become substandard by reason of the development of excess volatile acidity may be removed to a vinegar plant covered by bond, Form 1676, "Bond Covering Removal to and Use of Wine at Vinegar Plant."

Advice has been requested whether wine which has become substandard by reason of excess volatile acidity may (1) be blended with other wine to produce a wine conforming to the specifications for standard wine, and (2) may be transferred to a vinegar plant covered by bond, Form 1676, Bond Covering Removal to and Use of Wine at Vinegar plant.

Section 5381 of the Internal Revenue Code of 1954 provides, in part, that wine which has become substandard by reason of its condition shall, unless the condition is corrected, be transferred to premises in which wines other than natural wine may be stored or used.

Section 5362 of the Code provides, in part, that wine may be removed free of tax from bonded wine cellars for use in the production of vinegar. Sections 240.650 to 240.658, inclusive, of the Wine Regulations establish the requirements relative to such removals. No standard is prescribed in the law or regulations for wine removed for the manufacture of vinegar.

Wine which has become substandard by reason of the development of excessive volatile acidity may be blended on bonded wine cellar premises with another natural wine made from the same kind of fruit for the purpose of correcting the substandard condition, and the resulting blend may be marketed as a standard wine if the volatile acidity is within the limitations prescribed by section 21 of Regulations No. 4.

Wine which has become substandard by reason of the development of excess volatile acidity may be removed to a vinegar plant covered by bond, Form 1676.

SECTION 5382.—CELLAR TREATMENT OF NATURAL WINE

26 CFR 240.530: Notice. Rev. Rul. 55–41

A product known as "Aferrin" has been approved for use by winemakers to remove iron from wine since its use is recognized as a cellar treatment consistent with good commercial practice as provided in section 240.530 of the wine regulations.

Revenue Ruling 25, C. B. 1953–1, 431, is modified to include the above.

Prescribed methods and procedures for testing for residues when wine is treated with "Aferrin" or similar approved products may be obtained from the offices of the Assistant Regional Commissioner, Alcohol and Tobacco Tax.

SECTION 5382(b).—CELLAR TREATMENT OF NATURAL WINE: SPECIFICALLY AUTHORIZED TREATMENTS

36 CFR 240.353: Concentrated fruit juice. Rev. Rul. 55-400

Fruit juice concentrate reduced with water to a degree not less than the density of the juice from which it was made, and concentrate made from juice of an original density of more than 22 degrees Brix and reduced to not less than 22 degrees Brix, are deemed to be "juice" for purposes of standard wine production. Concentrated juice may be used in conjunction with unconcentrated juice derived from the same kind of fruit for development of alcohol in wine.

SECTION 5383(a).—AMELIORATION AND SWEETENING LIMITATIONS FOR NATURAL GRAPE WINES: SWEETENING OF GRAPE WINES

26 CFR 240.368: Sweetening in permanent storage. Rev. Rul. 55-215

Section 5383(a) of the Internal Revenue Code of 1954 provides that any natural grape wine produced thereunder may, if not in reserve inventory, be sweetened after fermentation and before tax-payment with pure dry sugar if the sugar solids content of the finished wine does not exceed 10 percent of the weight of the wine and the alcoholic content of the finished wine after sweetening is less than 14 percent by volume. *Held*, wine produced in conformity with the provisions of section 240.365 of the Wine Regulations may be sweetened by a winemaker who is not the producer of the wine, pursuant to section 240.368 of such regulations. The finished wine must be within the limitations specified as to sugar solids content and alcoholic content.

SUBCHAPTER G.—BREWERIES

PART II.—OPERATIONS

SECTION 5411.—USE OF BREWERY

26 CFR 245.10: Brewery. Rev. Rul. 55-364

Beer may be received without payment of tax by a brewer from another brewery belonging to him. Section 245.214 of the Beer Regulations requires that bottled beer so transferred must be received in the brewery bottling house. Section 245.10 of the regulations defines a brewery bottling house as that portion of the brewery set apart by the brewer and so described on Form 27-C, Notice by Brewer, where beer is to be bottled. *Held*, a room which does not have the usual bottling equipment and in which no beer is to be bottled is not considered as a bottling house within the meaning and intent of the Beer Regulations and may not be approved as such for use in receiving bottled beer from another brewery belonging to the same brewer.

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26 CFR 245.30: Restrictions. Rev. Rul. 55-365

The brewery office on bonded premises may not be used for administrative activities in connection with the purchase and sale of beer produced and bottled by another brewer.

Advice has been requested whether the brewery office on bonded premises may be used for administrative activities in connection with the purchase and sale of beer produced and bottled by another brewer.

The beer involved is produced and bottled by another brewer, and therefore the question does not relate to the resale of beer purchased in accordance with sections 245.300 to 245.303, inclusive, of the Beer Regulations. Under such conditions, and by reason of the sale of such purchased bottled beer, the brewer would be engaging in business as a wholesale dealer in beer in addition to his activities as a brewer. Section 245.30 of the regulations precludes the establishment or operation of a brewery in any building or on any premises where any liquor or beverages are kept, sold or dealt in either at wholesale or retail. Therefore, the brewery office on the bonded premises may not be used for administrative activities in connection with the purchase and sale of beer produced and bottled by another brewer in the brewer's capacity as a wholesale dealer in beer.

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26 CFR 245.31: Use of brewery. Rev. Rul. 55-216

A part of the racking room on the brewery premises, which is under refrigeration, may be partitioned off from the balance of the racking room by erecting a substantial wire partition between the two parts. This portion of the racking room under refrigeration may then be considered as, and made a part of, the bottling house premises and may be used for the storage of untaxpaid bottled beer. It should be so described in a supplemental notice filed on Form 27-C, Notice by Brewer, as required by section 245.70 of the Beer Regulations. The door from the room to be used for the storage of nontaxpaid bottled beer should lead directly onto the loading deck.

SUBCHAPTER H.—MISCELLANEOUS PLANTS AND WAREHOUSES

PART II.—VOLATILE FRUIT-FLAVOR CONCENTRATE PLANTS

SECTION 5511.—ESTABLISHMENT AND OPERATION

26 CFR 198.29: Use of premises. T. D. 6129

TITLE 26—INTERNAL REVENUE (1939).—CHAPTER 1, SUBCHAPTER C, PART 198.—PRODUCTION OF VOLATILE FRUIT-FLAVOR CONCENTRATES

Use of premises

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 relieve restrictions on use of volatile fruit-flavor concentrate plant premises, Regulations 30 [26 CFR 198 (1939)], as made

applicable to the Internal Revenue Code of 1954 by Treasury Decision 6091 [C. B. 1954–2, 47], dated August 16, 1954 and section 7807 of the Code, are amended as follows:

Section 198.29 is amended to read as follows:

SEC. 198.29. USE OF PREMISES.—The premises of a concentrate plant shall be used exclusively for the manufacture of concentrates by any process which includes evaporation from the mash or juice of any fruit. Such premises may be used by the proprietor, in addition to such manufacture of concentrates, for the production of a marketable article from the flashed juice or mash or for the production of a food product made from fruit of the same kind used in the manufacture of volatile fruit-flavor concentrates: *Provided*, That the assistant regional commissioner finds that such other business will not jeopardize the revenue, nor unduly increase administrative supervision. A proprietor desiring to use the premises for such other business must file application in triplicate with the assistant regional commissioner setting forth fully the details of the desired activity. Such other business may not be commenced until approval has been obtained from the assistant regional commissioner. (68A Stat. 627, 677; 26 U. S. C. 5171, 5511)

Because this Treasury Decision merely relieves restrictions on the use of volatile fruit-flavor concentrate plant premises, it is found that it is unnecessary to issue this Treasury Decision 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).

This Treasury Decision shall be effective upon filing for publication in the Federal Register.

(This Treasury Decision is issued under the authority contained in 68A Stat. 917; 26 U. S. C. 7805).

O. GORDON DELK,
Acting Commissioner of Internal Revenue.

Approved March 28, 1955.

H. CHAPMAN ROSE,
Acting Secretary of the Treasury.

(Filed with the Division of the Federal Register March 28, 1955, 4:03 p. m.)

SUBCHAPTER I.—MISCELLANEOUS GENERAL PROVISIONS

SECTION 5554.—PILOT PLANT OPERATIONS

26 CFR 170.40: Authority to waive regulatory provisions. T. D. 6116

TITLE 26—INTERNAL REVENUE, 1954.—CHAPTER I, SUBCHAPTER E, PART 170.—MISCELLANEOUS REGULATIONS RELATING TO LIQUOR

Authority for pilot and experimental operations

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:

Section 5554 of the Internal Revenue Code of 1954 (Public Law 591, 83d Cong., 2d sess.), provides as follows:

SEC. 5554. PILOT PLANT OPERATIONS.—For the purpose of facilitating the development and testing of improved methods of governmental supervision (necessary

for the protection of the revenue) over distilleries, internal revenue bonded warehouse, rectifying plants, industrial alcohol plants, industrial alcohol bonded warehouses, industrial alcohol denaturing plants, or similar premises established under this chapter or of chapter 26 of the Internal Revenue Code of 1939, the Secretary or his delegate is authorized to waive any regulatory provisions of this chapter for temporary pilot or experimental operations. Nothing in this section shall be construed as authority to waive the filing of any bond or the payment of any tax provided for in this chapter. The authority under this section shall terminate on December 31, 1955.

Pursuant to the above provision of law, there is added immediately following subpart B of part 170 of title 26 of the Code of Federal Regulations the following new subpart:

SUBPART C—PILOT AND EXPERIMENTAL OPERATIONS

SECTION 170.40. AUTHORITY TO WAIVE REGULATORY PROVISIONS.—Except as provided in section 170.41, the Director, Alcohol and Tobacco Tax Division, is authorized to waive, for such time as may be necessary, regulatory provisions of chapter 51 of the Internal Revenue Code of 1954 and regulations issued thereunder, for the purpose of facilitating the development, testing, and improvement of methods of governmental supervision (necessary for the protection of the revenue) over premises established and qualified under such provisions of law and regulations. For this purpose, the Director may, with the approval of the proprietor thereof, designate any such premises for such operations. The provisions of law and regulations waived and the period of time during which such waiver shall continue shall be stated in writing by the Director.

SEC. 170.41. LIMITATIONS ON WAIVER OF REGULATORY PROVISIONS.—The provisions of section 170.40 shall not be construed as authority to waive the filing of any bond or the payment of any tax provided for in chapter 51 of the Internal Revenue Code of 1954. The Director, Alcohol and Tobacco Tax Division, shall waive regulatory provisions of law only when such action is necessary to enable him to develop, test, and improve methods of governmental supervision necessary for protection of the revenue. The authority contained in section 170.40 shall terminate on December 31, 1955.

This Treasury Decision shall be effective upon publication in the Federal Register.

Because this Treasury Decision is necessary to give immediate effect to section 5554 of the Internal Revenue Code of 1954 to facilitate the development, testing, and improvement of methods of governmental supervision necessary for the protection of the revenue, it is found that 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.

(This Treasury Decision is issued under the authority contained in 68A Stat. 917; 26 U. S. C. 7805).

T. COLEMAN ANDREWS,
Commissioner of Internal Revenue.

Approved: December 23, 1954.

M. B. FOLSOM,
Acting Secretary of the Treasury.

(Published in the Federal Register December 29, 1954)

SECTION 5555.—RECORDS, STATEMENTS, AND RETURNS

26 CFR 182.643: Preparation and disposition.

For the method of showing the purpose for which taxfree alcohol is withdrawn, in cases where the withdrawal permit, Form 1450, does not show the specific purpose, see Rev. Rul. 55-321, page 572.

26 CFR 240.901: Form 2050.

Method of adjusting errors involving underpayment or overpayment of tax on wine. See Rev. Rul. 55-323, below.

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26 CFR 245.342: Beer tax return, Form 2034. Rev. Rul. 55-323
(Also 26 CFR 240.901.)

Where errors are found in a brewer's records, involving the overpayment and underpayment of tax on beer, which do not affect the quantities of beer removed subject to tax as reported on Form 103, Brewer's Monthly Report of Operations, and Form 2051, Record of Brewery Operations, the adjusting figures need be entered only on Form 2034, Beer Tax Return, in the spaces provided therefor. Where the quantities of beer reported on Forms 103 and 2051 are affected by the adjustments reported on Form 2034, the adjusting figures should be shown by special entries in the current reports, Forms 103 and 2051, followed by a memorandum notation explaining the errors.

Errors involving underpayment or overpayment of tax on wine may be similarly adjusted without requiring amended Form 702, Monthly Report of Wine Cellar Operations, by showing adjustments in the spaces provided therefor on Form 2050, Wine Tax Return, in instances where the quantities of wine reported on Form 702 are not affected by such adjustments. Where the quantities of wine reported on Form 702 are affected by the adjustments, the adjusting figures should be shown by the proprietor of the winery or bonded wine cellar by special entries in the report on Form 702 filed for the current month, followed by an explanatory notation in regard to the errors.

SECTION 5556.—REGULATIONS

26 CFR 182.439: Completion of operation required. Rev. Rul. 55-130
(Also 182.440; 26 CFR 220.706 and 220.709.)

> Where a plant, operated alternately as a registered distillery and an industrial alcohol plant, uses only one type of mash and the spirits or alcohol produced is identical except for designation, the stills may be considered sufficiently boiled out when the spirits drop in proof to a point below that required for the type of spirits being produced.

Advice has been requested whether it is necessary to completely boil out spirits remaining in the stills at the time operations of a plant as a distillery are discontinued and prior to its operation as an industrial alcohol plant, or vice versa.

The Industrial Alcohol Regulations, Part 182, and the Regulations relating to the Production of Distilled Spirits, Part 220, permit the alternate operation of a plant as an industrial alcohol plant and a distillery pursuant to the requirements specified therein. Sections 182.439 and 182.440 and sections 220.706 and 220.709 of such regulations provide for disposition of the alcohol and spirits produced (finished and unfinished) excepting the residues of such alcohol and spirits remaining in stills "which it is not practicable to completely

boil out," and the materials remaining on hand which may be transferred to the successor.

The provisions of the regulations were intended to permit the distiller to effect a practical method of concluding distillation for an alternate operation of the plant without the necessity of terminating operations. Consequently, the beer being conveyed to the beer stills should be cut preferably when the beer wells are empty and distillation should proceed until the quantity of beer entered into the stills has been practically exhausted.

When the same type of mash is being used in the production of the same type of spirits by the same manner of operations and the alcohol and spirits produced are identical except for designation, the stills may be considered sufficiently boiled out to comply with the provisions of the regulations when the spirits drop in proof to a point below that required for the type of spirits being produced.

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26 CFR 182.440: Transfer of materials, etc.

Beer remaining in the beer stills at the time a plant is alternated from a distillery to an alcohol plant or from an alcohol plant to a distillery. See Rev. Rul. 55-130, page 603.

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26 CFR 220.706: Completion of operation required.

Beer remaining in the beer stills at the time a plant is alternated from a distillery to an alcohol plant or from an alcohol plant to a distillery. See Rev. Rul. 55-130, page 603.

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26 CFR 220.709: Transfer of materials, etc.

Beer remaining in the beer stills at the time a plant is alternated from a distillery to an alcohol plant or from an alcohol plant to a distillery. See Rev. Rul. 55-130, page 603.

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26 CFR 225.969: Use of filter aids. Rev. Rul. 55-217
(Also 26 CFR 235.700; 26 CFR 230.193.)

The provisions of Revenue Rulings 54-185, C. B. 1954-1, 304, and 54-352, C. B. 1954-2, 475, permitting the use of activated carbon at the rate of 7 ounces to 400 gallons of spirits as a filtering medium in the clarification of whisky to be bottled without rectification and to be bottled in bond, respectively, provided the original character or composition of the distilled spirits is not changed thereby, are hereby modified to include all classes and types of distilled spirits bottled in bond or bottled without rectification.

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26 CFR 230.193: Use of filter aids.

Use of activated carbon as a filtering medium in the clarification of all classes and types of spirits bottled in bond and bottled without rectification. See Rev. Rul. 55-217, page 604.

Use of activated carbon as a filtering medium in the clarification of all classes and types of spirits bottled in bond and bottled without rectification. See Rev. Rul. 55-217, page 604.

SUBCHAPTER J.—PENALTIES, SEIZURES, AND FORFEITURES RELATING TO LIQUORS

PART I.—PENALTY, SEIZURE, AND FORFEITURE PROVISIONS APPLICABLE TO DISTILLING, RECTIFYING, AND DISTILLED AND RECTIFIED PRODUCTS

SECTION 5648.—PENALTY AND FORFEITURE FOR FRAUDULENT CLAIMS FOR EXPORT DRAWBACK OR UNLAWFUL RELANDING

(Also Part III-B, 2885 (d).) Rev. Rul. 55-324

Domestic distilled spirits may be withdrawn from customs custody, free of duty, by foreign persons having diplomatic or consular status, or by military personnel of foreign countries within the provisions of 19 U. S. C. 196a, provided there has been a valid withdrawal for exportation followed by a completed and bona fide exportation in respect of a particular lot of spirits and such spirits are reimported under the Tariff Act of 1930, as amended, 19 U. S. C., and placed in a Class 2 customs warehouse.

Advice has been requested whether domestic distilled spirits withdrawn for exportation free of tax or with benefit of drawback may be reimported and withdrawn from customs custody without payment of duty (equal to the internal revenue tax) for the purpose of supplying diplomats of foreign countries, or foreign military missions in the United States under section 196a of Title 19 of the United States Code.

Section 5648(b) of the Internal Revenue Code of 1954 reads as follows:

> Every person who intentionally relands within the jurisdiction of the United States any distilled spirits which have been shipped for exportation under the provisions of this chapter, or who receives such relanded distilled spirits, and every person who aids or abets in such relanding or receiving of such spirits, shall be fined not exceeding $5,000 and imprisoned not more than 3 years; and all distilled spirits so relanded, together with the vessel from which the same was relanded, within the jurisdiction of the United States, and all vessels, vehicles, or aircraft used in relanding and removing such distilled spirits, shall be forfeited to the United States.

The term "withdrawal for exportation" in section 5648(b) of the Code is interpreted to mean a withdrawal with the intention that such spirits be severed from the mass of goods in this country and entered into and flow in commerce in the foreign country. Similarly, "exportation" is not complete until the act of importation is effected in the foreign country. "Intentionally relands" is construed as meaning the bringing back to this country of goods that either have not been exported or were not withdrawn for valid exportation. Therefore, it would appear that a valid withdrawal for exportation which is followed by a completed exportation would not be subject to the prohibition against relanding contained in the above section of the Code, and would entitle the spirits, when reimported, to the advantages of the provisions of section 1201 of Title 19 of the U. S. Code.

Since the validity of the withdrawal for exportation depends upon the intention of the exporter, no hard and fast rule may be laid down as to what does or does not establish such intent. Each reimportation of distilled spirits previously exported must rest upon its own facts. If it can be shown that the so-called "exportation" was merely to evade, defeat, or delay the payment of tax by giving the product a temporary situs in a foreign country, then, upon relanding, the goods and persons concerned would be subject to liability under section 5648(b) of the Internal Revenue Code of 1954 (section 2885(d)(2) of the Internal Revenue Code of 1939). Compare *Flagler* v. *Kidd*, 78 Fed. 341.

Where there has been a valid withdrawal for exportation followed by a completed exportation as to a certain lot of spirits and such spirits are reimported under the Tariff Act of 1930 and placed in a Class 2 customs warehouse, they may be withdrawn free of duty by foreign persons enjoying diplomatic or consular status, or by military personnel of foreign countries within the provisions of section 196a of Title 19 of the U. S. Code in the same manner that such persons can secure spirits of foreign origin from such warehouses free of duty.

CHAPTER 80.—GENERAL RULES

SUBCHAPTER A.—APPLICATION OF INTERNAL REVENUE LAWS

SECTION 7805.—RULES AND REGULATIONS

26 CFR 220.379: Tests of beer and stillage. Rev. Rul. 55-218

The provisions of section 220.379 of the Distilled Spirits Regulations, which require the distiller to test samples of beer immediately prior to distillation, are intended to require such tests on the basis of individual fermenters. The provisions in the instructions on Form 1598, Proprietor's Report of Operations at Registered Distillery, relative to the sampling of beer from fermenters at registered distilleries will be changed to conform to the above requirement when the form is next revised. While the testing of composite samples of beer is not permitted, the alcoholic content of stillage or spent beer may be determined from a composite sample.

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26 CFR 230.115: Qualification. Rev. Rul. 55-345

Section 230.115 to section 230.118, inclusive, of the Regulations relating to Bottling of Taxpaid Spirits, contain the requirements and procedure for operations of a taxpaid bottling house under alternating proprietorships. The regulations do not require that alternate proprietors operate on the basis of 24-hour periods. *Held*, where each alternate proprietor has basically qualified for the operation of the taxpaid bottling house, the alternate operations may be effected at any designated time during regular business hours pursuant to the

filing and approval of Form 1696, Notice of Alternate Operations, in the manner provided in the sections referred to. The plant operation is of course subject to the restrictions provided by sections 230.155 and 230.156 of the regulations.

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26 CFR 235.129: Bottling tanks (Also 26 CFR 235.901.) Rev. Rul. 55–346

The outlet pipe lines of bottling tanks at rectifying plant premises are not required to be equipped with check valves where such bottling tanks are to be used exclusively for the bottling of unrectified products.

Revenue Ruling 55–56, page 569, this Bulletin, modified.

Advice has been requested whether the requirement of section 235.129 of the Regulations relating to the Rectification of Spirits and Wines, that check valves be installed in the outlet pipe lines of bottling tanks applies in the case of bottling tanks used exclusively for the bottling of unrectified products.

Section 235.685 of the regulations provides that proprietors of rectifying plants desiring to bottle taxpaid distilled spirits or wines without rectification will give notice on Form 230, Description and Gauge of Spirits or Wines for Bottling Without Rectification. Section 235.901 thereof requires Government locks upon the manheads, inlets, and outlets of bottling tanks except where the bottling is pursuant to Form 230.

In view of the provision of section 235.901 of the regulations, it is held that the requirement of section 235.129 for the installation of check valves in the outlet pipelines of bottling tanks does not apply to bottling tanks used exclusively for the bottling of spirits pursuant to Form 230. Accordingly, the Internal Revenue Service will not require the installation of check valves in the outlet pipelines of bottling tanks which are used only for the bottling of unrectified products pursuant to Form 230. However, if such bottling tanks are to be used at any time for the bottling of rectified products pursuant to Form 237, Report of Rectified Spirits and Wines, check valves must first be installed in the outlet pipelines.

Revenue Ruling 55–56, page 569, this Bulletin, is accordingly modified to eliminate the requirement for check valves on outlet pipelines in the case of bottling tanks used exclusively for the bottling of unrectified products pursuant to Form 230.

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26 CFR 235.901: Where locks are required.

For requirements with respect to installation of check valves on the outlet pipelines of bottling tanks at rectifying plants, see Rev. Rul. 55–346, page 607.

SUBPART B.—RULINGS AND DECISIONS UNDER THE INTERNAL REVENUE CODE OF 1939

Rulings and decisions published in Part III, subpart B, of the Internal Revenue Bulletin are based on the application of provisions of the Internal Revenue Code of 1939 and, unless otherwise noted therein, are published without consideration as to any application of the provisions of the Internal Revenue Code of 1954.

CHAPTER 26.—LIQUOR

SUBCHAPTER A.—DISTILLED SPIRITS

PART III.—INTERNAL REVENUE BONDED WAREHOUSES

SECTION 2885.—EXPORTATION OF SPIRITS WITHDRAWN FROM WAREHOUSES

Withdrawal of domestic distilled spirits from customs custody, free of duty, by foreign persons having diplomatic or consular status, or by military personnel of foreign countries. See Rev. Rul. 55-324, page 605.

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 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 4.—PERMITS

FAA Regulation No. 1, Section 1.42: Change in ownership, management, or control of business. Rev. Rul. 55-164

Section 1.42 of Regulations No. 1 provides that in the event of any change in the ownership, management, or control of any business operated pursuant to a basic permit (if the permittee is a corporation, if any change occurs in the officers, directors, or persons owning or controlling more than 10 percent of the voting stock of said corporation) the permittee shall immediately notify the applicable Assistant Regional Commissioner of such change, giving the names and addresses of all new persons participating in the ownership, management, or control of such business, or in the case of a corporation, the names and addresses of such new officers, directors, or persons owning or controlling more than 10 percent of the voting stock. This requirement for "immediate" notification of changes is interpreted in the light of other internal revenue regulations which require that such notification must be made *within 10 days*. See, for example, 26 CFR 220.260 of the Regulations Relating to the Production of Distilled Spirits. Accordingly, it is held that notification of such changes within 10 days by holders of basic permits under the Federal Alcohol Administration Act will satisfy the requirements of section 1.42 of Regulations No. 1.

SECTION 5(b).—UNFAIR COMPETITION AND UNLAWFUL PRACTICES: TIED HOUSE

FAA Regulations No. 6, Section 6.23: Inside signs: Wine and malt beverages. (Also Section 6.23a.) Rev. Rul. 55-403

In determining whether or not advertising signs, posters, displays, etc., intended for use consecutively in more than one retail establishment fall within the exceptions specified in section 6.23 and section

6.23a of Regulations No. 6, the total value may not be prorated proportionately to the amount of time the articles remain on the premises of a particular retailer.

FAA REGULATIONS No. 6, SECTION 6.23a: Inside signs: Distilled spirits.

Meaning of the term "total value" as used in sections 6.23 and 6.23a of Regulations No. 6. See Rev. Rul. 55-403, 609.

FAA REGULATIONS No. 6, SECTION 6.28: Retailer advertising specialties. Rev. Rul. 55-42

Section 6.28 of Regulations No. 6 provides that retailer advertising specialties, such as trays, coasters, beer mats, menu cards, meal checks, etc., which bear advertising matter and which are primarily valuable to the retailer as point-of-sale advertising media, may be furnished, given, or sold to a retailer if the aggregate cost to any industry member of such retailer advertising specialties furnished, given, or sold in connection with any one retail establishment in any one calendar year does not exceed $10. *Held:* Such retailer advertising specialties furnished by industry members to retailers which bear advertising matter of the industry member furnishing them may also bear the name or name and address of the retailer to whom furnished.

Rev. Rul. 55-166

An insurance policy purportedly protecting a retailer from the theft of bottles from a counter display is given to a retailer by a producer or wholesaler of distilled spirits or wine. *Held*, the giving of such insurance policy constitutes the furnishing of a thing of value within the meaning of section 5(b)(3) of the Federal Alcohol Administration Act. Accordingly, if retailers, either directly, or indirectly through wholesale channels, are induced to purchase distilled spirits or wine to the partial or complete exclusion of distilled spirits or wine sold or offered for sale by other persons in interstate or foreign commerce, by the furnishing of these insurance policies, violations of the Act would ensue. However, in view of the apparently negligible cost of the policies, it is doubtful that the furnishing of the policies to retailers would result in the "inducement" and "exclusion" proscribed by section 5(b)(3) of the Act.

Rev. Rul. 55-167

The furnishing of a pouring rack with bottles of distilled spirits or wine by producers or wholesalers of distilled spirits to retailers would come within the coverage of section 5(b)(3) of the Federal Alcohol Administration Act. It would not fall within any of the exceptions to the statute set forth in Regulations No. 6, relating to inducements furnished to retailers. Accordingly, if retailers, either directly, or indirectly through wholesale channels, are induced to purchase distilled spirits or wine to the partial or complete exclusion

of distilled spirits or wine sold or offered for sale by other persons in interstate or foreign commerce, as a result of furnishing these pouring racks, violations of the act would ensue. However, the cost of the racks would be a factor in determining as to whether the furnishing thereof to retailers would result in the proscribed "inducement" and "exclusion", *i. e.*, if the cost is nominal, it is questionable whether inducement and exclusion would result.

Rev. Rul. 55-168

An organization has among its members retail liquor dealers as well as various other local business establishments. It is a non-profit corporation organized for the purpose of inducing convention groups to hold their conventions in the city in which the organization is located. *Held*, dues payments made by wholesalers of distilled spirits, wine, and malt beverages to such organization would come within the coverage of section 5(b)(3) of the Federal Alcohol Administration Act. Violations thereof would result if such payments induced the various hotel and restaurant members (alcoholic beverage retailers) to purchase alcoholic beverages from such participating wholesalers to the partial or complete exclusion of alcoholic beverages sold or offered for sale by non-participating wholesalers. If, however, membership in the organization is on a completely voluntary basis with dues set at specified rates as, for example, $100 per year for small wholesale liquor dealers, $500 per year for medium-sized wholesale liquor dealers, and $1,000 per year for large wholesale liquor dealers, rather than on a sliding scale based on the volume of business enjoyed by each wholesaler, and there is no discrimination by the retailers who are members of the organization against non-member wholesalers, payments of dues by participating wholesalers would be unlikely to result in any violation of section 5(b)(3) of the Act.

Rev. Rul. 55-401

The purchase of tickets to a retailer's open house, anniversary party, remodeling party, or similar event sponsored by the retailer, would result in a violation of section 5(b)(3) of the Federal Alcohol Administration Act if the purchase of such tickets by producers, importers, or wholesalers from retailers results in the proscribed "inducement" and "exclusion."

Advice has been requested whether the purchase by a wholesaler of alcoholic beverages of tickets to a retailer's open house, anniversary party, remodeling party, or similar event, would fall within the coverage of section 5(b)(3) of the Federal Alcohol Administration Act.

Section 5(b)(3) of the Federal Alcohol Administration Act, among other things, makes it unlawful for any person engaged in business as a producer, importer, or wholesaler of alcoholic beverages, directly or indirectly or through an affiliate, to induce a retailer to purchase alcoholic beverages from such person to the exclusion or partial exclusion of alcoholic beverages sold or offered for sale by other persons in interstate commerce, under the conditions set forth therein and, in the case of malt beverages, within the jurisdiction limitations imposed by the penultimate paragraph of section 5, by giving money or other things of value to such retailers.

The purchase of tickets to a retailer's open house, anniversary party, remodeling party, or other similar event sponsored by the retailer, would fall within the cover of section 5(b)(3). Accordingly, if the purchase of such tickets by producers, importers, or wholesalers from retailers results in the proscribed inducement or exclusion, violations of the Act would ensue.

SECTION 5(e).—UNFAIR COMPETITION AND UNLAWFUL PRACTICES: LABELING

FAA REGULATIONS No. 3, SECTION 21: The standards of identity.

Blending of natural wine which has become substandard by reason of the development of excessive volatile acidity with another natural wine made from the same kind of fruit. See Rev. Rul. 55-214, page 597.

FAA REGULATIONS No. 4, SECTION 30: General.

Samples of wine for distribution by salesmen of a bonded wine cellar proprietor to prospective purchasers. See Rev. Rul. 55-213, page 596.

FAA REGULATIONS No. 4, SECTION 50: Certificate of label approval. Rev. Rul. 55-169
(Also FAA Regulations No. 5, Section 50; FAA Regulations No. 7, Section 41.)

> Bottlers and importers of distilled spirits, wines, and malt beverages may use sets of labels differing from sets of labels covered by certificates of approval only in that there has been added an additional shoulder, strip, or other label bearing the name, or name and address, of the wholesaler or retailer, preceded by such phrases as "bottled for," "selected for," "made for," or "imported for."
>
> Revenue Ruling 54-392, 2, C. B. 1954-2, 585, superseded.

Advice has been requested whether a wine importer may place on bottles of imported wine, labels identifying wholesale and/or retail distributors, even though such labels are not covered by the importer's Certificate of Label Approval, Form 1649.

The instructions on Form 1647, Application for Certificate of Label Approval Under the Federal Alcohol Administration Act, presently require that the complete set of labels to be used on any individual container must be submitted with this form. Form 1649, Certificate of Label Approval Under the Federal Alcohol Administration Act (which is issued pursuant to Form 1647), to which are affixed labels identical with those on Form 1647, authorizes only the use of such labels and others differing from them in certain specified respects, such as a change in the proportionate size of the labels or the statement of different net contents.

In order to avoid the constant resubmission of labels to cover sets of labels differing from previously approved labels only in that they

contain an additional strip, shoulder, or other label merely identifying a wholesaler or retailer for whom the product was bottled or imported, bottlers and importers of distilled spirits, wines, and malt beverages may use sets of labels differing from sets of labels covered by certificates of approval in that there has been added an additional shoulder, strip, or other label bearing only the name, or name and address, of the wholesaler or retailer, preceded by such phrases as "bottled for," "selected for," "made for," or "imported for," and containing no references whatever to the characteristics of the product.

Forms 1647 and 1649 will be appropriately revised when they are reprinted.

Revenue Ruling 54–392, C. B. 1954–2, 585, superseded.

FAA REGULATIONS No. 5, SECTION 21: The standards of identity.

Requirements with respect to age to be claimed on straight whisky which is taxpaid at 8 years of age and consolidated in the original containers as wholesale liquor dealer packages. See Rev. Rul. 55–399, page 572.

FAA REGULATIONS No. 5, SECTION 22: Alteration of class and type: Harmless coloring, flavoring, and blending materials. Rev. Rul. 55–165

The presence in a whisky produced in a given foreign country of not more than 2½ percent of harmless coloring, flavoring, or blending materials, including whiskies of other origin, is not required to be disclosed upon the label.

Advice has been requested whether the presence of bourbon, rye, or malt whisky used as all or a portion of the permissible 2½ percent harmless coloring, flavoring, and blending material, and of an origin other than that of the whisky in which it is used, would have to be disclosed on the label of such rectified product.

Section 22 of Regulations No. 5 permits the use in whiskies, other than American type straight whiskies, of "harmless coloring, flavoring or blending materials such as * * * straight malt or straight rye malt whiskies, * * * which are customarily employed therein in accordance with established trade usage, if such coloring, flavoring, or blending materials do not total more than 2½ percent by volume of the finished product."

The Internal Revenue Service does not consider that the origin of this limited amount of such flavoring materials, including whiskies permitted to be used in this connection, affects the right of the finished product to claim its proper State or country of origin. For example, a blend of straight Kentucky whiskies might contain the permissible amount of straight malt or straight rye malt whiskies, or similar whiskies suitable for use in this connection, of other than Kentucky origin, without affecting the right of the finished product to be designated as a Kentucky blend.

Similarly, any whisky produced in any given foreign country might contain 2½ percent of harmless coloring, flavoring, or blending ma-

terials, including whiskies of other origin, without any conflict occurring with the provisions of section 22 of Regulations No. 5. The presence of such whiskies used within the 2½ percent limitation would not be required to be disclosed upon the label. However, while it would not be necessary under the statute and regulations, there is no objection to the addition of the following statement to a standard certificate of origin properly issued by a duly authorized official of a foreign country:

The total coloring, flavoring or blending materials used in this product do not exceed 2½ percent by volume of the finished product.

FAA Regulations No. 5, Section 22: Alteration of class and type; harmless coloring, flavoring, and blending materials.

Use of recovered spirits (not neutral) and neutral spirits stored in reused cooperage as coloring, flavoring, or blending material in blends of whisky. See Rev. Rul. 55-176, page 577.

FAA Regulations No. 5, Section 50: Certificates of label approval.

Use of labels by bottlers and importers identifying wholesale or retail distributors, not covered by certificates of label approval. See Rev. Rul. 55-169, page 612.

FAA Regulations No. 7, Section 27: Net contents. Rev. Rul. 55-131

The new odd-size containers for malt beverages must bear very large and conspicuous statements of net contents on their labels, in the manner herein prescribed. All cans and labels for the new small sizes should be presented to the Director, Alcohol and Tobacco Tax Division, for approval.

When Regulations No. 7, Relating to Labeling and Advertising of Malt Beverages, were adopted in 1936, no provisions were made for standards of fill, as was the case initially with the distilled spirits labeling regulations and later with the wine labeling regulations so far as domestic wines are concerned. The omission of such standards from the malt beverage labeling requirements apparently resulted from the fact that containers for these products seemed well standardized and, with the exception of specialties and negligible quantities of beer and ale packaged in so-called "splits," were predominantly limited to the twelve-ounce, quart and two-quart containers, with the eleven-ounce container being used in limited areas of the West. This situation has continued relatively unchanged until quite recently.

Late in 1954, however, certain new containers, differing in net contents from the traditional cans and bottles, began to appear upon the market. One of these was the four-fifths quart and others were the ten and eleven-ounce cans. It has been rumored that still other sizes may make their appearance before long.

The Alcohol and Tobacco Tax Division is considering the advisability of holding a hearing looking toward the adoption of standards of fill for malt beverages, the determination as to which will be dependent, in part, on the results of a consumer survey now being undertaken. Pending a decision in this matter and effective immediately, the new odd size containers are required to bear very large and conspicuous statements of net contents on their labels in order to minimize any consumer deception which may result from the consumer's relative lack of familiarity with these sizes and their confusion in his mind with similar and larger containers to which he is accustomed. The mere blowing of the net contents statement in the base of a glass bottle does not constitute sufficient conspicuousness in the case of these new sizes. Such statement should appear in large type upon a neck or other front label. In the case of cans, the statement should appear with striking conspicuousness in a horizontal rather than a vertical position.

All cans and labels for the new small sizes should be presented to the Director, Alcohol and Tobacco Tax Division, for approval, regardless of the instructions on the label application form, Form 1647, Application for Certificate of Label Approval Under the Federal Alcohol Administration Act, and will henceforth be judged by these standards. Labels and cans already in use should be appropriately revised with all possible promptness.

Inquiries in regard to this Revenue Ruling should refer to the number thereof and the symbols O:AT:B.

FAA REGULATIONS No. 7, SECTION 41: Certificates of label approval.

Use of labels by bottlers and importers identifying wholesale or retail distributors, not covered by certificates of label approval. See Rev. Rul. 55-169, page 612.

Rev. Rul. 55-402

There is no provision in the Federal Alcohol Administration Act or in chapter 51 of the Internal Revenue Code of 1954 which would prohibit the sale by retail liquor dealers to consumer purchasers of packets of comic whisky labels.

SECTION 5(f).—UNFAIR COMPETITION AND UNLAWFUL PRACTICES: ADVERTISING

FAA REGULATIONS No. 7, SECTION 54: Prohibited statements. Rev. Rul. 55-404

References to the calorie content of malt beverages in the advertising thereof and to more specific implications, however made, that malt beverages are nonfattening or virtually so, are likely to mislead the consumer and may not be permitted.

The Internal Revenue Service has been requested to determine whether references in malt beverage advertising to calorie content and

representations implying that the malt beverage is nonfattening are likely to be misleading to the public.

Section 5(f) of the Federal Alcohol Administration Act and section 54 of Regulations No. 7, relative to malt beverage advertising, prohibit the use in any advertisement which is in interstate commerce or which is calculated to induce sales in interstate commerce of any statement that is false or misleading in any particular or that is disparaging of a competitor's products, if the law of the State into which the malt beverages are to be shipped imposes similar requirements.

For some time, various members of the brewing industry have employed advertising themes which either directly or indirectly have tended to convey the impression that their products are nonfattening or relatively less fattening than other competitive beverage items or than food items used in the normal diet. One early approach involved the use of claims of freedom from starch or relative freedom from sugar, on the part of the advertised malt beverage product.

In the spring of 1953, members of the industry were advised that such sugar and starch claims were misleading and contrary to the regulations since all beers are free of starch and none contains more than a negligible quantity of sugar, so small as not to account for any appreciable portion of the product's caloric content. This view was also stated, with respect to starch in beer, in Revenue Ruling 54–513, C. B. 1954–2, 593. In the spring of 1954, the industry was advised that calorie references, to avoid misleading the public, should be qualified by accurate statements as to actual caloric content. The industry was further advised that caloric comparisons between the advertised beer and food or beverage items commonly consumed by the public were not considered objectionable on the basis of the facts then available.

As time passed, however, and as additional brewing companies adopted the low calorie theme, it became increasingly evident that low calorie claims, even when qualified by statements of the actual caloric content, might be misleading in certain respects. Numerous industry members, as well as certain State control officials, urged the reexamination of this question.

During the closing weeks of the year 1954, the Alcohol and Tobacco Tax Division began a consumer survey in order to determine whether misleading implications were involved in the use of such a theme. This survey supports the position that treatments calculated to imply nonfattening or less fattening properties on the part of beer are misleading and therefore contrary to the regulations. Substantial percentages of the people interviewed in the survey received the impression that the advertised product was either entirely nonfattening or at least negligible in calorie content; that it was less fattening than other competitive beers; that the consumer could lose weight by drinking it; that the product was approximately equal in food value to the food item with which its calorie content was compared; or that the advertised product could be substituted for these food items with the same nutritional results.

Members of the brewing industry have been advised to desist from the use of any further references to the calorie content of their products and to more specific implications, however made, that their products are nonfattening or virtually so. Inasmuch as the Internal

Revenue Service did not previously object to calorie treatments, pending the development of specific evidence on this point, a reasonable time is being allowed for the preparation of substitute advertising copy. Since it is now evident, however, that such advertising is likely to result in consumer deception, the transition to unobjectionable advertising should be effected as expeditiously as possible.

Rev. Rul. 55–43

Section 5(f) of the Federal Alcohol Administration Act provides in part that it is unlawful for a distiller or rectifier among others to publish or disseminate in any newspaper, periodical or other publication or any other printed or graphic matter, any advertisement of distilled spirits, if such advertisement is in interstate commerce or is calculated to induce sales in such commerce or is disseminated by mail unless it conforms with regulations designed, among other things, to prevent consumer deception and prohibit disparaging or false or misleading statements. *Held*, sales pamphlets relating to distilled spirits or wines which are not distributed to or shown to consumers or left with retailers but are to be exhibited to prospective wholesaler or retailer purchasers by a permittee's salesman constitute advertising within the meaning of section 5(f) of the Act.

PART IV

LEGISLATION AND TREATIES

SUBPART A.—LEGISLATION

PUBLIC LAW 1, EIGHTY-FOURTH CONGRESS
[CHAPTER 1, FIRST SESSION]
H. R. 2369

An Act To amend section 7237 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 the first sentence of subsection (a) of section 7237 of the Internal Revenue Code of 1954 is hereby amended by striking out "subpart C of part I," and inserting in lieu thereof "Part I". Subsection (b) of such section is hereby amended by striking out "subpart C of".

Approved January 20, 1955.

PUBLIC LAW 18, EIGHTY-FOURTH CONGRESS
[CHAPTER 18, FIRST SESSION]
H. R. 4259

An Act To provide a one-year extension of the existing corporate normal-tax rate and of certain excise-tax rates.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That this Act may be cited as the "Tax Rate Extension Act of 1955."

SEC. 2. ONE-YEAR EXTENSION OF CORPORATE NORMAL TAX-RATE

Section 11(b) (relating to corporate normal tax), section 821(a)(1)(A) (relating to mutual insurance companies other than interinsurers), and section 821(b)(1) (relating to interinsurers) of the Internal Revenue Code of 1954 are hereby amended as follows:

(1) By striking out "April 1, 1955" each place it appears and inserting in lieu thereof "April 1, 1956";

(2) By striking out "April 1, 1955" each place it appears and inserting in lieu thereof "April 1, 1956";

(3) By striking out "March 31, 1955" each place it appears and inserting in lieu thereof "March 31, 1956";

(4) By striking out "March 31, 1955" each place it appears and inserting in lieu thereof "March 31, 1956".

SEC. 3. ONE-YEAR EXTENSION OF CERTAIN EXCISE TAX RATES.

(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"—

(1) section 4041(c) (relating to special fuels);

(2) section 4061 (relating to motor vehicles);

(3) section 4081 (relating to gasoline);
(4) section 5001(a)(1) (relating to distilled spirits);
(5) section 5001(a)(3) (relating to imported perfumes containing distilled spirits);
(6) section 5022 (relating to cordials and liqueurs containing wine);
(7) section 5041(b) (relating to wines);
(8) section 5051(a) (relating to beer); and
(9) section 5701(c)(1) (relating to cigarettes).

(b) TECHNICAL AMENDMENTS.—The following provisions of the Internal Revenue Code of 1954 are hereby amended as follows:

(1) Section 5063 (relating to floor stocks refunds on distilled spirits, wines, cordials, and beer) is amended by striking out "April 1, 1955" each place it appears and inserting in lieu thereof "April 1, 1956", and by striking out "May 1, 1955" and inserting in lieu thereof "May 1, 1956,".

(2) Section 5134(a)(3) (relating to drawback in the case of distilled spirits) is amended by striking out "March 31, 1955" and inserting in lieu thereof "March 31, 1956".

(3) Subsections (a) and (b) of section 5707 (relating to floor stocks refunds on cigarettes) are amended by striking out "April 1, 1955" each place it appears and inserting in lieu thereof "April 1, 1956", and by striking out "July 1, 1955" and inserting in lieu thereof "July 1, 1956".

(4) Subsections (a) and (b) of section 6412 (relating to floor stocks refunds on motor vehicles and gasoline) are amended by striking out "April 1, 1955" each place it appears and inserting in lieu thereof "April 1, 1956", and by striking out "July 1, 1955" each place it appears and inserting in lieu thereof "July 1, 1956".

Section 497 of the Revenue Act of 1951 (relating to refunds on articles from foreign trade zones), as amended by the Excise Tax Reduction Act of 1954, is hereby amended by inserting after "Internal Revenue Code" each place it appears "of 1939 (or section 5701(c), 5001(a), 5022, 5041(b), or 5051(a) of the Internal Revenue Code of 1954)", and by striking out "April 1, 1955" each place it appears and inserting in lieu thereof "April 1, 1956".

Approved March 30, 1955.

PUBLIC LAW 764, EIGHTY-THIRD CONGRESS
[CHAPTER 1209, SECOND SESSION]
H. R. 6287

An Act To extend and amend the Renegotiation Act of 1951[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 is hereby amended by striking out "December 31, 1953" and inserting in lieu thereof "December 31, 1954."

SEC. 2. (a) Section 105(f)(1) of such Act is amended by striking out "$250,000" wherever it appears therein and inserting in lieu thereof the following: "$250,000, in the case of a fiscal year ending before June 30, 1953, or $500,000, in the case of a fiscal year ending on or after June 30, 1953".

(b) Section 105(f)(3) of such Act is amended by inserting, in the second sentence thereof, after "the $250,000 amount" the following: ", the $500,000 amount,".

SEC. 3. (a) Paragraph (6) of section 106(a) of such Act is hereby amended by inserting immediately following the second period therein the following: "In designating those classes and types of contracts which shall be exempt and in exempting any individual contract under this paragraph, the Board shall consider as not having a direct or

[1] For excerpts from the Renegotiation Act of 1951, see C. B. 1951-1, 180.

immediate connection with national defense any contract for the furnishing of materials or services to be used by the United States, a Department or agency thereof, in the manufacture and sale of synthetic rubbers to a private person or to private persons which are to be used for nondefense purposes. If the use by such private person or persons shall be partly for defense and partly for nondefense purposes, the Board shall consider as not having a direct or immediate connection with national defense that portion of the contract which is determined not to have been used for national defense purposes. The method used in making such determination shall be subject to approval by the Board."

(b) The amendment made by subsection (a) shall be effective as if it were a part of such Renegotiation Act of 1951 on the date of its enactment.

SEC. 4. (a) Paragraph (1) of section 106(c) of such Act is hereby amended by striking out "from subcontracts" and inserting in lieu thereof "from contracts or subcontracts."

(b) Paragraph (1) of section 106(c) of such Act is further amended by inserting "(A)" after the word "except" and by adding before the period at the end of such paragraph the following: "and (B) to receipts and accruals from contracts for new durable productive equipment in cases in which the Board finds that the new durable productive equipment covered by such contracts cannot be adapted, converted, or retooled for commercial use".

(c) Paragraph (2) of such section 106(c) is hereby amended to read as follows:

> (2) DEFINITION.—For the purpose of this subsection, the term 'durable productive equipment' means machinery, tools, or other equipment which does not become a part of an end product, or of an article incorporated therein, and which has an average useful life of more than five years.

