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

Treasury Department : : : : : Bureau of Internal Revenue

Internal Revenue Bulletin

Cumulative Bulletin VI–1

JANUARY–JUNE, 1927

IN THIS ISSUE

	Page
Introductory Notes	III
Contents	V–VIII
Rulings Nos. 3027–3291—	
Income Tax—	
Part I (1926 Act)	1–132
Part II (1924 Act)	133–153
Part III (1921 and Prior Acts)	154–290
Sales Tax	291–307
Estate Tax	308–329
Miscellaneous Tax	330–339
Prohibition	340–355
Miscellaneous	356–359
Index	361–376

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

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

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

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Introductory Notes	III
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Rulings Nos. 3027–3291—	
Income Tax—	
Part I (1926 Act)	1–132
Part II (1924 Act)	133–153
Part III (1921 and Prior Acts)	154–290
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Prohibition	340–355
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Index	361–376

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The Internal Revenue Bulletin service for 1927 will consist of weekly bulletins, semiannual cumulative bulletins, and an annual digest.

The weekly bulletins will contain the rulings and decisions to be made public and all Treasury Department decisions (known as Treasury decisions) pertaining to Internal Revenue matters. The semiannual cumulative bulletins will contain all rulings and decisions (including Treasury decisions) published during the previous six months. The annual digest will contain in digested form all such rulings and decisions published during the year, the volume for 1927 to contain also digests of the rulings and decisions published during the years 1925 and 1926.

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

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

Persons desiring to obtain the one issue of Sales Tax Bulletin for 1920, Bulletin ST–1–20, and the Cumulative Bulletins for January–June and July–December, 1921, may procure them from the Superintendent of Documents at 15 cents and 5 cents each, respectively, per copy.

Persons desiring to obtain the Internal Revenue Bulletin service for the years 1922, 1923, 1924, 1925, and 1926 may do so at prices as follows: Cumulative Bulletin I–1 (January–June, 1922), 40 cents; Cumulative Bulletin I–2 (July–December, 1922), 30 cents; Cumulative Bulletin II–1 (January–June, 1923), 30 cents; Cumulative Bulletin II–2 (July–December, 1923), 40 cents; Cumulative Bulletin III–1 (January–June, 1924), 50 cents; Cumulative Bulletin III–2 (July–December, 1924), 50 cents; Digest No. 13 (January, 1922–December, 1924), 60 cents; Cumulative Bulletin IV–1 (January–June, 1925), 40 cents; Cumulative Bulletin IV–2 (July–December, 1925), 35 cents; Digest No. 17 (January–December, 1925), 25 cents; Cumulative Bulletin V–1 (January–June, 1926), 40 cents; Cumulative Bulletin V–2 (July–December, 1926), 30 cents; and Digest No. 21 (January–December, 1926), 15 cents.

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

INTRODUCTORY NOTES.

The Internal Revenue Cumulative Bulletin VI-1, in addition to all decisions of the Treasury Department (called Treasury decisions) pertaining to Internal Revenue matters, contains General Counsel's opinions, and rulings and decisions pertaining to income, estate, sales, capital stock, and miscellaneous taxes, as indicated on the title-page of this Bulletin, published in the weekly Bulletins (Volume VI, Nos. 1-26, inclusive) for the period January 1 to June 30, 1927. It should be retained, as its contents will not be reprinted in any subsequent volume.

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

ABBREVIATIONS.

The following abbreviations are used throughout the Bulletin:

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

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

Under the provisions of the Revenue Acts of 1924 and 1926 relating to appeals to the Board of Tax Appeals, the Commissioner may acquiesce in the decision of the Board or he may, if the appeal was heard by the Board prior to the passage of the 1926 Act, cause to be instituted a proceeding in court for the collection of any part of a tax determined by the Commissioner to be due but disallowed by the Board, provided that such proceeding is commenced within one year after final decision of the Board. As to appeals heard by the Board after the passage of the 1926 Act, the Commissioner may, within six months after the Board's decision is rendered, file a petition for a review of the decision by a Circuit Court of Appeals or by the Court of Appeals of the District of Columbia. In order that taxpayers and the general public may be informed as to whether or not the Commissioner has acquiesced in a decision of the Board of Tax Appeals disallowing a tax determined by the Commissioner to be due, announcement will be made in the weekly Bulletin at the earliest practicable date. Decisions so acquiesced in should be relied upon by officers and employees of the Bureau of Internal Revenue as precedents in the disposition of other cases before the Bureau.

CONTENTS.

Ruling.	Ruling No.	Page.
Treasury decisions:		
1 (Prohibition)	VI-17-3211	350
3948	VI-1-3033	344
3949	VI-1-3034	345
3950	VI-1-3036	291
	VI-1-3037	291
3951	VI-1-3038	314
3952	VI-5-3074	346
3953	VI-5-3068	91
3954	VI-5-3071	292
3955	VI-5-3072	302
3956	VI-5-3073	304
3957	VI-5-3076	343
3958	VI-5-3077	341
3959	VI-6-3086	278
3960	VI-6-3087	323
3961	VI-6-3089	328
3962	VI-6-3088	326
3963	VI-6-3085	263
3964	VI-6-3084	202
3965	VI-7-3106	294
3966	VI-7-3096	217
3967	VI-7-3107	301
3968	VI-7-3105	297
3969	VI-7-3095	200
3970	VI-7-3097	222
3971	VI-7-3098	246
3972	VI-7-3100	264
3973	VI-7-3101	287
3974	VI-7-3102	182
3975	VI-7-3103	185
3976	VI-7-3109	330
3977	VI-7-3104	242
3978	VI-8-3119	340
3979	VI-8-3117	154
3980	VI-10-3131	225
3981	VI-10-3133	256
3982	VI-10-3132	244
3983	VI-10-3130	176
3984	VI-10-3134	274
3985	VI-10-3135	281
3986	VI-10-3137	161
3987	VI-10-3140	345
3988	VI-10-3139	318
3989	VI-10-3138	306
3990	VI-10-3136	74
3991	VI-10-3142	344
3992	VI-11-3150	332
3993	VI-11-3149	310
3994	VI-11-3147	149
3995	VI-11-3148	163
3996	VI-11-3153	143
3997	VI-11-3154	222
3998	VI-12-3162	341
3999	VI-12-3163	346
4000	VI-13-3170	342
4001	VI-13-3172	26
4002	VI-13-3173	121
4003	VI-15-3188	220
4004	VI-15-3187	203
4005	VI-15-3189	298
4006	VI-15-3190	333
4007	VI-15-3193	128
4008	VI-15-3194	267
4009	VI-15-3195	268
4010	VI-15-3196	249
4011	VI-16-3185	77
4012	VI-16-3186	248
4013	VI-16-3200	59
Treasury decisions—Contd.		
4014	VI-16-3197	330
4015	VI-17-3213	299
4016	VI-19-3227	161
4017	VI-19-3228	258
4018	VI-23-3259	36
4019	VI-24-3269	90
4020	VI-24-3270	214
4021	VI-25-3278	189
4022	VI-26-3285	258
4023	VI-26-3286	259
4024	VI-26-3283	148
4025	VI-26-3289	75
4026	VI-26-3290	99
4027	VI-26-3291	164
General Counsel's memoranda:		
266A	VI-18-3217	233
386A	VI-8-3113	38
762	VI-I-3030	123
880	VI-2-3040	45
888	VI-3-3048	46
916	VI-3-3050	135
926	VI-6-3082	133
932	VI-5-3070	241
941	VI-4-3060	205
952	VI-1-3032	191
1020	VI-2-3043	119
1022	VI-3-3047	12
1023	VI-4-3056	19
1029	VI-2-3042	115
1030	VI-9-3122	26
1072	VI-2-3041	103
1090	VI-16-3204	240
1113	VI-12-3158	178
1122	VI-7-3099	256
1123	VI-5-3067	37
1140	VI-6-3081	117
1162	VI-4-3057	22
1164	VI-8-3118	315
1175	VI-7-3093	80
1205	VI-6-3080	104
1215	VI-11-3146	195
1231	VI-11-3144	82
1232	VI-7-3092	9
1234	VI-7-3094	168
1236	VI-9-3124	63
1226	VI-10-3129	65
1254	VI-8-3116	126
1268	VI-11-3145	83
1310	VI-9-3125	101
1342	VI-13-3168	177
1345	VI-13-3165	15
1367	VI-12-3157	96
1386	VI-12-3156	10
1387	VI-14-3176	48
1394	VI-15-3182	35
1402	VI-12-3159	270
1405	VI-13-3166	58
1424	VI-15-3183	69
1451	VI-17-3206	29
1455	VI-15-3184	87
1501	VI-19-3223	260
1505	VI-24-3262	208
1534	VI-21-3241	105
1535	VI-17-3210	249
1537	VI-20-3233	151
1539	VI-16-3203	107
1546	VI-17-3209	109
1552	VI-19-3220	10

Ruling.	Ruling No.	Page.
General Counsel's memoranda—Continued.		
1565	VI-18-3215	187
1581	VI-18-3216	197
1582	VI-26-3284	171
1597	VI-22-3248	71
1627	VI-20-3231	59
1637	VI-20-3234	166
1673	VI-21-3243	252
1682	VI-22-3250	110
1706	VI-25-3272	54
1710	VI-25-3275	145
1753	VI-23-3257	138
1766	VI-25-3274	122
1792	VI-24-3265	236
1802	VI-24-3263	219
1886	VI-25-3273	92
Board of Tax Appeals:		
289	VI-1-3027	4
321	VI-17-3205	2, 7
350	VI-4-3055	7
437	VI-22-3246	4
439	VI-23-3253	4
440	VI-23-3253	4
508	VI-21-3238	4
543	VI-22-3246	5
663	VI-16-3199	6
664	VI-16-3199	2
677	VI-9-3121	6
743	VI-26-3279	1
840	VI-20-3229	1, 4
844	VI-21-3238	3
1028	VI-1-3027	4, 6
1110	VI-14-3174	4
1114	VI-16-3199	6
1159	VI-16-3199	3
1173	VI-24-3260	1
1219	VI-4-3055	7
1220	VI-16-3199	1
1235	VI-22-3246	4
1236	VI-22-3246	4
1237	VI-22-3246	4
1238	VI-22-3246	4
1239	VI-22-3245	4
1271	VI-13-3164	6
1378	VI-18-3214	4
1394	VI-21-3238	1
1414	VI-15-3181	2
1460	VI-17-3205	5
1508	VI-22-3246	5, 6
1572	VI-5-3063	1
1593	VI-24-3260	3
1644	VI-17-3205	7
1741	VI-22-3246	2
1782	VI-12-3155 VI-12-3160	6 309
1799	VI-20-3229	6
1800	VI-1-3027	5
1840	VI-22-3246	2
1879	VI-2-3039	2
1907	VI-24-3260	1
1929	VI-15-3181	1
1961	VI-22-3246	4
1962	VI-22-3246	4
1967	VI-22-3246	4
1971	VI-10-3127	5
1977	VI-12-3155	4
2029	VI-4-3055	5
2086	VI-2-3039	6
2100	VI-7-3091	4
2121	VI-22-3246	2
2161	VI-24-3260 VI-24-3266	5 309
2194	VI-2-3039	2
2216	VI-22-3246	2
2242	VI-22-3246	4
2311	VI-17-3205	3
2340	VI-24-3260	3
2404	VI-21-3238	6
2440	VI-20-3229 VI-20-3235	7 309
2446	VI-17-3205	4
2459	VI-26-3279 VI-26-3287	2, 6 308-9

Ruling.	Ruling No.	Page.
Board of Tax Appeals—Contd.		
2507	VI-4-3055	3
2512	VI-19-3219	1
2513	VI-19-3219	6
2544	VI-11-3143	4
2584	VI-20-3229	3
2623	VI-20-3229	1
2657	VI-13-3164	2
2689	VI-4-3055	7
2723	VI-16-3199	6
2724	VI-21-3238	6
2778	VI-23-3253	1
2786	VI-21-3238	6
2801	VI-1-	
2825	VI-25- VI-25-	
2880	VI-15-3	
2888	VI-7-3	
2898	VI-24-3	
2933	VI-21-	
2951	VI-19- VI-19-	5 [illegible]
2975	VI-	1
3004	VI-	2
3042	VI- VI-21-3244	308
3156	VI-21-3238	4
3157	VI-21-3238	4
3158	VI-21-3238	1
3182	VI-19-3219 VI-19-3224	2, 3 308
3195	VI-1-3027	5
3241	VI-2-3039	4
3242	VI-12-3155	3, 7
3262	VI-4-3055	8
3263	VI-4-3055	7
3264	VI-4-3055	7
3307	VI-14-3174	3, 7
3308	VI-4-3055	3
3318	VI-13-3164	3
3401	VI-21-3238	1
3414	VI-16-3199	3
3439	VI-23-3253	4
3449	VI-20-3229	4
3457	VI-11-3143	6
3489	VI-17-3205	4
3495	VI-1-3027	3
3511	VI-1-3027	3
3522	VI-23-3253	1
3526	VI-16-3199	2
3531	VI-23-3253	4
3557	VI-26-3279	4
3576	VI-12-3155	5
3601	VI-4-3055	4
3611	VI-22-3246	3
3633	VI-26-3279 VI-26-3287	3, 5 308-9
3634	VI-1-3027	6
3657	VI-10-3127	1
3665	VI-3-3046	6
3671	VI-26-3279	2
3675	VI-23-3253	1
3688	VI-16-3199	6
3719	VI-24-3260	1
3725	VI-7-3091	5
3760	VI-1-3027	4
3764	VI-21-3238	2
3796	VI-13-3164	7
3767	VI-2-3039	8
3838	VI-26-3279	5
3839	VI-26-3279	3
3840	VI-26-3279	2
3843	VI-21-3238	2, 4
3857	VI-15-3181	6
3873	VI-19-3219	5
3879	VI-19-3219	3
3888	VI-19-3219	3
3914	VI-22-3246 VI-22-3251	5 309
3946	VI-10-3127	5
3972	VI-15-3181	2
3984	VI-10-3127	2
3994	VI-8-3112	5
4015	VI-15-3181	6

Ruling.	Ruling No.	Page.
Board of Tax Appeals—Contd.		
4017	VI-7-3091	2
4051	VI-4-3055	6
	VI-4-3061	309
4130	VI-4-3055	3
4184	VI-21-3238	5
4211	VI-23-3253	1
4219	VI-3-3046	7
	VI-3-3053	309
4232	VI-2-3039	1
4242	VI-26-3279	2
4263	VI-24-3260	6
4277	VI-16-3199	5
4301	VI-21-3238	2
4339	VI-20-3229	2
4358	VI-10-3127	4
4361	VI-7-3091	1
4384	VI-5-3063	5
4365	VI-5-3063	5
4426	VI-3-3046	3
	VI-3-3053	308
4436	VI-20-3229	1
4483	VI-17-3205	1
4494	VI-7-3091	5
4503	VI-17-3205	3
4554	VI-25-3271	7
4556	VI-22-3246	3
4588	VI-23-3253	6
4612	VI-16-3199	3
4695	VI-21-3238	1, 2, 4
4698	VI-26-3279	3
	VI-26-3287	308
4707	VI-24-3260	3
4714	VI-10-3127	4
4799	VI-26-3279	6
4822	VI-17-3205	6
4841	VI-15-3181	5
4871	VI-23-3253	5
4894	VI-5-3063	5
4909	VI-26-3279	6
	VI-26-3287	309
4937	VI-25-3271	1
4943	VI-26-3279	1
5120	VI-16-3199	2
5128	VI-10-3127	5
5185	VI-26-3279	5
	VI-26-3287	308
5215	VI-15-3181	2
5244	VI-21-3238	3
	VI-21-3244	308
5304	VI-23-3253	4
5329	VI-24-3260	5
5352	VI-16-3199	2
5365	VI-19-3219	3
5366	VI-19-3219	3
5367	VI-19-3219	3
5376	VI-21-3238	2
5384	VI-21-3238	4
5387	VI-13-3164	3
5389	VI-7-3091	3
5399	VI-26-3279	1
5436	VI-12-3155	5
5448	VI-4-3055	3
5499	VI-21-3238	5
5504	VI-22-3246	3
5554	VI-21-3238	6
5555	VI-21-3238	6
5576	VI-25-3271	5
5606	VI-21-3238	5
5621	VI-21-3238	1
5622	VI-21-3238	6
5623	VI-21-3238	6
5626	VI-21-3238	5
5636	VI-24-3260	6
5663	VI-21-3238	2
5695	VI-23-3253	4
5721	VI-21-3238	4
5737	VI-22-3246	4
5823	VI-21-3238	2
5840	VI-21-3238	5
5841	VI-21-3238	2
5850	VI-6-3078	7
5908	VI-21-3238	5

Ruling.	Ruling No.	Page.
Board of Tax Appeals—Contd.		
5931	VI-19-3219	3
	VI-19-3224	308
5967	VI-4-3055	4
5986	VI-21-3238	2
6012	VI-26-3279	7
6016	VI-24-3260	3
6023	VI-5-3063	5
6030	VI-2-3039	6
6031	VI-23-3253	5
6047	VI-7-3091	7
6057	VI-5-3063	2
6141	VI-14-3174	7
6148	VI-4-3055	2
6284	VI-16-3199	4
6302	VI-17-3205	2
6331	VI-22-3246	2
6332	VI-22-3246	5
6375	VI-17-3205	3
6406	VI-8-3112	6
6441	VI-21-3238	4
6542	VI-26-3279	6
6557	VI-15-3181	6
6609	VI-17-3205	6, 8
6610	VI-17-3205	2, 7
6647	VI-2-3039	4
6667	VI-2-3039	5
6720	VI-7-3091	2, 5
	VI-7-3108	308-9
6753	VI-6-3078	7
6765	VI-6-3078	7
6766	VI-16-3199	7
6831	VI-26-3279	4
6872	VI-15-3181	6
6931	VI-26-3279	3
7133	VI-17-3205	6, 8
7134	VI-17-3205	2, 7
7189	VI-25-3271	5, 7
7325	VI-17-3205	3
7359	VI-4-3055	6
7416	VI-9-3121	4
7440	VI-19-3219	1, 6
7577	VI-2-3039	5
7636	VI-26-3279	2
7719	VI-17-3205	4
7720	VI-17-3205	4
7915	VI-22-3246	5
7981	VI-22-3246	3
8162	VI-20-3229	5
8259	VI-23-3253	3
8735	VI-13-3164	2
9004	VI-21-3238	5
9030	VI-20-3229	3
9197	VI-21-3238	2
9198	VI-21-3238	2
9393	VI-15-3181	1
9559	VI-23-3253	4
9695	VI-16-3199	3
9921	VI-17-3205	7
10611	VI-24-3260	6
11279	VI-26-3279	4
11669	VI-26-3279	4
12061	VI-16-3199	2
12611	VI-17-3205	1
12662	VI-17-3205	3
13698	VI-4-3055	5
Office decisions (I. T.):		
2327	VI-1-3028	18
2328	VI-1-3029	21
2329	VI-1-3031	127
2330	VI-3-3049	76
2331	VI-3-3051	142
2332	VI-3-3052	191
2333	VI-4-3058	78
2334	VI-4-3059	82
2335	VI-5-3064	18
2336	VI-5-3066	21
2337	VI-5-3069	144
2338	VI-6-3079	74
2339	VI-9-3123	42
2340	VI-10-3128	43
2341	VI-13-3167	140
2342	VI-13-3169	178

Ruling.	Ruling No.	Page.
Office decisions (I. T.)—Contd.		
2343	VI-14-3175	41
2344	VI-14-3177	104
2346	VI-16-3201	66
2347	VI-16-3202	86
2348	VI-17-3207	67
2349	VI-17-3208	78
2350	VI-19-3221	20
2351	VI-19-3222	43
2352	VI-20-3230	32
2353	VI-20-3232	62
2354	VI-21-3239	75
2355	VI-21-3240	98
2356	VI-21-3242	168
2357	VI-22-3247	52
2358	VI-22-3249	90
2359	VI-23-3254	51
2360	VI-23-3255	63
2361	VI-23-3256	73
2362	VI-24-3261	85
2363	VI-24-3264	220
Office decisions (I. T.)—Contd.		
2364	VI-26-3280	13
2365	VI-26-3281	69
2366	VI-26-3282	104
Office decisions (MS.):		
62	VI-2-3044	334
63	VI-7-3110	335
64	VI-11-3151	336
65	VI-14-3179	337
66	VI-20-3236	338
67	VI-24-3267	339
Mimeographs:		
3506	VI-5-3065	20
3511	VI-8-3114	40
3512	VI-8-3115	100
3527	VI-15-3192	68
3537	VI-19-3226	81
	VI-6-3090	356
Miscellaneous	VI-14-3178	131
	VI-26-3288	358

CONTENTS OF CUMULATIVE BULLETINS (I. T.) 1 TO 5, S. T. FOR 1920 AND 1921, INTERNAL REVENUE I-1, I-2, II-1, II-2, III-1, III-2, IV-1, IV-2, V-1, V-2, AND VI-1.

Cumulative Bulletin.	Ruling Nos.
Income Tax:	
December, 1919 (No. 1)	1–655
January–June, 1920 (No. 2)	656–1033
July–December, 1920 (No. 3)	1034–1368
January–June, 1921 (No. 4)	1369–1710
July–December, 1921 (No. 5)	1711–1996
Sales Tax:	
1920 (ST. 1–20)	1–112
January–June, 1921	113–265
July–December, 1921	266–356
Internal Revenue Bulletin:	
January–June, 1922 (No. I–1)	1–383
July–December, 1922 (No. I–2)	384–665
January–June, 1923 (No. II–1)	666–956
July–December, 1923 (No. II–2)	957–1276
January–June, 1924 (No. III–1)	1277–1641
July–December, 1924 (No. III–2)	1642–1949
January–June, 1925 (No. IV–1)	1950–2251
July–December, 1925 (No. IV–2)	2252–2523
January–June, 1926 (No. V–1)	2524–2813
July–December, 1926 (No. V–2)	2814–3026
January–June, 1927 (No. VI–1)	3027–3291

INCOME TAX RULINGS.—PART I.

REVENUE ACT OF 1926.

TITLE IX.—BOARD OF TAX APPEALS.

ANNOUNCEMENTS RELATING TO DECISIONS OF THE UNITED STATES BOARD OF TAX APPEALS.

[1] VI-26-3279

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

Taxpayer.	Docket No.	Board of Tax Appeals.	
		Volume.	Page.
A.			
Acme, Palmers & DeMooy Foundry Co	4211	3	1126
Acorn Refining Co	1929	2	253
Adams, B. G	4361	5	113
Adams Motor Co	3522	4	589
Albia Box & Paper Co	1907	4	1184
American Packing Co., Inc	1173	3	195
Anderson-Harrington Coal Co	743	6	759
Anderson, Isabel	1394	5	27
Archbald, R. W., jr., executor	4695	4	483
Art Metal Construction Co	4943	4	493
Auditorium Co	4483	5	163
Authier, Joseph P	2778	5	736
B.			
Baird, James	9393	4	399
Barrows, Fletcher L	3158	4	1221
Bartley, R. A	2623	4	874
Bell, Rogers & Zemurray Bros. Co	1220	4	687
Benham Ice Cream Co	3401	5	97
Bentley, J. A	2512	5	314
Birmingham Trust & Savings Co., executor	7410	5	245
Bonneville Lumber Co	3657	2	489
Bosshardt, Frank J	4436	4	1262
Boynton, Charles T., estate of	840	5	294
Bradshaw, Rosena W., Mrs	5621	4	995
Braly-Ferguson Gin Co	5399	5	1290
Bray, Elizabeth J., administratrix estate of Richard Bray	2801	4	42
Bray, Richard, estate of	2801	4	42
Brown, Henry I	3675	4	1129
Brown, Warren E	2975	4	56
Brownell, Walter D	4937	4	1191
Brunner, Arnold W., estate of	3719	5	1135
Brunner, Emma B., executrix	3719	5	1135
Burgio, A. E	4232	4	4
Burns, J. R	12611	5	1003
Butler, John W., Inc	1572	1	1105

Footnotes at end of table.

Taxpayer.	Docket No.	Board of Tax Appeals. Volume.	Page.
C.			
Cadillac Automobile Co. of Illinois	2657	5	604
Capital City Investment Co	5376	4	933
Capitol Hotel Co.[2]	6610 7134	4	441
Caplis, Mary, deceased, estate of [3]	6720	4	983
Carmichael, D. L	12061	5	456
Case, J. I., Plow Works	664	3	981
Central States Coal Co	8735	4	1134
Charleston Security Co., executor	3843	4	1269
Chatterton & Son	6057	5	105
Chisholm's Sons Co., Wm. (Chisholm Shovel Co.)	1840	3	1070
Church & Hoiles Co	3526	4	1067
Citizens National Bank	6148	5	156
Coghlin Electric Co	1879	3	1071
Colitz, Benjamin	3004	3	947
Collins, W. C. and C. C	5986	5	102
Columbia Theatre Co	1414	3	622
Columbus Bread Co	5823	4	1126
Cook, H. G	1741	5	111
Cook, John F	6331	4	916
Coxe, Sophia G	2121	5	261
Cremin, E. F	9197	5	1164
Cremin, T. O	9198	5	1169
Crompton Building Corporation	4301	2	1056
Crosby, Everett U	3764	4	1147
Crothers, R. A	5841	5	670
D.			
Darling, Jay N	6302	4	499
DeLisser, Horace, estate of [3]	2459	2	102
DeLisser, Ione, executrix [3]	2459	2	102
Detroit Vapor Stove Co	5663	4	1043
E.			
Edmonds, Jeanne, executrix	3840	4	967
Edmonds, John W., estate of	3840	4	967
Ehrlich, Franz, jr., estate of	4695	4	483
Elm City Cotton Mills	7636	5	309
F.			
Fenner, Charles E. and Virginia S	2216	5	772
Ferry Market, Inc	3671	5	167
Finck, Henry, Co	4339	4	1188
Flaxlinum Insulating Co	5120	5	676
Frank-Sievers Undertaking Co	2194	3	94
Frankel, Osmond K., executor [3]	3182	3	1207
G.			
Gambee, Wheeler B	3972	4	1234
Gardner Governor Co.[2]	321	5	70
Gaskins, F. W	4242	4	619
Gassner, Louis	4017	4	1071
Gem State Lumber Co	3984	2	489
Georgia State Savings Association	5352	4	748
Germantown Braid Co	5215	3	1336

Footnotes at end of table.

Taxpayer	Docket No.	Board of Tax Appeals. Volume.	Page.
Gerst et al., Herbert J	3879, 3888, 5365, 5366, 5367	4	658
Gettys, M. E	3495	3	441
Giles, George A., Co	5387	4	335
berg, Harry S	5389	4	1073
t, George J., Construction Co	2584	5	395
Rudolph	2340	5	1163
rinting Co., The	4503	4	1264
ville Opera House Association	2311	5	887
r, Arthur B	1159	3	508
H.			
F. A., Co., Inc.[4]	4612	3	1172
Hamilton Manufacturing Co	2507	3	1045
Hardy, George W	7981	5	981
Harris, Charles L., administator estate of William L. Harris, deceased [3]	4426	5	41
Harris, William L., deceased, estate of [3]	4426	5	41
Hausmann, Louis, executor [3]	5931	5	199
Hausmann, Theresa R., estate of [3]	5931	5	199
Hayes Textile Co., Inc	844	4	1274
Henderson Cotton Mills	5504	4	1212
Henry, John	6375	6	131
Herald-Despatch Co	4556	4	1096
Hortenstine, J. L., coadministrator [3]	3633	3	697
Hotel Grunewald Co., Ltd	1593	5	761
Hovey, C. F., Co	5448	4	175
Humphries, C. C	3511	3	441
Hutchins Lumber & Storage Co.[2]	3307	4	705
I.			
Independent Brewing Co. of Pittsburgh [5]	3242	4	870
Irwin, J. F., Fuel Co	9030	6	303
Island Line Shipping Co	3414	4	1055
J.			
Johnson, Earl O	8259	5	253
Johnson, John E., jr., estate of	3839	4	967
Johnson, Theodosia, executrix	3839	4	967
Johnstown Building and Loan Association	2898	6	463
Jones, Henry M	7325, 12662	4	1286
K.			
Katz & Besthoff, Ltd	4707	5	750
Kaufman, Samuel R., estate of [3]	4698	5	31
Kaufman, Una Libby, executrix [3]	4698	5	31
Kennedy, et al., Annie S., executors [3]	5244	4	330
Kennedy, D. J., deceased, estate of [3]	5244	4	330
Kessler, George A., estate of [3]	3182	3	1207
Kilby Car & Foundry Co	6931	4	1294
King Lumber & Oil Co	9695	4	1253
Kobbe, Philip, Co., Inc	3308	4	663
Kolynos Co	4130	4	520
Konigsberg, Nathan	6016	4	1027
Krauss, Alexander	3611	5	799
Krieg Tanning Co	3318	4	1081

Footnotes at end of table.

Taxpayer.	Docket No.	Board of Tax Appeals. Volume.	Page.
L.			
Law and Credit Co	508	5	57
Leonard, Arthur H	3156	4	1221
Leonard, Charles M	3157	4	1221
Libby & Blouin, Ltd	7416	4	910
Liberty Light & Power Co	3760	4	155
Liggett, J. T	3489	5	169
Lindsey-Long Coal & Lumber Co	11279	5	243
	11669	5	243
Lockwood, R. H., estate of	3843	4	1269
Lonergan, John E	6441	4	1209
Lukins, F. W	2544	3	204
M.			
Mabel Elevator Co.[6]	1110	2	517
Mandel Bros	1977	4	341
Marine Insurance Co., Ltd	2242	4	867
Mason Machine Works Co	289	3	745
Mather Paper Co.[7]	1378	3	1
McCreery, Henry F	3557	4	967
McDonald, Mary E., executrix[3]	3042	2	1295
McDonald, Patrick J., estate of[3]	3042	2	1295
McGinnis, Bob H	6647	4	209
McGlynn, A. P	4714	4	1005
Meinhard, Carrie W	2100	3	612
Mereen-Johnson Machine Co	3531	5	400
Mertz, Edward P	5695	5	694
Mesirov, Harry S., executor	4695	4	483
Metairie Cemetery Association	437	4	903
Meyer, Anton M	5737	3	1329
Meyer & Bro. Co., F	5384	4	481
Meyrowitz, Emil B	3241	3	1327
Mickel, George E	439	5	979
Mickel, Tom E	440	5	979
Midwest Hotel Co	2933	5	121
Miles, W. C., Co	3439	5	625
	9559	5	625
Millard, Everett L., et al., trustees	840	5	294
Mills, Lucy M., estate of	1028	3	1016
Minnesota Cement Construction Co	6284	6	151
Morefield and wife, W. H	5721	4	394
Morgan, Walter G	3449	5	1035
Morrison-Merrill & Co	4358	2	489
Mosier, M. H	5304	5	674
Moyse, Sidney G	5967	4	834
N.			
Nazareth Cement Co	2446	4	1121
Nickey, A. B., estate of	1961	3	173
Nickey & Sons, A. B	1235	3	173
	1236	3	173
	1237	3	173
	1238	3	173
	1239	3	173
Nickey, S. M	1967	3	173
Nickey, W. E	1962	3	173
Norfolk & Western Ry. Co	3601	3	597
North McAlester Coal Co	6831	5	200
Norvell, B. R	7720	6	56
Norvell, Mrs. B. R	7719	6	56

Footnotes at end of table.

Taxpayer.	Docket No.	Board of Tax Appeals. Volume.	Page.
O.			
O'Hair, P. E., estate of	4184	3	1039
Ohio Grease Co	6023	4	1207
Olsen, John	1460	5	889
O'Neill, John, estate of [3]	5185	4	78
O'Neill, John, jr., et al., executors [3]	5185	4	78
Ottolander, C. J. W	4494	5	651
[illegible] and Lumber Co	3946	2	489
P.			
[illegible] Novelty Co	8162	5	1017
[illegible]h-Watson & Co., Inc	4894	4	605
[illegible]psco Ballast Co	1800	1	1081
[illegible]. Bradford C	6332	4	916
[illegible]ion Produce Co	3994	4	950
P[illegible], Charles F., jr	5606	6	450
Pickering, Loring	5908	5	670
Pickering, Rose C., estate of	5840	5	670
Pike County Coal Corporation [5]	7189	4	625
Pittsburgh & Bessemer Coal Co	5626 9004	5	45
Prouty, Anson V., et al., executor [3]	2951	5	107
Prouty, C. C., estate of [3]	2951	5	107
Purcell, Annie L., executrix	3838	4	967
Purcell, Joseph, estate of	3838	4	967
Purity Oats Co	4364	4	585
Purity Oats Co. of Davenport	4365	4	585
Putney, L. B., Mercantile Co	3195	3	836
R.			
Radel, John J., Co	5576	5	250
Raymond-Hadley Corporation	5128	4	889
Riffel, Henry	3576	3	436
Robertson, Harry F	5436	5	748
Rockford Brick & Tile Co	3873	4	313
Roden Coal Co	7915	5	654
Rosser, Luther Z., estate of [3]	2161	3	809
Roth, Charles F., estate of	1508	3	868
Ruckman Coal Co	4277	5	534
Russell Wheel & Foundry Co	2029	3	1168
S.			
[illegible] A. T	7577	4	1074
[illegible] Leon	3725	4	1109
[illegible]ings Home	4871	6	198
[illegible] Wilson E	1971	3	1141
[illegible] Joseph, estate of [3]	3914	5	326
[illegible] Julia Anna, executrix [3]	3914	5	326
[illegible], Andrew H	6667	4	35
[illegible] Samuel P., estate of [3]	3633	3	697
Seaboard Mills, Inc. (Fleitmann & Co., Inc., successor)	5499	5	575
Security Trust Co., executor [3]	6720	4	983
Seven Nineteen Fifth Avenue Co	6031	5	565
Sheen, Jessie G	543	6	114
Shelton, Charles B., et al., executors [3]	2161	3	809
Sheridan, Thomas F	13698	4	1299
Simons, James A., jr., and wife	5329	5	480
Smith, Bert K	5329	5	480
Smith, Mrs. Bert K	5329	5	480
Smith, Walter T	4841	4	397

Footnotes at end of table.

Taxpayer.	Docket No.	Board of Tax Appeals. Volume.	Page.
Sonenblick, David	3665	4	986
Sphar Brick Co	2086	2	946
Spofford, Hannah M., administratrix of estate of Lucy M. Mills	1028	3	1016
Stamey-Mackey Construction Co	1271	4	383
Standard Marine Insurance Co., Ltd	4822	4	853
Starck, Philip A., estate of [3]	4051	3	514
Starck, Philip T., executor estate of Philip A. Starck [3]	4051	3	514
Starrett, Paul	6557	4	398
Steinbach Co	2888	3	348
Stern, Samuel E. A., executor [3]	2459	2	102
Stollwerck Chocolate Co	6030	4	467
Stouts Mountain Coal Co	6542	4	1292
Suhr, Charles L	6406	4	1198
Sutliff, S. D	2786	4	1068
Swartz, A. R., & Co., Inc	3688	5	264
T.			
Ter Bush, David A	4015	4	984
Thompson, W. B	677	5	193
Titusville Trust Co., executor	1508	3	868
Troost Avenue Cemetery Association	1114	4	1169
Tsivoglou, Constantine J	3634	3	743
U.			
Uniola Real Estate Co	3457	3	1113
United States Fidelity & Guaranty Co	4263	5	23
United States Mortgage & Trust Co., executor [3]	2459	2	102
Unity School of Christianity	1799	4	61
W.			
Wall, Frank E	7359	4	915
Wall & Ochs, Inc	3857	4	1093
Wallis Tractor Co	663	3	981
Walter, George L., estate of [3]	1782	2	453
Walter, Howard K., et al., executors estate of George L. Walter, deceased [3]	1782	2	453
Warren Co., The	4588	3	1154
Washington Hotel Co.[2]	6609 7133	4	441
Webb Press Co., Ltd	2404	3	247
	2724	3	247
West, F. C., Corporation	6872	4	629
Westergren, M. F., Inc	2723	5	1185
Wheary, George H	4799	5	829
White, James, jr	5622	4	995
White, Julia A	5623	4	995
White, Robert P	5554	4	995
Wilbur, Loyd H	5636	5	597
	10611	5	597
Wilson, Charles Scotto, estate of [3]	4909	5	615
Wilson, Fannie L., executrix [3]	4909	5	615
Y.			
Young, I. F., estate of	7440	5	245
Yow, Frances White, Mrs	5555	4	995
Z.			
Zimmerman, E. W	2513	5	314

Footnotes at end of table.

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

Taxpayer.	Docket No.	Board of Tax Appeals. Volume.	Page.
A.			
American Express Co	350	2	498
B.			
Blair, J. W., administrator [3]	2440	4	959
Blair, W. A., estate of [3]	2440	4	959
Blossburg Mercantile Co	2880	4	690
Blydenburgh, Vail	9921	5	834
Burton, Lawrence Elmer	2689	5	99
C.			
Capitol Hotel Co.[8]	6610, 7134	4	441
Cross Mountain Coal Co	1219	2	587
G.			
Gardner Governor Co.[8]	321	5	70
Gooding, E. G., Mrs	3264	4	389
Gooding, Fred W., Mrs	3263	4	388
H.			
Haight, George W	6141	4	1075
Harry, S. J., Co	1644	4	211
Hendricks, Harmon W	4554	4	1257
Home Laundry Co	6047	4	45
Hutchins Lumber & Storage Co.[8]	3307	4	705
I.			
Independent Brewing Co. of Pittsburgh [9]	3242	4	870
J.			
Jackson, Minnie L., estate of [3]	4219	3	832
K.			
Klyman, E	6753	4	832
N.			
Nordholt, John B	3766	4	509
P.			
Parrett, O. S	6766	4	833
Pike County Coal Corporation [9]	7189	4	625
R.			
Randall, George W., estate of	5850	4	679
	6765	4	679
Root, Henry L., estate of [3]	2825	5	696
Root, Susie M., executrix [3]	2825	5	696
Roth, W. A	6012	4	834

Footnotes at end of table.

Taxpayer.	Docket No.	Board of Tax Appeals.	
		Volume.	Page.
S.			
Smith, Clarence C	3767	4	514
Smith, D. Sydney, Mrs	3262	4	385
W.			
Washington Hotel Co.[8]	6609 7133	4	441

[1] Ruling No. 3279 includes rulings Nos. 3027, 3039, 3046, 3055, 3063, 3078, 3091, 3112, 3121, 3127, 3143, 3155, 3164, 3174, 3181, 3199, 3205, 3214, 3219, 3229, 3238, 3246, 3253, 3260, and 3271. These rulings, published in the weekly Bulletins during the semi-annual period from January 1 to June 30, 1927, have been combined and the names of the taxpayers arranged in alphabetical order.

[2] Acquiescence does not relate to that part of decision involving application of Ayers decision (1 B. T. A., 1135).

[3] Estate tax decision.

[4] Nonacquiescence notice in the case of F. A. Hall Co., Inc. (C. B. V–1, 6), recalled.

[5] Acquiescence relates only to issue 1 in decision.

[6] Nonacquiescence notice published in Cumulative Bulletin IV–2, page 6, recalled.

[7] Nonacquiescence notice published in Cumulative Bulletin V–1 at page 7 recalled.

[8] Nonacquiescence relates only to that part of decision which relates to application of the Ayers decision (1 B. T. A., 1135).

[9] Nonacquiescence relates only to issue 2 in decision.

TITLE II.—INCOME TAX.

PART I.—GENERAL PROVISIONS.

SECTION 201.—DISTRIBUTIONS BY CORPORATIONS.

ARTICLE 1541: Dividends. VI-7-3092
G. C. M. 1232

REVENUE ACT OF 1926.

In 1920 the M Company issued shares of its stock at a premium. In 1926 the directors voted to distribute this premium, which had been carried on the books of the M Company in a separate capital account, to its shareholders, and thereafter a distribution was made.

This distribution should be considered as a distribution of earnings accumulated after February 28, 1913, to the extent that there were earnings accumulated since that date undistributed.

An opinion is requested in regard to a distribution by the M Company to its shareholders in 1926.

From the facts submitted it appears that in 1920 the M Company issued shares of its stock at a premium. In the accounting of the company this premium was carried in a separate capital account entitled "Premium on capital stock." On ——, 1926, the directors voted to distribute to the shareholders of record on that date the premium, and a distribution was made on ——, 1926.

Section 201 of the Revenue Act of 1926 provides in part as follows:

(a) The term "dividend" when used in this title (except in paragraph (9) of subdivision (a) of section 234 and paragraph (4) of subdivision (a) of section 245) means any distribution made by a corporation to its shareholders, whether in money or in other property, out of its earnings or profits accumulated after February 28, 1913.

(b) For the purposes of this Act every distribution is made out of earnings or profits to the extent thereof, and from the most recently accumulated earnings or profits. * * *

Under the above-quoted provisions it seems evident that the distribution made by the M Company as of ——, 1926, must, for the purposes of the Revenue Act of 1926, be considered as a distribution of earnings accumulated after February 28, 1913, to the extent that there were earnings accumulated since that date undistributed. The fact that this distribution was considered by the M Company as a distribution of a paid-in premium did not in any way affect the taxability of this distribution for income tax purposes, nor did the resolution of the board of directors directing that the so-called paid-in premium be distributed to the shareholders in any way change the final result. The shareholders should, therefore, be required to report in their income tax returns as a dividend subject to surtax the entire amount received upon distribution in 1926 to the extent of the earnings accumulated after February 28, 1913, and not previously distributed.

The reasoning of the Supreme Court in the case of *Edwards* v. *Douglas* (269 U. S., 204; T. D. 3797 [C. B. V-1, 158]) is applicable to the instant case. In that case, which arose under the Revenue Act of 1916, as amended by the Revenue Act of 1917, the court held that the distribution was to be considered as paid from the most recently

accumulated undivided profits and surplus, as provided in section 31(b) of the Act as amended. To the same effect is the case of *Routzahn* v. *Mason* (Sixth Circuit Court of Appeals, 13 Fed. (2d), 702; T. D. 3902 [C. B. V–2, 137]).

A. W. GREGG,
General Counsel, Bureau of Internal Revenue.

ARTICLE 1542: Source of distribution. VI–12–3156
G. C. M. 1386

REVENUE ACT OF 1926 AND PRIOR REVENUE ACTS.

Under the Revenue Acts in determining the amounts available for dividends the corporate earnings of the entire year should be taken as a unit.

In view of the decision in the case of *Routzahn* v. *Mason* (13 F. (2d), 702; T. D. 3902 [C. B. V–2, 137]), an opinion is requested on the following points:

1. In the case of a dividend declared December 15, 1916, and paid January 2, 1917, should this dividend be taxed wholly at 1917 rates, if the earnings for the year 1917 were sufficient to cover same?

2. In the case of a dividend declared and paid January 15, 1917, should this dividend be taxed wholly at 1917 rates if the earnings for the year were sufficient to cover the dividend?

Routzahn v. *Mason*, supra, was decided July 10, 1926, by the Circuit Court of Appeals for the Sixth Circuit. Citing *Edwards* v. *Douglas* (269 U. S., 204 [T. D. 3797, C. B. V–1, 158]), decided November 23, 1925, the court held that a stockholder's income from corporate dividends declared in 1916, made payable and paid in 1917, was taxable at 1917 rates, where the corporate earnings for the entire year 1917 were sufficient to cover the dividends. Obviously the same rule would apply in the case of a dividend both declared and paid in 1917.

In accordance with the *Routzahn* v. *Mason* decision, the answer to both inquiries is in the affirmative; that is, the dividends should be taxed wholly at 1917 rates if the corporate earnings for the entire year 1917 were sufficient to cover the dividends.

The general principle of the decision in *Routzahn* v. *Mason*, supra, should be followed under the other Revenue Acts; that is, the corporate earnings of the entire tax year should be taken as a unit in determining the amount available for dividends, and not merely the earnings up to the date a dividend was paid.

A. W. GREGG,
General Counsel, Bureau of Internal Revenue.

ARTICLE 1544: Distributions other than those out of earnings or profits. VI–19–3220
G. C. M. 1552

REVENUE ACT OF 1926.

In the case of a corporation having no surplus, either paid-in or earned, there can be no accumulation of profits until an operating deficit is made good. Where there was no surplus from which a

dividend could have been paid by the corporation, held, a distribution by the corporation was a distribution of capital, and in accordance with section 201(d) of the Revenue Act of 1926 should be applied against and reduce the basis of the stock in respect of which the distribution was made.

An opinion is requested regarding the taxability of a distribution made in the year 1926 by the M Company.

The facts in the case are as follows:

The M Company was organized in 1914, with a capital stock issue of $9x$ dollars. In 191— this was increased to $27x$ dollars, at which time the company acquired certain properties belonging to the O Company.

The company is relatively inactive. The property acquired from the O Company is nonproductive, and the company suffered severe losses in connection with unsuccessful attempts to utilize it. The company has never had a surplus, either paid-in or earned.

In 1925 the company's net loss was over $5x$ dollars, resulting in a deficit at the end of that year of $10x$ dollars.

During the year 1926 the company earned a net profit of $2x$ dollars and distributed x dollars in cash to its stockholders, leaving a net deficit at the end of 1926 of $9x$ dollars.

The term "dividend" is defined by section 201(a) of the Revenue Act of 1926 as any distribution made by a corporation to its shareholders, whether in money or in other property, out of its earnings or profits accumulated after February 28, 1913. Although it is provided in section 201(b) that for the purposes of the Act every distribution is made out of earnings or profits to the extent thereof, and from the most recently accumulated earnings or profits, there can be no accumulation of profits until an operating deficit is made good. As there was no surplus from which a dividend could have been paid, it necessarily follows that the distribution must have been out of capital. (See L. O. 942, C. B. 1, 300, and I. T. 2016, C. B. III–1, 29.)

The corporation not having been in existence prior to March 1, 1913, the question of charging the distribution to earnings or profits accumulated, or increase in value of property accrued, prior to that date could not arise. Section 201(c) provides that amounts distributed in partial liquidation of a corporation shall be treated as in part or full payment in exchange for the stock. It is provided in section 201(h), however, that the term "amounts distributed in partial liquidation" means a distribution by a corporation in complete cancellation or redemption of a part of its stock, or one of a series of distributions in complete cancellation or redemption of all or a portion of its stock. In the instant case there was no cancellation or redemption of stock, nor was any contemplated. Therefore, the transaction was not a distribution in partial liquidation.

It is necessary to refer to section 201(d), which provides as follows:

If any distribution (not in partial or complete liquidation) made by a corporation to its shareholder is not out of increase in value of property accrued before March 1, 1913, and is not out of earnings or profits, then the amount of such distribution shall be applied against and reduce the basis of the stock provided in section 204, 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. The provisions of this paragraph shall also apply to distributions from depletion reserves based on the discovery value of mines.

In view of the foregoing, it is the opinion of this office that the distribution by the M Company was a distribution of capital, and in accordance with section 201(d) of the Revenue Act of 1926 should be applied against and reduce the basis of the stock in respect of which the distribution was made.

A. W. GREGG,
General Counsel, Bureau of Internal Revenue.

SECTION 202.—DETERMINATION OF AMOUNT OF GAIN OR LOSS.

ARTICLE 1561: Determination of the amount of gain or loss. VI-3-3047 G. C. M. 1022
(Also Section 213(b), Article 72.)

REVENUE ACT OF 1926.

Where the taxpayer in 1925, in consideration of an annuity contract, conveyed real estate to a corporation, taxable gain was derived or (assuming the disposition of the real estate was a transaction entered into for profit) deductible loss was sustained for the year 1925, depending upon whether the value of the annuity contract was in excess of or less than the cost or other basis of the real estate. Annuity payments received will not constitute income until the cost or other basis of the annuity contract has been wholly recovered. Thereafter they will constitute income for the year of their receipt.

An opinion is requested relative to the income tax liability of the taxpayer arising out of the following transaction:

In 1925 the taxpayer conveyed to the M Company an apartment house in the city of R, and on the same date received from it an annuity contract, under which the corporation agreed to pay him, in consideration of the conveyance, the sum of $12x$ dollars annually during his lifetime. At the time of the conveyance the taxpayer was — years of age. The corporation has paid the taxpayer the sum of x dollars monthly, as provided in the annuity contract.

Upon the facts stated, it is the opinion of this office that taxable gain was derived or (assuming the disposition of the apartment house was a transaction entered into for profit) deductible loss was sustained by the taxpayer for the year 1925 on the exchange by him of the apartment house for the annuity contract, depending upon whether the value of the annuity contract (computed in accordance with the table published as "Table A" on page 20, Regulations 70, relating to the estate tax) was in excess of, or less than, the cost or other basis, with proper adjustment for depreciation, etc. (sec. 202, Revenue Act of 1926; art. 1561, Regulations 69), of the apartment house. (Sec. 204, Revenue Act of 1926; arts. 1591–1603, Regulations 69.)

As in the case of any other taxable exchange, the cost or basis to the taxpayer of the property received in exchange, i. e., the annuity contract, must be deemed to be its value at the time of its receipt. This cost or basis represents "the aggregate premiums or consideration paid" for the annuity contract within the meaning of section 213(b)2 of the Revenue Act of 1926, and pursuant to that

section the annuity payments received by the taxpayer will not constitute income until such time as he shall have wholly recovered the cost or basis to him of the annuity contract, after which time the payments received under the contract will constitute income for the year of their receipt.

A. W. GREGG,
General Counsel, Bureau of Internal Revenue.

SECTION 203.—RECOGNITION OF GAIN OR LOSS FROM SALES AND EXCHANGES.

ARTICLE 1571: Recognition of gain or loss.

REVENUE ACT OF 1926.

Gain or loss in connection with exchange of second Liberty loan converted 4¼ per cent bonds of 1927–42 (known as second 4¼'s) for 3½ per cent Treasury notes of Series A–1930–32. (See I. T. 2359, page 51.)

ARTICLE 1574: Exchanges in connection with corporate reorganizations. VI–26–3280 I. T. 2364

REVENUE ACT OF 1926.

A transaction by which a new corporation acquired all the stock or all the properties or both of three old corporations held to constitute a reorganization as contemplated and defined by section 203(h) of the Revenue Act of 1926. Gain or loss must be computed according to the circumstances obtaining with regard to each of the old companies.

Advice is requested relative to the correct method of treating various phases of the transaction consisting of the consolidation of the M Company, the N Company, and the O Company in accordance with the terms of an agreement entered into for that purpose by them under date of September —, 1925.

This agreement provides, among other things, that the three existing corporations were to be consolidated into a new corporation, to be known as the P Company, on approval of an application to that effect by the public service commission and the governor of the State of R, in accordance with the requirements of the State statute. Such approval was given on July —, 1926, at which time letters patent were issued to the new corporation. The new corporation has an authorized capital stock of 6,165y shares of a par value of $—— each, but it appears to have been the intention to issue only 4,338y shares at the time. The new corporation succeeded, in the manner hereinafter stated, to all the property, rights, franchises, and other assets of the three previously existing corporations, with the exception of the cash in the treasury of the N Company, on September —, 1925, and assumed their existing liabilities.

The O Company had outstanding at the time 226y shares of stock of a par value of $—— each. By the terms of the agreement, this company was to sell all its assets to the new corporation for the sum of x dollars and the new corporation was to assume all its liabilities. The

sum so received from the sale of the assets was to be distributed pro rata to the stockholders of the company.

The N Company had outstanding at the time 850y shares of stock of a par value of $—— each. In exchange therefor the stockholders of this corporation received two shares of stock in the new corporation of a par value of $—— each for each share of stock held by them in the old corporation.

The M Company had outstanding at the time 2,638y shares of stock of a par value of $—— each. It was provided that this stock should remain outstanding and be considered and treated as stock of the new or consolidated corporation.

With reference thereto, it is the opinion of this office that although the new or consolidated corporation was treated in some respects as a continuation of one of the old corporations, the M Company, the new corporation had a different capital, different assets, and different stockholders from such old corporation. The transaction amounted to a "consolidation" whereby a new corporate entity, the P Company, came into existence at the date of its incorporation on July —, 1926, at which time the old existing corporate entities were terminated. The three previously existing corporations are, therefore, required to render income tax returns for their respective taxable periods ended on July —, 1926. The new or consolidated corporation is required to render a return for its taxable period beginning with the date of its incorporation, July —, 1926.

As the new or consolidated corporation acquired all the capital stock or all the properties, or both, of three of the old corporations, the M Company, the N Company, and the O Company, the transaction to that extent constitutes a reorganization as contemplated or defined by section 203(h) of the Revenue Act of 1926. The N Company was taken over solely through an exchange of stock. The arrangement by which the stockholders of the M Company were considered as the holders of the same amount of stock in the new or consolidated corporation was the same as if their stock in the M Company had been exchanged share for share for stock in the new corporation. No gain or loss accordingly resulted for income tax purposes to the new or consolidated corporation or to either of these two old corporations from such disposition of their assets. The assets of the O Company were not acquired by an exchange of stock, but on the contrary were acquired by a separate purchase and sale, the consideration therefor being the sum of x dollars and the amount, if any, of its liabilities assumed. This was accordingly such a transaction as to result in a gain or loss for income tax purposes to the O Company, under section 203 of the Act, based on the cost, the last inventory value, or the fair market value as of March 1, 1913, as the case may be, as provided by section 204 of the Act.

As the stockholders of the old corporation, the M Company, had only stock in the new or consolidated corporation in lieu of the stock in the old corporation previously held, no gain or loss resulted to them for income tax purposes from the transaction. As to the stockholders of the O Company, the amount of x dollars paid to them for the surrender and cancellation of their stock had the effect of a distribution in complete liquidation as provided by section 201(c) of the Act. This was accordingly such a transaction as to result in a gain

or loss to them for income tax purposes, treating as the consideration received by a particular stockholder his pro rata share of the x dollars so received. The basis on which to compute the gain or loss resulting to a particular stockholder is the cost or the fair market value of his stock as of March 1, 1913, as the case may be, and any taxable gain so determined is subject to both normal tax and surtax.

With reference to the stockholders of the N Company, it will be noted that the agreement entered into provided that the amount of cash on hand on September —, 1925, should not pass to the new or consolidated corporation but should be distributed to the stockholders of the old corporation. Such distribution was made a part of the plan of reorganization, and the stockholders of that corporation, in exchange for their stock, accordingly received stock in the new or consolidated corporation and their pro rata share of the cash on hand on September —, 1925, which was required to be distributed in connection with the reorganization. As to the stockholders of this corporation, the transaction was such as to result in a taxable gain under section 203(d) of the Act, treating as the total consideration received by them for their old stock the fair market value of the stock in the new corporation received in exchange on July —, 1926, the effective date of the reorganization, plus their pro rata share of the cash so distributed. However, the amount of the taxable gain in such case is limited to the amount of cash so received. To the extent that the gain taxable to a particular stockholder was not in excess of his pro rata share of undistributed earnings and profits of the corporation accumulated after February 28, 1913, the amount of the gain to such stockholder is taxable as a dividend and is subject to the surtax only. The remainder of the gain so determined, if any, is subject to both the normal tax and surtax.

ARTICLE 1576: Receipt of stock or securities in reorganization.

VI–13–3165
G. C. M. 1345

REVENUE ACT OF 1926.

The M Company, after a dividend distribution to its stockholders, transferred its remaining assets to the S Company for stock in that company, which it distributed to its stockholders without requiring them to surrender their stock in the M Company. Held, there was a reorganization, and under section 203(c) of the Revenue Act of 1926 no gain to the M Company stockholders resulted from the receipt by them of the S Company stock. The basis of the M Company stock should be apportioned between such stock and the S Company stock.

An opinion is requested as to the taxability of certain distributions made by the M Company to its stockholders.

It appears that the M Company was incorporated in the State of Y in December, 1920, with a capital stock of —— shares of no par value; that the O Company purchased all the stock at $^1/_7x$ dollars per share, and distributed it to its stockholders at the same rate; that immediately afterwards the M Company acquired from the P Company some oil lands and —— shares (a controlling interest) of stock in the Q Company, all for the sum of $437{,}500x$ dollars. The stock of the Q Company at that time had a market value of a little less than x dollars a share and a par value of x dollars a share. Subse-

quently the stock of the Q Company was reduced in par value from x dollars to $\frac{1}{4}x$ dollars, and the original acquisition of the Q Company's stock by the M Company, therefore, amounted to —— shares of the new stock. By December —, 1925, the M Company increased its holdings in the Q Company to —— shares.

On December —, 1925, the board of directors of the M Company held a meeting to consider a plan to effect a "consolidation" of the M Company and the R Company into a new "consolidated" company, whereby the M Company would transfer to the new consolidated company all of its assets, except those to be reserved for distribution among the stockholders, by dissolution or otherwise, for which the new company was to issue —— shares of its stock. This plan was adopted by the board of directors, who authorized the officers to proceed to execute the plan by proper corporate action.

On January —, 1926, the executive committee approved a proposed agreement between the R Company and the M Company relating to the said consolidation. This agreement recited that the M Company proposed to distribute to its stockholders certain specified assets and that after making such distribution, but not later than March 1, 1926, the M Company and the R Company proposed to transfer all of their respective assets to a new corporation, the S Company. On the same day the executive committee also adopted a resolution that — of a share of stock of the Q Company and $1/33x$ dollars in cash be distributed for each share of stock to the stockholders of record on January —, 1926, subject to the requisite action by stockholders, (a) to reduce the capital stock of this company from $525{,}000x$ dollars to $17{,}500x$ dollars, and (b) to authorize the distribution.

These two resolutions were adopted by the board of directors, who, on the same day, resolved to call a special meeting of the stockholders to consider the following questions: (1) The reduction of the company's capital stock from $525{,}000x$ dollars to $17{,}500x$ dollars; (2) the distribution in whole, or in part, to the stockholders pro rata, at such times and in such manner as the board shall determine, of any surplus in excess of the amount to which the capital stock is reduced; and (3) the proposed "consolidation" of the M Company with the R Company. Notice of a proposed meeting to be held on February —, 1926, was sent to the stockholders on January —, 1926.

The assets excepted from the transfer to the new S corporation were to be (a) the M Company's interest on December 31, 1925, in properties and leases owned jointly with the Q Company; (b) cash, corporate stocks, bills and notes receivable, and other securities and accounts receivable, owned by the M Company at the close of business on December 31, 1925; (c) oil owned by the M Company and above ground, at midnight, on December 31, 1925; (d) such assets as leases, contracts, and other tangible or intangible property, except contracts for the sale of oil or oil products or gas made prior to January 1, 1926; (e) office furniture and fixtures, all books and records and corporate seal; (f) out of the earnings after January 1, 1926, from the properties transferred to the S Company, an amount equivalent to a dividend at the rate of $1/50x$ dollars per annum for the period from January 1, 1926, to March 15, 1926, on —— shares; and (g) such assets of the M Company as the parties in writing may agree shall be excluded from such transfer.

The assets to be transferred were thus referred to in the consolidation agreement:

It is the intent of this paragraph 3 that M Company shall transfer to S Company all assets owned by it as of December 31, 1925, except those hereinabove specified or referred to, and subject to usual expense of operation and maintenance and taxes from January 1, 1926, to date of actual transfer.

At the special meeting held on February —, 1926, the stockholders voted to reduce the capital stock of the company from 525,000x dollars to 17,500x dollars, approved the distribution of all assets in excess of the capital stock thus reduced, and adopted the consolidation plan.

In accordance with the general plan described above, the M Company acquired additional shares of stock in the Q Company to make up a total of —— shares, and on March —, 1926, distributed among its stockholders of record on January 28, 1926, for each share of stock held, 1/33x dollars in cash and — of a share of stock in the Q Company. The original agreement between the M Company and the R Company called for a transfer of the assets on March 1, 1926, but an amendment postponed the date of transfer. The property was transferred to the S Company on March —, 1926, and the M Company received — shares of stock which it distributed to its stockholders on May —, 1926, without requiring them to surrender their certificates of stock in the M Company.