(d) The amendments made by subsections (a), (b), and (c) 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. 5. (a) Section 106(a) of such Act is hereby amended—

(1) by striking out, in paragraph (7), "by reason of this subsection." and inserting in lieu thereof "by reason of any paragraph, other than paragraph (8), of this subsection; or"; and

(2) by adding at the end of such section the following:

> (8) any contract or subcontract for the making or furnishing of a standard commercial article, unless the Board makes a specific finding that competitive conditions affecting the sale of such article are such as will not reasonably prevent excessive profits. This paragraph shall apply to any such contract or subcontract only if (1) the contractor or subcontractor files, at such time and in such form and detail as the Board shall by regulations prescribe, such information and data as may be required by the Board under its regulations for the purpose of enabling it to reach a decision with respect to the making of a specific finding under this paragraph, and (2) within a period of six months after the date of filing of such information and data, the Board fails to make a specific finding that competitive conditions affecting the sale of such article are such as will not reasonably prevent excessive profits, or (3) within such six-month period, the Board makes a specific finding that competitive conditions affecting the sale of such article are such as will reasonably prevent excessive profits. Any contractor or subcontractor may waive the exemption provided in this paragraph with respect to receipts or accruals in any fiscal year by including a statement to such effect in the financial statement filed by such contractor or subcontractor for such fiscal year pursuant to section 105(e)(1). Any specific

finding of the Board under this paragraph shall not be reviewed or redetermined by any court or agency other than by the Tax Court of the United States in a proceeding for a redetermination of the amount of excessive profits determined by an order of the Board. For the purpose of this paragraph—

(A) the term "article" includes any material, part, component, assembly, machinery, equipment, or other personal property;

(B) the term "standard commercial article" means an article—

(1) which, in the normal course of business, is customarily manufactured for stock, and is customarily maintained in stock by the manufacturer or any dealer, distributor, or other commercial agency for the marketing of such article; or

(2) which is manufactured and sold by more than two persons for general civilian industrial or commercial use, or which is identical in every material respect with an article so manufactured and sold:

(C) the term "identical in every material respect" means of the same kind, manufactured of the same or substitute materials, and having the same industrial or commercial use or uses, without necessarily being of identical specifications; and

(D) the term "persons" does not include any person under control of, or controlling, or under common control with any other person considered for the purposes of subparagraph (B) (2) of this paragraph.

(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. 6. (a) Section 106(a)(4) of such Act is hereby amended by striking out "; or" at the end thereof and inserting the following: "and to such furnishing or sale in any case in which the Board finds that the regulatory aspects of rates for such furnishing or sale, or the type and nature of the contract for such furnishing or sale, are such as to indicate, in the opinion of the Board, that excessive profits are improbable; or".

(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 December 31, 1953.

SEC. 7. (a) Section 105 (d) of such Act is hereby amended by striking out the period at the end of the last sentence thereof and inserting the following: ", and shall also have the power to set aside and declare null and void any such agreement if, upon a request made to the Board within three years from the date of such agreement, the Board finds as a fact that the aggregate of the amounts received or accrued by the other party to such agreement during the fiscal year covered by such agreement was not more than the minimum amounts subject to renegotiation specified in section 105(f) for such fiscal year."

(b) The amendment made by subsection (a) shall be effective as if it were a part of the Renegotiation Act of 1951 on the date of its enactment.

SEC. 8. Section 201 (h) of such Act is hereby amended by striking out "two years" and inserting in lieu thereof "four years", and by adding at the end thereof the following new sentence: "If any such case has been dismissed by any court for failure to substitute for the War Contracts Price Adjustment Board prior to the effective date of this sentence, such case is hereby revived and reinstated in such court as if it had not been dismissed."

Approved September 1, 1954.

SUBPART B.—TAX CONVENTIONS

T. D. 6120

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER A, PART 7.—TAXATION PURSUANT TO TREATIES

Treasury Decision 6055 amended to provide that Form 1042 Supplement be filed with the District Director of Internal Revenue, Baltimore 2, Maryland.

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

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

PARAGRAPH 1. In order to provide for the filing of Form 1042 Supplement (relating to income paid to persons whose addresses are in any foreign country with which the United States has a tax treaty) with the District Director of Internal Revenue, Baltimore 2, Maryland, the first undesignated subparagraph of section 7.1(a) of Treasury Decision 6055 (26 CFR 7.1(a)(1)) [C. B. 1953-2, 77] is amended to read as follows:

Every United States withholding agent shall make and file an information return on Form 1042 Supplement with respect to each foreign country which has, or will have, entered into an income tax convention with the United States, if such convention provides for the mutual exchange of information and if the Commissioner of Internal Revenue determines that such return is required in the case of such country. For the calendar year 1953, this return shall be filed with the District Director of Internal Revenue for the district in which the withholding agent is located. For the calendar year 1954 and subsequent calendar years, Form 1042 Supplement shall be filed with the District Director of Internal Revenue, Baltimore 2, Maryland.

PAR. 2. The amendment provided by paragraph 1 shall apply notwithstanding any regulation to the contrary which has been approved prior to the date on which this Treasury Decision is published in the Federal Register.

Because this Treasury Decision merely amends Treasury Decision 6055 to change the designation of the official with whom certain documents shall be filed, it is hereby found unnecessary to issue this Treasury Decision with notice and public procedure thereon under section 4(a) of the Administrative Procedure Act, approved June 11, 1946, or subject to the effective date limitation of section 4(c) of that Act.

(This Treasury Decision is issued under the authority contained in section 7805 (68A Stat. 917; 26 U. S. C. 7805) of the Internal Revenue Code of 1954, and in the provisions relating to exchange of information which are found in the respective income tax conventions between the United States and the foreign countries here concerned.)

JUSTIN F. WINKLE,
Acting Commissioner of Internal Revenue.

Approved January 11, 1955.

M. B. FOLSOM,
Acting Secretary of the Treasury.

[(Published in the Federal Register January 15, 1955)

UNITED STATES-CANADA INCOME TAX CONVENTION

The convention between the United States and Canada for the avoidance of double taxation and the prevention of fiscal evasion with respect to income taxes (C. B. 1943, 526), which was signed at Washington on March 4, 1942, was modified and supplemented on June 12, 1950.

The supplementary convention was ratified by Canada on August 1, 1950; was approved for ratification by the United States Senate on September 17, 1951, and was ratified by the President on November 16, 1951. The ratifications were exchanged at Washington on November 21, 1951. The supplementary convention was proclaimed by the President on November 29, 1951, and is effective with respect to taxable years beginning on or after the first day of January of the calendar year in which occurs the exchange of the instruments of ratification.[1]

The convention, as so modified and supplemented, reads as follows:

ARTICLE I

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 in accordance with the articles of this convention to its permanent establishment in the latter State.

No account shall be taken in determining the tax in one of the contracting States, of the mere purchase of merchandise effected therein by an enterprise of the other State.

ARTICLE II

For the purposes of this convention, the term "industrial and commercial profits" shall not include income in the form of rentals and royalties, interest, dividends, management charges, or gains derived from the sale or exchange of capital assets.

Subject to the provisions of this convention such items of income shall be taxed separately or together with industrial and commercial profits in accordance with the laws of the contracting States.

ARTICLE III

1. If an enterprise of one of the contracting States has a permanent establishment in the other State, there shall be attributed to such permanent establishment the net industrial and commercial profit 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. Such a net profit will, in principle, be determined on the basis of the separate accounts pertaining to such establishment. In the determination of the net industrial and commercial profits of the permanent establishment there shall be allowed as deductions all expenses, wherever incurred, reasonably allocable to the permanent establishment, including executive and general administrative expenses so allocable.[2]

2. The competent authority of the taxing State may, when necessary, in execution of paragraph 1 of this Article, rectify the accounts produced, notably to correct errors and omissions or to reestablish the prices or remunerations entered in the books at the value which would prevail between independent persons dealing at arm's length.

3. If (*a*) an establishment does not produce an accounting showing its own operations, or (*b*) the accounting produced does not correspond to the normal usages of the trade in the country where the establishment is situated, or (*c*)

[1] Two separate versions of par. 1 of Article XV are effective on two different dates.

[2] The supplementary convention signed June 12, 1950, added the last sentence to par. 1 of Article III.

the rectifications provided for in paragraph 2 of this Article can not be effected the competent authority of the taxing State may determine the net industrial and commercial profit by applying such methods or formulae to the operations of the establishment as may be fair and reasonable.

4. To facilitate the determination of industrial and commercial profits allocable to the permanent establishment, the competent authorities of the contracting States may consult together with a view to the adoption of uniform rules of allocation of such profits.

ARTICLE IV

1. (a) When a United States enterprise, by reason of its participation in the management or capital of a Canadian enterprise, makes 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 should normally have appeared in the balance sheet of the Canadian enterprise but which have been, in this manner, diverted to the United States enterprise, may be incorporated in the taxable profits of the Canadian enterprise, subject to applicable measures of appeal.

(b) In order to effect the inclusion of such profits in the taxable profits of the Canadian enterprise, the competent authority of Canada may, when necessary, rectify the accounts of the Canadian enterprise, notably to correct errors and omissions or to reestablish the prices or remuneration entered in the books at the values which would prevail between independent persons dealing at arm's length. To facilitate such rectification the competent authorities of the contracting States may consult together with a view to such determination of profits of the Canadian enterprise as may appear fair and reasonable.

2. The same principle applies, *mutatis mutandis*, in the event that profits are diverted from a United States enterprise to a Canadian enterprise.

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 exempt from taxation in the other contracting State.

The present convention will not be deemed to affect the exchange of notes between the United States of America and Canada, dated August 2 and September 17, 1928, providing for relief from double income taxation on shipping profits.

ARTICLE VI

1. (a) Remuneration, wages or salary (other than pensions) paid to an individual by the United States of America, or by any agency, instrumentality or political subdivision thereof, in respect of services rendered in the discharge of governmental functions, shall be exempt from Canadian tax if the individual is either a citizen of the United States of America, or is not ordinarily resident in Canada or is ordinarily resident in Canada solely for the purpose of rendering those services.

(b) Remuneration, wages, or salary (other than pensions) paid to an individual, other than a citizen of the United States of America, by Canada, or by any agency, instrumentality or political subdivision thereof, in respect of services rendered in the discharge of governmental functions, shall be exempt from United States tax.

2. The provisions of paragraph 1 of this Article shall not apply to payments in respect of services rendered in connection with any trade or business carried on for purposes of profit by either of the contracting States or by any agency, instrumentality or political subdivision thereof.

3. (a) The United States of America agrees to exempt from its income tax income derived from sources outside the United States of America by a member of the Canadian forces or by a citizen of Canada serving or employed by the Government of Canada at defense establishments in the United States of America, or by the wife or minor children of such member or citizen.

(b) The same principle shall apply, *mutatis mutandis*, to income derived from sources outside Canada by a member of the United States forces or by a citizen of the United States of America serving or employed by the Government of the

United States of America at defense establishments in Canada or by the wife or minor children of such member or citizen.[3]

ARTICLE VI A

Pensions (including Government pensions) and life annuities derived from within one of the contracting States by a resident of the other contracting State shall be exempt from taxation in the former State.[4]

ARTICLE VII

1. A resident of Canada shall be exempt from United States tax upon compensation for personal (including professional) services performed during the taxable year within the United States of America if he is present therein 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 personal services performed as an officer or employee of a resident, or corporation or other entity of Canada, or

(b) his compensation received for such personal services does not exceed $5,000.

* * * * * * * [a]

3. The provisions of paragraphs 1 and 2 of this Article shall apply, *mutatis mutandis*, to a resident of the United States of America with respect to compensation for such personal services performed in Canada.[5]

ARTICLE VIII

Gains derived in one of the contracting States from the sale or exchange of capital assets by a resident or a corporation or other entity of the other contracting State shall be exempt from taxation in the former State, provided such resident or corporation or other entity has no permanent establishment in the former State.

ARTICLE VIII A

A professor or teacher who is a resident of one of the contracting States and 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 such other State, shall be exempted by such other State from tax on his remuneration for such teaching for such period.[6]

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[a] Paragraph 2 deleted by Protocol.

[3] Prior to amendment by the supplementary convention signed June 12, 1950, Article VI read as follows:

"ARTICLE VI.—Wages, salaries and similar compensation paid by the Government, or any agency or instrumentality thereof, of one of the contracting States or by the political subdivisions or territories or possessions thereof to citizens of such State residing in the other State shall be exempt from taxation in the latter State.

"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."

[4] Article VI A was added by supplementary convention signed June 12, 1950.

[5] Prior to amendment by the supplementary convention signed June 12, 1950, Article VII read as follows:

"ARTICLE VII.—1. A resident of Canada shall be exempt from United States income tax upon compensation for labor or personal services performed within the United States of America if he conforms to either of the following conditions:

"(*a*) He is temporarily present within the United States of America for a period or periods not exceeding a total of 183 days during the taxable year and such compensation (A) is received for labor or personal services performed as an employee of, or under contract with, a resident or corporation or other entity of Canada and (B) does not exceed $5,000 in the aggregate during such taxable year; or (*b*) he is temporarily present in the United States of America for a period or periods not exceeding a total of 90 days during the taxable year and the compensation received for such services does not exceed $1,500 in the aggregate during such taxable year.

"2. The provisions of paragraph 1(*a*) of this article shall have no application to the professional earnings of such individuals as actors, artists, musicians and professional athletes.

"3. The provisions of paragraphs 1 and 2 of this article shall apply, mutatis mutandis, to a resident of the United States of America deriving compensation for personal services performed within Canada."

[6] Article VIII A was added by supplementary convention signed June 12, 1950.

ARTICLE IX

Students or business apprentices from one of the contracting States residing in the other contracting State for purposes of study or for acquiring business experience shall not be taxable by the latter State in respect of remittances received by them from within the former State for the purposes of their maintenance or studies.

ARTICLE X

Income derived from sources within one of the contracting States by a religious, scientific, literary, educational, or charitable organization of the other contracting State shall be exempt from taxation in the State from which the income is derived if, within the meaning of the laws of both contracting States, such organization would have been exempt from income tax.

ARTICLE XI

1. The rate of income tax imposed by one of the contracting States, in respect of income derived from sources therein, upon individuals residing in, or corporations organized under the laws of, the other contracting State, and not having a permanent establishment in the former State, shall not exceed 15 percent for each taxable year.[7]

2. Notwithstanding the provisions of paragraph 1 of this article, income tax in excess of 5 percent shall not be imposed by one of the contracting States in respect of dividends paid by a subsidiary corporation organized under the laws of such State, or of a political subdivision thereof, to a parent corporation organized under the laws of the other contracting State, or of a political subdivision thereof: Provided, however, That this paragraph shall not apply if the competent authority in the former State is satisfied that the corporate relationship between the two corporations has been arranged or is maintained primarily with the intention of taking advantage of this paragraph.

3. Notwithstanding the provisions of Article XXII of this convention, paragraph 1 or paragraph 2, or both, of this Article, may be terminated without notice on or after the termination of the 3-year period beginning with the effective date of this convention by either of the contracting States imposing a rate of income tax in excess of the rate of 15 percent prescribed in paragraph 1 or in excess of the rate of 5 percent prescribed in paragraph 2.

4. The provisions of this Article shall not be construed so as to contravene the tax convention between the United States of America and Canada, effective January 1, 1936, to April 29, 1941.

ARTICLE XII

1. Dividends and interest paid by a corporation organized under the laws of Canada to a recipient, other than a citizen or resident of the United States of America or a corporation organized under the laws of the United States of America, shall be exempt from all income taxes imposed by the United States of America.

2. Dividends and interest paid by a corporation organized under the laws of the United States of America whose business is not managed and controlled in Canada to a recipient, other than a resident of Canada or a corporation whose business is managed and controlled in Canada, shall be exempt from all taxes imposed by Canada.[8]

ARTICLE XIII

1. Corporations organized under the laws of Canada, more than 50 percent of the outstanding voting stock of which is owned, directly or indirectly, throughout

[7] Prior to amendment by the supplementary convention signed June 12, 1950, par. 1 of Article XI read as follows:

"ARTICLE XI.—1. The rate of income tax imposed by one of the contracting States, in respect of income derived from sources therein, upon individuals residing in, or corporations organized under the laws of, the other contracting State, and not engaged in trade or business in the former State and having no office or place of business therein, shall not exceed 15 percent for each taxable year."

[8] Prior to amendment by the supplementary convention signed June 12, 1950, Article XII read as follows:

"ARTICLE XII.—Dividends and interest paid on or after the effective date of this convention by a corporation organized under the laws of Canada to individual residents of Canada, other than citizens of the United States of America, or to corporations organized under the laws of Canada shall be exempt from all income taxes imposed by the United States of America."

the last half of the taxable year by individual residents of Canada, other than citizens of the United States of America, shall be exempt from any taxes imposed by the United States of America with respect to accumulated or undistributed earnings, profits, income, or surplus of such corporations.

2. Corporations organized under the laws of the United States of America, more than 50 percent of the outstanding voting stocks of which is owned, directly or indirectly, throughout the last half of the taxable year by individual residents of the United States of America shall be exempt from any taxes imposed by Canada in the nature of undistributed profits tax on undistributed profits of the corporation with respect to accumulated or undistributed earnings, profits, income, or surplus of such corporations.[9]

ARTICLE XIII A

1. A resident or corporation organized under the laws of Canada deriving from sources within the United States of America rentals from real property may elect for any taxable year to be subject to the tax imposed by the United States of America on a net basis as if such resident or corporation were engaged in trade or business within the United States of America through a permanent establishment therein during such taxable year.

2. Rentals from real property derived from sources within Canada by an individual or corporation resident in the United States of America shall receive tax treatment by Canada not less favorable than that accorded under section 99, the Income Tax Act, as in effect on the date on which this Article goes into effect.[10]

ARTICLE XIII B

Directors' fees paid by a corporation to an individual residing in one of the contracting States for services at Directors' meetings held in that State shall be exempt from tax by the other State.[11]

ARTICLE XIII C

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.[12]

ARTICLE XIV

1. (a) The United States income tax liability for any taxable year beginning prior to January 1, 1936, of any individual resident of Canada, other than a citizen of the United States of America, or of any corporation organized under the laws of Canada, remaining unpaid as of the date of signature of this convention may be adjusted on a basis satisfactory to the Commissioner: Provided, That the amount to be paid in settlement of such liability shall not exceed the amount of the liability which would have been determined if—

(A) the Revenue Act of 1936 as modified by the tax convention between the United States of America and Canada, effective January 1, 1936, to April 29, 1941 (except in the case of a corporation organized under the laws of Canada more than 50 percent of the outstanding voting stock of which was owned directly or indirectly throughout the last half of the taxable year by citizens or residents of the United States of America), and

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[9] Prior to amendment by the supplementary convention signed June 12, 1950, Article XIII read as follows:

"ARTICLE XIII.—Corporations organized under the laws of Canada, more than 50 percent of the outstanding voting stock of which is owned directly throughout the last half of the taxable year by individual residents of Canada, other than citizens of the United States of America, shall be exempt from any taxes imposed by the United States of America with respect to accumulated or undistributed earnings, profits, income or surplus of such corporations. With respect to corporations organized under the laws of Canada not exempt from such taxes under the provisions of this article the competent authorities of the two contracting States will consult together."

[10] Article XIII A was added by supplementary convention signed June 12, 1950.

[11] Article XIII B was added by supplementary convention signed June 12, 1950.

[12] Article XIII C was added by supplementary convention signed June 12, 1950.

(B) Articles XII and XIII of this convention had been in effect for such year.

If the taxpayer was not, within the meaning of Revenue Act of 1936, engaged in trade or business within the United States of America and had no office or place of business therein during the taxable year, the amount of interest and penalties shall not exceed 50 percent of the amount of the tax with respect to which such interest and penalties have been computed.

(b) The United States income tax liability remaining unpaid as of the date of signature of this convention for any taxable year beginning after December 31, 1935, and prior to January 1, 1941, in the case of any individual resident of Canada, other than a citizen of the United States of America, or in the case of any corporation organized under the laws of Canada shall be determined as if the provisions of Articles XII and XIII of this convention had been in effect for such year.

2. The provisions of paragraph 1 of this article shall not apply—

(a) Unless the taxpayer files with the Commissioner within 2 years from the date of signature of this convention a request that such tax liability be so adjusted together with such information as the Commissioner may require;

(b) In any case in which the Commissioner is satisfied that any deficiency in tax is due to fraud with intent to evade the tax.

ARTICLE XV

1. As far as may be in accordance with the provisions of The Income Tax Act, Canada agrees to allow as a deduction from the Dominion income and excess profits taxes on any income which was derived from sources within the United States of America and was there taxed, the appropriate amount of such taxes paid to the United States of America.[13]

2. As far as may be in accordance with the provisions of the United States Internal Revenue Code, the United States of America agrees to allow as a deduction from the income and excess profits taxes imposed by the United States of America the appropriate amount of such taxes paid to Canada.[14]

ARTICLE XVI

Where a taxpayer shows proof that the action of the revenue authorities of the contracting States has resulted in double taxation in his case in respect of any of the taxes to which the present convention relates, he shall be entitled to lodge a claim with the State of which he is a citizen or resident or, if the taxpayer is a corporation or other entity, with the State in which it was created or organized. If the claim should be deemed worthy of consideration, the competent authority of such State may consult with the competent authority of the other State to determine whether the double taxation in question may be avoided in accordance with the terms of this convention.

ARTICLE XVII

Notwithstanding any other provision of this convention, the United States of America in determining the income and excess profits taxes, including all surtaxes, of its citizens or residents or corporations, may include in the basis upon which such taxes are imposed all items of income (other than income within the scope of par. 1(b) of Article VI) taxable under the revenue laws of the United States of America as though this convention had not come into effect.

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[13] This wording of par. 1 of Article XV is effective January 1, 1949, as amended by the supplementary convention signed June 12, 1950.

Effective prior to January 1, 1949, the wording of this paragraph read as follows:

"ARTICLE XV.—In accordance with the provisions of sec. 8 of the Income War Tax Act as in effect on the day of the entry into force of this convention, Canada agrees to allow as a deduction from the Dominion income and excess profits taxes on any income which was derived from sources within the United States of America and was there taxed, the appropriate amount of such taxes paid to the United States of America.

[14] Prior to amendment by the supplementary convention signed June 12, 1950, paragraph 2 of Article XV read as follows:

"ARTICLE XV.—In accordance with the provisions of section 131 of the United States Internal Revenue Code as in effect on the day of the entry into force of this convention, the United States of America agrees to allow as a deduction from the income and excess profits taxes imposed by the United States of America the appropriate amount of such taxes paid to Canada.

ARTICLE XVIII

The competent authorities of the two contracting States may prescribe regulations to carry into effect the present convention within the respective States and rules with respect to the exchange of information.

The competent authorities of the two contracting States may communicate with each other directly for the purpose of giving effect to the provisions of the present convention.

ARTICLE XVIII A

To avoid withholding of both United States tax and Canadian tax with respect to compensation for personal services performed by a resident of one of the contracting States while temporarily present in the other State—

(a) The Commissioner may, with the approval of the Secretary of the Treasury, by regulations specify the circumstances under which such compensation of a resident of the United States of America temporarily performing personal services in Canada may be exempted from deduction and withholding of United States tax, and

(b) The appropriate Canadian authority may by regulations specify the circumstances under which such compensation of a resident of Canada temporarily performing personal services in the United States may be exempted from deduction and withholding of Canadian tax.[15]

ARTICLE XIX

With a view to the prevention of fiscal evasion, each of the contracting States undertakes to furnish to the other contracting State, as provided in the succeeding articles of this convention, the information which its competent authorities have at their disposal or are in a position to obtain under its revenue laws in so far as such information may be of use to the authorities of the other contracting State in the assessment of the taxes to which this convention relates.

The information to be furnished under the first paragraph of this article, whether in the ordinary course or on request, may be exchanged directly between the competent authorities of the two contracting States.

ARTICLE XX

1. The competent authorities of the United States of America shall forward to the competent authorities of Canada 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 persons whose addresses are within Canada and who derive from sources within the United States of America dividends, interest, rents, royalties, salaries, wages, pensions, annuities, or other fixed or determinable annual or periodical profits and income, showing the amount of such profits and income in the case of each addressee.

2. The competent authorities of Canada shall forward to the competent authorities of the United States of America as soon as practicable after the close of each calendar year the following information relating to such calendar year:

(a) The names and addresses of all persons whose addresses are within the United States of America and who derive from sources within Canada, dividends, interest, rents, royalties, salaries, wages, pensions, or other fixed or determinable annual or periodical profits and income, showing the amount of such profits and income in the case of each addressee.

(b) The names and addresses of all persons whose addresses are outside of Canada and who derive through a nominee, or agent, or custodian in Canada income from sources within the United States of America, and who are not entitled to the reduced rate of 15 percent with respect to such income provided in Article XI of this convention, showing the amount of such income in the case of each addressee.

(c) The names and addresses, where available, of persons whose addresses are outside of Canada and who derive dividends during the calendar year from corporations organized under the laws of Canada, more than 50 percent of the gross income of which is derived from sources within the United States of America, showing the amount of such dividends in each case.

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[15] Article XVIII A was added by supplementary convention signed June 12, 1950.

(d) The names and addresses of all persons whose addresses are within the United States of America and who beneficially or of record own stocks or bonds, debentures or other securities, or evidences of funded indebtedness, of any company taxed in Canada as a non-resident-owned investment corporation. The term "Non-resident-owned investment corporation" shall have the same meaning as when used in the Income War Tax Act of Canada.

ARTICLE XXI

1. If the Minister in the determination of the income tax liability of any person under any of the revenue laws of Canada deems it necessary to secure the cooperation of the Commissioner, the Commissioner may, upon request, furnish the Minister such information bearing upon the matter as the Commissioner is entitled to obtain under the revenue laws of the United States of America.

2. If the Commissioner in the determination of the income tax liability of any person under any of the revenue laws of the United States of America deems it necessary to secure the cooperation of the Minister, the Minister may, upon request, furnish the Commissioner such information bearing upon the matter as the Minister is entitled to obtain under the revenue laws of Canada.

ARTICLE XXII

This convention and the accompanying protocol which shall be considered to be an integral part of the convention shall be ratified and the instruments of ratification shall be exchanged at Washington as soon as possible.

This convention and protocol shall become effective on the 1st day of January, 1941. They shall continue effective for a period of 3 years from that date and indefinitely after that period, but may be terminated by either of the contracting States at the end of the 3-year period or at any time thereafter provided that, except as otherwise specified in the case of Article XI, at least six months' prior notice of termination has been given, the termination to become effective on the 1st day of January following the expiration of the 6-month period.

PROTOCOL

1. The taxes referred to in this convention are:
   (a) for the United States of America:
   the Federal income taxes, including surtaxes, and excess-profits taxes.
   (b) for Canada:
   the Dominion income taxes, including surtaxes, and excess-profits taxes.

2. In the event of appreciable changes in the fiscal laws of either of the contracting States, the Government of the two contracting States will consult together.

3. As used in this convention:
   (a) the terms "person," "individual" and "corporation" shall have the same meanings, respectively, as they have under the revenue laws of the taxing State or the State furnishing the information, as the case may be;
   (b) the term "enterprise" includes every form of undertaking, whether carried on by an individual, partnership, corporation or any other entity;
   (c) the term "enterprise of one of the contracting States" means, as the case may be, "United States enterprise" or "Canadian enterprise";
   (d) the term "United States enterprise" means an enterprise carried on in the United States of America by an individual resident in the United States of America, or by a corporation, partnership or other entity created or organized in or under the laws of the United States of America, or of any of the States or Territories of the United States of America;
   (e) the term "Canadian enterprise" is defined in the same manner mutatis mutandis as the term "United States enterprise";
   (f) the term "permanent establishment" includes branches, mines and oil wells, farms, timberlands, plantations, factories, workshops, warehouses,

offices, agencies and other fixed places of business of an enterprise, but does not include a subsidiary corporation. The use of substantial equipment or machinery within one of the contracting States at any time in any taxable year by an enterprise of the other contracting State shall constitute a permanent establishment of such enterprise in the former State for such taxable year.[16]

When an enterprise of one of the contracting States carries on business in the other contracting State through an employee or agent established there, who has general authority to contract for his employer or principal or has a stock of merchandise from which he regularly fills orders which he receives, such enterprise shall be deemed to have a permanent establishment in the latter State.

The fact that an enterprise of one of the contracting States has business dealings in the other contracting State through a commission agent, broker or other independent agent or maintains therein an office used solely for the purchase of merchandise shall not be held to mean that such enterprise has a permanent establishment in the latter State.

4. The term "Minister," as used in this convention, means the Minister of National Revenue of Canada or his duly authorized representative. The term "Commissioner," as used in this convention, means the Commissioner of Internal Revenue of the United States of America, or his duly authorized representative. The term "competent authority," as used in this convention, means the Commissioner and the Minister and their duly authorized representatives.

5. The term "United States of America," when used in a geographical sense, includes only the States, the Territories of Alaska and Hawaii, and the District of Columbia. The term "Canada" when used in a geographical sense means the Provinces, the Territories and Sable Island.

6. The term "subsidiary corporation" as used in Article XI of this Convention means a corporation 95 percent of whose shares (other than directors' qualifying shares) having full voting rights are beneficially owned by another corporation, provided that (except in the case of corporation the chief business of which is the making of loans) ordinarily not more than one-quarter of the gross income of such subsidiary corporation is derived from interest and dividends other than interest and dividends received from its subsidiary corporations.[17]

7. (a) The term "rentals and royalties" referred to in Article II of this convention shall include rentals or royalties arising from leasing real or immovable or personal or movable property or from any interest in such property, including rentals or royalties for the use of, or for the privilege of using, patents, copyrights, secret processes and formulae, good will, trade marks, trade brands, franchises and other like property;

(b) the term "interest," as used in this convention, shall include income arising from interest-bearing securities, public obligations, mortgages, hypothecs, corporate bonds, loans, deposits, and current accounts;

(c) The term "dividends," as used in this convention, shall include all distributions of the earnings or profits of corporations.

8. The term "pensions" referred to in Article VI A of this convention means periodic payments made in consideration for services rendered or by way of compensation for injuries received.[18]

9. The term "life annuities" referred to in Article VI A of this convention 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 consideration of a gross sum or sums paid by the recipient or under a contributory retirement plan.[19]

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[16] The last sentence of the first paragraph 3(f) was added by supplementary convention signed June 12, 1950.

[17] Prior to amendment by the supplementary convention signed June 12, 1950, par. 6 read as follows:

"6. The term "subsidiary corporation" referred to in Article XI of this convention means a corporation all of whose shares (less directors' qualifying shares) having full voting rights are beneficially owned by another corporation, provided that ordinarily not more than one-quarter of the gross income of such subsidiary corporation is derived from interest and dividends other than interest and dividends received from its subsidiary corporations."

[18] The supplementary convention signed June 12, 1950, adds "A" to "VI" in par. 8 of the protocol.

[19] The supplementary convention signed June 12, 1950, adds "A" to "VI" in par. 9 of the protocol.

10. The term permanent establishment as used in Article XI of this convention, shall not be deemed to include an office used solely for the purchase of merchandise.[20]

11. 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.

12. The citizens of one of the contracting States residing within the other contracting State shall not be subjected to the payment of more burdensome taxes than the citizens of such other State.

DONE in duplicate, at Washington, this 4th day of March, 1942 (Original Convention).

DONE in duplicate, at Ottawa, this 12th day of June, 1950 (Supplementary Convention).

For the Government of the United States of America:

SUMNER WELLES (Original Convention)
JULIAN F. HARRINGTON (Supplementary Convention)

For the Government of Canada:

LEIGHTON MCCARTHY (Original Convention)
D. C. ABBOTT (Supplementary Convention)

UNITED STATES-CANADA INCOME TAX CONVENTION

T. D. 6047, SECTION 7.49: Natural resources, royalties, real property rentals, salaries, wages, emoluments, etc. (Also Part I, Section 1441.) — Rev. Rul. 55-200

> The earnings from within the United States of a trust created or organized in Canada as a part of a stock bonus, pension, or profit-sharing plan of a United States subsidiary of a Canadian corporation for the employees (including those rendering services only in the United States) of such subsidiary are subject to tax in the United States, and to the withholding of tax at source thereon as required by sections 871 and 1441 of the Internal Revenue Code of 1954, subject to the income tax convention between the United States and Canada, notwithstanding that such earnings are received on behalf of, and disbursed to, the beneficiaries of the trust by a United States bank acting as agent for the Canadian trustee. See income tax convention as modified and supplemented; T. D. 6047, C. B. 1953-2, 59.

The question has been raised as to whether earnings from sources within the United States of a Canadian trust forming part of a United States employer's pension plan for its United States employees are subject to the withholding of income tax at source, as required by section 1441 of the Internal Revenue Code of 1954, where such earnings are received on behalf of the trust, held on its behalf, and ultimately disbursed to its beneficiaries in the United States by a United States bank acting as agent for the Canadian trustee.

The *M* company, a United States employer and subsidiary of a Canadian parent corporation, adopted on behalf of its employees the pension plan and trust previously established in Canada by its Canadian parent corporation. All contributions to the trust by the United States subsidiary on behalf of its employees are made in United

[20] Prior to amendment by the supplementary convention signed June 12, 1950, par. 10 read as follows:

"10. The terms "engaged in trade or business" and "office or place of business" as used in Article XI of this convention shall not be deemed to include an office used solely for the purchase of merchandise."

States dollars to a United States bank acting as agent for the Canadian trustee. Such United States bank, at all times acting as agent of its principal (the Canadian trustee), holds and invests such contributions in the United States, receives the earnings on such investments, and ultimately distributes the contributions of the United States employer, and earnings thereon, to its United States employees or their designated beneficiaries. The United States bank does not constitute a permanent establishment in the United States of the Canadian trustee.

Section 401(a) of the Internal Revenue Code of 1954 provides, as a requirement for the qualification of a pension trust for exemption from tax in the United States under section 501(a) of the Code, that such trust shall be "created or organized in the United States."

Section 1441 of the Code provides, in general, that all persons having the control of income of any nonresident alien individual, to the extent that such income constitutes gross income from sources within the United States, shall deduct and withhold from such income a tax equal to 30 percent thereof. Article XI of the income tax convention between the United States and Canada, C. B. 1943, 526, as last modified and supplemented, page 627, this Bulletin provides, in part, that the rate of income tax imposed by one of the contracting States, in respect of income derived from sources therein, upon individuals residing in, or corporations organized under the law of, the other contracting State, and not having a permanent establishment in the former State, shall shall not exceed 15 percent for each taxable year. See T. D. 6047, C. B. 1953–2, 59.

On the basis of the facts herein set forth, since a trust created in Canada as a part of an employer's pension plan for employees will not qualify for exemption from tax in the United States, it is held that the income of such a trust from sources within the United States is subject to withholding of income tax at source in the United States, as required by section 1441 of the 1954 Code, at the rate of 15 percent thereof as provided by the income tax convention between the United States and Canada, notwithstanding such income is derived only from the investment in the United States of funds contributed to the trust on behalf of the United States employees by a United States employer and is received, held, and ultimately distributed to United States beneficiaries of the trust by a United States bank acting as resident agent of the nonresident trust.

UNITED STATES—CANADA INCOME TAX CONVENTION

T. D. 6047, SECTION 7.45: Introductory. Rev. Rul. 55–282
(Also Part I, Section 882.)

A Corporation organized under the laws of Canada as an investment company with an agent in the United States who has a discretionary power of attorney to purchase and sell securities in the United States, will be treated as a resident foreign corporation under section 882 of the Internal Revenue Code of 1954 and no reduction of the tax rate under the income tax convention between the United States and Canada, page 624, this Bulletin, is permissible.

Advice has been requested whether a Canadian corporation organized as an investment company, which has an agent in the United

States with a discretionary power of attorney to purchase and sell United States securities and to keep records of the Canadian corporation in this country, is a resident foreign corporation subject to the provisions of section 882 of the Internal Revenue Code of 1954, and, if so, whether it is entitled to be taxed at the reduced rate provided for in the income tax convention between the United States and Canada, page 624, this Bulletin.

Section 882 of the Code provides in part that a foreign corporation engaged in trade or business in the United States shall be taxable as provided in section 11 of the Code on income from sources within the United States, that foreign corporations shall not be allowed credits against tax for the taxes of foreign countries and United States possessions allowed by section 901, and that if any foreign corporation has no office or place of business in the United States, the return required by section 6012 of the Code shall be made by its agent.

The income tax convention between the United States and Canada, *supra*, provides that the rate of tax on income derived from sources within the United States shall not exceed 15 percent if the corporation has no permanent establishment in the United States. The protocol which accompanies the convention states that the term "permanent establishment" includes an agency and that if business is carried on in the United States through an employee or agent established there who has general authority to contract for the corporation, such enterprise shall be deemed to have a permanent establishment in the United States.

Accordingly, it is held that a Canadian corporation which has an agent in the United States with a discretionary power of attorney to purchase and sell United States securities, will be treated as a resident foreign corporation subject to the provisions of section 882 of the 1954 Code and that no reduction of the tax rate under the income tax convention is permissible. See G. C. M. 21219, C. B. 1939–1, Part 1, 201.

UNITED STATES–FEDERAL REPUBLIC OF GERMANY INCOME TAX CONVENTION

A convention between the United States and the Federal Republic of Germany for the avoidance of double taxation with respect to income taxes was signed at Washington on July 22, 1954. The convention was approved for ratification by the United States Senate on August 20, 1954, and was ratified by the President on September 22, 1954. The convention was ratified by Germany on December 19, 1954. The ratifications were exchanged at Bonn on December 20, 1954, and the President proclaimed the convention on December 24, 1954. It is effective for the taxable years beginning on and after January 1, 1954. The convention reads as follows:

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 Federal Republic: The income tax, the corporation tax and the Berlin emergency contribution (Notopfer).

(2) The present convention shall also apply to any other income or profits tax of a substantially similar character which may be imposed by one of the contracting States after 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 "Federal Republic" means the Federal Republic of Germany and when used in a geographical sense means the territory over which the Basic Law for the Federal Republic of Germany is in effect;

(c) The term "permanent establishment" means a branch, office, factory, workshop, warehouse, mine, stone quarry or other place of exploitation of the ground or soil, permanent display and sales office, or a construction or assembly project or the like the duration of which exceeds or will likely exceed twelve months, or other fixed place of business; but does not include the casual and temporary use of mere storage facilities, nor does it include an agent or employee unless the agent or employee has full power for the negotiation and concluding of contracts on behalf of the enterprise and also habitually exercises this power, or has a stock of merchandise from which he regularly fills orders on behalf of the enterprise. 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, 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 and merchandise shall not of itself constitute such fixed place of business a permanent establishment of the 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;

(d) The term "enterprise of one of the contracting States" means, as the case may be, "United States enterprise" or "German 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 in his individual capacity or as a member of a partnership) or a fiduciary 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 "German enterprise" means an industrial or commercial enterprise or undertaking carried on in the Federal Republic by a natural person (including an individual in his individual capacity or as a member of a partnership) resident in the Federal Republic or by a German company; the term "German company" means juridical persons together with entities treated as juridical persons for tax purposes under the laws of the Federal Republic; and

(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 the Federal Republic, the Federal Ministry of Finance.

(2) In the application of the provisions of this convention by one of the contracting States any term not otherwise defined shall, unless the context otherwise requires, have the meaning which the term has under its own applicable laws. For the purposes of this convention "residence" in the Federal Republic shall include the customary place of abode therein.

ARTICLE III

(1) Industrial or commercial profits of an enterprise of one of the contracting States shall not be subject to tax by the other State unless the enterprise 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 the entire income of such enterprise from sources within such State and will limit its taxation of the enterprise to income from such sources.

(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 allocable to the permanent establishment, including executive and general administrative expenses so allocable.

(5) The competent authorities of the two contracting States may lay down rules by agreement for the apportionment of industrial or 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, agrees to, or imposes on the latter enterprise, commercial or financial conditions differing 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

Profits derived by an enterprise of one of the contracting States from the operation of ships or aircraft, shall be exempt from tax by the other State.

ARTICLE VI

(1) The rate of tax imposed by the United States shall not exceed 15 percent in the case of dividends from sources within the United States derived by a German company not having a permanent establishment in the United States and owning at least 10 percent of the voting stock of the corporation paying such dividend.

(2) The rate of tax imposed by the Federal Republic shall not exceed 15 percent in the case of dividends from sources within the Federal Republic derived by a United States corporation not having a permanent establishment in the Federal Republic and owning at least 10 percent of the voting stock of the German company paying such dividend.

(3) If, subsequent to the date of signature of this Convention, the percentage of stock ownership provided in section 131(f)(1) of the Internal Revenue Code is reduced, the percentage of stock ownership provided in paragraphs (1) and (2) of this Article shall likewise be deemed to be simultaneously reduced.

ARTICLE VII

Interest on bonds, notes, debentures, securities or on any other form of indebtedness (exclusive of interest on debts secured by mortgages on farms, timberlands or real property used wholly or partly for housing purposes) derived, bona fide as interest,

(A) by a natural person resident in the Federal Republic, or by a German company, not having a permanent establishment in the United States, shall be exempt from tax by the United States; or

(B) by a resident, or corporation or other entity of the United States, not having a permanent establishment in the Federal Republic, shall be exempt from tax by the Federal Republic.

ARTICLE VIII

Royalties and other amounts derived as bona fide 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), derived

(A) by a natural person resident in the Federal Republic, or by a German company, not having a permanent establishment in the United States, shall be exempt from tax by the United States; or

(B) by a resident, or corporation or other entity of the United States, not having a permanent establishment in the Federal Republic, shall be exempt from tax by the Federal Republic.

ARTICLE IX

(1) Income from real property situated in one of the contracting States (including gains derived from the sale or exchange of such property and interest on debts secured by mortgages on farms, timberlands, or real property used wholly or partly for housing purposes) and royalties in respect of the operation of mines, stone quarries or other natural resources derived by a resident or corporation or other entity or company of the other contracting State, shall be taxable only by the former State.

(2) (a) A natural person resident in the Federal Republic or a German company deriving from sources within the United States any item of income coming within the scope of paragraph (1) of this Article, may, for any taxable year, elect to be subject to tax by the United States on a net income basis as if such resident or company were engaged in trade or business within the United States through a permanent establishment therein.

(b) A resident or corporation or other entity of the United States deriving from sources in the Federal Republic any item of income coming within the scope of paragraph (1) of this Article, may, for any taxable year, elect to be subject to tax by the Federal Republic on a net income basis as if such resident or corporation or other entity were engaged in trade or business within the Federal Republic through a permanent establishment therein.

ARTICLE X

(1) An individual resident of the Federal Republic 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 natural person resident in the Federal Republic, or a German company and such compensation is borne by such resident or company, or

(b) his compensation received for such labor or personal services does not exceed $3,000.

(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 the Federal Republic.

ARTICLE XI

(1) (a) Wages, salaries and similar compensation and pensions paid by the United States or by its states, territories or political subdivisions, to an individual (other than a German citizen) shall be exempt from tax by the Federal Republic.

(b) Wages, salaries and similar compensation and pensions paid by the Federal Republic, Laender or municipalities, or by a public pension fund, to an individual (other than a citizen of the United States and other than an individual who has been admitted to the United States for permanent residence therein) shall be exempt from tax by the United States.

(c) For the purposes of this paragraph the term "pensions" shall be deemed to include annuities paid to a retired civilian government employee.

(2) Private pensions and private life annuities which are from sources within one of the contracting States and are paid to individuals residing in the other contracting State shall be exempt from taxation by 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 2 years at a university, college, school or other educational institution in the other contracting State, shall be exempted by the other contracting State from tax on his remuneration for such teaching during that period.

ARTICLE XIII

(1) A resident of one of the contracting States who is temporarily present in the other contracting State solely as a student at a university, college, school or other educational institution in the other contracting State, shall be exempt from tax by the latter State with respect to remittances from abroad for study and maintenance.

(2) An apprentice (inclusive of Volontaere and Praktikanten in the Federal Republic), a resident of one of the contracting States, who is temporarily present in the other contracting State exclusively for the purposes of acquiring business or technical experience shall be exempt from tax by the latter State in respect of remittances from abroad for study and maintenance.

(3) A resident of one of the contracting States who is a recipient of a grant, allowance or award from a nonprofit religious, charitable, scientific, literary or educational organization, shall be exempt from tax by the other State on such payments from such organization (other than compensation for personal services).

(4) A resident of one of the contracting States who is an employee of an enterprise of such State or an organization described in paragraph (3) of this Article, and who is temporarily present in the other contracting State for a period not exceeding one year solely to acquire technical, professional or business experience from any person other than such enterprise or organization, shall be exempt from tax by such other State on compensation from abroad paid by such enterprise or organization if his annual compensation for services wherever performed does not exceed $10,000.

ARTICLE XIV

(1) Dividends and interest paid by a German company (other than a United States corporation) shall be exempt from United States tax where the recipient is a nonresident alien or a foreign corporation.

(2) Dividends and interest paid by a United States corporation shall be exempt from tax by the Federal Republic where the recipient is not a resident or company of the Federal Republic.

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 Federal Republic taxes specified in Article I of this convention. It is agreed that by virtue of the provisions of subparagraph (b) of this paragraph the Federal Republic satisfies the similar credit requirement set forth in section 131(a)(3), Internal Revenue Code.

(b) The Federal Republic, in determining its taxes specified in Article I of this convention in the case of residents of the Federal Republic or German companies, shall exclude from the basis upon which its taxes are imposed such items of income as are dealt with in this convention, derived from the United States and not exempt from United States tax; but in the case of a citizen of the United States resident in the Federal Republic there shall be excluded from the tax base all items of income derived from the United States provided that the items are taxed by the United States. The Federal Republic, however, reserves the right to take into account in the determination of the rate of its taxes the income excluded as provided in this subparagraph.

(2) The provisions of this Article shall not disturb the exemptions from tax of the United States or of the Federal Republic granted by Article XI (1) of the present 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 persons 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 any 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.

(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 his case to the State of which he is a citizen or a resident, or, if the taxpayer is a company or a corporation of one of the contracting States, to that State. Should the taxpayer's claim be deemed worthy of consideration, the competent authority of the State to which the claim is made shall endeavor to come to an agreement with the competent authority of the other State with a view to avoidance of double taxation.

(2) For the settlement of difficulties or doubts in the interpretation or application of the present convention or in respect of its relation to conventions of the contracting States with third States the competent authorities of the contracting States shall reach a mutual agreement as quickly as possible.

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, or by any other agreement between the contracting States.

(3) The citizens of one of the contracting States shall not, while resident in the other contracting State, be subject 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 juridical 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, Laender or municipal.

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

(1) The present convention shall also apply from the date specified in paragraph (1) of Article XXI to Land Berlin which for the purposes of this convention comprises those areas over which the Berlin Senate exercises jurisdiction.

(2) It is a condition to the application of this convention to Berlin in accordance with the preceding paragraph that the Government of the Federal Republic shall previously have furnished to the Government of the United States of America a notification that all legal procedures in Berlin necessary for the application of this convention therein have been complied with.

(3) After application of this convention to Land Berlin in accordance with paragraphs (1) and (2) of this Article, references in this convention to the Federal Republic shall also be considered references to Land Berlin.

ARTICLE XXI

(1) The present convention shall be ratified and the instruments of ratification shall be exchanged at Bonn 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 5 years beginning with the calender 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 5-year period or at any time thereafter, provided that at least 6 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 6-month period.

DONE at Washington, in duplicate, in the English and German languages, each text having equal authenticity, this twenty-second day of July, 1954.

For the United States of America:
JOHN FOSTER DULLES [SEAL]
For the Federal Republic of Germany:
ALBRECHT V. KESSEL [SEAL]

UNITED STATES-FEDERAL REPUBLIC OF GERMANY INCOME TAX CONVENTION

(Also Part I, Sections 1441, 1442.)
(Also Part II, Sections 143, 144; Regulations 118, Sections 39.143–1, 39.144–1.)

T. D. 6122

TITLE 26—INTERNAL REVENUE—CHAPTER I, SUBCHAPTER G. PART 503.—INCOME TAX WITHHOLDING; FEDERAL REPUBLIC OF GERMANY

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 Federal Republic of Germany and of German companies, as affected by the income tax convention between the United States and the Federal Republic of Germany proclaimed by the President of the United States on December 24, 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:

TABLE OF CONTENTS

Section
503.1 Introductory.
503.2 Dividends.
503.3 Interest.
503.4 Patent and copyright royalties and film rentals.
503.5 Private pensions and private life annuities.
503.6 Release of excess tax withheld at source.
503.7 Information to be furnished in ordinary course.
503.8 Beneficiaries of a domestic estate or trust.
503.9 Land Berlin.