This office is of the opinion that the distribution by the M Company to its stockholders of 1/33x dollars in cash and — of a share of stock in the Q Company for each share of stock held is taxable as a dividend to the extent that the M Company had earnings and profits accumulated after February 28, 1913. The balance goes to reduce the basis of the stock in the hands of the stockholder, and, if in excess of such basis, the excess (except that part which represents earnings or profits accumulated, or increase in value of property accrued, before March 1, 1913) is taxable in the same manner as gain from the sale or exchange of property, at normal and surtax rates, or, at the option of the taxpayer (if the stock with respect to which the distribution is made was held for more than two years), as capital gain under section 208. Since the actual transfer of the properties to the S Company took place after the distribution by the M Company of the 1/33x dollars in cash and the — of a share of stock in the Q Company, it constituted a transfer of substantially all the assets of one corporation to another, and, therefore, constituted a reorganization within the meaning of section 203(h)1(A) of the Revenue Act of 1926. The distribution of the S Company stock received by the M Company in exchange for its properties is not taxable to the stockholders of the M Company (section 203(c) of the Revenue Act of 1926). However, the bases of the M Company stock and S Company stock in the hands of the stockholders, for the purpose of determining gain or loss from subsequent sale or other disposition, are to be determined by distributing the basis of the M Company stock, resulting after the first distribution, proportionately between the M Company and the S Company shares.

A. W. Gregg,
General Counsel, Bureau of Internal Revenue.

SECTION 204.—BASIS FOR DETERMINING GAIN OR LOSS, DEPLETION, AND DEPRECIATION.

ARTICLE 1594: Property acquired by gift or transfer in trust on or before December 31, 1920, or by bequest, devise, or inheritance.

REVENUE ACT OF 1926.

Depreciation adjustment on sale of property devised to a trustee for the benefit of a life beneficiary with remainder to another person. (See G. C. M. 1597, page 71.)

ARTICLE 1599: Stock or securities distributed in reorganization. VI–5–3064 I. T. 2335

REVENUE ACT OF 1926.

Where in a reorganization a stockholder receives in exchange for common stock in a corporation a party to a reorganization similar stock and other classes of stock in another corporation a party to the reorganization, he should allocate the cost of the common stock surrendered between the different classes of stock received in exchange in the proportion of the fair market values of such different classes of stock at the date of the exchange.

Request is made for information as to the proper basis to be assigned to each class of securities received by A in certain transactions. The transactions fall within the class of exchanges of stock and securities for other stock and securities in a reorganization in which no gain or loss is recognized under section 203(b)2 of the Revenue Act of 1926.

It is to be noted that there is no provision in Regulations 69 interpreting the Revenue Act of 1926 which corresponds to article 1567 of Regulations 62 interpreting the Revenue Act of 1921, which reads in part:

* * * the proportion of the original cost, or other basis, to be allocated to each class of new securities is that proportion which the market value of the particular class bears to the market value of all securities received on the date of the exchange. * * *

In the opinion of this office the provision of article 1567 of Regulations 62, quoted above, lays down a principle which is equally applicable to reorganizations under the Revenue Act of 1926. (See article 1599, Regulations 69.)

In the event of the subsequent sale of stock received in a reorganization and the reporting of gain or loss therefrom, the taxpayer should file with his return a statement showing the basis (computed in accordance with the principle referred to) used for the determination of the gain or loss, together with any evidence he may have to support such basis.

ARTICLE 1602: Basis for allowance of depletion and depreciation. VI–1–3028 I. T. 2327

REVENUE ACT OF 1926.

The allowance for depletion provided by section 204(c)2 of the Revenue Act of 1926 in the case of oil and gas wells constitutes an allowable deduction under the Revenue Act of 1926 notwithstanding there is no depletable capital sum based upon cost.

Inquiry is made as to whether a taxpayer is entitled to depletion allowance computed in accordance with the provisions of section 204(c)2 of the Revenue Act of 1926 regardless of the fact that he has no depletable capital sum based upon cost.

Paragraph (2) of subdivision (c) of section 204, Revenue Act of 1926, reads as follows:

> In the case of oil and gas wells the allowance for depletion shall be 27½ per centum of the gross income from the property during the taxable year. Such allowance shall not exceed 50 per centum of the net income of the taxpayer (computed without allowance for depletion) from the property, except that in no case shall the depletion allowance be less than it would be if computed without reference to this paragraph.

It is the opinion of this office that the provisions quoted clearly provide for a depletion allowance which may be taken as a deduction in computing net income under the Revenue Act of 1926 notwithstanding that the taxpayer has no depletable capital sum based upon cost.

ARTICLE 1602: Basis for allowance of depletion and depreciation. VI–4–3056 G. C. M. 1023

REVENUE ACT OF 1926.

> Income arising from the sale of oil and gas property or any interest therein may not be taken into consideration in computing the allowance for depletion under section 204(c)2 of the Revenue Act of 1926.

An opinion is requested as to whether the M Company in computing its depletion allowance for 1926, under the provisions of section 204(c)2 of the Revenue Act of 1926, will be entitled to include in the gross and/or net income from the property, as those terms are used in the statute, the income resulting from the sale in 1926 of the royalty interest on account of which depletion is claimed.

It appears that subsequent to February 28, 1913, the M Company acquired certain lands for their value as farming lands, no part of the original purchase price having been paid with the knowledge that the land contained oil or gas. In 1922 an oil and gas lease covering the lands referred to was executed, the M Company retaining a one-eighth royalty interest in the oil and gas produced. During the year 1926, after oil had been produced for about two years, the M Company sold its one-eighth royalty interest to the lessee.

The question presented is whether the income arising from the sale of the royalty interest may be taken into consideration in computing the depletion allowance under section 204(c)2 of the Revenue Act of 1926.

Under the provisions of sections 214(a)9 and 234(a)8 of the Revenue Act of 1926, taxpayers, in the case of oil and gas wells and other natural deposits, are allowed as a deduction a reasonable allowance for depletion and for depreciation of improvements, according to the peculiar conditions in each case. In the case of leases, the deduction must be equitably apportioned between the lessor and the lessee.

Section 204(c) provides that the basis for depletion, exhaustion, wear and tear, and obsolescence shall be the same as is provided in subdivision (a) or (b) of such section for the purpose of determining the gain or loss upon the sale or other disposition of property, except

in the case of mines discovered by the taxpayer after February 28, 1913, and except that in the case of oil and gas wells the allowance for depletion shall be 27½ per cent of the gross income from the property during the taxable year, such allowance not to exceed 50 per cent of the net income of the taxpayer (computed without allowance for depletion) from the property, and in no case to be less than it would be if computed without reference to paragraph (2) of section 204(c).

Under the facts above stated, the M Company's depletion allowance under the Revenue Act of 1926 will be 27½ per cent of the gross income from its royalty interest during the taxable year prior to its sale but not in excess of 50 per cent of the net income from the royalty interest (computed without allowance for depletion). The words "gross income from the property during the taxable year" and "net income of the taxpayer (computed without allowance for depletion) from the property," as used in section 204(c)2, have reference to the gross income and net income derived from the royalty interest on account of the oil and gas produced from the leased property. Income arising from the sale of the oil and gas property or any interest therein may not be taken into consideration in computing the allowance for depletion under section 204(c)2.

A. W. GREGG,
General Counsel, Bureau of Internal Revenue.

ARTICLE 1602: Basis for allowance of depletion and depreciation. VI–19–3221 I. T. 2350

REVENUE ACT OF 1926.

Taxpayers are entitled to an allowance for depletion in the case of oil and gas wells under section 204(c)2 of the Revenue Act of 1926, regardless of whether there is a depletable capital sum based upon cost or March 1, 1913, value. Accordingly, an allowance for depletion based upon the income from the property during the taxable year as provided by such section constitutes a proper deduction, even though no entry thereof is made and no amount is charged off on the taxpayer's books.

SECTION 209.—EARNED INCOME.

ARTICLE 1661: Earned income. (Also Section 221, Article 361.) VI–5–3065 Mim. 3506

REVENUE ACT OF 1926.

Credit for earned income can not be extended by withholding agents.

TREASURY DEPARTMENT,
OFFICE OF COMMISSIONER OF INTERNAL REVENUE,
Washington, D. C., January 18, 1927.

To Collectors of Internal Revenue and Others Concerned:

A nonresident alien is required to file an individual return, Form 1040–B, in order to obtain the benefit of the earned-income credit provided under section 209 of the Revenue Act of 1926.

It, therefore, follows that a withholding agent can not extend the benefit of such credit to a recipient of income from which tax is

withheld in determining the amount of tax to be reported and paid on withholding return, Form 1042.

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

D. H. BLAIR, *Commissioner.*

ARTICLE 1661: Earned income.

REVENUE ACT OF 1926.

Application of earned income limitation to income exempt from tax under section 213(b). (See G. C. M. 1405, page 58.)

ARTICLE 1662: Definitions and limitations. VI-1-3029
I. T. 2328

REVENUE ACTS OF 1924 AND 1926.

Interest and dividends on securities received by a taxpayer in the course of his business of buying and selling securities constitute a part of the profits derived from the conduct of a business in which both personal services and capital are material income producing factors, and in the computation of earned income may be included as a part of such profits in applying the 20 per cent limitation provided for in section 209(a)1 of the Revenue Acts of 1924 and 1926.

PART II.—INDIVIDUALS.

SECTION 212.—NET INCOME OF INDIVIDUALS DEFINED.

ARTICLE 22: Computation of net income. VI-5-3066
I. T. 2336

REVENUE ACT OF 1926.

The following rates of exchange are accepted by the Bureau of Internal Revenue as the current market rates of exchange prevailing as of December 31, 1926:

Country or city.	Monetary unit.	Value in terms of United States money.	Country or city.	Monetary unit.	Value in terms of United States money.
Austria	Schilling	$0.1409	Spain	Peseta	$0.1528
Belgium	Belga	.1392	Sweden	Krona	.2673
Bulgaria	Lev	.007235	Switzerland	Franc	.1933
Czechoslovakia	Krone	.029622	Yugoslavia	Dinar	.017645
Denmark	Krone	.2668	Hongkong	Dollar	.4776
England	Pound	4.8533	China	Shanghai tael	.5926
Finland	Markka	.025208	China	Mexican dollar	.4378
France	Franc	.0395	India	Rupee	.3639
Germany	Reichsmark	.2379	Japan	Yen	.4893
Greece	Drachma	.012562	Singapore	Dollar	.5596
Hungary	Pengo	.1756	Canada	Dollar	.998779
Italy	Lira	.0449	Cuba	Peso	.999125
Netherlands	Guilder	.4002	Mexico	Peso	.466333
Norway	Krone	.2626	Argentina	Peso (gold)	.9395
Poland	Zloty	.1128	Brazil	Milreis	.1178
Portugal	Escudo	.0511	Chile	Peso	.1203
Rumania	Leu	.005271	Uruguay	Peso	1.022

ARTICLE 23: Bases of computation.
(Also Section 213(a), Article 42.)

VI-4-3057
G. C. M. 1162

REVENUE ACT OF 1926.

The gain from a sale of personal property on unusual and incidental terms of credit by a dealer not regularly engaged in selling personal property on the installment plan and in the regular course of its trade or business should be computed in accordance with the taxpayer's regular accounting method and without reference to section 212(d) of the Revenue Act of 1926.

An opinion is requested as to the propriety of permitting the taxpayer to return as income upon the installment basis gains resulting from a certain sale made in ——, 1919.

In 1919 the taxpayer was a —— corporation having its principal place of business in —— City and regularly engaged in the business of selling at wholesale and retail precious stones, including pearls. Its gross sales for that year amounted to $130x$ dollars. Among those sales, 30-day credit transactions predominated. The bulk of the remaining sales, all except the one transaction here in question, consisted of cash sales or sales made on two, four, six, or eight months' credit.

On August —, 1919, the taxpayer sold to A y pearls at an agreed price of $15x$ dollars. The price agreed upon was productive of a profit to the taxpayer of $6x$ dollars. To the selling price was added a 5 per cent war tax. At the time of the sale the taxpayer received from A the amount of the war tax together with a payment of $1.5x$ dollars to be applied against the selling price. A executed a note for the balance, $13.5x$ dollars, payable in one year. It was agreed collaterally, however, that this note should be retained by the taxpayer only as evidence of the balance due and that it should not be collected in accordance with its terms, discounted, or hypothecated. A was expected to make such payments on the account as should meet his convenience, but not less than $2.5x$ dollars each year. Whenever a payment was made, the old note was surrendered or destroyed and a new one was executed in the amount of the remaining balance. Payments subsequent to the purchase were made by A as follows:

	Dollars.
1920—December	x
1921—January	2 x
May	2.5x
1922—January	1.5x
July	x
September	x
October	x
1923—	1.5x

The taxpayer regularly kept its books and filed its income tax returns in accordance with the accrual method. It now contends, however, that it should be permitted to file amended returns, including as a part of 1919 income only that proportion of the gain ultimately to be realized on the transaction with A which the 1919 payment bears to the total selling price.

The Revenue Act of 1926 provides:

SEC. 212. (d) Under regulations prescribed by the Commissioner with the approval of the Secretary, a person who regularly sells or otherwise disposes of personal property on the installment plan may return as income therefrom

in any taxable year that proportion of the installment payments actually received in that year which the total profit realized or to be realized when the payment is completed, bears to the total contract price. In the case (1) of a casual sale or other casual disposition of personal property for a price exceeding $1,000, or (2) of a sale or other disposition of real property, if in either case the initial payments do not exceed one-fourth of the purchase price, the income may, under regulations prescribed by the Commissioner with the approval of the Secretary, be returned on the basis and in the manner above prescribed in this subdivision. As used in this subdivision the term "initial payments" means the payments received in cash or property other than evidences of indebtedness of the purchaser during the taxable period in which the sale or other disposition is made.

SEC. 1208. The provisions of subdivision (d) of section 212 shall be retroactively applied in computing income under the provisions of the Revenue Act of 1916, the Revenue Act of 1917, the Revenue Act of 1918, the Revenue Act of 1921, or the Revenue Act of 1924, or any of such Acts as amended. Any tax that has been paid under such Acts prior to the enactment of this Act, if in excess of the tax imposed by such Acts as retroactively modified by this section, shall, subject to the statutory period of limitations properly applicable thereto, be credited or refunded to the taxpayer as provided in section 284.

In authorizing retroactively the return of income computed upon the installment basis, Congress saw fit to distinguish between real and personal property transactions. It further distinguished between personal property transactions entered into by a dealer regularly selling on the installment plan and those constituting merely casual sales. The right with respect to each classification is subjected to certain express conditions or limitations not necessarily common to the other classifications.

To fall within the first group of personal property transactions affected by section 212(d), two conditions must prevail: (1) The taxpayer must be regularly engaged in selling on the installment plan; (2) the gain involved must have been derived from an installment sale. The second group of personal property transactions designated is characterized by three limitations: (1) The transaction productive of the gain in question must constitute a casual sale or other casual disposition; (2) the consideration involved must be $1,000 or more; (3) the initial payment received from the purchaser must not exceed 25 per cent of the selling price. A single condition only is imposed with respect to real property transactions: The initial payment received from the purchaser on the transaction in question must not exceed 25 per cent of the selling price.

This taxpayer seeks to bring the sale to A within the second group of personal property transactions. The selling price involved greatly exceeds $1,000 and the payment received within the year of the sale was far short of 25 per cent of the selling price. The sole question remaining is, Was the transaction with A a casual sale?

The Massachusetts workmen's compensation act employs the word "casual" in a sense fairly analogous to that in which it is employed in the Revenue Act. The Massachusetts act excepts from the benefits thereof the employee "whose employment is but casual." In *Gaynor v. Standard Accident Insurance Co.* (217 Mass., 86; 104 N. E., 339; L. R. A. 1916A, 363), the court said:

> The word "casual" is in common use. Its ordinary signification, as shown by the lexicographers, is something which comes without regularity, and is occasional and incidental. Its meaning may be more clearly understood by referring to its antonyms, which are "regular," "systematic," "periodic," and "certain."

This case involves a regular dealer in precious stones. A sale of pearls was not without regularity in its case. It was not a transaction occasional or incidental to its activities. The sale here in question was one entered into in the regular course of business and may be distinguished from all other sales made in that business only by a variation in or the departure from the terms of credit usually extended to purchasers.

It is argued on behalf of the taxpayer that the so-called installment method of computing gains should apply here because the sale to A was an installment sale in fact and because it was based upon irregular, unusual, and incidental terms of credit. In this connection it should be observed that the installment characteristic is a factor to be considered only in the case of a dealer regularly engaged in making installment sales. Whether or not the personal property sold is to be paid for in installments is a feature of no consequence in connection with transactions falling within the second group as designated above. Neither can that characteristic be substituted as a condition in lieu of those designated by Congress. Moreover, the word "casual," as used in the Act, is descriptive of the words "sale" and "disposition," and not of the terms or conditions upon which a sale or disposition may be made. The Act is not concerned with the irregular or unusual credit extended in the sale.

An interpretation which would regard as a casual sale each and every $1,000 transaction involving a credit of 75 per cent or more extended into subsequent taxable years would in effect eliminate from the statute the third condition imposed with reference to the second group of personal property transactions. That is a construction of the Act which this office believes to be unwarranted. The incidental personal property transaction must be distinguished from personal property sales made in the usual course of business. The two types are recognized in the same section of the statute and each is subjected to its own peculiar limitations. Congress was deliberately precise in drawing the line and the casual characteristic of sales falling within the second group can not be ignored.

As section 212(d) was proposed by the Senate it read:

> In the case (1) of a *casual* sale or other disposition of personal property for a price exceeding $1,000, or (2) of a sale or other disposition of real property * * *.

In conference, and in the interest of clearness and certainty, this language was modified to read:

> In the case (1) of a *casual* sale or other *casual* disposition of personal property for a price exceeding $1,000, or (2) of a sale or other disposition of real property * * *.

At page 32 the conference report characterized the amendment as operative "in the case of *casual* sales of personal property or of the sale or other *casual disposition of real property*." It would appear that the "casual" feature was never considered as a material factor in connection with real property transactions, and that the conference report was obviously in error, and this fact was noted by Mr. Green on the floor of the House when he said:

> While I have the floor I want to call the attention of the House to an error or misprint in the statement of the conferees. On page 32 thereof, in the next to the last line, the word "casual," before the words "disposition of real property," should be stricken out. (Congressional Record, page 4148.)

In construing the language of the statute here involved, this office has as a guide an express interpretation by the Congress itself of this exact language employed in another connection.

Certain expenditures incurred by one regularly engaged in carrying on a real estate trade or business enter into the computation of such dealer's net income. The case of a taxpayer not a regular dealer in real estate was presented for consideration. At page 34 of the conference report, the problem faced was summarized:

> It is claimed that occasionally real property is sold under contracts by others than dealers in such property which require the vendor to put in water system, sewers, streets, and to make other expenditures which can not be determined at the time of sale, and that unless such a vendor is allowed to take a deduction for such expenditure against the gain from the sale, he may not have sufficient income in future years to write such expenditures off against.

For the purpose of characterizing the transaction entered into by the occasional vendors of real estate, those "other than dealers in such property," for whose benefit alone the new provision was embodied in the Act, this expression is resorted to:

> In the case of a casual sale or other casual disposition of real property * * *. (Sec. 214(a)11.)

As the expression "casual sale or other casual disposition of real property" was employed for the purpose of distinguishing between the isolated real property transaction entered into by a vendor not regularly engaged in that business and sales of real estate made by dealers therein, it is probable that the corresponding expression "casual sale or other casual disposition of personal property" was intended by Congress to serve no other or different purpose than to designate personal property transactions other than those entered into by regular dealers in the commodity.

In making the so-called installment method of computing income available to the dealer upon certain conditions and to the casual vendor upon certain others, Congress has in a measure maintained the more or less familiar distinction between transactions entered into in the usual course of a trade or business and the isolated or casual deal, a distinction which has appeared in various phases throughout the several Revenue Acts, as will be noted by reference to the net loss provisions, the provisions authorizing deductions in computing net income, the provisions relating to the gains subject to the 1917 excess profits tax, the capital gain provisions, and others. The Bureau is not at liberty to disregard that distinction.

Inasmuch as this taxpayer was not regularly engaged in selling personal property on the installment plan, and inasmuch as the personal property transaction here involved was one made by a regular dealer in the commodity and in the usual course of its trade or business, this office is of the opinion that the gain resulting from the transaction should be computed in accordance with the taxpayer's regular accounting method and without reference to section 212(d) of the Revenue Act of 1926.

A. W. GREGG,
General Counsel, Bureau of Internal Revenue.

ARTICLE 23: Bases of computation.

REVENUE ACT OF 1926.

Accrual of State, county, and municipal taxes. (See G. C. M. 1240, page 65.)

ARTICLE 23: Bases of computation. VI–13–3172
T. D. 4001

INCOME TAX.

Article 23 of Regulations 69 amended.

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

To Collectors of Internal Revenue and Others Concerned:

Article 23 of Regulations 69 is hereby amended by the addition thereto of a new closing paragraph to read as follows:

The foregoing requirements relative to a change of accounting method are also applicable where a taxpayer desires to change from the installment basis of returning income, as provided in article 42, to a straight accrual basis. In cases where permission to make such change is granted, the taxpayer will be required to return as additional income for the taxable year in which the change is made all the profit not theretofore returned as income pertaining to the payments due on installment sales contracts as of the close of the preceding taxable year.

D. H. BLAIR,
Commissioner of Internal Revenue.

Approved March 21, 1927.

A. W. MELLON,
Secretary of the Treasury.

SECTION 213(a).—GROSS INCOME DEFINED: INCLUSIONS.

ARTICLE 31: What included in gross income. VI–9–3122
G. C. M. 1030

REVENUE ACT OF 1926.

Where income of a husband and wife, domiciled in Washington or Arizona, was produced both by separate property and the community, and both were essential factors in producing the income, the income should, if possible, be segregated between them in the proportion which each in fact contributed to the success of the enterprise. A general method which may often be applied in such cases is the segregation of the income between the investment of the separate property and the community in the proportion which a fair return on such investment bears to the fair value of the personal services rendered by the spouses.

Where it appears that income is essentially attributable either to the separate property or to the community, the entire income should be taxed as separate income if essentially attributable to the separate property; otherwise as community income.

An opinion is requested as to the correct rule for determining net income of spouses domiciled in Washington or Arizona in cases where one or both of the spouses invest separate property in a business carried on by one or both of them after marriage.

A similar case arising under the laws of Arizona was considered in Solicitor's Memorandum 3883 (C. B. IV–2, 125). The conclusion reached in that memorandum is as follows:

> This office is of the opinion that the profits derived from the business are separable—the husband being entitled as his separate property to the usual interest upon an investment well secured. As the remaining profits are considered as being the result of the husband's services, they constitute community property.

The question arises as to what, if any, method should be applied when the application of the rule just stated obviously results in the attributing of a disproportionate amount of the income to either the investment of separate property or the personal services of the spouses. A general method which may often be applied in such cases is the segregation of the income between the investment of the separate property and the community in the proportion which a fair return on such investment bears to the fair value of the personal services rendered by the spouses.

In cases where the income from the services of a spouse has been intertwined with income from the separate estate, the Supreme Court of the State of Washington has laid down several rules which should be observed in making such segregation. In all the cases hereinafter cited the courts recognized the fundamental rule of community estates, that the services of each spouse belong to the community.

In the case of *Jacobs* v. *Hoitt* (119 Wash., 283, 205 Pac., 414) the facts were that the husband, just prior to his marriage, borrowed about $8,000 from his mother to go into the baking business. This business was very profitable and to it both the husband and the wife gave their services. The court held that so much of the earnings as was used to repay his mother was separate property and the remainder was community property. In this connection the court said:

> * * * In the case before us, although the exact ratio between the return from the separate property investment and the return from the community efforts is not subject to mathematical determination, yet we are satisfied that at least the amount which we have found was used in paying off the separate indebtedness was the earning from the separate property, and the division between the separate and community nature of the present business is subject to what appears to us a mathematical determination.

The court further held with respect to certain money in the bank that it was impossible to segregate that deposit between separate and community property and therefore the whole was community property.

In re Carmack's estate (133 Wash., 374, 233 Pac., 942), the court went deep into the evidence in order to segregate the community estate from the separate estate of the husband. With respect to a certain piece of property, where it was stated that the naked lot had been deeded by the husband to the wife and that improvements had been erected by the use of community property and the separate property of the husband, the court said:

> * * * This situation would unquestionably give the community a large interest in, but not the entire ownership of, the property, because there can be a segregation of the community interest from the separate interest of Mrs. Carmack. The bare lot was hers, the improvements thereon belonged to the community.

In the case of Buchanan estate (89 Wash., 172, 154 Pac., 129), the facts were that Buchanan and his wife had started business with the

very small capital of $900, $400 of which was contributed by the husband and $500 by the wife. The married life of the husband and wife continued approximately 10 years and the value of the business increased over twentyfold. In this case the court quoted with approval from *Lake* v. *Lake* (18 Nev., 361, 4 Pac., 711), from which the following excerpt is made:

> And in this or any other case, if profits come mainly from the property, rather than the joint efforts of the husband and wife, or either of them, they belong to the owner of the property, although the labor and skill of one or both may have been given to the business. On the contrary, if profits come mainly from the efforts or skill of one or both, they belong to the community.

Applying the rule in *Lake* v. *Lake*, the court held that the whole of the estate was, at the death of the wife, community property.

In the case of Brown's estate (124 Wash., 273, 214 Pac., 10) the court considered a case in which at the time of marriage the husband had a separate estate worth about $70,000. This he invested in an investment corporation which he managed and through this corporation he accumulated a much larger estate. The court held that all of the accumulations were the separate estate of the husband. In that case the court laid down five rules which, omitting citations, among which is the Hoitt case, read as follows:

> 1. The presumption is that property acquired during coverture is community property. * * * And the burden is upon the person claiming it to be separate property to establish that as its character.
> 2. The status of property is to be determined as of the date of its acquisition. * * * This rule is equally true with regard to personal property as with real property. * * *
> 3. If property is once shown to have been separate property, the presumption continues that it is separate until overcome by evidence. * * * Separate property continues to be separate through all its changes and transitions, so long as it can be clearly traced and identified. * * *
> 4. The rents, issues, and profits of separate property remain separate property and profits resulting from money borrowed on separate credit are separate property. * * *
> 5. Separate property may lose its identity as such by being consolidated with community property. * * *

See appeal of Julius and Rebecca B. Shafer (2 B. T. A., 640).

From what has been stated the following rules may be drawn:

1. Where income from the business was produced both by separate property and the community, and both were essential factors in producing the income, the income should, if possible, be segregated between them in the proportion which each in fact contributed to the success of the enterprise. A general method which may often be applied in such cases is the segregation of the income between the investment of the separate property and the community in the proportion which a fair return on such investment bears to the fair value of the personal services rendered by the spouses.

2. Where it appears that income is essentially attributable either to the separate property or to the community, the entire income should be taxed as separate income if essentially attributable to the separate property; otherwise as community income.

A. W. GREGG,
General Counsel, Bureau of Internal Revenue.

ARTICLE 31: What included in gross income. VI-17-3206
G. C. M. 1451

REVENUE ACT OF 1926.

The M Company issues and sells "convertible certificates of ownership in municipal bonds." Coupons attached to the certificates entitle the holder to receive semiannually a specified amount from the avails of municipal bonds on deposit with a trustee according to the terms of such trust and the M Company covenants that such amount will be paid. The holder of an unmatured certificate can exercise no rights of ownership over the bonds held by the trustee and has no right in them except as security for the fulfillment by the M Company of its covenants. The rights of ownership are in the M Company.

The certificates issued by the M Company represent an obligation of the M Company and the interest received by a holder thereof is not exempt from Federal income tax.

The opinion of this office is requested as to whether interest on the "convertible certificates of ownership in municipal bonds" issued by the M Company is taxable income.

The contentions of the M Company are that upon the issuance by it of convertible certificates of ownership a sale of municipal improvement bonds to the certificate holder has been effected; that the covenants made by the M Company (hereinafter called the corporation) are in the nature of guaranties and not original obligations; and that the O Company (hereinafter called the trustee) is the mere conduit through which income from nontaxable securities is paid to the certificate holders who are the owners of the bonds held in trust.

There was filed a copy of one of such certificates, the material part of which reads as follows:

For value received, M Company, a corporation (hereinafter referred to as the "corporation"), does hereby sell and transfer to the purchaser of this certificate all of its right, title, and interest in municipal improvement bonds issued under special assessment laws of the State of R (hereinafter referred to as "bonds"), of the aggregate unpaid face value of $1,000, and said corporation hereby certifies that said bonds with other like bonds are now deposited with the O Company, a corporation (hereinafter referred to as the "trustee"), as trustee, to hold the same under a certain trust agreement, dated the — day of ——, 192—, and that the bearer hereof, or if this certificate be registered, the registered holder hereof, is entitled to participate in the proceeds and avails of such bonds, so deposited, to the extent of the principal sum of $1,000 payable from such proceeds and avails on the — day of ——, 193—, with interest on said sum from the date hereof at the rate of 6 per cent per annum, payable semiannually on the 1st days of January and July in each year * * *; or the bearer hereof, or such registered owner, is entitled at any time upon demand and the surrender of this certificate, together with its unmatured coupons, to said trustee, to receive bonds of unpaid face value equal to the principal sum herein mentioned, the accrued interest to be adjusted as of date of delivery on both this certificate and the bonds so delivered.

* * * * * * *

By the acceptance of this certificate, the bearer or registered owner hereof releases and waives all interest or other sums collected by said trustee upon such bonds in excess of the principal sum herein mentioned and interest thereon at the rate herein specified, and does hereby agree to all the terms of said trust agreement, which is hereby made a part hereof the same as though incorporated herein.

The corporation, for the purpose of better securing the distribution of the proceeds and avails of such bonds, has deposited with said trustee bonds of the aggregate unpaid face value equal to 110 per cent of the principal sum herein stated. The corporation hereby covenants that such percentage shall be

maintained and that the principal and interest to become due upon said bonds, when and as the same matures, will be paid. Such covenant to continue as long as such bonds remain on deposit with said trustee.

The date of the above certificate is July 1, 192—.

The coupons attached to this certificate each entitle the holder to receive $30 from the avails of bonds on deposit with the trustee according to the terms of such trust and the M Company covenants that such amount will be paid. These coupons are payable on the 1st of July and on the 1st of January.

A copy of another certificate which was filed is dated May 15, and the interest is payable semiannually on the 15th day of May and November of each year.

The trust agreement referred to in the certificate makes no provision as to the date under which certificates may be issued. That agreement states that the interest on the municipal improvement bonds is payable on the 2d days of January and July of each year. It will thus be seen that the dates of maturity of interest on the certificates bear no relation to the date of maturity of interest on the bonds.

In the certificate the holder releases "all interest or other sums collected by said trustee upon such bonds in excess of the principal sum herein mentioned and the interest thereon at the rate herein specified. * * *" He also agrees to abide by all of the terms of the trust agreement.

The bonds referred to in the certificate are municipal bonds, which, it is stated, generally bear interest at the rate of 7 per cent and mature in installments. The trust agreement provides that the corporation shall deposit with the trustee bonds in unpaid face value equal to 110 per cent of the par value of outstanding certificates, such bonds to bear interest at a rate not less than the rate mentioned in the certificate. The trust agreement also contains the following proviso:

> * * * provided, however, that the corporation may substitute a larger amount of bonds bearing a lower rate of interest in place of part or all of such bonds hereinabove required to be deposited, on condition that the amount of annual interest due on such bonds so deposited or substituted shall, in the aggregate, equal or exceed the aggregate amount of annual interest mentioned in such certificates.

The material question is whether the municipal improvement bonds in the hands of the trustee are the property of the corporation or of the certificate holders—that is, whether the certificate holders receive part of the interest from the bonds as owners thereof or from bonds belonging to the corporation as interest on its obligations.

The certificates recite an absolute sale but qualify this by making the trust agreement a part of the certificates to the same extent as though incorporated therein. The provisions of the trust agreement which is thus made a part of the certificates are inconsistent with the theory that the bonds are sold and title conveyed to the certificate holders. The ultimate purpose and effect of the transaction must be determined from an analysis of the provisions of the certificates and trust agreement read as a whole, regardless of the name by which the transaction may be labeled by the parties. In *Heryford* v. *Davis* (102 U. S., 235) the court said:

> What, then, is the true construction of the contract? The answer to this question is not to be found in any name which the parties may have given to the

instrument, and not alone in any particular provisions it contains, disconnected from all others, but in the ruling intention of the parties, gathered from all the language they have used. It is the legal effect of the whole which is to be sought for. The form of the instrument is of little account.

Though the contract industriously and repeatedly spoke of loaning the cars to the railroad company *for hire*, for four months, and delivering them for use *for hire*, it is manifest that no mere bailment for hire was intended.

The holder of an unmatured certificate can exercise no rights of ownership over the bonds held by the trustee and has no right in them except as security for the fulfillment by the corporation of its covenants. On the other hand, the corporation may at any time, while not in default on its obligation, withdraw any or all the bonds in the trust, provided it substitutes others of equal value in amount and interest. Thus, subject to the obligation to maintain bonds sufficient to comply with the trust agreement, the corporation has every right of ownership. It has even greater property rights than an ordinary pledgor.

Whenever certificates or coupons fall due, the corporation merely advances sufficient money to pay the obligation and withdraws the bonds it has pledged with the trustee.

Although a certificate recites a sale, it provides that upon its maturity the holder is to receive money from the avails of the bonds. It is true that it gives the holder the right at any time before maturity to surrender the certificate and receive bonds. It is also true that the trust agreement provides that nothing therein shall preclude the holder at maturity from taking bonds in lieu of cash. But the certificate holder in neither case can acquire bonds until he so elects. In other words, he possesses an option, and an unexercised option does not confer ownership. (*Western Union Telegraph Co.* v. *Brown*, 253 U. S., 101.)

It appears that the bonds mature in installments and at different times, and thus possess as tax exempt securities different market values. The corporation has the right to substitute bonds bearing different and lower rates of interest. The mass of bonds held by the trustee is not, therefore, composed, nor intended by the parties to be composed, of bonds of the same character or of the same value. The case is clearly distinguishable from those cases where there is a sale from a mass of fungible goods, such as grain, oil, or wine.

But if a certificate holder does exercise his option to take bonds, something is to be done before he can receive them. He is not entitled to any one or more of the bonds, but to only such as the trustee may select. The trust agreement provides that "the trustee shall select from the bonds on deposit with said trustee such bonds as *it may deem expedient*, either as to *maturity* or as to *security*, of the unpaid face value equal in amount *as near as possible* to the par value of said certificates surrendered." [Italics supplied.] It also provides for the payment of cash to make up whatever difference may exist.

It is to be noted further that a certificate holder received only 6 per cent, it matters not what may be the rate paid on the bonds, and that he receives no gain upon the sale of the bonds. This gain belongs to the corporation.

From the above it seems clear that it was in fact the intention of the parties that no title to the bonds, or any of them, legal or equitable, should vest in the certificate holder by virtue of the issuance

of the certificate. With respect to the bonds deposited with the trustee, the certificate holder acquired merely a lien securing to him the payment of the principal sum covered by the certificate and interest, together with the right at his election to exchange his certificate for bonds to be selected by the trustee. This was the intention of the parties and this was the legal effect of their transaction. The obligation of the certificate is the obligation of the corporation. If that certificate is retained by the holder and not surrendered in exchange for bonds, the full amount of the obligation, principal and interest, will be retired upon maturity by funds produced by the corporation. Such is the obligation of the corporation, regardless of any increase or decrease in the value of the bonds and regardless of the amount of any proceeds, principal or interest, derived therefrom. The certificate holder retaining his certificate is entitled to the payment in full of the principal sum represented thereby with interest and nothing more. The obligation of the certificate, however it may be disguised, represents an obligation of the corporation. The receipt of any payments made in connection therewith, principal or interest, is not such a receipt as will be tax exempt to the recipient. *Hitner* v. *Lederer*, published as Treasury Decision 3905 (C. B. V-2, 152–154).

It is, therefore, the opinion of this office that interest received by a holder of a convertible certificate of ownership of the M Company is not exempt from Federal income tax.

A. W. Gregg,
General Counsel, Bureau of Internal Revenue.

Article 31: What included in gross income. VI–20–3230
I. T. 2352

REVENUE ACTS OF 1921, 1924, AND 1926.

Where, under the laws of California, there was an oral agreement between a husband and wife that their earnings should constitute their separate property and they have given effect to their intention by depositing their earnings in separate bank accounts, each retaining the control over his or her own earnings, the wife's earnings constitute her separate income and may be reported by her in her separate income tax returns. In the absence of other evidence that the parents have relinquished their parental authority over a minor child under the laws of California, an oral agreement that his earnings shall not be appropriated by them is not sufficient to create an emancipation, and his earnings are community income to be reported by the husband and wife in their joint returns, or, if separate returns are filed, then in the separate return of the husband.

Inquiry is made relative to the income tax liability of A, his wife, B, and their minor son, C, for the years 1923, 1924, and 1925.

It is stated that each of the three taxpayers was gainfully employed during the years in question, and that there was an oral agreement between the husband and wife that the earnings of each should be and constitute his or her separate property and that the earnings of C should be and constitute his separate property. To give effect to this agreement, separate bank accounts were established by A and B and have been maintained since the agreement was made. According to the affidavit of one of the officers of the M Bank, there is also a bank account maintained under the caption

"B for C." It is stated that a letter specifying that all of the earnings of C should constitute a trust fund for his benefit was kept in a safe deposit box. It has since developed that there is no such letter in existence and that there was merely an oral agreement between A and B to the effect that C's earnings should not be appropriated by them but should be used and invested for his benefit.

In view of these facts, inquiry is made whether three separate returns may be filed for each taxable year. In this connection reference is made to sections 158 and 211 of the Civil Code of California.

Section 158 of the civil code to which reference is made provides that either husband or wife may enter into any engagement or transaction with the other respecting property which either might if unmarried. It has been held by the United States Supreme Court in the case of *United States* v. *Robbins* (269 U. S., 315) that in the case of a husband and wife domiciled in California the husband may be required to report for Federal income tax all the income which, under the laws of California, constitutes community income. This decision did not define what constitutes community income in California and, therefore, the previous rulings of the Bureau to the effect that in the absence of an agreement to the contrary the earnings of the wife constitute community income are controlling. (T. D. 3138, C. B. 4, 238, and O. D. 1128, C. B. 5, 199.) The question, therefore, is whether the oral agreement between A and B converted her earnings from community income to her separate income. That the husband and wife may, by contract, change the character of their income in this manner is recognized by a number of decisions of the Supreme Court of California. (*Title Insurance & Trust Co.* v. *Ingersoll*, 153 Cal., 1, 94 Pac., 94; *Perkins* v. *Sunset Telephone & Telegraph Co.*, 155 Cal., 712, 103 Pac., 190; *Ives* v. *Connacher*, 162 Cal., 174, 121 Pac., 394; In re Klumpke's Estate, 167 Cal., 415, 139 Pac., 1062; *Fay* v. *Fay*, 165 Cal., 469, 132 Pac., 1040; *Kaltschmidt* v. *Weber*, 145 Cal., 596, 79 Pac., 272.) From the decisions in these cases it is apparent that the courts of California do not hesitate to give effect to the intention of the parties where such intention is plainly evidenced even though there may be no written agreement expressing such intentions. In the present case there was an oral agreement between A and B that their earnings should constitute their separate property and they have given effect to their intention by depositing their earnings in separate bank accounts, each retaining the use and control of his or her own earnings. It is held, therefore, that B's earnings constitute her separate income and may be reported by her in her separate income tax returns.

The principal provisions of the civil code relating to the control of the earnings of a minor by his parents are as follows:

SEC. 197. The father and mother of a legitimate unmarried minor child are equally entitled to its custody, services, and earnings. If either the father or mother be dead or unable or refuse to take the custody or has abandoned his or her family, the other is entitled to its custody, services, and earnings.

SEC. 202. The parent, as such, has no control over the property of the child.

SEC. 211. The parent, whether solvent or insolvent, may relinquish to the child the right of controlling him and receiving his earnings. Abandonment by the parent is presumptive evidence of such relinquishment.

SEC. 212. The wages of a minor employed in service may be paid to him, until the parent or guardian entitled thereto gives the employer notice that he claims such wages.

These provisions follow the well-established legal principle that the right of a parent to the child's services and earnings arises out of his duty to support and protect the child, and that if he neglects that duty or surrenders his parental control to a third person he thereby loses his right to the child's services and earnings. In *Wardrobe* v. *Miller* (53 Cal. App., 370, 200 Pac., 77) the Supreme Court of California held that the right of a father to receive the wages of his minor children was reciprocal to his duty to support them, and that after an employer makes a contract with a minor in regard to wages the father may either adopt the contract and claim what is due under it or may repudiate it and claim the reasonable value of the services rendered. It will thus be observed that even if a minor makes his own contract of employment the father will not be precluded from claiming the child's earnings under the contract if he has not emancipated him.

Article 403 of Regulations 62, 65, and 69 provides that if a minor has been emancipated by his parent his earnings are his own income and such earnings regardless of amount are not to be included in the return of the parent, but that in the absence of proof to the contrary, a parent will be assumed to have the legal right to the earnings of the minor and must report them in his return. In the present case there is no evidence of emancipation, unless the establishment of a bank account for the benefit of C may be regarded as such. C's earnings arise from contracts with certain corporations, which are approved by his mother, B. His salary is paid to his mother, and the excess of his salary over his actual living expenses is deposited in a bank account, on which his mother is entitled to draw. He lives in the same house with his parents, although it is claimed that the house belongs to him. There is no evidence that the parents have relinquished their parental authority over him and the oral agreement that his earnings shall not be appropriated by them is not sufficient to create an emancipation. This view is supported by the decision of the Supreme Court of California in the case of *Smith* v. *Smith* (38 Cal. App., 388, 176 Pac., 382), where an action was brought by the plaintiff against his father and mother to recover an amount alleged to have been earned by him during his minority and turned over to his parents under an agreement that they would invest his earnings and return the principal and increment to him at his majority. The court held that inasmuch as the son was not emancipated at any time during his minority, the parents were entitled to his services and earnings during the entire period and that the alleged agreement was ineffectual.

In view of the foregoing, it is held that C's earnings constitute taxable income to his parents. It is then necessary to consider whether the earnings represent community income which, under the decision of the United States Supreme Court in the case of the *United States* v. *Robbins*, will be taxable to the husband or whether one-half of his earnings constitutes the separate income of the husband and one-half the separate income of the wife. No decision of a California court which is conclusive on this point has been found. In *Garrison* v. *Pearlstein* (68 Cal. App., 334, 229 Pac., 351), however, the Supreme Court of California had occasion to consider whether section 211 of the civil code (above quoted), declaring that parents of an unmarried minor child should be equally entitled to

his custody, services, and earnings, requires that the mother should be a party to an action by the father for losses sustained through injury to the minor child. It was held that the purpose of the statute was to secure to the mother a property right and that there was nothing in it which required the suit to be brought in the name of both the father and mother any more than it was necessary for a husband and wife to be joined when suing for property that was manifestly community property. In view of this decision and of the fact that under the Civil Code of California, in general, all property acquired by the husband and wife after marriage except that acquired by gift, bequest, devise, or descent constitutes community property, it is held that the earnings of C represent community income of his parents. There is no agreement between A and B which may be construed as having the effect of converting the earnings of C from community income into separate income. Therefore, his earnings should be included in the joint returns filed by A and B, or, if separate returns are filed, then in the separate returns of A.

The facts do not disclose whether C has any property from which he receives income (other than property acquired with his earnings which, for reasons previously given, represents community property of A and B) or whether there are any funds held in trust for him by his parents or guardian. If such is the case, however, and if C's net income from such sources is sufficient to require the filing of returns, separate returns disclosing the income from these sources should be filed in his behalf by his father or guardian.

ARTICLE 39: Sale of stock and rights. VI–15–3182
G. C. M. 1394

REVENUE ACT OF 1926.

Stock rights are issued within the meaning of article 39, Regulations 69, on the date when the rights accrue to stockholders of record.

An opinion is requested as to the date when rights to subscribe to stock are to be considered as issued under article 39, Regulations 69, which provides that where a corporation issues to its shareholders the right to subscribe to its stock and a shareholder does not exercise, but sells, his rights to subscribe, the cost or other basis of the stock with respect to which the rights are issued shall be apportioned between the rights and the stock in proportion to the respective values thereof at the time the rights are issued, and the basis for determining gain or loss from the sale of a right on one hand or a share of stock on the other will be the quotient of the cost or other basis assigned to the rights or the stock, divided, as the case may be, by the number of rights issued or by the number of shares held.

Stock rights are a type of security recognized commercially and traded in upon the exchanges. They are property as much as other securities. In the case of *Miles* v. *Safe Deposit Co.* (259 U. S., 247), it was held that such rights are analogous to stock dividends and do not constitute income at the time received but that gain or loss may result from the sale of the rights or the shares obtained through the exercise of such rights. It was further held that not all the amount received from the sale of such rights constitutes income but

that a portion of the cost or basis of the original shares must be attributed to the rights because the rights carry with them a portion of the capital interest that includes the old shares.

The date when such a separation of capital interest resulting in a cost attributable to the stock right occurs is the date when the stock right comes into existence separate and distinct from the shares of stock with respect to which it is issued, which in turn is the date the rights accrue to shareholders of record. Until that date the sale of a share of stock carries with it any right in connection therewith, and there is no diminution in the value of the shares. On that date, however, the rights accrue to and vest in shareholders of record, a portion of the capital interest is separated from the shares and vests in the shareholders individually, and thereafter the sale of a share of stock is "ex-rights." It is on that date that there first arises a cost of the right, thereby constituting a basis for determining gain or loss resulting from the sale of such right. The portion of article 39 referred to lays down the rule for determining such cost or basis and relates to the date when such cost arises.

It is, therefore, the opinion of this office that stock rights are issued within the meaning of article 39, Regulations 69, for the purpose of computing gain or loss arising from the sale of such rights on the date when the rights accrue to stockholders of record.

A. W. GREGG,
General Counsel, Bureau of Internal Revenue.

ARTICLE 39: Sale of stock and rights. VI–23–3259
T. D. 4018

INCOME TAX.

Article 39 of Regulations 69 not to be applied retroactively.

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

To Collectors of Internal Revenue and Others Concerned:

Section 1108(a) of the Revenue Act of 1926 provides that in case a regulation relating to the internal revenue laws is reversed by a subsequent regulation and such reversal is not immediately occasioned or required by a decision of a court of competent jurisdiction, such subsequent regulation may, in the discretion of the Commissioner, with the approval of the Secretary, be applied without retroactive effect. Article 39 of Regulations 69, accordingly, will not be applied retroactively and is applicable only to sales of stock or rights within the terms thereof taking place on or after January 1, 1925, the effective date of the Revenue Act of 1926.

C. R. NASH,
Acting Commissioner of Internal Revenue.

Approved June 2, 1927.

A. W. MELLON,
Secretary of the Treasury.

ARTICLE 42: Sale of personal property on installment plan.

REVENUE ACT OF 1926.

Computation of gain from sale of personal property on unusual and incidental terms of credit by a dealer not regularly engaged in selling personal property on installment plan and in the regular course of its trade or business. (See G. C. M. 1162, page 22.)

ARTICLE 42: Sale of personal property on installment plan.

VI–5–3067
G. C. M. 1123

REVENUE ACTS OF 1916, 1917, 1918, 1921, 1924, AND 1926.

If the books of the taxpayer, whose business consisted in large part of the sale of real property on the installment plan and who reported the income therefrom on the accrual basis, contain adequate information and have been so kept that income can be accurately computed on the installment basis, it may report the income accruing from the sales in question on the installment basis and file amended returns accordingly.

An opinion is requested as to the right of the M Company to file amended returns of income under section 1208 of the Revenue Act of 1926.

It appears from the facts presented that the business of the taxpayer has consisted in large part of the sale of real property on the installment plan, the terms of sale in each case providing for payments during the taxable year in which the sale was made of considerably less than one-fourth of the purchase price, subsequent installments being payable over a period averaging approximately 10 years.

It further appears that from the time of its organization the taxpayer has kept its accounts on the accrual basis, the entire profit applicable to each sale having been reported as income for the year in which the sale was made.

The taxpayer now asks, as to 1920 and subsequent years, whether it is entitled under the pertinent provisions of the Revenue Act of 1926 to set up its books on the installment basis and to adjust its returns accordingly.

Section 212(d) of the Revenue Act of 1926 provides that in the case of a sale or other disposition of real property, if the initial payments do not exceed one-fourth of the purchase price, the income may, under regulations prescribed by the Commissioner with the approval of the Secretary, be returned "on the basis and in the manner above prescribed in this subdivision," i. e., the vendor may return as income from such sale in any taxable year that proportion of the installment payments actually received in such year which the total profit realized, or to be realized when the payment is completed, bears to the total contract price. The term "initial payments" is defined in such section to mean "the payments received in cash or property other than evidences of indebtedness of the purchaser during the taxable period in which the sale or other disposition is made."

It is specified in section 1208 of such Act that the provisions of section 212(d) above referred to are to be "retroactively applied in computing income under the provisions of the Revenue Act of 1916,

the Revenue Act of 1917, the Revenue Act of 1918, the Revenue Act of 1921, or the Revenue Act of 1924, or any of such Acts as amended." Section 1208 also provides that "any tax that has been paid under such Acts prior to the enactment of this Act, if in excess of the tax imposed by such Acts as retroactively modified by this section, shall, subject to the statutory period of limitations properly applicable thereto, be credited or refunded to the taxpayer as provided in section 284."

Article 42 of Regulations 69 provides, as to dealers in personal property on the installment plan, in part as follows:

> The provisions of this article shall be retroactively applied in computing income from the sale of personal property under the Revenue Acts of 1916, 1917, 1918, 1921, and 1924, or any such Acts as amended. (See section 1208.) Any dealer in personal property on the installment plan whose books of account contain adequate information and were kept so that income can be accurately computed on the installment basis in accordance with the provisions of this article may file amended returns accordingly, and the excess of the amount of any tax previously paid over the tax as computed on the installment basis as herein provided shall, subject to the statutory period of limitations properly applicable thereto, be credited or refunded as provided in section 284 and articles 1301–1306.

There is no sound reason for making a distinction between dealers in personal property on the installment plan and taxpayers engaged in the sale of real estate on the installment plan in the matter of filing amended returns of income on the installment basis. Therefore, if the taxpayer's books contain adequate information and were kept so that income can be accurately computed on the installment basis, it is the opinion of this office that the taxpayer is entitled to report its income accruing from the sales in question on the installment basis and to file amended returns accordingly.

A. W. GREGG,
General Counsel, Bureau of Internal Revenue.

ARTICLE 42: Sale of personal property on installment plan.
(Also Section 284, Article 1301.)

VI–8–3113
G. C. M. 386A

REVENUE ACT OF 1926.

> A sale of personal property in 1919 was held to be a deferred payment sale not on the installment plan, but under the provisions of sections 212(d) of the Revenue Act of 1926, retroactively applied pursuant to section 1208 of that Act, is held to be an installment sale. The Commissioner has authority, under section 3220 of the United States Revised Statutes as amended by section 1111 of the Revenue Act of 1926, to abate any unpaid assessment based on the gain from the sale to the extent that the assessment exceeds the tax computed by treating the sale as an installment sale under section 212(d).

An opinion is requested on the following issues: (1) Whether the taxpayer is entitled to relief under the provisions of sections 212(d) and 1208 of the Revenue Act of 1926, and (2), if so entitled, whether the tax assessed on March —, 1926, can be abated under section 3220 of the Revised Statutes as a tax excessive in amount.

It appears that in 1919 the taxpayer sold his stock in the M Company for 50x dollars; 11x dollars of this sum was received in 1919

and the balance in payments distributed through the years 1920 to 1923, inclusive. The amount of profit derived from this sale was not disputed, but the taxpayer contended that it should be treated as an installment sale. The Unit ruled that the sale was on the deferred-payment (not installment) plan, and that the entire profit was taxable income for the year 1919. On March —, 1926, a deficiency of $5x$ dollars was accordingly assessed against the taxpayer. Relying on sections 212(d) and 1208 of the 1926 Act, the taxpayer has now offered to pay approximately x dollars for 1919, which would be the amount of the tax computed on an installment-sale basis.

(1) In the opinion of this office the sale of this stock should be treated as an installment sale, as the facts of the case meet the conditions prescribed for installment sales by section 212(d), supra, and article 42 of Regulations 69. It was a casual sale of personal property for an amount in excess of $1,000, the sum received as the initial payment being less than one-fourth of the purchase price and subsequent payments being distributed over a period of four years.

Section 1208 of the Revenue Act of 1926 provides as follows:

> The provisions of subdivision (d) of section 212 shall be retroactively applied in computing income under the provisions of the Revenue Act of 1916, the Revenue Act of 1917, the Revenue Act of 1918, the Revenue Act of 1921, or the Revenue Act of 1924, or any of such Acts as amended. Any tax that has been paid under such Acts prior to the enactment of this Act, if in excess of the tax imposed by such Acts as retroactively modified by this section, shall, subject to the statutory period of limitations properly applicable thereto, be credited or refunded to the taxpayer as provided in section 284.

Since section 1208 makes the provisions of section 212(d) retroactive in computing income under the provisions of prior Revenue Acts, it appears that the taxpayer is entitled to the benefit of the installment-sale provisions of section 212(d) of the Revenue Act of 1926.

(2) Attention is directed to that portion of section 1208, supra, which states that—

> Any tax that has been paid under such Acts prior to the enactment of this Act, *if in excess of the tax imposed by such Acts as retroactively modified* by this section, shall, subject to the statutory period of limitations properly applicable thereto, be credited or refunded to the taxpayer as provided in section 284. [Italics supplied.]

The tax in the instant case has been *assessed* but *has not been paid* and the question arises as to whether it may be remitted on the ground that the assessment was in excess of the amount of tax properly due the Government on the profit derived from the particular sale in question under the installment-sale provisions of the 1926 Act as retroactively applied.

The authority for the remitting of taxes which are excessive in amount is contained in section 3220 of the Revised Statutes, as amended by section 1111 of the Revenue Act of 1926, which provides in part as follows:

> Except as otherwise provided in sections 284 and 319 of the Revenue Act of 1926 the Commissioner of Internal Revenue, subject to regulations prescribed by the Secretary of the Treasury, is authorized to remit, refund, and pay back

all taxes erroneously or illegally assessed or collected, all penalties collected without authority, and all taxes that appear to be unjustly assessed or *excessive in amount*, or in any manner wrongfully collected. [Italics supplied.]

The language of the statute is clear and unambiguous to the effect that the Commissioner is authorized to remit taxes that are excessive in amount. Sections 284 and 319, which limit the application of section 1111, supra, concern the crediting or refunding of taxes already paid and are not applicable to the case in question.

In construing section 3220 of the Revised Statutes, as amended by section 1316 of the Revenue Act of 1918, this office held in Solicitor's Opinion 92 (C. B. 4, 325) that—

Where an excess amount of tax is assessed the Commissioner is authorized by section 3220, Revised Statutes, as amended by the Revenue Act of 1918, to abate the excess amount.

Therefore, in the opinion of this office, the Commissioner has authority under section 3220 of the Revised Statutes, as amended by section 1111 of the Revenue Act of 1926, to remit or abate the amount of the tax assessed on March —, 1926, which is in excess of the sum properly due the Government as a result of the provisions of section 212(d) of the Revenue Act of 1926, retroactively applied pursuant to section 1208 of that Act.

A. W. GREGG,
General Counsel, Bureau of Internal Revenue.

ARTICLE 42: Sale of personal property on installment plan. VI–8–3114 Mim. 3511

REVENUE ACT OF 1926.

Requirements with respect to dealers in real and personal property who claim the installment basis of computing income for prior years.

TREASURY DEPARTMENT,
OFFICE OF COMMISSIONER OF INTERNAL REVENUE,
Washington, D. C., January 29, 1927.

Collectors of Internal Revenue, Internal Revenue Agents in Charge, and Officers of the Income Tax Unit Concerned:

Reference is made to the last paragraph of article 42 of Regulations 69, which reads as follows:

* * * Any dealer in personal property on the installment plan whose books of account contain adequate information and were kept so that income can be accurately computed on the installment basis in accordance with the provisions of this article may file amended returns accordingly, and the excess of the amount of any tax previously paid over the tax as computed herein shall, subject to the statutory period of limitations properly applicable thereto, be credited or refunded as provided in section 284 and articles 1301–1306.

Where returns are filed in which the installment basis of computing income is claimed, not only must the books of account contain adequate information and show that they were kept so that income can be accurately computed on the installment basis, but segregation and computations of income must be made by taxpayer and must be supported by such analyses or schedules as will permit

readily of verification with the books of original entry. This requirement shall apply to dealers in real and personal property alike.

Correspondence in regard to the procedure outlined herein should refer to the above numbers and be addressed for attention of IT:E:CRN.

D. H. BLAIR, *Commissioner.*

ARTICLE 42: Sale of personal property on installment plan. VI–14–3175 I. T. 2343

REVENUE ACT OF 1926.

The continuance of the installment basis for 1926 and subsequent years is not required in all cases where a taxpayer, a dealer in personal property, exercises the privilege provided in article 42, Regulations 69, of filing amended returns on the installment basis for years prior to 1926.

A question is raised as to the proper interpretation of that portion of article 42, Regulations 69, under which dealers in personal property on the installment plan, whose books of account contain adequate information and were kept so that income can be accurately computed on the installment basis, are permitted to file amended returns on that basis for prior years subject to the statutory period of limitations properly applicable thereto.

It is stated that in some cases taxpayers have filed amended returns for taxable years prior to 1926 with respect to which the statute of limitations has not run, claiming the installment basis of reporting, but having no intention of reflecting such basis on their books of account for 1926 and subsequent years. These taxpayers contend that under the regulations it is only necessary that information be available from which the income can be computed on the installment basis and that there is nothing requiring them to keep their books in accordance with that basis.

It is contended that the provisions of article 42 of Regulations 69 in question contemplate that a taxpayer who has not heretofore filed on an installment basis but whose books of account contain adequate information for determination of income on that basis may file amended returns, but in order to claim such basis his books must be so kept for 1926 and subsequent years.

The Bureau has heretofore considered the installment basis merely an adaptation or modification of the ordinary accrual method of accounting. (See O. D. 623, C. B. 3, 105.) For this reason it has been held that no formal permission was necessary for the adoption by a taxpayer of the installment basis in lieu of the straight accrual basis. There is nothing in the existing regulations specifically governing a case where a taxpayer who is employing the installment basis desires to adopt the straight accrual basis instead. Where such a change is made, however, the taxpayer is required to report as income, in the year for which the change is effective, all profits applicable to outstanding balances on installment sales contracts made during prior years. (See I. T. 1805, C. B. II–2, 72.) It will be noted, therefore, that in so far as regulatory provisions are concerned, the proper use of the installment basis or of the straight accrual basis is optional with the taxpayer. Hence, the continuance

of the installment basis for 1926 and subsequent years is not necessarily required where a taxpayer exercises the privilege provided in article 42 of Regulations 69 (by reason of the retroactive application of section 212(d) of the Revenue Act of 1926 under the provisions of section 1208 of the statute), relative to the filing of amended returns for the years prior to 1926.

ARTICLE 44: Sale of real property involving deferred payments. VI-9-3123 I. T. 2339

REVENUE ACT OF 1926.

For the purpose of determining the classification under which a sale of real property involving deferred payments falls, amounts received by the vendor during the taxable year in which the sale is made through disposition of the purchaser's obligations are considered a part of the "initial payments."

Advice is requested relative to the classification of a sale of real estate under the conditions hereinafter described.

The vendor disposed of property for a total consideration of $6x$ dollars, receiving x dollars in cash at the time of the sale and two purchase money mortgages for x dollars and $4x$ dollars, respectively. Within five weeks and during the year of sale, the vendor converted the x dollars mortgage into cash. The question presented is whether or not the sale was one made on the installment plan within the meaning of section 212(d) of the Revenue Act of 1926 and article 44, Regulations 69.

In defining the term "initial payments," the amount of which determines the classification of a deferred-payment sale of real estate for income tax purposes, section 212(d) of the Revenue Act of 1926 provides:

* * * As used in this subdivision the term "initial payments" means the payments received in cash or property other than evidences of indebtedness of the purchaser during the taxable period in which the sale or other disposition is made.