SECTION 503.1 INTRODUCTORY.—(a) The income tax convention between the United States and the Federal Republic of Germany, signed on July 22, 1954, and proclaimed by the President of the United States on December 24, 1954, hereinafter referred to as the convention, provides in part as follows, effective for taxable years beginning on or after January 1, 1954:

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 Federal Republic: The income tax, the corporation tax and the Berlin emergency contribution (Notopfer).

(2) The present Convention shall also apply to any other income or profits tax of a substantially similar character which may be imposed by one of the contracting States after 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 "Federal Republic" means the Federal Republic of Germany and when used in a geographical sense means the territory over which the Basic Law for the Federal Republic of Germany is in effect;

(c) The term "permanent establishment" means a branch, office, factory, workshop, warehouse, mine, stone quarry or other place of exploitation of the ground or soil, permanent display and sales office, or a construction or assembly project or the like the duration of which exceeds or will likely exceed twelve months, or other fixed place of business; but does not include the casual and temporary use of mere storage facilities, nor does it include an agent or employee unless the agent or employee has full power for the negotiation and concluding of contracts on behalf of the enterprise and also habitually exercises this power, or has a stock of merchandise from which he regularly fills orders on behalf of the enterprise. 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, 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 and merchandise shall not of itself constitute such fixed place of business a permanent establishment of the 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;

(d) The term "enterprise of one of the contracting States" means, as the case may be, "United States enterprise" or "German 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 in his individual capacity or as a member of a partnership) or a fiduciary 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 "German enterprise" means an industrial or commercial enterprise or undertaking carried on in the Federal Republic by a natural person (including an individual in his individual capacity or as a member of a partnership) resident in the Federal Republic or by a German company; the term "German company" means juridical persons together with entities treated as juridical persons for tax purposes under the laws of the Federal Republic; and

(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 the Federal Republic, the Federal Ministry of Finance.

(2) In the application of the provisions of this Convention by one of the contracting States any term not otherwise defined shall, unless the context otherwise requires, have the meaning which the term has under its own applicable laws. For the purposes of this Convention "residence" in the Federal Republic shall include the customary place of abode therein.

* * * * * * *

ARTICLE VI

(1) The rate of tax imposed by the United States shall not exceed 15 percent in the case of dividends from sources within the United States derived by a German company not having a permanent establishment in the United States and owning at least 10 percent of the voting stock of the corporation paying such dividend.

* * * * * * *

(3) If, subsequent to the date of signature of this Convention, the percentage of stock ownership provided in section 131 (f) (1) of the Internal Revenue Code [of 1939] is reduced, the percentage of stock ownership provided in paragraphs 1 and * * * of this Article shall likewise be deemed to be simultaneously reduced.

ARTICLE VII

Interest on bonds, notes, debentures, securities or on any other form of indebtedness (exclusive of interest on debts secured by mortgages on farms, timberlands or real property used wholly or partly for housing purposes) derived, bona fide as interest,

(A) by a natural person resident in the Federal Republic, or by a German company, not having a permanent establishment in the United States, shall be exempt from tax by the United States; or

* * * * * * *

ARTICLE VIII

Royalties and other amounts derived as bona fide 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 (in-

cluding rentals and like payments in respect to motion picture films or for the use of industrial, commercial or scientific equipment), derived

(A) by a natural person resident in the Federal Republic, or by a German company, not having a permanent establishment in the United States, shall be exempt from tax by the United States; or

* * * * * * *

ARTICLE IX

(1) Income from real property situated in one of the contracting States (including gains derived from the sale or exchange of such property and interest on debts secured by mortgages on farms, timberlands, or real property used wholly or partly for housing purposes) and royalties in respect of the operation of mines, stone quarries or other natural resources derived by a resident or corporation or other entity or company of the other contracting State, shall be taxable only by the former State.

(2) (a) A natural person resident in the Federal Republic or a German company deriving from sources within the United States any item of income coming within the scope of paragraph (1) of this Article, may, for any taxable year, elect to be subject to tax by the United States on a net income basis as if such resident or company were engaged in trade or business within the United States through a permanent establishment therein.

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ARTICLE XI

(1) (a) Wages, salaries and similar compensation and pensions paid by the United States or by its states, territories or political subdivisions, to an individual (other than a German citizen) shall be exempt from tax by the Federal Republic.

(b) Wages, salaries and similar compensation and pensions paid by the Federal Republic, Laender or municipalities, or by a public pension fund, to an individual (other than a citizen of the United States and other than an individual who has been admitted to the United States for permanent residence therein) shall be exempt from tax by the United States.

(c) For the purposes of this paragraph the term "pensions" shall be deemed to include annuities paid to a retired civilian government employee.

(2) Private pensions and private life annuities which are from sources within one of the contracting States and are paid to individuals residing in the other contracting State shall be exempt from taxation by 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 XIV

(1) Dividends and interest paid by a German company (other than a United States corporation) shall be exempt from United States tax where the recipient is a nonresident alien or a foreign corporation.

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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 persons 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 any 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.

(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

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(2) For the settlement of difficulties or doubts in the interpretation or application of the present Convention or in respect of its relation to Conventions of the contracting States with third States the competent authorities of the contracting States shall reach a mutual agreement as quickly as possible.

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, or by any other agreement between the contracting States.

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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

(1) The present Convention shall also apply from the date specified in paragraph (1) of Article XXI to Land Berlin which for the purposes of this Convention comprises those areas over which the Berlin Senate exercises jurisdiction.

(2) It is a condition to the application of this Convention to Berlin in accordance with the preceding paragraph that the Government of the Federal Republic shall previously have furnished to the Government of the United States of America a notification that all legal procedures in Berlin necessary for the application of this Convention therein have been complied with.

(3) After application of this Convention to Land Berlin in accordance with paragraphs (1) and (2) of this Article, references in this Convention to the Federal Republic shall also be considered references to Land Berlin.

ARTICLE XXI

(1) The present Convention shall be ratified and the instruments of ratification shall be exchanged at Bonn 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 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.

* * * * * * *

(b) As used in this Treasury Decision, any term defined in the convention 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.

SEC. 503.2 DIVIDENDS—(a) *General.*—(1) Dividends paid by a German company (other than a United States corporation) and received in taxable years beginning on or after January 1, 1954, by a nonresident alien or a foreign corporation are exempt from United States tax under the provisions of Article XIV of the convention. Such dividends are, therefore, not subject to the withholding of United States tax at source.

(2) The rate of United States tax imposed by the Internal Revenue Code upon dividends (other than dividends falling within the scope of subparagraph (1)) derived from sources within the United States in taxable years beginning on or after January 1, 1954, by a German company (other than a United States corporation) shall not exceed 15 percent under the provisions of Article VI of the convention if (i) such company at no time during the taxable year in which such dividends are derived has a permanent establishment in the United States and (ii) such company owns, at the time the dividends are paid, 10 percent or more of the voting stock of the paying corporation.

(b) *Application of reduced rate of withholding.*—(1) To secure withholding of United States tax at the rate of 15 percent at source in the case of dividends to which paragraph (a) (2) is applicable, the German company shall notify the withholding agent by letter in duplicate that such income is subject to the reduced rate of United States tax under the provisions of Article VI of the convention. The letter of notification shall be signed by an officer of the company and shall show the name and address of the corporation paying the dividend, the name and address of the German company receiving the dividend, and the official title of the officer signing the letter. It shall contain a statement (i) that the owner of the dividend is a German company (other than a United States corporation), (ii) that the owner at no time during the current taxable year had a permanent establishment in the United States, and (iii) that the German company owns 10 percent or more of the voting stock of the corporation paying such dividend.

(2) This letter of notification, which shall constitute authorization for application of the reduced rate of withholding of United States tax at source, shall be filed with the withholding agent for each successive 3-calendar-year period during which such income is paid. For this purpose, the first such period shall commence with the beginning of the calendar year in which such income is first paid on or after January 1, 1954. Each such 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.

(3) If such letter is also to be used as authorization for the release, pursuant to section 503.6 (a) (3), of excess tax withheld from dividends, it shall also contain a statement (i) that, at the time when the dividends were derived from which the excess tax was withheld, the owner was a German company (other than a United States corporation), (ii) that the owner at no time during the taxable year in which such dividends were derived had a permanent establishment in the United States, and (iii) that the Germany company owned, at the time when such dividends were paid, 10 percent or more of the voting stock of the corporation paying such dividends.

(4) Once a letter has been filed in respect of any 3-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 reduction in rate of United States tax granted by the convention in respect to such dividends, such taxpayer shall promptly notify the withholding agent by letter in duplicate. When any change occurs in the ownership of the stock as recorded on the books of the payer, the reduction in the rate of 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.

(5) 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) *Dividends paid to German company where degree of stock ownership uncertain.*—(1) In any case in which a German company (other than a United States corporation) anticipates the receipt of dividends described in paragraph (a) (2) and the relationship existing between the German company and the paying corporation is such as to render uncertain whether, by reason of the requirement as to stock ownership, the reduction in rate of United States tax granted by article VI of the convention will apply to such dividends, the German company shall not undertake to file the letter of notification prescribed by paragraph (b) (1) unless it has, prior to such filing, applied for and received from the Commissioner of Internal Revenue, Washington 25, D. C., a determination that such German company owns 10 percent or more of the voting stock of 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) As soon as practicable after the application has been filed, the Commissioner of Internal Revenue will determine whether the German company owns sufficient voting stock of the paying corporation to permit it to claim the benefit of article VI of the convention in the case of such dividends and shall notify the German company of his determination. The German company shall forthwith file with the paying corporation a copy of the Commissioner's letter of notification.

(3) If the Commissioner's determination is that the German company does own 10 percent or more of the voting stock of the paying corporation, the German company may thereafter, if otherwise quali-

fied, secure the reduced rate of withholding at the source with respect to subsequent payments of such dividends, by filing the letter of notification in accordance with paragraph (b).

(4) A determination by the Commissioner that the German company does own sufficient voting stock of the paying corporation to permit it to claim the benefit of article VI of the convention will apply until such time as the stock ownership of the paying corporation has changed to the extent that, because of such change, dividends to be received from the paying corporation by the German company no longer qualify for the reduced rate of United States tax under article VI of the convention. If such change in stock ownership occurs, the German company shall promptly notify both the Commissioner of Internal Revenue and the paying corporation of the then existing facts with respect to such stock ownership.

(5) In any case in which a German company (other than a United States corporation) has received on or after January 1, 1954, dividends described in paragraph (a)(2) and the relationship existing between the German company and the paying corporation was, at the time the dividends were paid, such as to render uncertain whether, by reason of the requirement contained in article VI of the convention as to stock ownership, such dividends qualified for the reduced rate of United States tax, the German company shall apply to the Commissioner of Internal Revenue for a similar determination as to the degree of stock ownership at the time the dividends were paid. If the Commissioner's determination is that at such time the degree of stock ownership was such as to permit the application of the reduced rate of United States tax granted by article VI of the convention, his letter of notification may, subject to the provisions of section 503.6(b), authorize the release of excess tax withheld with respect to such dividends.

SEC. 503.3 INTEREST—(a) *General.*—(1) Interest paid by a German company (other than a United States corporation) and received in taxable years beginning on or after January 1, 1954, by a nonresident alien or a foreign corporation is exempt from United States tax under the provisions of article XIV of the convention. Such interest is, therefore, not subject to the withholding of United States tax at source.

(2) Interest (other than interest falling within the scope of subparagraph (1)) on bonds, debentures, securities, or on any other form of indebtedness, including interest on obligations of the United States and of instrumentalities of the United States, which is derived, bona fide as interest, in taxable years beginning on or after January 1, 1954, by a natural person (other than a citizen or resident of the United States) resident in the Federal Republic of Germany, or by a German company (other than a United States corporation), is exempt from United States tax under the provisions of article VII of the convention if such person or company at no time during the taxable year in which such interest is derived has a permanent establishment in the United States. Such interest is, therefore, not subject to the withholding of United States tax at source.

(3) The provisions of subparagraph (2) shall have no application to interest on debts secured by mortgages on farms, timberlands, or real property used wholly or partly for housing purposes.

(b) *Application of exemption from withholding.*—(1) To avoid withholding of United States tax at source in the case of coupon bond interest to which paragraph (a) (2) is applicable, the resident of the Federal Republic of Germany or the German company shall, for each issue of bonds, file Form 1001–GER 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 (i) that the owner is neither a citizen nor a resident of the United States but is a resident of the Federal Republic of Germany, or, in the case of a company, the owner is a German company (other than a United States corporation), and (ii) that the owner has no permanent establishment in the United States.

(2) The exemption from United States tax contemplated by article VII 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–GER, shall be executed.

(3) The original and duplicate of Form 1001–GER 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–GER need not be listed on Form 1012.

(4) To avoid withholding of United States tax at source in the case of interest, other than coupon bond interest, to which paragraph (a) (2) is applicable, the resident of the Federal Republic of Germany or the German company shall notify the withholding agent by letter in duplicate that such income is exempt from United States tax under the provisions of article VII 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 (i) that the owner is neither a citizen nor a resident of the United States but is a resident of the Federal Republic of Germany, or, in the case of a company, the owner is a German company (other than a United States corporation), and (ii) that the owner has at no time during the current taxable year had a permanent establishment in the United States.

(5) This letter of notification, which shall constitute authorization for the payment of such interest without witholding of United States tax at source, shall be filed with the withholding agent for each successive 3-calendar-year period during which such income is paid. For this purpose, the first such period shall commence with the beginning of the calendar year in which such income is first paid on or after January 1, 1954. Each such letter field 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 be-

cause of special circumstances, as soon as possible after such first payment.

(6) If such letter is also to be used as authorization for the release, pursuant to section 503.6(a)(3), of excess tax withheld from interest, other than coupon bond interest, it shall also contain a statement (i) 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 Federal Republic of Germany, or, in the case of a company, the owner was a German company (other than a United States corporation), and (ii) that the owner at no time during the taxable year in which such interest was derived had a permanent establishment in the United States.

(7) Once a letter has been filed in respect of any 3-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 the convention in respect to such interest, such taxpayer 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.

(8) 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.

SEC. 503.4 PATENT AND COPYRIGHT ROYALTIES AND FILM RENTALS—(a) *General.*—(1) Royalties and other amounts derived in taxable years beginning on or after January 1, 1954, by a natural person (other than a citizen or resident of the United States) resident in the Federal Republic of Germany, or by a German company (other than a United States corporation), as bona fide 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, are exempt from United States tax under the provisions of article VIII of the convention if such person or company at no time during the taxable year in which such income is derived has a permanent establishment in the United States. Such items of income, are, therefore, not subject to the withholding of United States tax at source.

(2) The provisions of this section shall apply to rentals and like payments in respect to motion picture films or for the use of industrial, commercial, or scientific equipment.

(b) *Application of exemption from withholding.*—(1) To avoid withholding of United States tax at source in the case of the income to which this section is applicable, the resident of the Federal Republic of Germany or the German company shall notify the withholding agent by letter in duplicate that such income is exempt from United States tax under the provisions of article VIII of the convention. The provisions of section 503.3(b) relating to the execution, filing, and effective period of the letter of notification prescribed therein with

respect to interest, 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.

(2) 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.

SEC. 503.5 PRIVATE PENSIONS AND PRIVATE LIFE ANNUITIES—(a) *General.*—Private pensions and private life annuities, as defined in article XI (3) and (4) of the convention, which are received from sources within the United States in taxable years beginning on or after January 1, 1954, by a nonresident alien individual who is a resident of the Federal Republic of Germany are exempt from United States tax under the provisions of article XI (2) of the convention. Such items of income are, therefore, not subject to the withholding of United States tax at source.

(b) *Application of exemption from withholding.*—(1) To avoid withholding of United States tax at source in the case of the items of income to which paragraph (a) is applicable, the nonresident alien individual who is a resident of the Federal Republic of Germany shall notify the withholding agent by letter in duplicate that such income is exempt from United States tax under the provisions of article XI 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 Federal Republic of Germany.

(2) If such letter is also to be used as authorization for the release, pursuant to section 503.6(a)(3), 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 received from which the excess tax was withheld, neither a citizen nor a resident of the United States but was a resident of the Federal Republic of Germany.

(3) This letter 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 such 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) 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 Return Section, Baltimore 2, Maryland.

SEC. 503.6 RELEASE OF EXCESS TAX WITHHELD AT SOURCE.—(a) *General.*—(1) In order to give the convention effective application at

the earliest practicable date, the exemptions from, and reduction in the rate of, withholding of United States tax at source granted by this Treasury Decision are hereby made effective beginning January 1, 1954, contingent upon compliance with the applicable provisions of sections 503.2 through 503.5.

(2) In the case of dividends and interest paid by a German company (other than a United States corporation) to a nonresident alien or to a foreign corporation, if United States tax at the statutory rate has been withheld on or after January 1, 1954, there shall be released by the withholding agent and paid over to the person from whom it was withheld, an amount equal to the tax so withheld from such items.

(3) In the case of every taxpayer whose address at the time of payment was in the Federal Republic of Germany and who furnishes to the withholding agent the letter of notification prescribed in sections 503.2(b), 503.3(b), 503.4(b), and 503.5(b) as authorization for the release of excess tax withheld, if United States tax at the statutory rate has been withheld on or after January 1, 1954, from the items of income in respect of which such letter is prescribed in such sections, there shall be released (except as provided in paragraph (b)) by the withholding agent and paid over to the person from whom it was withheld—

(i) In the case of dividends, the difference between the tax so withheld and the tax required to be withheld pursuant to section 503.2(b); and

(ii) In the case of interest (other than coupon bond interest), copyright royalties and other items to which section 503.4 is applicable, and private pensions and private life annuities as defined in article XI of the convention, an amount equal to the tax so withheld from such items.

(4) In the case of every taxpayer whose address at the time of payment was in the Federal Republic of Germany and who furnishes to the withholding agent Form 1001–GER clearly marked "Substitute" and executed in accordance with section 503.3(b), if United States tax at the statutory rate has been withheld from coupon bond interest on or after January 1, 1954, there shall be released by the withholding agent and paid over to the person from whom it was withheld an amount equal to the tax so withheld from such interest. 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.

(5) The original and duplicate of substitute Form 1001–GER 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–GER need not be listed on Form 1012.

(b) *Interest paid where degree of stock ownership is determined.*— If United States tax at the statutory rate has been withheld on or after January 1, 1954, from dividends described in section 503.2(a)(2) and paid to a German company (other than a United States corporation), and if the relationship existing between the German company and the paying corporation was, at the time the dividends were paid, such as to render uncertain whether, by reason of the requirement contained in

article VI of the convention as to stock ownership, such dividends qualified for the reduced rate of United States tax, the withholding agent shall release and pay over to the German company the difference between the tax so withheld and the tax required to be withheld pursuant to section 503.2(b), only if the German company (1) furnishes to the withholding agent a copy of the Commissioner's authorization of release prescribed in section 503.2(c)(5) and (2) files the letter of notification prescribed in section 503.2(b)(1).

Sec. 503.7 Information to be Furnished in Ordinary Course—(a) *General.*—In compliance with the provisions of article XVI of the convention the Commissioner of Internal Revenue will transmit to the Federal Ministry of Finance, 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 field pursuant to paragraph (b); and

(2) The duplicate copy of each available ownership certificate, Form 1001-GER, filed pursuant to section 503.3 (b) and substitute Form 1001-GER, filed pursuant to section 503.6 (a), in connection with coupon bond interest.

(b) *Information return.*—(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 the Federal Republic of Germany, 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 and to nonresident foreign corporations, whose addresses at the time of payment were in the Federal Republic of Germany, 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 constitute interest in respect of which Form 1001-GER or substitute Form 1001-GER has been filed in duplicate with the withholding agent are not required to be reported on such Form 1042 Supplement.

Sec. 503.8 Beneficiaries of a Domestic Estate or Trust.—A nonresident alien who is a resident of the Federal Republic of Germany and who is a beneficiary of a domestic estate or trust shall be entitled to the exemption from United States tax granted by articles VII, VIII and XIV of the convention with respect to dividends, interest, and copyright royalties and the like, to the extent such item or items are included in that portion of the income of such estate or trust which is (or would, but for such exemption, be) includible in the gross income of the beneficiary, provided that he otherwise satisfies the requirements of these respective articles. In order to be entitled

in such instance to the exemption from withholding of United States tax such beneficiary must otherwise satisfy such requirements and shall, where applicable, execute and submit to the fiduciary of such estate or trust in the United States the appropriate letter of notification prescribed in sections 503.3(b) and 503.4(b).

SEC. 503.9 LAND BERLIN. The convention shall also apply to Land Berlin effective for taxable years beginning on or after January 1, 1954, but only if the notification has been furnished to the United States Government in accordance with article XX (2) of the convention. After application of the convention to Land Berlin in accordance with article XX, references in the convention and in this Treasury Decision to the Federal Republic of Germany shall also be considered references to Land Berlin.

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 XIX of the convention.)

O. GORDON DELK,
Acting Commissioner of Internal Revenue.

Approved January 28, 1955.

M. B. FOLSOM,
Acting Secretary of the Treasury.

(Filed with the Division of the Federal Register January 28, 1955, 2:55 p. m.)

UNITED STATES-JAPAN ESTATE, INHERITANCE AND GIFT TAX CONVENTION

A convention between the United States and Japan for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on estates, inheritances and gifts was signed at Washington, D. C., on April 16, 1954. The convention was approved for ratification by the United States Senate on February 25, 1955, and was ratified by the President on March 7, 1955. The convention was duly ratified by Japan. The instruments of ratification were exchanged at Tokyo on April 1, 1955, and the President proclaimed the convention on April 8, 1955. It is effective with respect to estates or inheritances in the case of persons who die on or after April 1, 1955, and to gifts made on or after that date. The convention reads as follows:

ARTICLE I

(1) The taxes referred to in the present convention are:
(a) In the case of the United States of America: The Federal estate and gift taxes.
(b) In the case of Japan: The inheritance tax (including the gift tax).
(2) The present convention shall also apply to any other tax on estates, in-

heritances or gifts which has a character substantially similar to those referred to in paragraph (1) of this Article and which may be imposed by either contracting State after the date of signature of the present convention.

ARTICLE II

(1) As used in the present 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 "Japan", when used in a geographical sense, means all the territory in which the laws relating to the tax referred to in paragraph (1) (b) of Article I are enforced.

(c) The term "tax" means those taxes referred to in paragraph (1) (a) or (b) of Article I, as the context requires.

(d) 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 Japan, the Minister of Finance or his authorized representative.

(2) In the application of the provisions of the present convention by either contracting State any term not otherwise defined shall, unless the context otherwise requires, have the meaning which such term has under the laws of such State relating to the tax.

(3) For the purposes of the present convention, each contracting State may determine in accordance with its laws whether a decedent at the time of his death or a beneficiary of a decedent's estate at the time of such decedent's death, or a donor at the time of the gift or a beneficiary of a gift at the time of the gift, was domiciled therein or a national thereof.

ARTICLE III

(1) If a decedent at the time of his death or a donor at the time of the gift was a national of or domiciled in the United States, or if a beneficiary of a decedent's estate at the time of such decedent's death or a beneficiary of a gift at the time of the gift was domiciled in Japan, the situs at the time of the transfer of any of the following property or property rights shall, for the purpose of the imposition of the tax and for the purpose of the credit authorized by Article V, be determined exclusively in accordance with the following rules:

(a) Immovable property or rights therein (not including any property for which specific provision is otherwise made in this Article) shall be deemed to be situated at the place where the land involved is located.

(b) Tangible movable property (including currency and any other form of money recognized as legal tender in the place of issue and excepting such property for which specific provision is otherwise made in this Article) shall be deemed to be situated at the place where such property is physically located, or, if in transitu, at the place of destination.

(c) Debts (including bonds, promissory notes, bills of exchange, bank deposits and insurance, except bonds or other negotiable instruments in bearer form and such debts for which specific provision is otherwise made in this Article) shall be deemed to be situated at the place where the debtor resides.

(d) Shares or stock in a corporation shall be deemed to be situated at the place under the laws of which such corporation was created or organized.

(e) Ships and aircraft shall be deemed to be situated at the place where they are registered.

(f) Goodwill as a trade, business or professional asset shall be deemed to be situated at the place where the trade, business or profession to which it pertains is carried on.

(g) Patents, trade-marks, utility models and designs shall be deemed to be situated at the place where they are registered (or used in case they are not registered).

(h) Copyrights, franchises, rights to artistic and scientific works and rights or licenses to use any copyrighted material, artistic and scientific works, patents, trade-marks, utility models or designs shall be deemed to be situated at the place where they are exercisable.

(i) Mining or quarrying rights or mining leases shall be deemed to be situated at the place of such mining or quarrying.

(j) Fishing rights shall be deemed to be situated in the country in whose government's jurisdiction such rights are exercisable.

(k) Any property for which provision is not hereinbefore made shall be deemed to be situated in accordance with the laws of the contracting State imposing the tax solely by reason of the situs of property within such State, but if neither of the contracting States imposes the tax solely by reason of the situs of property therein, then any such property shall be deemed to be situated in accordance with the laws of each contracting State.

(2) The application of the provisions of paragraph (1) of this Article shall be limited to the particular property, and any portion thereof, which without such provisions would be subjected to the taxes of both contracting States or would be so subjected except for a specific exemption.

ARTICLE IV

Where one of the contracting States imposes the tax solely by reason of the situs of property within such State, in the case of a decedent who at the time of his death, or of a donor who at the time of the gift, was a national of or domiciled in the United States, or in the case of a beneficiary of a decedent's estate who at the time of such decedent's death, or a beneficiary of a gift who at the time of the gift, was domiciled in Japan, the contracting State so imposing the tax:

(a) shall allow a specific exemption which would be applicable under its laws if the decedent, donor, or beneficiary, as the case may be, had been a national of or domiciled in such State, in an amount not less than the proportion thereof which (A) the value of the property, situated according to Article III in such State and subjected to the taxes of both contracting States or which would be so subjected except for a specific exemption, bears to (B) the value of the total property which would be subjected to the tax of such State if such decedent, donor, or beneficiary had been a national of or domiciled in such State; and

(b) shall (except for the purpose of subparagraph (a) of this paragraph and for the purpose of any other proportional allowance otherwise provided) take no account of property situated according to Article III outside such State in determining the amount of the tax.

ARTICLE V

(1) Where either contracting State imposes the tax by reason of the nationality thereof or the domicile therein of a decedent or a donor or a beneficiary of a decedent's estate or of a gift, such State shall allow against its tax (computed without application of this Article) a credit for the tax imposed by the other contracting State with respect to property situated at the time of the transfer in such other State and included for the taxes of both States (but the amount of the credit shall not exceed that portion of the tax imposed by the crediting State which is attributable to such property). The provisions of this paragraph shall not apply with respect to any property referred to in paragraph (2) of this Article.

(2) Where each contracting State imposes the tax by reasons of the nationality thereof or the domicile therein of a decedent or a donor or a beneficiary, with respect to any property situated at the time of the transfer outside both contracting States (or deemed by each contracting State to be situated in its territory, or deemed by one contracting State to be situated in either contracting State and deemed by the other contracting State to be situated outside both contracting States or deemed by each contracting State to be situated in the other contracting State), each contracting State shall allow against its tax (computed without application of this Article) a credit for a part of the tax imposed by the other contracting State attributable to such property. The total of the credits authorized by this paragraph shall be equal to the amount of the tax imposed with respect to such property by the contracting State imposing the smaller amount of the tax with respect to such property, and shall be divided between both contracting States in proportion to the amount of the tax imposed by each contracting State with respect to such property.

(3) The credit authorized by this Article, if applicable, shall be in lieu of any credit for the same tax authorized by the laws of the crediting State, the credit applicable for the particular tax being either credit authorized by this Article or credit authorized by such laws, whichever is the greater. For the purposes of this Article, the amount of the tax of each contracting State attributable to

any designated property shall be ascertained after taking into account any applicable diminution or credit against its tax with respect to such property (other than any credit under paragraph (1) or (2) of this Article), provided, however, in case another credit for the tax of any other foreign State is allowable with respect to the same property pursuant to any other convention between the crediting State under the present convention and such other foreign State, or pursuant to the laws of the crediting State, the total of such credits shall not exceed the amount of tax of the crediting State attributable to such property computed before allowance of such credits.

(4) Credit against the tax of one of the contracting States for the tax of the other contracting State shall be allowed under this Article only where both such taxes have been simultaneously imposed at the time of a decedent's death or at the time of a gift.

(5) No credit resulting from the application of this Article shall be allowed after more than five years from the due date of the tax against which credit would otherwise be allowed, unless claim therefor was filed within such five-year period. Any refund resulting from the application of this Article shall be made without payment of interest on the amount so refunded, unless otherwise specifically authorized by the crediting State.

(6) Credit against the tax of one of the contracting States shall not be finally allowed for the tax of the other contracting State until the latter tax (reduced by credit authorized under this Article, if any) has been paid.

ARTICLE VI

(1) The competent authorities of both contracting States shall exchange such information available under the respective tax laws of both contracting States as is necessary for carrying out the provisions of the present convention or for the prevention of fraud or for the administration of statutory provisions against tax avoidance in relation to the tax. Any information so exchanged shall be treated as secret and shall not be disclosed to any person other than those, including a court, concerned with the assessment and collection of the tax or the determination of appeals in relation thereto. 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 the tax imposed by the other contracting State (as though such tax were the tax of the former State) as will ensure that the credit or any other benefit granted under the present convention by such other State shall not be enjoyed by persons not entitled to such benefits.

ARTICLE VII

Where a representative of the estate of a decedent or a beneficiary of such estate or a donor or a beneficiary of a gift shows proof that the action of the tax authorities of either contracting State has resulted, or will result, in double taxation contrary to the provisions of the present convention, such representative, donor or beneficiary shall be entitled to present the facts to the competent authorities of the contracting State of which the decedent was a national at the time of his death or of which the donor or beneficiary is a national, or if the decedent was not a national of either of the contracting States at the time of his death or if the donor or the beneficiary is not a national of either of the contracting States, to the competent authorities of the contracting State in which the decedent was domiciled or resident at the time of his death or in which the donor or beneficiary is domiciled or resident. Should the claim be deemed worthy of consideration, the competent authorities of such State to which the facts are so presented shall undertake to come to an agreement with the competent authorities of the other contracting State with a view to equitable avoidance of the double taxation in question.

ARTICLE VIII

(1) The provisions of the present 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 so as to increase the tax imposed by either contracting 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; it being understood, however, that this provision shall not be construed to preclude the contracting States from settling by negotiation any dispute arising under the present convention.

(4) The competent authorities of both contracting States may prescribe regulations necessary to interpret and carry out the provisions of the present convention and may communicate with each other directly for the purpose of giving effect to the provisions of the present convention.

ARTICLE IX

(1) The present convention shall be ratified and the instruments of ratification shall be exchanged at Tokyo as soon as possible.

(2) The present convention shall enter into force on the date of exchange of instruments of ratification and shall be applicable to estates or inheritances in the case of persons who die on or after the date of such exchange and to gifts made on or after that date.

(3) Either of the contracting States may terminate the present convention at any time after a period of five years shall have expired from the date on which the convention enters into force, by giving to the other contracting State notice of termination, provided that such notice is given on or before the 30th day of June 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 of the calendar year next following that in which such notice is given.

IN WITNESS WHEREOF, the undersigned Plenipotentiaries have signed the present convention.

DONE at Washington, in duplicate, in the English and Japanese languages, each text having equal authenticity, this sixteenth day of April, 1954.

For the United States of America:
WALTER BEDELL SMITH

For Japan:
S. IGUCHI

UNITED STATES—JAPAN INCOME TAX CONVENTION

A convention between the United States and Japan for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income was signed at Washington, D. C., on April 16, 1954. The convention was approved for ratification by the United States Senate on February 25, 1955, and was ratified by the President on March 7, 1955. The convention was duly ratified by Japan. The instruments of ratification were exchanged at Tokyo on April 1, 1955, and the President proclaimed the convention on April 8, 1955. It is effective for the taxable years beginning on and after January 1, 1955. The convention reads as follows:

ARTICLE I

(1) The taxes referred to in the present convention are:

(a) In the case of the United States of America: The Federal income taxes, including surtaxes.

(b) In the case of Japan: The income tax and the corporation tax.

(2) The present convention shall also apply to any other tax on income or profits which has a character substantially similar to those referred to in paragraph (1) of this Article and which may be imposed by either contracting State after the date of signature of the present convention.

ARTICLE II

(1) As used in the present 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 "Japan", when used in a geographical sense, means all the territory in which the laws relating to the taxes referred to in paragraph (1) (b) of Article I are enforced.

(c) The term "permanent establishment" means an office, factory, workshop, branch, warehouse or other fixed place of business, but does not include the casual and temporary use of merely storage facilities. It also includes an agency if 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 contracting State merely because it carried on business dealings in such other State through a bona fide commission agent, broker, 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 contracting State a fixed place of business 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. The fact that a corporation of one of the contracting States has a subsidiary corporation which is a corporation of the other contracting State or which is engaged in trade or business in the other contracting 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 Japanese 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, a fiduciary and partnership) of the United States or by a United States corporation or other entity; and 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 "Japanese enterprise" means an industrial or commercial enterprise or undertaking carried on in Japan by an individual resident in Japan or by a Japanese corporation or other entity; and the term "Japanese corporation or other entity" means a corporation or other association having juridical personality, or a partnership or other association without juridical personality, created or organized under the laws of Japan.

(g) The term "tax" means those taxes referred to in paragraph (1) (a) or (b) of Article I, as the context requires.

(h) 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 Japan, the Minister of Finance or his authorized representative.

(i) The term "industrial or commercial profits" includes manufacturing, mercantile, agricultural, fishing, mining, financial and insurance profits, but does not include income in the form of dividends, interests, rents or royalties, or remuneration for personal services.

(2) In the application of the provisions of the present convention by either contracting State any term not otherwise defined shall, unless the context otherwise requires, have the meaning which such term has under the laws of such State relating to the tax.

ARTICLE III

(1) An enterprise of one of the contracting States shall not be subject to the tax of the other contracting State in respect of its industrial or commercial profits unless it has a permanent establishment situated in such other State. If it has such permanent establishment such other State may impose its tax upon the entire income of such enterprise from sources within such other State.

(2) In determining the tax of one of the contracting States no account shall be taken of the mere purchase of merchandise therein by an enterprise of the other contracting State.

(3) Where an enterprise of one of the contracting States has a permanent establishment situated in the other contracting State, 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 on an independent basis with the enterprise of which it is a permanent establishment.

(4) In determining the industrial or commercial profits of a permanent establishment there shall be allowed as deductions all expenses wherever incurred, reasonably allocable to such permanent establishment, including executive and general administrative expenses so allocable.

(5) The competent authorities of both contracting States may, consistent with other provisions of the present convention, arrange details for the apportionment of industrial or 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 enterprise, in their commercial or financial relations, conditions different from those which would be made with an independent enterprise, any profits which would normally have been allocable to one of the enterprises, but by reason of such conditions have not been so allocated, may be included in the profits of such enterprise and taxed accordingly.

ARTICLE V

(1) Notwithstanding the provisions of Article III and Article IV of the present convention, income which an enterprise of one of the contracting States derives from the operation of ships or aircraft registered

(a) in such State, or

(b) in a third country which exempts (A) such enterprise and (B) an enterprise of the other contracting State, from its tax on earnings derived from the operation of ships or aircraft, as the case may be, registered in the respective States

shall be exempt from the tax of such other contracting State.

(2) The present convention shall not be construed to affect the arrangement between the Government of the United States and the Government of Japan providing for relief from double taxation on shipping profits effected by the exchange of notes at Washington dated March 31, 1926 and June 8, 1926.

ARTICLE VI

The rate of tax imposed by one of the contracting States on interest on bonds, securities, notes, debentures or any other form of indebtedness (including mortgages or bonds secured by real property) received 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.

ARTICLE VII

The rate of tax imposed by one of the contracting States on royalties and other amounts received as consideration for the right to use copyrights, artistic and scientific works, patents, designs, secret processes and formulae, trade-marks and other like property (including in such royalties and other amounts, rentals and like payments in respect of motion-picture films or for the use of industrial, commercial, or scientific equipment) 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.

ARTICLE VIII

A resident or corporation or other entity of one of the contracting States deriving

(a) 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), or

(b) royalties in respect of the operation of mines, quarries or other natural resources

situated within the other contracting State may elect, for any taxable year, to be subject to the tax of such other State on a net basis as if such resident or corporation or other entity had a permanent establishment in such other State during such taxable year.

ARTICLE IX

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.

ARTICLE X

(1) (a) Salaries, wages and similar compensation paid by the United States to an individual who is a citizen of the United States (other than an individual who has been admitted to Japan for permanent residence therein) shall be exempt from tax by Japan.

(b) Salaries, wages and similar compensation paid by Japan to an individual who is a national of Japan (other than an individual who has been admitted to the United States for permanent residence therein) shall be exempt from tax by the United States.

(2) The provisions of this article shall not apply to salaries, wages or similar compensation paid in respect of services rendered in connection with any trade or business carried on by either of the contracting States for purposes of profit.

ARTICLE XI

A resident of one of the contracting States, who, in accordance with agreements between the Governments of the contracting States or between educational establishments in the contracting States for the exchange of professors and teachers, or at the invitation of the Government of the other contracting State or of an educational establishment in such other State, temporarily visits such other State for the purpose of teaching for a period not exceeding two years at a university, college, school or other educational institution in such other State, shall be exempt from the tax of such other State on his remuneration for such teaching for such period.

ARTICLE XII

(1) A resident of one of the contracting States who is temporarily present in the other contracting State solely as a student at a recognized university, college or school in such other State, shall be exempt from the tax of such other State with respect to remittances from abroad (including payments, if any, by his employer abroad).

(2) A resident of one of the contracting States who is a recipient of a grant, allowance or award from a religious, charitable, scientific, literary or educational organization of such State and who is temporarily present in the other contracting State, shall be exempt from the tax of such other State on such grant, allowance or award remitted from abroad (other than compensation for personal services).

(3) A resident of one of the contracting States who is an employee of, or under contract with, an enterprise of such State or an organization referred to in paragraph (2) of this Article, and who is temporarily present in the other contracting State for a period not exceeding one year solely to acquire technical, professional or business experience from a person other than such enterprise or organization, shall be exempt from the tax of such other State on compensation from abroad paid by such enterprise or organiaztion for his services rendered during such period, if the amount of compensation paid by such enterprise or organization for his services during such period, when computed on the anual basis, does not exceed 6,000 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.

ARTICLE XIII

For the purpose of the present convention:

(a) Dividends paid by a corporation of one of the contracting States shall be treated as income from sources within such State.

(b) Interest paid by one of the contracting States including local Government thereof or by an enterprise of one of the contracting States not having a permanent establishment in the other contracting State shall be treated as income from sources within the former State.

(c) Gains, profits and income derived from the purchase and sale of personal property shall be treated as derived from the country in which such property is sold.

(d) Gains, profits and income derived from the sale by a taxpayer in one of the contracting States of goods manufactured in the other contracting State in whole or in part by such taxpayer shall be treated as derived in part from the country in which manufactured and in part from the country in which sold, and to the extent such gains, profits and income are not allocable under other provisions of the present convention they shall be allocated between both contracting States in accordance with such taxpayer's relative sales and property in the respective countries.

(e) 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 treated as income derived from the country in which such real property, mines, quarries or other natural resources are situated.

(f) Compensation for labor or personal services (including the practice of liberal professions) shall be treated as income from sources within the country where are rendered the services for which such compensation is paid.

(g) Royalties for using, or for the right to use, in one of the contracting States, patents, copyrights, designs, trademarks and like property shall be treated as income from sources within such State.

ARTICLE XIV

It is agreed that double taxation shall be avoided in the following manner:

(a) The United States, in determining the tax of its citizens, residents or corporations or other entities may, regardless of any other provision of the present 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 if the present convention had not come into effect. The United States shall, however, subject to the provisions of section 131 of the Internal Revenue Code as in effect on the first day of January 1954, deduct from its tax the amount of the tax of Japan. In determining the credit under the said section 131 of the Internal Revenue Code, any interest received from an enterprise of the United States with a permanent establishment in Japan shall be treated as income from sources within Japan to the extent so treated under the laws of Japan, if the debt with respect to which such interest is paid is made in connection with the business of such permanent establishment of such enterprise.

(b) Japan, in determining the tax of its residents or corporations or other entities may, regardless of any other provision of the present convention, include in the basis upon which such tax is imposed all items of income taxable under the tax laws of Japan as if the present convention had not come into effect. Japan shall, however, deduct from its tax so calculated the amount of the tax of the United States upon income from sources within the United States and included for the taxes of both contracting States, but in an amount not exceeding that proportion of the tax of Japan which such income bears to the entire income subject to the tax of Japan.

(c) In determining the taxes of the contracting States of a recipient, who is a citizen, resident or corporation or other entity of the United States, of a dividend from a Japanese corporation, in so far as the tax of Japan imposed on income or profits of a corporation out of which a dividend is paid is deemed under the tax laws of Japan to have been imposed on a recipient of such dividend:

(i) The United States shall deem that such recipient has paid with respect to such dividend the tax of Japan in an amount equal to 25 percent of the amount of such dividend, and deduct, under the provisions of paragraph (a) of this Article, from its tax the amount of the tax of Japan so deemed to have been paid provided the recipient includes in gross income the amount of tax thus deemed to have been paid, and

(ii) Japan shall impose with respect to such dividend received by such recipient (except as such recipient is a resident of or has a permanent establishment in Japan) no tax other than the tax imposed on income or profits of the corporation out of which such dividend is paid.

ARTICLE XV

(1) Organizations organized under the laws of Japan and operated exclusively for religious, charitable, scientific, literary or educational purposes shall, to the extent and subject to conditions provided in the United States Internal Revenue Code, be exempt from the tax of the United States.

(2) Organizations organized under the laws of the United States and operated exclusively for religious, charitable, scientific, literary or educational purposes shall, to the extent and subject to conditions provided in the tax laws of Japan, be exempt from the tax of Japan.

ARTICLE XVI

(1) There shall be allowed, for the purposes of the tax of the United States, in the case of a resident of Japan who is a nonresident of the United States (other than an officer or employee of the Government of Japan), in addition to the exemption provided in section 214 of the United States Internal Revenue Code as in effect on the first day of January 1954, a credit against net income, subject to the conditions prescribed in section 25 of the Internal Revenue Code as in effect on the said date, for the spouse of the taxpayer and for each child of the taxpayer who are present in the United States and residing with him in the United States at any time during the taxable year, but such additional credit shall not exceed that proportion thereof which the taxpayer's gross income from sources within the United States for the taxpayer's taxable year bears to his entire income from all sources for the fiscal or calendar year in which ends such taxable year.

(2) For the purposes of the tax of Japan, there shall be allowed in the case of a citizen of the United States who is a resident of Japan the same exemptions for a dependent or dependents as those granted to a national of Japan who is a resident of Japan.

ARTICLE XVII

(1) The competent authorities of both contracting States shall exchange such information available under the respective tax laws of both contracting States as is necessary for carrying out the provisions of the present convention or for the prevention of fraud or for the administration of statutory provisions against tax avoidance in relation to the tax. Any information so exchanged shall be treated as secret and shall not be disclosed to any person other than those, including a court, concerned with the assessment and collection of the tax or the determination of appeals in relation thereto. 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 the tax imposed by the other contracting State (as though such tax were the tax of the former State) as will ensure that the exemptions, reduced rates of tax or any other benefit granted under the present convention by such other State shall not be enjoyed by persons not entitled to such benefits.

ARTICLE XVIII

Where a taxpayer shows proof that the action of the tax authorities of either contracting State 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 competent authorities of the contracting State of which he is a national or a resident, or, if the taxpayer is a corporation or other entity, to those of the

contracting State under the laws of which it is created or organized. Should the taxpayer's claim be deemed worthy of consideration, the competent authorities of such State to which the facts are so presented shall undertake to come to an agreement with the competent authorities of the other contracting State with a view to equitable avoidance of the double taxation in question.

ARTICLE XIX

(1) The provisions of the present 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 determining the tax of 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; it being understood, however, that this provision shall not be construed to preclude the contracting States from settling by negotiation any dispute arising under the present convention.

(4) The competent authorities of both contracting States may prescribe regulations necessary to interpret and carry out the provisions of the present convention and may communicate with each other directly for the purpose of giving effect to the provisions of the present convention.

ARTICLE XX

(1) The present convention shall be ratified and the instruments of ratification shall be exchanged at Tokyo as soon as possible.

(2) The present convention shall enter into force on the date of exchange of instruments of ratification and shall be applicable to income or profits derived during the taxable years beginning on or after the first day of January of the calendar year in which such exchange takes place.

(3) Either of the contracting States may terminate the present convention at any time after a period of five years shall have expired from the date on which the present convention enters into force, by giving to the other contracting State notice of termination, provided that such notice is given on or before the 30th day of June 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 of the calendar year next following that in which such notice is given.

IN WITNESS WHEREOF, the undersigned Plenipotentiaries have signed the present convention.

DONE at Washington, in duplicate, in the English and Japanese languages, each text having equal authenticity, this sixteenth day of April, 1954.

For the United States of America:

WALTER BEDELL SMITH

For Japan:

S. IGUCHI

MEMORANDUM

It is understood that in the application of Article XIV and Articles XI and XII of the convention between Japan and the United States of America for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income

(1) the provisions of Article XIV shall not be construed to deny the exemptions from the Japanese tax or the United States tax, as the case may be, granted by Article X (1), Article XI and Article XII;

(2) neither of the contracting States shall be precluded from taxing its own nationals or citizens with respect to income coming within Article XI or Article XII.

UNITED STATES-JAPAN INCOME TAX CONVENTION

(Also Part I, Sections 1441, 1442.) T. D. 6130

TITLE 26—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER G, PART 506.—JAPAN

Release of excess tax withheld, and exemption from, or reduction in rate of, withholding of tax at source in the case of residents of Japan and of Japanese corporations or other entities, as affected by the income tax convention between the United States and Japan signed on April 16, 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:

TABLE OF CONTENTS

Section
506.1 Introductory.
506.2 Dividends.
506.3 Interest.
506.4 Patent and copyright royalties and film rentals.
506.5 Release of excess tax withheld at source.
506.6 Information to be furnished in ordinary course.
506.7 Beneficiaries of a domestic estate or trust.
506.8 Sources of income.
506.9 Effective date.

SECTION 506.1 INTRODUCTORY.—(a) *Pertinent provisions.*—The income tax convention between the United States and Japan which was signed on April 16, 1954, hereinafter referred to as the convention, provides in part as follows, effective with respect to income or profits derived during taxable years beginning on or after January 1, 1955.

ARTICLE I

(1) The taxes referred to in the present convention are:

(a) In the case of the United States of America: The Federal income taxes, including surtaxes.

(b) In the case of Japan: The income tax and the corporation tax.

(2) The present convention shall also apply to any other tax on income or profits which has a character substantially similar to those referred to in paragraph (1) of this Article and which may be imposed by either contracting State after the date of signature of the present convention.

ARTICLE II

(1) As used in the present 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 "Japan," when used in a geographical sense, means all the territory in which the laws relating to the taxes referred to in paragraph (1) (b) of Article I are enforced.

(c) The term "permanent establishment" means an office, factory, workshop, branch, warehouse or other fixed place of business, but does not include the casual and temporary use of merely storage facilities. It also includes an agency if 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 contracting State merely because it carried on business dealings in such other State through a bona fide com-

mission agent, broker, 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 contracting State a fixed place of business 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. The fact that a corporation of one of the contracting States has a subsidiary corporation which is a corporation of the other contracting State or which is engaged in trade or business in the other contracting State shall not of itself constitute that subsidiary corporation a permanent establishment of its parent corportion.

(d) The term "enterprise of one of the contracting States" means, as the case may be, United States enterprise or Japanese 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, a fiduciary and partnership) of the United States or by a United States corporation or other entity; and 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 "Japanese enterprise" means an industrial or commercial enterprise or undertaking carried on in Japan by an individual resident in Japan or by a Japanese corporation or other entity; and the term "Japanese corporation or other entity" means a corporation or other association having juridical personality, or a partnership or other association without juridical personality, created or organized under the laws of Japan.

(g) The term "tax" means those taxes referred to in paragraph (1) (a) or (b) of Article I, as the context requires.

(h) 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 Japan, the Minister of Finance or his authorized representative.