It is not clear whether the vendee paid the x dollar mortgage within the taxable period in which the sale was made or whether the mortgage was discounted at a bank or sold to some other third party. If the vendee himself liquidated this indebtedness, the rule announced in Office Decision 569 (C. B. 3, 108) would govern, and this amount together with the original cash payment would constitute a part of the initial payment for the purpose of determining whether the sale was an installment sale or one not on the installment plan. It is further held that even though the x dollar note was sold to a third party within the taxable year, the amount received therefor should be included as part of the initial payment for the purpose of determining the classification under which the sale falls. Therefore, the sale in question can not be classified as a sale on the installment plan, and the provisions of article 46 of Regulations 69 relative to the treatment of deferred-payment sales not on the installment plan are applicable.

ARTICLE 44: Sale of real property involving deferred payments. VI–19–3222 I. T. 2351

REVENUE ACT OF 1926.

Where a mortgagee of real property bought the property upon which he himself had the mortgage, held, that the case can not be considered as one where property was taken subject to a mortgage or a mortgage was assumed by the purchaser within the meaning of article 44.

The question is raised as to whether the income from the sale of certain real estate can be returned on the installment basis.

It appears that a prospective purchaser of real property in 1926 loaned a substantial sum of money (x dollars) to the owner thereof and took as security for the owner's note a first mortgage on the property. Within the same year he bought the property from the owner for $3x$ dollars. The note for x dollars was canceled at the time the deed was given. No part of the balance of the consideration, $2x$ dollars, was paid in 1926.

As the mortgagee and the purchaser were the same person, the mortgage placed on the property at the time of the loan merged in the fee when the property was acquired by the mortgagee-purchaser, so that the case can not be considered as one where property was taken subject to a mortgage, or where a purchaser assumed a mortgage, within the meaning of article 44 of Regulations 69 or Treasury Decision 3921 [C. B. V–2, 24]. Under such circumstances a sum equal to the amount of the mortgage should be included as part of the initial payment. The income from the sale in question can not, therefore, be returned on the installment basis.

ARTICLE 45: Sale of real property on installment plan. VI–10–3128 I. T. 2340

REVENUE ACT OF 1926.

Treatment of selling and incidental expenses incurred in connection with sales of real estate by persons not regularly engaged in that business.

Application of I. T. 2305 [C. B. V–2, 108.]

An opinion is requested as to the proper application of the first paragraph of I. T. 2305 in the case of an installment sale. This paragraph reads as follows:

In the case of sales of real estate by persons not regularly engaged in that business, commissions paid, while they do not reduce or otherwise affect the amount of the selling price, may be offset against the selling price in determining the amount of gain or loss realized from such sales, and in cases of installment sales in determining the percentage of profit in each installment payment which is to be included in gross income.

The proper application may be illustrated by the following computation:

	Dollars.	Dollars.
Selling price		20,000x
Selling expenses:		
Commissions paid	2,000x	
Abstract of title	20x	
Recording fees, etc	5x	
		2,025x
Selling price less offsets		17,975x
Cost of land or March 1, 1913, value	2,000x	
Cost or March 1, 1913, value of buildings	3,000x	
Depreciation to date of sale	1,000x	
	2,000x	
Subsequent improvement cost	1,800x	
Depreciation to date of sale	200x	
	1,600x	
		5,600x
Total profit to be realized on sale		12,375x
"Purchase price" to vendee		20,000x
First mortgage assumed by vendee		2,000x
"Total contract price"		18,000x
"Initial payment"		5,000x

Section 212(d) of the Revenue Act of 1926 provides that the taxpayer may return as income "that proportion of the installment payments actually received * * * which the total profit * * * to be realized * * * bears to the total contract price."

In accordance with this provision, $\frac{12,375}{18,000} \times 5{,}000x$ dollars or $3{,}437.5x$ dollars = taxable net income from sale for the year.

Allowable deductions:

	Dollars.
Local taxes	45x
Fire insurance	90x
	135x
Taxable net income	3,302.5x

It should be understood that the item of "fire insurance" is deductible from gross income only if paid or incurred in connection with property not used by the taxpayer as a residence or for other personal purposes.

It will be noted that in determining the percentage of profit to be applied to each installment payment, as received, two factors are to be considered, namely, "total contract price" and "total profit to be realized." In the above computation, the expenses incident to the sale are offset against the selling price for the purpose of determining the profit to be realized from the transaction. In this connection it should be noted, however, that under the provisions of article 44, Regulations 69, "Commissions and other selling expenses paid or incurred by the vendor are not to be deducted or taken into account in determining the amount of the 'initial payments,' the 'total contract price,' or the 'purchase price.'"

ARTICLE 46: Deferred-payment sale of real property not on installment plan. VI-2-3040 G. C. M. 880

REVENUE ACT OF 1916 AND SUBSEQUENT ACTS.

Upon the repossession of property, title to which the vendor transferred to the purchaser upon a deferred-payment sale other than on the installment plan, repossession is treated as the equivalent of an exchange by the vendor of the purchaser's obligations surrendered for the property repossessed, the gain or loss from the exchange being measured by the difference between the fair market value of the property repossessed and the basis in the hands of the vendor of the purchaser's obligations surrendered for the property.

An opinion is requested as to the effect of the repossession of real property under the following statement of facts:

The taxpayer sold his farm in 1920 for a total consideration of $44x$ dollars (face value). He received x dollars in earnest money in 1919, $8x$ dollars in cash upon delivery of the deed on January —, 1920, and notes for $35x$ dollars payable in 20 years, carrying 5 per cent annual interest. The notes were secured by a purchase money mortgage. The March 1, 1913, value of the farm was $28x$ dollars, which amount was in excess of what the taxpayer paid for the farm prior to that date. The taxpayer treated the sale as a deferred-payment sale not on the installment plan. The question of the taxpayer's income tax liability for 1920 was finally settled upon the basis that he derived no gain or sustained no loss from the sale of his farm in 1920 because the notes received from the purchaser and secured by mortgage on the farm had no fair market value.

Eventually the purchaser of the farm defaulted in paying the interest, and the taxpayer repossessed the property in 1922, by a transaction which resulted in the surrender by the taxpayer of the outstanding notes secured by mortgage in consideration for the property. It does not appear definitely that the taxpayer repossessed the property through foreclosure proceedings, but the record does indicate that the property was reacquired through an independent transaction having the same effect as a purchase at foreclosure sale.

Under these facts, the question is: What was the effect upon the taxpayer's income tax liability for 1922 of the repossession by him in 1922 of the farm which he sold and conveyed to a purchaser on January —, 1920?

The effect of the repossession of real property after a deferred-payment sale not on the installment plan, where title to the property was actually transferred to the purchaser, is treated in article 46 of Regulations 69 in the following language:

* * * If the vendor had previously transferred title to the purchaser, and the purchaser defaults in any of his payments and the vendor reacquires the property, such repossession shall be regarded as a transfer by the vendor, in exchange for the property, of so much of the face value of the purchaser's obligations as are applied by the vendor to the purchase or bid price of the property. Such an exchange will be regarded as having resulted in the realization by the vendor of gain or loss, as the case may be, for the year of repossession, measured by the difference between the fair market value of the property and the face value of those obligations of the purchaser which were applied by the vendor to the purchase or bid price of the property to the extent that the

fair market value thereof was previously recognized in computing income. The fair market value of the property shall be presumed to be the amount for which it is bid in by the vendor in the absence of clear and convincing proof to the contrary. If the property so acquired is subsequently sold, the basis for determining gain or loss is the fair market value of the property at the date of acquisition.

While the provisions quoted do not specifically cover the instant case, because the obligations of the purchaser received by the taxpayer upon the sale of his farm were held to have no fair market value at the time, the principle upon which those provisions are based does apply in the instant case as well as in a case where the obligations of the purchaser were regarded as having a fair market value. That underlying principle is that upon the repossession of property, title to which the vendor has actually transferred to the purchaser upon a deferred-payment sale other than on the installment plan, the repossession shall be treated as if there were an exchange by the vendor of the purchaser's obligations surrendered for the property repossessed, the gain or loss from the exchange being measured by the difference between the fair market value of the property repossessed and the basis in the hands of the vendor of the purchaser's obligations surrendered for the property. In the usual case that basis will be the fair market value of the obligations at the time they were received by the vendor, and that is the case specifically covered by the language of the regulations. In other cases the only variation will be in the basis for determining gain or loss to the vendor of the purchaser's obligations, that basis being, in general, the amount of the vendor's capital represented by the obligations. In the instant case the basis of the purchaser's obligations surrendered by the taxpayer to repossess the farm was $19x$ dollars, the amount obtained by subtracting from the March 1, 1913, value of the farm ($28x$ dollars) the $9x$ dollars received by him in cash upon the sale. It follows, giving application to the underlying principle of article 46 of Regulations 69, that, when the taxpayer repossessed the farm in 1922, he realized income measured by the excess of its fair market value (which, in the absence of clear and convincing proof to the contrary, must be presumed to be $35x$ dollars, the amount which he in effect offered for the property) over the basis to him ($19x$ dollars) of the purchaser's obligations surrendered for the property. Under this computation the profit derived by the taxpayer upon the repossession of the farm in 1922 was $16x$ dollars. If the taxpayer can satisfactorily prove that the fair market value of the farm at the time of its repossession was less than $35x$ dollars, the profit on the repossession will be correspondingly reduced.

A. W. GREGG,
General Counsel, Bureau of Internal Revenue.

ARTICLE 46: Deferred-payment sale of real property not on installment plan. VI–3–3048 G. C. M. 888

REVENUE ACT OF 1916 AND SUBSEQUENT ACTS.

Where a taxpayer presented no evidence that property repossessed by him after a deferred-payment sale thereof not on the installment plan did not have a fair market value equal to the face value of the consideration given by him in exchange therefor, in-

come was realized by the taxpayer upon repossession to the extent of the claim for unpaid interest surrendered as part consideration for the repossessed property. Recommended that I. T. 2178 (C. B. IV-2, 42) be modified.

An opinion has been requested relative to that part of I. T. 2178 which relates to the treatment, upon repossession of real property, of unpaid interest due a taxpayer who originally sold real property on the deferred-payment (not installment) plan, treating the deferred-payment obligations as the equivalent of cash to the extent of their face value, and in a subsequent year reacquired half of the property in consideration of the surrender of the outstanding deferred-payment obligations, the assumption of delinquent taxes, *and the remission of the unpaid interest on the obligations, which interest the taxpayer had never included in gross income* because he returned his income on a cash receipts and disbursements basis.

The holding in I. T. 2178 is:

It is held that the cancellation of the mortgage in question and the repossession of the 17*y* acres of the original farm constitutes an investment of capital and no taxable gain was derived or deductible loss sustained in the transaction. The 25*x* dollars plus the unpaid interest due under the mortgage and the amount of taxes for the year 1923 assumed by the taxpayer constitute the purchase price of the 17*y* acres deeded back to him in 1924.

The treatment, for income tax purposes under the Revenue Acts of 1916, 1917, 1918, 1921, 1924, and 1926, of the repossession of real property after a deferred-payment sale thereof not on the installment plan is covered by article 46 of Regulations 69. In accordance with the provisions of that article, the taxpayer in the instant case must be deemed to have acquired the repossessed property in exchange for the outstanding deferred-payment obligations surrendered, the amount of delinquent taxes which was assumed, and the unpaid interest which was remitted. In the absence of clear and convincing proof to the contrary, the fair market value of the repossessed property must be presumed to have been the aggregate amount of those three items. Taxable income was realized from the repossession to the extent that the fair market value of the repossessed property exceeded that part of the consideration given in exchange which represented capital in the hands of the taxpayer or items the income from which had been previously returned by him. Applying this principle, which follows the theory of repossession embodied in article 46 of Regulations 69, and analyzing the nature of the consideration given by the taxpayer in exchange for the repossessed property, it follows that income was realized by the taxpayer in 1924, upon the repossession of a portion of the real property previously sold by him, to the extent of the claim for unpaid interest which was surrendered as part consideration for the land. This conclusion is predicated upon the fact that the taxpayer presented no proof that the property repossessed by him did not have a fair market value equal to the face value of the consideration given by him in exchange therefor.

It is recommended that I. T. 2178 be modified in so far as it is inconsistent with the conclusion herein reached.

A. W. Gregg,
General Counsel, Bureau of Internal Revenue.

ARTICLE 46: Deferred-payment sale of real property not on installment plan.

VI-14-3176
G. C. M. 1387

REVENUE ACTS OF 1924 AND 1926.

Method of computing the profit to be reported by a taxpayer on the cash receipts and disbursements basis in the case of a casual sale of personal property when the initial payment exceeds one-fourth of the purchase price and the deferred payments are not represented by any notes or other evidence of indebtedness of the purchaser, the obligation of the purchaser to make such payments being based solely on the promise to pay contained in the contract.

A owned —— shares of stock of the M Company, which she acquired by purchase in July, 1924, at $\frac{1}{4}x$ dollars per share. She and all the other stockholders of the company entered into an agreement with the O Company in November, 1924, for the sale of their stock in the M Company to the O Company at $\frac{3}{4}x$ dollars per share. The agreement contains the following provision:

That if the said party of the second part shall first make the payments herein mentioned to be made and performed by the said party of the second part, the parties of the first part will thereupon transfer to the said second party the entire capital stock of the M Company, a corporation, consisting of —— shares of the par value of $\frac{1}{4}x$ dollars each, free and clear from all liens and encumbrances of every kind or nature, and the party of the second part agrees to pay to the parties of the first part as the purchase price of said —— shares of the capital stock of the said M Company, a corporation, the sum of $2{,}400x$ dollars in the following manner, to wit, $1{,}200x$ dollars cash in hand paid, the receipt whereof is hereby acknowledged, and $1{,}200x$ dollars on January —, 1925, without interest.

It was further agreed that the entire —— shares of stock should be indorsed in blank and deposited with the P Bank, to be held by such bank until the payment of the $1{,}200x$ dollars on January —, 1925, at which time the stock was to be transferred to the purchaser. Control of the M Company was to remain with the parties of the first part, but during the time between November —, 1924, and January —, 1925, no dividends were to be paid upon the stock or other disbursements made except ordinary and usual expenditures for carrying on the operations of the company. If the party of the second part should fail to make the second payment of $1{,}200x$ dollars on January —, 1925, the agreement might be terminated at the election of the parties of the first part and the party of the second part was to forfeit the payment of $1{,}200x$ dollars made on November —, 1924, in full satisfaction of all damages the parties of the first part may have sustained.

The payment to be made on January —, 1925, was not secured by any note or other evidence of indebtedness. The obligation of the O Company to make this payment was founded solely on the contract. In accordance with the terms of the agreement, the second payment was made on January —, 1925, and the stock was transferred to the purchaser.

The taxpayer's accounts are kept on a cash receipts and disbursements basis. She reported one-half of the profit from the sale in her return for 1924 and the balance in her return for 1925. She contends that the agreement was a mere option to purchase which the O Company had the right to exercise on or before January —, 1925. Special stress is laid on the fact that her books and accounts

are kept on a cash basis, that the contract provides that if the party of the second part makes the payment mentioned the stock shall be transferred, and that the control of the company did not pass to the purchaser until the payment of the 1,200*x* dollars on January —, 1925.

The revenue agent contends that the agreement cited is a contract of sale of the entire stock of —— shares and was a closed and completed transaction as of November —, 1924, and that, since it is a casual sale of personal property for a price exceeding $1,000, one-half of which was paid at the time of sale, it can not be treated as an installment sale, and consequently the entire profit should be reported in 1924.

In the protest filed reference is made to the case of *Ide* v. *Leiser* (10 Mont., 5, 24 Pac., 695) as supporting the contention that the agreement was merely an option. The court in its opinion in that case defines and distinguishes a sale, a contract of sale, and an option. The case of *Cullen* v. *Park Club Land Co.* (67 Colo., 210, 184 Pac., 303) is also cited in the protest, for the reason that the case of *Ide* v. *Leiser* is referred to in the Cullen opinion with approval. The contract under consideration in the Cullen case was a written instrument entitled "Contract of sale." The instrument is dated April 25, 1916, and recites the receipt of $50 as part payment on the purchase price of certain lots, the full price of such property being $1,875, payable as follows: Cash as above, $50; $25 on the 1st of each month commencing May 1, 1916, for 12 months; $50 per month thereafter commencing May 1, 1917, until May 1, 1919, on which date the balance of the purchase price was to be paid. The deferred payments were to bear interest at 6 per cent. The contract further provided—

> Time is the essence of this contract, and the failure to make each and all of the several payments at the place and times herein specified shall, at the election of the said Park Club Land Co., work an absolute forfeiture of all rights of the said purchaser under this contract, and in that case all payments on the purchase price aforesaid shall be forfeited to the Park Club Land Co., not as a penalty, but as liquidated damages; * * *.

The sole question before the court was whether the instrument was a contract for the sale of real estate or only an option to purchase. The court said:

> In the case of *Ide* v. *Leiser* (10 Mont., 5, 11, 24 Pac., 695, 24 Am. St. Rep., 17) is given a very excellent definition of an option, and the distinction between this and an agreement to sell land is pointed out. An examination of the instrument in question, in the light of this authority, will disclose that it wholly lacks the distinguishing characteristics of an option. If it could in any respect be said to be an option to the plaintiff to purchase the land in question, the cash payment of $50 was the consideration therefor, and the plaintiff exercised that option and converted it into a contract of purchase and sale when she made the first of the monthly payments under it. But the fact is that by its positive language—i. e., "part payment of the purchase price;" "full purchase price of said property;" "balance of purchase price to be paid;" "purchaser under this contract;" "payments on the purchase price"—it is a contract of sale. The only option it contains is an option to the vendor, in case of failure to make the payments called for, to declare it forfeited and retain the payments made. This option to the vendor to so elect he was in no way bound to exercise. Failing to so elect, it stood as a contract of sale, and vendor was entitled to bring suit for the unpaid purchase price, even had the instrument itself provided that upon failure to make the payments the contract should be held "void."

The foregoing opinion relates to a contract for the sale of land, but it is equally applicable to a similar contract for the sale of personal property. The agreement in the case under consideration, although providing for a large cash payment and only one deferred payment, is similar to the contract which was before the court in the Cullen case. By the language used it is a contract of sale—"the party of the second part *agrees to pay* to the parties of the first part as the *purchase price* of said —— shares of the capital stock of the said M Company, a corporation, the sum of 2,400*x* dollars in the following manner, to wit, *1,200x dollars cash in hand paid, the receipt whereof is hereby acknowledged, and 1,200x dollars on January —, 1925*, without interest." The only option it contains is the option of the vendors, in case the purchaser fails to make the second payment on January —, 1925, to terminate the agreement and retain the payment made. The vendors were not bound so to elect. They could tender the stock and sue for the balance of the purchase price.

The Cullen case does not support the contention of the taxpayer that the agreement between the stockholders of the M Company and the O corporation was an option. On the other hand, it does support the revenue agent's contention that the agreement was a contract of sale. Further, it is believed that a sale was effected in November, 1924.

There remains to be determined what is the correct basis on which the profit from the sale should be reported. The taxpayer has reported the profit on the installment basis. The transaction was a casual sale of personal property for more than $1,000 and the initial payment exceeded one-fourth of the purchase price. Consequently, it is not an installment sale within the provisions of section 212(d) of the Revenue Act of 1926, given retroactive application by section 1208 of that Act. The taxpayer was in error, therefore, in reporting one-half of the profit in 1924 and the balance in 1925.

The legal problem resolves itself into this: In the case of a taxpayer on a cash receipts and disbursements basis, what is the method of computing the profit to be reported in the case of a casual sale of personal property when the initial payment exceeds one-fourth of the purchase price and the deferred payments are not represented by any notes or other evidences of indebtedness of the purchaser, the obligation of the purchaser to make such payments being based solely on the promise to pay contained in the contract?

Such a sale is similar to a deferred-payment sale of real property not on the installment plan. Article 44 of Regulations 69, which is applicable under the Revenue Act of 1924 as well as under the Revenue Act of 1926, defines a deferred-payment sale of real property not on the installment plan as a sale in which the payments received in cash or property other than evidences of indebtedness of the purchaser during the taxable year in which the sale is made exceed one-fourth of the purchase price. The rule for computing the profit derived from such a sale is also applicable in the case of a deferred-payment sale of personal property not on the installment plan. Article 46 of Regulations 69 provides that in deferred-payment sales of real estate not on the installment plan the obligations of the purchaser received by the vendor are to be considered as the equivalent of cash to the amount of their fair market value in ascertaining the

profit or loss from the transaction, but, if the obligations received by the vendor have no fair market value, the payments in cash or other property having a fair market value shall be applied against and reduce the basis of the property sold, and, if in excess of such basis, shall be taxable to the extent of such excess. The terms "evidences of indebtedness of the purchaser" and "obligations of the purchaser received by the vendor" as used in articles 44 and 46, respectively, clearly refer to something received by the vendor to represent the promise or promises to pay contained in the contract of sale. If, therefore, the deferred payments are not represented by notes or other like obligations of the purchaser, the cash received by a taxpayer on the cash receipts and disbursements basis should be applied against and reduce the basis of the property sold and, if it is in excess of such basis, the excess should be reported as profit. When the deferred payments are received they should be applied against the reduced basis, if the initial payment was not in excess of the basis, and the excess over the reduced basis or the total amount received, as the case may be, should be included in income for the year of receipt.

Applying the above principles to the facts in this case, the taxpayer should have reported $54x$ dollars as profit in her return for 1924, which was the excess of the amount received in that year, $144x$ dollars, over the cost of the property, $90x$ dollars. The entire amount received in 1925, $144x$ dollars, should have been reported as profit in her return for that year.

A. W. Gregg,
General Counsel, Bureau of Internal Revenue.

SECTION 213(b).—GROSS INCOME DEFINED: EXCLUSIONS.

Article 72: Proceeds of insurance—Compensation—Pensions.

REVENUE ACT OF 1926.

Annuity payments received for a conveyance of real estate. (See G. C. M. 1022, page 12.)

Article 79: Liberty bond exemption under Second, Third, and Fourth Liberty Bond Acts. (Also Section 203, Article 1571.) VI–23–3254 I. T. 2359

REVENUE ACT OF 1926.

In connection with the exchange of second Liberty loan converted 4¼ per cent bonds of 1927–42 (known as second 4¼'s) for a like par or face value of 3½ per cent Treasury notes of Series A–1930–32, the duplicate interest from March 15 to May 15 is exempt for the purpose of the normal income tax. The exchange of the bonds for notes is a closed transaction such as to result in gain or loss. Gain or loss is not affected by the fact that interest was or is payable on both the bonds and notes for the period March 15 to May 15, 1927.

An opinion is requested relative to the exchange of second Liberty loan converted 4¼ per cent bonds of 1927–42 (known as second 4¼'s)

for a like par or face value of 3½ per cent Treasury notes of Series A–1930–32 made in accordance with the provisions of Treasury Department Circular No. 379, dated March 8, 1927. The following questions are presented in connection therewith and are answered in the order in which they are set out:

(1) Will the duplicate interest received between March 15 and May 15 be considered as tax-exempt interest?

(2) Will the exchange be considered as a closed transaction, and the profit and loss taken on the principal?

(3) Will the duplication of interest affect the gain or loss on principal in any way?

The fact that interest on the Liberty bonds was paid for the period extending up to May 15, 1927, while the Treasury notes bear interest from March 15, 1927, does not change the status of such interest for income tax purposes. As such interest has the status of interest on Liberty bonds and Treasury notes, respectively, it is exempt for the purpose of the normal income tax.

With reference to the second question, attention is directed to the fact that the bonds in question were not callable for redemption until November 15, 1927, and that the turning in of the bonds was in accordance with the terms of Circular No. 379; that is, in exchange for the Treasury notes. Accordingly, it was a disposition of the Liberty bonds by way of exchange. A disposition of property by way of exchange is such a transaction as to result in gain or loss for income tax purposes under section 202 of the Revenue Act of 1926 unless the exchange is such as to come within one of the exceptions specified in section 203. The exchange to which the inquiry pertains does not come within any of such exceptions, and it was, therefore, a closed transaction such as to result in a gain or loss for income tax purposes. The amount of the consideration received was the fair market value at the date of exchange of the Treasury notes so received, and the gain or loss so resulting is found by comparing the amount of such consideration with the cost or other basis of the Liberty bonds.

The gain or loss resulting from the disposition of the Liberty bonds, computed as above specified, is not affected by the fact that interest was or is payable on both the bonds and notes for the period from March 15 to May 15, 1927.

ARTICLE 88: Compensation of State officers and employees. VI–22–3247 I. T. 2357

REVENUE ACTS OF 1924 AND 1926.

The compensation received by the medical director of a county public hospital operating under a State law held to be exempt for 1924, but not for 1925 and subsequent years because the hospital is engaged in a proprietary rather than a governmental function.

An opinion is requested as to whether the salary received by A for his services as medical director of M County Public Hospital is exempt from the Federal income tax.

The pertinent facts in connection with the payment of this salary are stated below.

According to the information contained in an extract from the minutes of a meeting of the board of trustees of the M County Public Hospital held on January —, 1924, it appears that the board decided to employ a medical director for the hospital, and it was deemed advisable to secure the services of A, a leading tuberculosis specialist in that part of the country. A agreed to attend to the work for x dollars per month, and he was employed at that salary as medical director, his employment beginning February 1, 1924.

The State law in force provides for the establishment of county public hospitals, should the necessary votes cast upon the proposition at a general or special election favor the establishing of such hospitals. A special tax is authorized for the erection, equipment, and maintenance of such hospitals. The management of each county hospital is vested in a board of seven trustees, who, except those originally appointed, or those appointed to fill vacancies pending a general election, are elected for a prescribed term. All patients, except such as may have been found to be indigent and entitled to free care and treatment, shall pay to the board of trustees reasonable compensation for care and treatment. The county treasurer shall receive and disburse all funds, under the control of the said board of trustees, the same to be paid out only upon warrants drawn by the county auditor by direction of the board of supervisors after the claim for which the same is drawn has been certified as correct by the board of trustees.

The law also provides, among other things, that the board of trustees shall employ a superintendent, a matron, and the necessary assistants and employees, and fix their compensation, and shall have control and supervision over the physicians, nurses, attendants, and patients in the hospital. They may operate the hospital as a tuberculosis sanitarium or provide as a department of such hospital suitable accommodations and means for the care of persons afflicted with tuberculosis.

For 1925 and subsequent years compensation received by an individual for services rendered to a State, or political subdivision thereof, is included in gross income unless the person received such compensation as an officer or employee of a State, or political subdivision thereof, and the services were rendered in connection with the exercise of an essential governmental function. In accordance with the provisions of section 1211 of the Revenue Act of 1926, amounts received by an individual as compensation for personal services as an officer or employee of any State, or political subdivision thereof, in the year 1924 or prior years, are exempt from income tax, without regard to whether such services were rendered in connection with the exercise of an essential governmental function. Under all the Acts, therefore, unless a taxpayer is an officer or an employee of a State or political subdivision thereof, his compensation for personal services is not exempt.

An officer is a person who occupies a position in the service of the State or political subdivision, the tenure of which is continuous and not temporary and the duties of which are established by law or regulations and not by agreement. An employee is one whose duties consist in the rendition of prescribed services and not the accomplishment of specific objects and whose services are continuous, not occasional or temporary. The latter definition covers the case of A.

It is held that the employment of A as medical director of the M County Public Hospital constitutes him an employee of a political subdivision of the State of R, and that under the provisions of section 1211 of the Revenue Act of 1926 compensation received by him as director is exempt from Federal income tax under the Revenue Act of 1924. It is further held that the county in operating the hospital is engaged in a proprietary rather than a governmental function, and that the compensation of A as director is subject to Federal income tax under the Revenue Act of 1926.

ARTICLE 88: Compensation of State officers and employees. (Also Section 1211.)

VI–25–3272
G. C. M. 1706

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

The compensation received by the bar pilots of San Francisco for piloting vessels is taxable under the Revenue Act of 1926; but those pilots are entitled to the relief provided by section 1211 of that Act on account of taxes imposed by the Revenue Act of 1924 or prior Revenue Acts, subject to the statutory period of limitation.

An opinion is requested as to the taxability of the compensation of bar pilots of San Francisco, Calif., under the Revenue Acts of 1918, 1921, 1924, and 1926.

Inasmuch as article 88 of Regulations 69, applying to 1925 and subsequent years, treats of the taxability of compensation received by officers or employees of the States, the discussion naturally begins with a consideration of the case under that regulation, which, so far as pertinent, reads as follows:

Compensation paid to its officers and employees by a State or political subdivision thereof for services rendered in connection with the exercise of an essential governmental function of the State or political subdivision, including fees received by notaries public commissioned by States and the commissions of receivers appointed by State courts, is not taxable. Compensation received for services rendered to a State or political subdivision thereof is included in gross income unless (*a*) the person receives such compensation as an officer or employee of a State or political subdivision, and (*b*) the services are rendered in connection with the exercise of an essential governmental function. But see section 1211 as to 1924 and prior years.

An officer is a person who occupies a position in the service of the State or political subdivision, the tenure of which is continuous and not temporary and the duties of which are established by law or regulations and not by agreement. An employee is one whose duties consist in the rendition of prescribed services and not the accomplishment of specific objects, and whose services are continuous, not occasional or temporary.

This differs from the earlier regulations, especially in that it introduces the condition as to governmental function which is considered in Solicitor's Opinion 152 (C. B. II–2, 93).

At the outset a question is presented quite different from those obtaining in the ordinary case concerning the taxability of State officers and employees. The power to regulate pilots is one the Supreme Court has repeatedly held to be within the constitutional grant to Congress of power to regulate interstate and foreign commerce. (See *Anderson* v. *Pacific Coast Steamship Co.*, 225 U. S., 187 (which concerned the San Francisco pilots), and the cases therein cited.) By a statute passed August 7, 1879 (R. S., 4235),

it was enacted that pilots "shall continue to be regulated in conformity with the existing laws of the States * * * until further legislative provision shall be made by Congress." Since then several important Federal laws upon the subject of pilotage have been passed. "These several Acts assert and exercise the *plenary* power of Congress over the subject" (Ex parte McNeill, 13 Wall., 236), and the Supreme Court has not hesitated to declare State statutes in conflict with them to be invalid (*Sprague* v. *Thompson*, 118 U. S., 90), because, as was said in Ex parte McNeill (supra), the power belongs to the class of "those which may be exercised by the States, but only until Congress shall see fit to act on the subject," and is not one of "those which belong exclusively to the States." The reason for the rule prohibiting the States and the National Government from taxing one another's instrumentalities "rests on the conviction that each government, in order that it may administer its affairs within its *own sphere*, must be left free from undue interference by the other." *Metcalf* v. *Mitchell*, 269 U. S., 514, T. D. 3824 [C. B. V–1, 218].) It relates to the "*exclusive* powers" of each (*Knowlton* v. *Moore*, 178 U. S., 41, 59); and to those "means and instrumentalities employed for carrying on the operations of their governments, for preserving their existence, and fulfilling the high and responsible duties assigned to them in the Constitution." (*Collector* v. *Day*, 11 Wall., 113.) The power to control pilotage being "assigned in the Constitution" to Congress, and not being among the "exclusive powers" of the States, it follows that the power to tax these instrumentalities may not be denied the Federal Government, for that would be to deny the "plenary power" of Congress over the subject.

But aside from this rather unusual feature, it does not appear that these pilots, although they may be officers of the State, render any services "in connection with the exercise of an essential governmental function [of the State]." A pilot is "'a person taken on board at a particular place, for the purpose of conducting a ship through a river, road or channel, or from or into a port.' His duty, therefore, is properly the duty to navigate the ship over and through his pilotage limits * * *." The statutes of California impose no duties of a governmental nature upon pilots. These pilots regulate nothing, but are themselves the subjects of statutory regulations. (Calif. Pol. Code, Arts. V and VI.) They have a limited power of arrest, such as is frequently given to railway conductors and the like, but even this is exercised under the supervision of the "harbor master" (Pol. Code, sec. 2459), and they are not enumerated among the peace officers of the State. (Sec. 817, Calif. Penal Code.) They have no part in the regulation of the port and of commerce within the port, for these are duties of the "harbor commissioners" (secs. 2520, et seq., Calif. Pol. Code); quarantine and health regulations are within the jurisdiction of the board of health (Art. III, Pol. Code); and the pilots themselves are regulated through the "pilot commissioners," who are authorized to license pilots, prescribe their qualifications, and discipline them. See *The Queen* (206 Fed., 148), which construes the statutes of California regarding the San Francisco pilots.

That case quotes Ex parte McNeill (supra), which holds that pilots practice a "vocation" and are a part of "the commercial marine." By necessary inference it is quite conclusive against the idea that these pilots receive their compensation for official services of a governmental nature, for it supports the Federal admiralty jurisdiction over the subject on the ground that the pilot's right to compensation arises from *contract*. Admiralty has jurisdiction only over "maritime contracts," i. e., those having to do with the *trade or business* of navigation. (1 R. C. L., 13, *The Orleans* v. *Phoebus*, 1 Pet., 175.) Furthermore, the right of a public officer to his compensation does not rest on contract (*Butler* v. *Pennsylvania*, 10 How., 402; *Taylor* v. *Beckham*, 178 U. S., 54), with the only exception that an implied contract may arise *after* the services are performed (*Fisk* v. *Police Jury*, 116 U. S., 131). And pilotage is not within this exception because the contract arises *before* the performance. (*Steamship Co.* v. *Joliffe*, 2 Wall., 154, and Ex parte McNeill (supra), both cited as to the San Francisco pilots in *The Queen* (supra).)

But, granting the control of pilots to be an exclusively State function (which is not the case) and that their compensation was received for official services (and this also, as we have seen, is not so), and admitting (as seems to be true) that, in regulating them, the State of California has made them its officers, their compensation would still be taxable. Any argument to the contrary upon these premises appears to be foreclosed by the case of *South Carolina* v. *United States* (199 U. S., 437), where the agents of a State, which, in the exercise of its police powers, and as a means of regulating the liquor traffic, had taken charge of the business of selling intoxicating liquors, were held not to be relieved from the internal revenue tax. The arguments of the court in that case apply with even more force to this. For, if to exempt businesses taken over by the States would tend to cripple the National Government in its revenues, the danger from the simpler expedient of creating officers out of persons engaged in "vocations" or ordinary professions, under the regulatory power, obviously would be greater.

Considerations of quite a different nature obtain for years prior to 1925, in view of the retroactive provisions of section 1211 of the 1926 Act. Prior to the promulgation of Solicitor's Opinion 152, the Bureau had not expressed itself upon the taxability of compensation of State officers and employees received in connection with a nongovernmental function, and many such officers and employees, deeming themselves to be exempt, had reported no taxable income from these sources. As the legislative history of section 1211 shows, it was proposed for the purpose of relieving this situation. (See statement of Hon. Albert Johnson, Representative from State of Washington, hearings before Ways and Means Committee on 1926 Act, p. 185, et seq.) This section was, therefore, not framed as a statute of exemption, but merely provides for the remission or refunding of taxes already *imposed*. Being thus of a remedial nature, the strict rule of construction against exemptions from taxation need not be observed. (See Lewis Sutherland's Statutory Construction, Vol. II, p. 124.)

To entitle one to relief under this section it is necessary only to establish that the compensation was received for personal services as

an officer or employee of the State. An office is defined in *Metcalf* v. *Mitchell* (supra) as:

> A public station conferred by the appointment of government. The term embraces the idea of tenure, duration, emolument, and duties fixed by law. Where an office is created the law usually fixes its incidents, including its term, its duties, and its compensation. * * * The term "officer" is one inseparably connected with an office; * * *—

and, apparently, the court considered an oath of office of some importance. This is substantially the test prescribed by article 88 of Regulations 69.

The civil executive officers of California are enumerated by section 343 of the Political Code of that State. This section designates as officers "six pilots of each harbor where there is no board of pilot commissioners," and hence does not include the pilots of San Francisco, where there are pilot commissioners. The pilot regulations of San Francisco, Mare Island, and Benicia are the subject of Article VI of the Political Code—separate from those as to pilots generally, which are contained in Article V. Section 2457, Article VI, provides for the examination and licensing of not less than 15 nor more than 20 pilots for the port of San Francisco, and while no term of office is provided in this article, Article V, section 2430, specifies a term of 12 months for pilots generally. Article VI, sections 2466 and 2468, provides for the "rates of pilotage" and may be taken as prescribing the "emoluments." The "duties" may be presumed to be those of pilots generally as specified in Article V. Section 2431 of this article provides for an "official bond," but, although the title of that section is "Pilots to take official oath and give bond," the body of the section does not provide for the oath.

In view of this situation, it can not be said that all of the requirements of the Supreme Court's definition of the term officer are indubitably prescribed by the California statutes. And there is nothing whatever to indicate the relationship of employer and employee between the State and the pilot. On the contrary, a pilot is the servant of the shipowner, excepting in the case of compulsory pilotage. This is not imposed on all vessels coming into San Francisco Harbor (secs. 2465, 2467, 2468, Calif. Pol. Code; *Homer Ramsdell Co.* v. *Comp. Gen. Trans.*, 182 U. S., 407); and, in any event, the contract is not with the State but with the shipowner. (*The Queen* (supra).) The courts of California have, however, indirectly held the pilots of San Francisco to be State officers (*People* v. *Woodbury*, 14 Calif., 42, and *Flynn* v. *Abbott*, 16 Calif., 350), and, in view of the nature of section 1211, the doubts on this point may be resolved in favor of the pilots.

It has previously been said that the pilot's compensation is not received for "official services." But this is not essential under section 1211, which specifies compensation received for "*personal* services as an officer or employee." Fees received by virtue of an office are not always for official services, but may be "personal fees" for "unofficial services" (*United States* v. *Mosby*, 133 U. S., 273), and as a result of a "contract * * * in the way of compensation * * * to be paid by the person employing him." (*Sargent County* v. *Sweetman* (N. D.), 150 N. W., 876.) But they are re-

ceived "as an officer" none the less, for no one but an officer is qualified to render the particular service.

For the reasons stated, it is the opinion of this office that the compensation received by the bar pilots of San Francisco for piloting vessels is taxable under the Revenue Act of 1926; but that these pilots are entitled to the relief provided by section 1211 of that Act on account of taxes imposed by the Revenue Act of 1924 or prior Revenue Acts, subject to the statutory period of limitation.

A. W. GREGG,
General Counsel, Bureau of Internal Revenue.

ARTICLE 89: Additional exclusions from gross income.
(Also Section 209, Article 1661.)

VI-13-3166
G. C. M. 1405

REVENUE ACT OF 1926.

The $20,000 limitation contained in section 209(a)3 of the Revenue Act of 1926 is not applicable to the income which is exempt from tax under section 213(b)14 of the Act.

The opinion of this office is requested as to whether the $20,000 limitation of earned net income for the purpose of computing the earned income credit also applies in the case of earned income from sources without the United States which is exempt from tax under section 213(b)14 of the Revenue Act of 1926. Attention is called to the fact that the term "earned income" is defined in section 209(a)1, whereas the $20,000 limitation is contained in section 209(a)3, which defines "earned net income."

A letter from the taxpayer contains the following statement:

Our interpretation of this is that, regardless of amounts, all "earned income" is exempt and not to be included in gross income in the cases of all individual citizens of the United States who are bona fide nonresidents of the United States for more than six months during the taxable year. In accordance with this, it is our understanding that we should notify American employees in foreign countries that they are not required to report any earned income.

The income which is exempt from tax under section 213(b)14 is the amount received from sources without the United States which constitutes earned income as defined in section 209. Earned income is defined in section 209(a)1. The term defined in section 209(a)3 is "earned net income," which means the earned income as defined in paragraph (1) less the sum of the earned income deductions as defined in paragraph (2). The $20,000 limitation in paragraph (3) applies only to earned net income, and is for the purpose of computing the earned income credit allowable under section 209(b). It follows that the $20,000 limitation contained in section 209(a)3 is not applicable to the income which is exempt from tax under section 213(b)14.

The taxpayer's interpretation as to what income is exempt under section 213(b)14 is too broad. It is only earned income from sources without the United States which is exempt under that section.

A. W. GREGG,
General Counsel, Bureau of Internal Revenue.

ARTICLE 89: Additional exclusions from gross income. VI–16–3200 T. D. 4013

INCOME TAX.

Exemption from taxation of earnings of ships documented under the laws of The Netherlands.

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

To Collectors of Internal Revenue and Others Concerned:

Section 213(b)8 of the Revenue Acts of 1921, 1924, and 1926 provides that there shall be exempt from taxation the income of a nonresident alien or foreign corporation which consists exclusively of earnings derived from the operation of a ship or ships documented under the laws of a foreign country which grants an equivalent exemption to citizens of the United States and to corporations organized in the United States.

The Netherlands grants an equivalent exemption to citizens of the United States and to corporations organized in the United States, from January 1, 1921. Accordingly, article 89 of Regulations 62 as amended by Treasury Decision 3813 (C. B. V–1, 225), article 89 of Regulations 65 as amended by Treasury Decision 3812 (C. B. V–1, 47), and article 89 of Regulations 69, are hereby amended so as to include The Netherlands in the list of countries which exempt from tax so much of the income of citizens of the United States nonresident in such foreign countries and of corporations organized in the United States as consists of earnings derived from the operation of a ship or ships documented under the laws of the United States, and to exclude The Netherlands from the list of countries which do not grant such exemption.

D. H. BLAIR,
Commissioner of Internal Revenue.

Approved April 8, 1927.

C. S. DEWEY,
Acting Secretary of the Treasury.

SECTION 214(a)1.—DEDUCTIONS ALLOWED INDIVIDUALS: BUSINESS EXPENSES.

ARTICLE 101: Business expenses. VI–20–3231 G. C. M. 1627

REVENUE ACT OF 1926.

A contribution made by a corporation to a chamber of commerce to cover a proportionate part of the expenses incident to the efforts of that organization to secure from the Interstate Commerce Commission a revision of freight rates on a particular class of products held to be deductible in computing net income. Recommended that I. T. 2290 (C. B. V–1, 53) be revoked.

The question discussed in Office Decision 2290 is whether a contribution made by a corporation to a chamber of commerce to cover a proportionate part of the expenses incident to the efforts of that organization to secure from the Interstate Commerce Commission

a revision of freight rates on a particular class of products is deductible in computing net income. A review of this office decision has been requested, in light of the decision of the Board of Tax Appeals in the appeal of the Independent Brewing Co. of Pittsburgh (4 B. T. A., 870), in which the Commissioner has acquiesced with respect to the issue stated below.

There was a finding of fact in the case of the appeal of the Independent Brewing Co. of Pittsburgh to the effect that in its income tax return for the year 1919 it had deducted from gross income the amounts paid to three brewery associations, two being local associations and one a national association, organized and conducted for the furtherance of the interests of the brewery industry. The national association was interested in contesting the constitutionality of the prohibition amendment and a contribution of the taxpayer during the year 1919 was for attorney's fees in connection with this litigation. It was decided by the Board of Tax Appeals that the three brewery associations were performing lawful services for their members, that such services were in the furtherance of the members' business, that it was perfectly legal for brewers' associations to test the constitutionality of the prohibition amendment, and that a payment by the taxpayer of its proportionate share of attorney's fees expended by one of these associations was an ordinary and necessary expense of doing business.

In Office Decision 2290 the Bureau took the position that in order for a contribution to be deductible in computing net income it must constitute an ordinary and necessary business expense incurred in the operation and maintenance of a trade or business, and it was held that a contribution to a chamber of commerce of a portion of the expenses incident to the efforts of such organization to obtain a revision of freight rates in order to enable local producers to compete more successfully with producers in adjacent States having the benefit of lower freight rates was not deductible as an ordinary and necessary business expense. It was pointed out that the benefits which would inure to a taxpayer through any revision of freight rates obtained by the chamber of commerce were too remote to warrant a holding that such contribution was an ordinary and necessary business expense within the meaning of section 234(a)1 of the Revenue Act of 1926, which provides in part as follows:

> (a) In computing the net income of a corporation subject to the tax imposed by section 230 there shall be allowed as deductions:
> (1) All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, * * *.

Similar provisions are contained in prior Revenue Acts.

A number of cases involving issues similar to that involved in the question under review have been decided by the Board of Tax Appeals. In the appeal of Anniston City Land Co. (2 B. T. A., 526) it was held that a contribution to a chamber of commerce to aid in the purchase of a tract of land to be given to the United States Government in order to get an Army post located at a particular city was an allowable deduction, for the reason that the land company owned contiguous acreage and would benefit by an increased demand for its land. The Board stated that such a contribution had in a direct

sense a reasonable relation to the taxpayer's business. However, it was held in the cases of the Anniston Auto Co. (4 B. T. A., 689) and Bell-Rogers & Zemurray Bros. Co. (4 B. T. A., 687) that a contribution to a chamber of commerce in order to secure the desired location of an Army training camp was not an allowable deduction, and in the appeal of the Thomas Shoe Co. (1 B. T. A., 124) it was held that a contribution to a fund raised by local business organizations to purchase land upon which a naval ordnance plant would be erected was not an ordinary and necessary business expense incurred in the wholesale shoe business. In the latter case it was stated by the Board that to be deductible as a business expense a contribution, charitable or otherwise, must have in a direct sense some reasonable relation to the taxpayer's business. In the appeal of the Citizens Trust Co. of Utica (2 B. T. A., 1239) it was held that a contribution to a county farm bureau was an allowable deduction, the apparent reason for the decision being that the trust company received the benefit of the advertising occasioned through an active association and participation in the enterprise carried on by the county farm bureau. In the appeal of the Holt-Granite Mills Co. (1 B. T. A., 1246) there was allowed as a deduction an amount contributed to a school district for the purpose of aiding in the erection of a school building where 80 to 90 per cent of the pupils were children of employees in the mills. In the appeal of Poinsett Mills (1 B. T. A., 6) it was held that a contribution made by a corporation to a church maintained in its mill village was an allowable deduction, the Board stating that "the contribution was clearly made by the corporation for purposes connected with the operation of its business and legitimately represents a consideration flowing directly to the corporation as an incident to its business." In the appeal of the Lihue Plantation Co., Ltd. (2 B. T. A., 740), there was allowed the deduction of a contribution made to a Young Men's Christian Association for the purpose of maintaining welfare workers on the taxpayer's plantation in order that its employees might be more contented and its business operations more efficiently carried on.

It would seem that the decisions of the Board of Tax Appeals are to the effect that where a contribution has in a direct sense a reasonable relation to a corporation's business, it is an allowable deduction in computing net income. A contribution is likewise allowable as a deduction where it is in consideration of a benefit flowing directly to a corporation as an incident to its business.

In considering the question as to whether the amount contributed or paid by a corporation as its proportionate share of the expenses incurred by a chamber of commerce in its efforts to secure a favorable freight rate revision is an ordinary and necessary business expense of the corporation, it is important to consider the effect of such freight rate revision upon the taxpayer's business. In Office Decision 2290 the taxpayer appeared to be directly concerned, since its particular products were the subject of discriminatory freight rates due to the fact that dealers in other States received the benefit of more favorable rates.

It must be conceded that the question of freight rates is a matter of much moment to a corporation engaged in a business which re-

quires the shipping of its products by freight, where keen competition exists with shippers of similar products in other localities who have the benefit of more favorable rates. The differential between the freight rates available to the competing shippers may be detrimental if not actually destructive in its application to the business of the less favored shipper. His customers may seek the market which makes available the desired goods at a lower cost of delivery. So it is not an unusual but frequently a necessary procedure for a shipper to attempt to secure more favorable freight rates and even to engage attorneys to assist in effecting this end.

If a number of shippers should combine their efforts to secure freight rates more beneficial to themselves, an individual contribution to a common fund to carry on the joint undertaking might properly be regarded as a business expense of any one of the shippers, and the situation would appear to be little different whether a particular attorney, traffic bureau, or an association such as a chamber of commerce carried on the work of securing a revision of the freight rates. It is a logical conclusion that a revision of freight rates which will enable a shipper or a group of shippers to compete under more favorable circumstances with shippers of similar products in other localities will result in a direct benefit to the business of the shipper or shippers who may secure the benefit of the revision in freight rates. The increase in the volume of business or the ability to ship at a lower cost are benefits which are very material and necessary incidents of competitive trading and often material factors in the success of a business.

A review of the facts cited in Office Decision 2290 discloses that the expenditure by way of a contribution to the chamber of commerce was in an effort to secure the benefit of lower freight rates for the community, but more particularly with respect to the products of the taxpayer. The benefit to be obtained by the taxpayer was direct, and immediately applicable to its business.

This office has afforded careful consideration to the conclusion indicated in Office Decision 2290, and is of the opinion that such conclusion is erroneous. This office is also of the opinion that such conclusion is contrary to that indicated by the Board of Tax Appeals in the case of the Independent Brewing Co. of Pittsburgh and similar cases cited above.

It is accordingly recommended that Office Decision 2290 be revoked.

A. W. Gregg,
General Counsel, Bureau of Internal Revenue.

Article 101: Business expenses. VI–20–3232
I. T. 2353

REVENUE ACT OF 1926.

I. T. 2290 (C. B. V–1, 53) is revoked, in view of General Counsel's Memorandum 1627, page 59.

ARTICLE 101: Business expenses. VI-23-3255
I. T. 2360

REVENUE ACT OF 1926.

Amounts paid as dues or membership fees to the M Company, which is rendering a protective service to its members with respect to fraudulent practices and activities affecting their business, are allowable deductions as business expenses in determining net income of individuals or corporations.

Advice is requested as to the deductibility of dues paid by members to the M Company.

The corporation has for its object "To promote integrity and create confidence in advertising, selling, and all other phases of business and do all lawful things which may help attain such objects." Prospective members are divided into classes and pay dues in proportion to their size, amount of advertising, number of employees, and other considerations, such as the line of business and the amount of business done. The income of the organization is used exclusively for operation and maintenance costs.

The organization is affiliated in a cooperative way with the O Company, which is composed of better business bureaus located in the principal cities of the United States. The corporation functions to curb, as far as possible, false, misleading, deceptive advertising, fraudulent business practices, speculative and unsound investment offerings, and to do everything it can for the advancement of clean business. It issues bulletins and reports of accomplishments and warnings to its members. Its service is given to the public without charge and it cooperates quite extensively with State and Federal organizations in checking fraud and deception in business.

The M Company is rendering a protective service to its members with respect to fraudulent practices and activities affecting their business, and membership in the organization is employed as a means of advancing their business interests. The amounts paid as dues or membership fees are necessary and ordinary business expenses of the individuals or corporations making such payments and, therefore, are allowable deductions in determining net income.

SECTION 214(a)3.—DEDUCTIONS ALLOWED INDIVIDUALS: TAXES.

ARTICLE 131: Taxes. VI-9-3124
G. C. M. 1236

REVENUE ACT OF 1926.

The real estate tax imposed by the laws of Minnesota constitutes an accrual on the date of the delivery of the tax lists to the county treasurer by the county auditor, as provided in section 2074 of the General Statutes of Minnesota.

An opinion is requested with respect to the time of accrual of real property taxes in Minnesota.

The provisions of the General Statutes of Minnesota, 1923, pertaining to real estate taxes, are quoted in part as follows:

SEC. 1984. All real property subject to taxation shall be listed and assessed every even-numbered year with reference to its value on May 1 preceding the

assessment, and all real property becoming taxable any intervening year shall be listed and assessed with reference to its value on May 1 of that year.

* * * * * * *

SEC. 2071. The county auditor shall make out the tax lists according to the prescribed form, and to correspond with the assessment districts * * *.

* * * * * * *

SEC. 2074. On or before the first Monday in January in each year, the county auditor shall deliver the lists of the several districts of the county to the county treasurer, taking therefor his receipt showing the total amount of taxes due upon the lists. Such lists shall be authority for the treasurer to receive and collect taxes therein levied.

* * * * * * *

SEC. 2191. The taxes assessed upon real property shall be a perpetual lien thereon, and on all structures and standing timber thereon and on all minerals therein, from and including May 1 in the year in which they are levied, until they are paid; but, as between grantor and grantee, such lien shall not attach until the first Monday of January of the year next thereafter.

The question as to when the tax was ascertained and levied was considered by the Supreme Court of Minnesota in the case of *Nelson* v. *Becker* (63 Minn., 61). The provisions of the statute considered by the court in that case were substantially the same as those of section 2074 of the General Statutes of Minnesota, 1923, above quoted. The court stated in part as follows:

> He [the county treasurer] is not authorized to receive and collect taxes until the lists are delivered to him by the county auditor, who has the right to make and deliver this list at any time between October 10 and the ensuing first Monday in January. * * * nor is it merely making the levy; it is the ultimate fact of ascertaining and levying the taxes covered by section 1569, referred to. Of course, all this may be done prior to the first Monday of January in each year, because the law authorizes it to be done on or before that time; and, when done, whether in the months of October, November, or December, the total amount would then be ascertained and levied * * *.

In the opinion of this office, the real estate tax in question does not become such a known liability prior to the date of delivery of the tax lists by the county auditor to the county treasurer as to constitute an accrual. On the date of the delivery of the tax lists showing the total amount of taxes due for the tax year the amount of the tax is ascertainable and the liability for its payment becomes fixed. Accordingly the real estate tax imposed by the laws of Minnesota constitutes an accrual on the date of the delivery of the tax lists to the county treasurer by the county auditor, as provided in section 2074 of the general Statutes of Minnesota. As stated in *Nelson* v. *Becker*, supra, the delivery of the tax lists may occur prior to the first Monday in January of each year, because the law authorized it to be done on or before that time; but on whatever date the tax lists are delivered, whether in October, November, December, or in January on or before the first Monday, that is the date on which the tax accrues.

A. W. GREGG,
General Counsel, Bureau of Internal Revenue.

ARTICLE 131: Taxes. VI-10-3129
(Also Section 212, Article 23.) G. C. M. 1240

REVENUE ACT OF 1926.

The acquiescence of the Commissioner in the decision of the United States Board of Tax Appeals in the appeal of the Russell Milling Co. (1 B. T. A., 194, C. B. IV-1, 3), which held that State, county, and municipal taxes do not accrue until they become due, should not be construed to be applicable to the time of accrual of State income taxes. The decision of the United States Supreme Court in the case of *United States* v. *Anderson et al.* (269 U. S., 422; T. D. 3839, C. B. V-1, 179), holding that the tax on the income from the sale of munitions in 1916 constituted an accrual for that year, does not affect the ruling that property taxes accrue when they become due.

An opinion is requested as to whether the decision of the Board of Tax Appeals in the case of the Russell Milling Co. as to the time of accrual of property taxes, which decision has been acquiesced in by the Commissioner, is affected by the decision of the Supreme Court in the case of *United States* v. *Anderson et al.*

The decision in the Russell Milling Co. case, in so far as the time of accrual of property taxes is concerned, is that State, county, and municipal taxes imposed by the State of Kansas, which are due on November 1, and are payable on or before December 20, do not accrue until they become due.

Property taxes are annually recurring charges, which are payable whether or not the property produces income or is used in business, and whether or not the owner has income from any source. Such taxes are not expenses incurred in and directly attributable to the process of earning income in the sense that taxes imposed on income are. They are thus distinguishable from munitions taxes, the type of taxes considered by the Supreme Court in the Anderson case.

In Solicitor's Memorandum 4499A (C. B. V-1, 56) it was held that what was said with respect to munitions taxes in the Anderson case applies with equal force to income taxes and that the principles emphasized by the court, which are applicable to both income and munitions taxes, are:

> The income earned during any taxable year by a taxpayer keeping its books of account on the accrual basis must be charged with all the expenses incurred in, and attributable to, the process of earning such income; true annual income is only determinable after making due allowance for the *total* cost and expenses attributable to the production of that income; a taxpayer is not properly reporting income on the accrual basis unless he deducts from gross income not only accruals of interest and expenses but also reserves made to meet liabilities for taxes incurred in the process of creating income; a liability for tax may be incurred prior to the assessment or due date of a tax where prior thereto all the events "occur which fix the amount of the tax and determine the liability of the taxpayer to pay it," and in such cases both for purposes of accounting and of ascertaining true income the tax has accrued and does "not stand on any different footing than other accrued expenses."

The first three principles are not applicable to property taxes in the sense that they are applicable to taxes imposed on income. Whether the last principle is applicable to property taxes depends on whether all the events which fix the amount of the tax and determine the liability of the taxpayer to pay it occur prior to the due date thereof.

It may be stated generally that not until the tax roll is completed and turned over to the county treasurer or other officer designated by law to collect property taxes, with a warrant to collect such tax, have all the events occurred which fix the amount of the tax and determine the liability of the taxpayer to pay it. This is usually the due date. All that the taxpayer knows prior to that time is that he will have to pay taxes on his property. The value at which it will be assessed and the rate to be applied to such value are determined by the officials designated by law.

In the case of an income or munitions tax all the elements which enter into the computation of the amount of income subject to tax and the rate to be applied to such income are within the knowledge of the taxpayer. The income and munitions taxes are self-determined in the sense that the taxpayer makes the computation of the income subject to tax and the tax to be paid. Property taxes, on the other hand, are not self-determined. The property is valued and the tax computed by the officers designated by law. Not until such officers complete their computation and the tax roll or tax book is made up does a liability for any particular sum become fixed. Most property tax laws require that the tax rolls be completed on a certain date or on or before a certain date. The date on which such rolls are completed is ordinarily the due date of the tax. In Wisconsin the tax roll, with warrant attached, must be delivered to the town, city, or village treasurer on or before the third Monday in December. In Minnesota the tax lists are required to be delivered to the county treasurer on or before the first Monday in January. In both of these States, therefore, taxes become due when the tax roll is delivered to the proper treasurer, although payment of such taxes is not required until a subsequent date.

It is the opinion of this office, therefore, that the decision of the Supreme Court in the case of *United States* v. *Anderson et al.* does not affect the decision of the Board of Tax Appeals in the case of the Russell Milling Co. as to the time of accrual of property taxes. Accordingly, the ruling that State, county, and municipal taxes accrue when they become due is affirmed.

A. W. GREGG,
General Counsel, Bureau of Internal Revenue.

ARTICLE 132: Federal duties and excise taxes. VI–16–3201
I. T. 2346

REVENUE ACT OF 1926.

Where the tax imposed by section 400, Revenue Act of 1924, on cigars and cigarettes has been made a part of the cost of the merchandise, any amount refunded under section 1205 of the Revenue Act of 1926 should be treated as a reduction of the cost of the merchandise for the year in which it was added to such cost. If the tax has been taken as a deduction from gross income instead of being treated as a part of the cost of the merchandise, the tax return in which the deduction was originally claimed should be corrected to show no deduction for such tax.

Inquiry is made as to whether the amount of tax on cigars refunded to the M Company under section 1205 of the Revenue Act of 1926 constitutes income to the company for the year the refund was made.

Section 1205 of the Revenue Act of 1926 reads in part as follows:

(a) In the case of all cigars and little cigars in original and unbroken statutory packages held and intended for sale by any person on the effective date of the repeal of section 400 of the Revenue Act of 1924, including those in customs custody or in transit from the insular possessions of the United States, which on such date have affixed thereto stamps purchased at the rates of tax imposed by section 400 of the Revenue Act of 1924, there shall be allowed a refund equal to the difference between the tax imposed by such section and the tax imposed by section 400 of this Act.

(b) No refund shall be allowed under this section unless claim therefor is presented within 60 days after the effective date of the repeal of section 400 of the Revenue Act of 1924. No refund shall be made to any person if the claim is for an amount less than $10.

The tax imposed on cigars and cigarettes by section 400 of the Revenue Act of 1924 was payable by the manufacturer or importer. The refund under section 1205 of the Revenue Act of 1926 is allowable to the person who on the effective date of the repeal of section 400 of the Revenue Act of 1924 held and intended for sale cigars and little cigars in original and unbroken statutory packages, regardless of whether he is the manufacturer or importer who paid the tax thereon. Where the tax has been made a part of the cost of the merchandise, any amount refunded under section 1205 of the Revenue Act of 1926 should be treated as a reduction of the cost of the merchandise for the year in which it was added to such cost. If the tax has been taken as a deduction from gross income, as provided in article 132, Regulations 69, instead of being treated as a part of the cost of the merchandise, the tax return in which the deduction was originally claimed should be corrected to express the true ultimate fact and to show no deduction for such tax.

SECTION 214(a)7.—DEDUCTIONS ALLOWED INDIVIDUALS: BAD DEBTS.