(i) The term "industrial or commercial profits" includes manufacturing, mercantile, agricultural, fishing, mining, financial and insurance profits, but does not include income in the form of dividends, interest, rents or royalties, or remuneration for personal services.

(2) In the application of the provisions of the present Convention by either contracting State any term not otherwise defined shall, unless the contest otherwise requires, have the meaning which such term has under the laws of such State relating to the tax.

* * * * * * *

ARTICLE VI

The rate of tax imposed by one of the contracting States on interest on bonds, securities, notes, debentures or any other form of indebtedness (including mortgages or bonds secured by real property) received 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.

ARTICLE VII

The rate of tax imposed by one of the contracting States on royalties and other amounts received as consideration for the right to use copyrights, artistic and scientific works, patents, designs, secret processes and formulae, trade-marks and other like property (including in such royalties and other amounts, rentals and like payments in respect of motion-picture films or for the use of industrial, commercial, or scientific equipment) 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.

ARTICLE VIII

A resident or corporation or other entity of one of the contracting States deriving

(a) 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), or

(b) royalties in respect of the operation of mines, quarries or other natural resources situated within the other contracting State may elect, for any taxable year, to be subject to the tax of such other State on a net basis as if such resident or corporation or other entity had a permanent establishment in such other State during such taxable year.

* * * * * * *

ARTICLE XIII

For the purpose of the present convention:

(a) Dividends paid by a corporation of one of the contracting States shall be treated as income from sources within such State.

(b) Interest paid by one of the contracting States including local Government thereof or by an enterprise of one of the contracting States not having a permanent establishment in the other contracting State shall be treated as income from sources within the former State.

* * * * * * *

(e) 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 treated as income derived from the country in which such real property, mines, quarries or other natural resources are situated.

* * * * * * *

(g) Royalties for using, or for the right to use, in one of the contracting States, patents, copyrights, designs, trade-marks and like property shall be treated as income from sources within such State.

* * * * * * *

ARTICLE XV

(1) Organizations organized under the laws of Japan and operated exclusively for religious, charitable, scientific, literary or educational purposes shall, to the extent and subject to conditions provided in the United States Internal Revenue Code, be exempt from the tax of the United States.

* * * * * * *

ARTICLE XVII

(1) The competent authorities of both contracting States shall exchange such information available under the respective tax laws of both contracting States as is necessary for carrying out the provisions of the present convention or for the prevention of fraud or for the administration of statutory provisions against tax avoidance in relation to the tax. Any information so exchanged shall be treated as secret and shall not be disclosed to any person other than those, including a court, concerned with the assessment and collection of the tax or the determination of appeals in relation thereto. No information shall be exchanged which would disclose any trade, business, industrial or professional secret or any trade process.

* * * * * * *

ARTICLE XIX

(1) The provisions of the present 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 determining the tax of 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 quesion by mutual agreement; it being understood, however, that this provision shall not be construed to preclude the contracting States from settling by negotiation any dispute arising under the present convention.

(4) The competent authorities of both contracting States may prescribe regulations necessary to interpret and carry out the provisions of the present convention and may communicate with each other directly for the purpose of giving effect to the provisions of the present convention.

ARTICLE XX

(1) The present convention shall be ratified and the instruments of ratification shall be exchanged at Tokyo as soon as possible.

(2) The present convention shall enter into force on the date of exchange of instruments of ratification and shall be applicable to income or profits derived during the taxable years beginning on or after the first day of January of the calendar year in which such exchange takes place.

(3) Either of the contracting States may terminate the present convention at any time after a period of 5 years shall have expired from the date on which the present convention enters into force, by giving to the other contracting State notice of termination, provided that such notice is given on or before the 30th day of June 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 of the calendar year next following that in which such notice is given.

* * * * * * *

(b) *Meaning of terms.*—As used in this Treasury Decision, any term defined in the convention 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.

SEC. 506.2. DIVIDENDS.—Dividends paid by a Japanese corporation shall, in accordance with Article XIII(a) of the convention, be treated as income from sources within Japan. Dividends paid by such a corporation, and derived in taxable years beginning on or after January 1, 1955, by a nonresident alien individual or a foreign corporation are, therefore, exempt from United States tax and are not subject to the withholding of United States tax at source, since the gross income of such persons includes only the gross income from sources within the United States.

SEC. 506.3. INTEREST.—(a) *Exempt from tax.*—Interest paid by a Japanese enterprise not having a permanent establishment in the United States at any time during its taxable year shall, in accordance with Article XIII(b) of the convention, be treated as income from sources within Japan. Interest paid by such an enterprise, and derived in taxable years beginning on or after January 1, 1955, by a nonresident alien individual or a foreign corporation is, therefore, exempt from United States tax and is not subject to the withholding of United States tax at source, since the gross income of such persons includes only the gross income from sources within the United States.

(b) *Reduced rate.*—The rate of United States tax imposed upon interest (other than interest falling within the scope of paragraph (a) of this section) 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 received from sources within the United States in taxable years beginning on or after January 1, 1955, by a nonresident alien individual who is a resident of Japan, or by a Japanese 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 interest is received has a permanent establishment in the United States.

(c) *Trade or business.*—If, in the case of interest described in paragraph (b) of this section, a nonresident alien individual who is a resident of Japan 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 with respect to interest received 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.

(d) *Reduction in rate of withholding at source.*—(1) *Coupon bond interest.*—(i) *Form to use.*—To secure withholding of United States tax at the rate of 15 percent at source in the case of coupon bond interest to which paragraph (b) of this section applies, the nonresident alien individual who is a resident of Japan, or the Japanese corporation or other entity, shall, for each issue of bonds, file Form 1001–J 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, a description of the obligations, the amount of interest and its due date, and the date upon which the interest coupons were presented for payment. It shall contain a statement that the owner (A) is a resident of Japan, or is a Japanese corporation or other entity, and (B) has no permanent establishment in the United States.

(ii) *Reduction applicable only to owner.*—The reduction in the rate of United States tax contemplated by Article VI of the convention, insofar as it concerns coupon bond interest, is applicable only by the owner of the interest. The person presenting the coupon, or on whose behalf it is presented, shall, for the purpose of the reduction in 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–J, shall be executed.

(iii) *Disposition of form.*—The original and duplicate of Form 1001–J 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–J shall be listed on Form 1012.

(2) *Interest not payable by coupons*—(i) *Form to use.*—To secure withholding of United States tax at the rate of 15 percent at source in the case of interest (other than coupon bond interest) to which paragraph (b) of this section applies, the nonresident alien individual who is a resident of Japan, or the Japanese corporation or other entity, shall file Form 1001A–J in duplicate with the withholding agent in the United States. This form 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 that the owner (A) is a resident of Japan, or is a Japanese corporation or other entity, and (B) has no permanent establishment in the United States.

(ii) *Manner of filing.*—Form 1001A–J shall be filed with the withholding agent for each successive 3-calendar-year period during which such interest is paid. For this purpose, the first such period shall commence with the beginning of the calendar year in which such income is first paid on or after January 1, 1955. Each such form filed with any withholding agent shall be filed not later than 20 days preceding the date of the first payment within such successive period, or, if that is not possible because of special circumstances, as soon as possible after such first payment. Once such a form has been filed in respect of any 3-calendar-year period, no additional Form 1001A–J need be filed in respect thereto unless the Commissioner of Internal Revenue notifies the withholding agent that another such form shall be filed by the taxpayer. If, after filing such form, the taxpayer ceases to be eligible for the reduced rate of United States tax granted by Article VI of the convention in respect to such interest, 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 reduction in rate of withholding of United States tax shall no longer apply unless the new owner of record is entitled to and does properly file a Form 1001A–J with the withholding agent.

(iii) *Disposition of form.*—The duplicate of each Form 1001A–J (and letter) shall be immediately forwarded by the withholding agent to the District Director of Internal Revenue, Audit Division, Alien Returns Section, Baltimore 2, Maryland.

SEC. 506.4. PATENT AND COPYRIGHT ROYALTIES AND FILM RENTALS.—(a) *Reduced rate.*—Under Article VII of the convention, the rate of United States tax imposed upon royalties and other amounts received from sources within the United States in taxable years beginning on or after January 1, 1955, by a nonresident alien individual who is a resident of Japan, or by a Japanese corporation or other entity, as consideration, for the right to use copyrights, artistic and scientific works, patents, designs, secret processes and formulae, trademarks, and other like property, shall not exceed 15 percent if such alien, corporation, or other entity at no time during the taxable year in which such items are received has a permanent establishment in the United States.

(b) *Film rentals.*—The provisions of this section shall apply to rentals and like payments in respect of motion picture films or for the use of industrial, commercial, or scientific equipment.

(c) *Reduction in rate of withholding at source.*—(1) *Form to use.*—To secure withholding of United States tax at the rate of 15 percent at source in the case of the items of income to which this section applies, the nonresident alien individual who is a resident of Japan, or the Japanese corporation or other entity, shall file Form 1001A–J in duplicate with the withholding agent in the United States.

(2) *Manner of filing.*—The provisions of section 506.3(d)(2) relating to the execution, filing, effective period, and disposal of Form 1001A–J are equally applicable with respect to the income falling within the scope of this section.

SEC. 506.5. RELEASE OF EXCESS TAX WITHHELD AT SOURCE.—(a) *Amounts to be released.*—(1)—*Interest and royalties.*—In the case of every taxpayer whose address at the time of payment was in

Japan and who furnishes to the withholding agent Form 1001A–J in accordance with sections 506.3(d)(2) and 506.4(c), if United States tax at the statutory rate has been withheld on or after January 1, 1955, from the interest, and royalties and other like amounts, in respect of which such form is prescribed, 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 such sections.

(2) *Coupon bond interest.*—(i) *Substitute form.*—In the case of every taxpayer whose address at the time of payment was in Japan and who furnishes to the withholding agent Form 1001–J clearly marked "SUBSTITUTE" and executed in acordance with section 506.3(d)(1), if United States tax at the statutory rate has been withheld from coupon bond interest on or after January 1, 1955, 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 such section. 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–J 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–J shall be listed on Form 1012.

(3) *Dividends derived from Japanese corporation.*—If United States tax at the statutory rate has been withheld on or after January 1, 1955, from dividends paid to a nonresident alien individual or a foreign corporation by a Japanese corporation, 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 withheld.

(4) *Interest paid by Japanese enterprise.*—If United States tax at the statutory rate has been withheld on or after January 1, 1955, from interest paid to a nonresident alien individual or a foreign corporation by a Japanese enterprise not having a permanent establishment in the United States at any time during its taxable year, 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 withheld.

(b) *Amounts not to be released.*—The provisions of this section shall have no application to excess tax withheld at source which has been paid by the withholding agent to the District Director of Internal Revenue.

SEC. 506.6. INFORMATION TO BE FURNISHED IN ORDINARY COURSE.—(a) *Documents to Japan.*—In compliance with the provisions of Article XVII of the convention the Commissioner of Internal Revenue will transmit to the Minister of Finance of Japan, 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–J, filed pursuant to section 506.3(d)(1), and substitute Form 1001–J, filed pursuant to section 506.5(a)(2), in connection with coupon bond interest.

(b) *Information return by withholding agent.*—(1) *Form to use.*—To facilitate compliance with Article XVII 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 Japan, which shall be filed for the calendar year 1955 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 Japan, 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 constitute interest in respect of which Form 1001–J or substitute Form 1001–J has been filed in duplicate with the withholding agent is not required to be reported on such Form 1042 Supplement.

SEC. 506.7. BENEFICIARIES OF A DOMESTIC ESTATE OR TRUST.—If he otherwise satisfies the requirements of the respective articles concerned, a nonresident alien individual who is a resident of Japan and who is a beneficiary of a domestic estate or trust shall be entitled to the exemption from, or reduction in rate of, United States tax granted by Articles VI, VII, and XIII of the convention with respect to dividends, interest, and patent royalties and other like amounts, to the extent such item or items are included in that portion of the income of such estate or trust which, without regard to the convention, would be includible in his gross income. In order to be entitled in such instance to the exemption from, or reduction in rate of, withholding of United States tax such beneficiary must otherwise satisfy such requirements and shall, where applicable, execute and submit to the fiduciary of such estate or trust in the United States the Form 1001A–J prescribed in section 506.3(d)(2) and section 506.4(c).

SEC. 506.8. SOURCES OF INCOME.—For determining the sources of income for purposes of this Treasury Decision, see sections 861 to 864, inclusive, of the Internal Revenue Code of 1954 and Article XIII of the convention.

SEC. 506.9. EFFECTIVE DATE—(a) *General.*—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) *Fiscal years.*—Since the convention is effective with respect to income or profits derived during taxable years beginning on or after January 1, 1955, the fact that the exemption from, or reduction in the rate of, withholding of United States tax at source granted by this Treasury Decision is made effective beginning January 1, 1955, in respect of the item of income concerned is not a determination in itself that such item of income is entitled to the benefit of the exemption from, or reduced rate of, United States tax granted by the convention.

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 data limitation of section 4(c) of that Act.

(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) and in Article XIX of the income tax convention between the United States and Japan which was signed on April 16, 1954.)

O. GORDON DELK,
Acting Commissioner of Internal Revenue.

Approved April 22, 1955.

M. B. FOLSOM,
Acting Secretary of the Treasury.

(Filed with the Division of the Federal Register April 26, 1955, 8:51 a. m.)

UNITED STATES-REPUBLIC OF IRELAND INCOME TAX CONVENTION

T. D. 5897, SECTION 7.1002: Interest. Rev. Rul. 55-356.

Interest on United States Savings Bonds Series E held as surviving coowner by a citizen and resident of Ireland not engaged in business in the United States and subject to Irish tax on such interest is exempt from Federal income tax under Article VII(1) of the income tax convention between the United States and the Republic of Ireland.

Advice has been requested whether accrued interest received upon redemption of United States Savings Bonds Series E which were purchased with funds of a citizen of the United States is subject to Federal income tax in a case where the bonds are registered in the name of such citizen and a citizen and resident of the Republic of Ireland as coowners and the United States citizen dies prior to the redemption of the bonds.

Section 691 of the Internal Revenue Code of 1954 provides that all items of gross income in respect of a decedent which are not properly includible in respect of the taxable period in which falls the date of his death or a prior period shall be included in gross income, for the taxable year when received, by the one acquiring the right to receive such income..

However, Article VII(1) of the income tax convention between the United States and the Republic of Ireland, T. D. 5897, C. B. 1952–1, 89, provides in part as follows:

> Interest (on bonds, securities, notes, debentures, or any other form of indebtedness) derived from sources within the United States by a resident of Ireland who is subject to Irish tax on such interest and not engaged in trade or business in the United States, shall be exempt from United States tax * * *.

In view of the foregoing, it is held that when United States Savings Bonds Series E are presented for redemption by a resident and citizen of Ireland who is not engaged in trade or business in the United States and who is subject to Irish tax, the accrued interest thereon will not be subject to United States tax.

To obviate withholding at the source in the case of such interest the withholding agent should be notified by letter in duplicate signed by the owner of the bonds stating that such income is exempt from United States tax under the provisions of Article VII(1) of the convention. The letter should also contain a statement that the United States Government is obligator, that the owner is resident in Ireland, not a citizen of the United States, has no permanent establishment in the United States, and is subject to Irish tax on such interest. See section 7.1002(b) of the withholding regulations pertaining to the tax convention between the United States and the Republic of Ireland, T. D. 5897, *supra*. Such a letter shall constitute authorization for the payment of such interest without deduction of the tax at source.

UNITED STATES-UNITED KINGDOM DEATH TAX CONVENTION

T. D. 5565, SECTION 82.104: Situs of property. (Also Part II, Section 863; Regulations 105, Section 81.50.) — Rev. Rul. 55-163

> Where trust funds held by a New York trust company under a revocable deed of trust executed by a resident and national of Great Britain are invested by the trustee in participating units of a common trust fund, the situs of the participating units is in the United States for Federal estate tax purposes.

Advice has been requested whether the participating units of a common trust fund purchased with funds held by a New York trust company under a revocable deed of trust executed by a resident and national of Great Britain have a situs in the United States for Federal estate tax purposes.

The decedent, a resident and national of Great Britain executed a revocable deed of trust naming a trust company in New York as trustee. The funds of this trust were invested by the trustee in participating units of a common trust fund established and operated under the provisions of section 100–c of the New York Banking Law.

The object of a common trust fund is not to hold and conserve particular property, with incidental powers, as in the traditional type of trust. This type of trust is a legal business entity designed to provide a medium for the sharing of profits, capital gains, losses and expenses by constituent trusts in proportion to their contribution.

While each participating trust shares ratably in the common trust fund, the exclusive management and control is vested in the trust company as trustee and neither a fiduciary nor any beneficiary of a participating trust shall have or be deemed to have any ownership in any particular asset or investment held in the common trust fund. The trust company is required to keep the assets of the common trust fund separate from its own, and in its fiduciary capacity may not deal with itself or any affiliate. *Mullane* v. *Central Hanover Bank & Trust Co., et al.*, 339 U. S. 306.

The situs of an equitable interest in a conventional private trust is determined by reference to the underlying assets. *Commissioner* v. *David Barclay Nevius*, 76 Fed. (2d) 109, Ct. D. 1049, C. B. XIV–2, 350 (1935). In the instant case the participating units constitute the underlying assets of the trust established by the decedent. Such units are also evidence of the rights of the trust against the trustee of the common trust fund.

Inasmuch as the relationship of debtor and creditor between the settlor and the administrator of the common trust fund does not exist, the participating units do not constitute a "debt" within the meaning of Article II(2)(c) of the United States–United Kingdom Death Tax Convention, C. B. 1947–1, 125. In view of the rights to share in the profits, losses, capital gains, and expenses, these units are in the nature of proprietary interests. Since the situs rules of the convention do not cover this type of property, the situs is determined under the laws of the United States, the country of nondomicile. See Article III(2) of the convention.

In view of the foregoing, it is held that where trust funds held by a New York trust company under a revocable deed of trust executed by a resident and national of Great Britain are invested by the trustee in participating units of a common trust fund, the situs of the participating units is in the United States for Federal estate tax purposes.

UNITED STATES–UNITED KINGDOM INCOME TAX CONVENTION

T. D. 5569, SECTION 7.530: Reciprocal administrative assistance.
(Also Part I, Section 871; Part II, Section 211, Regulations 118, Section 39.211–7).

Rev. Rul. 55–9

The Internal Revenue Service will raise no objection to a domestic corporation's furnishing data appearing on its Corporation Income Tax Return, Form 1120, for the use of a United Kingdom bank in behalf of the United Kingdom stockholders of the corporation in order to facilitate the recognition of the credit allowed under the United Kingdom's tax laws for United States tax withheld or paid by the domestic corporation.

Advice has been requested whether a domestic corporation, which has been withholding a tax of 15 percent on dividends paid to United Kingdom stockholders of such domestic corporation, may upon request by a United Kingdom bank, provide a statement of data appearing on the Corporation Income Tax Return, Form 1120, for use by such bank in order to facilitate the recognition of the credit

allowed under the United Kingdom's tax laws for United States tax withheld or paid by the domestic corporation.

Pursuant to Article VI of the income tax convention between the United States and the United Kingdom of Great Britain and Northern Ireland, T. D. 5569, C. B. 1947–2, 100, a domestic corporation has been withholding a tax of 15 percent of the amount of dividends paid to United Kingdom stockholders of the corporation.

Article XIII of such convention provides, in part, as follows:

> (2) Subject to such provisions (which shall not affect the general principle hereof) as may be enacted in the United Kingdom, United States tax payable in respect of income from sources within the United States shall be allowed as a credit against any United Kingdom tax payable in respect of that income. Where such income is an ordinary dividend paid by a United States corporation, such credit shall take into account (in addition to any United States income tax deducted from or imposed on such dividend) the United States income tax imposed on such corporation in respect of its profits, and where it is a dividend paid on participating preference shares and representing both a dividend at the fixed rate to which the shares are entitled and an additional participation in profits, such tax on profits shall likewise be taken into account in so far as the dividend exceeds such fixed rate.

Thus, in contrast to the United States system of taxation, the British tax law views the tax paid by the domestic corporation as, in effect, a tax paid proportionately by the United Kingdom stockholders thereof and a credit is allowed by the United Kingdom not only for the United States tax of 15 percent withheld from the dividends at the source but also for a portion of the tax paid by such domestic corporation.

In accordance with Article XX of the convention the contracting parties adopt the principle of exchange of such information as is necessary to the administration of the provisions of the convention but not including information which would disclose any trade secret or trade process. The practice has existed since the effective date of the convention whereby United Kingdom Inland Revenue authorities have been furnished data by the Internal Revenue Service taken from Forms 1120 of various named domestic corporations.

Accordingly, the Internal Revenue Service will raise no objection to a domestic corporation's furnishing data appearing on its Corporation Income Tax Return, Form 1120, for the use of a United Kingdom bank in behalf of the United Kingdom stockholders of the corporation in order to facilitate the recognition of the credit allowed under the United Kingdom's tax laws for United States tax withheld or paid by the domestic corporation.

UNITED STATES–UNITED KINGDOM OF GREAT BRITAIN AND NORTHERN IRELAND TAX CONVENTION

T. D. 5569, SECTION 7.526: Visiting professors or teachers. — Rev. Rul. 55–211

(Also Part II, Section 22(a); Regulations 118, Section 39.22(a)–2.)

> Where the primary purpose of a professor or teacher from the United Kingdom of Great Britain and Northern Ireland in visiting the United States on an exchange visitor visa is to teach, lecture or

instruct at a university for a period of not more than 2 years from the date of arrival, his entire remuneration is exempt from Federal income tax by reason of the provisions of Article XVIII of the income tax convention between the United States and the United Kingdom of Great Britain and Northern Ireland. See Treasury Decision 5569, C. B. 1947–2, 100.

Advise has been requested whether certain grants and fellowships received by nationals of the United Kingdom of Great Britain and Northern Ireland in this country as fellows on exchange visitor visas are exempt from Federal income tax by reason of Article XVIII of the income tax convention between the United States and the United Kingdom of Great Britain and Northern Ireland.

A number of such nationals of foreign countries are at universities in this country on exchange visitor visas as fellows appointed by the appropriate government agency in charge of administration of the Fulbright program. These individuals all hold faculty appointments in the various universities but there are considerable differences in their duties.

Article XVIII of the Income Tax Convention between the United States and the United Kingdom of Great Britain and Northern Ireland, Treasury Decision 5569, C. B. 1947–2, 100, provides:

A professor or teacher from the territory of one of the contracting parties who visits the territory of the other contracting party for the purpose of teaching, for a period not exceeding 2 years, at a university, college, school, or other educational institution in the territory of such other contracting party shall be exempted by such other contracting party from tax on his remuneration for such teaching for such period.

If the primary purpose of a professor or teacher from the United Kingdom is visiting the United States is to teach, lecture or instruct at a University for a period of not more than 2 years from the date of arrival and a substantial portion of his time is devoted to such duties his entire remuneration would be regarded as arising from teaching and would be exempt from Federal income tax under Article XVIII of the income tax convention even though a portion of his time is devoted to research or other functions. Where, however, the primary purpose of his presence in the United States is the pursuit of research and like duties and any teaching is incidental to such research it cannot be considered that he is present in the United States "for the purpose of teaching" within the meaning of the exemption provided in Article XVIII.

In applying the above principles to the facts of a particular case, it is recognized that the normal duties of a teacher embrace not only formal classroom work involving regularly scheduled lectures, demonstrations or other student-participation activities but also the less formal methods of imparting ideas in seminars or other informal groups and in efforts undertaken jointly in a laboratory. For example, it is often one of the duties of a teacher in scientific fields to supervise the research projects of graduate students. Activities in which a teacher engages for the purpose of conferring on students the benefit of his knowledge and methods as distinguished from the pursuit of his own projects would be considered a part of his teaching.

Accordingly, it is held that if the primary purpose of a professor or teacher from the United Kingdom in visiting the United States

on an exchange visitor visa is to teach, lecture or instruct at a university for a period of not more than 2 years from the date of arrival, his entire remuneration is exempt from Federal income tax by reason of the provisions of Article XVIII of the income tax convention between the United States and the United Kingdom of Great Britain and Northern Ireland.

LIST OF TAX CONVENTIONS TO WHICH THE UNITED STATES IS A PARTY AS OF APRIL 11, 1955

Conventions relating to taxes on income which are in effect:

Country	Official text symbol	Signed	Ratifications exchanged	Effective date	Citation
Sweden	*TS 958	Mar. 23, 1939	Nov. 14, 1939	Jan. 1, 1940	C. B. 1940-2, 43
Canada	TS 983	Mar. 4, 1942	June 15, 1942	Jan. 1, 1941	C. B. 1943, 526
Supplemental	**TIAS 2347	June 12, 1950	Nov. 21, 1951	Jan. 1, 1951	P. 624, this Bull.
France	TS 885	Apr. 27, 1932	Apr. 9, 1935	(terminated)	
Second Convention	TS 988	July 25, 1939	Dec. 30, 1944	Jan. 1, 1945	C. B. 1946-1, 134
Supplemental	TIAS 1982	Oct. 18, 1946	Oct. 17, 1949	Jan. 1, 1950	
United Kingdom	TIAS 1546	Apr. 16, 1945	July 25, 1946	Jan. 1, 1945	C. B. 1947-2, 100
Denmark	TIAS 1854	May 6, 1948	Dec. 1, 1948	Jan. 1, 1948	C. B. 1950-1, 76
Netherlands	TIAS 1855	Apr. 29, 1948	Dec. 1, 1948	Jan. 1, 1947	C. B. 1950-1, 92
New Zealand	TIAS 2360	Mar. 16, 1948	Dec. 18, 1951	Jan. 1, 1951	
Norway	TIAS 2357	June 13, 1949	Nov. 11, 1951	Jan. 1, 1951	
Ireland	TIAS 2356	Sept. 13, 1949	Dec. 20, 1951	Jan. 1, 1951	
Switzerland	TIAS 2316	May 24, 1951	Sept. 27, 1951	Jan. 1, 1951	
South Africa	TIAS 2510	Dec. 13, 1946	July 15, 1952	July 1, 1946 and	C. B. 1954-2, 651
Protocol	TIAS 2510	July 14, 1950	July 15, 1952	July 1, 1948	C. B. 1954-2, 655
Finland	TIAS 2596	Mar. 3, 1952	Dec. 18, 1952	Jan. 1, 1952	
Belgium	TIAS 2833	Oct. 28, 1948	Sept. 9, 1953	Jan. 1, 1953	C. B. 1954-2, 626
Supplemental	TIAS 2833	Sept. 9, 1952	Sept. 9, 1953	Jan. 1, 1953	C. B. 1954-2, 626
Greece	TIAS 2902	Feb. 20, 1950	Dec. 30, 1953	Jan. 1, 1953	
Protocol	TIAS 2902	Apr. 20, 1953	Dec. 30, 1953	Jan. 1, 1953	
Australia	TIAS 2880	May 14, 1953	Dec. 14, 1953	Jan. 1, 1953	
Germany	TIAS	July 22, 1954	Dec. 20, 1954	Jan. 1, 1954	
Japan	TIAS	Apr. 16, 1954	Apr. 1, 1955	Jan. 1, 1955	P. 658, this Bull.

*Treaty Series.
**Treaties and Other International Agreement Series.

Conventions relating to taxes on income which are signed but not in effect:

Country	*Signed*
United Kingdom Supplemental	May 25, 1954
Italy	Mar. 30, 1955

Besides the above conventions which are in effect or have been signed, formal negotiations leading to the drafting of conventions, the texts of which have not yet been settled, have been held with Austria, Colombia, Cuba, Honduras, Israel, Luxemburg and Uruguay, and exploratory discussions have taken place with representatives of Argentina, Brazil, Mexico, Paraguay, the Philippines and Venezuela. Proposals have been made for extension of the convention with the Netherlands to the Netherlands Antilles and for extension of the convention with the United Kingdom to Aden, Barbados, British Honduras, Cyprus, Dominica, Falkland Islands, Gambia, Gold Coast, Grenada, Jamaica, Leeward Islands, Mauritius, Nigeria, St. Lucia, St. Vincent, Seychelles, Sierra Leone, and Trinidad and Tobago.

Conventions relating to taxes on estates and inheritances which are in effect:

Country	Official text symbol	Signed	Ratifications exchanged	Effective date	Optional date	Citation
Canada	TS 989	June 8, 1944	Feb. 6, 1945	June 14, 1941		C. B. 1945, 381
Supplemental	TIAS 2348	June 12, 1950	Nov. 21, 1951	Nov. 21, 1951		C. B. 1954-2,633
United Kingdom	TIAS 1547	Apr. 16, 1945	July 25, 1946	July 25, 1946	Jan. 1, 1945	C. B. 1947-1,125
France	TIAS 1982	Oct. 18, 1946	Oct. 17, 1949	Oct. 17, 1949		
Protocol	TIAS 1982	May 17, 1948	Oct. 17, 1949	Oct. 17, 1949		
Norway	TIAS 2358	June 13, 1949	Dec. 11, 1951	Dec. 11, 1951		
Ireland	TIAS 2355	Sept. 13, 1949	Dec. 20, 1951	Dec. 20, 1951	Jan. 1, 1951	
South Africa	TIAS 2509	Apr. 10, 1947	July 15, 1952	July 15, 1952	July 1, 1944	
Protocol	TIAS 2509	July 14, 1950	July 15, 1952	July 15, 1952	July 1, 1944	
Switzerland	TIAS 2533	July 9, 1951	Sept. 17, 1952	Sept. 17, 1952		
Finland	TIAS 2595	Mar. 3, 1952	Dec. 18, 1952	Dec. 18, 1952		
Greece	TIAS 2901	Feb. 20, 1950	Dec. 30, 1953	Dec. 30, 1953		
Protocol	TIAS 2901	July 18, 1953	Dec. 30, 1953	Dec. 30, 1953		
Australia	TIAS 2880	May 14, 1953	Jan. 7, 1954	Jan. 7, 1954		
Japan	TIAS	Apr. 16, 1954	Apr. 1, 1955	Apr. 1, 1955		P. 654, this Bull.

Conventions relating to taxes on estates and inheritances which are signed but not in effect:

Country	*Signed*
Belgium	May 27, 1954
Italy	Mar. 30, 1955

Besides the above conventions which are in effect, or have been signed, formal negotiations leading to the drafting of conventions, the texts of which still await settlement, have been held with Austria, Colombia, Germany, Luxemburg, Mexico, the Philippines, Sweden (supplemental convention) and Uruguay, and exploratory discussions have taken place with representatives of Argentina, Brazil, Cuba, Honduras, India, Israel, Netherlands, New Zealand and Venezuela.

Conventions relating to taxes on gifts which are in effect:

Country	*Official text symbol*	*Signed*	*Ratifications exchanged*	*Effective date*
Australia	TIAS 2879	May 14, 1953	Dec. 14, 1953	Dec. 14, 1953

The convention with Japan relating to taxes on estates and inheritances also relates to gift taxes.

SUBPART C.—COMMITTEE REPORTS

REVENUE ACT OF 1955

[House of Representatives Report No. 69, Eighty-fourth Congress, First Session]

[February 22, 1955]

Mr. Cooper, from the Committee on Ways and Means, submitted the following report [to accompany H. R. 4259]:

The Committee on Ways and Means, to whom was referred the bill (H. R. 4259) to provide a 1-year extension of the existing corporate normal-tax rate and of certain existing excise-tax rates, and to provide a $20 credit against the individual income tax for each personal exemption, having considered the same, report favorably thereon without amendment and recommend that the bill do pass.[1]

I. General Statement

The principal features of H. R. 4259 are as follows:

(1) The bill would provide an additional 1-year extension, from April 1, 1955, to April 1, 1956, of the existing 52-percent corporate tax rate by continuing the present normal tax rate of 30 percent.

(2) The bill would extend for one additional year, from April 1, 1955, to April 1, 1956, existing excise tax rates on certain alcoholic beverages, motor vehicles, gasoline, special fuels, and cigarettes.

(3) The bill would provide a $20 tax credit effective January 1, 1956, with respect to each personal exemption claimed by a taxpayer.

It is expected that the extensions of the corporate income-tax rate and the excise-tax rates, which were requested by the President and which otherwise would be reduced as of this April, will increase revenues in fiscal year 1955 by about $191 million and in fiscal year 1956 by about $1,964 million. The $20 tax credit would be effective for the calendar year 1956, the year with respect to which the President indicated he hoped to make a recommendation for a tax reduction. In the fiscal year 1956 the reduction will decrease individual tax liability by $815 million. The combined effect of the rate extensions and the individual income-tax reduction means a net increase in revenues in the fiscal year 1956 of $1,149 million.

The individual income-tax reduction granted in this bill is designed primarily to aid low-income taxpayers and to balance the stimulants provided for investment last year with increased stimulants to consumer purchasing power next year. It will stimulate the demand for consumer products which in turn will increase the market for producers' goods.

II. Revenue Effects

The revenue effects of your committee's bill for the fiscal years 1955 and 1956 and also on a full year's basis are shown in table 1. Total receipts in the President's budget are estimated at $59 billion in the fiscal year 1955 and $60 billion for the fiscal year 1956. These estimates anticipate revenue of approximately $200 million in fiscal year 1955 and approximately $2 billion in fiscal year 1956 to be derived from the extension of the present corporate and excise tax rates as recommended by the President. Without these recommended extensions, receipts under the President's budget would amount to $58.8 billion in the fiscal year 1955 and 57.7 billion in the fiscal year 1956. Your committee's bill will increase revenue over that provided under existing law in the fiscal year 1955 by $191 million and in the fiscal year 1956 by $1,149 million.

Only the extension of the excise taxes is expected to have any effect on budget receipts in the fiscal year 1955. Under existing law the excise-tax reductions would be effective for April, May, and June in the fiscal year 1955 and the collections for the fiscal year 1955 would reflect most of the reductions for these months. The reduction in corporate taxes under existing law would not be reflected in receipts in fiscal year 1955 because of the lag in corporate tax

[1] This act was approved by the President on March 30, 1955, and is known as Public Law 18, 84th Cong., 1st Sess., page 619 of this Bulletin.

collections. Most of the revenue effect from extending the present corporate income-tax rate for 1 year beyond April 1, 1955, would be reflected in collections for the fiscal year 1956, but some effect will carry over into the fiscal year 1957. The individual income tax reduction resulting from the tax credit of $20 per exemption would be effective in the last 6 months of the fiscal year 1956 (i. e., the period from January 1 to June 30, 1956). It is estimated that individual income taxes collected through withholding or under the declaration system will be reduced by $815 million for the fiscal year 1956 as a result of this provision. The $20 per exemption tax credit will be fully effective in the fiscal year 1957.

TABLE 1.—*Effect of H. R. 4259 on receipts*

[In millions of dollars]

	In the fiscal year—		On a full year's basis
	1955	1956	
Individual income tax $20 credit	.0	−815	−2,093
Extension of 5 percentage points of corporation normal tax	0	1,075	1,750
Extension of certain excise taxes	191	889	1,080
Total	191	1,149	737

NOTE.—Floor stock refunds amounting to about $200 million in 1955 and 1956 will be postponed for 1 year as a result of extending the above-mentioned excise tax rates.

Source: Prepared by the staff of the Joint Committee on Internal Revenue Taxation.

III. TAX CREDIT FOR INDIVIDUALS

Section 4 of your committee's bill allows to a taxpayer a $20 tax credit for each exemption claimed by him with respect to himself and any dependents he may have. However, in no case is this tax reduction to exceed the tax liability as otherwise determined. In the case of a married taxpayer with 2 children, this section provides a tax reduction of $80 except where his tax liability is less than that amount, in which case his liability would be completely eliminated. A taxpayer who qualifies for an extra exemption because he is 65 years of age or over or blind will receive an extra $20 credit with respect to each such exemption.

The tax reduction is provided in the form of a credit against the tax liability as otherwise computed. To simplify the tax computation for those with incomes below $5,000 who use the optional tax table, this reduction is reflected in the tax liability as shown in this table.

The $20 tax credit is to be available with respect to years beginning after December 31, 1955. Thus taxpayers on a calendar-year basis will receive the reduction provided by this bill for the entire calendar year 1956. For taxpayers on a fiscal-year basis this reduction is available only with respect to years beginning in 1956.

A number of technical amendments were required by the addition of the $20 credit. These include provision for the allowance of this credit in the case of estates (but not trusts), the raising by $100 of the requirement for filing declarations of estimated tax for those with more than $100 of income not subject to withholding, and provision for the prorating of this credit in the case of short taxable years. The $20 credit also is reflected in the revised withholding tax tables. This will mean that the reduction in taxes due to the credit will provide an increase in take-home pay effective January 1, 1956.

Table 2 shows by selected adjusted gross-income classes the number of taxpayers under present law and under the bill. It also shows by these classes the number of individuals relieved of tax under the bill and the amount of the tax reduction and its percentage distribution. Table 3 shows the tax burdens for a single person, a married couple with no dependents, and a married couple with two dependents under present law and under the bill. This indicates the amount of tax under present law and the bill for selected income levels, and the tax reduction for each level in terms of both dollar amounts and percentages. Table 4 shows the effective rates of tax under present law and under the bill

for selected income levels for a single person with no dependents, a married couple with no dependents, and a married couple with two dependents.

Your committee believes that tax relief for individual income taxpayers generally, and particularly low-income taxpayers, is needed to support an expanding economy. The $20 tax credit is equitable in that it benefits all taxpayers and is distributed to every taxpayer evenly on a dollar basis with respect to each personal exemption. This tax relief will be of particular benefit to those families having an adjusted gross income of under $5,000, as indicated in table 2.

In order to have expanding production we must have increasing consumption. The taxpayers in the income class of $5,000 and under, and this group includes the vast majority of our taxpayers, are the ones who of necessity must spend most of their income. Tax savings in this area immediately enters the Nation's spending stream. This in turn increases the demand for consumer goods which results in greater production. This type of tax relief will have a sustaining and dynamic effect on our economy.

Your committee is particularly concerned that our gross national product declined in 1954 to $357 billion from its 1953 level of $365 billion. This decline clearly points out the failure of our economy to reflect the growth that should result from our increases in population, labor force, and productivity.

Moreover, unemployment was 5 percent of the civilian labor force in 1954 as contrasted to only 2.5 percent in 1953. This occurred at the same time the average workweek in manufacturing decreased from 40.5 to 39.7 hours. The administration has made optimistic forecasts for the general level of business conditions in 1955. However, it appears doubtful that in 1955 we will reach the full employment level of 1953 and maintain it thereafter. A tax reduction, effective as of the first of next year, however, should lead to higher consumer expenditures in 1956 and thereafter.

By granting tax relief to the great bulk of our hard-pressed taxpayers who are in the low-income area, the $20 credit will tend to restore balance to our tax structure. The balance was distorted last year with the enactment of the Internal Revenue Code of 1954, which primarily gave relief to businesses and taxpayers in the higher income levels.

The present administration sponsored this tax relief last year on the grounds that it was necessary to encourage investment. Statistics indicate that these tax incentives for investment have not succeeded in halting the decline in investment in plant and equipment. Such investment has continued to decline since mid-1953. Your committee believes that tax concessions to investment income will not promote capital goods expansion unless such concessions are coupled with tax relief designed to bolster demand for consumer goods. The $20 tax credit will be effective in accomplishing an expanded consumer demand.

The $20 tax credit will make a reality out of the hope expressed by the President in his recent budget message, wherein he stated:

> I hope that tax reductions will be so justified next year. If so, I shall recommend a reduction in taxes to spread the relief fairly among all taxpayers in a way which will be the most effective to relieve individual tax burdens and to increase incentive for effort and investment.

Not only does the $20 tax credit make a reality out of this hope, it also spreads "the relief fairly among all taxpayers in a way which will be the most effective to relieve individual tax burdens and to increase incentive for effort and investment."

The $20 tax credit will insure that those taxpayers referred to by the President will be given the relief which he hopes to give them. At the same time this relief will expand private spending and tend to offset the contractive effect of our economy of reductions in Government expenditures.

The President's statement seems also to recognize the fact that in order to reestablish a balanced tax system, relief must be provided generally for all individual taxpayers. The relief provided last year, as the estimates have indicated and as many taxpayers have by now discovered, gave selective relief to high-bracket taxpayers and small taxpayers benefited only in exceptional cases. Low-income families who comprise the vast majority of our American taxpayers received only a token portion of that tax relief.

The proposed tax credit will tend to more equally distribute the tax burden among the various income classes.

The tax relief provided last year for corporations had a very substantial effect on their profits after taxes. Recent statistics indicate that even with declin-

ing sales corporate profits have generally increased. This has meant, in turn, larger payments of dividends to shareholders who were also granted tax relief last year on such income.

Efforts last year to provide more equitable tax relief almost succeeded in the House. It will also be recalled that practically every Member of the other body on 1 of 3 separate motions voted for a $20 tax credit of one kind or another. Your committee believes that these actions by the Congress indicated that both Houses recognized even last year that general tax relief was desirable.

It is estimated that the deficit for fiscal year 1956 will be $2.4 billion. The $20 tax credit, since it does not become effective until January 1, 1956, would add approximately $815 million to this estimated deficit, making the total $3.2 billion, assuming that there are no reductions in expenditures as presently estimated. This total deficit for 1956 would be $1.3 billion less than the $4.5 billion deficit for fiscal year 1955, which resulted in part from the tax reductions provided last year.

Your committee made the $20 tax credit effective January 1, 1956, because the President's budget indicates that the cash budget will show a substantial surplus in the last half of the fiscal year 1956, when this relief would first become effective.

On the basis of the foregoing discussion, your committee believes that the $20 tax credit, which provides relief fairly for all taxpayers, is fully warranted. Should there be a deterioration in world conditions and it becomes necessary to substantially increase our military expenditures, the Congress, as it has done in the past under such circumstances, would have to review our entire tax structure to determine where additional revenues could be equitably obtained.

TABLE 2.—*Estimated distribution of the number of taxpayers and total tax reduction by income classes resulting from a $20 tax credit for each exemption*

[Number of taxpayers in thousands; dollar amounts in millions]

Adjusted gross income classes	Number of taxpayers		Number of taxpayers relieved from all tax liability under bill	Tax reduction	
	Present law	Bill		Amount	Percentage of the total reduction going to each income class
Under $1,000	1,575	1,010	564	$26	1.24
$1,000–$2,000	7,109	6,267	842	149	7.13
$2,000–$3,000	12,613	10,563	2,050	311	14.86
$3,000–$4,000	15,113	13,955	1,159	448	21.42
$4,000–$5,000	13,476	13,103	372	440	21.01
Total under $5,000	49,885	44,898	4,987	1,374	65.65
$5,000–$10,000	16,947	16,947		564	26.95
$10,000–$25,000	3,606	3,606		125	5.95
$25,000–$50,000	616	616		22	1.06
$50,000–$100,000	173	173		6	.29
$100,000–$250,000	44	44		1	.07
$250,000–$500,000	5	5		(2)	.01
$500,000–$1,000,000	1	1		(1)	(2)
$1,000,000 and over	(3)	(3)		(1)	(2)
Total over $5,000	21,394	21,394		719	34.23
Total	71,279	66,292	4,987	2,093	100.00

[1] Less than $500,000.
[2] Less than 0.005 percent.
[3] Less than 500 taxpayers.

NOTE.—Figures may not add to totals due to rounding.

Source: Prepared by the staff of the Joint Committee on Internal Revenue Taxation.

TABLE 3.—*Comparison of the individual income tax burdens under present law and under a tax credit of $20 for each exemption*

Income after personal deductions but before the deductions for personal exemptions	Amount of tax		Tax reduction under bill	
	Present law	Bill	Amount	Percent
SINGLE PERSON, NO DEPENDENTS				
$700	$20	----------	$20	100.0
$1,000	80	$60	20	25.0
$2,000	280	260	20	7.1
$3,000	488	468	20	4.1
$4,000	708	688	20	2.8
$5,000	944	924	20	2.1
$8,000	1,780	1,760	20	1.1
$10,000	2,436	2,416	20	.8
$15,000	4,448	4,428	20	.4
$20,000	6,942	6,922	20	.3
$25,000	9.796	9.776	20	.2
$50,000	26,388	26,368	20	.1
$100,000	66,798	66,778	20	(1)
$300,000	247,274	247,254	20	(1)
$500,000	429,274	429,254	20	(1)
$1,000,000	[2]869,478	[2]869,458	20	(1)
MARRIED COUPLE, NO DEPENDENTS				
$1,400	$40	----------	$40	100.0
$2,000	160	$120	40	25.0
$3,000	360	320	40	11.1
$4,000	560	520	40	7.1
$5,000	760	720	40	5.3
$8,000	1,416	1,376	40	2.8
$10,000	1,888	1,848	40	2.1
$15,000	3,260	3,220	40	1.2
$20,000	4,872	4,832	40	.8
$25,000	6;724	6,684	40	.6
$50,000	19,592	19,552	40	.2
$100,000	52,776	52,736	40	.1
$300,000	222,572	222,532	40	(1)
$500,000	403,548	403,508	40	(1)
$1,000,000	858,548	858,508	40	(1)
MARRIED COUPLE, 2 DEPENDENTS				
$2,800	$80	----------	$80	100.0
$3,000	120	$40	80	66.7
$4,000	320	240	80	25.0
$5,000	520	440	80	15.4
$8,000	1,152	1,072	80	6.9
$10,000	1,592	1,512	80	5.0
$15,000	2,900	2,820	80	2.8
$20,000	4,464	4,384	80	1.8
$25,000	6,268	6,188	80	1.3
$50,000	18,884	18,804	80	.4
$100,000	51,912	51,832	80	.2
$300,000	221,504	221,424	80	(1)
$500,000	402,456	402,376	80	(1)
$1,000,000	857,456	857,376	80	(1)

[1] Less than 0.05 percent.
[2] Takes into account the maximum effective rate limitation of 87 percent of taxable income.

Source: Prepared by the staff of the Joint Committee on Internal Revenue Taxation.

TABLE 4.—*Comparison of the individual income tax effective rates under present law and under the committee bill to allow a tax credit of $20 to the taxpayer for each of his exemptions*

Income after personal deductions but before the deductions for persona. exemptions	Present law	Bill	Income after personal deductions but before the deductions for personal exemptions	Present law	Bill
SINGLE PERSON, NO DEPENDENTS					
	Percent	*Percent*		*Percent*	*Percent*
$700	2.9	-------	$15,000	29.7	29.5
$1,000	8.6	6.0	$20,000	34.7	34.6
$2,000	14.0	13.0	$25,000	39.2	39.1
$3,000	16.3	15.6	$50,000	52.8	52.7
$4,000	17.7	17.2	$100,000	66.8	66.8
$5,000	18.9	18.5	$300,000	82.4	82.4
$8,000	22.3	22.0	$500,000	85.9	85.9
$10,000	24.4	24.2	$1,000,000	[1] 86.9	[1] 86.9
MARRIED COUPLE. NO DEPENDENTS					
$1,400	2.9	-------	$20,000	24.4	24.2
$2,000	8.0	6.0	$25,000	26.9	26.7
$3,000	12.0	10.7	$50,000	39.2	39.1
$4,000	14.0	13.0	$100,000	52.8	52.7
$5,000	15.2	14.4	$300,000	74.2	74.2
$8,000	17.7	17.2	$500,000	80.7	80.7
$10,000	18.9	18.5	$1,000,000	85.9	85.9
$15,000	21.7	21.5			
MARRIED COUPLE, TWO DEPENDENTS					
$2,800	2.9	-------	$20,000	22.3	21.9
$3,000	4.0	1.3	$25,000	25.1	24.8
$4,000	8.0	6.0	$50,000	37.8	37.6
$5,000	10.4	8.8	$100,000	51.9	51.8
$8,000	14.4	13.4	$300,000	73.8	73.8
$10,000	15.9	15.1	$500,000	80.5	80.5
$15,000	19.3	18.8	$1,000,000	85.7	85.7

[1] Takes into account the maximum effective rate limitation of 87 percent of taxable income.

Source: Prepared by the staff of the Joint Committee on Internal Revenue Taxation.

IV. EXTENSION OF THE CORPORATE INCOME AND CERTAIN EXCISE TAX RATES

Your committe's bill also extends for 1 year the present 52 percent corporate income tax rate (composed of a 30-percent rate on the first $25,000 of earnings and 52 percent on earnings above that amount) otherwise due to revert to 47 percent as of April 1, 1955. Your committee's bill also extends the present excise tax rates due to be automatically reduced as of April 1, 1955. These include the excise taxes on distilled spirits, beer, wine, cigarettes, gasoline, automobiles, motorcycles, trucks, buses, truck trailers, automobile parts and accessories, and diesel and special motor fuel. These excises are described more fully in table 5 which shows the unit of tax, the rates before and after April 1, 1956, under this bill and the revenue effects of these extensions for the fiscal years 1955 and 1956 and also on a full-year basis.