ARTICLE 151: Bad debts. VI-17-3207
I. T. 2348

REVENUE ACT OF 1926.

Change from the reserve method of treating bad debts to that of deducting specific bad debts. (I. T. 1774 [C. B. II-2, 144] modified.)

Application has been made by the M Company for permission to change, beginning with the calendar year 1926, from the reserve method of treating bad debts for the purpose of computing net income to that of deducting those debts which are actually ascertained to be worthless and charged off.

As a condition to the right to make such change, the taxpayer will be required to include in its gross income for the calendar year 1926 an amount equal to the excess of the amounts added to the reserve for bad debts and taken as deductions during prior years under the reserve method over the bad debts actually ascertained to be worthless and charged off during those years. This amount should be the balance shown in the reserve for bad debts as of December 31, 1925. I. T. 1774 is modified accordingly.

ARTICLE 155: Reserve for bad debts. VI-15-3192
Mim. 3527

Reserve for bad debts—Revenue Acts of 1921, 1924, and 1926.

TREASURY DEPARTMENT,
OFFICE OF COMMISSIONER OF INTERNAL REVENUE,
Washington, D. C., March 30, 1927.

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

In view of the acquiescence of the Commissioner in the decision of the United States Board of Tax Appeals in the case of the Transatlantic Clock & Watch Co. (3 B. T. A., 1064), taxpayers in adopting the reserve method of treating bad debts for taxable years coming under the Revenue Acts of 1921 and 1924 are not required to determine the amount that should reasonably have been set up at the close of the taxable year preceding that in which they elected to use the reserve method, and are not permitted to deduct from gross income debts that were outstanding at the close of such preceding year and were ascertained to be worthless in whole or in part and were charged off during the taxable year in which they elected to use the reserve method. For the taxable year in which the election to use the reserve method is made or permission to change to such method is obtained, in accordance with the provisions of the regulations, a reasonable reserve for bad debts may be set up and deducted. Under the reserve method, a reasonable addition to such reserve may be deducted for each subsequent year. What constitutes a reasonable reserve for bad debts or a reasonable addition thereto must be determined in the light of the facts in each case. Consideration should be given to the volume of charge sales or other business transactions for the taxable year and the percentage of the reserve to such amount, the total amount of notes and accounts receivable at the beginning and close of the taxable year, and the amount of debts which have been ascertained to be wholly or partially worthless and have been charged against the reserve account during the taxable year.

Articles 151 and 155, Regulations 69, should be followed in cases coming under the Revenue Act of 1926.

The question has arisen as to the right of taxpayers who filed returns for the calendar year 1921 or for fiscal years ending in 1922 to change the method previously used of treating bad debts without first obtaining permission from the Commissioner.

Under the provisions of sections 214(a)7 and 234(a)5 of the Revenue Act of 1921, taxpayers had the right to treat bad debts in either of two ways—(1) by deducting debts ascertained to be worthless in whole or in part and charged off within the taxable year, or (2) by deducting a reasonable addition to a reserve for bad debts. Articles 151 and 155, Regulations 62, provide that for the year 1921 taxpayers, regardless of their previous practice, may elect to use either of the two methods, and that they will be required to continue the use in later years of the method so elected unless permission to change to the other method is first obtained from the Commissioner. Articles 151 and 155, Regulations 62, promulgated on February 15, 1922, constituted formal notification to taxpayers by the

Treasury Department as to their right to elect to treat bad debts upon either of the two methods above mentioned. Where a deduction was taken for the calendar year 1921 upon the basis of debts actually ascertained to be worthless and charged off during the taxable year, the taxpayer is not entitled, without permission from the Commissioner, to change to the reserve method for the calendar year 1922 and subsequent years. As a general rule, the returns for fiscal years ending in 1922 were the first returns filed after the promulgation of Regulations 62 by taxpayers having such fiscal years. A taxpayer having a fiscal year ending in 1922, regardless of the method previously used, had the right to elect the use of either of the two methods for treating bad debts without first having obtained permission from the Commissioner, for the reason that, in the absence of any extension of time for filing the return, the return for any fiscal year ending in 1921 was due on or before February 15, 1922, the date on which Regulations 62 were promulgated. In cases where, pursuant to extensions of time for filing returns, taxpayers filed returns after February 15, 1922, for fiscal years ending in 1921, they are deemed to have made an election as to the method to be used and can not change to the other method without obtaining permission from the Commissioner.

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

C. R. NASH,
Acting Commissioner.

ARTICLE 155: Reserve for bad debts. VI–26–3281
I. T. 2365

REVENUE ACT OF 1926.

The use of a reserve for bad debts is not permissible by a dealer in personal property on the installment plan who reports profits applicable to installment sales in accordance with the installment basis of accounting as contemplated by article 42, Regulations 69. The amount to be deducted from gross income as a bad debt, in cases of sales of personal property on the installment plan in which the unpaid installment obligations of the purchaser become worthless and are charged off and the property is not recovered by the vendor, is such proportion of the defaulted payments as represents the capital investment—that is, the cost of the goods sold—and this amount must be deducted for the year in which the default occurred. (O. D. 792 [C. B. 4, 86]; see also article 153, Regulations 69.)

SECTION 214(a)8.—DEDUCTIONS ALLOWED INDIVIDUALS: DEPRECIATION.

ARTICLE 161: Depreciation. VI–15–3183
G. C. M. 1424

REVENUE ACT OF 1926.

Only a legal life tenant, as distinguished from a life beneficiary under a trust, is entitled to the depreciation allowance provided for in section 214(a)8 of the Revenue Act of 1926.

An opinion is requested as to the application of section 214(a)8 of the Revenue Act of 1926 (1) to the life beneficiary of a trust of improved real estate and (2) to the remainderman.

The will of A, of New York City, dated ——, provided in part:

I give, devise and bequeath the remaining one-half share and moiety of all my said property unto my son B and my daughter C as trustees to hold the same in trust for the following purposes: To pay the income from such property to my daughter C during her life, the principal of such share upon her death to go to her children, if she leave any, her surviving, and in the event of her leaving no children her surviving, to my son B. In the event that my said son shall predecease my said daughter, leaving no widow or children him surviving, title to such share shall vest in my daughter absolutely.

The date of death of the testatrix is not stated, but it was apparently some time prior to the year 1925. Income of the trust is derived partly from improved real property under lease. B is acting as managing trustee under the will.

There is no provision in the will which requires the trustees to deduct an allowance for depreciation in computing the income to be distributed. Under the laws of New York State a trustee is not permitted to retain an allowance for depreciation of improved real property from amounts paid to a life beneficiary where the declaration of trust directs simply that the trustee pay over the "income" thereof. (*Fickett* v. *Cohn*, 14 Daly, 650, 1 N. Y. Supp., 436, 439; *N. Y. Life Insurance & Trust Co.* v. *Sands*, 24 Misc., 102, 53 N. Y. Supp., 320, 322; Re Cornells Estate, 15 App. Div., 285, 44 N. Y. Supp., 585.)

Section 214(a)8 of the Revenue Act of 1926 reads as follows:

SEC. 214. (a) In computing net income there shall be allowed as deductions:

(8) A reasonable allowance for the exhaustion, wear and tear of property used in the trade or business, including a reasonable allowance for obsolescence. In the case of improved real estate held by one person for life with remainder to another person, the deduction provided for in this paragraph shall be equitably apportioned between the life tenant and the remainderman under rules and regulations prescribed by the Commissioner with the approval of the Secretary.

It is apparent that only a legal life tenant, as distinguished from a life beneficiary under a trust, is entitled to the depreciation allowance provided for in section 214(a)8. A "life tenant" under that section is a person who "holds" improved real estate for life. This distinction between a life beneficiary and a life tenant is recognized by the Board of Tax Appeals in its recent opinion in the appeal of Samuel E. Prather (5 B. T. A., 623). The Board in referring to the fact that the taxpayer had created a trust by a conveyance of a life estate in certain real property stated:

He had prior thereto definitely parted with any interest which he had as a life tenant and his only interest in the property was that of cestui que trust.

That the above interpretation of section 214(a)8 is the only proper one is demonstrated by the following provisions of section 215(b):

Amounts paid under the laws of any State, Territory, District of Columbia, possession of the United States, or foreign country as income to the holder of a life or terminable interest acquired by gift, bequest, or inheritance shall not be reduced or diminished by any deduction for shrinkage (by whatever name called) in the value of such interest due to the lapse of time, nor by any deduction allowed by this Act for the purpose of computing the net income

of an estate or trust but not allowed under the laws of such State, Territory, District of Columbia, possession of the United States, or foreign country for the purpose of computing the income to which such holder is entitled.

It follows in the instant case that the trustee may take a proper deduction for the depreciation of the improved realty in computing the net income of the estate (although if the entire income of the trust is distributed annually the benefit of the deduction is necessarily lost), but the life beneficiary must return as her income the amounts paid to her undiminished by any allowance for depreciation. (*Baltzell* v. *Mitchell*, 3 Fed. (2d), 428; T. D. 3668 [C. B. IV–1, 191].) The remainderman can take no deduction for depreciation during the existence of the trust, although upon its termination he may claim a depreciation deduction as provided in article 161, Regulations 69.

A. W. GREGG,
General Counsel, Bureau of Internal Revenue.

ARTICLE 161: Depreciation. VI–22–3248
(Also Section 204, Article 1594.) G. C. M. 1597

REVENUE ACT OF 1926.

Certain real estate was devised by a testator to a trustee for the benefit of a life beneficiary with remainder to another person. The property was sold by the trustee at an advance over its appraised value at the date of the testator's death.

Held, that the equitable apportionment provided for in article 161, Regulations 69, must be between the life tenant (the trustee) and the remainderman, and the life tenant allowed depreciation on the part of the fair market value apportioned to it, as the property was used in a trade or business, irrespective of whether the terms of the will governing the trust property provided for keeping such property intact. The basis for determining gain or loss from a sale of the depreciable trust property by the trustee must be adjusted by the amount allowable to the trustee for depreciation whether or not such deduction was claimed by the trustee or formally allowed.

A died November —, 1922. Under the terms of his will certain improved real estate was devised to the M Company as trustee for the benefit of B, life beneficiary, with remainder to another person. This property was sold by the trustee at an advance over the appraised value of the property as of the date of the testator's death, and the question has arisen as to the adjustment for depreciation in determining the profit from the transaction. The trustee is under the impression that the life beneficiary under the trust was entitled to a reasonable allowance for depreciation on account of the trust property under section 214(a)8 of the Revenue Act of 1926, and upon that assumption desires to know whether after the life beneficiary has taken such depreciation as a deduction in his individual income tax return for the year 1925 and for the period during the year 1926 up to the time the property was sold the trustee must reduce the basis of the property for the purpose of determining gain or loss from its sale by the amount of depreciation taken by the life beneficiary.

Section 214(a)8 of the Revenue Act of 1926 reads as follows:

SEC. 214. (a) In computing net income there shall be allowed as deductions:
(8) A reasonable allowance for the exhaustion, wear and tear of property

used in the trade or business, including a reasonable allowance for obsolescence. In the case of improved real estate held by one person for life with remainder to another person, the deduction provided for in this paragraph shall be equitably apportioned between the life tenant and the remainderman under rules and regulations prescribed by the Commissioner with the approval of the Secretary.

A part of article 161, Regulations 69, construing section 214(a)8 of the Revenue Act of 1926, provides as follows:

* * * In the case of improved real estate held by one person for life with remainder to another person, the deduction for depreciation shall be equitably apportioned between the life tenant and the remainderman. Thus, if the improvement on real property devised to one for life with remainder over has an estimated useful life which exceeds the expectancy of the life tenant (as shown by the actuaries' combined experience table of mortality and expectation of life), the fair market value of the improvement at the time of its acquisition by devise shall be apportioned between the life tenant and the remainderman, and the life tenant will be entitled to depreciation on the part of such fair market value apportioned to him in case he uses the improvement in his trade or business, a ratable portion of the amount so allocated to be claimed as depreciation each year, while the remainderman, upon the termination of the life estate, will be entitled to depreciation on the balance of such fair market value of the improvement provided the property is used by him in his trade or business. In case the useful life of the improvement is less than the expectancy of the life tenant, the life tenant is entitled to depreciation thereon as if he were the owner of the fee.

When the above-quoted section of the law and article of the regulations construing said section are considered in connection with section 215(b) of the Revenue Act of 1926, it is apparent that the words "life tenant" used in section 214(a)8 apply to the holder of a legal life estate, and not to one entitled to the income from such an estate. The holder of the legal life estate in the instant case was the trustee. The trustee acquired the possession and use of the property, and it was the trustee who used the depreciable property in a trade or business. The trustee and the beneficiary are treated as separate taxable entities for income tax purposes.

It, therefore, follows that the equitable apportionment provided for in article 161, Regulations 69, must be between the life tenant (the M Company) and the remainderman, and the life tenant allowed depreciation on the part of such fair market value apportioned to it, as the trust property was used in a trade or business, and this irrespective of whether the terms of the will governing the trust property provided for keeping such property intact and for a portion of the income to be applied or held by the trustee for the purpose of making good the depreciation suffered on the depreciable property of the trust. If the entire income of the trust was distributable currently to the beneficiary, it is apparent that no benefit resulted to the life tenant from the right to the depreciation allowance, but that fact did not prevent the allowance from being available to the life tenant.

The trustee having been entitled to depreciation, the basis for determining gain or loss from a sale of the depreciable trust property by the trustee must be adjusted by the amount allowable to the trustee for depreciation, whether or not such deduction was claimed by the trustee or formally allowed.

A. W. GREGG,
General Counsel, Bureau of Internal Revenue.

SECTION 214(a)9.—DEDUCTIONS ALLOWED INDIVIDUALS: DEPLETION.

ARTICLE 216: Depletion—Adjustments of accounts based on bonus or advanced royalty. VI–23–3256 I. T. 2361

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

In computing deduction for depletion under article 216(a), Regulations 69, and corresponding provisions of article 215, Regulations 45 and 62, and of article 216, Regulations 65, as amended by Treasury Decision 3938 (C. B. V–2, 117), royalties expected to be received should not be reduced to present worth as at date of lease. The total expected royalties should be taken into consideration.

The provisions of the articles in question have no application to a bonus received by a lessor of unproven areas. In the case of a proven area, however, where the mineral content was known or was capable of being estimated at the time when the lease was granted and the bonus received, subdivision (a) of those articles should be given effect regardless of the fact that the area covered by the lease may have been nonproducing at that time.

Advice is requested relative to the application of paragraph (a) of article 216, Regulations 69, and the corresponding provisions of article 215, Regulations 45 and 62, and of article 216, Regulations 65, as amended by Treasury Decision 3938, under the following facts:

A—Cost, March 1, 1913, value or discovery value of oil property, $100,000.
B—Bonus received by lessor, $20,000, for lease.
C—At time of lease oil was being produced in commercial quantities.
D—Value of royalties to be expected determined on the basis of retained reserves over the economic life of production and reduced to present worth as at the date of lease involving bonus, $90,000.

The view has been presented that the entire bonus represents income to the lessor of nonproducing property even though the property was proven territory, and that, in order to come within the provisions of the regulations referred to above, the bonus must have been received subsequent to commercial production or discovery.

Article 216, Regulations 69, reads in part as follows:

(a) Where a lessor receives a bonus in addition to royalties, there shall be allowed as a depletion deduction in respect of the bonus an amount equal to that proportion of the cost or value of the property on the basic date which the amount of the bonus bears to the sum of the bonus and the royalties expected to be received. Such allowance shall be deducted from the amount remaining to be recovered by the lessor through depletion, and the remainder is recoverable through depletion deductions on the basis of royalties thereafter received.

The corresponding provisions of article 215, Regulations 45 and 62, and of article 216, Regulations 65, as amended by Treasury Decision 3938, are the same as the provisions of article 216(a), Regulations 69, above quoted.

Under the facts submitted, the royalties expected to be received from the lease have been reduced to their present worth as at the date of the lease. This is not in accordance with paragraph (a) of the articles of the regulations referred to, which expressly provide that there shall be allowed as a depletion deduction in respect of the bonus an amount equal to that proportion of the cost or value of the property on the basic date which the amount of the bonus bears to the sum of the bonus and the "royalties expected to be received." There is nothing in the regulations which would warrant the reduction to

their present worth of the royalties expected to be received from the lease. In computing the deduction for depletion, as provided by paragraph (a) of the regulations referred to, the "royalties expected to be received" should not be reduced to their present worth as at the date of the lease. The total expected royalties should be taken into consideration.

Paragraph (a) of article 216, Regulations 69, and the corresponding provisions of article 215, Regulations 45 and 62, and article 216, Regulations 65, as amended by Treasury Decision 3938, have no application to a bonus received by a lessor of unproven areas. In the case of a proven area, however, where the mineral content was known or was capable of being estimated at the time the lease was granted and the bonus was received, paragraph (a) of such articles applies regardless of the fact that the area covered by the lease may have been nonproducing at that time.

ARTICLE 219: Additional statement to be attached to return where depletion of oil or gas is claimed. VI-10-3136 T. D. 3990

INCOME TAX.

Article 219, Regulations 69, amended.

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

To Collectors of Internal Revenue and Others Concerned:

Article 219 of Regulations 69 is hereby amended by adding at the end thereof a paragraph reading as follows:

Where the allowance for depletion is based on the income from the property under section 204(c)2, the information required under the foregoing provisions of this article need not be furnished, except where it is necessary to determine gain or loss from the sale or other disposition of the property during the taxable year. For the purpose of computing the allowance for depletion upon the basis of the income derived from the property, there shall be submitted with the return a statement clearly showing the production, gross income, and net income (computed without allowance for depletion) from the property in respect of which the allowance for depletion is claimed.

D. H. BLAIR,
Commissioner of Internal Revenue.

Approved February 26, 1927.

A. W. MELLON,
Secretary of the Treasury.

ARTICLE 223: Charges to capital and to expense in the case of oil and gas wells. VI-6-3079 I. T. 2338

REVENUE ACT OF 1926.

In the case of oil and gas wells, a taxpayer has a new election for the year 1925 under article 223, Regulations 69, with respect to deducting or capitalizing expenditures made for wages, fuel, repairs, hauling, etc., in connection with the exploration of the property, drilling of wells, building of pipe lines, and development of the property.

ARTICLE 223: Charges to capital and to expense in the case of oil and gas wells. VI-26-3289 T. D. 4025

INCOME TAX.

Election to capitalize or deduct expenditures incident to exploration and development of oil and gas property.

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

To Collectors of Internal Revenue and Others Concerned:

Under the provisions of article 223, Regulations 69, such incidental expenses as are paid for wages, fuel, repairs, hauling, etc., in connection with the exploration of oil and gas property, drilling of wells, building of pipe lines, and development of such property, may at the option of the taxpayer be deducted as a development expense or charged to capital account. The regulations promulgated under the Revenue Acts of 1918, 1921, and 1924 provide for the same option.

In view of the change in the basis for depletion provided by the Revenue Act of 1926, in the case of oil and gas wells, taxpayers may make a new election as to the treatment of the expenditures above mentioned for taxable periods ending on or after January 1, 1925, but not later than six months after the date of this decision. Taxpayers desiring to make a new election are required to file amended returns for the taxable periods involved within six months from the date of this decision.

C. R. NASH,
Acting Commissioner of Internal Revenue.

Approved June 18, 1927.

A. W. MELLON,
Secretary of the Treasury.

SECTION 214(a)10.—DEDUCTIONS ALLOWED INDIVIDUALS: CONTRIBUTIONS OR GIFTS.

ARTICLE 251: Contributions or gifts.

ALL REVENUE ACTS.

Contributions to National Society of the Daughters of the American Revolution. (See I. T. 2334, page 82.)

SECTION 216.—CREDITS ALLOWED INDIVIDUALS.

ARTICLE 302: Personal exemption of head of family. VI-21-3239 I. T. 2354

REVENUE ACT OF 1926.

In June, 1926, the court granted a divorce to A's wife, awarded the custody of A's son to the mother, and ordered A to pay $—— a month toward his support.

Held, inasmuch as A has no right to exercise family control and as the dependent minor son makes his home at some place other than with A, the latter's classification is not that of the head of a family. If the amount furnished toward the minor son's support constitutes more than half of that actually required for his support, A is entitled to a credit of $400.

In June, 1926, the court granted a divorce to A's wife, awarded the custody of A's minor son to the mother, and ordered A to pay $—— a month toward his support. Inquiry is made as to whether A is entitled to exemption as the head of a family and also to a credit of $400 for the support of a dependent.

As defined by article 302 of Regulations 69, a head of a family is an individual who actually supports and maintains in one household one or more individuals who are closely connected with him by blood relationship, relationship by marriage, or by adoption, and whose right to exercise family control and provide for these dependent individuals is based upon some moral or legal obligation. In the absence of continuous actual residence together, whether or not a person with dependent relatives is the head of a family within the meaning of the statute must depend upon the character of the separation. If, however, without necessity, the dependent continuously makes his home elsewhere, his benefactor is not the head of a family, irrespective of the question of support.

It is held that inasmuch as A has no right to exercise family control and as the dependent minor son makes his home at some place other than with A, the latter's classification is not that of the head of a family within the meaning of section 216 of the Revenue Act of 1926 and article 302 referred to above. If, however, the amount furnished toward the minor son's support constitutes more than half of that actually required for his support, A would be entitled to a credit of $400.

SECTION 217.—NET INCOME OF NONRESIDENT ALIEN INDIVIDUALS.

ARTICLE 317: Income from sources within the United States. VI–3–3049 I. T. 2330

REVENUE ACT OF 1926.

Gain realized by a nonresident foreign corporation from purchasing in the United States bank acceptances at a discount and holding them until maturity represents income from sources within the United States irrespective of where payment is made at maturity.

Inquiry is made regarding the taxability of income realized by a nonresident foreign corporation from purchasing in the United States bank acceptances at a discount and holding them until maturity. The bank acceptances were the obligations of domestic corporations deriving 20 per cent or more of their income from sources within the United States.

Under section 233 of the Revenue Act of 1926, a foreign corporation (other than an insurance company subject to the tax imposed by section 243 or 246) is subject to tax only on income from sources within the United States as determined under the provisions of

section 217. Section 217 does not contain any provision specifically relating to the income derived upon the maturity of obligations which were purchased at a discount. Section 217(a) does provide, however, that there shall be included as income from sources within the United States—

(1) Interest on bonds, notes, or other interest-bearing obligations of residents, corporate or otherwise, not including (A) interest on deposits with persons carrying on the banking business paid to persons not engaged in business within the United States and not having an office or place of business therein, or (B) interest received from a resident alien individual, a resident foreign corporation, or a domestic corporation, when it is shown to the satisfaction of the Commissioner that less than 20 per centum of the gross income of such resident payor or domestic corporation has been derived from sources within the United States, as determined under the provisions of this section, for the three-year period ending with the close of the taxable year of such payor preceding the payment of such interest, or for such part of such period as may be applicable.

It will be noted that the effect of this provision is to base the determination of the source of interest upon the status of the obligor and not upon the place of payment or any other factor. It is believed that the gain derived upon the receipt of the principal at maturity of an interest-bearing obligation which was purchased at a discount should be regarded as having the same source as interest; that is, that the source of the income depends upon the status of the obligor. The Bureau adopted this view in Office Decision 890 (C. B. 4, 114), under section 213(c) of the Revenue Act of 1918. It was held in that ruling that if a foreign corporation not engaged in business in the United States should buy bonds of a foreign corporation or of a foreign government, payable at maturity either in a foreign country or in the United States at the then current or fixed rate of exchange, the profit realized on their retirement in neither case would be regarded as income from sources within the United States. While bank acceptances do not bear interest and are not altogether similar to bonds, it is considered that that ruling is applicable in the present case.

Accordingly, it is held that the gain realized by a nonresident foreign corporation from purchasing in the United States such acceptances at a discount and holding them until maturity will represent income from sources within the United States, irrespective of where payment is made at maturity.

SECTION 219.—ESTATES AND TRUSTS.

ARTICLE 343: Decedent's estate during administration. VI–15–3185 T. D. 4011

INCOME TAXES.

Amendment of article 343, Regulations 65 and 69.

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

To Collectors of Internal Revenue and Others Concerned:

Article 343 of Regulations 65 and 69 are hereby amended by changing the third sentence from the end thereof and the reference

directly following to read: "Where, however, the executor sells property of the estate for more than its cost or other basis to the decedent, as the case may be, the excess is income, or may be capital gain, taxable to the estate. (See articles 1561 and 1591.)" Article 343 of Regulations 65 and 69, as amended, reads as follows:

ART. 343. *Decedent's estate during administration.*—The "period of administration or settlement of the estate" is the period required by the executor or administrator to perform the ordinary duties pertaining to administration, in particular the collection of assets and the payment of debts and legacies. It is the time actually required for this purpose, whether longer or shorter than the period specified in the local statute for the settlement of estates. Where an executor, who is also named as trustee, fails to obtain his discharge as executor, the period of administration continues up to the time when the duties of administration are complete and he actually assumes his duties as trustee, whether pursuant to an order of the court or not. No taxable income is realized from the passage of property to the executor or administrator on the death of the decedent, even though it may have appreciated in value since the decedent acquired it. In the event of delivery of property in kind to a legatee or distributee, no income is realized. Where, however, the executor sells property of the estate for more than its cost or other basis to the decedent, as the case may be, the excess is income, or may be capital gain, taxable to the estate. (See articles 1561 and 1591.) An allowance paid a widow out of the corpus of the estate is not deductible from gross income. Where real estate is sold by the devisee or heir thereof, whether before or after settlement of the estate, he is taxable individually on any profit derived.

D. H. BLAIR,
Commissioner of Internal Revenue.

Approved April 6, 1927.

OGDEN L. MILLS,
Acting Secretary of the Treasury.

ARTICLE 343: Decedent's estate during administration. VI-17-3208 I. T. 2349

REVENUE ACT OF 1926.

Under the Code of Idaho the entire estate of a decedent, real and personal, whether decedent died testate or intestate, passes to his executor or administrator for the purposes of administration, and any profit from a sale of real estate for purposes of administration must be included in the gross income of the estate. Any amount of the profit properly paid or credited to the heirs or devisees is allowable as a deduction from such gross income.

ARTICLE 346: Stock bonus, pension, or profit-sharing trust. VI-4-3058 I. T. 2333

REVENUE ACTS OF 1921, 1924, AND 1926.

Dividends received on stock held by the trustees under a stock purchase plan retain the status of dividends when ultimately distributed or made available to the participating employees. The gain to a participating employee to the extent of his pro rata share of dividends received by the trustees is, accordingly, subject to the surtax only.

Advice is requested as to whether dividends paid during the year 1924 on stock held by the trustees under the stock purchase plan put

into effect in 1923 by the M Company for the benefit of its employees constitute taxable income either to the trustees or to the participating employees.

The plan is to be in operation for a period of five years unless sooner terminated. Employees who are eligible and who elect to participate authorize the corporation to deduct an amount from their compensation, not to exceed 20 per cent, and pay the same over to the trustees by whom such fund is to be administered, referred to as fund A. Concurrently with such payments made on behalf of the employees, the corporation contributes a sum equal to 50 per cent of the total of such payments, referred to as fund B. Interest earned and dividends received on stock held by the trustees are added to fund B and from this fund are paid the expenses incurred and interest accrued on withdrawals. The funds so accumulated are to be invested by the trustees in the purchase of stock of the corporation.

Provision is made by which a participating employee who withdraws from participation or who leaves the employment of the corporation or is discharged is to receive the amount deducted from his salary and paid into fund A, with interest at the rate of 6 per cent, or, at the option of the trustees, he may receive the equivalent thereof in stock. In case of the death or total disability of a participating employee, his pro rata share of both funds becomes payable, and at the termination of the plan both funds are to be distributed among the then participating employees in the ratio of their contributions.

The plan as put into effect and administered constitutes a trust as a part of a stock bonus or profit-sharing plan for the exclusive benefit of the participating employees within the meaning of section 219(f) of the Revenue Acts of 1921, 1924, and 1926. The principal and earnings of the trust, including dividends received on stock held by the trustees, are therefore not taxable in the hands of the trustees. The gain to a participating employee, consisting of his distributable share of the two funds so accumulated in excess of the amount contributed by him, constitutes taxable income to him as additional salary, wages, or determinable gains or profits for the year in which it is distributed or made available to him, taking into account his share of the stock so held at its fair market value at the time it is so distributed or made available.

With reference to dividends paid on stock held by the trustees as part of such funds, it will be noted that while the participating employees become entitled to their pro rata share of such stock only by complying with the terms or conditions—that is, by remaining as participants until the termination of the plan or until their death or total disability occurs—the stock is held outright during such time by the trustees for ultimate distribution to the participating employees entitled to receive it. Although not taxable in the hands of the trustees, dividends received on such stock go to form a part of the fund for ultimate distribution to the participating employees. Relative to the status of such portion of the funds when distributed or made available to the participating employees, section 219(f) of the Revenue Act of 1926 provides as follows:

* * * Such distributees shall for the purpose of the normal tax be allowed as credits such part of the amounts so distributed or made available as represents the items specified in subdivisions (a) and (b) of section 216.

The portion of fund B consisting of dividends received on stock held by the trustees therefore retains the status of dividends for income tax purposes when ultimately distributed or made available to the participating employees entitled to receive it. The gain to a participating employee as distributee of the fund, to the extent of his pro rata share of dividends received by the trustees on the stock so held by them, is accordingly subject to the surtax only.

SECTION 221.—PAYMENT OF INDIVIDUAL'S TAX AT SOURCE.

ARTICLE 361: Withholding tax at source.

REVENUE ACT OF 1926.

Extension by withholding agents of credit for earned income. (See Mim. 3506, page 20.)

ARTICLE 361: Withholding tax at source. VI–7–3093
G. C. M. 1175

REVENUE ACT OF 1926.

Example of a provision in a bond which is held to be a tax-free covenant clause. Joint obligations of an individual and a corporation held to be bonds of a corporation within the meaning of section 221(b) of the Revenue Act of 1926.

The opinion of this office is requested as to the effect with regard to section 221(b) of the Revenue Act of 1926 of certain quoted provisions in the bonds and mortgages of the M Company, to which obligations A, an individual, is also a party. The bonds contain the following provision:

M Company * * * and A * * * hereby acknowledge themselves indebted, and for value received, jointly and severally promise to pay to bearer, * * * the sum of $1,000 * * * and to pay interest thereon * * *.

Both principal and interest of this bond are payable without any deduction for any taxes or governmental charges in the nature thereof, which the company or the trustee under the mortgage or deed of trust hereinafter mentioned may be required or permitted to pay thereon, and to deduct or retain therefrom under any present or future law of the United States of America, except such portion of the Federal income tax with respect to income derived from such interest as shall be in excess of 2 per cent; and the makers hereof agree to pay all such taxes (except as herein specified) in so far as it may be lawful so to do.

The following paragraphs are from the mortgage:

* * * Said principal, interest and premium shall be paid without any deduction for any taxes or governmental charges in the nature thereof which the company or the trustee hereunder may be required or permitted to pay and deduct or retain under any present or future law of the United States, except such portion of the Federal income tax with respect to income derived from such interest as shall be in excess of 2 per cent; and the mortgagor agrees to pay such taxes except as hereinabove specified. * * *

This indenture is executed in two counterparts, each of which is, and for all purposes shall be treated as an original. By signing this indenture A assents to and becomes bound by and subject to all of the provisions thereof which by their terms or reasonable intendment are applicable to him as a joint and several maker of the said bonds and coupons.

In answer to the question as to whether or not these bonds are the joint and several obligations of the corporation and the individual,

it seems clear from the use of such language as "jointly and severally promise to pay" that they were intended to be such joint and several obligations. The effect, as stated in Bouvier's Law Dictionary, title "Joint and Several," "is as though all had given a joint bond and each a separate bond, and the creditor could elect on which bond he would sue." It follows, in answer to the second question, that the bonds are bonds of a corporation within the meaning of section 221(b) of the Revenue Act of 1926.

A. W. GREGG,
General Counsel, Bureau of Internal Revenue.

PART III.—CORPORATIONS.

SECTION 231.—CONDITIONAL AND OTHER EXEMPTIONS OF CORPORATIONS.

ARTICLE 511: Proof of exemption. VI-19-3226
Mim. 3537

Procedure with respect to applications for exemption under section 231 of the Revenue Act of 1926 and prior Revenue Acts.

TREASURY DEPARTMENT,
OFFICE OF COMMISSIONER OF INTERNAL REVENUE,
Washington, D. C., April 29, 1927.

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

Attention is invited to article 511 of Regulations 69, 65, 62, and 45, which contains a statement of the information required by the Bureau in determining whether an organization is exempt from tax under section 231 of the Revenue Act of 1926 and the corresponding provisions of the prior Revenue Acts. In order that a correct determination of the status of the organization seeking exemption may be made, it is essential that the information called for in article 511 be furnished.

Where, upon consideration of all the evidence presented covering the status of an organization under section 231, the Income Tax Unit has rendered an adverse ruling, the case, when requested by the applicant, will be referred to the General Counsel for review. An opportunity thereupon will be afforded the applicant for a hearing before the office of the General Counsel, if in the opinion of the General Counsel such a hearing is necessary to determine the status of the organization. The request for such review must be accompanied by all the additional statements of fact and arguments relied upon in support of the organization's claim for exemption, and addressed to the Commissioner of Internal Revenue, attention of Rules and Regulation Section, Income Tax Unit. The statements of fact must be sworn to by a principal officer of the organization. All the evidence and arguments in substantiation of the applicant's claim for exemption must be submitted to and considered by the Income Tax Unit before the case will be referred to the General Counsel.

D. H. BLAIR, *Commissioner.*

ARTICLE 515: Building and loan associations and cooperative banks. VI-11-3144 G. C. M. 1231

REVENUE ACTS OF 1921, 1924, AND 1926.

The sources of revenue of the M Building and Loan Association are installment stock and a small number of savings accounts. The company is operated on a mutual basis. Loans to members are made upon their subscription to at least 5 shares of installment stock. Loans are made for the building or acquiring of homes by members for their use and occupancy.

Held, that the organization is exempt from taxation under section 231(4) of the Revenue Acts of 1921, 1924, and 1926.

The sources of revenue of the M Building and Loan Association are installment stock and a small number of savings accounts to which contributions are made by members. The company is operated on a mutual basis. It has set up an elaborate and complicated system governing the application for a loan, the investigation of the home property offered as security, the inspection of dwellings under construction, and the other factors necessary to the creation of a sound security for the loan and conducive to the elimination of the customary construction problems on the part of the home owner.

Loans to members are made upon their subscription to at least 5 shares of installment stock. In the case of the sale of a member's home to another, the purchaser is required to subscribe to at least 1 share, thus becoming a member of the company. By this method the practice of the assumption of the original loan by the purchaser and the continuation of it under the original borrower's name is avoided, and incidentally a new member of the company is secured. In many cases the original borrowers are also owners of additional installment stock which is not pledged as collateral security for their home loans. These additional installment shares are usually held by the original subscribers even after sale is made of their property.

It appears that the loans made by the company were actually made to members for home building and acquiring purposes and not for investment or speculation. There was only one loan made during the period under consideration which was not for that purpose, and that loan was occasioned by a surplus of funds for which there was no demand on the part of the members.

In view of the foregoing, it is held that the M Building and Loan Association is exempt from taxation under section 231(4) of the Revenue Acts of 1921, 1924, and 1926.

A. W. GREGG,
General Counsel, Bureau of Internal Revenue.

ARTICLE 517: Religious, charitable, scientific, literary, and educational organizations and community chests. VI-4-3059 I. T. 2334
(Also Section 214(a)10, Article 251.)

ALL REVENUE ACTS.

The National Society of the Daughters of the American Revolution is held to be exempt under section 231(6) of the Revenue Act of 1926 and similar provisions of prior Acts. Contributions made to it by individuals are deductible in the manner and to the extent provided in section 214(a)10 of the Revenue Act of 1926 and similar provisions of prior Acts.

The National Society of the Daughters of the American Revolution has forwarded to the Bureau evidence for use in considering its claim for exemption from taxation under the provisions of section 231 of the Revenue Act of 1926.

It appears that the society was incorporated by Act of Congress in 1896. Its purposes are stated in the Act as follows:

* * * for patriotic, historical and educational purposes; to perpetuate the memory and spirit of the men and women who achieved American independence; by the acquisition and protection of historical spots and the erection of monuments; by the encouragement of historical research in relation to the Revolution and the publication of its results; by the preservation of documents and relics, and of the records of the individual services of Revolutionary soldiers and patriots, and by the promotion of celebrations of all patriotic anniversaries; to carry out the injunction of Washington in his farewell address to the American people, "to promote, as an object of primary importance, institutions for the general diffusion of knowledge," thus developing an enlightened public opinion and affording to young and old such advantages as shall develop in them the largest capacity for performing the duties of American citizens; to cherish, maintain, and extend the institutions of American freedom; to foster true patriotism and love of country, and to aid in securing for mankind all the blessings of liberty.

The actual activities of the society consist in carrying out the purposes outlined. It acquires historic spots, erects memorials, commemorates historic events, maintains a museum open to the public in which it preserves historic relics, and formulates and distributes plans and programs for the celebration of historic dates. It also establishes scholarships and aids students in obtaining an education. Its Americanization work is maintained for the training of teachers and pupils in the preservation of American ideals. Its income is derived from dues paid by members, contributions, and interest. No part of such income inures to the benefit of any private shareholder or individual.

Based upon the foregoing, it is held that the National Society of the Daughters of the American Revolution is organized and operated for educational purposes as provided in section 231(6) of the Revenue Act of 1926 and similar provisions of prior Acts. It will, therefore, be relieved of the duty of filing returns of annual income so long as its purposes and activities remain unchanged.

Since the society is organized and operated for educational purposes, it follows that contributions made to it by individuals are deductible for income tax purposes in the manner and to the extent provided in section 214(a)10 of the Revenue Act of 1926 and similar provisions of prior Acts.

ARTICLE 517: Religious, charitable, scientific, literary, and educational organizations and community chests. VI–11–3145 G. C. M. 1268

REVENUE ACTS OF 1924 AND 1926.

The benefits of the M Benevolent Association are confined to members of the association; membership in the association, as well as the benefits flowing therefrom, is contingent upon the regular payment of dues. The payment by the association of death benefits is not discretionary, but such payments may be demanded as a matter of right by the beneficiary of a member who has continuously paid his dues and otherwise complied

with the rules of the association. Less than 85 per cent of its income consists of amounts collected from members.

Held, that the organization is not organized and operated exclusively for charitable purposes within the meaning of section 231(6) of the Revenue Acts of 1924 and 1926 and that it is not entitled to exemption as a benevolent life insurance association under the provisions of section 231(10) of the Revenue Acts of 1924 and 1926.

An opinion is requested as to the exemption of the M Association under section 231 of the Revenue Acts of 1924 and 1926.

It is contended that the association is a charitable corporation within the meaning of section 231(6) of those Acts or a benevolent life insurance association within the meaning of section 231(10).

The organization was incorporated under the laws of the State of Y as the O Club. Subsequently the name was changed to the M Association. The constitution of the association states that its purpose is "to create a fund * * * for the relief of distressed, injured, sick, or disabled members and to establish a fund for the payment of death benefits to the families, heirs, blood relations, and wives of deceased members of this association." Any person who is a regularly appointed member of the R department, a branch of the city government, may become a member of the association upon application accompanied by an initiation fee of $25. Members of the association pay dues at the rate of 50 cents a month. Any member failing to pay the prescribed dues forfeits his membership in the association as well as the rights flowing therefrom. The certificate of membership of the association recites that in consideration of the member having complied with the rules of the association and having "paid all dues, fines, and assessments" the association promises and agrees to pay the beneficiary named in the certificate the amount therein provided in the event of death of the member.

In Solicitor's Memorandum 3028, published in Cumulative Bulletin IV–1, page 215, it is held that a corporation or association, organized and operated for the purpose of administering a fund which is used for the benefit of those who make regular contributions thereto, or their dependents, is not "organized and operated exclusively for * * * charitable * * * purposes * * *" within the meaning of section 231(6) of the Revenue Acts of 1918 and 1921. This ruling is equally applicable to the same section of the Revenue Acts of 1924 and 1926.

It is apparent from the provisions of the constitution and by-laws of the M Association that the benefits of the association are confined to members of the association; that membership in the association, as well as the benefits flowing therefrom, is contingent upon the regular payment of dues, and that the payment by the association of death benefits is not discretionary, but such payments may be demanded as a matter of right by the beneficiary of a member who has continuously paid his dues and otherwise complied with the rules of the association. These facts, in the opinion of this office, bring this association within the principle of Solicitor's Memorandum 3028 above referred to.

The records of the association for the year 1924 disclose that the association received as dues, assessments, and fines from members the sum of x dollars, whereas the receipts from the sale of tickets

for its annual ball amounted to approximately 27x dollars. The amount received from dues, assessments, and fines for subsequent years bears substantially the same ratio to the amount received from the sale of tickets to the annual ball. It follows, therefore, that the association is not entitled to exemption under section 231(10) of the Revenue Acts of 1924 and 1926, for the reason that more than 15 per centum of its income was derived from sources other than amounts collected from members.

A. W. GREGG,
General Counsel, Bureau of Internal Revenue.

ARTICLE 518: Business leagues, chambers of commerce, and boards of trade. VI-24-3261 I. T. 2362

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

A corporation organized (1) to encourage more careful study of the merchant's economic function and educate members to higher business standards; (2) to search out and secure the adoption of such better business methods as will result in most economical merchandise distribution; (3) to encourage uniformity of trade practices and the reform of commercial evils; (4) and to promote and maintain such friendly cooperation among retail merchants as will advance their mutual interests and extend their usefulness by more efficient service to the public, no part of the net income of which inures to the benefit of any private member or individual, is exempt under the provisions of section 231(7) of the Revenue Acts of 1918, 1921, 1924, and 1926.

An opinion is requested relative to the status of the M Association under the provisions of section 231 of the Revenue Act of 1926 and corresponding sections of the Revenue Acts of 1918, 1921, and 1924.

An examination of the evidence submitted discloses that the M Association was incorporated May —, 1901, under the laws of the State of R, without capital stock. The purpose for which the association was formed is to encourage more careful study of the merchant's economic function and educate its members to higher business standards; to search out and secure the adoption of such better business methods as will result in most economical merchandise distribution; to encourage uniformity of trade practices and the reform of commercial evils; and to promote and maintain such friendly cooperation among retail merchants as will advance their mutual interests and extend their usefulness by more efficient service to the public.

The evidence submitted further discloses that the membership is composed of 34 State and sectional associations with a present combined membership of approximately 21,600 of the country's leading retail merchants. The State and sectional associations pay a membership fee of 50 cents per capita for each of their members and subscribe for the official publication, paying therefor $— for each member. Subscriptions to the official publication are taken by members of the State and sectional associations, retired members, and salesmen. Approximately 94 per cent of the publications goes to members of these State and sectional associations. The income received from advertisements printed in the publication is used to reduce the cost of publishing same. It has never been sold to the

general public. The association collects and distributes to its members information concerning the retail business. In order that the association might be able to collect certain statistical information from its members and compile same for the information of all, it found that it would be necessary for its members to keep better records. With this in mind, the association developed certain forms to be used by its members in keeping their records. This was designated as an accounting service. However, the association did not install accounting systems for its members or audit their books. These forms have been furnished to its members each year at a loss. The association has aided the Department of Agriculture and the Department of Commerce from time to time in securing certain statistical information. It was explained that the securities held by the association consisted mostly of Liberty bonds. These Liberty bonds were purchased with the association's working surplus. Income is derived from membership fees, subscriptions to the official publication, advertising, and interest on securities. This income is used for the purpose of paying expenses and carrying on the various activities. No part of the income may, during the association's existence, inure to the benefit of any private member or individual.

In view of the foregoing, it is held that the purposes and activities of the M Association are such as to bring it within the provisions of section 231(7) of the Revenue Acts of 1918, 1921, 1924, and 1926.

SECTION 233.—GROSS INCOME OF CORPORATIONS DEFINED.

ARTICLE 545: Sale and retirement of corporate bonds. VI–16–3202 I. T. 2347

REVENUE ACT OF 1926.

When a corporation retires its bonds and converts them into stock, the issuing price of such stock, so far as the corporation is concerned, will be considered to be the issuing price of the bonds plus the amount of amortized discount previously taken as a deduction by the corporation.

An opinion is requested regarding the treatment for income tax purposes by the M Company of discount on convertible bonds.

During 1907 to 1910 the M Company issued convertible 10–25 year — per cent bonds with a par value of $117x$ dollars. The discount on all of these bonds amounted to x dollars. The bonds provided that the holder was entitled to convert them into common stock within a certain time. Some of the holders of the bonds converted them into common stock.

The questions raised are presented by the following illustration:

Assume one $1,000 bond was issued at a discount of 1 per cent, or $10. The bondholder decided to convert the bond into common stock after having held it a while. Query, How should the $10 discount be treated? Should the taxpayer take an aliquot part of the $10 as a deduction as long as the bond is outstanding? Immediately upon the holder converting the bond into common stock, should the discount be treated as a discount on common stock?

Article 545 of Regulations 69 provides that where bonds are issued at a discount the net amount of such discount is deductible by the

issuing corporation and is to be prorated over the life of the bonds; further, that where a corporation retires its bonds, in determining gain or loss from the transaction there shall be added to the issuing price, in arriving at a basis, the amount of discount which has already been deducted as an allowance for the discount at which the bonds were issued.

In the instant case the bonds were retired by the transaction and converted into stock. The balance of the allowance for the amortization of the discount which would have been otherwise allowable had such bonds continued outstanding ceased to be an allowable deduction, as there is no provision for allowing a deduction on account of the amortization of discount with respect to capital stock issued by a corporation. The issuing price of such stock so far as the corporation is concerned will be considered to be the issuing price of the bonds plus the amount of amortized discount previously taken as a deduction by the corporation; for example, if a $1,000 bond was issued at a discount of $10 and $5 has been recovered by the corporation through deductions on account of the amortization of such discount during the period in which the bond was outstanding, and thereupon the bond is exchanged by the holder for stock of the corporation, the issuing price of the stock issued for the bond will be $990 (which was the issuing price of the bond) plus $5, the amount of the discount recovered by the corporation through allowances for amortization; i. e., $995. No further deduction will thereafter be taken on account of the original discount of $10. (See article 543, Regulations 69.)

No gain or loss is recognized where the bondholder exercises the right to convert the bond into stock of the issuing corporation. The basis for computing gain or loss upon subsequent sale of the stock would be the basis of the bond exchanged therefor.

SECTION 234.—DEDUCTIONS ALLOWED CORPORATIONS.

ARTICLE 561: Allowable deductions. VI-15-3184
G. C. M. 1455

REVENUE ACT OF 1926.

Banks which purchased second Liberty loan converted 4¼ per cent bonds of 1927–42 (known as second 4¼'s) at a premium and on March 15, 1927, turn them in at par in exchange for Treasury notes, may deduct as a loss the amount by which the cost exceeds the fair market value of the notes at the time of the exchange.

The opinion of this office is requested on the following question which arises in connection with the recent financing by the Treasury Department under which second Liberty loan converted 4¼ per cent bonds of 1927–42 (known as second 4¼'s) were redeemed through the issuance of 3½ per cent Treasury notes of Series A-1930-32:

Can banks which purchased second 4¼'s at a premium and on March 15, 1927, turn them in at par deduct as a loss the amount of the premium when that loss is to be made up to them by the payment of the full interest on the second 4¼'s to May 15, which interest being received by a corporation is not subject to income tax?

The banks in question are obviously not original purchasers of the bonds, since the second 4¼'s were issued at par. The bonds mature in 1942, and under the law may be called for redemption at any time on and after November 15, 1927, upon six months' notice. The Treasury Department has proposed to redeem the bonds on March 15, 1927, issuing in place thereof Treasury notes bearing interest at the rate of 3½ per cent. The notes will bear the provided interest from March 15, 1927. In order to induce the holders of the bonds to turn them in for redemption, interest will be paid upon the second 4¼'s to May 15, 1927. Authority for such payment of interest is to be found in the provision of section 3699 of the Revised Statutes that "The Secretary of the Treasury may anticipate the payment of interest on the public debt, by a period not exceeding one year, from time to time, either with or without a rebate of interest upon the coupons, as to him may seem expedient * * *."

The basic question to be answered is whether the premium paid by the banks for the bonds results in a deductible loss upon the redemption of the bonds at par, or whether the premium should be applied as an offset in reduction of the additional interest received on the same theory that discount in the purchase of tax-exempt bonds is treated as the receipt of nontaxable interest. It seems obvious that the treatment of premium is analogous to that of discount, and, therefore, the Bureau rulings on the treatment of discount are in point.

The position originally taken by the Bureau was that discount was to be distinguished from interest in all cases, the excess of the amount received upon the maturity of a municipal bond over the purchase price being taxable profit whether or not the holder of the bond was the original purchaser. (O. D. 238, C. B. 1, 68.) A fortiori, the excess was held to be taxable profit where the municipal bond was sold instead of being held to maturity. (O. D. 21, C. B. 1, 67; O. D. 737, C. B. 3, 49; O. D. 774, C. B. 4, 31.)

This position was later modified to hold that the profit derived by purchasing municipal bonds at a discount and holding them to maturity was nontaxable where the profit was "in lieu of interest for the use of the taxpayer's money." It was considered immaterial whether or not the taxpayer was the original purchaser of the bonds, but the exempted amount could in no case exceed the total discount at which the securities were originally sold by the municipality. (O. D. 647, C. B. 3, 123; O. D. 856, C. B. 4, 110.) But where the bonds instead of being held to maturity were sold by one other than the original purchaser (or even by the original purchaser) at a profit, the profit was taxable income and not exempt interest, even though the bonds were originally issued at a discount. (O. D. 762, C. B. 4, 31; I. T. 1187, C. B. I–1, 27.)

The modification, it will be noted, related solely to the situation where the bonds were held to maturity, the first holding being that the discount was not to be treated as interest and the subsequent holding being that the discount should be considered as equivalent to interest, without regard to whether the taxpayer was the original purchaser of the bonds.

The final position taken made no change in the rule as to original purchasers but reverted to the position first taken in so far as tax-

payers who were not original purchasers were concerned. Thus, I. T. 1637 (C. B. II–1, 36) holds that where noninterest-bearing municipal bonds were issued at a discount, the profit realized upon payment at maturity by a holder who was not the original purchaser was taxable. The prevailing rule as to holders other than original purchasers—and that is the classification which includes the banks in the instant case—is that discount (and by analogy premium) is not to be treated as interest (or as an offset against interest in the case of premium) whether the bonds are sold or held to maturity. The amount for which the bonds are purchased without regard to any discount or premium element therein is to be taken as the basis for determining gain or loss on their sale or redemption (O. D. 726, C. B. 3, 49), any profit realized being a profit resulting from the conversion of a capital asset and any loss sustained being deductible.

Under all the above rulings the uniform holding has been that, regardless of the person in whose hands the bonds are at maturity, the amount of discount which is to be treated as interest and therefore tax exempt is limited to the amount of the discount at which the bonds were originally issued. Where bonds are originally issued at par, there can under no circumstances, whether in the case of an original or subsequent purchaser, be a sale or redemption so as to allow the difference between the purchase price and the sale price or the par value of the bonds received upon redemption to be tax exempt on the theory that it is to be treated as interest. In all such cases where the bonds are issued at par, the transaction becomes one of determining gain or loss, based upon the amount paid for the bonds and the amount received therefor. (O. D. 729, C. B. 3, 123.) In the instant case, the bonds were issued at par. Any purchase or sale thereof at either a discount or premium would therefore be subject to the provisions pertaining to gain or loss without reference to the question of tax-exempt interest. Accordingly, the banks having purchased the bonds in question at a premium, and the bonds being redeemed at par, the amount of the premium is a loss deductible in the year in which the bonds are redeemed. This conclusion seems unavoidable and is amply supported by either of the two grounds already stated, (1) that the bonds at redemption were not held by original purchasers, and (2) that the bonds were not originally issued either at a premium or at a discount.

The question presented is whether the banks which bought the bonds at a premium and on March 15, 1927, turned them in at par can deduct as a loss the amount of the premium. Assuming that the amount of the premium is deductible, if the transaction is regarded as an exchange of the second 4¼'s for the Treasury notes, it would not follow that there would be any loss sustained unless the fair market value of the notes at the date of the exchange was less than the amount paid for the second 4¼'s by the banks.

A. W. Gregg,
General Counsel, Bureau of Internal Revenue.

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ARTICLE 561: Allowable deductions. VI-22-3249
I. T. 2358

REVENUE ACT OF 1926.

Where a corporation transferred certain shares of stock to a trustee under a revocable trust agreement, dividends on the stock received by the trustee being payable to an officer of the corporation as additional compensation, the amount thereof may be deducted by the corporation as a business expense, provided such amount together with other sums paid to the officer as compensation is reasonable.

The M Company created a revocable trust under the name of the O Trust. The corpus of the trust is held by the N Bank as trustee under a revocable trust agreement between the bank and the M Company, and consists of shares of stock of the M Company; the income of the trust, consisting of dividends paid on the stock less trustee's fees, is payable to A, an officer of the M Company, as additional compensation. A included the income received from the trust in his personal return. The question presented is whether the amount of the income from the trust may be taken by the M Company as a deduction from income as compensation paid to one of its officers, and whether A was correct in reporting such income in his personal income tax return.

It is held that under the Revenue Act of 1926 the M Company may deduct in computing its net income an amount equal to the income of the trust as additional compensation paid to one of its officers, provided such amount together with other sums paid to the officer as compensation is reasonable. A will be required to report such amount for both normal tax and surtax purposes.

SECTION 237.—PAYMENT OF CORPORATION INCOME TAX AT SOURCE.

ARTICLE 601: Withholding in the case of non-resident foreign corporations. VI-24-3269
T. D. 4019

INCOME TAX.

Article 601 of Regulations 69 amended.

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

To Collectors of Internal Revenue and Others Concerned:

Article 601 of Regulations 69 is hereby amended by changing the last paragraph to read as follows:

As no withholding of tax on bond interest or other income is required in the case of a foreign corporation engaged in a trade or business within the United States or having an office or place of business therein, the person paying such income should be notified by a letter from the corporation that it is not subject to withholding. The letter from the corporation shall contain the address of its office or place of business in the United States, and be signed by an officer

of the corporation giving his official title. Such letters of notification shall be immediately forwarded by the recipients to the Commissioner of Internal Revenue, Sorting Section, Washington, D. C., to be examined.

C. R. NASH,
Acting Commissioner of Internal Revenue.

Approved June 7, 1927.

A. W. MELLON,
Secretary of the Treasury.

SECTION 239.—CORPORATION RETURNS.

ARTICLE 621: Corporation returns. VI-5-3068
T. D. 3953

INCOME TAX.

Article 621 of Regulations 69 amended.

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

To Collectors of Internal Revenue and Others Concerned:

Article 621 of Regulations 69 is hereby amended to read as follows:

ART. 621. *Corporation returns.*—Every corporation not expressly exempt from tax must make a return of income, regardless of the amount of its net income. In the case of ordinary corporations, the return shall be on Form 1120. For returns of insurance companies, see article 623; of foreign corporations, see article 624; and of affiliated corporations, see section 240 and article 632. A corporation having an existence during any portion of a taxable year is required to make a return. A corporation which has received a charter, but has never perfected its organization, which has transacted no business and had no income from any source, may upon presentation of the facts to the collector be relieved from the necessity of making a return so long as it remains in an unorganized condition. In the absence of a proper showing to the collector such a corporation will be required to make a return. A corporation which was dissolved in 1925, or in 1926 prior to the enactment of the Revenue Act of 1926, is not relieved from the necessity of rendering returns thereunder for any period or periods of its existence for which the Act is effective. Section 239(c) requires every corporation to include in its return a statement of such facts as will enable the Commissioner to determine the portion of the earnings, including gains, profits, and income not taxed, accumulated during the taxable year which has been distributed or ordered to be distributed, respectively, to its shareholders during such year. (See also articles 406 and 407.) Upon liquidation or dissolution of a corporation, there shall be attached to the final return a statement showing (1) the date and manner of dissolution, (2) the name and address of each shareholder at dissolution and the number and par value of the shares of stock held by each of them, (3) a description and the value of the liquidating assets received by each shareholder, (4) the name and address of each individual or corporation other than shareholders and creditors, if any, that received assets at dissolution, (5) a description and the value of the assets received by each such person or corporation, and (6) the consideration, if any, paid by each of them for the assets received.

D. H. BLAIR,
Commissioner of Internal Revenue.

Approved January 21, 1927.

A. W. MELLON,
Secretary of the Treasury.

ARTICLE 621: Corporation returns. VI-25-3273
G. C. M. 1880

REVENUE ACT OF 1926 AND PRIOR ACTS.

A union of national banks under the provisions of the Federal Act of November 7, 1918 (40 Stat., 1043), constitutes a "merger" as distinguished from a "consolidation."

The holding contrary to this conclusion in Solicitor's Recommendation 4152 (C. B. IV-1, 235) is overruled.

An opinion is requested as to whether an amalgamation of national banks constitutes a consolidation or a merger, and whether the "consolidation" ruling in Solicitor's Recommendation 4152 may be reconciled with the "merger" ruling in I. T. 1850 (C. B. II-2, 8).

The distinction between a consolidation and a merger is of material importance, since in the case of a true consolidation of companies the consolidated company is treated as a *new corporation* and files its first income tax return for the period beginning with the date of consolidation, whereas in the case of a true merger of companies under the charter of one of them the latter company is not treated as a new corporation at all but as a *continuing corporation* (merely having absorbed the other company or companies into itself) without effect upon the period for filing its tax return. In other words, if a "consolidation" of companies is effected on March 1 the *new* company files its tax return beginning with March 1 and the constituent companies for periods ending February 28, whereas if a "merger" of companies is effected on March 1 the *continuing* company files its tax return beginning with January 1 (if it uses a calendar-year basis for filing returns) and the absorbed company or companies for periods ending with February 28.

I. T. 1850 involved a case of the union of two national banks under the charter of one of them with a change of name to include the names of the constituent banks. This amalgamation of banks was treated as a "merger."

Solicitor's Recommendation 4152 was also concerned with the union of two national banks under the name and charter of one of them, but held directly that the union constituted a "consolidation" and not a "merger."

The issue, as above indicated, is whether such combinations of national banks constitute "consolidations" or "mergers."

The statute under which a union of national banks may be effected (and under which the unions in the rulings hereinbefore referred to were effected) is the Federal *Act of November 7, 1918, chapter 209, entitled "An Act to provide for the consolidation of national banking associations"* (40 Stat., 1043, 1044; U. S. Comp. Stat. of 1916, 1919 Suppl., secs. 9696-a and 9696-b), which provides as follows:

Any two or more national banking associations located within the same county, city, town, or village may, with the approval of the Comptroller of the Currency, consolidate into one association *under the charter of either existing banks*, on such terms and conditions as may be lawfully agreed upon by a majority of the board of directors of each association proposing to consolidate, and be ratified and confirmed by the affirmative vote of the shareholders of each such association owning at least two-thirds of its capital stock outstanding, * * *: *Provided*, That the capital stock of such consolidated association shall not be less than that required under existing law for the organiza-

tion of a national bank in the place in which it is located: * * * [then follow provisions for the protection of dissenting shareholders].

Associations consolidating with another association under the provisions of this Act shall not be required to deposit lawful money for their outstanding circulation, but their assets and liabilities shall be reported by the association with which they have consolidated.

And all the rights, franchises, and interest of the said national bank so consolidated in and to every species of property, personal and mixed, and choses in action thereto belonging, shall be deemed to be transferred to and vested *in such national bank into which it is consolidated* without any deed or other transfer, and the said consolidated national bank shall hold and enjoy the same and all rights of property, franchises, and interests in the same manner and to the same extent as was held and enjoyed by the national bank so consolidated therewith.

Prior to this Act of November 7, 1918 (40 Stat., 1043), the authority for national banks to consolidate was contained in *section 5223, United States Revised Statutes*, which provided as follows:

An association which is in good faith winding up its business for the purpose of consolidating with another association shall not be required to deposit lawful money for its outstanding circulation; but its assets and liabilities shall be reported by the association with which it is in process of consolidation.