TABLE 5.—*Excise tax rates extended until Apr. 1, 1956,[1] under the committee bill*

	Unit of tax	Rate extended for period from Apr. 1, 1955, to Mar. 31, 1956	Rate to become effective Apr. 1, 1956 [1]	Effect on revenue		
				Fiscal 1955	Fiscal 1956	Full year of operation
				Millions	*Millions*	*Millions*
Liquor taxes:						
Distilled spirits	Per proof gallon	$10.50	$9	$38	$89	$127
Beer	Per barrel	$9	$8	21	64	85
Wine:						
Still wine:						
Containing less than 14 percent alcohol.	Per wine gallon	17 cents	15 cents			
Containing 14 to 21 percent alcohol.	do	67 cents	60 cents			
Containing 21 to 24 percent alcohol.	do	$2.25	$2			
Containing more than 24 percent alcohol.	do	$10.50	$9			
Sparkling wines, liqueurs, cordials, etc.:				3	7	10
Champagne or sparkling wine.	do	$3.40	$3			
Liqueurs, cordials, etc.	do	$1.92	$1.60			
Artificially carbonated wines.	do	$2.40	$2			
Tobacco taxes: Cigarettes	Per 1,000	$4	$3.50	46	139	185
Manufacturer's excises:						
Gasoline	Per gallon	2 cents	1½ cents	31	219	250
Passenger cars and motorcycles.	Manufacturers' sale price.	10 percent	7 percent	37	263	300
Trucks, buses, truck trailers	do	8 percent	5 percent	7	53	60
Auto parts and accessories	do	do	do	7	49	56
Retailers' excises: Diesel and special motor fuel.	Per gallon	2 cents	1½ cents	1	6	7
Total excises				191	889	1,080

[1] These rates were increased by the Revenue Act of 1951 and the increases were scheduled to terminate on Apr. 1, 1954. The Excise Tax Reduction Act of 1954 extended these rate increases to Apr. 1, 1955.

Source: Prepared by the staff of the Joint Committee on Internal Revenue Taxation.

In addition to extending the rates specified above, your committee's bill also postpones for 1 more year the floor stock refunds or credits presently effective with respect to stocks of various taxpaid products on hand on April 1, 1955. These floor stock refunds are available in the case of distilled spirits, wines, and beer, cigarettes, gasoline, and automobiles, motorcycles, trucks, buses, truck trailers, and automobile parts and accessories.

The rate extension provided by the bill in the case of the corporate income tax is that of the 30-percent normal tax, due to be reduced to 25-percent. The extension in this case makes the 30-percent rate applicable to taxable years beginning and ending before April 1, 1956, and a 25-percent rate applicable with respect to taxable years beginning and ending thereafter. A proration formula, already in the Internal Revenue Code, provides for corporations whose taxable years overlap this date.

Your committee's bill provides for the extension of the corporate income-tax and the excise-tax rates for another year as requested by the President. Some $2.8 billion of revenue is involved on a full year's basis.

V. DETAILED EXPLANATION OF THE BILL

The first section provides that the bill, when enacted into law, may be cited as the "Revenue Act of 1955."

Section 2: This section provides for a 1-year extension of the corporate normal-tax rate at the 30-percent level.

Section 11(b) of the Internal Revenue Code of 1954 imposes on corporations in general a normal tax equal to 30 percent of the taxable income in the case of a taxable year beginning before April 1, 1955, and a normal tax equal to 25 per-

cent of the taxable income in the case of a taxable year beginning after March 31, 1955. Under the bill, the reduction from 30 percent to 25 percent would occur on April 1, 1956, rather than on April 1, 1955.

Section 11(c) of the 1954 Code imposes on corporations in general a surtax equal to 22 percent of the amount by which the taxable income exceeds $25,000. No change in the surtax rate is provided for in the 1954 Code or in the bill. Thus, the effect of the bill is to extend for 1 year the period during which the combined normal tax and surtax on taxable income in excess of $25,000 will be 52 percent, and to provide that at the expiration of such 1-year period the combined taxes on such taxable income will be reduced from 52 percent to 47 percent.

Section 2 of the bill also amends subsections (a)(1)(A) and (b)(1) of section 821 of the 1954 Code, which contain the tax-imposing provisions for certain mutual insurance companies (including such companies which are interinsurers or reciprocal underwriters). The effect of the bill is to provide that the reduction from 30 percent to 25 percent in the rate of the normal tax on the taxable income of such companies would occur on April 1, 1956, rather than on April 1, 1955.

The continuation of the existing normal tax rate on corporations for 1 year automatically affects computations under certain other provisions of the 1954 Code. For example, section 511(a)(1) of such Code imposes, on the unrelated business taxable income of certain charitable and other organizations, a normal tax and surtax computed as provided in section 11. Thus, although the bill contains no specific amendment to section 511(a)(1), the reduction in the tax imposed by that section would take effect on April 1, 1956, rather than on April 1, 1955.

Other examples of computations which would be affected by the extension of the 30-percent corporate normal tax rate for 1 year are those under the following sections of the 1954 Code; section 244 (relating to the deduction for dividends received by corporations on certain preferred stock of public utilities), section 247 (relating to the deduction for dividends paid on certain preferred stock of public utilities), section 522(a) (relating to tax on certain farmers' cooperatives), section 852(b)(1) (relating to tax on regulated investment companies), section 922 (relating to special deduction in the case of a Western Hemisphere trade corporation), and section 1361(h)(1) (relating to tax on unincorporated business enterprises electing to be taxed as corporations).

Section 3: Subsection (a) of this section would continue without change, until April 1, 1956, certain existing excise tax rates.

For a table showing the types of articles concerned, the units of tax, the existing excise tax rates, and the rates which, under the bill, would take effect on April 1, 1956, see table 5 on page 9 of this report.

The first sentence of subsection (b) of this section makes the technical amendments to the 1954 Code which are necessary to reflect the 1-year extension of existing excise tax rates made by subsection (a) of this section. The second sentence of subsection (b) makes similar conforming amendments to section 497 of the Revenue Act of 1951 (relating to refunds on articles from foreign trade zones).

Section 4: This section would amend the 1954 Code by inserting a new section 38, under which an individual taxpayer would be allowed a credit against income tax of $20, multiplied by the number of exemptions (including the additional exemptions for age and blindness and for dependents) allowed as a deduction under section 151 of the 1954 Code. The credit would apply only in the case of taxable years beginning after December 31, 1955. (There would be no partial credit for taxable years beginning in 1955 and ending in 1956.) An estate would be allowed a credit against income tax of $20; a trust would not be entitled to any such credit.

The amount of the credit allowed to the taxpayer may not exceed the amount of the tax imposed by chapter 1 of the 1954 Code, reduced by certain credits against tax already allowed by part IV of subchapter A of chapter 1. These credits which must be taken into account in computing the limitation on the new credit are: the credit with respect to taxes of foreign countries and possessions of the United States, the credit for dividends from certain domestic corporations received by individuals, the credit for partially tax-exempt interest received by individuals, and the credit for retirement income.

Section 5: This section contains the technical amendments necessary to conform the provisions of the 1954 Code to the new section 38 which would be inserted by section 4 of the bill.

Subsection (a) of this section contains nine numbered paragraphs. Paragraph (1) would amend section 1(d) of the 1954 Code to include in the cross references for such section 1 (which relates to the rates of income tax for individuals) a reference to the new section 38.

Paragraph (2) would amend section 3 of the 1954 Code (relating to the optional tax table if the adjusted gross income is less than $5,000) so as to insert a new tax table. This new table incorporates in its provisions the $20 credit against income tax. Thus, if the taxpayer is entitled to one exemption, the tax imposed under the new table is $20 less than the tax under the existing table; if he is entitled to three exemptions, the reduction is $60.

Paragraph (3) would amend section 21(d) of the 1954 Code (relating to effect of changes in rates during a taxable year.) This amendment is necessary to make it clear that the change in the optional tax table (which change is, in effect, a change in rates) will apply only to taxable years beginning after December 31, 1955, and that section 21 will not cause any reduction in the optional tax for any taxable year beginning before January 1, 1956. Since this amendment to subsection (d) of section 21 of the 1954 Code applies only to taxable years beginning before January 1, 1956, and ending after December 31, 1955, the existing provisions of section 21(d) will continue to apply to taxable years beginning before January 1, 1954, and ending after December 31, 1953.

Paragraph (4) would amend the table of sections for part IV of subchapter A of chapter 1 of the 1954 Code to reflect the insertion of the new section 38, and the renumbering of the existing section 38 as section 39.

Paragraph (5) would amend section 36 of the 1954 Code to provide that an individual electing to pay the optional tax under section 3 will not receive the new credit provided by section 38. This amendment is necessary because the credit has been fully reflected in the new optional-tax table.

Paragraph (6) would amend section 151 of the 1954 Code (relating to allowance of deductions for personal exemptions) to add a new subsection (f). The new subsection (f) contains a cross reference to the $20 credit per exemption provided by the new section 38.

Paragraph (7) would amend section 443(c) of the 1954 Code (relating to returns for less than 12 months by reason of a change in the annual accounting period). Under this amendment, a reduction in the new credit would be made on the same basis as is provided by existing section 443(c) for reducing the amount allowed for each personal exemption.

Paragraph (8) would amend subsection (a) of section 642 of the 1954 Code to add a new paragraph (4). The new paragraph (4) provides in effect that an estate (which, under section 642(b) of the 1954 Code, is entitled to one $600 exemption in lieu of the personal exemptions allowed by section 151) would be allowed one $20 credit under section 38(a). The amount of this credit would, of course, be subject to the limitations set forth in the new section 38(b).

Paragraph (9) would amend section 6015(a)(2)(A) of the 1954 Code (relating to the declaration of estimated income tax by individuals). Under the existing terms of this provision, an individual is required to file a declaration of estimated tax if his gross income for the taxable year can reasonably be expected to include more than $100 from sources other than wages and can reasonably be expected to exceed the sum of (A) the amount obtained by multiplying $600 by the number of exemptions to which he is entitled under section 151, plus (B) $400. The bill would change the $600 figure referred to in clause (A) of the preceding sentence to $700, in order to adjust this filing requirement to the new $20 credit.

Subsection (b) of section 5 contains two numbered paragraphs which would amend the existing withholding tables to reflect the new $20 credit. Paragraph (1) would amend the table contained in section 3402(b)(1) (relating to the percentage method of withholding income tax at source). Paragraph (2) would amend the tables contained in section 3402(c)(1) (relating to the wage bracket method of withholding income tax at source).

Subsection (c) of section 5 contains the effective dates for the amendments made by subsections (a) and (b) of that section. The technical amendments made by subsection (a) would apply only to taxable years beginning after December 31, 1955; except that the amendment made to section 21(d) of the 1954 Code by paragraph (3) of subsection (a) would apply only to taxable years beginning before January 1, 1956, and ending after December 31, 1955. The amendments to the withholding tables made by subsection (b) of this section would apply only with respect to wages paid after December 31, 1955.

VI. CHANGES IN EXISTING LAW[2]

* * * * * * *

TAX RATE EXTENSION ACT OF 1955

[Senate Report No. 36, Eighty-fourth Congress, First Session, Calendar No. 39]

[March 1, 1955]

Mr. Byrd, from the Committee on Finance, submitted the following report [to accompany H. R. 4259]:

The Committee on Finance, to whom was referred the bill (H. R. 4259) to provide a 1-year extension of the existing corporate normal-tax rate and of certain existing excise-tax rates, and to provide a $20 credit against the individual income tax for each personal exemption, having considered the same, report favorably thereon with amendments and recommend that the bill as amended do pass.

The amendments are as follows:

1. In the first section, amend the short title of the bill to be the "Tax Rate Extension Act of 1955."
2. Strike out sections 4 and 5 of the bill (relating to allowance of $20 credit for each personal exemption).
3. Amend the title of the bill so as to read:

An Act to provide a 1-year extension of the existing corporate normal-tax rate and of certain existing excise-tax rates.

I. GENERAL STATEMENT

H. R. 4259, as amended by your committee, like the House bill, provides for a 1-year extension of the present corporate income tax rate and the existing rates of certain excises. The rates of these taxes otherwise are scheduled for reduction on April 1, 1955. However, your committee's bill eliminates the sections of the House bill providing an individual income tax reduction for 1956.

The present 52 percent corporate income tax rate, without the 1-year extension provided in the bill, would revert to 47 percent as of the 1st of this April. The excise tax rates which without this bill also would be decreased this April are those on alcoholic beverages, cigarettes, gasoline, automobiles, trucks, auto parts, and diesel and special motor fuel.

The individual income tax reduction which would be provided by the House, but not by your committee's, bill is a $20 tax credit for each exemption. This would be effective beginning in the calendar year 1956.

Your committee agrees with the extensions of the present corporate and excise tax rates because the Federal budget is unbalanced for 1955 and 1956 and because it shows no expenditure reduction in 1956 to offset further tax reduction. Moreover, your committee does not believe that an individual income tax reduction for 1956 is justified this far in advance. The committee is not, however, closing the door to the future consideration of an individual tax reduction for 1956 if the financial conditions of the Treasury improve to a sufficient extent to make the reduction of individual taxes possible without adding to the debt.

II. REVENUE AND BUDGET EFFECTS

The revenue effects of your committee's bill and the House bill for the fiscal years 1955 and 1956, and also on a full year's basis, are shown in table 1. Only the extension of the excise taxes under either bill is expected to have any effect on budget receipts in the fiscal year 1955. Under existing law the excise tax reductions would be effective for April, May, and June in the fiscal year 1955 and the collections for the fiscal year 1955 would reflect most of the reductions for these months. Under both bills this decrease in revenue is avoided. The reduction in corporate taxes under existing law would not be reflected in receipts in fiscal year 1955 because of the lag in corporate tax collections. Most of the revenue effect from extending the present corporate income tax rate for 1 year beyond April 1, 1955, will be reflected in collections for the fiscal year 1956, but some effect will carry over into the fiscal year 1957. The individual income

[2] Not reproduced.

tax reduction provided by the House bill, but not your committee's bill, would be effective in the last 6 months of the fiscal year 1956 (i. e., the period from January 1 to June 30, 1956). It is estimated that individual income taxes collected through withholding or under the declaration system would be reduced by $815 million for the fiscal year 1956 as a result of this House provision. The $20 per exemption tax credit would be fully effective under the House bill in the fiscal year 1957.

TABLE 1.—*Comparison of effect of House and Finance Committee bills on receipts*

[In millions of dollars]

	In the fiscal year—			On a full year's basis	
	1955	1956			
	Both bills	Committee bill	House bill	Committee bill	House bill
Individual income tax $20 credit (House bill only)	0	0	−$815	0	−$2,093
Extension of 5 percentage points of corporation normal tax	0	$1,075	1,075	$1,750	1,750
Extension of certain excise taxes	$191	889	889	1,080	1,080
Total	191	1,964	1,149	2,830	737

Source: Staff of the Joint Committee on Internal Revenue Taxation.

Table 2 shows the effect of your committee's bill on the budget for the fiscal years 1955 and 1956. As this table indicates, expenditures in the President's budget are estimated at $63.5 billion and $62.4 billion, respectively, for the fiscal years 1955 and 1956. Receipts in the budget as provided for by existing law are estimated at $58.8 billion and $57.7 billion for these 2 years. This indicates in both years an excess of expenditures over these receipts of $4.7 billion. The extension of the excise rates as provided in your committee's bill decreases this deficit to $4.5 billion in the fiscal year 1955. In 1956 the combined effect of the excise and corporate income tax extensions reduce the deficit to $2.5 billion. The House income tax cut would increase this deficit again to $3.3 billion.

TABLE 2.—*Effect of the Finance Committee bill on the 1955 and 1956 budgets*

[In billions of dollars]

	Fiscal year—	
	1955	1956
Expenditures, including proposed legislation	$63.5	$62.4
Receipts, existing law only	58.8	57.7
Difference	−4.7	−4.7
Effect of extending corporate and excise tax rates as in committee bill:		
Increase in tax collection	+.2	[1] +2.0
Postponement of floor-stock refunds	0	[2] +.2
Budget deficit under existing law, adjusted for extension of rates	−4.5	[1] −2.5

[1] The budget estimate of the effect on revenue in the fiscal year 1956 of extending the corporate and excise tax rates is $100 million above the joint committee staff estimate. Using the budget figures would decrease the deficits shown by $100 million.

[2] These floor-stock refunds, without the extensions, might affect the 1955 instead of the 1956 budget. They, however, are shown as reported in the President's budget.

Source: Staff of the Joint Committee on Internal Revenue Taxation.

III. Reasons for Elimination of $20 Individual Income Tax Credit

The House bill would have allowed a taxpayer a $20 tax reduction for each exemption claimed by him with respect to himself and any dependents he might have. A taxpayer who was 65 or over or blind would have received an extra $20 with respect to each such exemption. The tax reduction was to take the form of a credit against the tax liability as otherwise computed but was not to exceed this tax liability. The reduction provided by the House bill would have been effective for the calendar year 1956 and subsequent years.

Your committee's bill deletes the provisions relating to this tax reduction. This reduction is omitted without intending to imply, however, that subsequent events may not justify an individual income tax reduction for 1956.

The tax reduction provided by the House bill would first become effective some 10 months from now and it is estimated that it would decrease revenues in the year ending June 30, 1956, by $815 million. The full impact of the reduction, however, would not be felt until the fiscal year 1957. In that year it is estimated that revenues would be decreased by $2.1 billion. Your committee is unable to tell this far in advance whether the economy in 1956 and 1957 will need such a reduction. Moreover, your committee believes that it would be most difficult to remove such a reduction, once granted, even though subsequent budgetary and economic conditions should show that such a reduction was unwarranted.

The President's budget presented this last January forecast a deficit of $4.5 billion for the fiscal year 1955 and $2.4 billion for the fiscal year 1956. These budget figures already take into account the revenue to be gained from the extension of the existing corporate and excise tax rates. No forecast is as yet available for 1957 when the House reduction would have its principal impact.

The 1955 budget is not reduced under either the House or your committee's bill. The House bill increases the 1956 deficit by $815 million, or to approximately $3.3 billion. Still more important, the House measure would make a balanced budget in 1957 much more difficult to accomplish, because it would decrease revenues in that year by $2.1 billion.

It is contended by some that despite the budgetary situation, economic conditions demand a tax reduction for individuals. This has been justified on the grounds that the gross national product for the calendar year 1954 fell about $8 billion behind the level of 1953. This decline in economic activity last year, however, would not appear to require a tax reduction next year. On the contrary, most economic indicators have shown an improvement in the latter part of 1954 which is continued in the early data available for 1955.

Thus, the gross national product increased in the last quarter of 1954, as also did the index of industrial production which (on a preliminary basis) showed further improvement in January of 1955. The factory workweek was lengthened in the latter part of 1954 and declined less than is usual in January of 1955. Unemployment also fell in the latter part of 1954. This same pattern of improvement is repeated in various other economic indicators. Certainly the recent improvement suggests that there is no need to rush in now to make an individual tax reduction which will not be effective until 10 months from now.

IV. Extension of the Corporate Income and Certain Excise Tax Rates

Your committee's bill, like the House bill, extends for 1 year the present 52 percent corporate income tax rate that otherwise is due to revert to 47 percent as of April 1, 1955. The 5 percentage point reduction would occur in the 30 percent normal tax to which all corporate taxable income is subject. The 22 percent surtax, which applies only to income above $25,000, remains unchanged.

Your committee's bill, also like the House bill, extends for 1 year the present excise tax rates due to be automatically reduced as of April 1, 1955. These include the excise taxes on distilled spirits, beer, wine, cigarettes, gasoline, automobiles, trucks, automobile parts and accessories, and diesel and special motor fuel. These excises are described more fully in table 3 which shows the unit of tax, the rates before and after April 1, 1956, under this bill and the revenue effects of these extensions for the fiscal years 1955 and 1956 and also on a full-year's basis.

TABLE 3.—*Excise tax rates extended until Apr. 1, 1956*[1] *under both the House committee bills*

	Unit of tax	Rate extended for period from Apr. 1, 1955, to Mar. 31, 1956	Rate to become effective Apr. 1, 1956[1]	Effect on revenue		
				Fiscal 1955	Fiscal 1956	Full year of operation
				Millions	*Millions*	*Millions*
Liquor taxes:						
Distilled spirits	Per proof gallon	$10.50	$9	$38	$89	$127
Beer	Per barrel	$9	$8	21	64	85
Wine:						
Still wine:						
Containing less than 14 percent alcohol.	Per wine gallon	17 cents	15 cents			
Containing 14 to 21 percent alcohol.	do	67 cents	60 cents			
Containing 21 to 24 percent alcohol.	do	$2.25	$2			
Containing more than 24 percent alcohol.	do	$10.50	$9			
Sparkling wines, liquers, cordials, etc.:				3		10
Champagne or sparkling wine.	do	$3.40	$3			
Liquers, cordials, etc.	do	$1.92	$1.60			
Artificially carbonated wines.	do	$2.40	$2			
Tobacco taxes: Cigarettes	Per 1,000	$4	$3.50	46	139	185
Manufacturer's excises:						
Gasoline	Per gallon	2 cents	1½ cents	31	219	250
Passenger cars and motorcycles	Manufacturers' sale price.	10 percent	7 percent	37	263	300
Trucks, buses, truck trailers	do	8 percent	5 percent	7	53	60
Auto parts and accessories	do	do	do	7	49	56
Retailers' excises: Diesel and special motor fuel.	Per gallon	2 cents	1½ cents	1	6	7
Total excises				191	889	1,080

[1] These rates were increased by the Revenue Act of 1951 and the increases were scheduled to terminate on Apr. 1, 1954. The Excise Tax Reduction Act of 1954 extended these rate increases to Apr. 1, 1955.

Source: Prepared by the staff of the Joint Committee on Internal Revenue Taxation.

In addition to extending the rates specified above, your committee's bill, and the House bill, postpone for 1 more year the floor stock refunds or credits presently effective with respect to stocks of various taxpaid products on hand on April 1, 1955. These floor stock refunds are available in the case of distilled spirits, wines, and beer, cigarettes, gasoline, and automobiles, trucks, and automobile parts and acessories.

The rate extension provided by the bill in the case of the corporate income tax makes the 52 percent rate applicable to taxable years beginning and ending before April 1, 1956, and a 47-percent rate applicable with respect to taxable years beginning and ending thereafter. A proration formula, already in the Internal Revenue Code, provides for corporations whose taxable years overlap this date.

Your committee has provided for the extension of the corporate income tax and the excise tax rates for another year primarily because the present budget situation does not justify such reductions at the present time. Some $2.8 billion of revenue is involved on a full year's basis. In this connection, the President in his recent budget message stated:

> Because we must keep our existing revenues intact, I have already recommended to the Congress in my state of the Union message that existing rates on both excises and corporate incomes be extended for 1 year Any other course of action would result in either (1) inadequate expenditures for national security, or (2) inflationary borrowing.

Your committee is in accord with the President in believing that the budget does not permit these reductions to take place in 1955.

V. CHANGES IN EXISTING LAW[1]

* * * * * * *

TAX RATE EXTENSION ACT OF 1955

[House of Representatives Report No. 305, Eighty-fourth Congress, First Session]

[March 28, 1955]

Mr. Cooper, from the committee of conference, submitted the following conference report [to accompany H. R. 4259]:

The committee of conference on the disagreeing votes of the two Houses on the amendments of the Senate to the bill (H. R. 4259) to provide a 1-year extension of the existing corporate normal-tax rate and of certain existing excise-tax rates, and to provide a $20 credit against the individual income tax for each personal exemption, having met, after full and free conference, have agreed to recommend and do recommend to their respective Houses as follows:

That the House recede from its disagreement to the amendments of the Senate numbered 1 and 2 and agree to the same.

That the House recede from its disagreement to the amendment of the Senate to the title of the bill and agree to the same.

JERE COOPER,
W. D. MILLS,
DANIEL A REED,
THOMAS A. JENKINS,
Managers on the Part of the House.
HARRY F. BYRD,
WALTER F. GEORGE,
by H. F. B.
ROBERT S. KERR,
E. D. MILLIKIN,
EDWARD MARTIN,
Managers on the Part of the Senate.

STATEMENT OF THE MANAGERS ON THE PART OF THE HOUSE

The managers on the part of the House at the conference on the disagreeing votes of the two Houses on the amendments of the Senate to the bill (H. R. 4259) to provide a 1-year extension of the existing corporate normal-tax rate and of certain existing excise-tax rates, and to provide a $20 credit against the individual income tax for each personal exemption, submit the following statement in explanation of the effect of the action agreed upon by the conferees and recommended in the accompanying conference report:

Amendment No. 1: The first section of the House bill authorized the bill to be cited as the "Revenue Act of 1955. The Senate amendment authorized the bill to be cited as the "Tax Rate Extension Act of 1955". The House recedes.

Amendment No.: Sections 4 and 5 of the House bill provided for a credit against the individual income tax in an amount equal to $20 multiplied by the number of exemptions allowed as deductions in computing taxable income. The credit applied to taxable years beginning after December 31, 1955. The Senate amendment struck out sections 4 and 5 of the House bill. The House recedes.

Amendment to the title: The Senate amendment to the title of the bill conformed the title to the amendments made by the Senate to the text of the bill. The House recedes.

JERE COOPER,
W. D. MILLS,
DANIEL A. REED,
THOMAS A. JENKINS,
Managers on the Part of the House.

[1] Not reproduced.

PART V.

ADMINISTRATIVE AND MISCELLANEOUS MATTERS

EXECUTIVE ORDER 10583

Amendment of Executive Order No. 10289,[1] relating to the performance of certain functions affecting the Department of the Treasury.

By virtue of the authority vested in me by section 301 of title 3 of the United States Code, and as President of the United States, it is ordered that Executive Order No. 10289 of September 17, 1951 (16 F. R. 9499), entitled "Providing for the Performance of Certain Functions of the President by the Secretary of the Treasury" be, and it is hereby, amended as follows:

1. Paragraph 1 is amended by adding at the end thereof the following subparagraph (i):

(i) The authority which is now vested in the President by section 2564(b) of the Internal Revenue Code (26 U. S. C. 2564(b)), and which on and after January 1, 1955, will be vested in the President by section 4735(b) of the Internal Revenue Code of 1954, to issue, in accordance with the provisions of the said section 2564(b) or 4735(b), as the case may be, orders providing for the registration and the imposition of a special tax upon all persons in the Canal Zone who produce, import, compound, deal in, dispense, sell, distribute, or give away narcotic drugs.

* * * * * * *

DWIGHT D. EISENHOWER.

THE WHITE HOUSE
December 18, 1954.

(Filed with the Division of the Federal Register December 20, 1954, 10:15 a. m.)

As amended by Executive Order 10583, *supra*, Executive Order 10289, insofar as it relates to internal revenue affairs, reads as follows:

Providing for the performance of certain functions of the President by the Secretary of the Treasury.

By virtue of the authority vested in me by section 1 of the act of August 8, 1950, 64 Stat. 419 (Public Law 673, 81st Congress), and as President of the United States, it is ordered as follows:

1. The Secretary of the Treasury is hereby designated and empowered to perform the following-described functions of the President without the approval, ratification, or other action of the President:

* * * * * * *

(h) The authority vested in the President by section 3650 of the Internal Revenue Code (26 U. S. C. 3650) to establish convenient collection districts (for the purpose of assessing, levying, and collecting the taxes provided by the internal revenue laws), and from time to time to alter such districts.

(i) The authority which is now vested in the President by section 2564(b) of the Internal Revenue Code (26 U. S. C. 2564(b)), and which on and after January 1, 1955, will be vested in the President by section 4735(b) of the Internal

[1] 16 F. R. 9499; 3 CFR, 1951 Supp., p. 469.

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Revenue Code of 1954, to issue, in accordance with the provisions of the said section 2564(b) or 4735(b), as the case may be, orders providing for the registration and the imposition of a special tax upon all persons in the Canal Zone who produce, import, compound, deal in, dispense, sell, distribute, or give away narcotic drugs.

2. The Secretary of the Treasury is hereby designated and empowered to perform without the approval, ratification, or other action of the President the following functions which have heretofore, under the respective provisions of law cited, required the approval of the President in connection with their performance by the Secretary of the Treasury:

* * * * * * *

(c) The authority vested in the Secretary of the Treasury by section 1805 of the Internal Revenue Code (26 U. S. C. 1805) to issue rules and regulations (with respect to silver bullion) necessary or proper to carry out the purposes of the said section.

* * * * * * *

4. As used in this order, the term "functions" embraces duties, powers, responsibilities, authority, or discretion, and the term "perform" may be construed to mean "exercise."

5. All actions heretofore taken by the President in respect of the matters affected by this order and in force at the time of the issuance of this order, including regulations prescribed by the President in respect of such matters, shall, except as they may be inconsistent with the provisions of this order, remain in effect until amended, modified, or revoked pursuant to the authority conferred by this order.

EXECUTIVE ORDER 10586

Designating Certain Officers to Act as Secretary of the Treasury

By virtue of the authority vested in me by section 179 of the Revised Statutes (5 U. S. C. 6), and section 301 of title 3 of the United States Code, it is ordered as follows:

In case of the death, resignation, absence, or sickness of the Secretary of the Treasury and the Under Secretary of the Treasury, the following-designated officers of the Treasury Department shall, in the order of succession indicated, act as Secretary of the Treasury until a successor is appointed or until the absence or sickness of the incumbent shall cease:

1. Under Secretary for Monetary Affairs.
2. Assistant Secretaries, in the order fixed from time to time by the Secretary of the Treasury.
3. General Counsel.

Executive Order No. 8714 of March 18, 1941, entitled "Designating Certain Officers To Act as Secretary of the Treasury in Case of Absence or Sickness of the Secretary", is hereby revoked.

DWIGHT D. EISENHOWER.

THE WHITE HOUSE,
January 13, 1955.

(Filed with the Division of the Federal Register January 13, 1955, 3:52 p. m.)

EXECUTIVE ORDER 10602

Designating the Secretary of the Interior as the Representative of the President to approve the obligation and expenditure of certain moneys by the Government of the Virgin Islands.

By virtue of the authority vested in me by section 7652(b)(3) of the Internal Revenue Code of 1954 (Public Law 591, 83rd Cong., 68A

Stat. 907), I hereby designate the Secretary of the Interior as the representative of the President to approve the obligation and expenditure by the government of the Virgin Islands of the moneys referred to in the said section 7652(b)(3).

DWIGHT D. EISENHOWER.

THE WHITE HOUSE,
March 23, 1955.

(Filed with the Division of the Federal Register March 24, 1955, 10:22 a. m.)

PROCLAMATION 3082

Determining 4,4–Diphenyl–6–Dimethylamino–3–Hexanone to be an Opiate.

BY THE PRESIDENT OF THE UNITED STATES OF AMERICA

A Proclamation

WHEREAS section 4731(g) of the Internal Revenue Code of 1954 provides in part as follows:

Opiate. The word "opiate", as used in this part shall mean any drug (as defined in the Federal Food, Drug, and Cosmetic Act; 52 Stat. 1041, section 201(g); 21 U. S. C. 321) found by the Secretary or his delegate, after due notice and opportunity for public hearing, to have an addiction-forming or addiction-sustaining liability similar to morphine or cocaine, and proclaimed by the President to have been so found by the Secretary or his delegate. * * *;

AND WHEREAS, the Secretary of the Treasury, after due notice and opportunity for public hearing, has found that the following named drug has an addiction-forming or addiction-sustaining liability similar to morphine, and that in the public interest this finding should be effective immediately:

4,4–diphenyl–6–dimethylamino–3–hexanone.

NOW, THEREFORE, I, DWIGHT D. EISENHOWER, President of the United States of America, do hereby proclaim that the Secretary of the Treasury has found that the aforementioned drug has an addiction-forming or addiction-sustaining liability similar to morphine and that in the public interest this finding should be effective immediately.

IN WITNESS WHEREOF, I have hereunto set my hand and caused the seal of the United States of America to be affixed.

DONE at the City of Washington this 23d day of February in the year of our Lord nineteen hundred and fifty-five, and of the Independence of the United States of America the one hundred and seventy-ninth.

(SEAL) DWIGHT D. EISENHOWER

By the President:

HERBERT HOOVER, Jr.,
Acting Secretary of State.

(F. R. Doc. 55–1840; Filed with the Division of the Federal Register Feb. 28, 1955; 3:03 p. m.)

T. D. 6118

TITLE 26—INTERNAL REVENUE

Temporary rules relating to the income tax and administrative matters under 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:

On August 27, 1954, notice of proposed rule making with respect to temporary rules relating to income tax and administrative matters under Internal Revenue Code of 1954 were published in the Federal Register (19 F. R. 5490). After consideration of all such relevant matter as was presented by interested persons, the proposed rules have been modified as set forth below and are hereby adopted:

TABLE OF CONTENTS

Paragraph
1 Annuities; certain proceeds of endowment and life insurance contracts; actuarial tables.
2 Income from discharge of indebtedness; special rule of exclusion; time and manner of filing consent to adjustment of basis.
3 Agreements as to useful life and rate of depreciation.
4 Charitable, etc., contributions and gifts; limitations for individuals; special rule.
5 Research and experimental expenditures.
6 Soil and water conservation expenditures treated as expenses not chargeable to capital account.
7 Organizational expenditures; time and manner of making election.
8 Prepaid income.
9 Accrual of real property taxes.
10 Reserves for estimated expenses.
11 Undistributed personal holding company income.
12 Deduction for deficiency dividends.
13 Undistributed foreign personal holding company income; taxes; election.
14 Definition of property; special rule as to operating mineral interests; election to aggregate under section 614(b).
15 Definition of property; special rule as to nonoperating mineral interests; permission to aggregate separate interests under section 614(c).
16 Special rules applicable to distributions by trusts in first 65 days of taxable year.
17 Foreign tax credit allowed to shareholders of a regulated investment company; manner of making election and notifying shareholders.
18 Adjusted basis; income from discharge of indebtedness.
19 Definitions; agreements treated as determinations.
20 Notice of qualification as executor or receiver.
21 Automatic extension of time for filing corporation income tax returns.

The following rules, prescribed under the Internal Revenue Code of 1954 (Public Law 591, 83d Cong., approved Aug. 16, 1954), relate to certain elections or other actions by taxpayers under provisions of such Code which do not correspond to provisions of the Internal Revenue Code of 1939 (as to cases involving corresponding provisions, see sec. 7807 of the Internal Revenue Code of 1954 and T. D. 6091, approved Aug. 16, 1954).

The rules set forth herein are designed to inform taxpayers as to how, when, and where to perform certain acts required or permitted under the Internal Revenue Code of 1954. More comprehensive rules with respect to the subjects involved will be incorporated in subse-

quent regulations under the Code. The inclusion in this Treasury Decision of rules relating to certain acts is intended to assist taxpayers in the performance of such acts. Rules with respect to other acts required or permitted by other provisions of the 1954 Code will be covered in subsequent regulations.

PARAGRAPH 1. ANNUITIES; CERTAIN PROCEEDS OF ENDOWMENT AND LIFE INSURANCE CONTRACTS; ACTUARIAL TABLES.—(a) *Application of paragraph.*—The computations and rules set forth in this paragraph are to be used to determine the extent to which amounts received in installments (to which section 72 applies) under annuity, life insurance, or endowment contracts are excludable from the gross income of the recipient, except for those cases where the special rules of section 72(d), (e), (g), (h), (j), or (k) apply.

(b) *General rule.*—(1) *Exclusion ratio.*—In order to determine the amount to exclude from gross income an exclusion ratio is to be found for the particular contract. This exclusion ratio is applied to the total receipts under the contract for the taxable year of the recipient. The difference between the total receipts and the result of the computation is to be included in the gross income of the recipient. The exclusion ratio is determined by dividing the investment in the contract at the annuity starting date by the expected return under the contract. Such investment in the contract shall consist of the aggregate of premiums and other consideration paid less the aggregate of any amount or amounts received before the annuity starting date to the extent that such amounts were excludable from the gross income of the recipient. Thus, assuming that the investment in the contract is $12,650 and the expected return is $16,000, the exclusion ratio is $12,650/$16,000, or 79.1 percent (79.06 rounded to the nearest tenth). If the monthly payment is $100, the amount to be excluded from gross income in connection with each monthly payment is $79.10 (79.1 percent of $100). Thus, if 12 such monthly payments are received, the total amount to be excluded for the taxable year is $949.20 (12×$79.10) and $250.80 is the amount to be included in the gross income of the annuitant.

(2) *Annuity starting date.*—The annuity starting date (except in the case of an annuity described in subparagraph (d)(2)) is the first day of the first period for which an amount is received as an annuity under the contract, except that if such date was before January 1, 1954, then the annuity starting date is January 1, 1954. In the case of an annuity described in subparagraph (d)(2), the annuity starting date is January 1, 1954, or the first day of the first period for which an amount is received as an annuity under the contract by the surviving annuitant, whichever is later. The first day of the first period for which an amount is received as an annuity shall be whichever is the later of the following:

(i) The date upon which the obligations of the contract become fixed, or

(ii) The first day of the period (year, half-year, quarter, or month depending on whether payments are to be made annually, semiannually, quarterly, or monthly) which ends on the date of the first annuity payment.

(3) *Expected return for one annuitant.*—In the case of an annuity, endowment, or life insurance contract under which one annuitant is to receive a monthly income for life, the expected return is determined by multiplying the annual payment by the multiple shown in Table I of subparagraph (f) under the age and sex of the annuitant as of the annuity starting date. Thus, where a male has purchased a single-premium-immediate annuity of $100 per month for his life and at the time of purchase (in this case the annuity starting date) the annuitant's age at his nearest birthday is 66, the expected return is computed as follows:

Monthly payment of $100×12 months equals annual payment of	$1,200
Multiple shown in Table I, male, age 66	14.4
Expected return ($1,200×14.4)	$17,280

(4) *Adjustment of multiple for early or other than monthly payments.*—If payments are to be made quarterly, semiannually, or annually, or if the interval between the annuity starting date and the date of the first payment is less than the interval between future payments, an adjustment of the applicable multiple shown in Table I may be required, but no such adjustment is required if the payments are to be made more frequently than monthly. The amount of the adjustment, if any, is to be found in accordance with the following table:

If the number of whole months from the annuity starting date to the first payment date is—	Less than 1	1	2	3	4	5	6	7	8	9	10	11	12
And payments under the contract are to be made:													
Annually	+0.5	+0.5	+0.4	+0.3	+0.2	+0.1	0	0	−0.1	−0.2	−0.3	−0.4	−0.5
Semiannually	+.3	+.2	+.1	0	0	−.1	−.2						
Quarterly	+.2	+.1	0	−.1									
Monthly	+.1	0											

Thus, at age 66, male, the multiple found in Table I, adjusted for quarterly payments the first of which is to be made 1 full month after the annuity starting date, is 14.5 (14.4+.1); for semiannual payments the first of which is 6 full months from the annuity starting date, the adjusted multiple is 14.2 (14.4−.2); for annual payments the first of which is 1 full month from the annuity starting date, the adjusted multiple is 14.9 (14.4+.5). If the annuitant in the example shown in subparagraph (b) (3) were to receive an annual payment of $1,200 12 full months after his annuity starting date, the amount of the expected return would be $16,680 ($1,200 × [14.4−.5=13.9]).

(5) *Expected return under uniform payment joint and survivor annuity.*—In the case of a joint and survivorship contract involving two annuitants which provides the first annuitant with a monthly income for life and, after the death of the first annuitant, provides an identical monthly income for life to a second annuitant, the expected return shall be determined by multiplying the amount of the annual payment by the multiple shown in Table II under the ages and sexes of the annuitants as of the annuity starting date. For example, a husband purchased a joint and survivorship annuity contract providing for payments of $100 per month for life and, after his death, for the same amount to his wife for the remainder of her life. At the annuity starting date his age at his nearest birthday is 70 and that of his wife is 67. The expected return is computed as follows:

Twelve monthly payments of $100	$1,200
Multiple shown in Table II (male, age 70; female, age 67)	19.7
Expected return ($1,200 × 19.7)	$23,640

An adjustment of the applicable multiple shown in Table II is required where payments under a joint and survivorship contract are made quarterly, semiannually, or annually, or where the interval between the annuity starting date and the date of the first payment is less than the interval between future payments. This adjustment shall be made in the same manner as described in subparagraph (b) (4).

(6) *Expected return under variable payment joint and survivor annuities.*—(i) In the case of a contract which provides that a specified annuitant is to receive a certain payment as an annuity for life and after his death a reduced annuity is to be paid to a specified survivor (but not if the second annuitant predeceases the first), the expected return shall be computed in the following manner. The multiple applicable to the first annuitant is to be found in Table I as though the contract were for a single life annuity. The portion of the expected return with respect to the first annuitant is then computed by applying the multiple so found in Table I to the total payments received annually. See the example in subparagraph (b) (3).

Table II is then used to locate the multiple under both of the annuitants' ages as of their nearest birthdays on the annuity starting date. The multiple so determined for both annuitants is reduced by the amount of the single life multiple determined for the first annuitant. The difference is then multiplied by the amount of the total payment to be received annually by the second annuitant. Add this result to the portion of the expected return with respect to the first annuitant to obtain the expected return under the contract. These principles may be illustrated by the following example:

Example. A husband purchased a joint and survivorship annuity contract providing for payments of $100 per month ($1,200 per year) for life and, after his death, payments to his wife of $50 per month ($600 per year) for life. At

the annuity starting date, his nearest birthday is 70 and that of his wife 67. The expected return under the contract is computed as follows:

Multiple from Table II (male, age 70; female, age 67)	19.7
Multiple from Table I (male, age 70)	12.1
Difference (multiple applicable to second annuitant)	7.6
Portion of expected return (second annuitant), 7.6×$600	$4,560
Portion of expected return (first annuitant), 12.1×$1,200	$14,520
Expected return under the contract	$19,080

The total expected return (in this example, $19,080) is to be used in computing the amount to be excluded from gross income. Thus, if the investment in the contract in this example is $14,310, the exclusion ratio is $14,310/$19,080, or 75 percent. The amount excludable from each monthly payment made to the husband is 75 percent of $100, or $75, and $25 of each payment received in his taxable year by the annuitant will be included in his gross income. After the husband's death, the amount to be excluded by the surviving wife would be 75 percent of each monthly payment of $50, or $37.50, and $12.50 of each payment received in her taxable year would be includible in her gross income. An adjustment of the applicable multiples shown in Tables I and II is required where payments under a joint and survivorship contract are made quarterly, semiannually, or annually, or where the interval between the annuity starting date and the date of the first payment is less than the interval between future payments. This adjustment shall be made in the same manner as described in subparagraph (b) (4).

(ii) In the case of a contract which provides that a certain amount is to be paid as an annuity to a specified annuitant for the joint lives of such annuitant and another person, or is to be paid jointly to both during their joint lives, and a smaller amount is to be paid as an annuity to the survivor regardless of which of the annuitants is the first to die, the expected return shall be computed in the following manner. Table II is used to locate the multiple under both the annuitants' ages as of their nearest birthdays on the annuity starting date. The multiple so determined is reduced by the multiple under both the annuitants' ages found in Table IIA. The difference is then multiplied by the amount of the reduced payment to be received annually by the survivor annuitant. Add this result to the portion of the expected return obtained by multiplying the multiple found in Table IIA by the total payment to be received annually while both annuitants are alive. These principles may be illustrated by the following example:

Example. A husband purchased a joint and survivorship annuity contract providing for payments of $100 per month ($1,200 per year) for as long as both he and his wife live, and, after the death of the first to die, payments to the survivor of $50 a month ($600 per year) for life. At the annuity starting date, his nearest birthday is 70 and that of his wife 67. The expected return under the contract is computed as follows:

Multiple from Table II (male, age 70; female, age 67)	19.7
Multiple from Table IIA (male, age 70; female, age 67)	9.3
Difference	10.4
Portion of expected return (reduced payment), 10.4×$600	$6,240
Portion of expected return (full payment), 9.3×$1,200	$11,160
Expected return under the contract	$17,400

The total expected return (in this example, $17,400) is to be used in computing the amount to be excluded from gross income. Thus, if the investment in the contract in this example is $13,250, the exclusion ratio is $13,250/$17,400, or 76.1 percent. The amount excludable from each monthly payment made while both are alive is 76.1 percent of $100, or $76.10, and $23.90 of each payment received in the taxable year will be included in gross income. After the death of the first to die, the amount to be excluded by the survivor would be 76.1 percent of each monthly payment of $50, or $38.05, and $11.95 of each payment received in his or her taxable year (as the case may be) would be includible in his or her gross income. An adjustment of the applicable multiples shown in Tables II and IIA is required where payments under a joint and survivorship contract are made quarterly, semiannually, or annually, or where the interval between

the annuity starting date and the date of the first payment is less than tl interval between future payments. This adjustment shall be made in the san manner as described in subparagraph (b)(4).

(7) *Expected return for term certain.*—In the case of an annuity which to be paid for a term certain such as a fixed number of months or years, witho regard to life expectancy, the expected return is determined by multiplying tl fixed number of years or months, as the case may be, by the amount of the pa ment provided in the contract for each such period.

(c) *Exclusion where there is a refund feature.*—If (*1*) the expected retur under a contract depends to some extent on life expectancy, (*2*) the annuit contract provides for payments to a beneficiary or the estate of an annuitan and (*3*) such payments are in the nature of a refund of the consideration pai the investment in the contract is to be determined in the following manner:

(i) Determine the number of years necessary for the guaranteed amour to be fully paid by dividing the maximum amount guaranteed as of th annuity starting date by the amount to be received annually under the co tract. The number of years should be stated in terms of the nearest whol year considering for this purpose a fraction of one-half or more as the ne greater number of whole years.

(ii) Consult Table III for the appropriate percentage under the whol number of years found in (i) and the age of the annuitant at the annuit starting date.

(iii) Using the percentage found in (ii), find the percentage of whicheve of the following is the smaller: (*a*) the investment in the contract as c the annuity starting date or (*b*) the total amount guaranteed as of such dat

(iv) Subtract the amount found in (iii) to the nearest dollar from th investment in the contract as of the annuity starting date.

The result is the investment in the contract adjusted for the value of the refun feature and is to be used in determining the exclusion ratio. No adjustmen similar to that required by subparagraph (b)(4) is required to the percentag found in Table III. These principles may be illustrated by the followin example:

Example. A husband, age 65, purchased for $21,053, an immediate installmen refund annuity payable $100 per month for life. The contract provided tha in the event the husband did not live long enough to recover the full purchas price, payments were to be made to his wife until the total payments under th contract equaled the purchase price. The investment in the contract adjuste for the purpose of determining the exclusion ratio is computed in the followin manner:

Cost of the annuity contract (investment in the contract, unadjusted)		$21,05
Amount to be received annually	$1,200	
Number of years for which payment is guaranteed ($21,053 divided by $1,200)	17.5	
Rounded to nearest whole number of years	18	
Percentage located in Table III for age 65 (age of the annuitant as of the annuity starting date) and 18 (the number of whole years)	30	
Less value of refund feature to the nearest dollar (30% of $21,053)		6,31
Investment in the contract adjusted for the value of the refund feature		$14,73

In the case of contracts, under which the investment in the contract is less tha the guaranteed amount, only the portion of the guaranteed amount which doe not exceed the investment in the contract constitutes a refund of the premium or other consideration paid.

(d) *Special rules relating to investment in the contract.*—(1) *Employer co tributions.*—The term "aggregate of premiums and other consideration paid," fc the purposes of this paragraph, shall include not only amounts contributed by th employee, but also amounts contributed by the employer to the extent that (i such amounts were includible in the gross income of the employee at the tim contributed or (ii) such amounts would not have been includible in the gros income of the employee had they been paid directly to the employee at the tim contributed by the employer.

In addition to the foregoing, any amount found excludable under paragraph (1) and (2)(D) of section 101(b), under paragraph (1) of section 22(b) of th Internal Revenue Code of 1939, or under regulations with respect to either

these, shall also be treated as consideration paid by the employee. Contributions of employers excludable from employees' gross income at the time contributed which, had they been paid directly to the employees, would have been includible in their gross income are not to be included in the "aggregate of premiums and other consideration paid" in determining investment in the contract. Thus, if an employer made contributions, under a qualified plan, toward the purchase of a contract providing an annuity for an employee or his beneficiary, and if such contribution would have been taxable income to the employee at the time had it been paid directly to him as compensation instead, the aggregate of premiums and other consideration paid would not include such contributions.

(2) *Certain survivor annuitants.*—In the case of a joint and survivor annuity contract in respect of which the first annuitant died in 1951, 1952, or 1953, section 72(i) requires that the "aggregate of premiums or other consideration paid" with respect to the surviving annuitant shall be the basis of the contract as determined under section 113(a)(5) of the Internal Revenue Code of 1939. (For rules governing this determination, see Regs. 118, § 39.113(a)(5)-1.) In determining such surviving annuitant's investment in the contract, such aggregate shall be reduced only by amounts received under the contract by the surviving annuitant alone and so received before the annuity starting date to the extent such an amount was excludable from his gross income at the time of receipt. For definition of annuity starting date for such cases, see subparagraph (b) (2) of this paragraph.

(e) *Special cases.*—If the terms of the contract are such that Tables I, II, IIA, and III cannot be correctly applied, assistance should be requested from the office of the District Director of Internal Revenue with whom the income tax return is to be filed. In such cases the computation shall be made on the basis of tables which will be consistent with Tables I, II, IIA, and III.

(f) *Tables.*—The tables to be used in connection with this paragraph are as follows:

TABLE I.—*Ordinary life annuities—one life—expected return multiples*

Ages		Multiples	Ages		Multiples	Ages		Multiples
Male	Female		Male	Female		Male	Female	
6	11	65.0	41	46	33.0	76	81	9.1
7	12	64.1	42	47	32.1	77	82	8.7
8	13	63.2	43	48	31.2	78	83	8.3
9	14	62.3	44	49	30.4	79	84	7.8
10	15	61.4	45	50	29.6	80	85	7.5
11	16	60.4	46	51	28.7	81	86	7.1
12	17	59.5	47	52	27.9	82	87	6.7
13	18	58.6	48	53	27.1	83	88	6.3
14	19	57.7	49	54	26.3	84	89	6.0
15	20	56.7	50	55	25.5	85	90	5.7
16	21	55.8	51	56	24.7	86	91	5.4
17	22	54.9	52	57	24.0	87	92	5.1
18	23	53.9	53	58	23.2	88	93	4.8
19	24	53.0	54	59	22.4	89	94	4.5
20	25	52.1	55	60	21.7	90	95	4.2
21	26	51.1	56	61	21.0	91	96	4.0
22	27	50.2	57	62	20.3	92	97	3.7
23	28	49.3	58	63	19.6	93	98	3.5
24	29	48.3	59	64	18.9	94	99	3.3
25	30	47.4	60	65	18.2	95	100	3.1
26	31	46.5	61	66	17.5	96	101	2.9
27	32	45.6	62	67	16.9	97	102	2.7
28	33	44.6	63	68	16.2	98	103	2.5
29	34	43.7	64	69	15.6	99	104	2.3
30	35	42.8	65	70	15.0	100	105	2.1
31	36	41.9	66	71	14.4	101	106	1.9
32	37	41.0	67	72	13.8	102	107	1.7
33	38	40.0	68	73	13.2	103	108	1.5
34	39	39.1	69	74	12.6	104	109	1.3
35	40	38.2	70	75	12.1	105	110	1.2
36	41	37.3	71	76	11.6	106	111	1.0
37	42	36.5	72	77	11.0	107	112	.8
38	43	35.6	73	78	10.5	108	113	.7
39	44	34.7	74	79	10.1	109	114	.6
40	45	33.8	75	80	9.6	110	115	.5
						111	116	0

TABLE II.—*Ordinary joint life and last survivor annuities—two lives—expected return multiples*

Ages														
	Male	35	36	37	38	39	40	41	42	43	44	45	46	47
Male	Female	40	41	42	43	44	45	46	47	48	49	50	51	52
35	40	46.2	45.7	45.3	44.8	44.4	44.0	43.6	43.3	43.0	42.6	42.3	42.0	41.8
36	41	------	45.2	44.8	44.3	43.9	43.5	43.1	42.7	42.3	42.0	41.7	41.4	41.1
37	42	------	------	44.3	43.8	43.4	42.9	42.5	42.1	41.8	41.4	41.1	40.7	40.4
38	43	------	------	------	43.3	42.9	42.4	42.0	41.6	41.2	40.8	40.5	40.1	39.8
39	44	------	------	------	------	42.4	41.9	41.5	41.0	40.6	40.2	39.9	39.5	39.2
40	45	------	------	------	------	------	41.4	41.0	40.5	40.1	39.7	39.3	38.9	38.6
41	46	------	------	------	------	------	------	40.5	40.0	39.6	39.2	38.8	38.4	38.0
42	47	------	------	------	------	------	------	------	39.6	39.1	38.7	38.2	37.8	37.5
43	48	------	------	------	------	------	------	------	------	38.6	38.2	37.7	37.3	36.9
44	49	------	------	------	------	------	------	------	------	------	37.7	37.2	36.8	36.4
45	50	------	------	------	------	------	------	------	------	------	------	36.8	36.3	35.9
46	51	------	------	------	------	------	------	------	------	------	------	------	35.9	35.4
47	52	------	------	------	------	------	------	------	------	------	------	------	------	35.0

Ages														
	Male	48	49	50	51	52	53	54	55	56	57	58	59	60
Male	Female	53	54	55	56	57	58	59	60	61	62	63	64	65
35	40	41.5	41.3	41.0	40.8	40.6	40.4	40.3	40.1	40.0	39.8	39.7	39.6	39.5
36	41	40.8	40.6	40.3	40.1	39.9	39.7	39.5	39.3	39.2	39.0	38.9	38.8	38.6
37	42	40.2	39.9	39.6	39.4	39.2	39.0	38.8	38.6	38.4	38.3	38.1	38.0	37.9
38	43	39.5	39.2	39.0	38.7	38.5	38.3	38.1	37.9	37.7	37.5	37.3	37.2	37.1
39	44	38.9	38.6	38.3	38.0	37.8	37.6	37.3	37.1	36.9	36.8	36.6	36.4	36.3
40	45	38.3	38.0	37.7	37.4	37.1	36.9	36.6	36.4	36.2	36.0	35.9	35.7	35.5
41	46	37.7	37.3	37.0	36.7	36.5	36.2	36.0	35.7	35.5	35.3	35.1	35.0	34.8
42	47	37.1	36.8	36.4	36.1	35.8	35.6	35.3	35.1	34.8	34.6	34.4	34.2	34.1
43	48	36.5	36.2	35.8	35.5	35.2	34.9	34.7	34.4	34.2	33.9	33.7	33.5	33.3
44	49	36.0	35.6	35.3	34.9	34.6	34.3	34.0	33.8	33.5	33.3	33.0	32.8	32.6
45	50	35.5	35.1	34.7	34.4	34.0	33.7	33.4	33.1	32.9	32.6	32.4	32.2	31.9
46	51	35.0	34.6	34.2	33.8	33.5	33.1	32.8	32.5	32.2	32.0	31.7	31.5	31.3
47	52	34.5	34.1	33.7	33.3	32.9	32.6	32.2	31.9	31.6	31.4	31.1	30.9	30.6
48	53	34.0	33.6	33.2	32.8	32.4	32.0	31.7	31.4	31.1	30.8	30.5	30.2	30.0
49	54	------	33.1	32.7	32.3	31.9	31.5	31.2	30.8	30.5	30.2	29.9	29.6	29.4
50	55	------	------	32.3	31.8	31.4	31.0	30.6	30.3	29.9	29.6	29.3	29.0	28.8
51	56	------	------	------	31.4	30.9	30.5	30.1	29.8	29.4	29.1	28.8	28.5	28.2
52	57	------	------	------	------	30.5	30.1	29.7	29.3	28.9	28.6	28.2	27.9	27.6
53	58	------	------	------	------	------	29.6	29.2	28.8	28.4	28.1	27.7	27.4	27.1
54	59	------	------	------	------	------	------	28.8	28.3	27.9	27.6	27.2	26.9	26.5
55	60	------	------	------	------	------	------	------	27.9	27.5	27.1	26.7	26.4	26.0
56	61	------	------	------	------	------	------	------	------	27.1	26.7	26.3	25.9	25.5
57	62	------	------	------	------	------	------	------	------	------	26.2	25.8	25.4	25.1
58	63	------	------	------	------	------	------	------	------	------	------	25.4	25.0	24.6
59	64	------	------	------	------	------	------	------	------	------	------	------	24.6	24.2
60	65	------	------	------	------	------	------	------	------	------	------	------	------	23.8

TABLE II.—*Ordinary joint life and last survivor annuities—two lives—expected return multiples*—Continued

Ages														
	Male	61	62	63	64	65	66	67	68	69	70	71	72	73
Male	Female	66	67	68	69	70	71	72	73	74	75	76	77	78
35	40	39.4	39.3	39.2	39.1	39.0	38.9	38.9	38.8	38.8	38.7	38.7	38.6	38.6
36	41	38.5	38.4	38.3	38.2	38.2	38.1	38.0	38.0	37.9	37.9	37.8	37.8	37.7
37	42	37.7	37.6	37.5	37.4	37.3	37.3	37.2	37.1	37.1	37.0	36.9	36.9	36.9
38	43	36.9	36.8	36.7	36.6	36.5	36.4	36.4	36.3	36.2	36.2	36.1	36.0	36.0
39	44	36.2	36.0	35.9	35.8	35.7	35.6	35.5	35.5	35.4	35.3	35.3	35.2	35.2
40	45	35.4	35.3	35.1	35.0	34.9	34.8	34.7	34.6	34.6	34.5	34.4	34.4	34.3
41	46	34.6	34.5	34.4	34.2	34.1	34.0	33.9	33.8	33.8	33.7	33.6	33.5	33.5
42	47	33.9	33.7	33.6	33.5	33.4	33.2	33.1	33.0	33.0	32.9	32.8	32.7	32.7
43	48	33.2	33.0	32.9	32.7	32.6	32.5	32.4	32.3	32.2	32.1	32.0	31.9	31.9
44	49	32.5	32.3	32.1	32.0	31.8	31.7	31.6	31.5	31.4	31.3	31.2	31.1	31.1
45	50	31.8	31.6	31.4	31.3	31.1	31.0	30.8	30.7	30.6	30.5	30.4	30.4	30.3
46	51	31.1	30.9	30.7	30.5	30.4	30.2	30.1	30.0	29.9	29.8	29.7	29.6	29.5
47	52	30.4	30.2	30.0	29.8	29.7	29.5	29.4	29.3	29.1	29.0	28.9	28.8	28.7
48	53	29.8	29.5	29.3	29.2	29.0	28.8	28.7	28.5	28.4	28.3	28.2	28.1	28.0
49	54	29.1	28.9	28.7	28.5	28.3	28.1	28.0	27.8	27.7	27.6	27.5	27.4	27.3
50	55	28.5	28.3	28.1	27.8	27.6	27.5	27.3	27.1	27.0	26.9	26.7	26.6	26.5
51	56	27.9	27.7	27.4	27.2	27.0	26.8	26.6	26.5	26.3	26.2	26.0	25.9	25.8
52	57	27.3	27.1	26.8	26.6	26.4	26.2	26.0	25.8	25.7	25.5	25.4	25.2	25.1
53	58	26.8	26.5	26.2	26.0	25.8	25.6	25.4	25.2	25.0	24.8	24.7	24.6	24.4
54	59	26.2	25.9	25.7	25.4	25.2	25.0	24.7	24.6	24.4	24.2	24.0	23.9	23.8
55	60	25.7	25.4	25.1	24.9	24.6	24.4	24.1	23.9	23.8	23.6	23.4	23.3	23.1
56	61	25.2	24.9	24.6	24.3	24.1	23.8	23.6	23.4	23.2	23.0	22.8	22.6	22.5
57	62	24.7	24.4	24.1	23.8	23.5	23.3	23.0	22.8	22.6	22.4	22.2	22.0	21.9
58	63	24.3	23.9	23.6	23.3	23.0	22.7	22.5	22.2	22.0	21.8	21.6	21.4	21.3
59	64	23.8	23.5	23.1	22.8	22.5	22.2	21.9	21.7	21.5	21.2	21.0	20.9	20.7
60	65	23.4	23.0	22.7	22.3	22.0	21.7	21.4	21.2	20.9	20.7	20.5	20.3	20.1
61	66	23.0	22.6	22.2	21.9	21.6	21.3	21.0	20.7	20.4	20.2	20.0	19.8	19.6
62	67	------	22.2	21.8	21.5	21.1	20.8	20.5	20.2	19.9	19.7	19.5	19.2	19.0
63	68	------	------	21.4	21.1	20.7	20.4	20.1	19.8	19.5	19.2	19.0	18.7	18.5
64	69	------	------	------	20.7	20.3	20.0	19.6	19.3	19.0	18.7	18.5	18.2	18.0
65	70	------	------	------	------	19.9	19.6	19.2	18.9	18.6	18.3	18.0	17.8	17.5
66	71	------	------	------	------	------	19.2	18.8	18.5	18.2	17.9	17.6	17.3	17.1
67	72	------	------	------	------	------	------	18.5	18.1	17.8	17.5	17.2	16.9	16.7
68	73	------	------	------	------	------	------	------	17.8	17.4	17.1	16.8	16.5	16.2
69	74	------	------	------	------	------	------	------	------	17.1	16.7	16.4	16.1	15.8
70	75	------	------	------	------	------	------	------	------	------	16.4	16.1	15.8	15.5
71	76	------	------	------	------	------	------	------	------	------	------	15.7	15.4	15.1
72	77	------	------	------	------	------	------	------	------	------	------	------	15.1	14.8
73	78	------	------	------	------	------	------	------	------	------	------	------	------	14.4

TABLE II.—*Ordinary joint life and last survivor annuities—two lives—expected return multiples*—Continued

Ages													
	Male	74	75	76	77	78	79	80	81	82	83	84	85
Male	Female	79	80	81	82	83	84	85	86	87	88	89	90
35	40	38.0	38.5	38.5	38.5	38.4	38.4	38.4	38.4	38.4	38.4	38.3	38.3
36	41	37.7	37.6	37.6	37.6	37.6	37.5	37.5	37.5	37.5	37.5	37.5	37.4
37	42	36.8	36.8	36.7	36.7	36.7	36.7	36.6	36.6	36.6	36.6	36.6	36.6
38	43	36.0	35.9	35.9	35.9	35.8	35.8	35.8	35.8	35.7	35.7	35.7	35.7
39	44	35.1	35.1	35.0	35.0	35.0	34.9	34.9	34.9	34.9	34.8	34.8	34.8
40	45	34.3	34.2	34.2	34.1	34.1	34.1	34.1	34.0	34.0	34.0	34.0	34.0
41	46	33.4	33.4	33.3	33.3	33.3	33.2	33.2	33.2	33.2	33.1	33.1	33.1
42	47	32.6	32.6	32.5	32.5	32.4	32.4	32.4	32.3	32.3	32.3	32.3	32.3
43	48	31.8	31.8	31.7	31.7	31.6	31.6	31.5	31.5	31.5	31.5	31.4	31.4
44	49	31.0	30.9	30.9	30.8	30.8	30.8	30.7	30.7	30.7	30.6	30.6	30.6
45	50	30.2	30.1	30.1	30.0	30.0	29.9	29.9	29.9	29.8	29.8	29.8	29.8
46	51	29.4	29.4	29.3	29.2	29.2	29.2	29.1	29.1	29.0	29.0	29.0	28.9
47	52	28.7	28.6	28.5	28.5	28.4	28.4	28.3	28.3	28.2	28.2	28.2	28.1
48	53	27.9	27.8	27.8	27.7	27.6	27.6	27.5	27.5	27.5	27.4	27.4	27.4
49	54	27.2	27.1	27.0	26.9	26.9	26.8	26.8	26.7	26.7	26.6	26.6	26.6
50	55	26.4	26.3	26.3	26.2	26.1	26.1	26.0	26.0	25.9	25.9	25.8	25.8
51	56	25.7	25.6	25.5	25.5	25.4	25.3	25.3	25.2	25.2	25.1	25.1	25.0
52	57	25.0	24.9	24.8	24.7	24.7	24.6	24.5	24.5	24.4	24.4	24.3	24.3
53	58	24.3	24.2	24.1	24.0	23.9	23.9	23.8	23.7	23.7	23.6	23.6	23.5
54	59	23.6	23.5	23.4	23.3	23.2	23.2	23.1	23.0	23.0	22.9	22.9	22.8
55	60	23.0	22.9	22.8	22.7	22.6	22.5	22.4	22.3	22.3	22.2	22.2	22.1
56	61	22.3	22.2	22.1	22.0	21.9	21.8	21.7	21.6	21.6	21.5	21.5	21.4
57	62	21.7	21.6	21.5	21.3	21.2	21.1	21.1	21.0	20.9	20.8	20.8	20.7
58	63	21.1	21.0	20.8	20.7	20.6	20.5	20.4	20.3	20.2	20.2	20.1	20.0
59	64	20.5	20.4	20.2	20.1	20.0	19.9	19.8	19.7	19.6	19.5	19.4	19.4
60	65	19.9	19.8	19.6	19.5	19.4	19.3	19.1	19.0	19.0	18.9	18.8	18.7
61	66	19.4	19.2	19.1	18.9	18.8	18.7	18.5	18.4	18.3	18.3	18.2	18.1
62	67	18.8	18.7	18.5	18.3	18.2	18.1	18.0	17.8	17.7	17.7	17.6	17.5
63	68	18.3	18.1	18.0	17.8	17.6	17.5	17.4	17.3	17.2	17.1	17.0	16.9
64	69	17.8	17.6	17.4	17.3	17.1	17.0	16.8	16.7	16.6	16.5	16.4	16.3
65	70	17.3	17.1	16.9	16.7	16.6	16.4	16.3	16.2	16.0	15.9	15.8	15.8
66	71	16.9	16.6	16.4	16.3	16.1	15.9	15.8	15.6	15.5	15.4	15.3	15.2
67	72	16.4	16.2	16.0	15.8	15.6	15.4	15.3	15.1	15.0	14.9	14.8	14.7
68	73	16.0	15.7	15.5	15.3	15.1	15.0	14.8	14.6	14.5	14.4	14.3	14.2
69	74	15.6	15.3	15.1	14.9	14.7	14.5	14.3	14.2	14.0	13.9	13.8	13.7
70	75	15.2	14.9	14.7	14.5	14.3	14.1	13.9	13.7	13.6	13.4	13.3	13.2
71	76	14.8	14.5	14.3	14.1	13.8	13.6	13.5	13.3	13.1	13.0	12.8	12.7
72	77	14.5	14.2	13.9	13.7	13.5	13.2	13.0	12.9	12.7	12.5	12.4	12.3
73	78	14.1	13.8	13.6	13.3	13.1	12.9	12.7	12.5	12.3	12.1	12.0	11.8
74	79	13.8	13.5	13.2	13.0	12.7	12.5	12.3	12.1	11.9	11.7	11.6	11.4
75	80	------	13.2	12.9	12.6	12.4	12.2	11.9	11.7	11.5	11.4	11.2	11.0
76	81	------	------	12.6	12.3	12.1	11.8	11.6	11.4	11.2	11.0	10.8	10.7
77	82	------	------	------	12.1	11.8	11.5	11.3	11.1	10.8	10.7	10.5	10.3
78	83	------	------	------	------	11.5	11.2	11.0	10.7	10.5	10.3	10.1	10.0
79	84	------	------	------	------	------	11.0	10.7	10.5	10.2	10.0	9.8	9.6
80	85	------	------	------	------	------	------	10.4	10.2	10.0	9.7	9.5	9.3
81	86	------	------	------	------	------	------	------	9.9	9.7	9.5	9.3	9.1
82	87	------	------	------	------	------	------	------	------	9.4	9.2	9.0	8.8
83	88	------	------	------	------	------	------	------	------	------	9.0	8.7	8.5
84	89	------	------	------	------	------	------	------	------	------	------	8.5	8.3
85	90	------	------	------	------	------	------	------	------	------	------	------	8.2

TABLE IIA.—*Annuities for joint life only—two lives—expected return multiples*

Ages														
	Male	35	36	37	38	39	40	41	42	43	44	45	46	47
Male	Female	40	41	42	43	44	45	46	47	48	49	50	51	52
35	40	30.3	29.9	29.4	29.0	28.5	28.0	27.5	27.0	26.5	26.0	25.5	24.9	24.4
36	41	------	29.5	29.0	28.6	28.2	27.7	27.2	26.7	26.2	25.7	25.2	24.7	24.2
37	42	------	------	28.6	28.2	27.8	27.3	26.9	26.4	25.9	25.5	25.0	24.4	23.9
38	43	------	------	------	27.8	27.4	27.0	26.5	26.1	25.6	25.2	24.7	24.2	23.7
39	44	------	------	------	------	27.0	26.6	26.2	25.8	25.3	24.8	24.4	23.9	23.4
40	45	------	------	------	------	------	26.2	25.8	25.4	25.0	24.5	24.1	23.6	23.1
41	46	------	------	------	------	------	------	25.4	25.0	24.6	24.2	23.8	23.3	22.9
42	47	------	------	------	------	------	------	------	24.6	24.2	23.8	23.4	23.0	22.6
43	48	------	------	------	------	------	------	------	------	23.9	23.5	23.1	22.7	22.2
44	49	------	------	------	------	------	------	------	------	------	23.1	22.7	22.3	21.9
45	50	------	------	------	------	------	------	------	------	------	------	22.4	22.0	21.6
46	51	------	------	------	------	------	------	------	------	------	------	------	21.6	21.2
47	52	------	------	------	------	------	------	------	------	------	------	------	------	20.9

Ages														
	Male	48	49	50	51	52	53	54	55	56	57	58	59	60
Male	Female	53	54	55	56	57	58	59	60	61	62	63	64	65
35	40	23.8	23.3	22.7	22.1	21.6	21.0	20.4	19.8	19.3	18.7	18.1	17.5	17.0
36	41	23.6	23.1	22.5	22.0	21.4	20.8	20.3	19.7	19.1	18.6	18.0	17.4	16.9
37	42	23.4	22.9	22.3	21.8	21.2	20.7	20.1	19.6	19.0	18.4	17.9	17.3	16.8
38	43	23.2	22.6	22.1	21.6	21.1	20.5	20.0	19.4	18.9	18.3	17.8	17.2	16.7
39	44	22.9	22.4	21.9	21.4	20.9	20.3	19.8	19.3	18.7	18.2	17.7	17.1	16.6
40	45	22.7	22.2	21.7	21.2	20.7	20.1	19.6	19.1	18.6	18.0	17.5	17.0	16.5
41	46	22.4	21.9	21.4	20.9	20.4	19.9	19.4	18.9	18.4	17.9	17.4	16.9	16.3
42	47	22.1	21.6	21.2	20.7	20.2	19.7	19.2	18.7	18.2	17.7	17.2	16.7	16.2
43	48	21.8	21.4	20.9	20.5	20.0	19.5	19.0	18.6	18.1	17.6	17.1	16.6	16.1
44	49	21.5	21.1	20.6	20.2	19.8	19.3	18.8	18.4	17.9	17.4	16.9	16.4	15.9
45	50	21.2	20.8	20.4	19.9	19.5	19.1	18.6	18.1	17.7	17.2	16.7	16.3	15.8
46	51	20.9	20.5	20.1	19.7	19.2	18.8	18.4	17.9	17.5	17.0	16.6	16.1	15.6
47	52	20.5	20.1	19.8	19.4	19.0	18.5	18.1	17.7	17.3	16.8	16.4	15.9	15.5
48	53	20.2	19.8	19.4	19.1	18.7	18.3	17.9	17.5	17.0	16.6	16.2	15.7	15.3
49	54	------	19.5	19.1	18.8	18.4	18.0	17.6	17.2	16.8	16.4	16.0	15.5	15.1
50	55	------	------	18.8	18.4	18.1	17.7	17.3	16.9	16.6	16.2	15.8	15.3	14.9
51	56	------	------	------	18.1	17.8	17.4	17.0	16.7	16.3	15.9	15.5	15.1	14.7
52	57	------	------	------	------	17.4	17.1	16.8	16.4	16.0	15.7	15.3	14.9	14.5
53	58	------	------	------	------	------	16.8	16.4	16.1	15.8	15.4	15.1	14.7	14.3
54	59	------	------	------	------	------	------	16.1	15.8	15.5	15.1	14.8	14.4	14.1
55	60	------	------	------	------	------	------	------	15.5	15.2	14.9	14.5	14.2	13.9
56	61	------	------	------	------	------	------	------	------	14.9	14.6	14.3	13.9	13.6
57	62	------	------	------	------	------	------	------	------	------	14.3	14.0	13.7	13.4
58	63	------	------	------	------	------	------	------	------	------	------	13.7	13.4	13.1
59	64	------	------	------	------	------	------	------	------	------	------	------	13.1	12.8
60	65	------	------	------	------	------	------	------	------	------	------	------	------	12.6

TABLE IIA.—*Annuities for joint life only—two lives—expected return multiples*—Continued

Ages														
	Male	61	62	63	64	65	66	67	68	69	70	71	72	73
Male	Female	66	67	68	69	70	71	72	73	74	75	76	77	78
35	40	16.4	15.8	15.3	14.7	14.2	13.7	13.1	12.6	12.1	11.6	11.1	10.7	10.2
36	41	16.3	15.8	15.2	14.7	14.1	13.6	13.1	12.6	12.1	11.6	11.1	10.6	10.2
37	42	16.2	15.7	15.1	14.6	14.1	13.6	13.0	12.5	12.0	11.5	11.1	10.6	10.1
38	43	16.1	15.6	15.1	14.5	14.0	13.5	13.0	12.5	12.0	11.5	11.0	10.6	10.1
39	44	16.0	15.5	15.0	14.5	13.9	13.4	12.9	12.4	11.9	11.5	11.0	10.5	10.1
40	45	15.9	15.4	14.9	14.4	13.9	13.4	12.9	12.4	11.9	11.4	11.0	10.5	10.0
41	46	15.8	15.3	14.8	14.3	13.8	13.3	12.8	12.3	11.8	11.4	10.9	10.5	10.0
42	47	15.7	15.2	14.7	14.2	13.7	13.2	12.7	12.3	11.8	11.3	10.9	10.4	10.0
43	48	15.6	15.1	14.6	14.1	13.6	13.1	12.7	12.2	11.7	11.3	10.8	10.4	9.9
44	49	15.5	15.0	14.5	14.0	13.5	13.1	12.6	12.1	11.7	11.2	10.8	10.3	9.9
45	50	15.3	14.8	14.4	13.9	13.4	13.0	12.5	12.0	11.6	11.1	10.7	10.3	9.8
46	51	15.2	14.7	14.2	13.8	13.3	12.9	12.4	12.0	11.5	11.1	10.6	10.2	9.8
47	52	15.0	14.6	14.1	13.7	13.2	12.8	12.3	11.9	11.4	11.0	10.6	10.1	9.7
48	53	14.9	14.4	14.0	13.5	13.1	12.6	12.2	11.8	11.3	10.9	10.5	10.1	9.7
49	54	14.7	14.3	13.8	13.4	13.0	12.5	12.1	11.7	11.3	10.8	10.4	10.0	9.6
50	55	14.5	14.1	13.7	13.3	12.8	12.4	12.0	11.6	11.2	10.7	10.3	9.9	9.5
51	56	14.3	13.9	13.5	13.1	12.7	12.3	11.9	11.5	11.1	10.7	10.3	9.9	9.5
52	57	14.1	13.7	13.3	12.9	12.5	12.1	11.7	11.3	10.9	10.6	10.2	9.8	9.4
53	58	13.9	13.6	13.2	12.8	12.4	12.0	11.6	11.2	10.8	10.5	10.1	9.7	9.3
54	59	13.7	13.4	13.0	12.6	12.2	11.9	11.5	11.1	10.7	10.3	10.0	9.6	9.2
55	60	13.5	13.2	12.8	12.4	12.1	11.7	11.3	11.0	10.6	10.2	9.9	9.5	9.1
56	61	13.3	12.9	12.6	12.2	11.9	11.5	11.2	10.8	10.5	10.1	9.8	9.4	9.0
57	62	13.0	12.7	12.4	12.0	11.7	11.4	11.0	10.7	10.3	10.0	9.6	9.3	8.9
58	63	12.8	12.5	12.2	11.8	11.5	11.2	10.9	10.5	10.2	9.8	9.5	9.2	8.8
59	64	12.6	12.3	11.9	11.6	11.3	11.0	10.7	10.4	10.0	9.7	9.4	9.1	8.7
60	65	12.3	12.0	11.7	11.4	11.1	10.8	10.5	10.2	9.9	9.6	9.3	8.9	8.6
61	66	12.0	11.8	11.5	11.2	10.9	10.6	10.3	10.0	9.7	9.4	9.1	8.8	8.5
62	67	------	11.5	11.2	11.0	10.7	10.4	10.1	9.8	9.6	9.3	9.0	8.7	8.4
63	68	------	------	11.0	10.7	10.5	10.2	9.9	9.7	9.4	9.1	8.8	8.5	8.2
64	69	------	------	------	10.5	10.2	10.0	9.7	9.5	9.2	8.9	8.7	8.4	8.1
65	70	------	------	------	------	10.0	9.8	9.5	9.3	9.0	8.8	8.5	8.2	8.0
66	71	------	------	------	------	------	9.5	9.3	9.1	8.8	8.6	8.3	8.1	7.8
67	72	------	------	------	------	------	------	9.1	8.9	8.6	8.4	8.1	7.9	7.7
68	73	------	------	------	------	------	------	------	8.6	8.4	8.2	8.0	7.7	7.5
69	74	------	------	------	------	------	------	------	------	8.2	8.0	7.8	7.6	7.3
70	75	------	------	------	------	------	------	------	------	------	7.8	7.6	7.4	7.2
71	76	------	------	------	------	------	------	------	------	------	------	7.4	7.2	7.0
72	77	------	------	------	------	------	------	------	------	------	------	------	7.0	6.8
73	78	------	------	------	------	------	------	------	------	------	------	------	------	6.7

TABLE IIA.—*Annuities for joint life only—two lives—expected return multiples*—Continued

Ages														
	Male	74	75	76	77	78	79	80	81	82	83	84	85	86
Male	Female	79	80	81	82	83	84	85	86	87	88	89	90	91
35	40	9.7	9.3	8.9	8.5	8.1	7.7	7.3	6.9	6.6	6.2	5.9	5.6	5.3
36	41	9.7	9.3	8.9	8.4	8.0	7.7	7.3	6.9	6.6	6.2	5.9	5.6	5.3
37	42	9.7	9.3	8.8	8.4	8.0	7.6	7.3	6.9	6.5	6.2	5.9	5.6	5.3
38	43	9.7	9.2	8.8	8.4	8.0	7.6	7.2	6.9	6.5	6.2	5.9	5.6	5.3
39	44	9.6	9.2	8.8	8.4	8.0	7.6	7.2	6.9	6.5	6.2	5.9	5.6	5.3
40	45	9.6	9.2	8.8	8.4	8.0	7.6	7.2	6.9	6.5	6.2	5.9	5.5	5.2
41	46	9.6	9.2	8.7	8.3	7.9	7.6	7.2	6.8	6.5	6.2	5.8	5.5	5.2
42	47	9.5	9.1	8.7	8.3	7.9	7.5	7.2	6.8	6.5	6.2	5.8	5.5	5.2
43	48	9.5	9.1	8.7	8.3	7.9	7.5	7.2	6.8	6.5	6.1	5.8	5.5	5.2
44	49	9.5	9.0	8.6	8.2	7.9	7.5	7.1	6.8	6.4	6.1	5.8	5.5	5.2
45	50	9.4	9.0	8.6	8.2	7.8	7.5	7.1	6.8	6.4	6.1	5.8	5.5	5.2
46	51	9.4	9.0	8.6	8.2	7.8	7.4	7.1	6.7	6.4	6.1	5.8	5.5	5.2
47	52	9.3	8.9	8.5	8.1	7.8	7.4	7.1	6.7	6.4	6.1	5.8	5.5	5.2
48	53	9.3	8.9	8.5	8.1	7.7	7.4	7.0	6.7	6.4	6.0	5.7	5.4	5.1
49	54	9.2	8.8	8.4	8.1	7.7	7.3	7.0	6.7	6.3	6.0	5.7	5.4	5.1
50	55	9.1	8.8	8.4	8.0	7.7	7.3	7.0	6.6	6.3	6.0	5.7	5.4	5.1
51	56	9.1	8.7	8.3	8.0	7.6	7.3	6.9	6.6	6.3	6.0	5.7	5.4	5.1
52	57	9.0	8.6	8.3	7.9	7.6	7.2	6.9	6.6	6.2	5.9	5.6	5.4	5.1
53	58	8.9	8.6	8.2	7.9	7.5	7.2	6.9	6.5	6.2	5.9	5.6	5.3	5.1
54	59	8.9	8.5	8.2	7.8	7.5	7.1	6.8	6.5	6.2	5.9	5.6	5.3	5.0
55	60	8.8	8.4	8.1	7.7	7.4	7.1	6.8	6.4	6.1	5.8	5.6	5.3	5.0
56	61	8.7	8.4	8.0	7.7	7.3	7.0	6.7	6.4	6.1	5.8	5.5	5.3	5.0
57	62	8.6	8.3	7.9	7.6	7.3	7.0	6.7	6.4	6.1	5.8	5.5	5.2	5.0
58	63	8.5	8.2	7.9	7.5	7.2	6.9	6.6	6.3	6.0	5.7	5.5	5.2	4.9
59	64	8.4	8.1	7.8	7.5	7.1	6.8	6.5	6.3	6.0	5.7	5.4	5.2	4.9
60	65	8.3	8.0	7.7	7.4	7.1	6.8	6.5	6.2	5.9	5.6	5.4	5.1	4.9
61	66	8.2	7.9	7.6	7.3	7.0	6.7	6.4	6.1	5.9	5.6	5.3	5.1	4.8
62	67	8.1	7.8	7.5	7.2	6.9	6.6	6.4	6.1	5.8	5.5	5.3	5.0	4.8
63	68	8.0	7.7	7.4	7.1	6.8	6.6	6.3	6.0	5.7	5.5	5.2	5.0	4.7
64	69	7.8	7.6	7.3	7.0	6.7	6.5	6.2	5.9	5.7	5.4	5.2	4.9	4.7
65	70	7.7	7.4	7.2	6.9	6.6	6.4	6.1	5.9	5.6	5.4	5.1	4.9	4.7
66	71	7.6	7.3	7.1	6.8	6.5	6.3	6.0	5.8	5.5	5.3	5.1	4.8	4.6
67	72	7.4	7.2	6.9	6.7	6.4	6.2	6.0	5.7	5.5	5.2	5.0	4.8	4.6
68	73	7.3	7.0	6.8	6.6	6.3	6.1	5.9	5.6	5.4	5.2	4.9	4.7	4.5
69	74	7.1	6.9	6.7	6.4	6.2	6.0	5.8	5.5	5.3	5.1	4.9	4.7	4.5
70	75	7.0	6.8	6.5	6.3	6.1	5.9	5.7	5.4	5.2	5.0	4.8	4.6	4.4
71	76	6.8	6.6	6.4	6.2	6.0	5.8	5.6	5.3	5.1	4.9	4.7	4.5	4.3
72	77	6.6	6.4	6.3	6.1	5.9	5.7	5.5	5.3	5.0	4.9	4.7	4.5	4.3
73	78	6.5	6.3	6.1	5.9	5.7	5.5	5.3	5.1	5.0	4.8	4.6	4.4	4.2
74	79	6.3	6.1	6.0	5.8	5.6	5.4	5.2	5.0	4.9	4.7	4.5	4.3	4.1
75	80	------	6.0	5.8	5.6	5.5	5.3	5.1	4.9	4.8	4.6	4.4	4.2	4.1
76	81	------	------	5.6	5.5	5.3	5.2	5.0	4.8	4.7	4.5	4.3	4.1	4.0
77	82	------	------	------	5.3	5.2	5.0	4.9	4.7	4.5	4.4	4.2	4.1	3.9
78	83	------	------	------	------	5.0	4.9	4.7	4.6	4.4	4.3	4.1	4.0	3.8
79	84	------	------	------	------	------	4.7	4.6	4.5	4.3	4.2	4.0	3.9	3.7
80	85	------	------	------	------	------	------	4.5	4.4	4.2	4.1	3.9	3.8	3.6
81	86	------	------	------	------	------	------	------	4.2	4.1	3.9	3.8	3.7	3.6
82	87	------	------	------	------	------	------	------	------	4.0	3.8	3.7	3.6	3.5
83	88	------	------	------	------	------	------	------	------	------	3.7	3.6	3.5	3.4
84	89	------	------	------	------	------	------	------	------	------	------	3.5	3.4	3.3
85	90	------	------	------	------	------	------	------	------	------	------	------	3.3	3.2
86	91	------	------	------	------	------	------	------	------	------	------	------	------	3.1

TABLE III.—*Percent value*

Ages		Duration of guaranteed amount																
		Years																
Male	Female	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17
		Per-cent	*Per-cent*	*Per-cent*	*Per-cent*	*Per-cent*	*Per-cent*	*Per-cent*	*Per-cent*	*Per-cent*	*Per-cent*	*Per-cent*	*Per-cent*	*Per-cent*	*Per-cent*	*Per-cent*	*Per-cent*	*Per-cent*
6	11	-----	-----	-----	-----	-----	-----	-----	-----	1	1	1	1	1	1	1	1	1
7	12	-----	-----	-----	-----	-----	-----	-----	-----	1	1	1	1	1	1	1	1	1
8	13	-----	-----	-----	-----	-----	-----	-----	1	1	1	1	1	1	1	1	1	1
9	14	-----	-----	-----	-----	-----	-----	-----	1	1	1	1	1	1	1	1	1	1
10	15	-----	-----	-----	-----	-----	-----	-----	1	1	1	1	1	1	1	1	1	1
11	16	-----	-----	-----	-----	-----	-----	-----	1	1	1	1	1	1	1	1	1	1
12	17	-----	-----	-----	-----	-----	-----	-----	1	1	1	1	1	1	1	1	1	1
13	18	-----	-----	-----	-----	-----	-----	-----	1	1	1	1	1	1	1	1	1	1
14	19	-----	-----	-----	-----	-----	-----	-----	1	1	1	1	1	1	1	1	1	1
15	20	-----	-----	-----	-----	-----	-----	-----	1	1	1	1	1	1	1	1	1	1
16	21	-----	-----	-----	-----	-----	-----	-----	1	1	1	1	1	1	1	1	1	1
17	22	-----	-----	-----	-----	-----	-----	-----	1	1	1	1	1	1	1	1	1	1
18	23	-----	-----	-----	-----	-----	-----	-----	1	1	1	1	1	1	1	1	1	1
19	24	-----	-----	-----	-----	-----	-----	-----	1	1	1	1	1	1	1	1	1	1
20	25	-----	-----	-----	-----	-----	-----	-----	1	1	1	1	1	1	1	1	1	1
21	26	-----	-----	-----	-----	-----	-----	-----	1	1	1	1	1	1	1	1	1	1
22	27	-----	-----	-----	-----	-----	-----	1	1	1	1	1	1	1	1	1	1	1
23	28	-----	-----	-----	-----	-----	-----	1	1	1	1	1	1	1	1	1	1	2
24	29	-----	-----	-----	-----	-----	-----	1	1	1	1	1	1	1	1	1	2	2
25	30	-----	-----	-----	-----	-----	-----	1	1	1	1	1	1	1	1	1	2	2
26	31	-----	-----	-----	-----	-----	1	1	1	1	1	1	1	1	1	2	2	2
27	32	-----	-----	-----	-----	-----	1	1	1	1	1	1	1	1	2	2	2	2
28	33	-----	-----	-----	-----	-----	1	1	1	1	1	1	1	1	2	2	2	2
29	34	-----	-----	-----	-----	-----	1	1	1	1	1	1	1	2	2	2	2	2
30	35	-----	-----	-----	-----	1	1	1	1	1	1	1	2	2	2	2	2	2
31	36	-----	-----	-----	-----	1	1	1	1	1	1	1	2	2	2	2	2	3
32	37	-----	-----	-----	-----	1	1	1	1	1	1	2	2	2	2	2	3	3
33	38	-----	-----	-----	1	1	1	1	1	1	1	2	2	2	2	3	3	3
34	39	-----	-----	-----	1	1	1	1	1	1	2	2	2	2	3	3	3	3
35	40	-----	-----	-----	1	1	1	1	1	2	2	2	2	2	3	3	3	4
36	41	-----	-----	-----	1	1	1	1	1	2	2	2	2	3	3	3	4	4
37	42	-----	-----	1	1	1	1	1	2	2	2	2	3	3	3	3	4	4
38	43	-----	-----	1	1	1	1	1	2	2	2	2	3	3	3	4	4	4
39	44	-----	-----	1	1	1	1	2	2	2	2	3	3	3	4	4	4	5
40	45	-----	-----	1	1	1	1	2	2	2	3	3	3	4	4	4	5	5
41	46	-----	-----	1	1	1	1	2	2	2	3	3	3	4	4	5	5	6
42	47	-----	-----	1	1	1	2	2	2	3	3	3	4	4	5	5	5	6
43	48	-----	1	1	1	1	2	2	2	3	3	4	4	4	5	5	6	6
44	49	-----	1	1	1	1	2	2	3	3	3	4	4	5	5	6	6	7
45	50	-----	1	1	1	2	2	2	3	3	4	4	5	5	6	6	7	7
46	51	-----	1	1	1	2	2	3	3	3	4	4	5	5	6	7	7	8
47	52	-----	1	1	1	2	2	3	3	4	4	5	5	6	7	7	8	9
48	53	-----	1	1	2	2	2	3	3	4	5	5	6	6	7	8	8	9
49	54	-----	1	1	2	2	3	3	4	4	5	5	6	7	8	8	9	10
50	55	-----	1	1	2	2	3	3	4	5	5	6	7	7	8	9	10	11
51	56	-----	1	1	2	3	3	4	4	5	6	6	7	8	9	9	10	11
52	57	1	1	2	2	3	3	4	5	5	6	7	8	8	9	10	11	12
53	58	1	1	2	2	3	4	4	5	6	7	7	8	9	10	11	12	13
54	59	1	1	2	2	3	4	5	5	6	7	8	9	10	11	12	13	14
55	60	1	1	2	3	3	4	5	6	7	8	8	9	10	11	13	14	15
56	61	1	1	2	3	4	4	5	6	7	8	9	10	11	12	13	15	16
57	62	1	1	2	3	4	5	6	7	8	9	10	11	12	13	14	16	17
58	63	1	2	2	3	4	5	6	7	8	9	10	12	13	14	15	17	18
59	64	1	2	3	4	5	6	7	8	9	10	11	12	14	15	16	18	19
60	65	1	2	3	4	5	6	7	8	10	11	12	13	15	16	18	19	20
61	66	1	2	3	4	5	6	8	9	10	12	13	14	16	17	19	20	22
62	67	1	2	3	4	6	7	8	10	11	12	14	15	17	18	20	22	23
63	68	1	2	4	5	6	7	9	10	12	13	15	16	18	20	21	23	25
64	69	1	3	4	5	7	8	9	11	13	14	16	17	19	21	23	24	26
65	70	1	3	4	6	7	9	10	12	13	15	17	19	20	22	24	26	28

of refund feature

Duration of guaranteed amount—Continued

Years

18	19	20	21	22	23	24	25	26	27	28	29	30	31	32	33	34	35
Per-cent	Per-cent	Per-cent	Per-cent	Per-cent	Per-cent	Per-cent	Per-cent	Per-cent	Per-cent	Per-cent	Per-cent	Per-cent	Per-cent	Per-cent	Per-cent	Per-cent	Per-cent
1	1	1	1	1	1	2	2	2	2	2	2	2	2	2	2	2	2
1	1	1	1	1	1	2	2	2	2	2	2	2	2	2	2	2	3
1	1	1	1	1	1	2	2	2	2	2	2	2	2	2	2	2	3
1	1	1	1	1	1	2	2	2	2	2	2	2	2	2	2	3	3
1	1	1	1	1	2	2	2	2	2	2	2	2	2	2	3	3	3
1	1	1	1	1	2	2	2	2	2	2	2	2	2	2	3	3	3
1	1	1	1	2	2	2	2	2	2	2	2	2	3	3	3	3	3
1	1	1	1	2	2	2	2	2	2	2	2	2	3	3	3	3	3
1	1	1	1	2	2	2	2	2	2	2	2	2	3	3	3	3	3
1	1	1	2	2	2	2	2	2	2	2	2	3	3	3	3	3	4
1	1	1	2	2	2	2	2	2	2	2	2	3	3	3	3	4	4
1	1	2	2	2	2	2	2	2	2	2	3	3	3	3	4	4	4
1	2	2	2	2	2	2	2	2	3	3	3	3	3	4	4	4	4
1	2	2	2	2	2	2	2	3	3	3	3	3	4	4	4	4	5
2	2	2	2	2	2	2	3	3	3	3	3	4	4	4	4	5	5
2	2	2	2	2	2	3	3	3	3	3	4	4	4	4	5	5	5
2	2	2	2	2	2	3	3	3	3	3	4	4	4	5	5	5	5
2	2	2	2	2	3	3	3	3	3	4	4	4	5	5	5	5	6
2	2	2	2	3	3	3	3	3	4	4	4	5	5	5	6	6	6
2	2	2	3	3	3	3	3	4	4	4	5	5	5	6	6	6	7
2	2	3	3	3	3	3	4	4	4	5	5	5	6	6	6	7	7
2	3	3	3	3	3	4	4	4	5	5	5	6	6	6	7	7	8
2	3	3	3	3	4	4	4	5	5	5	6	6	6	7	7	8	8
3	3	3	3	4	4	4	5	5	5	6	6	6	7	7	8	8	9
3	3	3	4	4	4	5	5	5	6	6	6	7	7	8	8	9	9
3	3	4	4	4	5	5	5	6	6	7	7	7	8	8	9	10	10
3	4	4	4	5	5	5	6	6	7	7	7	8	8	9	10	10	11
4	4	4	5	5	5	6	6	7	7	8	8	9	9	10	10	11	12
4	4	5	5	5	6	6	7	7	8	8	9	9	10	10	11	12	12
4	5	5	5	6	6	7	7	8	8	9	9	10	10	11	12	13	13
4	5	5	6	6	7	7	8	8	9	9	10	11	11	12	13	13	14
5	5	6	6	7	7	8	8	9	9	10	11	11	12	13	13	14	15
5	6	6	7	7	8	8	9	9	10	11	11	12	13	14	14	15	16
6	6	7	7	8	8	9	9	10	11	11	12	13	14	15	15	16	17
6	7	7	8	8	9	9	10	11	11	12	13	14	15	16	16	17	18
6	7	8	8	9	9	10	11	12	12	13	14	15	16	17	18	18	19
7	8	8	9	9	10	11	12	12	13	14	15	16	17	18	19	20	21
7	8	9	9	10	11	12	12	13	14	15	16	17	18	19	20	21	22
8	9	9	10	11	12	12	13	14	15	16	17	18	19	20	21	22	23
9	9	10	11	12	12	13	14	15	16	17	18	19	20	21	22	24	25
9	10	11	12	12	13	14	15	16	17	18	19	20	21	23	24	25	26
10	11	12	12	13	14	15	16	17	18	19	20	22	23	24	25	26	28
11	11	12	13	14	15	16	17	18	19	21	22	23	24	25	27	28	29
11	12	13	14	15	16	17	18	20	21	22	23	24	26	27	28	29	31
12	13	14	15	16	17	18	20	21	22	23	25	26	27	28	30	31	32
13	14	15	16	17	18	20	21	22	23	25	26	27	29	30	31	33	34
14	15	16	17	19	20	21	22	24	25	26	28	29	30	32	33	34	36
15	16	17	18	20	21	22	24	25	26	28	29	31	32	33	35	36	38
16	17	18	20	21	22	24	25	26	28	29	31	32	34	35	36	38	39
17	18	20	21	22	24	25	27	28	29	31	32	34	35	37	38	40	41
18	20	21	22	24	25	27	28	30	31	33	34	36	37	39	40	41	43
19	21	22	24	25	27	28	30	31	33	34	36	37	39	40	42	43	45
21	22	24	25	27	28	30	31	33	35	36	38	39	41	42	44	45	47
22	24	25	27	28	30	32	33	35	36	38	40	41	43	44	46	47	48
23	25	27	28	30	32	33	35	37	38	40	41	43	44	46	47	49	50
25	27	28	30	32	33	35	37	38	40	42	43	45	46	48	49	51	52
26	28	30	32	33	35	37	39	40	42	44	45	47	48	50	51	52	54
28	30	32	33	35	37	39	41	42	44	46	47	49	50	52	53	54	55
30	32	33	35	37	39	41	42	44	46	47	49	50	52	53	55	56	57

TABLE III.—*Percent value*

Ages		Duration of guaranteed amount																
		Years																
Male	Female	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17
		Per-cent	*Per-cent*	*Per-cent*	*Per cent*	*Per-cent*	*Per-cent*	*Per-cent*	*Per-cent*	*Per-cent*	*Per-cent*	*Per-cent*	*Per-cent*	*Per-cent*	*Per-cent*	*Per-cent*	*Per-cent*	*Per-cent*
66	71	1	3	4	6	8	9	11	13	14	16	18	20	22	24	26	28	29
67	72	2	3	5	6	8	10	12	14	15	17	19	21	23	25	27	29	31
68	73	2	3	5	7	9	11	13	14	16	18	21	23	25	27	29	31	33
69	74	2	4	6	7	9	11	13	16	18	20	22	24	26	28	30	33	35
70	75	2	4	6	8	10	12	14	17	19	21	23	26	28	30	32	34	37
71	76	2	4	6	9	11	13	15	18	20	22	25	27	29	32	34	36	39
72	77	2	5	7	9	12	14	16	19	21	24	26	29	31	34	36	38	41
73	78	2	5	7	10	12	15	18	20	23	25	28	30	33	35	38	40	43
74	79	3	5	8	11	13	16	19	22	24	27	30	32	35	37	40	42	45
75	80	3	6	8	11	14	17	20	23	26	29	31	34	37	39	42	44	47
76	81	3	6	9	12	15	18	21	24	27	30	33	36	39	41	44	46	49
77	82	3	7	10	13	16	20	23	26	29	32	35	38	41	43	46	48	51
78	83	4	7	11	14	17	21	24	28	31	34	37	40	43	45	48	50	53
79	84	4	8	11	15	19	22	26	29	33	36	39	42	45	48	50	53	55
80	85	4	8	12	16	20	24	27	31	34	38	41	44	47	50	52	55	57
81	86	4	9	13	17	21	25	29	33	36	40	43	46	49	52	54	57	59
82	87	5	9	14	18	23	27	31	35	38	42	45	48	51	54	56	59	61
83	88	5	10	15	19	24	28	33	37	40	44	47	50	53	56	58	61	63
84	89	5	11	16	21	26	30	34	38	42	46	49	52	55	58	60	63	65
85	90	6	11	17	22	27	32	36	41	44	48	51	55	57	60	62	65	67

PAR. 2. INCOME FROM DISCHARGE OF INDEBTEDNESS; SPECIAL RULE OF EXCLUSION; TIME AND MANNER OF FILING CONSENT TO ADJUSTMENT OF BASIS.—Section 108(a) provides that the taxpayer may exclude income resulting from the discharge of indebtedness for which the taxpayer is liable, or subject to which the taxpayer holds property, if the indebtedness was incurred or assumed by a corporation, or by an individual in connection with the acquisition of property used in his trade or business. However, to exclude such income, the taxpayer must consent to the regulations then in effect under section 1017. Until regulations are issued under section 108, such consent, in the case of either a corporation or an individual, shall be filed in accordance with § 39.22(b)(9)-1 and 39.22(b)(9)-2 of Regulations 118 (26 C. F. R., pt. 39).