Under this latter Act the case of *Bonnet* v. *First National Bank of Eagle Pass* (60 S. W. (Tex., 1900), 325) was decided, holding that the combination of national banks there effected (under the charter and name of one of them) did not involve a purchase and sale of assets. Although not necessary to the decision, the court then referred to the union of the banks as constituting a consolidation resulting in effect in the creation of a new corporation. Treating this latter statement as the court's ruling, the holding in Solicitor's Recommendation 4152 is based squarely upon it. But the true weight to be attached to such statement is pointed out by the United States Board of Tax Appeals in the appeals of A. J. Siegel et al. (4 B. T. A., 186, at page 193), decided June 23, 1926, where the Board in discussing the Bonnet case (and particularly the following question of the court: "Was the consolidation (for it is treated by appellant as a consolidation) or amalgamation of the banks *ultra vires*, and therefore void?") said:

It appears that the court had itself some doubt whether there was a consolidation or amalgamation (merger), but in its opinion it followed the theory of the appellant. Whether there was a consolidation or a merger, the result would be the same, and while the opinion contains a statement concerning the effect of a consolidation, and a further statement that, in effect, a new corporation existed, it can not be considered authority for the proposition that a consolidation, rather than a merger, resulted, or that a new legal entity came into being. We must also bear in mind that the consolidation or merger in that case did not take place under the provisions of the law which is here involved.

In the "merger" case of *Central Railroad & Banking Co.* v. *Georgia* (92 U. S., 665, 670), the court said with respect to an act of the legislature authorizing the "union and consolidation" of two railroads under the name and charter of the company cited:

Did the act contemplate a surrender of its charter by the Central Railroad & Banking Co., and the grant to it of a new charter, or a regrant of the old? It may be that the consolidation of two corporations, or amalgamation, as it is called in England, if full and complete, may work a dissolution of them both, and its effect may be the creation of a new corporation. Whether such be the effect or not must depend upon the statute under which the consolidation takes

place, and of the intention therein manifested. *If, in the statute, there be no words of grant of corporate powers, it is difficult to see how a new corporation is created.* If it is, it must be by implication; and it is an unbending rule that a grant of corporate existence is never implied. In the construction of a statute, every presumption is against it. [Italics supplied.]

And again:

It (the amalgamation) is to be done under the name and charter of the Central Railroad & Banking Co.; that is, *the union is to be under that charter, not under a new charter of a company bearing that name.* * * * [Italics supplied.]

The court also commented on page 672 on the language of the act in providing that the capital stock of the company should not exceed its present authorized capital plus the present authorized capital of the constituent company, to show that the creation of no new corporation was intended. (*Idem, Tomlinson* v. *Branch*, 15 Wall., 460.)

It will be noted that "no words of grant of corporate powers" are contained in section 5223, United States Revised Statutes, on which the Bonnet case is founded, and that the union of banks was under the charter and name of one of them.

It is true that the effect of a legislative act and the terms of consolidation under it may work a dissolution of the constituent companies, and at the same instant the creation of a new corporation with property, liabilities, and stockholders derived from those then passing out of existence, as in the leading "consolidation" case of *Railroad Company* v. *Georgia* (98 U. S., 359), in which the opinion was written by the same judge (Mr. Justice Strong) who wrote the opinion in the "merger" case of *Central Railroad & Banking Co.* v. *Georgia*, supra, but in that event such effect must be manifested in the act to be construed. In the "consolidation" case of *Railroad Company* v. *Georgia* the words of the legislative act (page 361) were held to effect *a new grant of a full set of corporate powers*, and therefore to contemplate the dissolution of the constituent companies and the creation of a new corporation. (To the same effect, see *Keokuk & Western Railroad Co.* v. *Missouri*, 152 U. S., 301, and *Yazoo & Mississippi Valley Railway Co.* v. *Adams*, 180 U. S., 1, these cases commenting in detail upon, and distinguishing, each of the "merger" and "consolidation" Federal court cases cited in this memorandum.)

In *Railroad Company* v. *Georgia*, supra, the court, bearing in mind the new grant of corporate powers contained in the legislative act in question, said:

It is conceded that under this act a consolidation took place. It is, therefore, a vital question, What was its effect? Did the consolidated companies become a *new corporation*, holding its powers and privileges as such under the act of 1863? Or was the consolidation a mere *alliance* between two preexisting corporations, in which each preserved its identity and distinctive existence? Or, still further, was it an *absorption* of one by another, whereby the former was dissolved, while the latter continued to exist? The answer to these inquiries must be found in the intention of the legislature as expressed in the consolidating act. We think that intention was the creation of a new corporation out of the stockholders of the two previously existing companies. *The consolidation provided for was clearly not a merger of one into the other, as was the case of Central Railroad & Banking Co.* v. *Georgia* (92 U. S., 665). *Nor was it a mere alliance or confederation of the two.* If it had been, each would have preserved its separate existence, as well as its corporate name. * * * Looking thus at the legislative intent appearing in the consolidation act, we are constrained to the conclusion that a new corporation was created by the consolidation effected thereunder in the place and in lieu of the two

companies previously existing, and that whatever franchises, immunities, or privileges it possesses, it holds them solely by virtue of the grant that act made. That generally the effect of consolidation, as distinguished from a union by merger of one company into another, is to work a dissolution of the companies consolidating, and to create a new corporation out of the elements of the former, is asserted in many cases, and it seems to be a necessary result.

The material question now to be decided, therefore, is the effect of the Federal *Act of November 7, 1918* (40 Stat., 1043), quoted supra, providing for the consolidation of national banking associations. Does it contemplate a "merger" (*Central Railroad & Banking Co.* v. *Georgia*, 92 U. S., 665) or does it contemplate a "consolidation" (*Railroad Company* v. *Georgia*, 98 U. S., 359)?

An examination of the Act discloses that the so-called consolidation is to take place "under the charter of either existing banks," thereby contemplating no new charter, and, since there is no grant of corporate powers, resulting in a "merger" of the banks as distinguished from a "consolidation." The correctness of this view is emphasized by the provisions of the second section of the Act, providing that the constituent companies "shall not be required to deposit lawful money for their outstanding circulation" (as is required in the case of dissolved banks), and further that "all the rights, franchises, and interests of the said national bank so consolidated * * * shall be deemed to be transferred to and vested in such national bank *into which it is consolidated* without any deed or other transfer * * *." The proviso that "the capital stock of such consolidated association shall not be less than that required under existing law for the organization of a national bank in the place in which it is located" is consistent with a "merger."

In the case of the appeals of A. J. Siegel et al., previously cited, the United States Board of Tax Appeals after a full discussion of the matter held that a union of three banking associations under the charter of one of them, under the above-cited Federal Act of November 7, 1918, constituted a "merger" as distinguished from a "consolidation."

The foregoing view that a "merger" is contemplated and effected by a consolidation of national banking associations under the Act in question, and not a "consolidation" resulting in the creation of a new corporation, has still further support. In connection with Solicitor's Opinion 115 (C. B. 5, 47), involving a union of two national banks on February 21, 1919, an opinion was requested of the Comptroller of the Currency (whose approval of such unions is required by the Act of November 7, 1918) as to the effect of such union under that Act. His office replied on December 26, 1919, in part as follows:

> When two national banks are consolidated neither bank is placed in liquidation, but the *continuing* bank is the successor of the two banks that were consolidated. In this case the consolidation was effected under the title and charter of the O National Bank, and the O National Bank represents the M National Bank just as fully as it represents the N National Bank.
>
> This office advised the O National Bank that in making report of earnings and dividends for June 30, 1919, they must cover the entire six months period from *January 1, 1919*, to June 30, 1919, and the earning and dividend return of the O National Bank was made on this basis. [Italics supplied.]

Solicitor's Recommendation 4152 and Solicitor's Opinion 115 involved different phases of the same bank case, Solicitor's Recom-

mendation 4152 being directly concerned with the question as to whether there was technically a "merger" or a "consolidation." However, the opinion of the Comptroller of the Currency must have been founded on a "merger" basis, for the reason that a report of earnings and dividends was required by him beginning with *January 1, 1919*, and not with February 21, 1919 (the date of the amalgamation). If there had been a "consolidation" resulting in the creation of a new corporation, the report would not have been required for a period antedating the date of the creation of the new corporation, but only for a period beginning with February 21, 1919, the date of creation.

In view of the foregoing authorities, it is the conclusion of this office that a union of national banks under the provisions of the Federal Act of November 7, 1918 (40 Stat., 1043), hereinbefore quoted, constitutes a "merger" as distinguished from a "consolidation." The holding contrary to this conclusion in Solicitor's Recommendation 4152 is hereby overruled. It can not be reconciled with the merger ruling in I. T. 1850.

A. W. GREGG,
General Counsel, Bureau of Internal Revenue.

SECTION 240.—CONSOLIDATED RETURNS OF CORPORATIONS.

ARTICLE 632: Consolidated returns. VI–12–3157
G. C. M. 1367.

REVENUE ACT OF 1926.

Where four affiliated corporations elected to file separate returns for the taxable year 1924, returns for the taxable year 1925 must be made upon the same basis where permission to file a consolidated return was not granted by the Commissioner. For the taxable year 1926 the members of the affiliated group may elect to file a consolidated return under the provisions of article 632, Regulations 69.

An opinion is requested as to whether under section 240(a) of the Revenue Act of 1926, affiliated corporations may elect to file either a consolidated return or separate returns for the taxable year 1925 without securing permission from the Commissioner.

It appears that during the years 1922, 1923, and 1924 the M Company, the N Company, the O Company, and the P Company were affiliated by reason of the fact that all the stock in the four corporations was owned by the same interests. Separate returns were filed by the four companies for the taxable year 1924. During January, 1925, the M Company acquired the stock of the R Company. The returns of the M Company and the R Company were consolidated for the taxable year 1925, but the other three affiliated companies named above filed separate returns. The Income Tax Unit has ruled that the filing of separate returns for the year 1924 constituted an election under section 240(a) of the Revenue Act of 1924, and that separate returns should have been filed for all of the affiliated corporations for the year 1925, inasmuch as permission had not been secured from the Commissioner to submit a consolidated return.

The M Company claims that a consolidated return would have been filed for the entire group of corporations for the year 1925 but at that time it was unaware of the fact that two or more corporations were deemed to be affiliated if substantially all their stock was owned by the same interests. It claims that section 240(a) of the Revenue Act of 1926 permits an election for the taxable year 1925, and that the affiliated companies are entitled to file an amended return on the consolidated basis.

Inquiry is made whether under section 240(a) of the Revenue Act of 1926 affiliated corporations are granted an election in the matter of filing separate or consolidated returns (1) for the taxable year 1925, (2) for the taxable year 1926, or (3) for both the taxable years 1925 and 1926.

Section 240(a) of the Revenue Acts of 1924 and 1926 states as follows:

> Corporations which are affiliated within the meaning of this section may, for any taxable year, make separate returns or, *under regulations prescribed by the Commissioner with the approval of the Secretary, make a consolidated return of net income for the purpose of this title*, in which case the taxes thereunder shall be computed and determined upon the basis of such return. If return is made on either of such bases, all returns thereafter made shall be upon the same basis unless permission to change the basis is granted by the Commissioner. [Italics supplied.]

By the terms of section 240(a), supra, the conditions under which a consolidated return may be made are left to the Commissioner to prescribe.

Article 632 of Regulations 69 provides:

> Affiliated corporations as defined in section 240(d), irrespective of the basis upon which returns were filed prior to 1926 under section 240(a) of the Revenue Acts of 1924 and 1926, *may for 1926 elect to make separate returns or file a consolidated return in which will be reported the consolidated net income of the affiliated group.* If return is made upon either of these bases, all subsequent returns must be made upon the same basis except as permission to change may be granted by the Commissioner * * *. [Italics supplied.]

Thus the right of election is granted not for the taxable year 1925 but for the taxable year 1926.

The returns for the M Company and the R Company were consolidated for the taxable year 1925, but the other three companies in the affiliated group filed separate returns. However, this office has held that corporations which are affiliated can not file a consolidated return for two members of the group and individual returns for the other companies. (S. M. 2683, C. B. IV–1, 238.)

The corporations concerned in this case have, under section 240(a) of the 1924 Act and article 632, Regulations 65, elected to file separate returns for the taxable year 1924, and in view of that election the returns for the taxable year 1925 must be made upon the same basis, as permission to file a consolidated return was not granted by the Commissioner. For the taxable year 1926 the members of this affiliated group may elect to file a consolidated return under the provisions of article 632, Regulations 69.

A. W. Gregg,
General Counsel, Bureau of Internal Revenue.

ARTICLE 632: Consolidated returns.
(Also Section 246, Article 691.)

VI-21-3240
I. T. 2355

REVENUE ACT OF 1926.

Where a tax is assessed upon the basis of a consolidated return, and one of the affiliated companies, on the basis of a separate return, would be entitled to the lower rate of tax allowed domestic insurance companies under the provisions of section 246(a)1 of the Revenue Act of 1926, no part of the consolidated net income will be taxable at such lower rate unless the group of affiliated corporations as a whole can qualify as a domestic insurance company.

The entire outstanding capital stock of the M Title Investment Co. is held by the O Title Insurance Co. These companies filed a consolidated return for 1925, in view of which it is contended that they will be required to file consolidated returns for all subsequent years. It is pointed out that under the provisions of section 230 of the Revenue Act of 1926, a domestic corporation is subject to a tax of 13 per cent upon its taxable net income for the calendar year 1925 and a tax of 13½ per cent upon its taxable net income for the calendar year 1926 and subsequent years, and that under the provisions of section 246(a)1 of the same Act, a domestic insurance company (other than a life or mutual insurance company) is subject to a tax of 12½ per cent upon its taxable net income for 1925 and subsequent years. In view of these different rates of tax in the cases mentioned, advice is requested relative to the proper method of computing the tax liability of the O Company and the M Company in rendering a consolidated return for each of the years 1925 and 1926.

On the basis of the facts as stated it appears that the O Company and the M Company were affiliated during the years 1925 and 1926 within the purview of subdivisions (c)1 and (d)1, respectively, of section 240 of the Revenue Act of 1926, which read as follows:

(c) For the purpose of this section two or more domestic corporations shall be deemed to be affiliated (1) if one corporation owns at least 95 per centum of the voting stock of the other or others, * * *.

(d) For the purpose of this section two or more domestic corporations shall be deemed to be affiliated (1) if one corporation owns at least 95 per centum of the stock of the other or others, * * *.

Article 632 of Regulations 69, promulgated under the Revenue Act of 1926, provides in part as follows:

Affiliated corporations as defined in section 240(d), irrespective of the basis upon which returns were filed prior to 1926 under section 240(a) of the Revenue Acts of 1924 and 1926, may for 1926 elect to make separate returns or file a consolidated return in which will be reported the consolidated net income of the affiliated group. If return is made upon either of these bases, all subsequent returns must be made upon the same basis except as permission to change may be granted by the Commissioner. * * *

The filing of a consolidated return by the O Company and its subsidiary for the year 1925 did not constitute an election under article 632, Regulations 69, for the filing of their returns for 1926 and subsequent years. These corporations may, in accordance with article 632, elect to file a consolidated return for 1926 and each subsequent year thereafter, or may elect to file separate returns for that year and each subsequent year thereafter.

With regard to the inquiry as to the proper method of computing the tax in the case of a consolidated return, there is no provision in

the taxing statute which would warrant the computation of the consolidated tax by the use of two different rates, whether or not the computation is supported by a schedule showing the net income of the separate companies, the different rates of tax applied to each, and the net amount of tax for each company. Attention is directed to the provision of section 240(b) of the Revenue Act of 1926, that in any case "in which a tax is assessed upon the basis of a consolidated return, the total tax shall be computed in the first instance as a unit * * *." Therefore, unless the group of affiliated corporations as a whole can qualify as a domestic insurance company, no part of the consolidated net income will be subject to the 12½ per cent rate, but the entire net income of the group will be taxable at 13 per cent for 1925 and at 13½ per cent for 1926 and subsequent years.

ARTICLE 632: Consolidated returns. VI-26-3290
T. D. 4026

INCOME TAX.

Consolidated returns.—Article 632 of Regulations 69 amended.

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

To Collectors of Internal Revenue and Others Concerned:

Article 632 of Regulations 69 is hereby amended by the elimination of the first and second sentences and the substitution therefor of three sentences reading as follows:

ART. 632. *Consolidated returns.*—Affiliated corporations as defined in section 240(c) and the first sentence of article 633, irrespective of the basis upon which returns were filed prior to 1925 under section 240(a) of the Revenue Act of 1924, may for 1925 elect to make separate returns or file a consolidated return in which will be reported the consolidated net income of the affiliated group. Affiliated corporations as defined by section 240(d) and the second sentence of article 633, irrespective of the basis upon which returns were filed for 1925 under section 240(a) of the Revenue Act of 1926, may for 1926 elect to make separate returns or file a consolidated return in which will be reported the consolidated net income of the affiliated group. If return is made upon either of these bases for 1926, all subsequent returns must be made upon the same basis except as permission to change may be granted by the Commissioner.

C. R. NASH,
Acting Commissioner of Internal Revenue.

Approved June 22, 1927.

A. W. MELLON,
Secretary of the Treasury.

NOTE.—General Counsel's Memorandum 1367 [see page 96] is overruled, in effect, by Treasury Decision 4026, supra.

SECTIONS 246 AND 247.

ARTICLE 691: Tax on insurance companies.

REVENUE ACT OF 1926.

Affiliated group not entitled to lower rate allowed insurance company on any part of the consolidated net income unless affiliated group as a whole can qualify as an insurance company. (See I. T. 2355, page 98.)

PART IV.—ADMINISTRATIVE PROVISIONS.

SECTION 257.—RETURNS TO BE PUBLIC RECORDS.

ARTICLE 1091: Furnishing of copies of income returns. VI–8–3115 Mim. 3512

REVENUE ACT OF 1926.

Charges applicable to the furnishing of copies of returns and other documents.

TREASURY DEPARTMENT,
OFFICE OF COMMISSIONER OF INTERNAL REVENUE,
Washington, D. C., February 4, 1927.

Collectors of Internal Revenue, Internal Revenue Agents in Charge, Heads of Divisions, Chiefs of Sections, and Others Concerned:

The following rates are approved for furnishing copies of returns or other documents to persons authorized to receive them:

Return	$1.00 per copy.
Schedules, balance sheets, revenue agents' reports, etc	.25 per page.

The amount of $1 covers the charge for a copy of the bare return only and does not include a copy of any schedule, statement, or other document attached to and made a part of the return. Twenty-five cents for each page will be charged for copies of such schedules, statements, etc., attached to the return.

An additional charge of 50 cents will be made for each certification.

No charge will be made for furnishing such copies required for official use by the officers of any branch of the Federal Government, or for copies authorized by the law and the regulations, furnished to State governments.

Moneys received by collectors or internal revenue agents for furnishing copies of records in their files should be deposited to the credit of the Treasurer of the United States as miscellaneous receipts and taken up in the accounts current.

When the copies of the returns or other documents have been prepared, a statement of account will be forwarded to the person entitled to receive the copies of the desired documents. Such person will be informed that upon receipt of the necessary remittances the copies will be forwarded to him. The statement of account will be made in duplicate, the original to be forwarded to the person receiving the copies of the documents and the duplicate filed as a permanent record. When payment is made, appropriate receipt therefor will be given and proper entries made on the duplicate statement of account.

Queries regarding this order, or procedure in connection therewith, should be directed to IT:E:CRN.

D. H. BLAIR, *Commissioner.*

PART V.—PAYMENT, COLLECTION, AND REFUND OF TAX AND PENALTIES.

SECTION 270.—DATE ON WHICH TAX SHALL BE PAID.

ARTICLE 1204: Collection of tax by distraint. VI–9–3125
G. C. M. 1310

REVENUE ACT OF 1926.

Where property is conveyed in Oregon to a husband and wife and where the conveyance provides for no different estate, an estate by the entirety exists, and the right of the husband therein is subject to the tax lien under the provisions of section 3186 of the Revised Statutes, as amended, and may be sold to satisfy the tax lien.

It appears that notice of lien was filed against A by the collector with the clerk of the United States district court and also with the county clerk of R County, Oreg., for unpaid 1917 excess profits tax and penalty, amounting to a total of $12x$ dollars.

A and his wife owned a house and lot in ——, Oreg., as tenants by the entirety. After the notice of lien was filed they conveyed the property to B. Acting on advice from the United States district attorney, the collector levied on the property, and sold it at public sale, notice having been given to B. The property was bid in by C for $4x$ dollars. He later refused to complete the purchase, contending that the interest of the husband in an estate by the entirety was not subject to execution, and that the sale was therefore void. It is the conclusion of this office that the contention is not well taken.

Section 3186 of the Revised Statutes as amended by the Act of February 26, 1925 (43 Stat., 994), provides among other things:

> That 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 from the time when the assessment list was received by the collector, except when otherwise provided, until paid, with the interest, penalties, and costs that may accrue in addition thereto *upon all property and rights to property belonging* to such person; * * *. [Italics supplied.]

Since the decision in *Howell* v. *Folson* (38 Or., 184, 63 Pac., 116), the courts of Oregon have recognized that where property is conveyed to a husband and wife, and where the conveyance provides for no different estate, an estate by the entirety exists. The courts, however, have shown by their decisions that the estate by the entirety, as known to the common law, has been most materially modified by the statutes of Oregon with reference to the property rights of married women. Thus in *Howell* v. *Folson*, supra, the court held that under the Oregon statute conferring upon married women the right to convey their property to the same extent as though single, a mortgage by the wife during coverture was a valid lien on the wife's interest where the wife survived the husband. In that opinion the court referred with approval to *Buttlar* v. *Rosenblath* (42 N. J. Eq., 651, 9 Atl., 695), *Hyles* v. *Fisher* (144 N. Y., 306, 39 N. E., 337), and *Branch* v. *Polk* (61 Ark., 388, 33 S. W., 424). In the opinion in *Hyles* v. *Fisher*, which the Supreme Court of Oregon termed "very

satisfactory," it was held that where the husband alone mortgaged the entire estate by the entirety to secure his individual debt and subsequently, but during the life of the wife, the mortgage was foreclosed, the purchaser at the foreclosure sale acquired the husband's interest subject to the right of survivorship of the wife with the right to use an undivided half interest in the property during the joint lives of husband and wife. A reading of the New Jersey and Arkansas cases shows that they reach a similar conclusion as to the respective rights of a husband and wife in such an estate.

In the recent case of *Breneman* v. *Corrigan* (4 Fed. (2d), 225) the Circuit Court of Appeals in the Ninth Circuit, after citing *Howell* v. *Folson*, supra, and *Hayes* v. *Horton* (46 Oregon, 597, 81 Pac., 386), said: "During the life of both husband and wife, they own, as has been shown, in equal shares, with the right of survivorship in both." (See also *Heacock* v. *Loder*, 106 Ore., 323, 211 Pac., 950.)

It thus appears that the taxpayer, A, had a material and valuable right in the house and lot owned by him and his wife by the entirety, a property right which is subject to the tax lien under the provisions of section 3186 of the Revised Statutes, as amended. This property right is real estate, which, under and subject to the provisions of section 3196 of the Revised Statutes, may be sold to satisfy the tax imposed.

While the decisions of the State courts as to the nature of interest in real estate control as rules of property, neither such decisions nor the statutes of any State are binding on the United States on the question whether property rights as so determined are subject to sale to satisfy a tax or other demand due the Federal Government. Thus the exemption and homestead laws of the various States do not prevent the sale of such State exempt property to pay a demand of the Federal Government. (I. T. 1683 [C. B. II–1, 172]; S. M. 2836 [C. B. IV–1, 68]; *United States* v. *Howell*, 9 Fed., 674; *Staley* v. *Hopkins*, 9 Fed. (2), 976.) The reason for this rule is thus stated in *United States* v. *Howell*, supra:

> * * * The National Government, though limited as to its objects, is supreme as to those objects, and any State law in conflict with the rights and powers of the National Government is inoperative to the extent of such interference. The National Government, in the exercise of its legitimate powers, has devised and adopted a system of internal revenue, and no State convention or legislature can impede and obstruct the free course and accomplishment of those measures, as they are essential to the important objects for which the National Government was established.

Upon a sale under distraint it appears that a purchaser would acquire, as set forth in *Hyles* v. *Fisher*, supra, the taxpayer's interest, subject to the right of survivorship of his wife and the right to use an undivided half interest in the property during the joint lives of the taxpayer and his wife.

A. W. Gregg,
General Counsel, Bureau of Internal Revenue.

ARTICLE 1205: Liens and enforcement of tax liens by bill in equity. VI–2–3041 G. C. M. 1072

REVENUE ACT OF 1926.

The obligation of a taxpayer for the payment of taxes due the Government continues although the taxpayer has been discharged in bankruptcy and the collector has received credit for the taxes as uncollectible. In such case a discharge of tax lien should not be filed by the collector with the clerk of the United States court.

An opinion is requested as to whether a collector should file Form 669 (discharge of tax lien) with the clerk of the United States court under the following circumstances:

In a number of cases where Form 668 (notice of tax lien) has been filed with the clerk of the United States court, it has been found impossible to make collection of the amount of tax involved, and the collector has received credit for the amount as uncollectible in accordance with Form 53. The greater number of the cases have reference to bankrupt concerns where there were no funds available to pay the claims filed by the collector in the bankruptcy proceedings, such concerns now being out of existence.

It is the opinion of this office that a discharge of tax lien should not be filed in these cases. Under the provisions of section 17 of the National Bankruptcy Act, a discharge in bankruptcy does not relieve a taxpayer from liability for payment of taxes due the United States (I. T. 1682, C. B. II–1, 172). See also section 282(b) of the Revenue Act of 1926.

Article 1303 of Regulations 69 provides in part as follows:

The collector may also present claims for credit of taxes not erroneously assessed but found to be uncollectible. See section 3218 of the Revised Statutes. In such cases the collector or deputy collector who made the demand for payment and is conversant with the facts may prepare the claim for credit on Form 53. Even though the collector is so credited with the amount allowed as uncollectible, nevertheless the obligation to pay still remains upon the person assessed. It is the duty of the collector to use the same diligence to collect the tax after he has received credit for an amount as uncollectible as before the allowance of such credit. Collectors should therefore keep a record of all taxes thus credited and of the persons from whom they are due and should enforce payment whenever it is in their power to do so.

Since the obligations of the bankrupt concerns for taxes continue in spite of their discharge in bankruptcy and the fact that the collector has received credit for the taxes as uncollectible in accordance with Form 53, and since it is the duty of the collector to collect the taxes later if possible, it is obvious that the Government's lien for taxes should not be discharged. Even though the taxpayer concerns are organizations which have ceased to exist, the lien should be continued for the purpose of binding any assets that may have been distributed to transferees.

A. W. GREGG,
General Counsel, Bureau of Internal Revenue.

ARTICLE 1205: Liens and enforcement of tax liens by bill in equity. VI-14-3177 I. T. 2344

REVENUE ACT OF 1926.

The act of February 7, 1927, passed by the legislature of Montana, effective February 7, 1927, is accepted by the Bureau of Internal Revenue as the "appropriate legislation" referred to in the second proviso of section 3186, Revised Statutes, as amended by the Act of March 4, 1913 (37 Stat., 1016), and the Act of February 26, 1925 (43 Stat., 994), authorizing the filing of notices of Federal tax liens with certain designated county or other officials.

ARTICLE 1205: Liens and enforcement of tax liens by bill in equity. VI-26-3282 I. T. 2366

REVENUE ACT OF 1926.

The act of April 27, 1927, passed by the legislature of West Virginia, effective from the date of its enactment, is accepted by the Bureau of Internal Revenue (except the provisions of sections 2 and 3 thereof) as the "appropriate legislation" referred to in the second proviso of section 3186, Revised Statutes, as amended by the Act of March 4, 1913 (37 Stat., 1016), and the Act of February 26, 1925 (43 Stat., 994), authorizing the filing of notices of Federal tax liens with certain designated county or other officials.

SECTIONS 273 AND 274.—DEFICIENCY IN TAX.

ARTICLE 1232: Assessment of a deficiency. VI-6-3080 G. C. M. 1205

REVENUE ACT OF 1926.

A waiver of the right of appeal and consent to immediate assessment filed by an agent under his general power of attorney to act in all matters pertaining to income tax for a corporation is legally binding upon the latter and covers excess-profits taxes.

An opinion is requested in the matter of the additional tax liability of the M Company for the fiscal periods ended June 30, 1920, and June 30, 1921, under the following circumstances:

Additional assessments were made without the issuance of a 60-day letter advising the taxpayer of its right to appeal to the Board of Tax Appeals. This was done because there is on file a waiver of the right of appeal and a consent to immediate assessment, applicable to these taxable periods, signed for the taxpayer by A, agent. It is the claim of the taxpayer that A did not have authority to sign such a waiver and consent under his general power of attorney. The taxpayer also points out that the power of attorney authorizes A to act only in income tax matters, but does not authorize him to act in excess-profits tax matters.

The power of attorney in question authorizes A to act in all matters "pertaining to income tax for the years 1919 to 1923, inclusive," with "full power and authority to do and perform all and every act or thing requisite and necessary to be done in and about

the premises as fully to all intents and purposes as it might or could do if personally present." Under such a power of attorney, it is believed that the waiver of appeal and consent to assessment signed by A is legally binding upon the corporation and that the waiver and consent covers excess-profits taxes, since excess-profits taxes are taxes levied on income under the authority in the Constitution to levy income taxes. Therefore, the taxpayer should be advised that a 60-day letter will not be issued.

A. W. GREGG,
General Counsel, Bureau of Internal Revenue.

ARTICLE 1235: Interest on a deficiency. VI-21-3241
G. C. M. 1534

REVENUE ACT OF 1926.

Interest on deficiencies in tax imposed by the Revenue Act of 1921 must be assessed in the same manner and subject to the same provisions and limitations as in the case of interest on deficiencies in tax imposed by the Revenue Act of 1926.

The opinion of this office is requested on the question whether interest on an additional tax assessed against the M Company for the fiscal year ended August 31, 1922, should run to the date of notice and demand by the collector, or whether it is limited to 30 days after the filing of a waiver as provided by section 274(j) of the Revenue Act of 1926.

The taxpayer was advised of the proposed assessment under date of June —, 1926, and subsequently executed the waiver specified in section 274(d) of the Revenue Act of 1926. The collector of internal revenue takes the position that interest should be collected for the period from the date of the expiration of 30 days after the filing of the waiver prescribed in section 274(d) to the date of notice and demand for the payment of the deficiency in tax, and the taxpayer protests against the collection of interest for this period. The question presented, therefore, is whether interest on a deficiency in tax imposed by the Revenue Act of 1921 is subject to the same provisions and limitations, in case a waiver of the restrictions on assessment and collection of the deficiency is filed by the taxpayer, as in the case of interest on a deficiency in tax imposed by the Revenue Act of 1926.

As a part of the remedial provisions prescribed in the Revenue Act of 1926, it is provided in subdivision (d) of section 274 that:

The taxpayer shall at any time have the right, by a signed notice in writing filed with the Commissioner, to waive the restrictions provided in subdivision (a) of this section on the assessment and collection of the whole or any part of the deficiency.

And subdivision (j) of that section provides that:

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 subdivision (d) of this section, to the thirtieth day after the filing of such waiver or to the date the deficiency is assessed whichever is the earlier.

With respect to a deficiency in tax imposed by prior Revenue Acts, section 283(a) provides as follows:

> If after the enactment of this Act the Commissioner determines that any assessment should be made in respect of any income, war-profits, or excess-profits tax imposed by the Revenue Act of 1916, the Revenue Act of 1917, the Revenue Act of 1918, the Revenue Act of 1921, or the Revenue Act of 1924, or by any such Act as amended, the Commissioner is authorized to send by registered mail to the person liable for such tax notice of the amount proposed to be assessed, which notice shall, for the purposes of this Act, be considered a notice under subdivision (a) of section 274 of this Act. In the case of any such determination the amount which should be assessed (whether as deficiency or as interest, penalty, or other addition to the tax) shall, except as provided in subdivision (d) of this section, be computed as if this Act had not been enacted, but the amount so computed shall be assessed, collected, and paid in the same manner and subject to the same provisions and limitations (including the provisions in case of delinquency in payment after notice and demand and the provisions prohibiting claims and suits for refund) as in the case of a deficiency in the tax imposed by this title, except as otherwise provided in section 277 of this Act.

In the present case the tax and interest thereon for the fiscal year ended in 1922 are imposed by the Revenue Act of 1921. Section 250(b) of that Act provides that interest at the rate of one-half of 1 per centum per month on deficiencies in tax shall be paid upon notice and demand by the collector. The procedural provisions governing the assessment and collection of deficiencies in tax, together with the penalty and interest, if any, applicable thereto, are prescribed in subdivision (d) of section 250 of the said Act. These procedural provisions are, by virtue of section 283 of the Revenue Act of 1926, superseded entirely by the provisions of the latter Act. Under the provisions of section 283(a), quoted above, it is clear that any amount of interest on deficiencies in tax imposed by a prior Act is required to be "assessed, collected, and paid in the same manner and subject to the same provisions and limitations" as in the case of interest on a deficiency in tax imposed by the Revenue Act of 1926. To hold otherwise would render much of the language contained in the procedural provisions of the Revenue Act of 1926 inapplicable with respect to interest on deficiencies in tax imposed by a prior Act. Thus, while in section 283 it is provided that "the amount which should be assessed (whether as deficiency or as interest * * *)" shall be computed as if the Revenue Act of 1926 had not been enacted, it would be manifestly impossible to compute the amount of interest on a deficiency in tax imposed by the Revenue Act of 1921, up to the date of notice and demand by the collector, as was the procedure under that Act, and at the same time assess and collect the amount of interest so computed in the same manner and subject to the same provisions and limitations as in the case of interest on deficiencies in tax imposed by the Revenue Act of 1926. Nor does the language used in section 283 indicate that the interest shall be computed up to the date of notice and demand by the collector, for it refers to the *amount which should be assessed*, and that amount by reason of the parenthetical clause must include any interest due up to the date the assessment is made. Again, in section 279(a) of the Revenue Act of 1926, it is provided that:

> If the Commissioner believes that the assessment or collection of a deficiency will be jeopardized by delay, *he shall immediately assess such deficiency (together with all interest, additional amounts, or additions to the tax provided for by law)* and notice and demand shall be made by the collector for the payment thereof. [Italics supplied.]

And in section 276(b), which deals with additions to the tax in case of delinquency, and which is expressly made applicable to any tax determined to be due under a prior Act, it is provided that:

> Where a deficiency, or any interest or additional amounts *assessed in connection therewith* under subdivision (j) of section 274, * * * is not paid in full within 10 days from the date of notice and demand from the collector, there shall be collected as part of the tax, interest upon the unpaid amount at the rate of 1 per centum a month from the date of such notice and demand until it is paid. [Italics supplied.]

The foregoing provisions clearly indicate that any interest or additional amount due in connection with a deficiency in tax determined to be due under the Revenue Act of 1921 is required to be assessed at the same time as the deficiency in tax is assessed, and inasmuch as these provisions are expressly made applicable to taxes imposed by the Revenue Act of 1921, it is the opinion of this office that any interest on deficiencies in tax imposed by such Act must be assessed in the same manner and subject to the same provisions and limitations as in the case of interest on deficiencies in tax imposed by the Revenue Act of 1926.

It is accordingly concluded that in the instant case the interest on the deficiency in tax imposed by the Revenue Act of 1921 is collectible only up to the thirtieth day after the filing of the waiver under subdivision (d) of section 274, or to the date the deficiency in tax was assessed, whichever is the earlier.

A. W. GREGG,
General Counsel, Bureau of Internal Revenue.

SECTIONS 277 AND 278.—PERIOD OF LIMITATION UPON ASSESSMENT AND COLLECTION OF TAX.

ARTICLE 1272: Period of limitation upon collection of tax. VI–16–3203 G. C. M. 1539

REVENUE ACT OF 1926.

> Where deficiencies were assessed and appeals filed with the United States Board of Tax Appeals prior to the enactment of the Revenue Act of 1926, the running of the statute of limitations upon the collection of such assessments is suspended for the period from the date of the enactment of the Revenue Act of 1926 to the date the decision of the Board becomes final and for 60 days thereafter. No opinion is expressed as to whether the running of the statute of limitations is suspended for any additional period of time prior to the enactment of the aforesaid Act.

An opinion is requested as to whether the filing of an appeal with the United States Board of Tax Appeals suspends the running of the six-year statute of limitations, provided in section 278(d) of the Revenue Act of 1926, upon the collection of income and profits taxes.

It appears that the collector at —— has several outstanding accounts where the six-year period after date of assessment has expired in connection with which appeals have been taken to the Board of Tax Appeals. One of these cases is in the name of A and represents additional 1918 income taxes assessed under date of June —, 1920. The taxpayer filed a claim for abatement of the tax, which was apparently rejected by the Bureau some time since the passage

of the 1924 Act. The taxpayer thereupon filed an appeal with the Board, and while the appeal was pending the six-year period for collection of the tax expired June —, 1926.

In a somewhat similar case, in the name of the M Company, there was assessed additional tax for the year 1918 under date of September —, 1920, against which a claim for abatement was filed by the taxpayer. This claim was rejected by the Bureau subsequent to the enactment of the 1924 Act, and the taxpayer filed an appeal with the Board. While the appeal was pending the six-year period for collection of the tax expired under date of September —, 1926, no collection waiver having been filed by the taxpayer.

The records disclose that the appeals in the cases were filed with the United States Board of Tax Appeals prior to the enactment of the Revenue Act of 1926; that the appeal in the case of A is still pending before the Board; and that the appeal in the case of the M Company was decided by the Board under date of November —, 1926.

Section 277(b) of the Revenue Act of 1926 provides that:

> The running of the statute of limitations provided in this section or in section 278 on the making of assessments and the beginning of distraint or a proceeding in court for collection, in respect of any deficiency, shall (after the mailing of a notice under subdivision (a) of section 274) be suspended for the period during which the Commissioner is prohibited from making the assessment or beginning distraint or a proceeding in court, and for 60 days thereafter.

Section 283 provides in part as follows:

> (e) If any deficiency in any income, war-profits, or excess-profits tax imposed by the Revenue Act of 1916, the Revenue Act of 1917, the Revenue Act of 1918, or the Revenue Act of 1921, or by any such Act as amended, was assessed before June 3, 1924, but was not paid in full before the date of the enactment of this Act, and if the Commissioner, after the enactment of this Act, finally determines the amount of the deficiency, he is authorized to send by registered mail to the person liable for such tax notice of such deficiency, which notice shall, for the purposes of this Act, be considered a notice under subdivision (a) of section 274 of this Act. In the case of any such final determination the amount of the tax (whether deficiency or interest, penalty, or other addition to the tax) shall, except as provided in subdivision (h) of this section, be computed as if this Act had not been enacted, but the amount so computed shall be collected and paid in the same manner and subject to the same provisions and limitations (including the provisions in the case of delinquency in payment after notice and demand, and the provisions relating to claims and suits for refund) as in the case of a deficiency in the tax imposed by this title, except as otherwise provided in section 277 of this Act and in subdivision (i) of this section.
>
> (f) If any deficiency in any income, war-profits, or excess-profits tax imposed by the Revenue Act of 1916, the Revenue Act of 1917, the Revenue Act of 1918, or the Revenue Act of 1921, or by any such Act as amended, was assessed before June 3, 1924, but was not paid in full before that date, and if the Commissioner after June 2, 1924, but before the enactment of this Act finally determined the amount of the deficiency, and if the person liable for such tax appealed before the enactment of this Act to the Board and the appeal is pending before the Board at the time of the enactment of this Act, the Board shall have jurisdiction of the appeal. In all such cases the powers, duties, rights, and privileges of the Commissioner and of the person who has brought the appeal, and the jurisdiction of the Board and of the courts, shall be determined, and the computation of the tax shall be made, in the same manner as provided in subdivision (e) of this section, except as provided in subdivision (j) of this section and except that the person liable for the tax shall not be subject to the provisions of subdivision (d) of section 284.
>
> * * * * * * *

(i) In cases within the scope of subdivision (e), (f), or (g), if the Commissioner believes that the collection of the deficiency will be jeopardized by delay, he may, despite the provisions of subdivision (a) of section 274 of this Act, instruct the collector to proceed to enforce the payment of the unpaid portion of the deficiency, and notice and demand shall be made by the collector for the payment thereof. Within 10 days after such jeopardy notice and demand the person liable for the tax may obtain a stay of collection of the whole or any part of the amount included in the notice and demand by filing with the collector a bond in like manner, under the same conditions, and with the same effect, as in the case of a bond to stay the collection of a jeopardy assessment under section 279 of this Act.

Under the foregoing provisions, in any case where an appeal was pending before the United States Board of Tax Appeals at the time of the enactment of the Revenue Act of 1926 with respect to a deficiency in tax assessed before June 3, 1924, but not paid in full before that date, the collection of the tax so assessed shall be subject to the same provisions and limitations as in the case of a deficiency in tax imposed by the Revenue Act of 1926, and, except in the case of jeopardy (see subdivision (i)), the prohibition against a distraint or a proceeding in court for the collection of a deficiency in tax as prescribed in section 274 (a) is applicable. The prohibition so prescribed, however, covers only the period from the date of the enactment of the Revenue Act of 1926 to the date the decision of the Board has become final, and correspondingly, therefore, the period of the suspension of the running of the statute of limitations provided for in subdivision (b) of section 277 covers only such period and 60 days thereafter.

It is accordingly the opinion of this office that, if the appeals filed in the cases of A and the M Company were in respect to outstanding assessments, the running of the statute of limitations upon the collection of such assessments was suspended for the period from the date of the enactment of the Revenue Act of 1926 to the date the decision of the Board has become final and for 60 days thereafter.

No opinion is expressed on the question as to whether under the provisions of subdivision (1) of section 283 of the Revenue Act of 1926 the running of the statute of limitations is suspended for any additional period of time prior to the enactment of the said Act, as under the facts presented by the instant cases an opinion on that question is unnecessary.

A. W. Gregg,
General Counsel, Bureau of Internal Revenue.

ARTICLE 1272: Period of limitation upon collection of tax. VI–17–3209 G. C. M. 1546

REVENUE ACTS OF 1924 AND 1926.

In any case where the five-year period of limitation contained in section 250(d) of the Revenue Act of 1921, or such five-year period as extended by waivers, expired prior to the date of the enactment of the Revenue Act of 1924 (June 2, 1924), the six-year period of limitation upon the collection of a tax after assessment contained in section 278(d) of the Revenue Acts of 1924 and 1926 does not apply, and collection can not be made in such cases either by distraint or a proceeding in court.

An opinion is requested as to whether an income tax assessed against the M partnership for 1917 can be legally collected.

It appears that the partnership return for 1917 was filed on March 30, 1918; that an assessment waiver was executed on February 10, 1921, which expired, under Mimeograph 3085 (C. B. II–1, 174), on April 1, 1924; that the tax was assessed on January 30, 1924; and that on August 5, 1925, a lien was recorded on the proper records. It further appears that no proceeding, either by distraint or in court, has been commenced for the collection of the tax.

In *United States* v. *Board et al.* (14 Fed. (2d), 459) the court said:

The Act of 1924 extended the time within which suit might be brought on account of taxes accruing under the Revenue Acts of 1916, 1917, 1918, and 1921 for six years following the assessment of the tax, provided the assessment was made within five years after the return was filed; and provided further, that the right to bring such action was not barred under such previous statutes at the time the Revenue Act of 1924 was enacted.

Since the decision in the Board case, supra, the Supreme Court, on February 21, 1927, rendered its decision in the case of the *New York & Albany Lighterage Co.* v. *Bowers* [see T. D. 4009, page 268]. It was held in that case that collection by distraint of income and excess profits taxes imposed by the Revenue Acts of 1916 and 1917 is barred by section 250(d) of the Revenue Act of 1921, upon the expiration of five years from the time the return was filed, although the taxes were duly assessed within the five-year period provided by section 250(d) of that Act.

The effect of these two decisions is that in any case where the five-year period of limitation provided by section 250(d) of the Revenue Act of 1921, or such five-year period as extended by waivers, expired prior to the date of the enactment of the Revenue Act of 1924 (June 2, 1924), the six-year period of limitation upon the collection of a tax after assessment provided by section 278(d) of the Revenue Acts of 1924 and 1926 does not apply, and that collection can not be made in such cases either by distraint or a proceeding in court.

The time for assessment and collection of the tax in the instant case expired prior to June 2, 1924, the date of the enactment of the Revenue Act of 1924. Consequently, under the rule of the above-cited cases, the tax assessed against the M partnership can not now be legally collected.

A. W. Gregg,
General Counsel, Bureau of Internal Revenue.

ARTICLE 1272: Period of limitation upon collection of tax. VI–22–3250 G. C. M. 1682

REVENUE ACT OF 1926.

A waiver executed by a corporation is not invalid by reason of the absence of the corporate seal thereon and the fact that it bears only the signature of the president of the taxpayer corporation.

The validity of a waiver or agreement by a taxpayer that the statute of limitations with respect to collections shall be waived, which was executed by the taxpayer prior to the enactment of the Revenue Act of 1926, is not affected by the absence of the Commissioner's signature where the Commissioner has otherwise indicated his acceptance of the taxpayer's offer to waive the statute of limitations by reliance on, or parol acceptance of, the waiver in its terms.

The decision of the Supreme Court of the United States in the case of *Bowers* v. *The New York & Albany Lighterage Co.* [see T. D. 4009, page 268] is not applicable where the period of limita-

tion with respect to the collection of the tax was extended by an agreement in writing by the Commissioner and the taxpayer, as provided for in section 278 (d) and (e) of the Revenue Act of 1926.

An opinion is requested as to whether the collection of an outstanding tax for the year 1917 may be effected from the M Company under waivers executed on behalf of the corporation by its president.

It appears that the M Company, the taxpayer, is a corporation whose principal office is located at ——, and that there is now outstanding an additional tax against the corporation for the taxable year 1917, which was assessed in 1919. On November 25, 1925, the taxpayer filed a waiver with respect to this outstanding item of tax, under the terms of which it waived the statute of limitations as to the time within which distraint or a proceeding in court might be begun for the collection of the tax in order to enable the Bureau to give consideration to any claims for abatement or credit filed on behalf of the taxpayer, such waiver to remain in effect until December 31, 1926. This waiver was executed in the name of the taxpayer by A, its president, but its corporate seal was not affixed. A second waiver, dated December 29, 1926, was executed by A, president, in the name of the taxpayer, and the seal of the corporation was impressed. By the terms of the second waiver the period during which collection might be effected was extended to December 31, 1927, there being contained in the waiver, however, a statement to the effect that the "taxpayer does not waive any rights that may have accrued, notwithstanding anything herein contained."

The taxpayer contends that the waiver dated November 25, 1925, is not valid, for the reason that it was signed by only one officer of the corporation and did not have the corporate seal affixed. With respect to the second waiver, it is apparently contended that in view of the invalidity of the first waiver the second waiver was necessarily of no effect because of the insertion of the above-quoted clause to the effect that no rights were waived which may have accrued. The additional question is presented as to whether the collection of the outstanding item of tax is now barred as a result of the recent decision of the Supreme Court of the United States in the case of *Bowers* v. *New York & Albany Lighterage Co.*

The outstanding item of tax for the year 1917 was assessed in December, 1919, and therefore within the statutory period provided for assessment under the Revenue Act then in force. The question whether collection may be effected at the present time is governed by the provisions of those subdivisions of section 278 of the Revenue Act of 1926, which read:

(d) Where the assessment of any income, excess-profits, or war-profits tax imposed by this title or by prior Act of Congress has been made (whether before or after the enactment of this Act) within the statutory period of limitation properly applicable thereto, such tax may be collected by distraint or by a proceeding in court (begun before or after the enactment of this Act), but only if begun (1) within six years after the assessment of the tax, or (2) prior to the expiration of any period for collection agreed upon in writing by the Commissioner and the taxpayer.

(e) This section shall not bar a distraint or proceeding in court begun before the enactment of the Revenue Act of 1924; nor shall it authorize the assessment of a tax or the collection thereof by distraint or by proceeding in court (1) if at the time of the enactment of this Act such assessment, distraint or proceeding was barred by the statutory period of limitation properly applicable

thereto, unless prior to the enactment of this Act the Commissioner and the taxpayer agreed in writing thereto, or (2) contrary to the provisions of subdivision (a) of section 274 of this Act.

By the express terms of the portion of the statute quoted above, if the tax was properly assessed within the statutory period, it may be collected at any time prior to the expiration of any period for collection agreed upon in writing by the taxpayer and the Commissioner. Therefore the question for determination is whether there has been a valid agreement in writing between the taxpayer and the Commissioner.

As previously stated, it is contended by the taxpayer that the waiver executed by it on November 25, 1925, is defective in its execution by reason of the absence of a corporate seal and by reason of the fact that it bears only the signature of the president of the taxpayer corporation.

It appears to be a settled principle of law that the corporate seal need not be attached to a corporate instrument unless a similar instrument, when executed by an individual, would require a seal. (Cook on Corporations, vol. 3, sec. 721.) However, the taxpayer is a corporation, with its principal office in the State of New York, and the instruments referred to above as waivers were executed in that State. Accordingly, resort may be had to the substantive law of New York State to determine the validity or effect of the waivers with respect to the purpose they were designed to accomplish. Under the interpretations of the laws of New York State by the courts of that State, the contracts of corporations are valid even though they do not bear the corporate seal. In *Hoag* v. *Lamont et al.* (60 N. Y., 96) the Court of Appeals of New York held that neither the corporate seal nor a formal resolution of the managers is necessary to the making of a valid contract by a corporation. In *Lienkauf* v. *Calman et al.* (110 N. Y., 50, 17 N. E., 389) the Court of Appeals of New York disposed of a similar proposition in the following language:

* * * It is not necessary for us to decide, in respect of this instrument, further than that it represented a promise or agreement of the corporation, within the scope of its legitimate purposes, through its officers, and must be considered as a valid contract, though not bearing its corporate seal. It was a memorandum in writing, evidencing a corporate act, and making the corporation liable to the plaintiff; and it is not for the defendants to object to irregularities or defects of execution. The doctrine that no corporate act can be binding without being in writing, or under the corporate seal, has long ceased to be maintained. (Aug. & A. Corp., sec. 231; *Danforth* v. *Turnpike Co.*, 12 Johns., 227; *Trustees* v. *Cagger*, 6 Barb., 576; *Moss* v. *Averell*, 10 N. Y., 449–454.)

The decisions of the New York courts in other cases are of similar import, and it would appear to be established that in the State of New York the obligations and agreements of corporations are not rendered invalid by the omission of the corporate seal. Even such formal instruments as mortgages and leases are valid, although they may not bear the seal of the corporation in whose behalf they are executed. It also appears the rule has arisen in New York State that a contract, which apparently is a corporate contract, being signed by the president, is presumed to be a corporate contract until want of authority of the president is shown by the corporation. (Cook on Corporations, vol. 3, sec. 716, and cases cited thereunder.)

In respect to the waiver dated December 29, 1926, there appears to be no contention raised as to any irregularity in its execution which

might render it invalid. By this waiver the taxpayer agreed to extend the time for the collection of the unpaid tax until December 31, 1927, but with the reservation that any rights that may have accrued would not be waived. The particular rights impliedly referred to by this reservation are with respect to the running of the statute of limitations, but the statute had been tolled by the execution of the waiver dated November 25, 1925, and obviously no rights accrued between the time of the execution of the first and second waivers if the first waiver is to be regarded as a valid agreement of the corporation. The second waiver merely extends the period referred to in the first waiver.

There is involved in this case another question, which will be considered in anticipation of inquiries respecting similar situations. The waiver dated November 25, 1925, was not signed by the Commissioner prior to the enactment of the Revenue Act of 1926. Therefore the question is raised as to whether such waiver, when signed by the taxpayer and not by the Commissioner, constituted an agreement in writing by the Commissioner and the taxpayer, such as is referred to in subdivisions (d) and (e) of the portion of the statute quoted above.

The Revenue Act of 1924 contains no provision for agreements in writing between the Commissioner and the taxpayer, extending the time within which collection of a tax after assessment may be made. However, during the period the collection of taxes was governed by the said Act, it was the practice for taxpayers to file waivers of the statutory period of limitation applicable to collection after assessment, and such waivers were signed by the taxpayer but not by the Commissioner. It would clearly appear, therefore, that, when Congress prescribed in section 278(e) that section 278 shall not authorize the collection of a tax if it is barred by "the statutory period of limitation" at the time of the enactment of the Revenue Act of 1926, "unless prior to the enactment of this Act the Commissioner and the taxpayer agreed in writing thereto," it had reference to the time agreed upon in such waivers as were accepted and relied upon by the Commissioner prior to the enactment of the said Act, but which were not specifically authorized by statute.

It will be noted that the language of the statute here under consideration contains the expression "unless prior to the enactment of this Act the Commissioner and the taxpayer agreed in writing thereto." A study of the statute containing this phrase leads to the conclusion that nothing more is meant than that there should be an agreement between the Commissioner and the taxpayer with respect to waiving the statute of limitations and that this should be reduced to writing. The taxpayer, in waiving the benefit of the statute of repose, would of course indicate its action by signing the instrument under the terms of which it relinquishes its right. There appears to be no reason why the acceptance of the terms of the waiver by the Commissioner may not be by parol. The taxpayer having divested itself of the benefit of the statute of limitations, no specific act of acceptance is necessary on behalf of the Commissioner, save, of course, reliance upon the overt act of the taxpayer as reflected by the taxpayer's execution of an instrument in writing. It would appear that a proper construction of the agreement in writing referred to in subdivisions (d) and (e) of section 278 is that construction ordinarily afforded to contracts. According to the weight of authority, a writ-

ten offer signed by the party to be charged, if orally accepted by the person to whom it is made, may itself constitute a sufficient written memorandum of the contract by the person by whom the offer is made, though the other person may plead the statute (statute of frauds). In such case, if the memorandum is otherwise sufficient when it is assented to by the person to whom the proposal has been made, the contract is consummated by the meeting of the minds of the two parties, and the evidence necessary to render it valid and capable of enforcement is supplied by the signature of the party sought to be charged to the offer to sell or buy. (25 R. C. L., 674, and the long line of decisions therein cited.)

Under the statute of frauds, either at common law or as enacted with modifications in the codes of the several States, where a transaction is required to be evidenced by a memorandum, written agreement or other evidence of contract signed by the party to be charged thereby, it is held sufficient that the other party to the transaction accept the proposition by parol acceptance or by adoption, and the signature of such second party is not necessary to validate the memorandum or written agreement. (*Milliken-Tomlinson Co.* v. *American Sugar Refining Co.*, 9 Fed. (2d), 809; *Russell* v. *Ives*, 178 N. W., 300; *Krohn* v. *Dustin*, 172 N. W., 213; *Jones* v. *School District No. 48*, 208 S. W., 798; *Anderson* v. *Hall*, 202 S. W., 539; *Bache* v. *Bankograph Co.*, 197 N. Y. S., 663; *Halperin* v. *Magida*, 201 N. Y. S., 180.) Where a contract between two parties is reduced to writing and signed by one of them and is accepted by the other, it is sufficient to impose on it the character of a written instrument. (*Clegg* v. *Brannan*, 234 S. W., 1076.)

Viewing the matter from the standpoint that Congress was acquainted with the practice of the Bureau of Internal Revenue in accepting collection waivers not specifically authorized by statute and required to be signed only by the taxpayer, and further considering the matter in the light of the fact that it was apparently the intention of Congress in effecting the legislation under review to provide with respect to such waivers already in existence, this office has no difficulty in reaching the conclusion that the signature of the Commissioner to an instrument executed by the taxpayer prior to the enactment of the Revenue Act of 1926 for the purpose of tolling the statute of limitations with respect to the collection of tax would add nothing to the legal effect of such instrument, and that it would be valid in the absence of the Commissioner's signature. And if the matter is viewed in the light of the decisions of the courts with respect to the more formal instruments required by the various statutes of fraud, it will be found that oral acceptance of the memoranda and agreements provided under such statutes by the parties to whom offers are made is deemed sufficient. This office is therefore of the opinion that the validity of a waiver or agreement by a taxpayer that the statute of limitations with respect to collections shall be waived, which was executed by the taxpayer prior to the enactment of the Revenue Act of 1926, is not affected by the absence of the Commissioner's signature where the Commissioner has otherwise indicated his acceptance of the taxpayer's offer to waive the statute of limitations by reliance on, or parol acceptance of, the waiver in its terms.

With respect to the question raised that the collection of the tax might be barred as a result of the application of the decision of the United States Supreme Court in the case of *Bowers* v. *The New York & Albany Lighterage Co.*, it seems sufficient to state that in that case the court had under interpretation section 250(d) of the Revenue Act of 1921, which provided that no suit or proceeding for the collection of any taxes due under certain Revenue Acts could be begun after the expiration of five years after the date such return of tax was filed, and the opinion was rendered to the effect that the collection of the tax by distraint would be a proceeding within the meaning of the statute under consideration. However, in the instant case the taxpayer has waived the benefits of the statute of limitations, and the bar of the statute of repose is therefore not applicable until after the expiration of the period for which the statute of limitations was to be tolled.

To summarize, this office has reached the following conclusions: (1) That the instrument dated November 25, 1925, was properly executed, and, although not signed by the Commissioner, was a valid waiver or agreement in writing to the effect that the tax could be collected at any time prior to December 31, 1926; (2) that by the terms of the instrument or waiver dated December 29, 1926, the period during which the tax could be collected was extended to December 31, 1927; and (3) that the decision of the Supreme Court of the United States in the case of *Bowers* v. *The New York & Albany Lighterage Co.* is not applicable to the instant case.

A. W. GREGG,
General Counsel, Bureau of Internal Revenue.

SECTION 280.—CLAIMS AGAINST TRANSFERRED ASSETS.

ARTICLE 1291: Claims in cases of transferred assets. VI-2-3042 G. C. M. 1029

REVENUE ACT OF 1926.

Under the provisions of section 280 of the Revenue Act of 1926, the transferee of the property of a taxpayer can not be assessed where the period of limitation for assessment against the taxpayer expired prior to the enactment of the Revenue Act of 1926 without any assessment against the taxpayer having been made, or without any court proceeding for the collection of the tax having been begun, within such period.

In connection with the administration of section 280 of the Revenue Act of 1926, the question is presented whether, under that section, a transferee of the property of a taxpayer can be assessed where the period of limitation for assessment against the taxpayer expired prior to February 26, 1926, the date on which the Revenue Act of 1926 was approved.

It is provided in section 280(b) of the Revenue Act of 1926 that—

> The period of limitation for assessment of any such liability of a transferee or fiduciary shall be as follows:
>
> (1) Within one year after the expiration of the period of limitation for assessment against the taxpayer; or
>
> (2) If the period of limitation for assessment against the taxpayer expired before the enactment of this Act but assessment against the taxpayer was

made within such period, then within six years after the making of such assessment against the taxpayer, but in no case later than one year after the enactment of this Act.

(3) If a court proceeding against the taxpayer for the collection of the tax has been begun within either of the above periods, then within one year after return of execution in such proceeding.

The statute is silent as to whether a transferee may be assessed where the period of limitation for assessment against the taxpayer expired prior to the enactment of the Revenue Act of 1926 without any assessment against such taxpayer having been made or without any proceeding in court against him having been begun. Whether or not section 280, supra, permits the assessment of the transferee under such circumstances is the problem for solution.

In section 286 of the Revenue Act of 1926 it is provided, among other things, that sections 271 to 285, inclusive, "shall take effect from the enactment of this Act." The effective date, therefore, of section 280 is February 26, 1926.

Was it intended by Congress that section 280 should have a retroactive application? That is, was it the purpose of Congress in enacting the Revenue Act of 1926 to make effective, as against a transferee, a tax liability which could not be asserted under the law against the transferor taxpayer because of the bar of the statute of limitations? (See section 278(e), Revenue Act of 1926.)

There is nothing in the section itself, or in any portion of the Revenue Act of 1926, or in the legislative history of the Act, which indicates that Congress intended that any liability of the taxpayer which could not be asserted should be made effective by the provisions of section 280 against the transferee of the taxpayer's property.

It is a well-recognized rule of construction that all statutes are to be presumed as prospective unless the language is express to the contrary or there is a necessary implication to that effect. (*Fullerton-Krueger Lumber Co.* v. *Northern Pacific Railway Co.*, 266 U. S., 435, citing *Harvey* v. *Tyler*, 2 Wall., 328; *Sohn* v. *Watterson*, 17 Wall., 596; *Twenty Per Cent Cases*, 20 Wall., 179; *Chew Heong* v. *United States*, 112 U. S., 536; *Shwab* v. *Doyle*, 258 U. S., 529.)

In *Shwab* v. *Doyle*, supra, where it was held on the authority of cited precedents that a law is not to be considered as applying to cases that arose prior to its passage unless that intention is clearly disclosed in the statute, the Supreme Court said (page 535 of the text) that if there is no clear, strong, and imperative declaration of retroactivity, and if the absence of such a declaration leaves to the statute a double sense, that sense which rejects retroactive operation must be selected.

The underlying reason for the position taken by the Supreme Court is thus expressed by Story (Commentaries on the Constitution of the United States, sec. 1398):

> Retrospective laws are, indeed, generally unjust; and, as has been forcibly said, neither accord with sound legislation nor with the fundamental principles of social compact.

Prior to the enactment of the Revenue Act of 1926 there was no statutory authority for assessing transferees of taxpayers' property to satisfy taxes due or found to be due the United States. True it is that in some instances the amount of taxes was recoverable by suit from transferees where the facts showed they were proper parties to the proceedings by reason of the application of the trust-fund doc-

trine, but there was no existing statute which gave the right to assess against a transferee amounts due the United States as taxes for which his transferor was primarily and immediately liable. Such right was given for the first time by section 280 of the Revenue Act of 1926. Under that section the transferee's liability is no greater or more comprehensive than that of the transferor taxpayer. The section merely prescribes a method for the enforcement of an established liability and adopts, for this purpose, the method of assessment applicable to the collection of taxes in the ordinary case. The logical conclusion is that it was not the purpose of Congress to make effective against a transferee a tax liability which at the time of the enactment of the Revenue Act of 1926 could not be asserted against the transferor taxpayer because of the bar of the statute of limitations.

It is, therefore, the opinion of this office that section 280 of the Revenue Act of 1926 should be given a prospective application only, and that under that section a transferee of the property of a taxpayer can not be assessed where the period of limitation for assessment against the taxpayer expired prior to the enactment of the Revenue Act of 1926 without any assessment against the taxpayer having been made, or without any court proceeding for the collection of the tax having been begun, within such period.

A. W. GREGG,
General Counsel, Bureau of Internal Revenue.

ARTICLE 1291: Claims in cases of transferred assets. VI-6-3081 G. C. M. 1126

REVENUE ACTS OF 1921 AND 1926.

Liability of transferees (former stockholders and those who are not former stockholders) for payment of 5 per cent penalty and 1 per cent per month interest asserted against a corporation for failure to pay its income tax within 10 days after notice and demand where (1) the tax is placed on the assessment list after the dissolution of the corporation, (2) where the tax is placed on the assessment list before the corporation dissolves but the dissolution is effected (*a*) prior to the expiration of the 10-day period, (*b*) after the expiration of the 10-day period.

An opinion is requested as to whether the 5 per cent penalty and 1 per cent per month interest asserted against a corporation for failure to pay its income tax within 10 days after notice and demand may be collected from the transferees of the property of the corporation under the provisions of section 280 of the Revenue Act of 1926.

In this connection, attention is called to I. T. 1455 (C. B. I-2, 211), which provides as follows:

Where a tax is placed on the assessment list after the dissolution of the corporation against which it is assessed, the former stockholders of the dissolved corporation are not liable to the 5 per cent penalty and 1 per cent per month interest on account of the failure of the dissolved corporation to pay the tax within 10 days after notice and demand.

If it is held that the provisions of I. T. 1455 preclude the assertion of the 5 per cent penalty and 1 per cent per month interest in cases where the taxes were placed on the assessment list after the dissolution of the corporation, an opinion is desired as to whether this penalty and interest may be collected in cases where the tax upon which it is computed was assessed before the dissolution of the corporation.

(1) Section 280 of the Revenue Act of 1926 provides, in part, as follows:

(*a*) The amounts of the following liabilities shall, except as hereinafter in this section provided, be assessed, collected, and paid in the same manner and subject to the same provisions and limitations as in the case of a deficiency in a tax imposed by this title (including the provisions in case of delinquency in payment after notice and demand, the provisions authorizing distraint and proceedings in court for collection, and the provisions prohibiting claims and suits for refunds):

(1) The liability, at law or in equity, of a transferee of property of a taxpayer, in respect of the tax (including interest, additional amounts, and additions to the tax provided by law) imposed upon the taxpayer by this title or by any prior income, excess-profits, or war-profits tax Act.

The phrase in section 280(a)1 which reads "including interest, additional amounts, and additions to the tax provided by law" is broad enough to cover penalties, and it expressly includes interest. Since this phrase modifies the preceding word, "tax," and since the "tax" referred to is the tax "imposed upon the taxpayer (i. e., the transferor) by this title or by any prior income * * * tax Act," it follows that the interest and penalties imposed by any prior income tax Act on a taxpayer, as well as the tax itself, may be collected from the transferee of such taxpayer. But the *manner* of assessment and collection from the transferee is to be in the same manner and subject to the same limitations as in the case of a deficiency in a tax imposed by the 1926 Act, including the provisions in case of delinquency in payment after notice and demand, etc.

Section 280 does not repeal I. T. 1455, because the "interest, additional amounts, and additions to the tax" are only such as are "provided by law," and the term "law" in this connection must be taken to mean the statutes, plus the prior interpretation of the statutes, unless there is a clear indication to the contrary.

Since the liability of transferees is not extended by the 1926 Act, it follows that I. T. 1455 still precludes the collection from former stockholders of the 5 per cent penalty and 1 per cent per month interest for failure of a corporation to pay a tax within 10 days after notice and demand, where the tax was placed on the assessment list after the dissolution of the corporation against which it was assessed.

(2) There may be cases, however, where the transferees are not former stockholders, and the question then arises whether the 5 per cent penalty and 1 per cent per month interest could be collected from such transferees. I. T. 1455 precludes the collection only from former stockholders.

It is the opinion of this office that transferees who are former stockholders are in no better position than transferees who are not former stockholders, and that consequently the penalty and interest may not be collected from the latter class of transferees in cases where the tax was placed on the assessment list after the dissolution of the corporation.

(3) Where a tax is placed on the assessment list before the corporation dissolves, but the dissolution is effected prior to the expiration of the 10-day period, the 5 per cent penalty is not collectible in any case, since the corporation ceased to exist before its period of grace in payment expired. The 1 per cent a month interest should be collected, however, since this is not properly a penalty but a part of the tax itself. (*Billings* v. *United States*, 232 U. S., 261, 34 Sup.

Ct., 421, 426; *United States* v. *Proctor*, 286 Fed., 272; *Nolte* v. *Hudson Nav. Co.*, 8 Fed. (2d). 859, 867; *United States* v. *Childs*, 266 U. S., 304, 45 Sup. Ct. Rep., 110; T. D. 3671 [C. B. IV–1, 241].) The interest runs from the date the tax is due, not from the date of the expiration of the 10-day period, although it may not be charged by the Government if the tax is paid within the 10-day period. The interest is part of the tax and the tax became due before the corporation dissolved. The interest should therefore be collected from the transferees in any case where the corporation would have been liable if it had not dissolved.

(4) Where the tax is placed on the assessment list before the dissolution of the corporation, and the corporation does not dissolve until after the expiration of the 10-day period after notice and demand, both the 5 per cent penalty and the 1 per cent per month interest may be collected from the transferees in any case where the corporation itself was liable for such penalty and interest.

A. W. GREGG,
General Counsel, Bureau of Internal Revenue.

SECTION 284.—CREDITS AND REFUNDS.

ARTICLE 1301: Authority for abatement, credit, and refund of tax.

REVENUE ACT OF 1926.

Tax assessed upon a sale of personal property in excess of the sum properly due the Government under the installment-sale provisions of sections 212(d) and 1208 of the Revenue Act of 1926. (See G. C. M. 3864, page 38.)

ARTICLE 1302: Abatement, credit, and refund adjustments.

REVENUE ACT OF 1926.

Acquiescence by Commissioner in a decision of the Board of Tax Appeals as a "final decision by the Commissioner of Internal Revenue." (See G. C. M. 941, page 205.)

ARTICLE 1304: Claims for refund by taxpayers. VI–2–3043
G. C. M. 1020

REVENUE ACT OF 1926.

A claim for refund which sets forth only vague generalities and affords the Commissioner no basis on which to consider whether the tax has been illegally assessed and paid or to correct errors, is not a claim within the meaning of the statute and the regulations.

An opinion is requested relative to an application filed for the reconsideration of a claim for refund in the amount of 22*x* dollars, covering taxes overpaid by the M Company for the taxable year 1917.

The facts pertinent to the claim appear to be substantially as follows:

The M Company filed an income and profits tax return for the taxable year 1917 in March, 1918, showing a total tax due of $22x$ dollars, which amount was assessed and paid. In July, 1923, the taxpayer made payment of an additional tax of x dollars, which amount was assessed in June, 1921. Prior to the payment of this additional tax, the taxpayer, on February —, 1923, filed a claim for refund of the full amount of tax originally paid, based upon the following grounds:

> The Revenue Act of 1916 and the Revenue Act of 1917 were not enacted in accordance with the requirements of the sixteenth amendment of the Constitution of the United States, and were hence null and void. The regulations and form of return were not in accordance with the terms of such Acts, and hence were of no force and effect. This claim is filed in order to fully protect the rights and interests of this taxpayer, under the terms of section 252 of the Revenue Act of 1921.

This claim was rejected on December —, 1923, after the taxpayer had made payment of the additional tax, the letter of rejection reading as follows:

> Your claim for refund for 1917 income and excess-profits taxes in the sum of $22x$ dollars has been examined and will be rejected, inasmuch as the statements upon which the claim is based are not deemed sufficiently specific to meet the requirements of the Bureau. The rejection of your claim will officially appear in the next schedule approved by the Commissioner.

The taxpayer, having filed in December, 1920, a waiver of the statute of limitations upon assessment of the tax for the taxable year 1917, had until April 1, 1925, within which to file a claim for refund of the full amount of tax originally paid (see section 252 of the Revenue Act of 1921, as amended March 13, 1924, section 281(e) of the Revenue Act of 1924, and section 284(g) of the Revenue Act of 1926); or until July, 1927, within which to file a claim for refund limited in amount to the amount of additional tax, namely, x dollars, paid in July, 1923. The taxpayer, however, took no further action after the rejection of its claim in December, 1923, to file a claim setting forth the basis therefor until April 22, 1925, at which time it filed a formal claim for refund, setting forth in detail the basis therefor. This formal claim was filed after the expiration of the period of limitation (which expired on April 1, 1925) within which to file a claim for refund of the original tax paid, and, therefore, was effective only as to the additional tax paid in July, 1923, namely, x dollars. However, it contained a request that the original claim, filed on February —, 1923, which was rejected in December, 1923, be reconsidered so as to permit the allowance of a refund in excess of the additional tax on the basis set forth in the formal claim of April 22, 1925.

A claim which sets forth only vague generalities as a basis therefor is not a claim as contemplated by the statute and the regulations. As stated by the Circuit Court of Appeals of the Fifth Circuit, in the case of *W. C. Tucker* v. *Alexander, collector*, decided October 27, 1926, the evident purposes and objects of the statute in requiring that a claim be filed "are to afford the Commissioner an opportunity to correct errors made by his office and to spare the parties and the courts the burden of litigation in respect thereto. Unless the claimant were required to present to the Commissioner all the grounds upon which he relies for refund, the above purposes and objects would be

partially or entirely defeated." (See also opinion of the Circuit Court of Appeals of the Eighth Circuit, in the case of *Red Wing Malting Co.* v. *Willcuts, collector*, decided November 5, 1926.) In the instant case the taxpayer merely asserted that the statute was unconstitutional and that the regulations were not in accordance with the statute. A claim so filed affords the Commissioner no basis whatsoever to consider on its merits the question as to whether the tax assessed and paid has been illegally assessed and paid, or to correct any errors, if any errors have been made, in the amount of tax finally determined to be due. The claim of the taxpayer did not point out wherein the statute was unconstitutional or wherein the regulations were not in accordance with the statute. Such an instrument can not be regarded as a claim.

This office is accordingly of the opinion that the application for a reconsideration of the original claim should be denied.

A. W. GREGG,
General Counsel, Bureau of Internal Revenue.

ARTICLE 1304: Claims for refund by taxpayers. VI–13–3173
T. D. 4002

INCOME TAX.

Claims for refund by taxpayers.

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

To Collectors of Internal Revenue and Others Concerned:

Article 1304 of Regulations 69 is hereby amended to read as follows:

ART. 1304. *Claims for refund by taxpayers.*—Claims by the taxpayer for the refunding of taxes, interest, penalties, and additions to tax erroneously or illegally collected shall be made on Form 843. All facts relied upon in support of the claim should be clearly set forth in detail under oath. If a return is filed by an individual and a refund claim is thereafter filed by a legal representative of the deceased, 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 executor, administrator, or other fiduciary by whom the claim is filed. 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 or interest 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. The affidavit may be made by the agent of the person assessed, but in such case a power of attorney must accompany the claim. Checks in payment of claims allowed will be drawn in the names of the persons entitled to the money and will be sent directly to them. But see section 3477 of the Revised Statutes, which provides:

"All transfers and assignments made of any claim upon the United States, or of any part or share thereof, or interest therein, whether absolute or conditional, and whatever may be the consideration therefor, and all powers of attorney, orders, or other authorities for receiving payment of any such claim, or of any part or share thereof, shall be absolutely null and void, unless they

are freely made and executed in the presence of at least two attesting witnesses, after the allowance of such a claim, the ascertainment of the amount due, and the issuing of a warrant for the payment thereof. Such transfers, assignments, and powers of attorney must recite the warrant for payment, and must be acknowledged by the person making them, before an officer having authority to take acknowledgment of deeds, and shall be certified by the officer; and it must appear by the certificate that the officer, at the time of the acknowledgment, read and fully explained the transfer, assignment, or warrant of attorney to the person acknowledging the same."

The Commissioner has no authority to refund on equitable grounds penalties or other amounts legally collected. As to claims for refund of sums recovered by suit, see article 1352.

D. H. Blair,
Commissioner of Internal Revenue.

Approved March 24, 1927.

A. W. Mellon,
Secretary of the Treasury.

Article 1304: Claims for refund by taxpayers. VI-25-3274
G. C. M. 1766

REVENUE ACT OF 1926.

Correspondence with a collector relative to procuring a copy of a return, in which it was stated that the taxpayer intended to file a claim for refund, but which did not set out any grounds upon which it expected to recover, is not sufficient to constitute an informal claim for refund.

An opinion is requested as to whether certain letters written by the taxpayer's representative are sufficient to constitute an informal claim for refund.

The M Company filed its income tax return for the fiscal year ended May 31, 1922, in November, 1922. During the same month it paid the tax shown on the return, together with a 25 per cent ad valorem penalty for delinquency. On October 6, 1923, a claim for refund of the penalty was rejected. During the early months of 1926 numerous letters were written by the taxpayer's representative to the collector of internal revenue at ———, relative to procuring a copy of the taxpayer's income tax return for the fiscal year 1922. In these letters it was stated that the taxpayer intended to file a claim for refund and that the copy of the return was needed in order that the claim for refund could be properly prepared. In compliance with these requests a photostatic copy of the return was forwarded to the taxpayer on June 17, 1926. The period in which a claim for refund of the tax paid in this case could be filed expired, under section 284(b) of the Revenue Act of 1926, during the month of November, 1926. The formal claim for refund was filed January 17, 1927.

The taxpayer contends that the numerous letters written by its representative prior to the expiration of the period of limitation were sufficient to constitute an informal claim for refund.

In Law Opinion 1116 (C. B. III-1, 350) this office, in following 14 Op. Atty. Gen., 614, held that although a letter from the taxpayer's representatives could not be considered as a formal claim for refund, nor as an amendment of a formal claim previously filed, it could be treated as an informal claim for refund. In that case

the letter from the taxpayer's representatives set out specifically the grounds upon which the taxpayer expected to rely.

In General Counsel's Memorandum 1020 [see page 119] this office held that a claim which set forth only vague generalities and afforded the Commissioner no basis on which to consider whether the tax had been illegally assessed or paid, or to correct errors, was not a claim within the meaning of the statute and regulations.

In the instant case the correspondence did not purport to set out any grounds upon which the taxpayer expected to recover, nor did it in any way afford the Commissioner any basis on which to consider the merits of the claim. At most, the correspondence could only be considered as notice of an intention to file a claim for refund at some future date.

It is, therefore, the opinion of this office that the correspondence in this case is not sufficient to constitute an informal claim for refund; and that the formal claim for refund, filed January 17, 1927, must be rejected as not having been filed within the time prescribed by law.

A. W. GREGG,
General Counsel, Bureau of Internal Revenue.

ARTICLE 1305: Limitations upon the crediting and refunding of taxes paid.

VI–1–3030
G. C. M. 762

REVENUE ACT OF 1926.

An unrestricted Indian member of the Choctaw Tribe of Indians is not entitled to a refund of taxes erroneously paid upon income from tax-exempt lands where no claim for refund was filed until after the running of the statute of limitations.

It is found, from an examination of the approved roll of members of the Choctaw Tribe of Indians, that the taxpayer is an enrolled member, his name appearing opposite roll No. ——, being of one-sixteenth Indian blood. He filed income tax returns for various years wherein he included income derived from lands allotted to him in severalty out of the tribal lands of the tribe. These lands were allotted subject to the condition that they should remain nontaxable so long as they should continue in his ownership as original allottee, not exceeding a period of 21 years from the date of the patent. The exemption continued during the taxable years here involved. A claim was filed for refund of the tax paid on such income, but not within the period prescribed by statute. The question is raised whether the bar of the statute of limitations applies, it being the taxpayer's contention that the refund should be allowed irrespective of the statute.

In the opinion of the Attorney General, dated August 14, 1924 (34 Ops. A. G., 302), it was ruled that claims for the refund of taxes paid on exempt income by the Superintendent of the Five Civilized Tribes in behalf of *restricted Indians* may be allowed even if filed after the expiration of the period of limitation. As indicated above, the taxpayer in the instant case is an *unrestricted Indian*.

The classification of these Indian allottees as restricted or unrestricted Indians depends on whether Congress has imposed restrictions upon the alienation of lands allotted to them in severalty. The imposition of such restrictions reflects a policy on the part of the Federal Government to protect some of the allottees in the ownership of such lands for a stated period, or until it shall have been determined, before the expiration of the period, that the particular allottee is no longer in need of protection. It is, therefore, in the nature of a guardianship of the individual Indian allottee, and the relation between such allottee and the Federal Government during the continuance of these restrictions has been referred to as a relationship of guardian and ward.

The Five Civilized Tribes were originally located in the southeastern portion of the United States. In the period which may be roughly estimated as between 1828 and 1835 the Federal Government prevailed upon them to migrate to Indian Territory, now a part of the State of Oklahoma. In the various treaties made with the tribes, the principal consideration offered them to migrate was that they should possess said lands unmolested forever as an independent people with their own forms of government. See the opinion of the Attorney General, dated March 15, 1924 (T. D. 3570, C. B. III–1, 85). However, by the year 1893 conditions in the Indian Territory had become most unsatisfactory by reason of the great influx of white people, with the consent of the tribes, some of whom had become members of the tribes. Inasmuch as the lands were held under and in the name of the tribes for the common benefit of all members, it happened that a few enterprising citizens, frequently not of Indian blood, had in fact become the possessors of the best and greatest part of these lands. In order to correct the inequities which arose out of the situation, Congress embarked upon legislation designed to dissolve the tribal organizations and to distribute tribal property, with the consent of the tribes so far as necessary, with the ultimate purpose of creating a State or States of the Union out of the Territory. See section 16 of the Act of March 3, 1893 (27 Stat., 612, 645). This resulted in the enactment of various allotment Acts, the ones applying to the Choctaws being embodied in the Act of June 28, 1898 (30 Stat., 495, 505), and the Act of July 1, 1902 (32 Stat., 641). In *Heckman* v. *United States* (224 U. S., 413) the Supreme Court said:

> But in executing this policy, Congress was solicitous to conserve the interest of the Indians and to fulfill the national obligation, not simply by assuring an equitable apportionment of the property but by safeguarding the Indian ownership of allottees through suitable restrictions, which were designed to secure them in their possession and to prevent their exploitation.
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> The placing of restrictions upon the right of alienation was an essential part of the plan of individual allotment, and limitations were imposed by it in the allotment agreements. The separate statutes were supplemented by the general Acts of 1906 and 1908, already mentioned. These restrictions evinced the continuance *to this extent, at least*, of the guardianship which the United States had exercised from the beginning. * * *
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> *During the continuance of this guardianship, the right* and duty of the Nation to enforce by all proper means the restrictions designed for the security of the Indians can not be gainsaid. While relating to the welfare of the Indians, the maintenance of the limitations which Congress has prescribed as a part of its plan of distribution is distinctly an interest of the United States. A review of

its dealings with the tribes permits no other conclusion. Out of its peculiar relation to these dependent peoples sprang obligations to the fulfillment of which the national honor has been committed. * * *

* * * * * * *

It was the intent of Congress that for their sustenances and as a fitting aid to their progress they should be secure in their possession during the periods specified and should actually hold the title to the allotted lands. [Italics supplied.]

At the time of the original allotment, the lands allotted to *every* member of the Choctaw Tribe were restricted as to alienation, the homestead allotment being inalienable for 21 years from the date of patent and the surplus allotment being alienable one-fourth in one year, one-fourth in three years, and the balance in five years from the date of patent.

Thereafter, in 1908, an Act was passed entitled "An Act for the removal of restrictions from part of the lands of the allottees of the Five Civilized Tribes, and for other purposes." (35 Stat., 312.) Under that Act it was provided:

SECTION 1. That from and after 60 days from the date of this Act the status of the lands allotted heretofore or hereafter to allottees of the Five Civilized Tribes *shall, as regards restrictions on alienation or incumbrance,* be as follows: *All lands, including homesteads, of said allottees enrolled as intermarried whites, as freedmen, and as mixed-blood Indians having less than half Indian blood, including minors, shall be free from all restrictions.* [Italics supplied.]

Thereupon the restrictions on the alienation of lands allotted to the taxpayer in the instant case, being of one-sixteenth Indian blood, were removed. Upon such removal of restrictions, the guardianship of such allottees, as explained in *Heckman* v. *United States*, supra, was ended. In section 4 of the Act it was provided:

That all lands from which restrictions have been or shall be removed shall be subject to taxation *and all other civil burdens as though it were the property of other persons* than allottees of the Five Civilized Tribes. [Italics supplied.]

Whatever purpose of protection or guardianship may theretofore have existed as to Indians of less than one-half Indian blood was done away with, and persons comprehended within the removal became what are known as unrestricted Indians, it having been determined that this class was no longer in need of the protection or guardianship which had originally been imposed. Thereafter, the supervision which had been exercised by the Secretary of the Interior, through the Superintendent of the Five Civilized Tribes, was relinquished, and such supervision has been continued only as to restricted Indians.

Special provision was made in section 6 of the Act of 1908 for continued supervision of minors of all classes during the period of minority, independent of the removal of restrictions. However, as the taxpayer in the instant case was an adult, he was subject to all the provisions made in the Act of 1908 with respect to unrestricted Indians, other than minors.

The opinion of the Attorney General of August 14, 1924, has to do only with restricted Indians. Owing to the supervision continued by the Act of 1908, the Superintendent for the Five Civilized Tribes made returns of income for restricted Indians because of the continued policy of the Federal Government to protect and conserve the allotted lands of this class. It was ruled by the Attorney General

that it would be inconsistent to interpose the bar of the statute of limitations against the refund of taxes erroneously paid on behalf of such persons.

With respect to unrestricted Indians, other than minors, as to whom the policy of protection and conservation ended with the Act of 1908, it can not be said that they come within the principle of the opinion of the Attorney General. There is no reason for the application of a preferential rule to them, and they should be treated after removal of restrictions in the same manner as every other citizen of the United States; that is to say, subject to all civil burdens, to use the language of section 4 of the Act of 1908.

It is the opinion of this office, therefore, that the taxpayer, an unrestricted Indian member of the Choctaw Tribe of Indians, of one-sixteenth Indian blood, is not entitled to a refund of taxes erroneously paid upon income from tax-exempt lands where no claim for refund was filed until after the running of the statute of limitations.

A. W. GREGG,
General Counsel, Bureau of Internal Revenue.

ARTICLE 1305: Limitations upon the crediting and refunding of taxes paid.

VI–8–3116
G. C. M. 1254

REVENUE ACTS OF 1921, 1924, AND 1926.

The provisions of section 252 of the Revenue Act of 1921, section 281(c) of the Revenue Act of 1924, and section 284(c) of the Revenue Act of 1926, with respect to the crediting or refunding of overpayments of income or profits taxes notwithstanding the expiration of the period of limitation, are not applicable where there is no profits tax liability.

The taxpayer protests against the disallowance of a refund of taxes alleged to have been overpaid for taxable years prior to 1919. The taxpayer was notified by a 60-day letter dated May —, 1926, that the final determination of the Commissioner for the taxable year 1919 disclosed a deficiency in tax of x dollars, and that—

In view of the fact that there is no excess-profits tax, the proposed refunds for prior years as shown in office letter dated December —, 1924, have been disapproved. Where there is no excess-profits tax liability, the statute does not provide that a decrease in invested capital shall be made in order that there may be an adjustment of taxes for prior years resulting in refunds.

No war-profits or excess-profits tax was determined to be due from the taxpayer for the taxable year 1919, and the deficiency in tax referred to represented a deficiency in income tax only.

Section 284(c) of the Revenue Act of 1926 provides that—

If the invested capital of a taxpayer is decreased by the Commissioner, and such decrease is due to the fact that the taxpayer failed to take adequate deductions in previous years, with the result that there has been an overpayment of income, war-profits, or excess-profits taxes in any previous year or years, then the amount of such overpayment shall be credited or refunded, without the filing of a claim therefor, notwithstanding the period of limitation provided for in subdivision (b) has expired. [Similar provisions appear in section 252 of the Revenue Act of 1921 and section 281(c) of the Revenue Act of 1924.]

The above section does not provide that the Commissioner shall decrease the invested capital of a taxpayer on account of inadequate

deductions taken in prior years, but provides that *if* that is done, then the amount of tax overpaid as the result of failure to take adequate deductions shall be credited or refunded, without the filing of a claim therefor, notwithstanding the statute of limitations. Where no war-profits or excess-profits tax has been assessed or paid, and none has been found to be due by the Commissioner, it can not be said that the Commissioner has decreased the taxpayer's invested capital, for his authority so to do does not extend beyond cases where it is necessary to compute and assess a war-profits or excess-profits tax. The above section does not authorize the allowance of a refund or credit after the statutory period where no refund claim was filed merely because the taxpayer overpaid his tax as a result of his failure to take adequate deductions. A refund is permissible after the period of limitation where no claim for refund was filed only where the taxpayer is forced to accept a decrease in his invested capital in connection with the adjustment of his tax for a subsequent year by the Commissioner.

In view of the foregoing, it is the opinion of this office that the refunds in the case of the taxpayer were properly disallowed.

A. W. GREGG,
General Counsel, Bureau of Internal Revenue.

TITLE XI.—GENERAL ADMINISTRATIVE PROVISIONS.

SECTION 1106.—FINAL DETERMINATIONS AND ASSESSMENTS.

ARTICLE 1341: Final determination and assessment of tax or penalty. VI–1–3031 I. T. 2329

REVENUE ACT OF 1926.

The request of a corporation, which has been held to be exempt from taxation under the Revenue Act of 1926 and prior Acts, for the execution of an agreement under section 1106(b) of the Revenue Act of 1926 must be denied, such corporation not being a taxpayer.

A request has been submitted by a corporation for the execution of an agreement under section 1106(b) of the Revenue Act of 1926.

An agreement under section 1106(b) of the Revenue Act of 1926 may be entered into only where the person desiring the agreement is able to comply with the conditions which that section requires to be fulfilled before such an agreement may be made. The section provides as follows:

(b) If after a determination and assessment in any case the taxpayer has paid in whole any tax or penalty, or accepted any abatement, credit, or refund based on such determination and assessment, and an agreement is made in writing between the taxpayer and the Commissioner, with the approval of the Secretary, that such determination and assessment shall be final and conclusive, then (except upon a showing of fraud or malfeasance or misrepresentation of fact materially affecting the determination or assessment thus made) (1) the case shall not be reopened or the determination and assessment modified by any officer, employee, or agent of the United States, and (2) no suit, action, or proceeding to annul, modify, or set aside such determination or assessment shall be entertained by any court of the United States.

It will be observed that the statute prescribes that there must be a taxpayer to enter into such an agreement.

In considering the request for the execution of an agreement under section 1106(b) of the Revenue Act of 1926, it is necessary to first determine whether the corporation is a taxpayer within the contemplation of the statute. The term "taxpayer" is defined in section 2 of the Revenue Act of 1926 as "any person subject to a tax imposed by this Act." A similar definition of the word "taxpayer" is contained in the Revenue Acts of 1918, 1921, and 1924. In a communication from this office, dated August —, 1926, the corporation was held to be exempt from taxation under the Revenue Act of 1926 and prior Acts. Consequently, it must be held that the corporation is not a taxpayer within the contemplation of the statute.

In view of the foregoing, the corporation's request for the execution of an agreement under section 1106(b) of the Revenue Act of 1926 must be denied.

SECTION 1113.—LIMITATIONS UPON SUITS AND PROCEEDINGS BY THE TAXPAYER.

ARTICLE 1351: Suits for recovery of taxes erroneously collected. VI–15–3193 T. D. 4007

INCOME TAXES—REVENUE ACT OF 1917—REVENUE ACT OF 1926—DECISION OF COURT.

1. SUIT—CLAIM FOR REFUND.

Under sections 1112 and 1113 of the Revenue Act of 1926, amending sections 3228 and 3226 of the Revised Statutes, a formal written claim for refund is necessary as a prerequisite to suit, and a verbal claim for refund does not comply with the statutory requirement.

2. ESTOPPEL—STATUTE OF LIMITATIONS.

The Government is not estopped to plead the bar of the statute of limitations by reason of representations made by a revenue agent that it was not necessary to file a written claim for refund.

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

To Collectors of Internal Revenue and Others Concerned:

The following decision of the United States District Court for the Western District of Pennsylvania in the case of *Daniel Ritter* v. *United States* is published for the information of internal revenue officers and others concerned.

D. H. BLAIR,
Commissioner of Internal Revenue.

Approved April 4, 1927.

OGDEN L. MILLS,
Acting Secretary of the Treasury.

DISTRICT COURT OF THE UNITED STATES FOR THE WESTERN DISTRICT OF PENNSYLVANIA.

Daniel Ritter, plaintiff, v. *United States of America, defendant.*

[February, 1927.]

OPINION.

SCHOONMAKER, Judge: This case is now before the court on statutory demurrer filed under the Pennsylvania practice act of 1915. The well-pleaded facts of the statement of claim are therefore admitted. So far as a reference to them is necessary for the discussion of this case on demurrer, they are as follows:

The plaintiff, on or about April 1, 1918, filed an income tax return under the Revenue Act of 1917, disclosing a tax liability for the calendar year 1917 of $6,964.95, and paid that amount. His correct tax liability for that year was, however, only $5,873.14, so that he overpaid his tax for the year 1917 in the sum of $1,091.81. This fact was discovered by United States Field Revenue Agent Timberlake on December 30, 1922, on an audit of plaintiff's books, and the agent thereupon notified the plaintiff of this overpayment. The plaintiff then made a verbal claim for the repayment of this amount to Field Agent Timberlake, who advised the plaintiff that no other claim was necessary and that in due course of procedure in the office of the Commissioner of Internal Revenue the excess tax paid would be refunded to the plaintiff as a matter of course. Later, on November 25, 1924, the Commissioner of Internal Revenue notified the plaintiff by letter of that date that the revenue agent's report disclosed an overassessment of only $1,080.43, and that the claim of the plaintiff appears to be barred by the statute of limitations.

It does not appear that any claim for refundment of this overpayment was ever made directly to the Commissioner of Internal Revenue.

The defendant contends that these facts do not entitle the plaintiff to recover by reason of section 1112 of the Revenue Act of 1926, amending section 3228 of the Revised Statutes, and section 1113 of the Revenue Act of 1926, amending section 3226 of the Revised Statutes, which require an applicant for refundment to file his claim for such refundment with the Commissioner of Internal Revenue prior to the institution of suit. These two sections are as follows:

"SEC. 1112. Section 3228 of the Revised Statutes, as amended, is amended to read as follows:

"SEC. 3228. (a) All claims for the refunding or crediting of any internal-revenue tax alleged to have been erroneously or illegally assessed or collected, or of any penalty alleged to have been collected without authority, or of any sum alleged to have been excessive or in any manner wrongfully collected must, except as provided in sections 284 and 319 of the Revenue Act of 1926, be presented to the Commissioner of Internal Revenue within four years next after the payment of such tax, penalty, or sum."

* * * * * * *

"SEC. 1113. (a) Section 3226 of the Revised Statutes, as amended, is reenacted without change, as follows:

"SEC. 3226. No suit or proceeding shall be maintained in any court for the recovery of any internal-revenue tax alleged to have been erroneously or illegally assessed or collected, or of any penalty claimed to have been collected without authority, or of any sum alleged to have been excessive or in any manner wrongfully collected until a claim for refund or credit has been duly filed with the Commissioner of Internal Revenue, according to the provisions of law in that regard, and the regulations of the Secretary of the Treasury established in pursuance thereof; but such suit or proceeding may be maintained, whether or not such tax, penalty, or sum has been paid under protest or duress. No such suit or proceeding shall be begun before the expiration of six months from the date of filing such claim unless the Commissioner renders a decision thereon within that time, nor after the expiration of five years from the date of the payment of such tax, penalty, or sum, unless such suit or proceeding is begun within two years after the disallowance of the part of such claim to which such suit or proceeding relates. The Commissioner shall within 90 days after any such disallowance notify the taxpayer thereof by mail.

"(b) * * *."

The plaintiff contends that no claim for refundment is required in the instant case; that even if it were, the verbal claim made to the Revenue Agent Timberlake was a sufficient compliance with the law; and that the statement of the revenue agent to the effect that no other claim than that made to him was necessary and that the refundment would be made on his report as a matter of course, now estops the Government from pleading the bar of the statute.

First, then, is a claim for refund necessary in the present case as a condition precedent to suit? This question must be answered in the affirmative. We are of the opinion that sections 1112 and 1113 of the Revenue Act of 1926, above quoted, are the statutes which govern the taxpayer's right to sue. By these sections it is clear that claims for refundment must be filed with the Commissioner of Internal Revenue as a necessary prerequisite to suit to recover an alleged overpayment of taxes. The United States may be sued only in the manner that it consents to be sued by statutes. If a taxpayer failed to comply with the statutory prerequisites, action is barred. The courts have repeatedly so held. (*Nichols* v. *U. S.*, 74 U. S., 122; *Kings County Sav. Inst.* v. *Blair*, 116 U. S., 200; *Rock Island, etc., R. R. Co.* v. *U. S.*, 254 U. S., 141; *B. & O. R. R. Co.* v. *U. S.*, 260 U. S., 565; *Union Fisherman's Co-Oper. Pkg. Co.* v. *Huntley*, 285 Fed., 671; *Hayner* v. *U. S.* (decided May 10, 1926, by Court of Claims, not yet reported).) Plaintiff has cited a number of Treasury Department regulations showing that reduction of internal revenue assessments and adjustments of overpayment of revenue may be made in certain cases by the Commissioner without a claim being filed by the taxpayer. The fact that Commissioner may adjust overpayments of his own motion without claim by the taxpayer does not change the situation when the taxpayer comes to sue the Government. In that case the statutory prerequisites must be strictly complied with before the suit will lie.

We then pass to the next question of the case. Was the claim for refundment made verbally by the plaintiff to Revenue Agent Timberlake a compliance with the statute? This question must be answered in the negative. The plain language of the statute requires claim for refundment to be made to the Commissioner of Internal Revenue. The statute must be strictly construed. A field revenue agent is not the person to whom claim can be made under the terms of the statute. Therefore the verbal claim to Agent Timberlake was not a claim for refundment prescribed by the statute.

The last question presented is whether or not the Government is now estopped from pleading the bar of the statute in view of the conduct and statements of Field Agent Timberlake. On December 30, 1922, the revenue agent told the plaintiff that he had overpaid his 1917 income tax and that the amount overpaid was properly and legally refundable to the plaintiff, who thereupon verbally claimed the amount from the revenue agent and asked him what steps would be required to take in order to get the amount of the tax refunded. The agent then told the plaintiff that no further claim was necessary and that in the regular course of routine procedure in the office of the Commissioner of Internal Revenue the excess tax paid by the plaintiff would be refunded. If this agent had any authority to act for the Government it ought to be concluded by his statement, but the trouble is that he was utterly without power to bind the Government by any statement he made. The courts have held that no officer of the Government has any power or authority, either expressly or by acts, to waive limitations imposed by statute upon suits against the United States. (*Finn* v. *United States*, 123 U. S., 227 (233); *Lee* v. *Munroe & Thornton*, 7 Cranch, 366; *Pine River Logging Co.* v. *U. S.*, 186 U. S., 279 (291); *Utah Power & Light Co.* v. *U. S.*, 243 U. S., 389 (408).)

Counsel for the plaintiff has called our attention to the case of *Black* v. *Bolen* (268 Fed., 427), which holds that where a claim for an abatement of an income tax has been rejected by the Commissioner of Internal Revenue, it is not necessary to file a claim for refundment of such part of the tax paid under protest before commencing suit for its recovery. But that case is not parallel with the instant case or controlling on the facts here, for in that case the Commissioner himself, the very officer of the Government who had the power to reject claims for refundment, had acted upon the claim on its merits and had informed the taxpayer that no other claim for refundment was necessary in order to institute suit. There, the Commissioner had in effect refused a claim for refundment, and it would have been an idle act for the taxpayer to file such a claim.

That is not the situation in the instant case. The Commissioner had not acted and had not rejected the plaintiff's claim in any way. The statutes point-

ing out the manner in which the taxpayer might bring suit to recover taxes paid were open to the plaintiff in this case as well as to all other persons, and we can not hold that the Government was estopped by the statement of a revenue agent who had no actual power to pass upon the plaintiff's claim for refundment. The Commissioner was the only one who could act on that. We therefore hold that the defendant is not estopped by the statements of the revenue agent now to plead the bar of the statute. An order may be submitted sustaining the statutory demurrer in this case.

TITLE XII.—GENERAL PROVISIONS.

SECTION 1211.—SALARIES OF STATE AND MUNICIPAL OFFICERS.

REVENUE ACT OF 1926.

Compensation of bar pilots, San Francisco. (See G. C. M. 1706, page 54.)

MISCELLANEOUS.

VI–14–3178

H. R. 16462. PUBLIC—NO. 660, SIXTY-NINTH CONGRESS.

An Act making appropriations to supply urgent deficiencies in certain appropriations for the fiscal year ending June 30, 1927, and prior fiscal years, and to provide urgent supplemental appropriations for the fiscal year ending June 30, 1927, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That the following sums are appropriated, out of any money in the Treasury not otherwise appropriated, to supply urgent deficiencies in certain appropriations for the fiscal year ending June 30, 1927, and prior fiscal years, and to provide urgent supplemental appropriations for the fiscal year ending June 30, 1927, and for other purposes, namely:

* * * * * * *

TREASURY DEPARTMENT.

BUREAU OF INTERNAL REVENUE.

Refunding taxes illegally collected: For refunding taxes illegally collected under the provisions of sections 3220 and 3689, Revised Statutes, as amended by the Revenue Acts of 1918, 1921, 1924, and 1926, including the payment of claims for the fiscal year 1928 and prior years, $175,000,000, to remain available until June 30, 1928: *Provided*, That no part of this appropriation shall be available for paying any claim allowed in excess of $75,000 until after the expiration of 60 days from the date upon which a report giving the name of the person to whom the refund is to be made, the amount of the refund, and a summary of the facts and the decision of the Commissioner of Internal Revenue is submitted to the Joint Committee on Internal Revenue Taxation: *Provided further*, That a report shall be made to Congress of the disbursements hereunder as required by such Acts, including the names of all persons and corporations to whom payments are made together with the amount paid to each: *Provided further*, That no part of this appropriation shall be available to

refund any amount paid by or collected from any manufacturer, producer, or importer in respect of the tax imposed by subdivision (3) of section 600 of the Revenue Act of 1924, or subdivision (3) of section 900 of the Revenue Act of 1921 or of the Revenue Act of 1918, unless the Commissioner of Internal Revenue certifies to the proper disbursing officer that such manufacturer, producer, or importer has filed with the Commissioner, under regulations prescribed by the Commissioner with the approval of the Secretary of the Treasury, a bond in such sum and with such sureties as the Commissioner deems necessary, conditioned upon the immediate repayment to the United States of such portion of the amount refunded as is not distributed by such manufacturer, producer, or importer, within six months after the date of the payment of the refund, to the persons who purchased for purposes of consumption (whether from such manufacturer, producer, importer, or from any other person) the articles in respect of which the refund is made, as evidenced by the affidavits (in such form and containing such statements as the Commissioner may prescribe) of such purchasers, and that such bond, in the case of a claim allowed after the passage of this Act, was filed before the allowance of the claim by the Commissioner.

* * * * * * *

INCOME TAX RULINGS.—PART II.

REVENUE ACT OF 1924.

TITLE II.—INCOME TAX.

PART I.—GENERAL PROVISIONS.

SECTION 201.—DISTRIBUTIONS BY CORPORATIONS.

ARTICLE 1541: Dividends.

REVENUE ACT OF 1924.

Issuance by one corporation of rights to subscribe for shares of interest in the stock of another corporation. (See G. C. M. 916, page 135.)

ARTICLE 1541: Dividends. VI–6–3082
(Also Section 204, Article 1591.) G. C. M. 926

REVENUE ACT OF 1924.

The rights issued to the stockholders of the M Company by that company to subscribe to O Company rights which the M Company had received as a stockholder of the O Company represent a taxable dividend to the M Company stockholders to the extent of the undistributed earnings and profits of the M Company accumulated after February 28, 1913.

Upon the exercise of the M Company rights each stockholder of that company may treat as the basis of the O Company rights received from the M Company the subscription price of the rights plus the basis to him of the M Company rights exchanged therefor. In the event of the exercise of the O Company rights so acquired, the basis for the P Company stock thereby acquired will be the basis of the O Company rights exercised plus the amount of cash paid as a condition to their exercise.

As a stockholder of the O Company, the M Company in January, 1924, received from the O Company so-called rights, two of which entitled the holder to subscribe before January 1, 1926, for a certificate of interest in one share of the capital stock of the P Company, at the rate of $.03x$ dollars for a certificate of interest in one share. The M Company subsequently issued to its stockholders assignable subscription warrants evidencing the right of the stockholders named therein, or their assigns, to purchase O Company rights from the M Company upon the payment of $.02x$ dollars a right and the surrender of the subscription warrant or warrants at any time on or before March —, 1924. For each five shares of stock of the M Company held of record at the close of business on February 1, 1924, a stockholder was given the right to purchase an O Company right.

The question is presented as to the income tax liability of the stockholders of the M Company resulting from the receipt by them of M Company rights, the sale of M Company rights, the exercise of such

rights and the receipt of O Company rights, the sale of O Company rights, the exercise of O Company rights and the receipt of either certificates of interest in the capital stock of the P Company or the stock of such company, and finally the sale of such certificates or stock. None of the issues raised involves the treatment of subscription rights issued by a corporation to subscribe to its own stock, and therefore the decision of the United States Supreme Court in the case of *Miles* v. *Savings Deposit & Trust Co. of Baltimore* (259 U. S., 247) is not applicable.

Subscription rights are usually represented, as in the instant case, by warrants or certificates which pass by indorsement and are a species of property. Such rights are regarded as securities, are listed on the stock exchanges, and are freely sold, exchanged, and otherwise dealt in the same as other kinds of securities. The M Company rights received by the stockholders of that company in 1924 undeniably constituted property with a fair market value, received by them from the M Company by reason of their ownership of stock in the company. Therefore, the rights represented a dividend by the M Company to its stockholders and are taxable as such to the extent of the then undistributed earnings or profits of that company accumulated after February 28, 1913. The M Company rights were assets in the hands of the stockholders of the company, with a basis for determining gain or loss equal to the fair market value of the rights at the time they were received. The stockholders who sold their rights realized gain or loss measured by the difference between such basis and the amount realized upon the sale of the rights. In the case of the stockholders who exercised their M Company rights and acquired in place thereof O Company rights upon the payment of $.02x$ dollars for each O Company right, no gain or loss was realized, but the O Company rights took the place of the M Company rights so exercised, and the basis for determining gain or loss in the case of the O Company rights was the amount of the basis of the M Company rights which were exercised plus the subscription price of the O Company rights. Gain or loss was realized by the stockholders who sold their O Company rights measured by the difference between the basis of the O Company rights sold and the amount realized upon their sale. Stockholders who exercised their O Company rights and acquired either certificates of interest in the capital stock of the P Company or the stock of that company upon the payment of $.03x$ dollars for each share of the P Company stock involved realized no gain or loss, but the certificates or shares acquired took the place of the O Company rights exercised, with a basis for determining gain or loss equal to the sum of the basis of the O Company rights exercised and the amount paid as a condition to their exercise. The gain or loss realized by stockholders on the sale of certificates or shares acquired by the exercise of O Company rights was the difference between the basis of the property sold, arrived at as provided in the preceding sentence, and the amount realized on such sale.

A. W. Gregg,
General Counsel, Bureau of Internal Revenue.

ARTICLE 1542: Source of distribution.

REVENUE ACT OF 1924.

Rule to be followed in determining amount available for dividends. (See G. C. M. 1386, page 10.)

SECTION 203.—RECOGNITION OF GAIN OR LOSS FROM SALES AND EXCHANGES.

ARTICLE 1577: Definitions. VI–3–3050
(Also Section 201, Article 1541; Section 204, Article 1591.) G. C. M. 916

REVENUE ACT OF 1924.

Pursuant to a court decree ordering the severance of the relationship between the M Company and the O Company and directing that the M Company's interest in the stock of the O Company be transferred to trustees for disposition as directed therein, the M Company in 1924 transferred to trustees all its rights, title, and interest in the O Company stock and issued to its own stockholders assignable subscription rights authorizing them to subscribe for shares of interest in the O Company stock equal in number to the shares of the M Company stock then held. The distribution so made by the M Company does not come within the provisions of section 203(c) of the Revenue Act of 1924, but is a distribution taxable to the stockholder as a dividend to the extent paid from the earnings and profits of the M Company accumulated since February 28, 1913.

The basis for computing gain or loss from the sale of the rights is the fair market value of the rights when received by the stockholders. The basis in the case of shares of interest in the O Company stock acquired upon the exercise of the rights is the basis of the rights plus the subscription price paid upon the exercise of the rights.

The M Company owned all the shares of outstanding stock of the O Company, subject, however, to a general consolidated mortgage in favor of the R Company, to whom the shares were pledged.

On November —, 1923, the District Court of the United States for the —— District of ——, pursuant to a mandate of the Supreme Court of the United States, entered a decree ordering the severance of the relationship between the M Company and the O Company and directing that the M Company's interest in the stock of the O Company be transferred to trustees for disposition as therein provided. As directed by this decree, the M Company, by trust deed under date of March —, 1924, transferred to trustees all its right, title, and interest in the O Company stock. The trustees were to pay therefor 25,000x dollars, and were to issue certificates for y shares of interest in such stock, the number of shares corresponding with the number of shares of the M Company's stock outstanding. Pursuant to the decree of November —, 1923, it was provided (1) that any person subscribing for shares of interest in the O Company stock must dispose of them on or before December 31, 1927, or, as an alternative, must dispose of all of his stock in the M Company; (2) that the shares of interest of any such person who failed to file an affidavit on or before December 31, 1927, to the effect that he did

not then own any stock of the M Company, should be canceled of record, and the subscription price of .02x dollars per share refunded; (3) that on or before December 31, 1927, shares of interest could be transferred only to persons who were not stockholders of the M Company; (4) that until the holders of 85 per cent of the shares of interest should file affidavits of nonownership of M Company stock, all voting rights in respect of O Company stock should be vested in the trustees; and (5) that dividends should be paid only upon shares of interest in respect of which an affidavit of nonownership of M Company stock was filed, dividends on all other shares of interest being withheld and accumulated without interest for payment to the holder or transferee upon filing an affidavit of nonownership of M Company stock.

The M Company issued assignable subscription rights to the M Company stockholders of record on March 15, 1924, authorizing each of them to subscribe for the same number of shares of interest in the stock of the O Company at .02x dollars a share as the number of shares of M Company stock held by each on that date. Some of the M Company stockholders immediately sold these rights; others exercised them and received shares of interest in the O Company stock.

The main contention advanced by the attorneys for the M Company is that the distribution made by the M Company to its stockholders in 1924, whether the distribution be regarded as a distribution of rights to subscribe to shares of interest in the stock of the O Company or a direct distribution of the shares of interest, was a nontaxable distribution falling within the provisions of section 203(c) of the Revenue Act of 1924. That section provides as follows:

> If there is distributed, in pursuance of a plan of reorganization, to a shareholder in a corporation a party to the reorganization, stock or securities in such corporation or in another corporation a party to the reorganization, without the surrender by such shareholder of stock or securities in such a corporation, no gain to the distributee from the receipt of such stock or securities shall be recognized.

The subdivision quoted applies only to a distribution of corporate securities made pursuant to a plan of reorganization by a corporation which is a party to a reorganization as the term "reorganization" is used in section 203. Subdivision (h) of that section provides:

> (1) The term "reorganization" means (A) a merger or consolidation (including the acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation, or substantially all the properties of another corporation), or (B) a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor or its stockholders or both are in control of the corporation to which the assets are transferred, or (C) a recapitalization, or (D) a mere change in identity, form, or place of organization, however effected.
>
> (2) The term "a party to a reorganization" includes a corporation resulting from a reorganization and includes both corporations in the case of an acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation.

The M Company was not involved in a merger or consolidation; it did not acquire a majority of the stock or substantially all of the properties of another corporation, nor did any other corporation acquire a majority of its stock or substantially all of its properties;

the company did not transfer any of its assets to another corporation which it or its stockholders, or both, controlled after such transfer; there was no recapitalization of the M Company, as the term is commonly understood; and no change in its identity, form, or place of organization was effected.

The various transactions which are mentioned in the statement of facts amounted merely to a disposition by the M Company of part of its assets to or for the benefit of its stockholders. No authority has been cited or found holding that a mere disposition by a corporation of a part of its property to its stockholders may be regarded as effecting a reorganization of the corporation. That the disposition in question was not made voluntarily but under the terms of a court decree is immaterial. In no aspect of the case was there a reorganization of the M Company, or was that company a party to a reorganization within the contemplation of section 203 of the 1924 Act.

Even if it were possible to regard the disposition in question as a distribution by the M Company of securities in the O Company, a contention strongly urged by the attorneys for the M Company, the distribution would not fall within the provisions of section 203(c) of the Revenue Act of 1924, as one in which no gain should be recognized. In order for that section to be applicable it is essential that the distribution be made by a corporation upon reorganization.

When the revenue bill of 1926 was being considered by Congress, an amendment was proposed by the Senate to broaden the scope of section 203(c) of the bill, which was patterned after section 203(c) of the 1924 Act, by adding a provision to the effect that—

> If a corporation which owns at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation distributes such stock to its shareholders no gain to the distributee from the receipt of such stock shall be recognized.

The amendment was not adopted, being stricken out in conference, with the following explanation:

> The existing law provides in section 203(c) that if on a reorganization there is distributed to the shareholders stock or securities in a corporation a party to the reorganization no gain to the distributee from such receipt shall be recognized. This amendment broadens this provision and provides that where one corporation owns at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation and distributes such stock to such shareholders, then no gain to the distributee shall be recognized even though there is no reorganization. The Senate recedes.

For the reasons stated, this office concludes that the distribution in question made by the M Company in 1924 to its stockholders was not a nontaxable distribution under section 203(c) of the 1924 Act.

The evidence shows that upon the severance of the relationship between the M Company and the O Company, the subscription rights to shares of interest in the stock of the O Company received by the stockholders of the M Company had a fair market value, and were listed on the —— market.

Undeniably the subscription rights to shares of interest in the stock of the O Company issued to the stockholders of the M Company in 1924 constituted property with a fair market value received by them by reason of their ownership of stock in the M Company. The rights were something of exchangeable value produced by and

proceeding from the stockholders' investment in the M Company, severed from it and drawn by them for their separate use. The conclusion seems unavoidable, therefore, that to the amount of their fair market value the rights constituted a dividend to the stockholders within the common acceptation of that term as well as within the definition of the term as set forth in the various Revenue Acts, it being assumed that at the time the rights were issued the M Company had on hand earnings or profits accumulated after February 28, 1913, at least equal to the fair market value of the rights issued. The principle established by the United States Supreme Court in the case of *Miles* v. *Safe Deposit & Trust Co. of Baltimore* (259 U. S., 247) is not applicable, as that principle applies only to rights which are issued by a corporation to subscribe to its own stock, such rights being analogous to a stock dividend.

The subscription rights received by the M Company stockholders by way of a dividend were assets in their hands, with a basis for determining gain or loss equal to the fair market value of the rights at the time they were received. The stockholders who sold their rights realized gain or loss measured by the difference between such basis and the amount realized upon their sale. In the case of the stockholders who exercised their rights and acquired shares of interest in the O Company stock upon the payment of .02x dollars a share, no gain or loss was realized, but the shares of interest acquired took the place of the rights exercised, with a basis for determining gain or loss equal to the sum of the basis of the rights exercised and the amount paid as a condition to their exercise. Gain or loss was realized by the stockholders who sold their shares of interest measured by the difference between the basis of the shares of interest sold and the amount realized upon their sale.

A. W. Gregg,
General Counsel, Bureau of Internal Revenue.

Article 1577: Definitions. VI–23–3257
G. C. M. 1753

REVENUE ACT OF 1924.

The stockholders of a company entered into a contract with two individuals for the organization of a new company. All the property of the old company was conveyed to the new company for 51 per cent of the latter's stock, and the old company dissolved and surrendered its charter.

Held, a reorganization was effected as defined in subdivision (h)(1)(A) of section 203 of the Revenue Act of 1924.

Such subdivision is not inconsistent with subdivision (h)(1)(B) of section 203.

An opinion is requested (1) whether the taxpayer, the M Company, realized a gain in the transfer of its property to the O Company in the year 1924; and (2) whether section 203(h)(1)(A) is inconsistent with section 203(h)(1)(B) of the Revenue Act of 1924, and, if not, the type of cases each is intended to affect.

The taxpayer was incorporated under the laws of the State of R in 1920 and had capital stock outstanding in 1924 held equally by A and B. The taxpayer being in need of additional funds and having, through its stockholders, interested two individuals in the possibilities of its business, it was agreed by the two stockholders and

the two individuals, by a contract dated October —, 1924, that a new corporation, to be called the O Company, should be organized under the laws of the State of S with a capital of $100x$ dollars. The two stockholders agreed that the old company should convey all of its property to the new company for $51x$ dollars of the stock of the new company. The two individuals agreed to purchase y shares of the new company for $49x$ dollars in cash. The two stockholders agreed to dissolve the old company and surrender its charter. The evidence submitted shows that the agreement was carried out and that the taxpayer conveyed all of its property to the new company.

The revenue agent, in making his examination of the books and accounts of the taxpayer for the year 1924, took the position that this was not a reorganization within the meaning of the Revenue Act of 1924, and computed a profit on the transaction, which action the taxpayer protests.

It is the contention of the taxpayer that this was solely a reorganization and, in accordance with section 203(b)3 of the Revenue Act of 1924, no taxable gain resulted to the corporation.

Section 203(b)3 of the Revenue Act of 1924, referred to above, provides that:

> No gain or loss shall be recognized if a corporation a party to a reorganization exchanges property, in pursuance of the plan of reorganization, solely for stock or securities in another corporation a party to the reorganization.

Section 203(h)1 defines the term "reorganization" as:

> (A) A merger or consolidation (including *the acquisition by one corporation of* at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation, or *substantially all the properties of another corporation*), or (B) a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor or its stockholders or both are in control of the corporation to which the assets are transferred, or (C) a recapitalization, or (D) a mere change in identity, form, or place of organization, however effected. [Italics supplied.]

It is the opinion of this office that under the facts stated there was effected a reorganization as defined in section 203(h)(1)(A) of the Revenue Act of 1924, and that the taxpayer realized no gain or loss from the exchange of all its properties for stock in the new corporation. The fact that the new corporation was formed to take over the assets of the old company does not take the exchange from without the purview of the section.

Section 203(h)(1)(A) is not inconsistent with section 203(h)(1)(B). One supplements the other. For example, a transfer of *all* the assets of a corporation constitutes a reorganization under the second part of definition (A) irrespective of the element of 80 per cent control demanded by definition (B). Again, a transfer of but a part of the assets of a corporation can never, of itself, result in a reorganization under section 203(h)(1)(A), but it does result in a reorganization under section 203(h)(1)(B) if there is present an additional element, namely, immediate control of the transferee corporation by the transferor or its stockholders, or both.

A. W. Gregg,
General Counsel, Bureau of Internal Revenue.

SECTION 204.—BASIS FOR DETERMINING GAIN OR LOSS, DEPLETION, AND DEPRECIATION.

ARTICLE 1591: Basis for determining gain or loss from sale.

REVENUE ACT OF 1924.

Rights issued by one corporation to subscribe for shares of interest in the stock of another corporation. (See G. C. M. 916, page 135.)

ARTICLE 1591: Basis for determining gain or loss from sale.

REVENUE ACT OF 1924.

Rights issued by one corporation to subscribe to stock in another corporation. (See G. C. M. 926, page 133.)

ARTICLE 1602: Basis for allowance of depletion and depreciation.

REVENUE ACT OF 1924.

Basis for depletion (in absence of discovery) and depreciation with respect to property acquired by gift, devise, or inheritance both prior to and after March 1, 1913. (See I. T. 2337, page 144.)

SECTION 208.—CAPITAL GAINS AND LOSSES.

ARTICLE 1654: Capital net losses. VI–13–3167
I. T. 2341

REVENUE ACT OF 1924.

Method of computing tax liability where a capital net loss has been sustained.

When a taxpayer has sustained a capital net loss within the meaning of section 208 of the Revenue Act of 1924, two computations of tax are required to determine the taxpayer's liability. Under the first computation a tax on his ordinary net income (without any deduction for capital net loss) is determined and this tax is reduced by 12½ per cent of the amount of the capital net loss. Under the second computation a tax is computed on the net income determined without regard to the provisions of section 208; that is, on the net income after the capital net loss has been taken as an ordinary deduction. If the tax determined under the first computation is less than the tax determined under the second, then the tax under the second computation is the tax due; if it is greater, the tax under the first computation is the tax due. For example, if A sustains a loss of $23,000 on securities held for more than two years, realizes a gain of $5,000 on the sale of real property held for more than two years,

receives partnership profits of $39,000, pays State and local taxes in the amount of $1,000, and is entitled to personal exemption as a single man, the computations are as follows:

I.

Partnership income		$39,000
Taxes paid		1,000
Ordinary net income		38,000
Personal exemption		1,000
		37,000
Amount taxable at 2 per cent		4,000
Amount taxable at 4 per cent		4,000
Amount taxable at 6 per cent		29,000
Tax of 2 per cent on $4,000		80
Tax of 4 per cent on $4,000		160
Tax of 6 per cent on $29,000		1,740
Surtax on $38,000		1,780
Total		3,760
Capital loss	$23,000	
Capital gain	5,000	
Less 12½ per cent of	18,000	2,250
Balance		1,510
Earned income, 20 per cent of $39,000	$7,800	
Less personal exemption	1,000	
Balance	6,800	
2 per cent on $4,000	80	
4 per cent on $2,800	112	
Credit of 25 per cent of	192	48
Balance of tax		1,462

II.