PAR. 3. AGREEMENTS AS TO USEFUL LIFE AND RATE OF DEPRECIATION.—Section 167(d) provides that a taxpayer and the Secretary or his delegate may, in accordance with regulations prescribed by the Secretary or his delegate, enter into a binding written agreement dealing specifically with the useful life and rate of depreciation of any depreciable property. No such agreement will be entered into until after the promulgation of the regulations under section 167(d).

PAR. 4. CHARITABLE, ETC., CONTRIBUTIONS AND GIFTS; LIMITATIONS FOR INDIVIDUALS; SPECIAL RULE.—The purpose of this paragraph is to prescribe the method of application of the benefits and limitations provided by section 170 (b) (1) with respect to the special rule applicable to charitable contributions described in subparagraph (A) of that section. An individual may claim a deduction for charitable contributions made during the taxable year "to or for the use of" those recipients described in section 170(c) to the extent that such contributions do not exceed 20 percent of the taxpayer's adjusted gross income. However, in any case where the total contributions exceed the 20-percent limitation, the special rule in section 170(b)(1)(A) should be first applied. The total contributions made directly "to" but not merely "for the use of" any church, school, or hospital, as defined in clauses (i), (ii), and (iii) of that section, should be claimed as a contribution deduction to the extent that such contributions do not exceed 10 percent of the taxpayer's adjusted gross income. Any excess should be added to the other contributions to form a basis for the contributions subject to the 20-percent limitation. Adjusted gross income need not be reduced by any net operating loss carryback for purposes of applying either the 10-percent or the 20-percent limitation. The term "hospital" referred to in clause (iii) means an organization, the principal functions of which are providing medical or hospital care. Such term does not include medical education or medical research

of refund feature—Continued

Duration of guaranteed amount—Continued																	
Years																	
18	19	20	21	22	23	24	25	26	27	28	29	30	31	32	33	34	35
Per-cent	*Per-cent*	*Per-cent*	*Per-cent*	*Per-cent*	*Per-cent*	*Per-cent*	*Per-cent*	*Per-cent*	*Per-cent*	*Per-cent*	*Per-cent*	*Per-cent*	*Per-cent*	*Per-cent*	*Per-cent*	*Per-cent*	*Per-cent*
31	33	35	37	39	41	43	44	46	48	49	51	52	54	55	56	58	59
33	35	37	39	41	43	45	46	48	50	51	53	54	56	57	58	59	61
35	37	39	41	43	45	47	48	50	52	53	55	56	57	59	60	61	62
37	39	41	43	45	47	48	50	52	53	55	56	58	59	60	62	63	64
39	41	43	45	47	49	50	52	54	55	57	58	60	61	62	63	64	65
41	43	45	47	49	51	52	54	56	57	59	60	61	63	64	65	66	67
43	45	47	49	51	53	54	56	58	59	60	62	63	64	65	66	67	68
45	47	49	51	53	55	56	58	59	61	62	64	65	66	67	68	69	70
47	49	51	53	55	57	58	60	61	63	64	65	66	67	68	69	70	71
49	51	53	55	57	58	60	62	63	64	66	67	68	69	70	71	72	72
51	53	55	57	59	60	62	63	65	66	67	68	69	70	71	72	73	-----
53	55	57	59	61	62	64	65	66	68	69	70	71	72	73	74	-----	-----
55	57	59	61	62	64	65	67	68	69	70	71	72	73	74	-----	-----	-----
57	59	61	63	64	66	67	68	70	71	72	73	74	75	-----	-----	-----	-----
59	61	63	64	66	67	69	70	71	72	73	74	75	-----	-----	-----	-----	-----
61	63	65	66	68	69	70	72	73	74	75	75	-----	-----	-----	-----	-----	-----
63	65	66	68	69	71	72	73	74	75	76	-----	-----	-----	-----	-----	-----	-----
65	66	68	70	71	72	73	74	75	76	-----	-----	-----	-----	-----	-----	-----	-----
67	68	70	71	73	74	75	76	77	-----	-----	-----	-----	-----	-----	-----	-----	-----
68	70	71	73	74	75	76	77	-----	-----	-----	-----	-----	-----	-----	-----	-----	-----

organizations referred to in section 503(b)(5). The application of this paragraph may be illustrated by the following examples:

Example (1). A, an individual, reports his income on the calendar year basis and for the year 1954 has an adjusted gross income of $10,000. During 1954 he made contributions to the following charitable organizations:

		Deductible contributions
1. Organizations described in sec. 170(b)(1)(A)	$2,400	
2. Other charitable organizations	700	
3. Total contributions paid	3,100	
4. Contributions to organizations described in sec. 170(b)(1)(A)	2,400	
5. Special limitation under section 170(b)(1)(A): 10 percent of adjusted gross income	1,000	
6. Deductible amount: line 4 or line 5, whichever is the lesser		$1,000
7. Excess of line 4 over line 5	1,400	
8. Add: contributions to other charitable organizations	700	
9. Contributions subject to the limitation under sec. 170(b)(1)(B)	2,100	
10. Limitation under sec. 170(b)(1)(B): 20 percent of the adjusted gross income	2,000	
11. Deductible amount: line 9 or line 10, whichever is the lesser		2,000
12. Contributions not deductible	100	
13. Total deduction for contributions		3,000

Example (2). B, an individual, reports his income on the calendar-year basis and for the year 1954 has an adjusted gross income of $10,000. During 1954 he made contributions to the following charitable organizations:

1. Organizations described in sec. 170(b)(1)(A)	$700
2. Other charitable organizations	2,400
3. Total contributions paid	3,100
4. Contributions to organizations described in sec. 170(b)(1)(A)	700
5. Limitation described in sec. 170(b)(1)(A): 10 percent of the adjusted gross income	1,000

		Deductible contributions
6. Deductible amount: line 4 or line 5, whichever is the lesser		$700
7. Excess of line 4 over line 5	0	
8. Add: contributions to other charitable organizations	2,400	
9. Contributions subject to the limitation under sec. 170(b)(1)(B)	2,400	
10. Limitation under sec. 170(b)(1)(B): 20 percent of the adjusted gross income	2,000	
11. Deductible amount: line 9 or line 10, whichever is the lesser		2,000
12. Contributions not deductible	400	
13. Total deduction for contributions		2,700

PAR. 5. RESEARCH AND EXPERIMENTAL EXPENDITURES.—(a) *Election to treat such expenditures as expenses not chargeable to capital account.*—(1) *Manner of making election not requiring consent.*—Section 174(a)(2)(A) authorizes an election to treat research or experimental expenditures as expenses which are not chargeable to capital account. An election not requiring consent may be made for the first taxable year subject to the Internal Revenue Code of 1954 for which such expenditures are paid or incurred. The election shall be applicable to all such expenditures and shall be made by a statement attached to the return for the first taxable year to which the election is applicable. Such statement shall indicate that the taxpayer has elected under the provisions of section 174(a)(2)(A) to treat all research and experimental expenditures as deductible expenses not chargeable to capital account.

(2) *Application to change method.*—An election once made under subparagraph (a)(1) shall be binding for the taxable year for which the election is made and for all subsequent taxable years, unless consent to make a change is obtained from the District Director of Internal Revenue for the district in which the return is filed. Applications for consent to make a change will not be accepted before the promulgation of regulations under section 174.

(3) *Consent to make election at any time.*—Section 174(a)(2)(B) provides that a taxpayer may, with the consent of the Secretary or his delegate, elect at any time to treat research or experimental expenditures as expenses which are not chargeable to capital account. No application for consent under that section will be accepted before the date of promulgation of the regulations under section 174. Such regulations, however, will provide a reasonable period of time within which taxpayers will be permitted to apply for such consents in the case of taxable years subject to the Internal Revenue Code of 1954 which end after the enactment of such Code and before the promulgation of regulations under section 174.

(b) *Amortization of such expenditures.*—(1) *Manner of making election not requiring consent.*—Section 174(b)(1) provides that a taxpayer may treat certain research or experimental expenditures as deferred expenses to be deducted ratably over such period of not less than 60 months as may be selected by the taxpayer beginning with the month in which the taxpayer first realizes benefits from such expenditures. The election may be made for any taxable year beginning after December 31, 1953, provided it is made not later than the time prescribed for filing the return for such taxable year (including extensions thereof). Such election shall be made by a statement attached to the taxpayer's return for the first taxable year to which the election is applicable. Such statement shall set forth the amounts of each type of such expenditures and the length of the period over which such expenditures are to be ratably deducted.

(2) *Application to change method.*—An election once made under subparagraph (b)(1) shall be binding for the taxable year for which the election is made and for all subsequent taxable years, unless consent to make a change is obtained from the District Director of Internal Revenue for the district in which the return is filed. Applications for consent to make a change will not be accepted before the promulgation of regulations under section 174.

PAR. 6. SOIL AND WATER CONSERVATION EXPENDITURES TREATED AS EXPENSES NOT CHARGEABLE TO CAPITAL ACCOUNT.—(a) *Manner of making election not requiring consent.*—Section 175(d)(1) authorizes an election to treat soil and water conservation expenditures as expenses which are not chargeable to capital

account. An election not requiring consent may be made for the first taxable year subject to the Internal Revenue Code of 1954 for which such expenditures are paid or incurred. The election shall be applicable to all such expenditures and shall be made by a statement attached to the return for the first taxable year to which the election is applicable. Such statement shall specify the amount of each type of such expenditures and shall describe them in detail.

(b) *Application to change method.*—An election once made under subparagraph (a) shall be binding for the taxable year for which the election is made and for all subsequent taxable years, unless consent to make a change is obtained from the District Director of Internal Revenue for the district in which the return is filed. Applications for consent to make a change will not be accepted before the promulgation of regulations under section 175.

(c) *Consent to make election at any time.*—Section 175(d)(2) provides that a taxpayer may, with the consent of the Secretary or his delegate, elect at any time to treat soil and water conservation expenditures as expenses which are not chargeable to capital account. No application for consent under that section will be accepted before the date of promulgation of the regulations under section 175. Such regulations, however, will provide a reasonable period of time within which taxpayers will be permitted to apply for such consents in the case of taxable years subject to the Internal Revenue Code of 1954 which end after the enactment of such Code and before the promulgation of regulations under section 175.

PAR. 7. ORGANIZATIONAL EXPENDITURES; TIME AND MANNER OF MAKING ELECTION.—The election provided by section 248(a) with respect to organizational expenditures shall be made in a statement attached to the corporation's income tax return for a taxable year beginning after December 31, 1953. The return and statement must be filed not later than the date prescribed by law for filing the return (including any extensions of time) for the taxable year for which the election is made. The statement shall describe the expenditures and set forth the amount thereof and the number of months (not less than 60), beginning with the month in which the taxpayer began business, over which such expenditures are to be deducted ratably. The period so elected shall be adhered to in computing the taxpayer's taxable income for the taxable year for which the election is made and all subsequent taxable years.

PAR. 8. PREPAID INCOME.—(a) *Manner of making election not requiring consent.*—Section 452 permits taxpayers to elect to take prepaid income into account as if received over certain specified periods. The election to report prepaid income as taxable income under the provisions of section 452(a), 452(b)(1), and 452(d)(3)(A) may be made, without consent, for the first taxable year subject to the Internal Revenue Code of 1954 in which such prepaid income in the particular trade or business is received. Such election shall be applicable to all prepaid income of the particular trade or business received in the taxable year for which the election is made and in all subsequent taxable years (except as provided in section 446(e) and section 452(d)(2). The election shall be made by a statement attached to the taxpayer's return for the first taxable year to which the election is applicable. This statement shall show:

(1) the method of accounting used by the taxpayer in the particular trade or business;

(2) the nature of the prepaid income, for example, "rent from real estate" or "rents and royalties";

(3) the period over which each class of liability described in section 452(e)(2) extends;

(4) the taxable years and the amounts of prepaid income to be included in gross income for each year; and

(5) the method of allocation.

If any part of the prepaid income is connected with a liability of indefinite duration, that fact shall be noted under (3) and the prepaid income shall be apportioned as between items with respect to which the period of liability is definite and as to which the period of liability is indefinite.

(b) *Consent to change method of apportioning income; consent to make election at any time.*—An application for consent under section 452 (a)(1) or (a)(2), 452(b)(2), and 452(d)(3)(B), will not be be accepted before the date of the promulgation of the regulations under section 452. Such regulations, however, will provide a reasonable period of time within which taxpayers will be permitted to apply for such consents in the case of taxable years subject to the Internal Revenue Code of 1954 which end after the enactment of such Code and before the promulgation of regulations under section 452.

PAR. 9. ACCRUAL OF REAL PROPERTY TAXES.—(a) *In general.*—Section 461 (c) permits taxpayers who compute taxable income under an accrual method of accounting to accrue real property taxes ratably over the period of time to which such taxes relate. If the accrual of real property taxes is proper in connection with one of the methods of accounting described in section 446(c) (3) and (4), any taxpayer using such a method of accounting may elect to accrue such taxes ratably in the manner described above. See, however, section 164(d) relating to apportionment of taxes on real property between seller and purchaser.

(b) *Manner of making election not requiring consent.*—Section 461(c)(3)(A) provides that the method of treating taxes provided in section 461(c) may be adopted without consent for the first taxable year subject to the Internal Revenue Code of 1954 in which the taxpayer incurs real property taxes. Such election must be made not later than the time prescribed by law for filing the return for such year (including extensions thereof). The election shall be made by a statement attached to the taxpayer's return for the first taxable year to which the election is applicable. The statement shall show: (1) The method of accounting used by the taxpayer and (2) the period of time to which the taxes are related.

(c) *Consent to make election at any time.*—An application for consent under section 461(c)(3)(B) will not be accepted before the date of promulgation of regulations under section 461. Such regulations, however, will provide a reasonable period of time within which taxpayers will be permitted to apply for such consents in the case of taxable years subject to the Internal Revenue Code of 1954 which end after the enactment of such Code and before the promulgation of regulations under section 461.

PAR. 10. RESERVES FOR ESTIMATED EXPENSES.—(a) *Manner of making election not requiring consent.*—Section 462 permits taxpayers in computing taxable income to elect to deduct a reasonable addition to reserves for estimated expenses. An election under the provisions of section 462(c)(3)(A) may be made without consent for the first taxable year subject to the Internal Revenue Code of 1954 for which there are estimated expenses attributable to the particular trade or business. Such election shall be applicable to all estimated expenses attributable to the particular trade or business for the taxable year for which the election is made and for all subsequent taxable years (except as provided in sec. 446(e)). The election shall be made by a statement attached to the taxpayer's return for the first taxable year to which the election is applicable. This statement shall show:

(1) the method of accounting used by the taxpayer in the particular trade or business;

(2) the nature of the estimated expenses, for example, "warranties on appliances", or "guaranties on service contracts";

(3) if related to a contract the period over which the liability on each class of such contracts extends; and

(4) a schedule showing in detail how the amount of the estimated expenses was computed.

(b) *Consent to make election at any time.*—An application for consent under section 462(c)(3)(B) will not be accepted before the date of the promulgation of regulations under section 462. Such regulations, however, will provide a reasonable period of time within which taxpayers will be permitted to apply for such consents in the case of taxable years subject to the Internal Revenue Code of 1954 which end after the enactment of such Code and before the promulgation of regulations under section 462.

PAR. 11. UNDISTRIBUTED PERSONAL HOLDING COMPANY INCOME.—(a) *Taxes; election.*—The election provided by section 545(b)(1), relating to the method of deducting certain taxes in computing the undistributed personal holding company income, shall be made by deducting the taxes accrued during the taxable year, in the return for any taxable year ending after June 30, 1954. The election shall apply to the taxable year for which made and all subsequent taxable years and shall be irrevocable.

(b) *Amount of lien in favor of the United States; shareholders' election.*—The election by shareholders of personal holding companies, provided by section 545(b)(9), with respect to dividends attributable to the satisfaction or release of a lien in favor of the United States, shall be made by filing a statement as a part of the taxpayer's return for the taxable year (which year is subject to the Internal Revenue Code of 1954) in which the dividends are required to be reported as income. The statement shall show the computation of the increase in the shareholder's income tax for each prior taxable year which would have resulted if the portion of the dividend attributable to the satisfaction or release

of the lien which is allocable to such prior taxable year had been received in such prior taxable year.

PAR. 12. DEDUCTION FOR DEFICIENCY DIVIDENDS.—(a) *Determination; agreements other than closing agreements.*—The agreement provided by section 547(c)(3) (relating to determination by agreement other than a closing agreement under section 7121) shall be executed in duplicate, and shall set forth the amount of the personal holding company tax liability for the taxable year. It shall be signed by, or on behalf of, the taxpayer and by the District Director and shall have the same effect as a determination under any other provision of section 547(c). The date of the determination under such agreement shall be the date on which it is signed by the District Director.

(b) *Claim required; time for filing claim.*—Until regulations are issued under section 547, the rules set forth in Regulations 118 with respect to filing of a claim for deficiency dividend credit (see Regs. 118, § 39.506–5) shall apply in filing a claim for a deficiency dividend deduction with the following exceptions:

(1) The time for filing a claim for a deficiency dividend deduction shall be 120 days after the date of the determination provided by section 547(c); and

(2) A determination under section 547(c) shall include a determination by agreement signed by the taxpayer and the District Director as provided by section 547(c)(3) and the rules under subparagraph (a).

PAR. 13. UNDISTRIBUTED FOREIGN PERSONAL HOLDING COMPANY INCOME; TAXES; ELECTION.—The election provided by section 556(b)(1), relating to the method of deducting certain taxes in computing undistributed foreign personal holding company income, shall be made by deducting the taxes accrued during the taxable year, in the return for such taxable year. The election may be made in any taxable year ending after the date of the enactment of the Internal Revenue Code of 1954, shall apply to the taxable year for which made and all subsequent taxable years, and shall be irrevocable.

PAR. 14. DEFINITION OF PROPERTY; SPECIAL RULE AS TO OPERATING MINERAL INTERESTS; ELECTION TO AGGREGATE UNDER SECTION 614(b).—Section 614(b) authorizes a taxpayer who owns two or more separate operating mineral interests which constitute part or all of an operating unit to elect, in accordance with regulations, to aggregate, and to treat as one property, any two or more of such interests, and to treat as a separate property each such interest which he does not elect to include within the aggregation. The election must be made with respect to each separate operating mineral interest not later than the time prescribed for filing the return (including extensions thereof) for whichever of the following taxable years is the later: The first taxable year beginning after December 31, 1953, or the first taxable year in which any expenditure for exploration, development, or operation in respect of the interest is made by the taxpayer after the acquisition of such interest. Such election shall be made in a statement attached to the taxpayer's return for the first taxable year prescribed for making such election. Such statement shall include information to show that the interests aggregated are part or all of one operating unit. The taxpayer should also attach to the return a property map, and such explanatory data as may be necessary, to identify the operating unit, the properties in the unit which are being aggregated, and the properties which will be treated separately. 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 years unless consent to make a change is obtained. Applications for consent to make a change will not be accepted before the promulgation of regulations under section 614.

PAR. 15. DEFINITION OF PROPERTY; SPECIAL RULE AS TO NONOPERATING MINERAL INTERESTS; PERMISSION TO AGGREGATE SEPARATE INTERESTS UNDER SECTION 614(c).—Section 614(c) provides that the Secretary or his delegate may, on showing of undue hardship, permit the taxpayer to treat (for all purposes of subtitle A) certain separate nonoperating mineral interests as one property. Permission will not be granted under section 614(c) to aggregate such separate nonoperating mineral interests prior to the promulgation of regulations under that section. However, if the taxpayer has regularly aggregated such separate nonoperating mineral interests in prior taxable years the first return subject to the provisions of the Internal Revenue Code of 1954 may be filed on such basis subject to the approval of the District Director of Internal Revenue, provided that permission to continue such treatment is requested as a part of such return and the return is timely filed. In other cases the filing of a return for any taxable year subject to the Internal Revenue Code of 1954 prior to the issuance of regulations under section 614(c) shall not preclude the taxpayer from requesting permission to

adopt an aggregation in an amended return in accordance with such regulations.

PAR. 16. SPECIAL RULES APPLICABLE TO DISTRIBUTIONS BY TRUSTS IN FIRST 65 DAYS OF TAXABLE YEAR.—Section 663(b) permits fiduciaries of certain trusts to elect to treat as paid or credited by the trusts on the last day of the preceding taxable year amounts which are properly paid or credited within the first 65 days of the taxable year. The election shall be made in a statement attached to the return for the first taxable year subject to the Internal Revenue Code of 1954. The election must be made not later than the time prescribed by law for filing the return for such year (including extensions thereof). Once made, the election is irrevocable with respect to the taxable year to which the election is applicable and all subsequent taxable years. Since the election affects not only the amount allowable as an additional deduction to the trust under section 661, but also the amount treated as taxable to the recipient beneficiary under section 662, the fiduciary shall notify such beneficiary of the election.

PAR. 17. FOREIGN TAX CREDIT ALLOWED TO SHAREHOLDERS OF A REGULATED INVESTMENT COMPANY; MANNER OF MAKING ELECTION AND NOTIFYING SHAREHOLDERS.—A regulated investment company shall make the election under section 853 by attaching a statement to its return for the taxable year setting forth sufficient facts to establish that it meets the requirements of section 853 and indicating—

(1) the total amount of income, war-profits, or excess profits taxes paid to foreign countries or possessions of the United States;

(2) the date and form of notice to its shareholders; and

(3) the proportionate share of such taxes paid during the taxable year allocable to each share of each class of stock of the regulated investment company.

The election is applicable only with respect to taxable years subject to the Internal Revenue Code of 1954 and shall be made with respect to all such taxes and must be made not later than the time prescribed for filing the return (including extensions thereof).

PAR. 18. ADJUSTED BASIS; INCOME FROM DISCHARGE OF INDEBTEDNESS.—Section 1017 provides that, where income from discharge of indebtedness is excluded under section 108(a), the whole or a part of the amount so excluded shall be applied in reduction of the basis of the property held by the taxpayer during the taxable year of such discharge. Until regulations are issued under section 1017, the amount of the adjustment and the method for allocating it to particular property, in the case of either a corporation or an individual, shall be determined in accordance with sections 39.113(b)(3)-1 and 39.113(b)(3)-2 of Regulations 118 (26 C. F. R., pt. 39).

PAR. 19. DEFINITIONS; AGREEMENTS TREATED AS DETERMINATIONS.—Section 1313(a)(4) provides that an agreement entered into by the Secretary or his delegate and the taxpayer (in addition to a closing agreement under sec. 7121) shall be treated as a determination for the purpose of the adjustment authorized by section 1311. No such agreement will be entered into until after the promulgation of regulations under section 1313(a)(4).

PAR. 20. NOTICE OF QUALIFICATION AS EXECUTOR OR RECEIVER.—Until regulations are issued under section 6036, the notice of qualification as executor, receiver, etc., required by such section shall be required at the time and only to the extent provided in existing regulations under the Internal Revenue Code of 1939 which are continued in effect under the Internal Revenue Code of 1954. See, for example, sections 81.57 through 81.60 of Regulations 105 (26 C. F. R. 81.57 through 81.60), relating to notice of qualification by executors.

PAR. 21. AUTOMATIC EXTENSION OF TIME FOR FILING CORPORATION INCOME TAX RETURNS.—The automatic extension of 3 months for filing corporation income tax returns, provided for in section 6081(b), will be granted upon the filing of Form 7004 in accordance with the rules prescribed in IR-Mimeograph No. 54-20, dated February 12, 1954.

PAR. 22. RULES APPLICABLE TO DELEGATION OF AUTHORITY.—In any case in which a function is vested by the Internal Revenue Code of 1954 in the Secretary or his delegate, and Treasury regulations or Treasury decisions (including this Treasury decision) provide that such function may be performed by a District Director of Internal Revenue, a Regional Commissioner of Internal Revenue, an Assistant Commissioner of Internal Revenue, or by a designated officer or employee in the office of a District Director, Regional Commissioner, or Assistant Commissioner—

(a) Such provision in the regulations or a Treasury Decision shall constitute a delegation by the Secretary to the Commissioner of the authority to perform

such function and a redelegation thereof by the Commissioner to the designated officer or employee, and

(b) An officer or employee authorized by regulations or a Treasury Decision to perform a function shall have authority to redelegate the performance of such function to any officer or employee performing services under his supervision and control, unless such power to so redelegate is prohibited or restricted by proper order or directive, and

(c) The Commissioner may also redelegate authority to perform such function to other officers or employees of the Internal Revenue Service and, to the extent he deems proper, may authorize further redelegation of such authority, and

(d) The Commissioner may prescribe such limitations as he deems proper on the extent to which any officer or employee of the Internal Revenue Service shall perform any such function, but, in the case of an officer or employee designated in regulations or a Treasury Decision as authorized to perform such function, such limitations shall not render invalid any performance by such officer or employee of the function which, except for such limitations, such officer or employee is authorized to perform by such regulations or Treasury Decision in effect at the time the function is performed.

(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).)

JUSTIN F. WINKLE,
Acting Commissioner of Internal Revenue.

Approved December 30, 1954.

M. B. FOLSOM,
Acting Secretary of the Treasury.

(Filed with the Division of the Federal Register December 30, 1954, 12:04 p. m.)

T. D. 6124

TITLE 26—INTERNAL REVENUE

Temporary rules relating to unincorporated business enterprises electing to be taxed as domestic corporations under section 1361 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 unincorporated business enterprises electing to be taxed as domestic corporations, Treasury Decision 6118 [I. R. B. 1955–3, 90], approved December 30, 1954, is hereby amended by adding at the end thereof the following paragraph:

PAR. 23. UNINCORPORATED BUSINESS ENTERPRISES ELECTING TO BE TAXED AS DOMESTIC CORPORATIONS—(a) *In general.*—Section 1361 permits certain unincorporated business enterprises to elect to be taxed as domestic corporations. If the qualifications stated in section 1361(b) are met, and if a proper election is filed in accordance with the provisions of this paragraph, then an unincorporated business enterprise with respect to which such an election is filed shall be treated for income tax purposes as a domestic corporation under the provisions of section 1361. The election may be made only with respect to taxable years of the partnership, or the proprietor, beginning after December 31, 1953, and ending after August 16, 1954.

(b) *Manner of making election.*—(1) The election shall be made by filing a statement that the partners or the proprietor, as the case may be, elects under section 1361(a) to have the enterprise treated as a corporation, and by filing the return or amended return required by subparagraph (3) within the time prescribed by that subparagraph. The election is void unless perfected by the filing of such return or amended return.

(2) The statement shall be filed during the first 60 days after the close of the first taxable year of the partnership or proprietor to which the election is applicable. The statement shall give sufficient information to establish that the enterprise meets the qualifications set forth in section 1361(b). It shall also contain an agreement to notify the district director with whom the statement is filed if the interest of the electing proprietor or partners in the capital and profits of the enterprise becomes 80 percent or less, or if the enterprise becomes a corporation. The statement shall be signed by the proprietor or all of the partners owning an interest in the enterprise at any time during the period beginning with the first day of the first taxable year to which the election applies and ending on the day the election is filed. For example, a partner or proprietor having an interest at any time during the first taxable year with respect to which the election applies is required to sign the statement even though he holds no interest at the end of such year or at the time of the election. A partner or proprietor who acquires his interest after the end of the first taxable year to which the election applies but prior to the date of the election is also required to consent to the election by signing the statement even though he holds no interest at any time during the first year to which the election is applicable.

(3) If a statement of election is timely filed, the election must be perfected by filing for such enterprise an income tax return on Form 1120 containing a statement that such return has been prepared in compliance with the regulations under section 1361. If the last day prescribed for filing the return for such enterprise (including any extension of time for such filing) falls before the last day of the third month following the month in which the regulations under section 1361 are published in the Federal Register, the election shall be perfected by filing an amended return containing a similar statement, rather than a return, on or before the last day of such third month.

(4) The required statement and the income tax return (and any amended return) shall be filed with the district director of internal revenue with whom the enterprise would be required to file its return if it were a domestic corporation. See section 6091(b)(2).

(5) An election made in compliance with this paragraph shall be irrevocable as provided in section 1361(e) and shall apply to the taxable year for which made and to all subsequent taxable years.

(c) *Administrative provisions.*—(1) The income tax return of the enterprise (and any amended return) shall be filed on Form 1120 [Corporation Income Tax Return] and shall be signed by the proprietor or by any of the partners of the enterprise. Such return shall be clearly designated as a return of a section 1361 enterprise. There shall be attached to the return a schedule of the personal holding company income of the enterprise and the expenses attributable to such income. (See section 1361(i).) In the case of a partnership, the schedule shall

disclose the amount and nature of each partner's distributive share of the personal holding company income and the expenses attributable thereto.

(2) The time for filing Form 1120 by an unincorporated business enterprise subject to the election under section 1361 is extended 6 months or until September 15, 1955, whichever is earlier, provided a tentative return is filed on or before the due date prescribed by section 6072(b) of the 1954 Code, and provided such enterprise pays, on or before the date prescribed for payment of the tax, the amount properly estimated as its tax or the first installment thereof required under section 6152. This extension shall not apply to the individual returns of the proprietor or partners of the enterprise. If, any such partner or proprietor should desire an extension of time for filing his individual income tax return, he should request permission therefor from the district director. In such a case the taxpayer should give full information as to the reasons for requesting such an extension.

(3) Each individual proprietor or partner of the enterprise shall file an amended individual income tax return, or a statement that no such return is necessary, on or before the last day of the third month following the month in which the regulations under section 1361 are published. The amended return or statement shall be filed with the district director for the district in which the original return was filed.

Because the election provided in section 1361 must be exercised within 60 days after the close of the taxable year of the enterprise, 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.

(This Treasury Decision is issued under the authority contained in sections 1361, 6081, and 7805 of the Internal Revenue Code of 1954 (68A Stat. 350, 751, 917; 26 U. S. C. 1361, 6081, 7805).)

T. COLEMAN ANDREWS,
Commissioner of Internal Revenue.

Approved February 24, 1955.

H. CHAPMAN ROSE,
Acting Secretary of the Treasury.

(Filed with the Division of the Federal Register February 24, 1955, 12:36 p. m.)

T. D. 6131

TITLE 26.—INTERNAL REVENUE

Temporary rules relating to the dates for making deposits and payments and for filing excise tax returns by certain persons required to collect and pay over certain excise taxes imposed by 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 relating to the dates for making deposits and payments of certain excise taxes and for the

filing of returns of such taxes under the Internal Revenue Code of 1954, Treasury Decision 6118, page 698, this Bulletin, approved December 30, 1954, as amended by Treasury Decision 6124, page 719, this Bulletin, approved February 24, 1955, is further amended by adding at the end thereof the following paragraph:

PAR. 24. DATES FOR DEPOSITING, PAYING, AND FILING RETURNS OF CERTAIN EXCISE TAXES.—(a) The rules set forth in this paragraph prescribe the dates on which persons described in (b) hereof are required to file returns on Form 720 reporting the excise taxes imposed under section 4251 (communications), 4261 (transportation of persons), or 4271 (transportation of property), of the Internal Revenue Code of 1954 and the dates on which such persons are required to deposit and pay over such taxes to the United States. All other requirements relating to the filing of returns and the depositing and payment of such taxes set forth in the applicable regulations and Treasury Decision 6025 [C. B. 1953–2, 400], approved July 3, 1953, as made applicable to the Internal Revenue Code of 1954 by Treasury Decision 6091 [C. B. 1954–2, 47], signed August 16, 1954, remain in full force and effect.

(b) In the case of any person who obtained a permanent extension of time (which extension was in effect on December 31, 1954) for filing any return and making any deposit or payment of the taxes imposed under section 3465, 3469, or 3475 of the Internal Revenue Code of 1939, each quarterly return (Form 720) of the excise taxes imposed under section 4251, 4261, or 4271 of the Internal Revenue Code of 1954 shall be filed, and each deposit and payment of such excise taxes shall be made, on or before the last day which would have been fixed under such permanent extension of time for filing the return and for making the deposit and payment of the excise taxes imposed under the corresponding section of the Internal Revenue Code of 1939, as the case may be, if the Internal Revenue Code of 1939 had not been repealed.

Because the rules prescribed herein are of a liberalizing character, it is hereby found that it is unnecessary to issue this Treasury Decision with notice and public procedure thereon under section 4(a) of the Administrative Procedure Act, approved June 11, 1946, or subject to the effective date limitations of section 4(c) of said Act.

(This Treasury Decision is issued under the authority contained in secs. 6071, 6302, and 7805 of the Internal Revenue Code of 1954 (68A Stat. 749, 775, 917; 26 U. S. C. 6071, 6302, 7805).)

T. COLEMAN ANDREWS,
Commissioner of Internal Revenue.

Approved April 29, 1955.

M. B. FOLSOM,
Acting Secretary of the Treasury.

(Filed with the Division of the Federal Register May 4, 1955, 8:49 a. m.)

Jurisdiction and procedure relating to offers in compromise of narcotics, smoking opium, and marihuana. See Rev. Rul. 55–153, page 199.

INDEX

Page

ADMINISTRATIVE:
- Abatements, jeopardy assessment ... 466
- Accounting periods, interim rules for change ... 47
- Assessment, collection, refund, abatement, 1954 regulations ... 145
- Assessments, jeopardy, abatement ... 466
- Claims for abatement, jeopardy assessment ... 466
- Claims for refund or abatement, waiver of right to institute suit ... 558
- Claims for refund:
  - Documentary stamps affixed to lost documents ... 522
  - Inheritance tax credit, correspondence within statutory period as claim ... 462
  - Paid erroneously by trustee in bankruptcy ... 557
  - Recoupment, application of barred estate tax over-assessment against income tax ... 469
- Collection of tax:
  - Government depositaries, deposits less than collections ... 196
  - Levy on accrued wages due State employees ... 551
  - Levy on joint checking accounts ... 197
  - Penalties, failure to deposit taxes ... 196
- Court decisions:
  - *Acri, et al., Michael P.; United States* v ... 547
  - *Liverpool & London & Globe Insurance Co., Ltd., and Sunnyland Wholesale Furniture Co.; United States* v ... 549
  - *Sovil, et al., R. P.; United States* v ... 548
- Deferment for filing returns, husband and/or wife serving in Korea ... 559
- Delegation of authority:
  - Designation of officers to act as the Secretary ... 696
  - Offers in compromise, narcotics ... 199
  - Performance of certain functions of the President by the Secretary of the Treasury ... 695
  - Secretary of Interior as representative of President in Virgin Islands to perform certain duties ... 696
- Distraint, levy on accrued wages due State employees ... 551
- Elections:
  - Depreciation, allowed prior to 1952 ... 95
  - Unincorporated business enterprises taxed as domestic corporations ... 719
- Enforcement, employee's rights under pension plan ... 393
- Extension of time, excise taxes, special due dates for certain returns ... 721
- Judgments, withdrawal of plea of nolo contendere after judgment pronounced and sentence passed ... 554
- Liens:
  - Estate tax, bank holding funds of nonresident deceased coowner ... 464
  - Filing, in New Hampshire ... 196
- Liens for taxes:
  - Future payments due under fixed right to receive property ... 544
  - Levy on joint checking accounts ... 197
  - Priority:
    - Attachment lien, Ohio ... 547
    - Garnisheeing insurance proceeds, attorney's fees, Texas ... 549
    - Landlord's distress for rent, South Carolina ... 548
    - Trustee in bankruptcy ... 545
- Limitation period:
  - Refunds or abatement, waiver of right to institute suit ... 558
- Penalties:
  - Estimated tax, failure to file declaration, substantial underestimate ... 414
  - Failure to deposit taxes ... 196
  - Government depositaries, deposits less than collections ... 196
  - Withholding receipts, held available to employees not sufficient ... 503

ADMINISTRATIVE—Continued Page

Returns:
Excise taxes, special due dates for certain returns 721
Extension of time:
Consolidated 141
Employees' trust 139
Nontaxable fiduciary 141
Federal credit union, information 138
Husband and wife, legal guardian of missing spouse for self and spouse 131
Information supporting deductions, contributions to employees' trust 300
Inspection:
House of Representatives, Committee on Government Operations 144, 142, 335
Senate Committee on Government operations 143, 142, 335
Prepared for taxpayer, verification 139
Suits, refunds, waiver of right to institute 558
Temporary rules under 1954 Code 698

ALCOHOL TAX:
Advertising:
Material, total value, defined 609
Prohibitive, malt beverages as nonfattening 615
Retailer advertising specialties furnished by industry 610
Sales pamphlets displayed to prospective wholesalers or retailer purchasers 617
Alcohol:
Development in wine, use of concentrated fruit juice 599
Export stamps 569
Isopropyl, used on specially denatured alcohol permittee's premises, records 595
Tax-free:
Aircraft supplies, Costa Rica 577
Withdrawal, method of showing purpose 572
Transfers under T. D. 5864, use at distillery for vodka 573
Beer:
Bottled, purchase, sale at another brewer's office 600
Bottling house defined 599
Breakage losses, brewer's monthly claims 568
Nonfattening, prohibitive advertising 615
Odd size containers, labeling 614
Tax-free aircraft supplies, Costa Rica 577
Untaxpaid bottled, storage 600
Blending:
Substandard wine with natural wine 597
Whiskey of foreign production, containing other whiskies as blending, coloring or flavoring material 613
Bonded wine cellars:
Alcohol development, use of concentrated fruit juice 599
Production of flavoring syrup for soft drinks 595
Proprietor bottling under trade name, own production, labels 597
Wineries:
Reports, tax overpayment, underpayment, errors 603
Standard wine premises, production, storage, handling salted wine 596
Use of "Aferrin" to remove iron from wine 598
Bonds, export, withdrawals from more than one industrial alcohol bonded warehouse 576
Bottlers:
Alternate operation of taxpaid bottling house 606
Distilled spirits, wines, malt beverages; labels, certificates of approval 612
Breweries:
Bottling house for receipt of beer 599
Brewers' monthly claims for breakage losses 568

ALCOHOL TAX—Continued Page
Breweries—Continued
Office use, purchase, sale, bottled beer produced by another brewer 600
Reports, tax overpayment, underpayment, errors 603
Storage of untaxpaid bottled beer 600
Claims:
Redemption:
Distilled spirits strip stamps 565
Unused beer, wine stamps 566
Refund, or credit, beer lost by breakage 568
Containers:
Bottles:
Beer received from another brewery 599
Eight-year-old straight whisky, labeling 572
New odd size, malt beverages, labeling 614
Containers:
Packages:
Consolidated, taxpaid, eight-year straight whisky, marking, branding 572
Purchase by agents of producers, for proprietary solvents, lacquer thinners 594
Reused wooden, for neutral grain spirits reduced in proof 570
Tax-free alcohol, marked "scientific" 572
Corporations, changes in officers, etc., notice 609
Customs:
Custody, reimported domestic distilled spirits withdrawn free of duty 605
Dealers and users, specially denatured alcohol permittee, isopropyl alcohol used on premises, records 595
Denaturants, alternate, approved by National Office 589
Denaturing plants:
Industrial alcohol:
Alternate and synthetic denaturants 589
Establishment and operation procedure 578
Distilled spirits:
Advertised in sales pamphlets displayed to prospects 617
Bottled in bond or without rectification, addition of activated carbon 604
Commercial gauge by proprietor, internal revenue bonded warehouse 575
Coupon stamps eliminated, excise stamps, extended use 569
Distilleries, internal revenue bonded warehouses, rectifying plants, etc 601
Domestic, reimported, withdrawn from customs custody, free of duty 605
Neutral grain, dumped, reduced in proof, packaged in reused wooden cooperage 570
Recovered spirts, for coloring, flavoring, of blended whisky 577
Tax-free aircraft supplies, Costa Rica 577
Taxpaid eight-year straight whisky, marking, branding, labeling 572
Taxpayment in excess of requirements for blending 568
Transfers under T. D. 5864, use for vodka 573
Distilleries:
Registered:
Alternate operations, boiling out stills 603
Testing samples of beer and stillage 606
Transfers of spirits under T. D. 5864, use in production of vodka 573
Equipment and supplies:
Breweries, partition of racking room 600
Check valves, bottling tanks, unrectified products 607
Check valves in outlet pipe connections on bottling tanks 569
Containers, for proprietary solvents, lacquer thinners 594
Pouring racks furnished retailers by wholesalers 610
Proprietor's locks, doors of internal revenue bonded warehouse 574

ALCOHOL TAX—Continued Page
Equipment and supplies—Continued
Seals, locks, emergency removal from internal revenue bonded warehouse doors 575
Fermented malt liquors. (*See* Beer.)
Formulae:
Salted wine, production, storage, handling on standard wine premises 596
Sugar solids, and alcoholic content, finished grape wine 599
Gauge, commercial, distilled spirits, internal revenue bonded warehouse 575
Importers:
Distilled spirits, wines, malt beverages; labels, certificates of approval 612
Purchasing tickets to retailers' sponsored events 611
Inducements:
Advertising material, value defined 609
Insurance furnished by wholesalers 610
Industrial alcohol plants:
Alternate operations, boiling out stills 603
Bonded warehouses, denaturing plants 601
Establishment and operation procedure 578
Labels:
Blend of substandard and natural wines 597
Bottled eight-year straight whisky 572
Distilled spirits, wines, malt beverages, certificates of approval 612
New odd size containers, malt beverages 614
Whisky:
Comic, retailer, sale to trade 615
Foreign production containing other whiskies as blending, coloring or flavoring material 613
Wine produced, bottled under trade name by proprietor 597
Wine removed from bonded wine cellars as samples 596
Losses, breakage, brewer's monthly claims 568
Marks and brands:
Alcohol withdrawn taxfree, purpose 572
Consolidated packages, taxpaid eight-year straight whisky 572
Materials:
Activated carbon added to distilled spirits, bottled in bond or without rectification 604
"Aferrin" to remove iron from wine 598
Coloring, flavoring or blending, use of recovered and neutral spirits 577
Flavoring syrup for soft drinks produced at bonded wine cellars 595
Remaining in stills at time of alternate operations 603
Testing samples of beer and stillage in fermenters 606
Whiskies used to flavor, color, and blend, labeling 613
Partnerships, changes in time of notification 609
Permits, basic, permittees, notice of business changes 609
Proprietary solvents, lacquer thinners, containers, purchase by agents of producers 594
Records, isopropyl alcohol used on specially denatured alcohol permittee's premises 595
Rectifying plants:
Bottling tanks, outlet pipe connections 569
Check valves, bottling tanks, unrectified products 607
Regulations:
26 CFR:
170, Pilot plant operations 601
182, Industrial alcohol 578
198.29, Use of volatile fruit-flavor concentrate plant premises 600
Reports, brewers, winemakers, errors 603
Retail liquor dealers:
Counter displays protected by insurance furnished by wholesalers 610
Interior advertising material, total value, defined 609
Members with retailers in nonprofit organization 611

ALCOHOL TAX—Continued Page
Retail liquor dealers—Continued
Members with wholesalers in nonprofit organization 611
Pouring racks furnished by wholesalers 610
Sale, to trade, comic whisky labels 615
Sponsoring events, tickets purchased by wholesalers, importers, producers 611
Samples:
Beer and stillage, testing 606
Wine, distribution by salesmen 596
Stamps:
Distilled spirits, excise, extended use 569
Export, issuance for packages, casks of distilled spirits and alcohol 569
Fermented malt liquors, disposition, redemption of unused stamps 566
Strip, issuance devaluation, redemption 565
Wine, disposition, redemption of unused stamps 566
Stills, boiling out, alternate operations 603
Tanks:
Bottling, check valves in outlet pipe connections 569
Bottling unrectified products, check valves 607
Bulk gauging, distilled spirits taxpaid in excess of requirements for blending 570
Taxpaid bottling houses, operation by alternate proprietors 606
Vinegar plants, transfer of substandard wine from standard wine premises 597
Violations:
Insurance furnished by wholesalers 610
Retailer, sale of comic whisky labels, to trade 615
Ticket purchase, by wholesalers, importers, producers, to retailer sponsored events 611
Wholesalers furnishing pouring racks to retailers 610
Wholesaler-retailer membership in nonprofit organization 611
Volatile fruit-flavor concentrates, plant premises used to manufacture other products 600
Warehouses:
Industrial alcohol bonded:
Establishment and operation procedure 578
Withdrawals from more than one, export bond 576
Internal revenue bonded:
Commercial gauge, proprietor 575
Emergency removal of seals, locks from doors 575
Proprietor's locks affixed to doors 574
Wholesale liquor dealers:
Furnishing pouring racks to retailers 610
Purchasing tickets to retailer sponsored events 611
Wine:
Advertised in sales pamphlets, displayed to prospects 617
Alcohol development, use of concentrated fruit juice 599
Natural, removal of iron with "Aferrin" 598
Natural grape, sweetened by winemaker other than producer 599
Produced, bottled under trade name by proprietor 597
Salted, production, storage, handling on standard premises 596
Samples for distribution by salesmen 596
Substandard blended with natural wine 577
Tax-free aircraft supplies, Costa Rica 562
Wineries. (*See* Bonded wine cellars.)
EMPLOYMENT TAXES:
Benefit provisions, waiver of exemption, wholly-owned State instrumentality 119
Domestic service, additional at employer's place of business 120
Employer:
Eight or more employees 496
Employment service, casework agency, homemakers 480