Partnership income		$39,000
Sale of property		5,000
Total		44,000
Loss on bonds	$23,000	
Taxes paid	1,000	
		24,000
Net income		20,000
Personal exemption		1,000
		19,000
Amount taxable at 2 per cent		4,000
Amount taxable at 4 per cent		4,000
Amount taxable at 6 per cent		11,000
Tax of 2 per cent on $4,000		80
Tax of 4 per cent on $4,000		160
Tax of 6 per cent on $11,000		660
Surtax on $20,000		220
Total		1,120
Earned income, 20 per cent of $39,000	$7,800	
Less personal exemption	1,000	
Balance	6,800	
2 per cent on $4,000	80	
4 per cent on $2,800	112	
Credit of 25 per cent of	192	48
Balance of tax		1,072

Inasmuch as the tax under computation I is $1,462 and the tax under computation II is $1,072, the tax of $1,462 is the amount due.

SECTION 209.—EARNED INCOME.

ARTICLE 1662: Definitions and limitations.

REVENUE ACT OF 1924.

Interest and dividends on securities received by a taxpayer in the course of buying and selling securities. (See I. T. 2328, page 21.)

PART II.—INDIVIDUALS.

SECTION 213(a).—GROSS INCOME DEFINED: INCLUSIONS.

ARTICLE 31: What included in gross income.

REVENUE ACT OF 1924.

Income of husband, wife, and minor child domiciled in State of California. (See I. T. 2352, page 32.)

ARTICLE 42: Sale of personal property on installment plan.

REVENUE ACT OF 1924.

Applicability of section 212(d) and section 1208 of the Revenue Act of 1926 to taxpayer selling real estate on the installment basis who reported the income therefrom on the accrual basis. (See G. C. M. 1123, page 37.)

ARTICLE 46: Deferred-payment sales of real estate not on installment plan.

REVENUE ACT OF 1924.

Treatment of the repossession of property, title to which the vendor transferred to the purchaser upon a deferred-payment sale other than on the installment plan. (See G. C. M. 880, page 45.)

ARTICLE 46: Deferred-payment sales of real estate not on installment plan. VI–3–3051 I. T. 2331

REVENUE ACT OF 1924.

I. T. 2178 (C. B. IV–2, 42) is modified in so far as it is inconsistent with General Counsel's Memorandum 888 (see page 46.)

ARTICLE 46: Deferred-payment sales of real estate not on installment plan.

REVENUE ACT OF 1924.

Remission of unpaid interest by vendor on repossession of property. (See G. C. M. 888, page 46.)

ARTICLE 46: Deferred-payment sales of real estate not on installment plan.

REVENUE ACT OF 1924.

Method of computing profit to be reported by taxpayer on cash receipts and disbursements basis in the case of a sale of personal property not on the installment plan. (See G. C. M. 1387, page 48.)

SECTION 213(b).—GROSS INCOME DEFINED: EXCLUSIONS.

ARTICLE 88: Compensation of State officers and employees.

REVENUE ACT OF 1924.

Status of salary received by medical director of county public hospital. (See I. T. 2357, page 52.)

ARTICLE 88: Compensation of State officers and employees.

REVENUE ACT OF 1924.

Compensation of bar pilots, San Francisco. (See G. C. M. 1706, page 54.)

ARTICLE 89: Additional exclusions from gross income.

REVENUE ACT OF 1924.

Amendment of article 89, Regulations 65, to include The Netherlands in the list of countries which satisfy the equivalent exemption requirement of section 213(b)8 of the Revenue Act of 1924. (See T. D. 4013, page 59.)

SECTION 214(a)7.—DEDUCTIONS ALLOWED INDIVIDUALS: BAD DEBTS.

ARTICLE 155: Reserve for bad debts. VI-11-3153
T. D. 3996

INCOME TAXES.

Amendment of article 155 of Regulations 65.

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

To Collectors of Internal Revenue and Others Concerned:

Article 155 of Regulations 65 is hereby amended to read as follows:

ART. 155. *Reserve for bad debts.*—Taxpayers who have, prior to 1924, established the reserve method of treating bad debts and maintained proper reserve accounts for bad debts, or who, in accordance with article 151, or upon securing permission from the Commissioner, adopt the reserve method of treating bad debts, may deduct from gross income a reasonable addition to a reserve for bad debts in lieu of a deduction for specific bad-debt items.

What constitutes a reasonable addition to a reserve for bad debts must be determined in the light of the facts, and will vary as between classes of business and with conditions of business prosperity. A taxpayer using the reserve method should make a statement in his return showing the volume of his charge sales (or other business transactions) for the year and the percentage of the reserve to such amount, the total amount of notes and accounts receivable at the beginning and close of the taxable year, and the amount of the debts which have been ascertained to be wholly or partially worthless and charged against the reserve account during the taxable year.

D. H. BLAIR,
Commissioner of Internal Revenue.

Approved March 10, 1927.

A. W. MELLON,
Secretary of the Treasury.

ARTICLE 155: Reserve for bad debts.

REVENUE ACT OF 1924.

Method of treating bad debts for taxable years coming under the Revenue Act of 1924. (See Mim. 3527, page 68.)

SECTION 214(a)8.—DEDUCTIONS ALLOWED INDIVIDUALS: DEPRECIATION.

ARTICLE 164: Capital sum recoverable through depreciation allowances.

REVENUE ACT OF 1924 AND PRIOR ACTS.

Basis for depreciation with respect to property acquired by gift, bequest, devise, or inheritance both prior to and after March 1, 1913. (See I. T. 2337, below.)

SECTION 214(a)9.—DEDUCTIONS ALLOWED INDIVIDUALS: DEPLETION.

ARTICLE 201: Depletion of mines, oil and gas wells; depreciation of improvements. VI–5–3069 I. T. 2337
(Also Section 204, Article 1602; Section 214(a)8, Article 164.)

REVENUE ACT OF 1924 AND PRIOR ACTS.

Basis for depletion (in the absence of discovery) and depreciation under Revenue Acts of 1913, 1916, 1917, 1918, 1921, and 1924 with respect to property acquired by gift, bequest, devise, or inheritance both prior to and after March 1, 1913.

(1) With respect to property acquired by gift, bequest, devise, or inheritance prior to March 1, 1913, the basis to be used in the computation of depletion (in the absence of discovery) and depreciation is:

(*a*) Under the Revenue Act of 1921 and prior Acts, the fair market value of such property as of March 1, 1913, regardless of acquisition value;

(*b*) Under the Revenue Act of 1924, the fair market value of such property as of the date of acquisition or as of March 1, 1913, whichever is greater.

(2) With respect to property acquired without consideration on or after March 1, 1913, the basis to be used in the computation of depletion (in the absence of discovery) and depreciation under all Acts is:

(*a*) In the case of such property acquired by bequest, devise, or inheritance, the fair market value of such property as of the date of acquisition;

(*b*) In the case of such property acquired by gift prior to January 1, 1921, the fair market value of such property as of the date of acquisition;

(*c*) In the case of such property acquired by gift on or after January 1, 1921, the basis as it would have been for the purpose of determining gain or loss in the hands of the donor or the last preceding owner by whom it was not acquired by gift.

ARTICLE 216: Depletion—Adjustments of accounts based on bonus or advanced royalty.

REVENUE ACT OF 1924.

Treatment of royalties expected to be received in computing deductions for depletion and treatment of bonus received by lessor of unproven areas. (See I. T. 2361, page 73.)

SECTION 214(a)10.—DEDUCTIONS ALLOWED INDIVIDUALS: CONTRIBUTIONS OR GIFTS.

ARTICLE 251: Contributions or gifts.

REVENUE ACT OF 1924.

Contributions to National Society of the Daughters of the American Revolution. (See I. T. 2334, page 82.)

SECTION 219.—ESTATES AND TRUSTS.

ARTICLE 343: Decedent's estate during administration.

REVENUE ACT OF 1924.

Amendment of article 343, Regulations 65. (See T. D. 4011, page 77.)

ARTICLE 346: Stock bonus or profit-sharing trust.

REVENUE ACT OF 1924.

Status of dividends on stock held by trustees under a stock purchase plan when ultimately distributed to participating employees. (See I. T. 2333, page 78.)

SECTION 221.—PAYMENT OF INDIVIDUAL'S TAX AT SOURCE.

ARTICLE 363: Exemption from withholding. VI-25-3275
(Also Section 281, Article 1302.) G. C. M. 1710

REVENUE ACT OF 1924.

> That part of section 221(b) establishing February 1 as the last date for filing exemption certificates, Form 1001, is not a statute of limitations running against the debtor corporation for the purpose of refunds. February 1 is merely a date on or prior to which certificates may be accepted by the withholding agent without delaying its annual return, Form 1013, which is due on or before March 15 of each year.

An opinion is requested regarding a claim for refund of x dollars income tax withheld at the source during the year 1924 with respect to interest on tax-free covenant bonds.

Section 221(b) of the Revenue Act of 1924 provides in part as follows:

> In any case where bonds, mortgages, or deeds of trust, or other similar obligations of a corporation contain a contract or provision by which the obligor agrees to pay any portion of the tax imposed by this title upon the obligee, or to reimburse the obligee for any portion of the tax, or to pay the interest without deduction for any tax which the obligor may be required or permitted to pay thereon, or to retain therefrom under any law of the United States, the obligor shall deduct and withhold a tax equal to 2 per centum of the interest upon such bonds, mortgages, deeds of trust, or other obligations, whether such interest is payable annually or at shorter or longer periods and whether payable to a nonresident alien individual or to an individual citizen or resident of the United States or to a partnership. * * * Such deduction and withholding shall not be required in the case of a citizen or resident entitled to receive such interest, if he files with the withholding agent on or before February 1 a signed notice in writing claiming the benefit of the credits provided in subdivisions (c) and (d) of section 216 * * *.

This section of the law does not impose a tax upon the withholding agent but provides a method of collecting at the source income tax imposed by section 210, which section in subdivision (a) provides in part that in the case of a citizen or resident of the United States the rate upon the first $4,000 of net income in excess of the credits provided in section 216 shall be 2 per cent. It is evident that to require a tax of 2 per cent to be withheld from interest upon tax-free covenant bonds would, in cases where the income of the bondholder from all sources was less than the credits provided in section 216, necessitate the deduction at the source and payment to the Government of an amount in excess of the liability of the individual bondholder. To remedy this a provision was inserted in section 221(b), permitting a citizen or resident of the United States to file with the withholding agent on or before February 1 a signed notice in writing claiming the benefit of the credit for personal exemption and dependents provided in subdivisions (c) and (d), respectively, of section 216. Under the provisions of section 221(c) the return of the withholding agent is required to be filed on or before March 15 of the succeeding year, and by requiring the notices to be filed with it on or before February 1, sufficient time was allowed the withholding agent to make the necessary adjustments in its monthly list returns, Form 1012, before filing the annual return of income tax to be paid at the source, Form 1013. That part of section 221(b) establishing February 1 as the last date for filing the exemption certificates, Form 1001 (which is the signed notice in writing), is not a statute of limitations running against the debtor corporation for the purpose of refunds. February 1 is merely a date on or prior to which certificates may be accepted by the withholding agent without delaying its annual return, Form 1013, which is due on or before March 15 of each year. It is a well-known fact that the tax is not actually withheld with respect to interest on tax-free covenant bonds, the procedure being that the debtor corporation or the withholding agent pays the bondholder the full amount of interest and, if an ownership certificate, Form 1000 (exemption not claimed), is filed, also assumes liability and pays to the Government the 2 per cent tax required to be withheld at the source. It is very obvious, therefore, that to deny the withholding agent a refund of the 2 per cent tax paid in behalf of a bondholder, who is not liable for a tax, merely because the exemption certificate was not filed on or before February 1, would be unjust and work a

hardship which was not intended by the statute. This was recognized by inserting in the Revenue Act of 1924 a provision, designated as section 281(d), which reads as follows:

Where there has been an overpayment of tax under section 221 or 237 any refund or credit made under the provisions of this section shall be made to the withholding agent unless the amount of such tax was actually withheld by the withholding agent.

This latter subdivision makes it clear that it was the intention of Congress that where the debtor corporation assumed liability for and paid the tax in behalf of its bondholders, and it could be shown later that such bondholders were not in fact liable for any tax, the excess should be refunded to the withholding agent for the reason that the tax was not actually deducted or withheld from the interest payments.

In view of the foregoing it is the opinion of this office that the claim should be allowed.

A. W. GREGG,
General Counsel, Bureau of Internal Revenue.

PART III.—CORPORATIONS.

SECTION 231.—CONDITIONAL AND OTHER EXEMPTIONS OF CORPORATIONS.

ARTICLE 511: Proof of exemption.

REVENUE ACT OF 1924.

Procedure with respect to applications for exemption under section 231 of the Revenue Act of 1924. (See Mim. 3537, page 81.)

ARTICLE 515: Building and loan associations and cooperative banks.

REVENUE ACT OF 1924.

Exemption of association whose sources of revenue are installment stock and a small number of savings accounts. (See G. C. M. 1231, page 82.)

ARTICLE 517: Religious, charitable, scientific, literary, and educational organizations and community chests.

REVENUE ACT OF 1924.

Exemption of the National Society of the Daughters of the American Revolution. (See I. T. 2334, page 82.)

ARTICLE 517: Religious, charitable, scientific, literary, and educational organizations and community chests.

REVENUE ACT OF 1924.

Exemption of association, paying death benefits to members, contingent upon regular payment of dues, the payment of which benefits is not discretionary. (See G. C. M. 1268, page 83.)

ARTICLE 518: Business leagues.

REVENUE ACT OF 1924.

Exemption of retail merchants' association. (See I. T. 2362, page 85.)

SECTION 239.—CORPORATION RETURNS.

ARTICLE 621: Corporation returns.

REVENUE ACT OF 1924.

A union of national banks under Act of November 7, 1918 (40 Stat., 1043). (See G. C. M. 1880, page 92.)

SECTION 240.—CONSOLIDATED RETURNS OF CORPORATIONS.

ARTICLE 634: Change in ownership during taxable year. VI-26-3283 T. D. 4024

INCOME TAX.

Consolidated returns of corporations.—Article 634 of Regulations 65 amended.

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

To Collectors of Internal Revenue and Others Concerned:

Article 634 of Regulations 65 is hereby amended by the elimination of the first paragraph and the substitution for the paragraph eliminated of the following paragraphs:

ART. 634. *Change in ownership during taxable year.*—(a) Where corporations are affiliated at the beginning of a taxable year but due to a change in stock ownership during the year the affiliated status is terminated, or (b) where corporations are not affiliated at the beginning of the taxable year but through change of stock ownership during the year become affiliated, a full disclosure of the circumstances of such changes of stock ownership shall be submitted to the Commissioner.

Ordinarily in such cases, where only two corporations are involved, the parent or principal corporation, under the conditions described in (a) above, should file a consolidated return including the income of such subsidiary or subordinate corporation to the date of the change of stock ownership, and each should file a separate return from the date of such change in stock ownership to the end of the taxable period, and, under the conditions described in (b) above, each corporation should file a separate return from the beginning of the taxable period to the date of the change in stock ownership, and a consolidated return should be filed by the parent or principal corporation from the date of change of stock ownership to the end of the taxable year, including therein the income of the subsidiary or subordinate corporation for such period.

Where there are more than two corporations affiliated at the beginning of the taxable year, and due to a change in stock ownership the affiliated status of one or more is terminated, but there remain at least two corporations affiliated during the entire year, the parent or principal corporation should file a consolidated return for the entire year, excluding from its return the income of the corporations whose affiliated status is terminated from the date of the change in stock ownership; or where two or more corporations are affiliated

at the beginning of the taxable year, and through change in stock ownership additional corporations become affiliated, the parent or principal corporation should file a consolidated return and include the income of such corporations from the date of change of stock ownership. In either case, the subsidiary or subordinate corporation whose status is changed during the taxable year should make a separate return for that part of the taxable year during which it was outside of the affiliated group.

D. H. BLAIR,
Commissioner of Internal Revenue.

Approved June 14, 1927.
A. W. MELLON,
Secretary of the Treasury.

PART V.—PAYMENT, COLLECTION, AND REFUND OF TAX AND PENALTIES.

SECTION 270.—DATE ON WHICH TAX SHALL BE PAID.

ARTICLE 1202: Collection of tax by suit. VI-11-3147
T. D. 3994

INTERNAL REVENUE TAXES—REVENUE ACTS OF 1918 AND 1924—DECISION OF CIRCUIT COURT OF APPEALS.

1. SUIT—ABATEMENT CLAIM—BOND—SURETY—DEFENSE.

In a suit by the United States, against the principal and surety on a bond given in support of a claim for abatement which was rejected in part, the action is one for the breach of the condition of the bond and the amount or validity of the tax can not be raised as a defense.

2. SAME—STATUTE OF LIMITATIONS.

A suit instituted on May 29, 1925, is within the five-year limitation provided by sections 277 and 1009 of the Revenue Act of 1924, the return having been filed on May 29, 1920.

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

To Collectors of Internal Revenue and Others Concerned:

The following decision of the United States Circuit Court of Appeals for the Fifth Circuit in the case of *Gray Motor Co. et al.* v. *United States* is published for the information of internal revenue officers and others concerned.

C. R. NASH,
Acting Commissioner of Internal Revenue.

Approved March 5, 1927.
A. W. MELLON,
Secretary of the Treasury.

UNITED STATES CIRCUIT COURT OF APPEALS, FIFTH CIRCUIT.

Gray Motor Co. et al., plaintiffs in error, v. United States of America, defendant in error.

Error to the District Court of the United States for the Northern District of Texas.

[January 3, 1927.]

FOSTER, Circuit Judge: This case comes up on an agreed statement of facts. Those material to a decision are as follows:

The Gray Motor Co., a Texas corporation, hereafter referred to as the company, was in the automobile business in Dallas. Its fiscal year ended February 29. On May 29, 1920, it filed its income and profits tax return, showing that it was indebted to the United States in the sum of $2,256.57. At the same time a payment of $564.15 was made, leaving a balance due of $1,692.42. On November 20, 1920, a claim for abatement of the balance of the tax was filed, and in connection therewith the company executed a bond in the sum of $2,100, to Scott Reed, collector of internal revenue, to secure the payment of $1,692.42, shown to be due under the return. On this bond W. O. Connor and F. F. Florence, the other plaintiffs in error, were sureties. Briefly stated, the condition of this bond was that the company should promptly pay the amount finally adjudicated by the Commissioner of [Internal] Revenue to be due the United States by the company for the year 1919 as taxes, penalties, and interest. Thereafter the return was audited and the Commissioner of Internal Revenue determined that an overassessment of $365.16 had been made. A certificate to that effect was issued and the amount credited upon the account of the company, reducing the outstanding taxes against it to $1,327.27, and the claim for abatement was denied and rejected. This amount was not paid, and on May 29, 1925, suit was brought on the bond. The company and the sureties filed answers, in which in substance they denied there was anything due, pleaded the statute of limitations of five years, and set up that Tom Gray, the manager of the company, had been guilty of fraudulent acts by which the company had lost money so that in fact no profit was earned during its fiscal year 1919.

The district court sustained demurrers to that part of the answer setting up the statute of limitations and fraudulent acts of the manager of the company. The jury was waived and judgment was entered in favor of the United States against the company and the sureties in the sum of $1,327.27, with interest at the rate of 1 per cent per month from November 14, 1922, and costs.

Error is assigned to the sustaining of the demurrers, to the exclusion of evidence to sustain the allegations of the answer demurred to, and to the entering of the final judgment.

Extended discussion and citation of authority are unnecessary to sustain the ruling of the district court. The suit was on a bond, the condition of which had been clearly breached. By giving bond the company postponed payment of the amount admitted to be due by the return and secured immunity from distraint of its assets. To contest the amount of tax found to be due by the Commissioner in this proceeding would be to permit a collateral attack upon the assessment, something not countenanced by the law. If the company desired to dispute the assessment, the way was open by paying the tax and taking the proper steps to recover it back.

In any aspect of the case the plea of limitation is without merit. Had no bond been given and the suit had been merely to collect the tax, it would have been timely, as it was brought within five years after the return was filed. Sections 277, 1009, Revenue Act of 1924. No other statute of limitation is relied on.

No error appearing in the record, the judgment appealed from is affirmed.

SECTIONS 277 AND 278.—PERIOD OF LIMITATION UPON ASSESSMENT AND COLLECTION OF TAX.

ARTICLE 1272: Period of limitation upon collection of tax.

REVENUE ACT OF 1924.

Applicability of six-year period of limitation upon collection of tax where five-year period, or such period as extended by waivers, expired prior to enactment of Revenue Act of 1924. (See G. C. M. 1546, page 109.)

SECTION 281.—CREDITS AND REFUNDS.

ARTICLE 1302: Refund, credit, and abatement adjustments.

REVENUE ACT OF 1924.

Refund of tax where exemption certificates were not filed with withholding agent before February 1. (See G. C. M. 1710, page 145.)

ARTICLE 1307: Limitations upon the crediting and refunding of taxes paid. VI–20–3233 G. C. M. 1537

REVENUE ACT OF 1924.

An invalid assessment waiver for 1918 filed by an executor subsequent to five years after the return was filed, the law of New York prohibiting executors from waiving claims barred by the statute of limitations, is not validated by the subsequent ratification of the executor's act in filing such waiver by a surrogate court of that State.

An opinion is requested as to whether an assessment waiver signed by the executors of the estate of A on June 3, 1924, and received in the Bureau on June 12, 1924, should be accepted for the purpose of allowing the refund of an overpayment of income taxes found to have been made by the estate for the year 1918. A claim for refund was not filed until September 6, 1924.

The waiver could not be accepted for this purpose, since it was neither executed nor filed within five years after the return for the year 1918 was filed. Executors have no authority under the laws of New York to waive claims that are barred by the statute of limitations at the time the waiver is executed. Since the claim of the United States for taxes for the year 1918 was barred when the waiver was filed, the waiver was invalid, and, therefore, did not satisfy the condition in section 281(e) of the Revenue Act of 1924 providing that if the taxpayer has filed a waiver on or before June 15, 1924, in respect of the taxes due for the year 1918 a credit or refund for such taxes may be allowed if claim therefor is filed on or before April 1, 1925.

On June —, 1925, the surrogate court, upon a petition filed by the executors of the estate and by a legatee under the will, entered an order ratifying and approving the action of the executors in filing

the waiver. It is stated that the petition to the surrogate court was filed by all of the parties then having any interest in the estate.

The question is presented whether the order of the surrogate court gave validity to the waiver.

Since the court's order purports only to be a ratification of the action of the executors in filing the waiver, it would seem to follow that no greater rights will result from that ratification than from any other valid ratification. The consequences of ratification are discussed as follows in 1 Mechem on Agency (2d ed., pp. 354, 356, 358):

> By ratifying the unauthorized act the principal assumes and adopts it as his own, and as has been seen, this adoption extends to the whole of the act—it goes back to its inception and continues to its legitimate end. Subject therefore to an exception to be immediately noticed, it is the universal rule that as against the principal the ratification is retroactive and equivalent to a prior authority * * *.
>
> * * * Yet where prior to * * * ratification * * * third persons have in good faith acquired such substantial rights or have been placed in such position in reference to the same transaction that they will be prejudiced by such retroactive effect, the ratification should not be allowed to overreach and defeat those rights. And such is the rule of law. * * *
>
> The doctrine of the preceding section has also been applied, in a number of cases, to prevent the loss by third persons, through the principal's ratification, of existing defenses against liability, conditions affecting liability, rights to escape liability, and the like. * * *

The United States is in the position of a third person who, prior to ratification, has acquired a defense against liability, the loss of which should therefore be prevented. It must be kept in mind that rights and liabilities of both the taxpayer and the United States are involved in section 281(e) of the Revenue Act of 1924. The taxpayer must have filed a valid waiver on or before June 15, 1924, of the limitation affecting the Government's right to assess taxes against him. If this was done and a claim for refund was filed before April 1, 1925, the taxpayer acquired the right to a refund for overpayment for the year 1918. If only the limitation against the Government's right to assess taxes were involved, the ratification of the waiver might relate back to the date of the waiver and validate it as of that date without cutting off any defenses of the Government. But since the waiver when filed was invalid, the Government then had a defense to the taxpayer's claim for a refund. Consequently, if the ratification were to relate back in time as to third persons, the effect would be to cut off the Government's defense. As has been noted, this would be contrary to the law of ratification itself. It must be emphasized, however, that the denial of such a result is not in any way a collateral attack on the validity of the court order. On the contrary, the ratification, for the sake of argument, is assumed to be valid, and the same rules are then applied to it as would be applied to any valid ratification. The result is that the Government's defense to its liability for refund is not impaired by the ratification of the waiver.

It may be argued, however, that the true meaning of the court's order is that the ratification should be retroactive as to third persons also, so as to cut off any rights or defenses they might have acquired before the ratification. If this is the meaning of the order, the answer is that the court had no jurisdiction over third persons not served with process or appearing before the court. Yet a person whose right or whose defense to liability is directly affected by the

order is a necessary party to the proceeding. (See *Jackson* v. *Smietanka*, 272 Fed., 970; T. D. 3159 (C. B. 4, 96).) A necessary party who is not served with process or who does not voluntarily appear can collaterally attack the order for want of jurisdiction over the person. (34 C. J., 532; In re Killan's Estate, 172 N. Y., 547, 65 N. E., 561.)

The result is that the claim for refund should not be allowed.

A. W. GREGG,
General Counsel, Bureau of Internal Revenue.

ARTICLE 1307: Limitations upon the crediting and refunding of taxes paid.

REVENUE ACT OF 1924.

Refund or credit of overpayment for prior years where there is no profits tax liability for current taxable year. (See G. C. M. 1254, page 126.)

INCOME TAX RULINGS.—PART III.

REVENUE ACT OF 1921 OR PRIOR REVENUE ACTS.

TITLE II.—INCOME TAX.

PART I.—GENERAL PROVISIONS.

SECTION 200.—DEFINITIONS.

ARTICLE 1523: Personal service corporation. VI-8-3117
T. D. 3979

INCOME AND EXCESS PROFITS TAXES—REVENUE ACT OF 1918—DECISION OF COURT OF CLAIMS.

1. CORPORATIONS—PERSONAL SERVICE.

A corporation engaged in selling goods on commission is not entitled to be taxed under section 303 of the Revenue Act of 1918 unless the business can be segregated into distinctly separate units, one a personal service unit as defined in section 200 and the others employing capital.

2. SAME—EVIDENCE.

The record must furnish convincing proof that the alleged personal service branch is capable of distinct separation from its other sources of income and meets exactly the requirements of section 200.

3. CAPITAL—GUARANTEE—ACCOUNTS.

The guaranteeing of customer's accounts whereby payment for purchases made are secured involves the employment of capital.

4. SAME—REGULATIONS.

Article 1529 of Regulations 45, denying personal service classification unless at least 80 per cent of the stock of the company is held by those regularly engaged in the active conduct of its affairs, is approved.

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

To Collectors of Internal Revenue and Others Concerned:

The following decision of the United States Court of Claims in the case of *J. H. Lane & Co., Inc.*, v. *United States* is published for the information of internal revenue officers and others concerned.

D. H. BLAIR,
Commissioner of Internal Revenue.

Approved February 12, 1927.

A. W. MELLON,
Secretary of the Treasury.

COURT OF CLAIMS OF THE UNITED STATES.

J. H. Lane & Co., Inc., a Corporation, v. The United States.

[December 6, 1926.]

OPINION.

BOOTH, Judge, delivered the opinion of the court.

The action in this case is the result of differences of opinion between the plaintiff and the Commissioner of Internal Revenue as to the sections of the internal revenue laws of 1918 and 1919 under which the plaintiff's income, war, and excess profits tax should be computed. No jurisdictional questions are involved and the amount in dispute is $322,079.16. The case is one of importance.

The Revenue Act of 1918 (40 Stat., 1059) provides in part as follows:

"The term 'personal service corporation' means a corporation whose income is to be ascribed primarily to the activities of the principal owners or stockholders who are themselves regularly engaged in the active conduct of the affairs of the corporation and in which capital (whether invested or borrowed) is not a material income-producing factor; but does not include any foreign corporation, nor any corporation 50 per centum or more of whose gross income consists either (1) of gains, profits or income derived from trading as a principal, or (2) of gains, profits, commissions, or other income, derived from a Government contract or contracts made between April 6, 1917, and November 11, 1918, both dates inclusive."

Section 303 of the same law (40 Stat., 1089) is as follows:

"That if part of the net income of a corporation is derived (1) from a trade or business (or a branch of a trade or business) in which the employment of capital is necessary, and (2) a part (constituting not less than 30 per centum of its total net income) is derived from a separate trade or business (or a distinctly separate branch of the trade or business) which if constituting the sole trade or business would bring it within the class of 'personal service corporations,' then (under regulations prescribed by the Commissioner with the approval of the Secretary) the tax upon the first part of such net income shall be separately computed (allowing in such computation only the same proportionate part of the credits authorized in sections 311 and 312), and the tax upon the second part shall be the same percentage thereof as the tax so computed upon the first part is of such first part: *Provided*, That the tax upon such second part shall in no case be less than 20 per centum thereof, unless the tax upon the entire net income, if computed without benefit of this section, would constitute less than 20 per centum of such entire net income, in which event the tax shall be determined upon the entire net income, without reference to this section, as other taxes are determined under this title. The total tax computed under this section shall be subject to the limitations provided in section 302."

The plaintiff is a New York corporation with a paid up capital stock of $1,400,000, divided into 14,000 shares of the par value of $100 each. Its place of business is New York City. The business of the plaintiff from which it derives income is conducted in the following manner: With 23 cotton mills it has contracts to sell their output upon the basis of a commission of 4 per cent of the purchase price. With a few of the mills the contracts are in writing; with the others it is not so; but the plaintiff concedes that for all the mills its obligations are identical—whether in writing or oral. At the beginning of a season when markets for the mills' products are available the mills quote to the plaintiff their fixed prices. From these prices plaintiff may not deviate. The plaintiff, through its organization, finds the buyers, and from them obtains contracts to purchase. Contracts of purchase were made out in triplicate, one copy for the purchaser, one for the mills, and one for the plaintiff.

The goods embraced within a contract of purchase were shipped directly from the mills to the purchaser, the plaintiff being advised of this fact. Payments for the merchandise so shipped were made to the plaintiff and by it remitted, less commission, to the mills, the plaintiff guaranteeing to the mills the payment in full of the purchase price. The terms of sale fixed by the mills were usually cash, with an allowed discount of 2 per cent if paid within 10 days

from receipt of shipment. The plaintiff in the course of its dealings with purchasers quite frequently advanced to them a sufficient sum of money to pay their bills and either taking advantage of the 2 per cent discount allowed or charging interest for the advancement. Sometimes it so happened that a purchaser of the product of the mills required merchandise of a character the mills could not supply. In order to meet this emergency the plaintiff went into the open market, procured the desired merchandise, and itself sold it to the purchaser at a profit.

The mills on occasions needed financial assistance at the beginning of a season. When so in need the plaintiff loaned to them the sums sought and collected interest for the loan. The plaintiff also derived income from stock investments, Liberty loan bonds, and interest upon bank deposits.

The plaintiff is a close corporation, its stockholders of a limited number, in virtue of an express agreement between them whereby an option to purchase is granted to the remaining members in the event of the death or voluntary retirement of an owner. Its stock is not listed on the stock exchange and not offered for public sale. Fourteen stockholders owned an aggregate of 70 per cent of the capital stock, and it is conceded by the defendant that the owners of 0.662 of the stock in 1918 and 0.744 in 1919 were regularly engaged in the active conduct of its business.

Plaintiff seeks, for taxation purposes, classification under section 303 (supra) as a part personal service corporation in which invested capital is not a material income-producing factor and a part capitalized corporation in which invested capital is not only employed but necessary. In order to meet the requirements of the statute plaintiff contends that its business activities are capable of distinct separation into distinct branches of a trade or business, and proof is adduced to support an allegation that the corporation is divided into the following distinct and separate branches, viz:

"1. Personal-service branch, not requiring the use of capital, to wit: Selling as agent on a commission. 2. Buying and selling on its own account, i. e., trading. 3. Interest received upon advances to mills. 4. Unearned or forfeited discounts. 5. Interest on bank deposits. 6. Allocation of part income to guarantee feature of its contracts."

It is to be observed that all of the alleged separate branches require the use of invested capital. As to the alleged personal-service branch, the argument is that the small allocation of invested capital to this activity is not a material income-producing factor. Invested capital performs a necessary and indispensable part in producing income as to the remaining branches.

The plaintiff's system of accounting, reflected in bookkeeping, disclosed the income received from its various sources, but did not disclose an allocation of invested capital to any one or more of its alleged branches. Prior to making its claim for a refund of taxes claiming an assessment on the basis set out therein, an expert tax accountant was employed, and to him the plaintiff exhibited its correct accounts, showing gross income from each source, and from these figures the accountant allocated $1,089,913.30 for 1918 and $1,595,159.72 for 1919 of plaintiff's net income to business in which invested capital was not a material income-producing factor and $445,375.77 for 1918 and $433,309.11 for 1919 to business requiring the use of invested capital, allocating $100,000 of the plaintiff's invested capital to its alleged personal service branch and the entire balance to its alleged branches requiring capital.

Section 303 (supra) is not a tax-exempting statute. It is no more than a legislative recognition of the existence of corporations wherein personal service and invested capital do each produce income capable of segregation. Distinctly personal service corporations were entirely exempt from income taxation under section 200 (supra), and Congress extended to corporations, wherein its personal service branch was distinct and separate from a branch or branches of its trade employing invested capital, a substantial reduction in rate rather than total exemption from income taxation.

The defendant first challenges the plaintiff's contention with an assertion that it was not engaged in a trade or business having separate and distinct branches within the meaning of section 303 of the Revenue Act of 1918. The question is a vital one.

The record must furnish convincing proof that the alleged personal service branch of the plaintiff's business is capable of distinct separation from its other sources of income and meets exactly the requirements of section 200 (supra) of the revenue law defining a personal service corporation. The interposed defense may only be overcome by sufficient proof that the income

allocated to the personal service feature is due primarily to the activities of the principal owners or stockholders regularly engaged in the active conduct of the affairs of the corporation and not to invested capital to any material extent. That this is obvious and indispensable appears from the express provisions of section 303, wherein Congress, in pointing out the degree of segregation necessary to establish a personal service branch of a corporation, uses this language:

"A separate trade or business (or a distinctly separate branch of the trade or business) which if constituting the sole trade or business would bring it within the class of 'personal service corporations.'"

The plaintiff's organization and single business enterprise was to earn income through commissions on sales of merchandise—a commission house. When incorporated it capitalized for $1,400,000. In 1918 its conceded statutory invested capital was $2,623,271.37. In 1919 it had attained the amount of $3,019,192.04. Therefore, it is indisputably evident from the plaintiff's own record that the corporation, when incorporated, regarded capital as necessary to its business, and subsequent events have demonstrated the wisdom of its presence. Manifestly it was not the intention of the corporation to depend upon the personal service of its stockholders exclusively for returns from its business as a whole. Having at all times available an abundance of capital, the plaintiff was able to adopt a business policy whereby as an intermediary between the mills, its chief source of income, and its customers, to whom it sold their products, it could with profit extend accommodations, sporadic and temporary favors, incidental to and directly connected with the main object of its incorporation, and thereby retain the trade of both angles of its business, and supplement the same with additional customers.

The plaintiff did not hold itself out to the business world as a money lender, nor as a merchandising corporation. It did not deal with the public generally in this respect. To its own customers, a limited class from whom it derived its substantial and yearly income by way of commissions, it extended these accommodations, and to no others. There is no evidence in the record that the plaintiff cultivated this alleged special trade, nor maintained separate and distinct organizations to attend to it. True, as plaintiff's commission business expanded, this source of income expanded along with it, an incidental development, one that follows naturally from the inseparable connection of the two. As one grew the other grew in proportion thereto. The plaintiff was and is essentially a commission house, not dependent upon the personal service of its stockholders exclusively for income, but combining therewith invested capital of sufficient proportions to single it out from a distinct and purely personal service corporation, and attract to it business a corporation not so situated might be unable to obtain.

The so-called branches of its business, so sedulously insisted upon, were not, within the contemplation of the revenue law, separate and distinct enterprises; they were, as the defendant observes, "sources of income," incidental activities, suggested by and inseparably a part of a commission business, the identical activities which in the very nature of the enterprise in hand would suggest themselves to a sagacious manager of a commission house. In keeping its books it never occurred to the plaintiff that its business embraced five distinct and separate branches, for its accounts were not so kept, and it required the services of an expert to make an allocation of income thereto. The plaintiff treated the various features of its business policy as merely supplemental and subsidiary to its unified business purpose.

The plaintiff's contention is vulnerable in this respect from other points of view. It is admitted that the guaranty given by the plaintiff to the mills, whereby payment for purchases made are secured, involves the employment of capital. As a matter of fact, the plaintiff's expert ascribes $266,512 in 1918 and $266,929.88 as commission income derived from this source. The basis for this conclusion is one-half of 1 per centum of plaintiff's total sales made for the mills less the total of its merchandise sales and a special commission included therein. Possibly this computation is the best obtainable under the circumstances, but clearly it is hypothetical, and along with the allocation of $100,000 of the company's invested capital to the commission business more or less arbitrary. A sound financial commission house obligates itself to guarantee some of its customers against loss. The customers thus guaranteed patronize the concern to the extent of very large sums, from which the corporation realizes most substantial profits in commissions.

Is it within the range of exact computation or even measurably accurate estimates to proportion in dollars and cents the amount of income chargeable alone to this business policy? We think not. Is it logical to conclude that an obligation thus assumed in some instances in the written contracts, which in terms fixes the commissions to be paid for the service to be rendered, and the corresponding obligations of the broker, that the plaintiff was segregating its commission business into branches, one of which was this guaranty? The mills turned over their products to the plaintiff to sell for them, induced in part so to do because they could rest secure in the knowledge that the purchase price would be paid to them, if not by the purchaser then by the plaintiff. The plaintiff did not have written contracts with many of the mills, and much is made of this fact; but irrespective of this, the plaintiff dealt with all of its customers on the same basis and observed this obligation, whether in writing or otherwise. Of exactly the same nature and consequence was the plaintiff's policy of loaning money to its customers to whom it sold the products of the mills. To retain both the mills and the purchasers was essential to its enterprise.

The plaintiff purchased cotton goods in the open market and held them for sale to such of its customers as could not fully supply their needs from the mills. In this respect the plaintiff acted upon its own account, and doubtless instituted the policy to maintain a relationship with the purchasers whereby they could be assured that all their business needs could be supplied by the plaintiff and thus forestall the necessity of patronizing other commission houses. Assuredly the income realized from this source designates it as a mere adjunct to the plaintiff's main efforts. The plaintiff under no possible circumstances depended upon this source of income for profits. It was not setting itself up as a merchandising corporation or a part merchandising and part personal service. The intended purpose was to retain patronage to the end of realizing profits from personal service, the adoption of business policies sufficiently attractive to bring to the company its large and growing commission business.

It is hardly necessary to indulge comment upon the remaining alleged branches of the plaintiff's business. Interest on Government bonds and on bank deposits classify themselves. The language of the statute, evidenced by the precision with which it speaks, seems to clearly exclude from its terms a corporation whose business may not be segregated into the distinctly separate units, one a personal-service unit under section 200 and the others employing capital.

It is scarcely probable that Congress was intending to reach a corporation so organized that the division and allocation of its income to its various activities depends upon arbitrary, obscure, and hypothetical computations. To a situation wherein the plaintiff concedes that the allocations made are more favorable to the Government than to the plaintiff, a concession which admits inaccuracy, certainly the Government has no lawful right to exact more than is lawfully due. The revenue law requires a degree of certainty, to say the least. Surely Congress was not providing for doubtful situations and extremely technical cases. A separate trade or business or a distinctly separate branch of the trade or business ought not, under ordinary circumstances, be difficult to identify. In the first enumeration the way is clear. In the second the word "distinctly" imports a trade or business disconnected with any other distinct trade or business making up the enterprise. It does not include the adoption of a concerted business policy of a corporation, employing various activities incidental to and inseparably intertwined with its main business, the purpose of which is to attain the success of the principal and unified business of the corporation.

The mere fact that income accrues from the activities so mentioned is not of itself sufficient to sustain a separate and distinct branch of the business. The income, like the activity, is incidental. It is not the source from which the corporation contemplates its real profits from which to pay dividends and accumulate a surplus. On the contrary, it is but a contributing factor toward the maintenance and support of the business the corporation was originally organized to conduct. In other words, within the plaintiff's own prescribed circle all the resources at its command were utilized to and did develop a most successful brokerage business, the identical and single object of its incorporation. As was said by the court in *Matteson Co.* v. *Willcuts* (12 Fed. (2d), 447):

"* * * Every corporation has full control of its own activities. It knows what the requirements of a personal service corporation are. It may comply therewith and easily keep within the limits thereof if it so choose, or it may not if it otherwise prefers. If it does not fairly observe and keep within the requirements of the law, it should not claim the benefits which the law confers. To nearly comply with the law, or to come within hailing distance thereof, is not enough."

A pointed illustration of a corporation engaged in distinct and separate branches of a trade or business is found in the following cases: *Fidelity & Deposit Co. of Maryland* v. *United States* (259 U. S., 296 [T. D. 3356, C. B. I–2, 347]); *Malley* v. *Old Colony Trust Co.* (299 Fed., 523, 527).

Article 1525, Regulations of the Commissioner, reads as follows:

"In order that a corporation may be deemed to be a personal service corporation its earnings must be derived principally from compensation for personal services rendered by the corporation to the persons with whom it does business. Merchandising or trading either directly or indirectly in commodities or the services of others is not rendering personal service. Conducting an auction, agency, brokerage or commission business strictly on the basis of a fee or commission is rendering personal service. If, however, the corporation assumes any such risks as those of market fluctuation, bad debts, failure to accept shipments, etc., or if it guarantees the accounts of the purchaser or is in any way responsible to the seller for the payment of the purchase price, the transaction is one of merchandising or trading, and this is true even though the goods are shipped directly from the producer to the consumer and are never actually in the possession of the corporation. The fact that earnings of the corporation are termed commissions or fees is not controlling. The fact that a commisssion or fee is based on a difference in the prices at which the seller sells and the buyer buys raises a presumption that the transaction is one of merchandising or trading, and it will be so considered in the absence of satisfactory evidence to the contrary."

The remaining obstacle to plaintiff's right of recovery, as disclosed by the record, is found in the fact that it is not entitled in any event to classification as a personal service corporation within the terms of section 200 of the revenue law—i. e., the plaintiff's alleged commission branch, even if it constituted its sole business, does not meet the requirements of the law. Section 200 (supra) of the revenue law prescribes three positive essentials before a corporation may be classified as one depending upon personal service for its income: (1) The principal owners or stockholders must be regularly engaged in the active conduct of the affairs of the corporation, (2) the corporation's income must be ascribed pr marily to the activities of such principal owners or stockholders, and (3) capital must not be a material income-producing factor.

The defendant concedes, as shown in Finding XV, that the principal owners of 0.662 in 1918 and 0.744 in 1919 of the plaintiff's capital stock were regularly engaged in the active conduct of the affairs of the corporation. Article 1529 of the Commissioner of Internal Revenue Regulations provides:

"No definite percentage of stock or interest in the corporation which must be held by those engaged in the active conduct of its affairs in order that they may be deemed to be the principal owners or stockholders can be prescribed as a conclusive test, as other facts may affect any presumption so established. No corporation or its owners or stockholders shall, however, make a return in the first instance on the basis of its being a personal service corporation unless at least 80 per cent of its stock is held by those regularly engaged in the active conduct of its affairs."

It declines the receipt of a corporation's return, in the first instance, on the basis of personal-service classification unless at least 80 per cent of its stock is held by those regularly engaged in the active conduct of its affairs. The plaintiff vigorously assails the validity of the foregoing regulations, asserts it to be unwarranted and arbitrary, contrary to the statute, and an apparent attempt to engraft terms into the law omitted by Congress. With this contention we are disinclined to agree. The inherent structure of a personal-service corporation, one within the terms of the statute, compels an active and regular service from its principal owners or stockholders. The statute itself fixes limitations; "principal owners or stockholders" certainly contemplates that a personal service corporation must depend upon income from service from this source.

Stockholders may not profit from its return without distinct contribution in active service to their production. How this shall be ascertained is not definitely set forth in section 200 (supra), but in section 303 (supra), the Act under which plaintiff claims, it is expressly provided that the tax imposed shall be computed "under regulations prescribed by the Commissioner with the approval of the Secretary." The Supreme Court said, in *United States* v. *Grimaud* (220 U. S., 506, 520):

"The legislature can not delegate its power to make a law, but it can make a law to delegate a power to determine some fact or state of things upon which the law makes, or intends to make its own action depend. To deny this would be to stop the wheels of government. There are many things upon which wise and useful legislation must depend which can not be known to the lawmaking power, and must, therefore, be a subject of inquiry and determination outside of the halls of legislation."

In addition, the regulation challenged does not irrevocably fix as a determinative factor a specific percentage of stock ownership. The Bureau recognizes that the statute does not definitely refer to any fixed figures as a conclusive test in this respect, and all that regulation itself does is to provide for "first instance" return, leaving open the question of final determination and an avenue for other contentions and claims.

The plaintiff's income is not to be ascribed primarily to the activities of its principal stockholders. On the contrary, as heretofore discussed, invested and borrowed capital played an exceedingly important part in producing returns. It would be more than difficult to hold, in view of the findings, that without the large sums of invested capital constantly available the personal service of the stockholders would have resulted in the income realized. That the invested capital of plaintiff's company was a material income-producing factor is not alone disclosed in the preceding discussion, but clearly appears from the income realized from this source.

The purpose of exempting a strictly personal service corporation from income taxes was to place them in a similar status with partnerships so engaged. Congress, by section 303, in extending a limited exemption to a part personal service and a part capitalized corporation, carefully circumscribed the privilege, by entailing upon the corporation claiming it the positive necessity of a distinct separation of its personal-service branch from its other branches in such a way as to meet the statutory requirements of section 200. However difficult it may be to segregate a going business concern into the parts required, it must be done if the right is to prevail. There are no border-line cases. They must be within or without the law. Industrial corporations employ capital, and if they combine as separate and distinct a personal-service business along with the other business operations, the scope of activities must be capable of being broken up into units and not overlap, so that the Commissioner of Internal Revenue may not have nonsolvable difficulties in untangling one from the other.

The principal owners or stockholders, it seems to us, are required to give substantially all their time to the personal-service branch. Capital is to be an unimportant factor employed in a merely incidental way toward the payment of overhead expenses and not yielding appreciable income. Why, in this very case, if we are to accept the computations offered by the plaintiff, $100,000 of a statutory invested capital of $3,019,192.04 is allocated to the commission business yielding an annual profit in excess of $1,600,000 yearly, averaging at least 72 per cent of the plaintiff's total net income, and the remaining $2,919,192.04 of invested capital allocated to branches producing not to exceed 28 per cent of its total net income. The growth of the plaintiff's commission business, the company's good will and financial status in the business world is, it seems to us, a complete refutation that it was aught else than a commission house, employing its substantial capital in its commission business.

It follows that the petition should be dismissed. And it is so ordered.

ARTICLE 1524: Personal service corporation: certain corporations excluded. VI-19-3227 T. D. 4016

INCOME TAX.

Personal service corporation: certain corporations excluded.—Article 1524 of Regulations 45 (1920 edition) and article 1524 of Regulations 62 amended.

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

To Collectors of Internal Revenue and Others Concerned:

Article 1524 of Regulations 45 (1920 edition) and article 1524 of Regulations 62 are hereby amended by the elimination of the fourth and fifth sentences and the substitution therefor of a new sentence, the articles as amended to read as follows:

ART. 1524. *Personal service corporation: certain corporations excluded.*—The following classes of corporations are expressly excluded from classification as personal service corporations: (*a*) foreign corporations; (*b*) corporations 50 per cent or more of whose gross income consists of gains, profits, or income derived from trading as a principal; and (*c*) corporations 50 per cent or more of whose gross income consists of gains, profits, commissions, or other income derived from a Government contract or contracts made between April 6, 1917, and November 11, 1918, inclusive. See article 1510. A corporation is not a personal service corporation merely because less than 50 per cent of its gross income was derived from trading as a principal or from Government contracts. A corporation can not be considered a personal service corporation when another corporation is one of its principal owners or stockholders.

D. H. BLAIR,
Commissioner of Internal Revenue.

Approved April 30, 1927.
A. W. MELLON,
Secretary of the Treasury.

SECTION 201.—DIVIDENDS.

ARTICLE 1541: Dividends. VI-10-3137 T. D. 3986

INCOME TAX—REVENUE ACT OF 1918—DECISION OF CIRCUIT COURT OF APPEALS.

INCOME—DIVIDENDS—WITHDRAWALS.

Unauthorized withdrawals in proportion to stock holdings from the funds of a corporation during the year 1920, which are ratified in 1921 by formal declaration of a dividend in the amount of the withdrawals, are taxable to stockholders as income for the year 1920 under section 201(a) of the Revenue Act of 1918.

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

To Collectors of Internal Revenue and Others Concerned:

The following decision of the United States Circuit Court of Appeals for the Sixth Circuit in the case of *Chattanooga Savings*

Bank, Administrator of the Estate of John D. Key, v. *Brewer, Collector*, is published for the information of internal revenue officers and others concerned.

D. H. BLAIR,
Commissioner of Internal Revenue.

Approved February 26, 1927.

A. W. MELLON,
Secretary of the Treasury.

UNITED STATES CIRCUIT COURT OF APPEALS, SIXTH CIRCUIT.

Chattanooga Savings Bank, Administrator of the Estate of John D. Key, Deceased, plaintiff in error, v. *E. P. Brewer, Collector of Internal Revenue for the District of Tennessee, defendant in error.*

[January 14, 1927.]

Per curiam: John D. Key and Webster T. James were sole owners of the capital stock of the Key-James Brick Co. During the year 1920 they withdrew funds from the business without corporate action or authority, charging the withdrawals to themselves upon the books of the corporation. These withdrawals were made, from time to time, in practically the same proportion as their respective stock holdings. The final withdrawal of November 9, 1920, brought their totals for the year into exact proportions to such interests. Key received on that date $22,982.82, and James $7,017.18. On July 14, 1921, the directors of the company declared a dividend in an amount equal to the combined withdrawals of the two for the preceding year, crediting it to their respective accounts. The Government assessed a tax against Key for 1920 on his withdrawals for that year. Key paid the tax, and this action was brought by his administrator to recover it back on the ground that the amounts so received were income for 1921 and not 1920.

The case was tried without a jury and the court found among other things that the amounts paid to Key and James during the year 1920 were dividends under section 201(a) of the Revenue Act of 1918 and as such were subject to a tax for that year. We think there is substantial evidence to support the finding. A formal declaration of the dividend was not necessary. (*Spencer* v. *Lowe*, 198 Fed., 961; *Smith* v. *Moore*, 199 Fed., 689.) Any distribution by the company to its shareholders, out of earnings or profits accumulated since February 28, 1913, was a dividend within the meaning of section 201(a) of the Revenue Act. While James did not know at the time each payment was made to him that Key was also paying to himself an amount of like proportion to his own stock, it appears that monthly statements were furnished to both parties showing the payments and thus James on receipt of these became advised of each preceding distribution. The final distribution, in November, 1920, indicates, not only because of the unusual or odd amounts paid but also because it brought the totals into the correct ratable proportion to the stock holdings, that it was understood between the two that these payments as well as prior withdrawals were made from earnings and were to be treated as dividends. The charter of the company forbade making loans to stockholders. It will not be assumed that the payments, although appearing on the books of the company as drawings charged against the formal accounts of the parties, were made in violation of the charter provisions of the company. We think the court was justified, under the evidence, in finding that they were intended as, and in fact were, a distribution of earnings which had theretofore been accumulated.

Judgment affirmed.

ARTICLE 1541: Dividends.

REVENUE ACT OF 1921.

Revocation of I. T. 1545 (C. B. II–1, 54). (See I. T. 2332, page 191.)

ARTICLE 1542: Source of distribution.

REVENUE ACT OF 1921 AND PRIOR ACTS.

Rule to be followed in determining amount available for dividends. (See G. C. M. 1386, page 10.)

ARTICLE 1542: Source of distribution. VI–11–3148
T. D. 3995

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

1. INCOME—DIVIDENDS.

Although a surplus from business done in 1916 existed at the date of declaration, dividends declared and paid during the year 1917 are taxable to stockholders at the rates prescribed by the Revenue Act of 1917, there being sufficient earnings during the year 1917 to pay the dividends.

2. CASE FOLLOWED.

The decision in *Edwards* v. *Douglas* (269 U. S., 204, T. D. 3797 [C. B. V–1, 158]) followed.

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

To Collectors of Internal Revenue and Others Concerned:

The following decision of the United States Court of Claims in the case of *Fred M. Kirby* v. *United States* is published for the information of internal revenue officers and others concerned.

C. R. NASH,
Acting Commissioner of Internal Revenue.

Approved March 5, 1927.
A. W. MELLON,
Secretary of the Treasury.

COURT OF CLAIMS OF THE UNITED STATES.

Fred M. Kirby v. *The United States.*

[January 17, 1927.]

OPINION.

BOOTH, Judge, delivered the opinion of the court.

This is an income-tax case. Plaintiff asserts that the tax upon that part of his income derived from dividends paid to him by the F. W. Woolworth Co., a New York corporation, in March, April, and June of 1917 should have been computed at the rate fixed in the Revenue Act of 1916 instead of the Revenue Act of 1917.

Defendant, in opposition, relies upon the case of *Edwards* v. *Douglas* (269 U. S., 204).

We think it unnecessary to enter upon a review or a statement of the facts. The Commissioner's findings are conceded by the parties to be correct.

Plaintiff's brief and arguments are directed toward an effort to bring this case within an exception to the opinion of the Supreme Court in the above case; that is, while not challenging the construction given to the statute by the Supreme Court, a contention is made that the facts in this case present a right of recovery under that decision. With this contention we disagree. In our opinion the decision of the Supreme Court in *Edwards* v. *Douglas* precludes recovery herein, and the petition will be dismissed. It is so ordered.

SECTION 202.—BASIS FOR DETERMINING GAIN OR LOSS.

ARTICLE 1561: Basis for determining gain or loss from sale.

REVENUE ACT OF 1918.

Repossession of oil and gas lease parted with under contract to sell, title to which was retained by the vendor. (See G. C. M. 952, page 191.)

ARTICLE 1561: Basis for determining gain or loss from sale.

REVENUE ACT OF 1921.

Revocation of I. T. 1545 (C. B. II–1, 54). (See I. T. 2332, page 191.)

ARTICLE 1561: Basis for determining gain or loss from sale. VI–26–3291 T. D. 4027

INCOME TAX—REVENUE ACTS OF 1917 AND 1918—DECISION OF COURT.

1. STOCK DIVIDEND—INCOME—BASIS IN DETERMINING GAIN FROM SALE.

Income resulting from the sale of stock received as a stock dividend is not the receipt of a dividend but gain or profit derived from the sale of stock.

In determining the gain from a sale of original common stock in respect of which dividend stock of the same character, except that it had no voting rights, was issued, and also the gain from a sale of the dividend stock, the cost of each share of each kind of stock sold is computed by dividing the total cost of the old shares by the total number of the old and the new shares.

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

To Collectors of Internal Revenue and Others Concerned:

The following decision of the United States Court of Claims in the case of *John D. Chapman* v. *United States* is published for the information of internal revenue officers and others concerned.

C. R. NASH,
Acting Commissioner of Internal Revenue.

Approved June 22, 1927.

A. W. MELLON,
Secretary of the Treasury.

COURT OF CLAIMS OF THE UNITED STATES.

John D. Chapman v. *The United States.*

[February 14, 1927.]

OPINION.

Moss, Judge, delivered the opinion of the court.

Plaintiff, John D. Chapman, is seeking by this action to recover the sum of $132,089.99 additional income taxes collected from him for the years 1917 and 1918, $103,371.58 of which was collected for the year 1917 and $28,697.41 for the year 1918. The history of the transaction out of which this controversy arose is as follows:

Throughout the year 1917 plaintiff was the owner of 1,800 shares of the common capital stock of the Bethlehem Steel Corporation, which were acquired at a cost of $48 per share, or $86,400. On January 23, 1917, the directors voted to increase the capitalization of the said corporation, and in this connection declared a stock dividend of 200 per cent upon the common stock; and on February 17, 1917, plaintiff received from the corporation 3,600 shares of the new stock as his proportion of the stock dividend. In his tax return for the year 1917 plaintiff reported said stock dividend as dividend. In the same year, and prior to December 31, 1917, plaintiff sold the 3,600 shares received as a stock dividend for the sum of $371,928.

It is the plaintiff's contention that the income resulting from the sale in 1917 of the stock received as a stock dividend in that year was taxable at the rates for prior years under the provisions of section 31 of the Revenue Act of 1916, as amended by section 1211 of the Revenue Act of 1917 (40 Stat., 300, 336–337), in which it is provided that in any distribution made by a corporation, whether represented by cash or by stock of the corporation, such distribution shall be considered income to the amount of the earnings or profits so distributed.

The Government contends, on the other hand, that the income resulting from the sale of the stock received as a stock dividend was not the receipt of dividend but was gain or profit derived from the sale of the stock, and that section 31 of the Act of 1916 as amended has no application. The Commissioner of Internal Revenue assessed the tax on this basis, computing the tax on the difference between the cost of the stock and the amount realized from its sale, properly applying the 1917 rates.

The theory upon which the Commissioner proceeded was correct as determined by the United States Supreme Court in the case of *Towne* v. *Eisner* (245 U. S., 418), in *Eisner* v. *Macomber* (252 U. S., 189), and in other cases, in which it was distinctly held that a stock dividend does not constitute taxable income.

In April, 1918, plaintiff sold his original 1,800 shares of stock, and his income-tax return for the year 1918 included the sale price with other sales of stocks and bonds during that year. In computing the profit from the sale of the 1,800 shares plaintiff reported the cost of said shares at $48 per share, or a total of $86,400. The Commissioner, however, in computing the cost of the 1,800 shares properly considered the original cost of $86,400, paid by plaintiff for the 1,800 shares, as representing the total cost of both the 1,800 shares and the 3,600 shares distributed as a stock dividend; and on this basis the Commissioner fixed the cost of the 1,800 shares at $16 per share and assessed the additional tax accordingly. The plan adopted by the Commissioner in ascertaining the profit was correct. To state the question simply, by the payment of the sum of $86,400 plaintiff acquired a capital interest in the corporation, and he received as evidence of this interest 1,800 shares of the original common stock, and without further cost he also received an additional 3,600 shares, or a total of 5,400 shares. His interest in the corporation was neither increased nor diminished by the later acquisition of the 3,600 shares. It remained precisely the same.

The same question applies to the sale of the 3,600 shares, and the same procedure was followed by the Commissioner in arriving at the profit on that sale.

The contention of the plaintiff that the Government is barred by the statute of limitations is not tenable. It is the opinion of the court that plaintiff is not entitled to recover. It is therefore the judgment of the court that plaintiff's petition should be dismissed. And it is so ordered.

ARTICLE 1566: Exchange of property which results in no gain or loss. VI-20-3234 G. C. M. 1637

REVENUE ACT OF 1921.

The exchange by taxpayers in December, 1922, of the obligations of an industrial corporation for the obligations of a State, of political subdivisions thereof, and of a Federal land bank was an exchange of property for property of a "like kind" within the meaning of section 202(c)1.

An opinion is requested as to the treatment for income tax purposes of an exchange by A and B in December, 1922, of bonds of the M Company for certain municipal and other bonds.