EMPLOYMENT TAXES—Continued Page
Employer—Continued
Partnerships, death of partner, interest transferred by widow to son 404
Wages paid by predecessor, $3,000 limitation 499
Employer-employee relationship:
Auto repairman, percentage basis 122
Drivers, used cars to auction 483
Fiduciaries, services outside official duties 484
Homemakers, furnished by casework agency 480
Management services, mobile diner operated on commission 475
Promoters, organizing forum-type dinner clubs 116
Salesmen, electrical appliances 482
Sexton maintaining cemetery under written contract 98
Teacher in public schools, also private tutor 485
Telephone service, keeping car inventory for dealers 481
Telephone solicitors, company products 486
Traveling salesmen, status after 1950 476
Watch repairman, percentage of receipts for space in store 117
Government employees serving abroad, Fulbright Act 488
Include-excluded service, domestic in non-farm home, additional at employer's place of business 120
Instrumentalities:
State:
Military institute, Virginia 119
National Guard units, civilian employees 117
Ministers; faculty members and chaplains:
Colleges 490
Theological seminaries 489
Railroad retirement tax:
Compensation, $350 limitation, retroactive application 495
Employee tax, deduction, retroactive effective date of $350 limitation 495
Returns:
Due date Saturday, Sunday, or legal holiday 523
Household employees, additional services at employer's place of business 120
Judgment covering unpaid minimum or overtime wages 114
Tax:
Deduction, payment to Government, suits under Fair Labor Standards Act 114
Payments, quarterly returns, due date Saturday, Sunday, or legal holiday 523
Wages:
Awards earned by salesmen paid to wives 115
Paid by predecessor employer, $3,000 limitation 499
Paid by United States to citizens of Guam, services in Guam 500
Traveling expenses, reimbursement arrangements 492–3
When to be reported, judgment covering unpaid minimum or overtime wages 114
Waivers, State instrumentality 119

ESTATE TAX:
Administration expenses:
Attorney's fees, etc., election to deduct from gross income of estate 460
Sections 81.74, 81.92, abatement, jeopardy assessments 466
Assessments, jeopardy, abatement 466
Bank deposits:
Nonresident alien, safe-deposit box in United States bank 465
Nonresident deceased coowner, tax liability of bank avoided only by transfer certificate 464
Bonds, United States, value Series G and K savings 442
Charitable gifts and bequests:
Contingent bequests, possibility that charity will receive too remote, dependent on lack of descendants 450

ESTATE TAX—Continued Page
Charitable gifts and bequests—Continued
Deductions:
Bequests distributed by executor, reimbursed by estate 455
Transfer to income participation fund of exempt organization 295
Claims against estate:
Debts of decedent, payment by executors of tax on gifts, split with surviving spouse for gift tax 449
Claims for refund:
Allowance of credit for State inheritance taxes, interest 461
Inheritance tax credit, correspondence within statutory period as claim 462
Contingent interests, legal fees, interest in property 443
Court decision:
Sternberger Estate, Louis; Commissioner v 450
Credits against tax:
Foreign tax credit, Province of Ontario, reciprocal requirement of death tax credit 464
Inheritance tax credit:
Correspondence within statutory period as claim 462
Interest on refund 461
Interest on overpayments, credit for State inheritance taxes 461
Indians, Osage, value of real property owned at death 445
Insurance, life:
Transferred or assigned, value, survivor's annuity, or present worth, refund payments 446
Lien for tax, bank holding funds of nonresident deceased coowner 464
Marital deduction:
Adjusted gross estate, election to deduct administration expenses from gross income of estate 460
Bequests, etc., to surviving spouse, exempt property set off by local statute 458
Power of appointment:
Insurance policy proceeds 456
Naming of takers in default 458
Terminable interest, no power to appoint exercisable by spouse alone 458
Nonresidents—not citizens:
Funds in safe deposit box in United States bank 465
Trust fund of British national 674
Real property, owned by Osage Indian at death 445
Situs of property:
New York trust company, funds for British nationals 674
Safe-deposit box in United States bank, funds of non resident alien decedent 465
Tax conventions, United States–Japan, estate, inheritance and gift taxes 654
Transfers:
Income, possession or enjoyment retained, specific annuity or living expenses 447
Power to alter, amend, revoke or terminate, contingent power of decedent 448
Retirement and death benefits, lump-sum payment under Social Security Act 112
Treaties:
United States–Japan, estate, inheritance and gift taxes 654
United States–United Kingdom, situs rules 674
Valuation:
Contingent fees for legal services 443
Excise tax on jewelry, furs, etc 110
Optional method:
Increase in value of insurance policy 449
Property increased or decreased in value 449
Real property owned by Osage Indian at death 445
Series G and K United States savings bonds 442

EXCESS PROFITS TAX: Page

- Abnormal tax year:
  - Income from sale by Commodity Credit Corporation of pledged crop 424
  - Increases in redemption prices of noninterest-bearing obligations 426
- Adjusted excess-profits net income:
  - Abatements of taxes by relief provisions, liability for interest 435
  - Interest on borrowed capital 421
- Court decision:
  - *Koppers Company, Inc., successor on merger to Koppers United Company and Subsidiaries; United States* v.; *Premier Oil Refining Company of Texas* v. *United States* 435
- Excess profits credits:
  - Based on income, stock dividend, net capital addition or reduction 422
  - Invested capital, equity, insurance carried by corporation on lives of officers 428
- Relief for new corporations:
  - Corporation reactivated after a de facto dissolution 419
  - Interest on borrowed capital 421

EXCISE TAXES:

- Admissions tax:
  - Advertising booklets containing coupons 506
  - Contributions to charitable organization, membership fees or goods donated 506
  - Opera, civic or community association 508
- Amendments:
  - Regulations 5, narcotics, oral prescriptions 431
  - Regulations 66, tax-free importation of playing cards 515
  - T. D. 6118, special due dates for certain returns 721
- Claims:
  - Refund:
    - Documentary stamps affixed to lost documents 522
    - Interest on manufacturers' excise taxes erroneously paid by retail dealers 199
- Coin-operated devices, ball gum or candy vending machines, toy charms as prizes 519
- Committee reports:
  - Tax Rate Extension Act of 1955:
    - House of Representatives Report No. 69 97
    - Senate Report No. 36 357
    - Conference Report No. 305 110
- Communications tax:
  - Automatic transmitter reading perforated tape through a teletype circuit 530
  - Coin-operated telephone service 531
  - Special due dates for certain returns 721
  - Stock quotations delivered by messenger or telephone 529
  - Subscribers, tie-line 529
- Court decision:
  - *Lewis, Frank*, v. *United States* 520
- Dues, initiation fees, etc.:
  - Charges for privileges or facilities 509
  - Honorary memberships 510
  - Lifetime memberships to widows of members 511
- General, certain tax rates extended 619
- Import taxes, oleomargarine, use of documentary stamps as evidence of payment 127
- Legislation:
  - Eighty-fourth Congress:
    - Public Law 1, violations relating to narcotic drugs 619
    - Public Law 18, Tax Rate Extension Act of 1955 619
- Manufacturers' tax:
  - Appliances:
    - Exhaust or intake ventilating fan 528
    - Household type, electric incinerators 528

EXCISE TAXES—Continued Page
Manufacturers' tax—Continued
Automobiles, etc.;
Parts or accessories, belt-driven compressors and condensing units 525
Pencil air pressure gauges 525
Person qualifying for credit allowance under section 3403(e) of the 1939 Code 525
Rebuilt armature used in reconditioning a used generator 524
General:
Credit shown on return, claim 528
Oscilloscope type analyzers designed for detecting variations of aircraft engine performance 527
Radio and TV receivers, premium subminiature tubes designed for use in military equipment 526
Narcotics:
Filling oral prescriptions 201
4, 4-Diphenyl-6-Dimethylamino-3-Hexanone 697
Penalty violations 619
Regulations. (*See* Amendments.)
Regulatory taxes:
Cotton futures, use of documentary stamps as evidence of payment 127
White phosphorus matches, use of documentary stamps as evidence of payment 127
Retailers' tax:
Jewelry, unassembled article, complete as to parts 518
Toilet preparations, beard softeners 518
Returns:
Filing, payment of tax, due date Saturday, Sunday, or legal holiday 523
Special due dates for certain returns 721
Stamp taxes:
Bonds, etc.:
Corporate obligations, renewal by purchaser of mortgaged property 513
Extension by a straw man 512
Playing cards, tax-free importation 515
Stocks, etc.:
Rates and computation, sales and transfers, Regulations 71 applicable under 1954 Code 126
Transfer by odd-lot dealer as principal to himself as custodian for purchaser 514
Transfers effected outside United States, duplicate records in United States 513
Transportation tax:
Persons:
Bus chartered by girl scout troops 531
Emergency precludes stop outside northern portion of Western Hemisphere 534
Motor vehicle on skis and endless track 533
Special due dates for certain returns 721
Trip by United States resident, within Canada 126
Truck on charter basis, per capita charge 534
United States portion of package tours beginning and ending in Canada 531
Property:
Back-haul transportation by truck owners 539
Clothing, packing and unpacking charges, dispensable carton 536
Construction material for a State instrumentality 541
Funeral director transporting corpse in own hearse or ambulance 535
Movement of goods for export stopped at port of embarkation 543
Person liable for payment of the tax 538

EXCISE TAXES—Continued — Page

Transportation tax—Continued
Property—Continued
Special due dates for certain returns — 721
State highway use taxes imposed on carrier and billed to shipper — 538
Towing by port terminal operator — 537
United States mail by motor carrier — 540
Wheat shipped from interior points to grain elevator at port of exportation — 542
Wagering taxes:
Lotteries, non-coin-operated machines, free game — 520
Occupational, District of Columbia — 520

FIREARMS:
Classification:
Barrel action, component parts — 562
Pistol, revolver grips — 561
20-gauge gun, two barrels pointing in opposite directions — 129
Various "gadget" guns — 129
Dealer:
Licensed, referring orders to bona fide manufacturers — 128
Records, sale of barrel actions — 562
License, manufacturer's, assembling of firearms, component parts — 562
Manufacturer:
Firearms assembled from component parts — 562
License, dealer manufacturing, importing pistol, revolver grips — 561
Records, sale of barrel actions — 562
Manufacturers' excise tax, sale, firearms, assembled by dealer — 562
Special tax, occupational referral of orders to manufacturers by licensed dealer — 128

GIFT TAX:
Amendments:
Regulations:
Sections 86.43, 86.44, abatement, jeopardy assessments — 466
Assessment of tax:
Deficiency, jeopardy, abatement — 466
Charitable gifts, transfer to income participation fund of exempt organization — 295
Exclusions:
Future interest, gift valuation indeterminable — 471
Insurance:
Assignment of, life policy given donee — 113
Present interest, life insurance policy — 113
Split gifts, to third party, marital rights in property waived by each spouse — 470
Trusts, income distribution, sole discretion of trustee — 471
Valuation:
Excise tax on jewelry, furs, etc — 110
General, Series E savings bonds — 471

INCOME TAX:
Abatement. (*See* Claims for refund or abatement.)
Accounting methods, prepaid income and estimated expenses, 1954 Regulations — 50
Accounting period:
Change:
Estimated short period net income — 333
Short taxable year, limitation on deductions — 384
Interim rules for changes — 47
Parent changed to conform with subsidiaries — 387
Adjusted gross income:
Colorado tax on income from oil and gas property interests, deduction — 258
Employee's salary and expenses combined — 257

INCOME TAX—Continued Page

Advance payments, departing aliens, date interest on overpayment begins 557
Aliens (nonresident):
Disclosure by domestic corporation of income tax return data 675
Venezuela, tax imposed on transportation companies 77
Withholding regulations under United States-Japan convention 665
Aliens (resident), income from livestock raised and sold outside the United States 212
Amendments:
Regulations 118:
Section 39.273–1, jeopardy assessments, abatement 410
Regulations 120:
26 CFR, 406.207, 406.607, withholding of income tax, payments during 1954 and 1955 under wage continuation plans 123
Amortization, election, taxable and partially taxable bonds 381
Amortization (emergency facilities), completed unit of two-way facility, not a separate facility 381
Annuities:
Taxability:
Amounts paid deceased employees' beneficiary under a group contract 230
"Death benefit" payment received by beneficiary under single premium deferred annuity contract 219
Payment to charitable organization by husband for annuity 233
Proceeds, annuity contract, surrendered in trust distribution 394
Transfer of pension funds from one qualified trust to another 40
Armed Forces:
Pay:
Combat, Korea 17
Deceased member, gratuity to beneficiary 236
First 60 days accrued leave at time of discharge 218
"Prisoner of war" reimbursement for loss of personal rights 213
Period of time disregarded:
Filing returns of husband and/or wife serving in Korea 559
Limitation on assessment and collection, due date for filing returns 559
Retirement pay:
Disability:
Members of "uniformed services" under Career Compensation Act of 1949 241
Portion refunded due to limitation on civilian pay, amount excluded 245
Uniforms, traveling expenses, reservists 261
Assessment of tax:
Jeopardy abatement 410
Tax Regulations (1954) promulgated 145
Assignment (income), unpaid accounts receivable assigned to irrevocable trust 211
Awards, prizes, etc.:
American Chemical Society 235
Cadet or midshipman appointed to service academy 21
Back pay, retroactive increase in air mail pay, proposed downward adjustment 68
Bad debts:
Banks using reserve method 282
Patronage allocations, document form 282
Banks:
Alternative method of computing additions to reserves 282
Experience factor, recovery of loan charged off as bad debt 283
Basis:
Common stock of subsidiary for preferred stock of parent in tax-free exchange under orders SEC 418
Merger of common trust funds 402
Properties consolidated under one deed 339

INCOME TAX—Continued Page
Basis—Continued
Property:
Amounts received from sale of old buildings, voluntary removal from land purchased 280
In hands of testamentary beneficiary 352
Stock, earnings and profits, nonstatutory merger 35
Stock:
Common for preferred in corporate liquidation 344
Merger, subsidiaries of foreign corporation 34
Trust principal, partial distribution in kind 233
Beneficiaries:
Basis of property withdrawn from trust and appointed to self 352
Death payments under plan, employee dying while employed 231
Deceased employee, payments on behalf of employer by insurance company 230
Deceased member of Armed Forces, gratuity paid by United States 236
Trust, termination, gains on unpaid installment obligations 391
United States citizen, United States income distributed by Canadian trust 385
Benefits under plans:
Accident and health, sickness during pregnancy 16
Annuity, insurance, to beneficiary of employee deceased prior to retirement 266
Bonds:
Interest:
Accrued on Series E, prior to reissuance 471
Anticipated for period held between maturity and redemption dates 26
Genesee Valley Regional Market Authority 14
Issued at discount 213
National Savings Bonds of Mexico 213
Political subdivision:
Maine Turnpike Authority 239
Michigan Mackinac Bridge Authority 238
Secondary coupons on municipal bonds retained by broker 236
Treasury bonds redeemed at loss before maturity 279
United States savings, citizen and resident of Ireland surviving co-owner 673
Premiums, amortizable, election on taxable or partially taxable bonds 381
Building and loan associations:
Penalties retained upon withdrawal of shares 305
Preferred stock dividends, addition to bad debts reserve 306
Business expenses:
Capitalized:
Bonus on capital of foreign corporation imposed by Pennsylvania 281
Delay rentals, nonproducing oil and gas leases 320
Indirect expenditures in connection with reforestation 319
Employees, reimbursement for moving expenses 317
Capital assets:
Definition:
Classification of assets of sole proprietorship 370
Rights in distributorship agreement 370
Holding period, securities purchased by partnership for member 403
Capital expenditures:
Bonus on capital of foreign corporation imposed by Pennsylvania 281
Cost of affidavit, continued use of trademark 319
Deepening existing well, constructing new well, result of drought 25
Delay rentals, nonproducing oil and gas leases 320
Direct costs in connection with reforestation 319
Greens on golf course 320
Insolvent corporation's debts to trade creditors paid by new corporation 320
Litigation to void a residual trust 275

INCOME TAX—Continued Page
Capital expenditures—Continued
Permanent roadway in connection with development of rental property 320
"Rental payments" on auto equipment 283
Capital gains and losses:
Estates and trusts:
Installment obligations, distribution at termination of trust 391
Redemption of stock acquired in reorganization, payment of taxes 364
Individuals:
Assets of sole proprietorship allocation of selling price 370
Bonds issued at discount 213
Employee-participant electing to withdraw all or part of funds standing to his credit in an employees' profit-sharing trust 41–43
Patronage allocations, document form 282
Redemption of National Savings Bonds of Mexico 213
Sale of rights in distributorship agreement 370
Livestock. (*See* Livestock sales.)
Property—117(j) treatment, sale of underlying water rights 373
Timber and coal, period timber held by transferor, treatment by transferee 372
Casualty losses. (*See* Losses: Casualty or theft.)
Capital stock:
Basis, bank stock after reorganization 350
Transferred to corporation controlled by transferor 340
Carrybacks and carryovers, net operating loss deduction in year of accrual 376, 378
Charitable contributions. (*See* Contributions (deductibility).)
Citizens of United States:
Foreign born child of nonresident alien mother and United States citizen soldier, adopted by United States citizens 323
Pensions for services performed abroad 368
Citizens of United States (nonresident):
Taxes on personal residences abroad, medical expenses 366
Teachers in nursery schools on United States bases abroad 94
Treatment of income earned abroad 80
Claims for refund or abatement:
Income Tax Regulations (1954) promulgated 145
Taxes paid erroneously by trustee in bankruptcy 557
Waiver of right to institute suit 558
Collection of tax, Tax Regulations (1954) promulgated 145
Commissions:
Brokers, secondary interest coupons on bonds 236
Insurance salesman, discount on own policy 221
Committee reports:
Tax Rate Extension Act of 1955:
House of Representatives Report No. 69 97
Senate Report No. 36 357
Conference Report No. 305 110
Community property and income, wife's share of husband's income from without United States 92
Compensation received:
Convenience of employer, new employment, moving expenses 317
Property other than cash:
Awards earned by salesmen, paid to wives 115
Discount allowed salesman on own policy 221
Salaries, fees, etc., paid by more than one employer affecting employee's pension plan eligibility 401
Sickness or injuries:
Absence in 1953 qualifying for 1954 exclusion 17
Employee absent because of quarantine or illness of family member 17
Illness during pregnancy 16

INCOME TAX—Continued Page
Compensation received—Continued
Sickness or injuries—Continued
Member of Armed Forces, convalescent doing light work for hospital 16
United States civil servants 15
Consolidated returns. (*See* Returns: Consolidated.)
Contracts:
Government:
Renegotiation subject to Vinson Act 104
Termination 325
Group annuity, payments to deceased employee's beneficiaries on behalf of employer 230
Contributions (deductibility):
Corporations:
Fair market value of donated inventory property 223
Payment to exempt organizations earmarked for charitable organizations 29
Pension payments to widow of deceased employee 299
Reserve officers' association 292
Individuals:
Charitable organization, property in satisfaction of pledge 297
Contributions to a rehabilitation center 28
Expenses of National Guard officer 269
Fair market value of donated inventory property 223
Installment notes credited as gifts to maker 293
Payments to exempt organizations earmarked for charitable organizations 29
Retirement system, transferred with interest to new system 329
Social club, membership dues earmarked for charities 294
Special deduction 26
Activities for exempt organizations 291
Duties for exempt organization 28
Value of remainder interest, income participation fund of exempt organization 295
Limitation:
Employees' trusts, treatment past service costs 303
Museum exempt as educational organization 28
Special deduction 26
Trusts:
Charitable donation before termination 390
Charitable gifts per settlement agreement 390
Contributions by employer to temporary depository, employees' benefits 45
Employees', information supporting deductions 300
Unlimited:
Charitable, meaning of income taxes paid 30
Effect overpayment credited against estimated tax for succeeding year 374
Cooperatives:
Distribution, patronage dividends, retention of less than whole dollar amounts 337
Patronage dividends, "cooperative" not in name 338
Tenant-stockholder, deduction of interest and taxes 312
Corporations:
General:
Income from transaction through nominal agency of an officer 217
Loss upon voluntary removal of old buildings 280
Stock option, employee, combined voting power rule 46
Liquidation, nonstatutory merger 35
Court decisions:
General American Investors Company, Inc. v. *Commissioner* 210
Glenshaw Glass Company and William Goldman Theatres, Inc.; Commissioner v 207
Godley Estate, Ida S.; Commissioner v 253

INCOME TAX—Continued — Page

Court decisions—Continued
- *Green, Matter of Ben* — 545
- *Hirshon Trust, Fannie; Commissioner* v. — 248
- *Lewyt Corporation* (now known as *Lewyt Manufacturing Corporation*) v. *Commissioner* — 378
- *Olympic Radio and Television, Inc.; United States* v. — 376
- *Sullivan, Odom Farrell* v. *United States* — 554

Credits against tax, Tax Regulations (1954) promulgated — 145
Credits (dependents). (*See* Exemptions.)
Criminal prosecutions, validity of indictment secured without sanction of Attorney General — 554
Damages, fraud and antitrust violation — 207
Decedents, lump sum payment due Government employee — 75
Declarations. (*See* Estimated tax.)
Deductions:
- Business expenses:
  - Contribution to committee to bring convention to locality — 22
  - Convention, business trip, wife accompanies husband — 315
  - Employer's premiums paid on insurance covering group insurance and annuities — 266
  - Entertainment, liquor purchased or used in Oklahoma — 22
  - Insurance premiums paid on policy covering overhead expenses during absence due to sickness or injury — 11
  - Limitation, deductions for individuals, separate activities in single commodity — 382
  - Maintenance, golf course greens — 320
  - Payment for release of mortgage — 259
  - Payments into reserve for vessel damage not covered by insurance — 265
  - Premium on insurance policy covering portion of body vital to profession — 271
  - Real estate development company, maintenance fund disbursements — 216
  - Supplementary contributions by employer to reimburse insurer for refunds of employees' contributions to annuity plan — 302
  - Transportation expenses attending drills, Reserve Components of Armed Forces — 261
  - Travel and study, teacher on sabbatical leave — 318
- Contributions. (*See* Contributions (deductibility).)
- Employees:
  - Clothing to protect commercial fishermen — 274
  - Travel and related expenses, long line truck drivers — 274
  - Travel, meals, lodging, by commercial fishermen — 274
- Fines and penalties, withdrawal of shares, building and loan association — 305
- Medical expenses:
  - Certain unusual expenditures made for purposes of health — 307
  - Not attributable to includible or excludable income, United States citizen, nonresident — 366
  - Premium on insurance policy covering portion of body vital to profession — 271
- Nonbusiness expenses:
  - Attorney's fees, etc., paid by fiduciary — 275
  - Custody fee paid to sponsored investment plan — 275
  - Dues, members of Armed Forces clubs — 270
  - Employees' salary and expenses combined — 257
  - Incurred by National Guard officer — 269
  - Litigation to void residual trust — 275
  - Payment for release of mortgage — 259
  - Travel, trip to explore investment possibilities — 317
- Personal expenses. (*See* Personal expenses.)
- Taxes:
  - Colorado, income from oil and gas property interests — 258
  - Georgia sales and use, purchaser or consumer — 277

INCOME TAX—Continued — Page

Deductions—Continued
- Taxes—Continued
  - Levied by Moffat Tunnel Improvement District — 25
  - Louisiana on cigarettes — 24
  - Louisiana sales, used in purchasers' trade or business — 23
  - Mississippi on cigarettes, cigars, smoking tobacco — 278
  - Nebraska on cigarettes — 23
  - Ohio real property — 67
  - Personal residence abroad, United States citizen nonresident — 366
  - Wisconsin, additions to tax — 277
  - Tenant-stockholder in cooperative apartment — 312
- When to be taken:
  - Excess profits tax paid during year but accrued in prior year — 376, 378
  - Ohio real property taxes — 67
  - Potential refund, adjustment of retroactive increase in air-mail pay — 68
  - Reserves for estimated expenses, 1954 Regulations — 50
  - Vacation pay, time of accrual — 68

Deficiencies:
- Abated by relief provisions, liability for interest — 435
- Eliminated by relief provisions — 413

Dependents (credit). (*See* Exemptions.)

Depletion:
- Clay in conjunction with shale identified — 358
- Crushed rock produced and sold at quarry, similar products resulting from subsequent operations, percentage — 290
- Gypsum defined — 357
- Haulage allowances by Atomic Energy Commission — 239
- Hydraulically mined salt, percentage — 290
- Loam, basis for depletion — 212
- Oil and gas properties, treatment of subleases — 286
- Processes used in the manufacture of brick and tile, percentage — 73
- Sale of iron ore, prepayment discount — 285
- Sand and gravel dredged from bed of navigable river under Federal permit, percentage — 288
- Treatment processes in manufacturing shale and slate — 357

Depreciation:
- Basis of property acquired in exchange for annuity contract — 352
- Building constructed by lessee on lessor's property, devisee of lessor — 284
- Elections, 1954 regulations, allowed prior to 1952 — 95
- Leased automotive equipment — 283

Distributions:
- Dividends, involuntary liquidation of inventory — 359

Distributions (corporations):
- Employee-participant electing to withdraw all or part of funds standing to his credit in an employees' profit-sharing trust — 41–43
- Portion of stock redeemed due to contraction of business, partial liquidation — 363
- Redemption of stock owned by estate, acquired in reorganization — 364
- Reorganization, undistributed earnings and profits — 345
- Stock dividends, amount taxable to shareholder-distributees — 248
- Stock of a controlled corporation — 31
- Stock sold by owner to another corporation owned by him — 361
- Transfer of pension funds from one qualified trust to another — 40

Dividends:
- Distribution:
  - Check returned, held for patron — 337
  - Equalization payments by open end investment company — 416
  - Stock sold by owner to another corporation owned by him — 361
- Liquidation, partial, stock redeemed for price in excess of inventories sold — 363
- Paid credit:
  - Building and loan association, penalties for withdrawal of shares — 305

INCOME TAX—Continued — Page

- Dividends—Continued
  - Paid credit—Continued
    - Declared in an undetermined amount by insurance company — 406
  - Patronage:
    - Document form — 282
    - Stock certificate returned, held for patron — 337
    - Word "cooperative" not in name of association — 338
  - Stock dividends:
    - Building and loan associations, preferred stockholder-depositor — 306
    - Distribution in kind, amount taxable to shareholder-distributees — 248
    - Stock of controlled corporation distributed to stockholders — 31
- Earned income (sources without United States):
  - Nonresident citizens — 80
  - Pensions paid retired United States citizens — 368
  - Teachers in nursery schools on United States bases abroad — 94
  - Wife's share of husband's income — 92
- Elections (manner and effect):
  - Depreciation allowed before 1952, 1954 regulations — 95
  - Overpayment credited against estimated tax, unlimited deduction for charitable contributions — 374
  - Temporary rules under 1954 Code — 698
  - Unincorporated business enterprises taxed as domestic corporations, temporary rules under 1954 Code — 719
- Employees' trusts. (*See* Trusts: Employees'.)
- Estates and trusts. (*See* Trusts: Estates and trusts.)
- Estimated tax:
  - Clarification of filing instructions — 132
  - Failure to file declaration, substantial underestimate, penalties — 414
- Exchanges of property, transfer of stock to corporation controlled by transferor — 340
- Exempt corporations and associations:
  - Agricultural, guarding purity of the breed of Welsh ponies — 71
  - Charitable, widows and children of policemen or firemen killed in line of duty — 73
  - Employees operating bus for own convenience — 72
  - Employees' trusts, returns, extension of time — 139
  - Federal credit unions, information returns — 138
  - Foundation promoting books of an incorporator — 72
  - Payments earmarked for use in distributing literature to charitable organizations — 29
  - State instrumentality — 119
  - Transfer of stock of new corporation — 340
- Exempt income:
  - Award for scientific achievement, American Chemical Society — 235
  - Payments made during 1954 and 1955 under wage continuation plans — 123
  - Sources without the United States, Ryukyu Islands — 409
- Exemptions:
  - Dependents:
    - Cadet or midshipman appointed to service academy — 21
    - Multiple support agreement — 19
    - Foreign born child of nonresident alien mother and United States citizen soldier — 323
    - Spouse, separated under interlocutory decree of divorce — 322
  - Head of household, maintains principal abode of granddaughter — 205
  - Spouse, status as dependent — 18
- Extension of time:
  - Consolidated returns — 141
  - Filing of returns:
    - Dissolved subsidiary — 140
    - Employees' trusts — 139
    - Farmers — 334

INCOME TAX—Continued Page

Farmers and farming:
Livestock held for breeding, gain or loss on sale of animals born and raised on farm 226
Livestock producers, association guarding purity of the breed of Welsh ponies 71
Fiduciaries:
Filing Form 1041 at death of life tenant, distribution of trust assets 130
Legal guardian of missing spouse, filing returns 113
Foreign corporations:
Agent in United States to buy and sell United States securities 634
Basis, property acquired by merger, subsidiaries of foreign corporation 34
Canadian, mutual investment company composed largely of stockholders in United States 77
Venezuela, tax imposed on transportation companies 77
Foreign tax credit:
Disclosure by domestic corporation to foreign bank 675
Distribution received by domestic corporation from foreign subsidiary 80
India, similar requirement 79
Saudi-Arabian additional tax on companies producing petroleum 386
Status of Ryukyu Islands 409
United Kingdom, similar requirement 386
United States income distributed by Canadian trust to beneficiaries in United States 385
Venezuela, tax imposed on transportation companies 77
Gain or loss:
Basis:
Adjusted, property acquired in exchange for annuity contract 352
Bank stock after reorganization 350
Common stock of subsidiary for preferred stock of parent in tax-free exchange under orders of SEC 418
Merger of common trust funds 402
Properties consolidated under one deed 339
Property in hands of testamentary beneficiary 352
Stock, partial distribution of trust principal 233
General, assigment of subleases in oil and gas properties 286
Recognition:
Appreciated or depreciated property, donated in satisfaction of pledge made in terms of dollars 297
Condemned property replaced with borrowed funds 342
Exchange of property between domestic subsidiaries of foreign corporation 34
Exchange of property in nonstatutory merger 35
Exchange of stock 340
Partition proceedings, tenants in common 339
Period for determining construction cost of "new residence" 348
Proceeds from sale of residence invested in new residence 347
Purchase of partnership interest by corporation for replacement purposes 343
Real property, sold and repurchased by owners in their same respective interests 340
Renegotiation Act of 1951 amended 620
Reorganization, common given for preferred stock 344
Sale by owner of underlying water rights 373
Sale of family residence rented while owner was in Armed Forces 349
Sale of stock by owner to another corporation owned by him 361
Stock of controlled corporation distributed 31
Substitution of mortgage for balance due on installment of land contract 331
Warehouse corporation merged into new cooperative 345
Gifts, retired ministers and rabbis, unsolicited payments granted by former congregation 14

INCOME TAX—Continued Page

Gross income:
Exclusions:
Compensation for period of sickness or injuries convalescent member of Armed Forces doing light work for hospital 16
Death payment, employees' trust 228
Death payment under plan, employee dying while employed 231
Deceased member of Armed Forces, gratuitous payment to beneficiary 236
Dividends distributed to patrons of "cooperative" 338
Husband's income from sources without United States, domicile in community property state 92
Income from sources without the United States, United States citizen 80
Premiums, Federal employees' group life insurance policy 13
Premiums paid on endowment contract which includes other benefits 232
Refunds by insurer of employees' contributions to an annuity plan 302
Remuneration of visiting teachers, Great Britain and Northern Ireland 676
Reserve for insurance protection, Shipowners' Protective and Indemnity Association 265
Transfer of pension funds from one qualified trust to another 40
Trust principal appreciated in value, partial distribution 233
Wages for period of sickness or injuries, United States civilian employee 15
Wages or payments under plan, illness in 1953 continuing into 1954 17
Inclusions:
Annuity payments or gifts to beneficiaries of trust 75
Compensation for first 60 days accrued leave, members of Armed Forces upon discharge 218
"Death benefit" payment received by beneficiary under a single premium deferred annuity contract 219
Development allowances, Atomic Energy Commission 239
Income from transaction by corporation through nominal agency of an officer 217
Lump sum due deceased Government employee paid to beneficiaries or estate 75
Maintenance charges paid to development company by lot owners 216
Partner's proportionate share of partnership gross income 412
Premiums paid for other benefits in endowment contract 232
Prepaid income, 1954 Regulations 50
Proceeds from insurance policy covering reimbursement for overhead expenses incurred during absence due to sickness or injury 11
Proceeds from sale of loam 212
Revenues of utility in excess of approved rates 215
Wages during absence because of quarantine or illness of family member 17
When included:
Corporate distribution in kind, amount taxable to shareholder-distributees as dividends 248
Disability retirement pay, members of "uniformed services" 241
Interest allowed on future payment funds held by a Federal Land Bank 326
Interest, contributions to old retirement system transferred to new system 329
Interest received on redemption of bonds 213
Redemption of National Savings Bonds of Mexico 213
Stock certificates received and pledged as additional collateral for notes 331
Termination of Government contract 325
Unpaid accounts receivable assigned to irrevocable trust 211

INCOME TAX—Continued — Page

- Head of household, maintains principal abode of granddaughter — 205
- Holding period:
  - Partners purchase of interests of all other partners — 372
  - Timber held by transferor, treatment by transferee — 372
- Income:
  - From sources within United States possessions, wages paid by United States to citizens of Guam, services in Guam — 500
  - From sources without the United States:
    - Status of Ryukyu Islands — 409
    - Teachers in nursery schools on United States bases abroad — 94
- Installment sales:
  - Rights in distributorship agreement, casual sale of personalty — 370
  - Stock certificates received and pledges as additional collateral for notes, income — 331
  - Substitution of mortgage for balance due on installment land contract — 331
- Insurance:
  - Premiums:
    - Endowment contracts, including other benefits — 232
    - Government portion, Federal employees' group life insurance policy — 13
    - Policy covering portion of body vital to profession — 271
- Insurance:
  - Proceeds:
    - "Death benefit" payment received by beneficiary under a single premium deferred annuity contract — 219
    - Death benefits, purchased by United Nations — 227
    - Policy covering portion of body vital to profession — 271
- Insurance companies:
  - Life, health and accident policy with option not to renew, life insurance reserves — 405
  - Mutual, other than life:
    - Characteristics, absence of democratic ownership and control — 406
    - Dividends declared in undetermined amount — 406
    - Reinsurance recoveries — 76
  - Other than life or mutual, dividends declared in undetermined amount — 406
- Interest:
  - Exempt:
    - Bonds:
      - Maine Turnpike Authority — 239
      - Michigan Mackinac Bridge Authority — 239
      - Political subdivision, New York — 14
- Interest:
  - On tax:
    - Deficiency abated by relief provisions — 435
    - Result of amendments to 1954 Code, date from which computed — 198
  - Overpayments of tax, advance payment by departing alien, date interest begins — 557
  - Paid:
    - Debentures sold, temporary investment of funds borrowed — 276
    - Payment for release of mortgage — 259
    - Tenant-stockholder in cooperative apartment — 312
- Interest:
  - Received:
    - Bonds, discount at which issued — 213
    - Excessive accrual, future payment funds held by a Federal Land Bank — 326
    - United States savings bond, citizen and resident of Ireland surviving co-owner — 673
- Inventories:
  - Adjustment, property donated to exempt organizations — 223
  - Livestock born and raised on farm, held for breeding purposes — 226
  - Retail value, merchandise at beginning and end of year — 69

INCOME TAX—Continued — Page

Inventories (LIFO):
- Department stores, January 1955 BLS price indexes — 69
- Involuntary liquidation, replacement in subsequent years — 359
- Variety stores, use of alternative set of indexes — 247

Involuntary conversions:
- Condemned property, replaced with borrowed funds — 342
- Partnership interest purchased by corporation for replacement purposes, treatment — 343

Legislation:
- Eighty-third Congress:
  - Public Law 764, extending and amending the Renegotiation Act of 1951 — 620
- Eighty-fourth Congress:
  - Public Law 18, Tax Rate Extension Act of 1955 — 619

Licenses, exclusive, patent royalties — 97

Limitation period:
- Assessment of tax, collection of tax, time disregarded, individuals outside the Americas — 559
- Collection of tax, partner's share of partnership gross income, information return — 412
- Refunds and abatement, waiver of right to institute suit — 558

Liquidations, partial, portion of stock redeemed due to contraction of business — 363

Livestock sales, computation of gain or loss, animals born and raised on farm — 226

Loans, charged off as bad debt, recovered, experience factor — 283

Losses:
- Casualty or theft:
  - Drying up of well during drought — 25
  - Moth damage to fur coat — 25

Losses:
- Individuals:
  - Deductibility, anticipated interest on bonds between maturity, redemption dates — 26
  - Limitation on deductions, accounting period, short taxable year — 384
  - Redemption Treasury Bonds before maturity, refund of interest — 279
  - Voluntary removal of old buildings — 280
- Limitation on:
  - Separate business activities from single commodity — 382
  - Uranium exploration or mining ventures — 382
- Miscellaneous, computation of abnormal insurance losses — 76

Medical expenses. (*See* Deductions.)

Military personnel. (*See* Armed Forces.)

Mines:
- Development allowances, when taxable — 239
- Sale of iron ore, prepayment discount — 285
- Salt, hydraulic methods, percentage depletion — 290
- Uranium exploration or mining ventures, losses, limitation on deductions — 382

Net income:
- Inclusion in estate residue, settlement agreement — 390
- Trusts, transfer of income by lifetime income beneficiary to another — 389

Net operating loss:
- Carrybacks and carryovers, involuntary liquidation of inventory — 359
- Deduction in year of accrual — 376, 378

Oil and gas properties, assignment of subleases — 286

Options, employee stock, combined voting power rule — 46

Partnerships:
- Basis of property, securities purchased by partnership for member — 403
- Capital gains and losses, partner's purchase of interests of all other partners — 372

INCOME TAX—Continued — Page

Partnerships—Continued
- Death of partner, interest transferred by widow to son — 404
- Returns, limitation period for collection, each partner's share returned — 412

Patents, special license agreements, royalties — 241

Penalties:
- Estimated tax, failure to file declaration, substantial underestimate — 414
- Failure to make declaration and pay estimated tax — 413
- Payment for release of mortgage — 259

Pensions:
- Retired ministers and rabbis, unsolicited payments, granted by former congregation — 14
- Widow of deceased employee — 299

Pension trusts. (*See* Trusts: Employees'.)

Period of time disregarded:
- Assessment, collection of tax, individuals outside the Americas — 559
- Husband and/or wife serving with armed forces in Korea — 559

Personal expenses:
- Attorney's fees, etc., paid by fiduciary — 275
- Convention, business trip, wife accompanies husband — 315
- Lecturer, establishing professional reputation — 317
- Long line truck drivers, meals in general area of home terminal — 274
- Reimbursement for moving expenses — 317
- Travel and study, teacher on sabbatical leave — 318
- Travel, trip to explore investment possibilities — 317
- Uniforms of Reservists, Armed Forces — 261

Personal holding companies:
- Finance company, exemption from surtax in absence of pertinent State law — 434
- Royalties, in-oil payment rights — 434

Real estate:
- Cost of "new residence," construction period — 348
- Sale of family residence rented while owner was in Armed Forces — 349
- Sale of residence, proceeds invested in new residence — 347
- Sold and repurchased by owners in their same respective interests, to perfect title — 340

Recoveries, investment company, "insider profits" — 210

Redemption of stocks and bonds:
- Owned by estate and acquired in reorganization — 364
- Portion of stock redeemed for price in excess of inventories sold — 363
- Treasury bonds redeemed before maturity, refund of interest — 279
- Treatment of discount at which bond was purchased — 213

Refunds. (*See* Claims for refund or abatement.)

Regulated investment companies:
- Equalization payments by open end investment company, percentage requirement — 363
- Recovery of "insider profits" — 210

Regulations:
- 26 CFR:
  - 1.452–1 through 1.452–8, 1.462–1 through 1.462–7; Treatment of prepaid income, reserves for estimated expenses — 50
  - 1.1020, Elections, depreciation — 95
  - 1.1491–1 through 1.1494–2, Tax on transfers to avoid income tax — 106
  - 301.6201, Assessment Authority: 301.6301, Collection authority; 301.6402, Authority to make credits or refunds; 301.6404, Abatements — 145
- Withholding, income tax conventions, filing Form 1042 Supplement, T. D. 6055 amended — 623
- Withholding, United States–Japan Income Tax Convention — 665

Renegotiation. (*See* War contracts.)

INCOME TAX—Continued Page

Reorganizations:
Merger subsidiaries of foreign corporation 34
Recapitalization common stock exchanged for preferred 344
Recognition of gain or loss, nonstatutory merger 35
Warehouse corporation merged into new cooperative 345
Residence. (*See* Real estate.)
Resident aliens. (*See* Aliens (resident).)
Retirement income, ministers and rabbis, unsolicited payments granted by former congregation 14
Returns:
Consolidated:
Accounting period changed to conform with subsidiaries 387
Extension of time for filing 141
Fiduciary:
Form 1041, filed at death of life tenant, distribution of trust assets 130
Legal guardian of missing person 131
Fractional part of year, dissolved subsidiary 140
Husband and wife:
Interlocutory decree of divorce 322
Legal guardian of missing spouse for self and spouse 131
Spouse claimed as dependent 18
Individuals, extension of time for farmers 334
Information:
Federal credit union 138
Form 1042 Supplement, to be filed in Baltimore, T. D. 6055 amended 623
Inspection, taxpayer's copy by State officials 335
Signature, statement of verification 139
Time for filing, period disregarded, individuals outside the Americas 559
Royalties:
Assigned subleases in oil and gas properties 286
Exclusive license agreements 97
In-oil payment rights, personal holding company income 434
Sales or exchanges:
Allocation of selling price among all assets 370
Cost of "new residence", construction period 348
Partition proceedings, tenants in common 339
Patents, exclusive rights 97
Property acquired in exchange for annuity contract 352
Real property, sold and repurchased by owners in their same respective interests to perfect title 340
Securities transactions:
"Insider profits," recovery by investment company 210
Investment by partnership of member's contributed capital 403
Servicemen. (*See* Armed Forces.)
Suits, refunds, waiver of right to institute 558
Surtaxes, exemption:
Corporation merged with parent corporation during taxable year 206
Tax conventions:
Canadian investment corporation having agent in United States to buy and sell United States securities 634
United States–Canada 624
United States–Federal Republic of Germany 635
United States–Japan, income tax 654
United States–United Kingdom of Great Britain and Northern Ireland, visiting teachers 676
Withholding of tax on earnings in United States of Canadian trust 633
Withholding regulations under United States–Federal Republic of Germany convention 641

INCOME TAX—Continued Page

Taxes:
Deduction:
Colorado, income from oil and gas property interests 258
Excess profits taxes paid during year but accrued in prior year 376, 378
Georgia sales and use, purchaser or consumer 277
Levied by Moffat Tunnel Improvement District 25
Louisiana on cigarettes 24
Louisiana sales, used in purchasers' trade or business 23
Mississippi on cigarettes, cigars, smoking tobacco 278
Nebraska on cigarettes 23
Ohio real property 67
Tenant-stockholder in cooperative apartment 312
Wisconsin, additions to tax 277
Foreign countries. (*See* Foreign tax credit.)
Rates of certain existing corporate normal tax extended 619
Transfers to avoid income tax, stock or securities to foreign enterprises, 1954 regulations 106
Activities for tax exempts 291
Commercial fishermen, away from home port 274
Duties for exempt organization 28
Long line truck drivers 274
Teacher on sabbatical leave 318
Treaties:
Canadian investment corporation having agent in United States to buy and sell United States securities 634
United States–Canada, income tax 624
United States–Ireland, interest on United States savings bonds 673
United States–Japan, income tax 654
United States–United Kingdom, disclosure of tax data by domestic corporation 675
Withholding regulations under United States–Japan convention 665
Trusts:
Employees':
Annuity contract, surrendered in distribution 394
Compensation paid by more than one employer affecting eligibility 401
Contributions:
Employer to temporary depository 45
Information supporting deductions 300
Treatment past service costs 303
Death payment, excludable 228
Extension of time for filing returns 139
Net unrealized appreciation on distributed stock 396
Participant electing to withdraw all or part of funds standing to his credit 41–43
Pension or profit-sharing plan, taxability of interest received by trust 40
Pension plan:
Enforcement of employee's rights 393
Only one employee 392
Profit-sharing, discontinuance of contributions by employer 39
Supplementary contributions by employer to reimburse insurer for refunds of employees' contributions to annuity plan 302
Termination, variance in distributive shares, effect on qualification 37
Transfer of pension funds from one qualified trust to another 40
United States subsidiary of Canadian corporation, withholding of tax on earnings of Canadian trust 633
Estates and trusts:
Charitable donation, deductibility of before termination 390
Income transferred by lifetime income beneficiary to another 389
Payments from special fund for annuities or gifts 75
Settlement agreement, charitable gifts, deductibility 390

INCOME TAX—Continued — Page

Trusts—Continued
Estates and trusts—Continued
Status during distribution of assets — 130
Termination, gains on unpaid installment obligations — 391
Income for benefit of grantor, life expectancy of grantor less than 10 or 15 years — 226
Miscellaneous, irrevocable, unpaid accounts receivable assigned to — 211
Vacation pay, accrual and deduction — 68
War contracts, renegotiation, Renegotiation Act of 1951, subject to Vinson Act — 104
War losses, Austrian bonds and German railroad stock, nominee in neutral country on date war declared — 382
Western Hemisphere corporations:
Countries listed — 94
Wholly-owned Canadian or Mexican subsidiary — 339
Withholding:
Employer, judgment under Fair Labor Standards Act, unpaid back wages — 114
Exemptions, filing of letters of notification by nonresident aliens with withholding agent — 102
Foreign corporation, payments for use of technical "know-how" — 388
Income tax at source:
Awards earned by salesmen, paid to wives — 115
Disability retirement pay, members of "uniformed services" under Career Compensation Act of 1949 — 241
Earnings in United States of Canadian trust for United States employees — 633
Payments to foreign corporation — 388
Regulations under United States-Federal Republic of Germany convention — 641
Regulations under United States-Japan convention — 665
United States income distributed by Canadian trust to beneficiaries in United States — 385
Nonresident aliens:
Disclosure of domestic corporation to foreign bank — 675
Filing of letters of notification of exemption with agent — 102
Information on Form 1042 Supplement, to be filed in Baltimore, T. D. 6055 amended — 623
Payment, due date Saturday, Sunday, or legal holiday — 523
Receipts, held available to employee not sufficient — 503
Records, payment during 1954 and 1955 under wage continuation plans — 123
Wages:
Paid by United States to citizens of Guam, services in Guam — 500
Payments during 1954 and 1955 under wage continuation plans — 123
Traveling expenses, reimbursement arrangement for commission salesmen — 492–3

SELF-EMPLOYMENT TAX:
Earnings:
Sales through real estate firm, lots remaining in improved subdivision — 431
Sexton maintaining cemetery under written contract — 98
Included and excluded earnings, private tutor also teacher in public schools — 485
Partners and partnerships, working partner's salary — 430
Trade or business:
Consultant, scientific, United States citizen in foreign country — 98
Contest entrant, value of prizes won — 433
Private tutor also substitute teacher in public schools — 485
Sales through real estate firm, lots remaining in improved subdivision — 431

SELF-EMPLOYMENT TAX—Continued Page
Trade or business—Continued
Sexton maintaining cemetery under written contract 98
Telephone bureau, maintaining car inventory for dealers 481
Watch repairman, percentage of receipts for space in store 117
Writing and lecturing activities of full-time professor 100
TAX CONVENTIONS:
Conventions in effect, or in the negotiation stage, between the United States and various foreign governments 678
TOBACCO TAX:
Rates, cigars, retail price determined 516

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