It appears that, for some years prior to 1922, A and B owned a majority of the capital stock of the N Company and its predecessors. On November 30, 1922, A owned $5y$ shares and B $5y$ shares, constituting all the outstanding capital stock. On December 1, 1922, all the assets and business of the N Company were transferred to the M Company, a newly organized corporation, the latter company exchanging all its common stock and an issue of bonds for the capital stock of the N Company held by the taxpayers. The balance sheet as of November 30, 1922, of the N Company showed its assets to consist of capital in the amount of $2x$ dollars and surplus to the amount of $10x$ dollars. The taxpayers exchanged $10y$ shares of the $100 par value common stock of the N Company for no par value class A and class B common stock of the M Company, valued at $1.3x$ dollars, together with class A 6 per cent bonds maturing on December 1, 1923, of the face value of $5x$ dollars, and class B 6 per cent bonds maturing on December 1, 1925, of the face value of $5x$ dollars. Preferred stock in the new corporation to the amount of x dollars was sold to other parties.

On December 8, 1922, the taxpayers exchanged their class B bonds with the O Bank for 4¼ per cent bonds of the city of —— maturing in 197—. The taxpayers have submitted an affidavit of C, vice president of the O Bank, to the effect that these bonds of the city of —— had been acquired by the bank prior to December 8, 1922; that they were held as an investment by the bank; and that the bonds of the M Company received by it in exchange were held until paid at maturity.

On December 15, 1922, the taxpayers exchanged their class A bonds with the R Bank for certain bonds of the city of ——, the city of ——, the Federal land bank, and the State of ——. It appears from the affidavit of D, in charge of the bond department of the R Bank, that the bonds received by the taxpayers had been acquired prior to December 15, 1922, by the bank; that at the time of the exchange the bonds were owned by the bank; that no charge was made by the bank as a commission for securing the exchange; and that the bonds of the M Company were held by the bank until they were paid at their maturity.

It is apparent that the transaction by which the taxpayers received the stock and bonds of the M Company resulted in no taxable gain to them. (Section 202(c)2, Revenue Act of 1921.) Furthermore, the transactions with the O Bank and the R Bank whereby the taxpayers transferred their bonds and received in return munici-

pal and other obligations were true exchanges within the meaning of section 202(c) of the Revenue Act of 1921. Accordingly, the sole issue presented is whether bonds of an industrial corporation and bonds issued by municipalities, a State, and the Federal land bank are of "like kind" within the meaning of section 202(c)1.

Section 202(c) of the Revenue Act of 1921 reads in part:

For the purposes of this title, on an exchange of property, real, personal or mixed, for any other such property, no gain or loss shall be recognized unless the property received in exchange has a readily realizable market value; but even if the property received in exchange has a readily realizable market value, no gain or loss shall be recognized—

(1) When any such property held for investment, or for productive use in trade or business (not including stock-in-trade or other property held primarily for sale), is exchanged for property of a like kind or use.

Article 1566 of Regulations 62, 1922 edition, reads in part:

Exchange of property which results in no gain or loss.—Where property is exchanged for other property, even if the property received in exchange has a readily realizable market value, no gain or loss is recognized:

(a) Where property held for investment is exchanged for other property of a like kind, or where property held for productive use in trade or business is exchanged for other property of a like use. The words "like kind" are defined as having reference to the nature or character of the property and not its grade or quality. Therefore under this paragraph no gain or loss is realized by one other than a dealer from the exchange of real estate for real estate, or from the exchange of evidences of indebtedness (such as bonds and notes) for evidences of indebtedness, * * *. Where evidences of indebtedness are exchanged for other evidences of indebtedness, the fact that any of the evidences of indebtedness involved in such exchange are secured by mortgage or other lien, or the fact that any real estate involved in an exchange is improved or unimproved, makes no difference, for such facts relate only to grade or quality of the property and not to its kind or class.

The 1923 amendment to subdivisions (c) and (e) of section 202 of the Revenue Act of 1921 and Treasury Decision 3468 (C. B. II–1, 27), amending paragraph (a) of article 1566 and article 1568 of Regulations 62, are retroactive only to January 1, 1923, and have no application to the present transactions.

While the exchange occurred within 8 and 15 days after the receipt of the bonds from the M Company, pursuant to the reorganization, such bonds were issued to the taxpayers against the surplus acquired from the N Company which had previously been represented by the common stock held by the taxpayers in that company. There appears to be no reason why the bonds should not be considered as "held for investment" within the meaning of article 1566(a), Regulations 62. Obligations of industrial corporations and those of States and political subdivisions thereof and of the Federal land bank are all equally "evidences of indebtedness." The difference in the nature of the security in any case relates only to the grade or quality of the obligation and not to its kind or class. The present exchanges appear to fall within the express provisions of section 202(c) of the Revenue Act of 1921 prior to its amendment in 1923.

It is accordingly the opinion of this office that the taxpayers realized neither gain nor loss on the exchange of their bonds of the M Company for the various municipal and other nonindustrial bonds. In accordance with section 202(d)1, the bonds received should be considered as taking the place of the bonds exchanged therefor. Since the latter were acquired in a reorganization involving neither

loss nor gain, the basis of the stock formerly held by the taxpayers in the N Company should be considered as distributed between the no par value common stock now held in the M Company and the municipal and other bonds received in the exchanges, and any gain or loss on subsequent disposition of either should be computed on the proper proportionate part of the original basis of the N Company stock.

A. W. GREGG,
General Counsel, Bureau of Internal Revenue.

ARTICLE 1566: Exchange of property which results in no gain or loss. VI–21–3242 I. T. 2356

REVENUE ACT OF 1921.

No loss is recognized from the trading in of trucks and passenger cars used for business purposes on new trucks and passenger cars to be used for like purposes.

Advice is requested relative to the allowance of a loss in respect of automobiles traded in on new automobiles in the case of the M Company.

The taxpayer during the year 1922 traded in three trucks and three passenger cars, all used for business purposes, for new trucks and passenger cars to be used for like purposes. The trade-in value was $7x$ dollars less than the depreciated cost as at the date of the exchange. In 1923, two cars were traded in at a trade-in value of x dollars less than the depreciated cost. The taxpayer deducted these amounts as a loss in computing net income for 1922 and 1923.

The automobiles in respect of which the taxpayer claimed a deductible loss were used for business purposes, and, therefore, were held "for productive use in trade or business," within the meaning of section 202(c)1 of the Revenue Act of 1921. They were "exchanged for property of a like kind or use" within the purview of such statute. Consequently, no loss is recognized from the exchange.

ARTICLE 1568: Exchanges of property for other property and money. (Also Section 206, Article 1651.) VI–7–3094 G. C. M. 1234

REVENUE ACT OF 1921.

A taxpayer who owned all the stock of the M Company purchased from it additional stock at par and later sold to the company the same amount of stock at par. The taxpayer also owned all the stock of the O Company. He exchanged all the stock in these two companies for cash and all the stock in P Company, a new corporation organized by him.

Held, that no taxable gain resulted in the first transaction. The second transaction constituted an exchange of capital assets in a reorganization, and the excess of the amount of cash received over the basis of the stock which the taxpayer exchanged is a "capital gain" with respect to which he may elect to be taxed at the rate of 12½ per cent under section 206 of the Revenue Act of 1921.

The opinion of this office is requested on the following issues:

(1) Whether A derived taxable income as the result of a purchase from him at par on January —, 1922, by the M Company of 9.6*y* shares of its own stock theretofore sold to him at par on August —, 1918.

(2) Whether the taxpayer realized a taxable gain of 24*x* dollars from the exchange by him on December —, 1922, of his remaining .4*y* shares of stock of the M Company and 5*y* shares of stock of the O Company for 15*y* shares of stock of the P Company and 24*x* dollars in cash.

Prior and subsequent to the dates referred to in the first issue, the M Company had only .4*y* shares of capital stock outstanding, all owned by the taxpayer. A charter amendment was effected increasing the authorized capital stock of the company, and 9.6*y* additional shares of capital stock were sold to the taxpayer at par on August —, 1918, for the purpose of financing an increase in the company's business due to the war. Curtailment of business after the war enabled the company to purchase and retire these 9.6*y* shares. On each date the stock was worth much more than par, since the company's surplus was much in excess of 20*x* dollars. The transaction resulting in the issuance to the taxpayer of the additional shares of stock can not be treated as a loan to the company, since there was a bona fide investment by him of 19*x* dollars in the company at the risk of the business, paid in for the 9.6*y* shares of stock.

Except for the increased value of the remaining .4*y* shares of stock of the M Company (represented by the increased worth of the company's assets on January —, 1922, over those of August —, 1918), the taxpayer on January —, 1922, stood exactly where he was on August —, 1918. The 19*x* dollars repaid him for 9.6*y* shares of stock merely replaced the 19*x* dollars (borrowed from the banks) which he had invested.

In view of the foregoing, it is the conclusion of this office that the amount of 19*x* dollars represented a return to the taxpayer of his capital investment of a like amount in 9.6*y* shares of the capital stock of the M Company, and therefore that it did not constitute taxable income to him.

The second issue presents greater difficulty. The taxpayer was the sole owner of the M Company (with .4*y* shares of stock outstanding) and the O Company (with 5*y* shares of stock outstanding) when on or about December —, 1922, he organized the P Company, and on December —, 1922, exchanged the aforesaid 5.4*y* shares of stock for 15*y* shares of stock of the P Company, plus 24*x* dollars in cash. The latter company had no cash, therefore it borrowed 24*x* dollars from the M Company (which was equivalent to the entire book surplus of the M Company and the O Company), and caused this amount to be paid over to the taxpayer as part of the exchange in question. This transaction constituted a "reorganization" under section 202(c)2 of the Revenue Act of 1921. The P Company filed a consolidated return for the balance of the year, and in March, 1923, merged in itself its two totally owned subsidiaries, thereby effecting the extinguishment of the above-mentioned "loan."

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On December —, 1922, when this exchange transaction took place, *section 202(e) of the Revenue Act of 1921* was in force, and it provided as follows:

* * * but when property is exchanged for property [in a reorganization], * * * together with money or other property of a readily realizable market value * * *, the money or the fair market value of such other property received in exchange shall be applied against and reduce the basis, provided in this section, of the property exchanged, and if in excess of such basis, shall be taxable to the extent of the excess.

This was a section of the law as originally enacted before the amendment of March 4, 1923, which was effective January 1, 1923. *Section 206 of the same Act* afforded individual taxpayers an election of paying a "capital gain" tax of 12½ per cent on "taxable gain from the sale or exchange of capital assets consummated after December 31, 1921," if acquired and held for more than two years, as in the instant case, in lieu of paying the ordinary income taxes.

Applying section 202(e) of the Revenue Act of 1921, supra, the taxpayer restored the basis of his old 5.4y shares of stock (represented to be 21x dollars), and in his 1922 return reported himself subject to a "capital gain" tax of 12½ per cent, under section 206 of the said Act, supra, on the difference between the aforesaid sum of 21x dollars and the sum of 24x dollars received by him in the reorganization, claiming that the transaction involved an exchange of capital assets in a reorganization and not the payment of a dividend.

It may be that the distribution of 24x dollars (equivalent to the combined surplus of the two original companies) had the *effect* of a taxable dividend. Relative to such cases, Congress provided in section 203(d)2 of the Revenue Act of *1924* that where a cash distribution in connection with a reorganization had the effect of a taxable dividend, it should be taxed as a dividend. But there was no such provision in the Revenue Act of 1921 applying to the year 1922.

Considering the fact that there were bona fide incidental reasons for the reorganization and that the reorganization was not fictitious (for instance, one of the original companies was a Delaware corporation and the other a Maryland corporation, and the organization of a single company under the laws of one State would effect an economy of expenses), this office is of the opinion that there is no basis for disregarding the separate corporate entities and looking through them to their individual owner and treating him under the Revenue Act of *1921* as having received a dividend which was not declared. It must be concluded that the taxpayer properly reported his income for 1922. All amounts realized by the taxpayer upon the future disposition of any part or all of the 15y shares of stock of the P Company now held by him will constitute taxable income in their entirety.

A. W. Gregg,
General Counsel, Bureau of Internal Revenue.

SECTION 203.—INVENTORIES.

ARTICLE 1581: Need of inventories. VI-26-3284
(Also Section 214(a)1, Article 111. G. C. M. 1582

REVENUE ACT OF 1917.

Interpretation of the word "deliverable" as used in Law Opinion 1087 (C. B. I-1, 32).

There should be eliminated from the taxpayer's gross income for 1917 those net proceeds from its operations during that year which it was required to pay to another as a result of a judgment which became final in 192—.

An opinion is requested in the case of the M Company on two issues, which will be considered separately.

I. What interpretation should be put upon the word "deliverable" as used in Law Opinion 1087?

Law Opinion 1087 was based upon the facts in this case. The facts involved are fully detailed in that opinion, and, in so far as they are here material, may be briefly summarized as follows:

In 1916 and subsequent years the taxpayer, the M Company, was engaged in the mining of copper ore. All of its product was turned over to a smelting company under a contract whereby the latter agreed to deliver to the former within 140 days a certain amount of refined copper. The mining company had by contract appointed an exclusive sales agent for the purpose of disposing of its refined copper. The selling company was regularly and promptly notified by the mining company of the rights acquired by the latter to receive refined copper from the smelting company. The selling company negotiated sales of copper, frequently in anticipation of production, and would notify the mining company of such sales as negotiated. Payment to the mining company of the sales price was guaranteed and generally advanced in part by the selling company. The refined copper, when put in marketable form, was placed by the smelting company or its subsidiary upon stock piles subject to the exclusive control of the selling company.

Law Opinion 1087 contains the following expressions:

* * * the possession by the selling company of such metal was the possession of the M Company; and thereafter any metal on the stock pile of the Q Company equivalent to the amounts *deliverable* to the M Company under the contract in question, in excess of sales which the selling company had theretofore reported to the M Company at the close of the taxable years 1916 and 1917, was metal in possession of the M Company and should have been included in its inventory as of that date at cost, or cost or market, whichever was lower, according to the method of inventory employed generally in making its returns.

* * * notifications to the M Company by the selling company during the closing months of 1916 and 1917 of sales of copper for delivery in the following years, in excess of the amounts of copper *deliverable* from the smelting company to the M Company during such months, did not constitute sales of copper, because the copper at the time of such notifications was not in existence. * * *

* * * any copper on the stock pile of the Q Company, the equivalent of any amount *deliverable* to the M Company under its contract with the smelting company, included in sales theretofore reported by the selling company to the M Company, should be included in sales by the M Company.

A restatement of the rules advanced by Law Opinion 1087 may prove helpful.

1. Under the prevailing contracts, the delivery of the copper ore to the smelter constituted a sale. The M Company no longer had copper ore among its assets. It had received in exchange therefor the obligation of the smelting company to deliver to the M Company within 140 days a certain quantity of refined copper. Inasmuch as this taxpayer was making returns upon the accrual basis, the obligation of the smelting company should be accrued in the year of the sale of the ore. That obligation was an account receivable in copper, however, and not in money. If it remained undischarged at the end of the taxable year, it should, therefore, be included in the taxpayer's inventory of assets at cost, or cost or market, whichever is lower, in accordance with the taxpayer's regular inventory method. The cost of the accounts receivable in copper for inventory purposes is represented by the fair market value on the date of the exchange of the smelter's obligation to deliver copper.

2. The delivery to the taxpayer's selling agent by the smelting company of refined copper for application on the obligations of the smelting company to this taxpayer constituted delivery to the taxpayer, and it is of no consequence that the refined copper so delivered was confused by the smelting company or by the selling company with like refined copper delivered for the account of other producers for whom the selling company likewise acted as agent. The segregation of particles constituting a fungible mass is not material to the passage of title or to the discharge of the obligations of the smelting company. Furthermore, actual delivery of refined copper having been made, it is immaterial whether or not the 140-day period allowed for delivery had in fact elapsed. If the obligation of the smelting company was thus discharged prior to the end of the taxable year, there should be included in the taxpayer's inventory of assets, in accordance with the taxpayer's inventory methods, the refined copper actually in the possession of the selling agent for the account of the taxpayer. The cost of this refined copper for inventory purposes would be represented by the fair market value of the refined copper received in exchange for the account receivable in copper and in discharge of the obligation of the smelting company to deliver copper as of the date of such exchange and discharge.

3. When a sale of copper was negotiated by the selling company, the taxpayer was notified to that effect and the selling price guaranteed to the taxpayer and partially advanced by the selling company. Whether the amount of copper previously carried by the selling company for the account of the taxpayer and now covered by the notification of sale is thereafter carried by the agent for its own account or for the account of the purchaser is immaterial. The sale was made and the selling price guaranteed, and the copper was no longer carried for the account of the taxpayer. If the sale was negotiated prior to the close of the taxable year, the amount of copper covered thereby should be eliminated from the taxpayer's inventory, and an account receivable in money accrued in an amount measured by the selling price.

4. The relationship existing between the taxpayer and the selling company was that of principal and agent. It was not the relationship of vendor and purchaser. The taxpayer did not sell to its agent the obligations of the smelting company payable in copper. Neither

were those obligations sold by the agent for the account of the taxpayer. The consistent practice under the existing contracts was to receive refined copper in satisfaction of the obligations of the smelting company and to sell the copper. Therefore, notifications to the taxpayer by the selling company of sales made in excess of the amount of refined copper on hand for sale constituted merely contracts to sell and should not be accrued as sales in advance of actual receipt from the smelting company of the refined copper.

In other words, the taxpayer should carry among its assets at the close of any taxable year the ore produced and on hand, the obligation of the smelting company for refined copper in place of the ore sold and delivered to the smelter, the refined copper on hand received from the smelting company in satisfaction of its obligations, or the account receivable in money accrued against the purchaser of refined copper or the taxpayer's del credere agent, depending upon the stage to which the transaction may have advanced. The inventory should reflect the ownership of property or property rights as they existed at the end of the year. (See article 1611, Regulations 69.)

This opinion should remove any difficulty which may have arisen as to the interpretation to be given to the word "deliverable" as used in Law Opinion 1087.

II. Will a certain judgment which became final in 192– and which required the taxpayer to account to another for profits realized through the extraction and sale in 1917 of mineral ore belonging to the other justify either the allowance of a 1917 deduction in computing net income, or an amendment to the 1917 return of the taxpayer eliminating from its gross income as reported for that year the amount of those profits?

Throughout the years 191– to 192–, inclusive, it would appear that this taxpayer encroached inadvertently upon ore deposits belonging to the T Company. The latter brought suit in equity to quiet title, for an accounting for ore removed, and for an injunction against further extractions. This taxpayer denied liability, but without success. An accounting was ordered and a final decree based thereon was entered by the United States District Court for the District of —— on ———, 192–. This decree was affirmed and petition for a writ of certiorari was denied by the United States Supreme Court.

The relief sought by the plaintiff in equity was:

> That the defendant be required to account for all ores extracted from said premises of plaintiff hereinbefore described, and that the plaintiff have judgment and decree for the value of said ore so wrongfully extracted and removed, together with interest thereon.

In laying down the rules by which the accounting was to be governed, the court said that:

> It (the defendant) should account for the full value of the ore converted by it, less the actual expense incurred by it in extracting and marketing the ore.

The accounting as approved by the court was completed as of December 1, 192–, and the judgment was paid by the taxpayer on ———, 192–.

Included in the accounting as of December 1, 192–, were amounts representing the proceeds from the sale of lead extracted in 1917 reduced by the cost of producing and marketing, together with inter-

est at 8 per cent on the net proceeds from the 25th day of the month following the month in which the ore was shipped. In a similar way, the account showed the net proceeds resulting from the 1917 extractions and sale of copper together with interest computed from a date 140 days after the 1st of the month following the month in which the ore was shipped. Summarized, these 1917 items appear as follows:

	Dollars.
Net proceeds from lead	59x
Net proceeds from copper	2x
Total net proceeds	61x
State net proceeds tax	4x
Net proceeds reduced by tax	57x
Interest to December 1, 1921	20x
Total liability with respect to 1917 extractions	77x

The taxpayer contends that it should be permitted to eliminate from its 1917 income the item of 77x dollars, not as a loss sustained by it in that year, but as an item constituting the gains or profits of another and such as was not properly a part of the gross income of this taxpayer.

This taxpayer mined the ore, made profits, assumed that those profits belonged to itself, and made return for income tax purposes upon that assumption. It later developed that that assumption was ill-founded, and that those profits were in equity the gains of another. This taxpayer has been treated as a borrower thereof from the date of their realization. It has been required to account to another for those gains together with interest. The proceeds resulting from this operation have been awarded to another. They constitute gain taxable to the other and not to the operator accumulating them in the other's behalf.

Office Decision 825 (C. B. 4, 95), dealing with oil royalties, presents an analogous situation. The same question was again considered in Office Decision 1141 (C. B. 5, 134), and there the distinction is clearly drawn between the right of a taxpayer to reduce its income as reported for a former year by the amount of gains included in its return for that year as having resulted from a dealing in property with respect to which gains it was later required to account to another, and the case of a judgment for damages awarded in a later year, the amount of which may be allowed as a deductible loss only in the year of the judgment. The following reasoning of that decision applies precisely to the facts and the law here involved:

> In the case of a dispute as to the title of oil-producing land, the royalties belong to the true owner. They follow the land and come into existence regardless of the person or activities of the owner. If one collects the royalties thinking he is the owner and then by judgment of court finds that another is the owner, he must surrender the royalties received not as damages but simply because they belong, and belonged from the beginning, to the true owner. The one who first received the royalty did so because he thought the land, and, therefore, the royalties were his.

In I. T. 1164 (C. B. I–1, 17) a stockholder had received in 1917 and accounted in his return for the amount of a corporate distribu-

tion made to him without the corporation having retained sufficient funds to pay Federal taxes. In a later year the stockholder was required to return for the payment of corporate taxes a certain portion of the amount so received. It was there held:

As the liability for unpaid taxes assessed against a corporation attaches to a stockholder to the amount of the assets received by him from the corporation upon liquidation, it is held that the taxpayer is in the nature of a trustee of so much of the amount received by him in 1917 as he was required to pay to the Government for taxes due by the company and that this amount did not represent income to him for 1917. He may, therefore, file an amended return for 1917, in which his income may be recomputed, omitting the amount which he paid to cover his proportionate part of the tax, * * *.

Dictum of the Board of Tax Appeals in *Providence Coal Mining Co.* v. *Commissioner* (5 B. T. A., 1179) gives expression to the same principle:

If we were satisfied, and we are not, that the entire amount, or a definite part of it, represented cost of goods sold, it would not be a question of deduction, but rather a question of reducing the income reported for the year in which the coal was mined by an amount which never should have been included in that income.

There should be eliminated from this taxpayer's gross income for 1917 those net proceeds from its 1917 operations with respect to which it was required in equity to account to the T Company. Similar adjustment should be made as to other taxable years involved in the accounting.

Having included in its gross income the proceeds from the sale of ore belonging to another, this taxpayer was allowed certain depletion deductions with respect to that income. Elimination of that income from its account will, of course, necessitate a corresponding adjustment in its depletion allowance.

A. W. GREGG,
General Counsel, Bureau of Internal Revenue.

SECTION 204.—NET LOSSES.

ARTICLE 1601: Net losses, definition and computation.

REVENUE ACT OF 1921.

Exclusion from gross income of value of demonstration plant transferred to taxpayer without cost. (See G. C. M. 1581, page 197.)

SECTION 206.—CAPITAL GAIN.

ARTICLE 1651: Definition and illustration of capital net gain.

REVENUE ACT OF 1921.

Amount of cash received by shareholder in 1922 in excess of basis of old stock as a result of an exchange upon reorganization represents a "capital gain" taxable at 12½ per cent at the election of the taxpayer. (See G. C. M. 1234, page 168.)

PART II.—INDIVIDUALS.

SECTION 211.—SURTAX.

ARTICLE 13: Surtax on sale of mineral deposits. VI–10–3130
T. D. 3983

INCOME TAXES—REVENUE ACT OF 1918—DECISION OF CIRCUIT COURT OF APPEALS.

1. SURTAX—COMPUTATION—MINES—SALE—REGULATIONS.

In computing the surtax under section 211 (a) and (b) of the Revenue Act of 1918, on the profit arising from the sale of mineral lands, the method prescribed by article 13 of Regulations 45 should be followed.

2. DECISION AFFIRMED.

Decision of the District Court (11 Fed. (2d), 895, T. D. 3879 [C. B. V–1, 176]) affirmed.

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

To Collectors of Internal Revenue and Others Concerned:

The following decision of the United States Circuit Court of Appeals for the Fifth Circuit in the case of *Mrs. Darlie Fowler and M. Fowler* v. *United States* is published for the information of internal revenue officers and others concerned.

D. H. BLAIR,
Commissioner of Internal Revenue.

Approved February 24, 1927.

A. W. MELLON,
Secretary of the Treasury.

UNITED STATES CIRCUIT COURT OF APPEALS, FIFTH CIRCUIT.

Mrs. Darlie Fowler and M. Fowler v. *United States.*

Error to the District Court of the United States for the Northern District of Texas.

[January 11, 1927.]

Plaintiffs in error, hereafter referred to as plaintiffs, brought separate suits to recover overpayments of income taxes assessed under the Revenue Act of 1918 (40 Stat., 1057 et seq.), alleged to be $6,984.76 in each case. The suits were consolidated and the trial resulted in a judgment rejecting plaintiffs' demands.

There is no dispute as to the facts. The plaintiffs are husband and wife and citizens of Texas and so divided their total income as community property and filed separate returns. Each had a net income for the year 1918 of $87,934.01. Of this, $41,572.90 was profit from the sale of certain oil property, which had originally cost the community $500 and the value of which had been increased by exploration and development.

Section 211 of the Revenue Act of 1918 imposes surtaxes on incomes of over $5,000 graduated from 1 to 65 per centum, according to the amount of income, in addition to the normal taxes, and concludes with this provision:

" (b) In the case of a bona fide sale of mines, oil or gas wells, or any interest therein, where the principal value of the property has been demonstrated by prospecting or exploration and discovery work done by the taxpayer, the portion

of the tax imposed by this section attributable to such sale shall not exceed 20 per centum of the selling price of such property or interest."

In conformity with Treasury Regulations 45, article 13, in computing the taxes due by plaintiffs the Bureau of Internal Revenue assessed a surtax of $8,451.62 against each of plaintiffs based on their total net income including profits from the oil property. The Bureau then computed 20 per cent of the selling price of the oil property and deducted the difference between that and the proportion of the surtax attributable to the profit derived from the sale. According to the schedule provided by section 211, the percentage of surtax imposed on the total net income amounted to a little over 20½ per cent, so that in granting a reduction based on the proviso above quoted the difference was only $260.80.

It is the contention of plaintiffs, as shown by their pleadings, that the surtax should have been calculated on the amount of their net income excluding the profit from the oil lands and that then 20 per cent should have been calculated on the selling price of the oil lands, these two amounts to make up the total surtaxes to be imposed.

The district court, in a very full and well considered opinion (11 F. (2d), 895), held against this contention. As we concur in the conclusions reached by the district court, but little need be said in affirming the judgment.

We deem the provisions of the statute too plain to require either interpretation or construction. The method of calculation adopted by the Treasury Department is simple and reasonable and fully conforms to both the spirit and letter of the law. That it results in very little saving to the taxpayer in this case is merely incidental.

The judgment of the district court was right.

Affirmed.

SECTION 212.—NET INCOME OF INDIVIDUALS DEFINED.

ARTICLE 22: Computation of net income. VI–13–3168
G. C. M. 1342

REVENUE ACTS OF 1918 AND 1921.

A corporation keeping its accounts on an accrual basis will not be permitted to deduct from gross income a sum in anticipation of the amount the corporation may be required to allow as cash discount on accounts due and payable in the succeeding year. Recommended that I. T. 1348 (C. B. I–1, 51) be overruled.

The taxpayer, which kept its accounts on an accrual basis, relying on an experience covering 10 years that 98.7 per cent of its customers took advantage of a 10 per cent cash discount, at the end of the calendar years 1918, 1919, 1920, and 1921 set up a cash discount reserve equal to 10 per cent of its customers' outstanding accounts receivable, as allowed by I. T. 1348, which provides:

Section 212 of the Revenue Acts of 1918 and 1921 provides that the net income shall be computed in accordance with the method of accounting regularly employed in keeping the books of the taxpayer. Good accounting practice sanctions two methods of dealing with cash discounts. Under the first the seller in setting up accounts receivable currently sets up a reserve for the amount of cash discounts allowable. In such case he reports each year the amount of his sales less the cash discount allowable. Under the second method the seller sets up no reserve but reports the gross amount of his sales, taking as a deduction therefrom the actual discounts allowed during the current year, and in the following year he takes a deduction in respect of any discounts allowed upon outstanding accounts at the close of the preceding year. These two methods should be recognized by the Bureau and the taxpayer allowed to make his income tax return accordingly if he consistently follows either method.

The following should be accepted as guidance in matters of this kind:

Where a taxpayer regularly sets up a reserve for the amount of cash discounts allowable, he should return each year the amount of his sales less the cash discounts allowable. Any portion of such discounts collected in subsequent years should be returned as income when collected. Where the taxpayer sets up no reserve for cash discounts but regularly reports the gross amount of his sales, he should take as a deduction from gross sales the amount of the discounts actually allowed during the year for which return is made. Any discounts allowed in the following year on outstanding accounts at the close of the preceding taxable year should be taken as a deduction in the year in which allowed. Under no circumstances will the taxpayer be allowed to throw back into the prior year discounts actually allowed after the close of that year.

Office Decision 146 (C. B. 1, 221) overruled.

In allowing the taxpayer only the cash discounts taken during the several years the Unit is now following Office Decision 146, which ruling was overruled by I. T. 1348.

It is the opinion of this office that in view of the several decisions of the Board of Tax Appeals, in the appeals of William J. Ostheimer (1 B. T. A., 18), Uvalde Co. (1 B. T. A., 932), and M. I. Stewart & Co. (2 B. T. A., 737), I. T. 1348 should be revoked and the original ruling in Office Decision 146 be now recognized, in so far as it prohibits setting up reserves for cash discounts. Office Decision 146 is approved to the extent that it provides:

A corporation keeping its accounts on an accrual basis will not be permitted to deduct from gross income a sum in anticipation of the amount the corporation may be required to allow as cash discount on accounts due and payable in the succeeding year.

The Board, in the Stewart case, said:

The taxpayer alleges error * * * on the part of the Commissioner in connection with the auditing of its returns. It alleges: (1) That the Commissioner should have allowed reserves for discounts which it expected to pay in connection with the settlement of the accounts of its customers.

In our opinion the decision of the Board has fully disposed of this point. Reserves are not allowable deductions from gross income unless specifically provided for by statute. Appeal of William J. Ostheimer (1 B. T. A., 18); appeal of Consolidated Asphalt Co. (1 B. T. A., 79); appeal of Uvalde Co. (1 B. T. A., 932); appeal of Pan-American Hide Co. (1 B. T. A., 1249).

A. W. GREGG,
General Counsel, Bureau of Internal Revenue.

ARTICLE 22: Computation of net income. VI–13–3169
I. T. 2342

REVENUE ACTS OF 1918 AND 1921.

I. T. 1348 (C. B. I–1, 51) is revoked in so far as it is inconsistent with the provisions of General Counsel's Memorandum 1342, published on page 177.

ARTICLE 25: Accounting period. VI–12–3158
G. C. M. 1113

REVENUE ACT OF 1918.

A taxpayer keeping its books on the basis of a fiscal year, taking a physical inventory and making an annual report to its stockholders on such basis, should have filed returns subsequent to the passage of the Revenue Act of 1918 on the basis of a fiscal year as required by section 212(b) of that Act.

The opinion of this office is requested as to whether the taxpayer should be allowed to file amended returns on the basis of a fiscal year, original returns having been filed on the basis of a calendar year.

The tax liability on the return for the year 1918 amounted to $57.5x$ dollars, which was assessed. An additional assessment of $15x$ dollars was made on the June, 1920, income tax list, so that the total assessment for the year 1918 amounted to $72.5x$ dollars. In 1924 this liability was reduced by $10.2x$ dollars, leaving a net assessment for 1918 of $62.3x$ dollars, which has been paid.

The tax reported and assessed for the year 1919 amounted to $59.3x$ dollars. An amended return for the year 1919 was filed on December 15, 1920, indicating a tax due of $55.6x$ dollars. The taxpayer has satisfied this liability for the year 1919 by several payments amounting in the aggregate to the tax specified on the amended return. A claim for the abatement of the difference between the amount originally reported and that reported on the amended return, to wit, $3.7x$ dollars, was allowed to the extent of $1.4x$ dollars on or about August, 1925, and was rejected as to the balance.

The taxpayer is now asking that amended returns be accepted on the basis of a fiscal year ending June 30 for the taxable years subsequent to June 30, 1918. This would result in a considerable readjustment of the tax liability of the taxpayer previously determined on a calendar-year basis.

The record shows that from 1909 to 1924 the taxpayer made its returns on a calendar-year basis. In view of the present contention it is not at all apparent why the corporation never made its returns on a fiscal-year rather than a calendar-year basis. The books were so kept that it was readily possible to determine at the end of each calendar year the amount of net income for that year. The corporation found it more convenient for income tax purposes to adopt a calendar-year basis for making its returns to the Government than to utilize the fiscal-year basis used in relation to its stockholders. It was more convenient for the corporation to continue its practice of making returns on a calendar-year basis, even though after the passage of the Revenue Act of 1913 it might have availed itself of the provisions of paragraph G(c) of that Act and established a fiscal-year basis for its return. Another opportunity was given by section 13 of the Revenue Act of 1916 to accomplish this end, but still the company persisted in making its income tax returns on a calendar-year basis. In short, whatever may have been the practice of the taxpayer in respect to its stockholders, in its relation to the Government it had established and consistently maintained during the period of its taxability a calendar year as its accounting period for tax purposes.

No application for a change to a fiscal year was ever made nor was the question raised until after 1920, when the corporation's business year was made to end December 31 instead of June 30, as formerly.

Controversies relative to its exact tax liability often arose during the period prior to 1920 and were the subjects of consideration and adjustments; but never, until September, 1924, did the taxpayer even suggest in any of its claims or briefs that its books were kept on a fiscal rather than a calendar year basis. With accountants to prepare its annual returns and with attorneys to represent it before the

Bureau in its various controversies, neither the taxpayer nor its representatives ever advanced any claim prior to September, 1924, that any of its returns over the period from 1909 to 1920 had been wrongfully made, or that its accounting period was a fiscal and not a calendar year.

The question is whether, under the provisions of section 212(b) of the Revenue Act of 1918, the taxpayer was required to make its returns for 1918 and subsequent years on a fiscal-year basis instead of on a calendar-year basis.

Section 212(b) of the Revenue Act of 1918 provides:

> The net income shall be computed upon the basis of the taxpayer's annual accounting period (fiscal year or calendar year, as the case may be) in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; but if no such method of accounting has been so employed, or if the method employed does not clearly reflect the income, the computation shall be made upon such basis and in such manner as in the opinion of the Commissioner does clearly reflect the income. If the taxpayer's annual accounting period is other than a fiscal year as defined in section 200 or if the taxpayer has no annual accounting period or does not keep books, the net income shall be computed on the basis of the calendar year.
>
> * * * * * * *

Article 25 of Regulations 45 provides as follows:

> The return of a taxpayer is made and his income computed for his taxable year, which means his fiscal year, or the calendar year if he has not established a fiscal year. The term "fiscal year" means an accounting period of 12 months ending on the last day of any month other than December. No fiscal year will, however, be recognized unless before its close it was definitely established as an accounting period by the taxpayer and the books of such taxpayer were kept in accordance therewith. The taxable year 1918 is the calendar year 1918 or any fiscal year ending during the calendar year 1918. See section 200 of the statute. A taxpayer having an existing accounting period which is a fiscal year within the meaning of the statute not only needs no permission to make his return on the basis of such a taxable year, but is required to do so, regardless of the former basis of rendering returns. A person having no such fiscal year must make return on the basis of the calendar year. The first return under the present statute of a taxpayer who has heretofore made return on a basis different from his accounting period will necessarily overlap his next previous return. For the method of adjusting the tax in such a case see section 205 of the statute and articles 1621–1624. Section 226 has no application to this situation. Except in the cases of a return for the taxable year 1918 and of a first return for income tax a taxpayer shall make his return on the basis (fiscal or calendar year) upon which he made his return for the taxable year immediately preceding unless, with the approval of the Commissioner, he has changed the basis of computing his net income.

As to what was the taxpayer's "accounting period" and "what were the methods of accounting regularly employed in keeping its books," the by-laws of the corporation throw considerable light, at least in so far as mutual relationship of the corporation and of the stockholders is concerned.

For many years prior to August 31, 1920, section 1, article 1, provided that the annual meeting of the stockholders should be held on the first Wednesday of September in each year. On August 31, 1920, this section was amended to provide for the holding of the annual meeting on the first Wednesday in March of each year.

Section 4, article 4, of the by-laws originally provided:

> * * * The president shall submit to the directors at their regular meeting in September of each year, and to the stockholders at each annual meeting, a complete report of the operations of the company for the preceding year, and

the state of its affairs on the 30th day of June, and from time to time shall report to the directors all matters within his knowledge which the interests of the company may require to be brought to their notice.

On August 31, 1920, the section just quoted was amended to read as follows:

* * * The president shall submit to the directors at their regular meeting in March of each year and to the stockholders at each annual meeting a complete report of the operations of the company for the year ending on the 31st day of December next preceding, and from time to time shall report to the directors all matters within his knowledge which the interests of the company may require to be brought to their notice.

It was the practice of the corporation to issue, under the date of June 30 in each year, an annual report for submission to the stockholders; one for the period ended June 30, 1919, was entitled "The Twentieth Annual Report to the Stockholders of the M Company for the Fiscal Year Ended June 30, 1919"; the twenty-first annual report was dated June 30, 1920; the twenty-second report, dated December 31, 1920, was for the six-months' period ended on that date. The report last referred to was submitted apparently because of the changes made in the by-laws on August 31, 1920.

It was also the taxpayer's practice prior to 1920 to take but one physical inventory each year. That was taken as of June 30. In 1920 two physical inventories were taken—one as of June 30, which antedated the change in the by-laws made on August 31, 1918, and the other as of December 31, 1920, which was after the changes above mentioned.

While it was the custom of the corporation prior to 1920 to make but one physical inventory for each year, it was the practice to take a book inventory as of December 31, which book inventory was used in connection with the preparation of the annual income tax returns. The physical inventory of June 30, 1919, and the book inventory of December 31, 1918, were entered in the general ledger. For the years prior to 1919 the physical inventory only was entered, although the book inventory as of December 31 was relied upon in making out income tax returns.

The corporation also submitted to its stockholders brief quarterly reports of earnings.

The facts are conclusive that as between itself and its stockholders the accounting period of the taxpayer, prior to the amendment of the by-laws made on October 31, 1920, was from July 1 of one year to June 30 of the succeeding year. In other words, the accounting period as to the stockholders was a fiscal year.

The Income Tax Unit in the instant case has recognized that the taxpayer conducted its business on a fiscal-year basis. Revenue agents have so reported, and, under date of November 18, 1925, the taxpayer was formally advised by Bureau letter that its returns for 1918 and subsequent years should have been filed on the basis of a fiscal year ending June 30.

The premises considered, it is concluded that the taxpayer should have filed its returns subsequent to the passage of the Revenue Act of 1918 on a fiscal-year basis, as required by section 212(b) of that Act.

A. W. GREGG,
General Counsel, Bureau of Internal Revenue.

SECTION 213(a).—GROSS INCOME DEFINED: INCLUSIONS.

ARTICLE 31: What included in gross income. VI-7-3102
(Also Section 213(b), Article 73.) T. D. 3974

INCOME TAX—REVENUE ACT OF 1913—DECISION OF CIRCUIT COURT OF APPEALS.

1. STOCK—SALE—GAIN OR LOSS—INCOME.

The gain derived from the sale of stock received as a gift, based upon the difference between the selling price and the value at the time of the gift, is taxable as income under the provisions of the Act of 1913.

2. SAME—GIFT—EXEMPTION.

The exemption from taxation of the corpus of gifts does not exempt the profit derived from a sale of the property given.

3. STOCK—VALUATION—EVIDENCE.

In the absence of an established market the admission of evidence of actual sales on the curb market, although few in number, and of "bid" and "asked" notations from accepted financial journals, was not error.

4. REFUND—INTEREST.

Where the principal amount under a claim for refund is accepted, suit can not be brought to recover interest, although a receipt is given in which there is a reservation of the "right, if any, to recover any additional sum for which suit might thereafter be brought."

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

To Collectors of Internal Revenue and Others Concerned:

The following decision of the United States Circuit Court of Appeals for the Second Circuit in the case of *Julia Barnett Rice* v. *Eisner, Collector*, is published for the information of internal revenue officers and others concerned.

D. H. BLAIR,
Commissioner of Internal Revenue.

Approved February 5, 1927.

A. W. MELLON,
Secretary of the Treasury.

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

Julia Barnett Rice, plaintiff in error, v. *Mark Eisner, Collector, defendant in error.*

[December 24, 1926.]

Writ of error sued out by the plaintiff to a judgment of the District Court for the Southern District of New York entered upon the verdict of a jury in her favor.

The complaint was at law for money paid under duress to a tax collector in discharge of the plaintiff's income tax, as assessed for the year 1915, under the Act of October 3, 1913. On October 10, 1914, the plaintiff's husband gave her 23,923 of common and 1,925 of preferred shares in the Electric Boat Co., of which he was then the majority owner. These she sold during the summer of 1915, and upon her income tax return for that year she was taxed in the sum of

$258,762.28, assessed upon the difference between the value of the shares on October 10, 1914, and the amounts which she received upon their sale. She was forced to pay the tax, and after receiving $17,178.31 as a refund from the Commissioner, she sued to recover part of the balance, $191,080.05.

The cause was tried to a jury and the court held that she was taxable upon the theory adopted by the taxing officers, but that the jury must decide what was the value of the shares at the time of the gift. Evidence upon this issue was submitted by both sides, and the jury by special verdict found the value of the common shares to have been $24, and of the preferred $43.50. The court thereupon directed a verdict for the plaintiff in the amount found due her, the taxing officers having found the value of the shares at a lesser amount. The plaintiff, being unsatisfied, sued out the writ at bar.

The chief points raised are two: That under the Act of October 3, 1913, the appreciation in the value of property given to a taxpayer is not part of his taxable income; that there was no adequate evidence to support the findings of the jury as to the value of the shares. Certain rulings of the court during the course of the trial were also challenged, and a claim is made for interest upon the amount refunded by the Commissioner.

HAND, Circuit Judge: On the main point we have no question that the learned district judge was right. The first paragraph of section B of Section II of the Act of October 3, 1913, provides that the income taxable "shall include gains, profits, and income derived from * * * sales or dealings in property, whether real or personal, growing out of the ownership or use of or interest in real or personal property * * * or gains or profits and income derived from any source whatever, including the income from but not the value of property acquired by gift, bequest, devise, or descent." This is the only relevant enactment, and the question is whether it includes "gains * * * derived from sales" of personal property acquired by gift. Section 2(a) of the Act of September 8, 1916, defines taxable income in the same language but omits the words "including the income from but not the value of," etc., just quoted. These occur, however, in section 4 of that Act, among the exemptions allowed, as follows: "The value of property acquired by gift, bequest, devise or descent (but the income from such property shall be included as income)." We can see no conceivable difference between the meaning of the two statutes: the fact that in the first the exemption is coupled with the definition of the taxable income, while in the second it is placed among the exemptions, is of no consequence whatever.

That appreciation in the corpus of property received upon bequest is taxable under the Act of 1916 was expressly held in *Merchants L. & T. Co.* v. *Smietanka* (255 U. S., 509). True, in that case the person assessed was a testamentary trustee, but that can make no difference, for trustees are taxed like other individuals. Nor can it of course be a distinction that the case at bar involves a gift and not a bequest. *Gray* v. *Darlington* (15 Wall., 63) was definitely held to be inapplicable because of the difference in language of the statutes, and *Lynch* v. *Turrish* (247 U. S., 221) was distinguished because no gains had been made since the law was passed.

By section 2(c) of the Act of 1916 it was provided that the gain derived from the sale of the property acquired before March 1, 1913, should be taken as its appreciation since that day, and the same provision was contained in section 202 of the Act of February 24, 1919. Until 1921 nothing specific was said about computing the gain on gifts and bequests, but by section 202(a)(2) of the Act of November 23, of that year, it was provided that when gifts were made before January 1, 1921, their value should be taken as of the time of their acquisition, and thereafter at the time when the donor acquired the property. The argument is that then for the first time did Congress mean to tax the profit on gifts at all, since only then did it provide a means for computing it. If so, Congress did not mean to tax the appreciation of purchased property between 1913 and 1916, because only in 1916 was any rule laid down which professed to cover it, and then only in a form equally applicable to gifts and bequests. *The argument proves too much.*

The Act of 1921 was apparently passed for quite another reason; that is, in the future to prevent donors from escaping the high taxes prevailing by giving property to their wives or children. As the latter would be allowed on any subsequent sales to subtract the value of the gift when they received it, and as a gift was not a sale as regards the donors, all increment escaped taxation

which had accrued during the ownership of the donors. As to earlier gifts, the rule remained as it had been in practice applied before the Act of 1921 was passed. From this no inference can be made that before the statute fixed the rule gifts were not to be taxed at all, but rather that the computation of profits upon gifts had been left to the regulation of the Department, as it had certainly been on purchases for the first three years. As difficulties in administration arose, Congress met them, following probably the suggestion of the Department itself.

The exemption in all the statutes of the corpus of gifts and bequests shows that in the minds of those who drew the Acts it was thought open to question whether even this might not be considered income. To suppose that in addition they meant to exempt profits upon them, while taxing profits on purchases, would be a curious inversion of any fair incidence of the tax. Conceivably one might imagine the opposite a tenable notion, but the suggestion of the plaintiff appears to us to presuppose not only a baseless, but an unjust, distinction. We have no doubt, quite independently of authority, that from the outset the profits on gifts and bequests was included with gains derived from the sale of all kinds of property, however acquired. So much for the plaintiff's liability.

The jury found the value of the shares on October 10, 1914, in accordance with the law and the evidence, so far as we can see. The judge charged them to take the market price, if there was one established by free sales; if not, to find the "intrinsic value" of the property, at best a tenuous conception. He did not tell them that they must find that there had been such a market. So far as appears, they may have based their verdict on "intrinsic value," except for the somewhat ingenuous insistence of the plaintiff that in so doing they should have accepted a corporate balance sheet with an item for "Patents, good will, and development," of over seven millions, which, standing alone, the judge quite naturally told them was insufficient evidence.

However, if there was no adequate basis for establishing a market value, the plaintiff's objection would be sound, for the charge allowed that finding, and there is every reason to suppose that the jury based their verdict upon it. These shares in 1914 were not dealt upon in the New York Stock Exchange, so that the fact is irrelevant that it was closed from early in August until March of 1915. They were, however, dealt in on the New York Curb, at that time a loose, spontaneously grown, gathering of brokers who met only in the street, though they made a very active and real market. The Curb was also closed early in August, but it opened on November 20, 1914, and thereafter all conditions of a free market existed, because the trading was unrestricted. Before that time people also did more or less private trading in shares of stock, among them 200 shares of this company. These we may omit, for after doing so there remain between November 19 and December 1 sales of 1,215 common shares and of 425 preferred. The average price of the first was less than $24 and of the second less than $42. It is urged that these sales are too meager to justify a conclusion as to the value of the plaintiff's holdings, which in the common was nearly twenty times as large. Yet it must be remembered that the value of that number of shares in the hands of a single holder could not be greater than the sale price of smaller quantities, unless some one wished to gain control of the company. Such a possible higher value is wholly speculative, and any attempt to market so large a quantity would have probably sent down the value far below the prices which prevailed. The size of her holdings, so far as it counts at all, counts against her; all we need say is that she is not injured if it be ignored. *Walter* v. *Duffy* (287 Fed. Rep., 41 (C. C. A. 3)) is not parallel. The market in that case had been very sluggish, and each sale was a matter of negotiation; in several years only six or seven hundred shares had been sold, of which nearly 500 were thrown upon the market by a bank in selling out a pledge.

The price of the common shares between May and August had been about 13, and the jury would have been warranted in taking a figure between that and the opening price on November 20 of 24, as the taxing officers apparently did when they reassessed the tax. The existence of the Great War was steadily raising the prices of such securities, and after the first of the year this one commenced to go up rapidly, so that by summer it had reached enormous heights, due to the demand for submarines by the belligerents. On the whole evidence not only do we think that the jury was justified in their verdict, but it seems to us that they took the highest figure which that evidence admitted.

The judge admitted in evidence "bid and asked" quotations from certain accepted financial journals. Some of the witnesses for the defense testified that these were records of actual events and were treated by brokers as a reliable index of value. Whatever might be our own judgment as to the value of such quotations, we can not see how the judge could have excluded them under this proof. If genuine, "asked" prices are those at which holders will sell, and therefore their opinion of the worth of their securities. In the end, value is no more than the opinions of those who have and those who have not when they coincide. When they do not, "asked" prices are a measure of the most sanguine opinions about the security; sellers can demand no more. It is well settled that the records, qua records, were competent. (*Cliquot's Champagne*, 3 Wall., 114, 140, 141; *Virginia* v. *West Virginia*, 238 U. S., 202, 212.)

The burden of proof rested upon the plaintiff to establish that the defendant had extorted from her money to which he was not entitled. (*United States* v. *Anderson*, 269 U. S., 422, 443 [T. D. 3839, C. B. V–1, 179]; *U. S.* v. *Mitchell*, 271 U. S., 9, 12 [T. D. 3865, C. B. V–1, 233].)

None of the requests to charge added anything of substance to the judge's colloquial charge, except those which he should have denied outright. Such requests only serve to call generally to the judge's attention those questions which the party wishes to have brought before the jury. We need hardly repeat that they in no sense compel him to use the language chosen, and it is only when he has misconceived the law at large that they can be the basis for reversing the judgment.

The complaint did not ask for interest upon the sum which the Commissioner of Internal Revenue refunded before suit brought, nor was there a motion to amend the pleading during the trial. That would in our judgment be final in any case, but on the merits the claim is bad. The plaintiff gave a receipt for this amount in which she reserved "her right, if any, to recover any additional sum for which suit might thereafter be brought." After accepting the principal she could not have sued for interest alone. (*Stewart* v. *Barnes*, 153 U. S., 456, 462–464.) Literally, therefore, interest does not fall within the terms of her reservation; we think it does not so fall substantially. It is a reasonable requirement that if a taxpayer means to reserve such a right, he should so express himself definitely. Whether such a reservation would have been effective in any case we need not say; conceivably, the taxpayer has only the alternatives of accepting his principal without interest or suing to recover both.

Judgment affirmed.

ARTICLE 31: What included in gross income. (Also Section 213(b), Article 73.) VI–7–3103 T. D. 3975

INCOME TAX—ACT OF 1913 AND REVENUE ACT OF 1916—DECISION OF COURT OF CLAIMS.

1. INCOME—EXEMPTION—GIFT—BEQUEST.

The income received by a life beneficiary under a testamentary trust is not exempt from Federal income tax under Section II, paragraph B, of the Act of 1913, and section 4 of the Revenue Act of 1916 as property acquired by gift, bequest, devise, or descent, since those sections exempt only the corpus of the property and not the income.

2. DECISIONS FOLLOWED.

Irwin v. *Gavit* (268 U. S., 161; T. D. 3710 [C. B. IV–1, 123]) and *Drexel* v. *United States* (61 Ct. Cls., 216) followed.

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

To Collectors of Internal Revenue and Others Concerned:

The following decision of the United States Court of Claims in the case of *William R. Verner, Sole Executor Under the Will of*

Emily L. Moore, deceased, v. *United States* is published for the information of internal revenue officers and others concerned.

D. H. BLAIR,
Commissioner of Internal Revenue.

Approved February 5, 1927.

A. W. MELLON,
Secretary of the Treasury.

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COURT OF CLAIMS OF THE UNITED STATES.

William R. Verner, Sole Executor Under the Will of Emily L. Moore, deceased, v. *The United States.*

[November 8, 1926.]

OPINION.

CAMPBELL, Chief Justice, delivered the opinion of the court.

The facts are undisputed. It appears from them that Alfred F. Moore, who died in September, 1912, left a will by which he devised and bequeathed the residue of his estate to the executors and trustees, in trust, to invest and safely keep it and "to pay the entire net income, interest, rents, issues, dividends, and profits arising therefrom" to the wife of the testator "for and during the full term of her natural life."

After her death certain other persons were to have the income for life and ultimately the corpus was to go to the Moore School of Electrical Engineering. In accordance with the terms of the will, there was paid to Mrs. Moore by the executors "the entire net income, interest, rents, issues, dividends, and profits arising from the said trust" during each year from the testator's death in 1912 until January, 1923, when she died, nothing being paid her in 1912. On the amounts so paid her during the several years 1913, 1914, 1915, 1916, and 1917, she paid the Federal income tax, having included these amounts in her tax returns for these years. But she or the plaintiff as her executor applied to the Commissioner of Internal Revenue for a refund of the tax paid in each case "on the ground that the alleged income on which that portion of the tax was computed and imposed was itself a bequest to her under the will of Alfred F. Moore and was accordingly under the law and regulations exempt from tax."

The Commissioner having denied the application for a refund, the plaintiff brings suit in the Court of Claims and renews here the contention that the payments by the executors of the husband's will to Mrs. Moore were themselves the payments of bequests and as such were not taxable under the Acts of October 3, 1913 (38 Stat., 167), and of September 8, 1916 (39 Stat., 758), which in terms impose a tax on "gains or profits and income derived from any source whatever, including the income from but not the value of property acquired by gift, bequest, devise, or descent."

It is not questioned that the statute does not exempt the income from property received by devise or bequest. If the bequest had been to her of the residuary estate for life it could not be contended that the income arising from it would not be subject to income tax. Does the circumstance of the intervention of executors or trustees to hold and administer the trust so change the situation that the same "income" is not taxable? We do not think Congress so intended. The questions raised are settled by the case of *Irwin* v. *Gavit* (268 U. S., 161), which is not distinguishable from the present case. A contention similar to that made by plaintiff was urged in the Drexel case (61 C. Cls., 216). A writ of certiorari was denied in that case by the Supreme Court in April, 1926.

The petition should be dismissed. And it is so ordered.

ARTICLE 31: What included in gross income. VI-18-3215
G. C. M. 1565

REVENUE ACT OF 1921.

Under the laws of the State of Texas the profits derived from the sale of the separate personal property of the husband are community property and in accordance with section 1212 of the Revenue Act of 1926 are taxable to the husband and wife in equal shares.

An opinion is requested as to the taxable status under the laws of Texas of the profits derived by A from the sale of his separate personal property.

Prior to his marriage on April —, 1921, A owned certain shares of stock, which he sold during the year 1922 at a profit, which sum was included by A and his wife as community income in separate returns filed for the taxable year 1922, each spouse reporting as gross income one-half of the profit from the sale of the stock. The examining officer disallowed the return of this profit on the community basis, as he considered that the entire gain from the sale was the separate income of the husband. Inquiry is made whether profits from the sale of the separate personal property of a husband domiciled in Texas constitute community income or separate income of the husband.

Section 15, article 16, of the constitution of Texas declares:

All property, both real and personal, of the wife, owned or claimed by her before marriage, and that acquired afterwards by gift, devise, or descent, shall be her separate property; and laws shall be passed more clearly defining the rights of the wife, in relation as well to her separate property as that held in common with her husband. Laws shall also be passed providing for the registration of the wife's separate property.

Article 4621 (Vernon's Sayles' Texas Civil Statutes, 1918 ed.) provides as follows:

All property, both real and personal, of the husband, owned or claimed by him before marriage, and that acquired afterwards by gift, devise, or descent, as also the increase of all lands thus acquired, and the rents and revenue derived therefrom, shall be his separate property. The separate property of the husband shall not be subject to the debts contracted by the wife, either before or after marriage, except for necessaries furnished herself and children after her marriage with him. All property of the wife, both real and personal, owned or claimed by her before marriage, and that acquired afterwards by gift, devise, or descent, as also the increase of all lands thus acquired, and the rents and revenues derived therefrom, shall be the separate property of the wife.

In *Arnold* v. *Leonard* (Tex. Civ. App., 273 S. W., 799) the Supreme Court of Texas held unconstitutional that portion of article 4621 (Vernon's Sayles' Texas Civil Statutes), supra, which undertook to make rents and revenues from the wife's separate lands a part of her separate estate. The court stated in part as follows:

Since rents and revenues derived from the wife's separate lands are entirely without the constitutional definition of the wife's separate property, and since the legislature can neither enlarge nor diminish such property, it follows that the portions of the acts of 1917 and 1921, which undertake to make rents and revenues from the wife's separate lands a part of her separate estate, are invalid.

The Texas statutes clearly set forth what property acquired by the husband after marriage shall be his separate property and profits from the sale or investment of his separate personal property are not

included therein, such profits being neither acquired by gift, devise, or descent nor derived from separate real property. In *Lee* v. *Lee* (112 Tex., 392, 247 S. W., 828) the court declared:

> The statutes having defined and limited the separate property of the husband and wife, it follows with absolute certainty that all other property acquired by them during the marriage is a part of the common estate.

The Supreme Court of Texas has consistently held that profits from the investment of the separate personal estate of either the husband or wife are community property. (*DeBlane* v. *Lynch*, 23 Tex., 25; *Carr* v. *Tucker*, 42 Tex., 330; *Barr* v. *Simpson*, 54 Tex. Civ. App., 105, 117 S. W., 1041; *Epperson* v. *Jones*, 65 Tex., 425.)

In *Ezell* v. *Dodson* (60 Tex., 332) the court stated in part as follows:

> But of the property which a wife may acquire during marriage, none becomes her separate estate except such as is derived by gift, devise, or descent.

In *Bryan* v. *Sturgis National Bank* (40 Tex. Civ. App., 307, 90 S. W., 704) the court said:

> It is not denied that dividends earned by the separate property of either spouse become community property when such dividends are declared; * * *.

In an opinion dated August 24, 1920, published as Treasury Decision 3071 [C. B. 3, 221], the Attorney General, after reviewing certain decisions of the Supreme Court of Texas interpreting the community property laws of that State, said in part as follows:

> It is to be noted that the increase of separate personal property and the revenue derived therefrom are not the separate property of the owner of the personalty, but are community property (*Carr* v. *Tucker*, 42 Tex., 330; *Epperson* v. *Jones*, 65 Tex., 425; *Barr* v. *Simpson*, 117 S. W., 1041). They are therefore "income" to the community, to wit: "Gains, profits, and income * * * from businesses, commerce, or sales or dealings in property * * * growing out of the ownership or use of or interest in such property."
>
> * * * * * * *
>
> Community property, under the laws of Texas, belongs jointly to husband and wife; it follows that the income therefrom accrues to husband and wife in equal shares.

Section 1212 of the Revenue Act of 1926 provides as follows:

> Income for any period before January 1, 1925, of a marital community in the income of which the wife has a vested interest as distinguished from an expectancy, shall be held to be correctly returned if returned by the spouse to whom the income belonged under the State law applicable to such marital community for such period. Any spouse who elected so to return such income shall not be entitled to any credit or refund on the ground that such income should have been returned by the other spouse.

Accordingly, this office is of the opinion that under the laws of Texas the profits derived from the sale in 1922 of the separate personal property of A are community property, and, in accordance with section 1212 of the Revenue Act of 1926, are taxable to the husband and wife in equal shares.

A. W. GREGG,
General Counsel, Bureau of Internal Revenue.

ARTICLE 31: What included in gross income.

REVENUE ACT OF 1921.

Income of husband, wife, and minor child domiciled in State of California. (See I. T. 2352, page 32.)

ARTICLE 31: What included in gross income. VI-25-3278
(Also Section 213(b), Article 73.) T. D. 4021

INCOME TAX—REVENUE ACT OF 1918—DECISION OF COURT.

1. GROSS INCOME—BEQUEST OF INCOME FROM TRUST FUND.

Annual payments made to a taxpayer by a trustee under a will and arising from the interest on a capital sum which had been set apart and invested by the trustee in accordance with the provisions of the will are not annual gifts or bequests to the taxpayer exempt from income tax under section 213(b)3 of the Revenue Act of 1918, but income upon which a tax is imposed by that Act.

2. DECISION FOLLOWED.

Irwin v. *Gavit* (268 U. S., 161, T. D. 3710 [C. B. IV-1, 123]).

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

To Collectors of Internal Revenue and Others Concerned:

The following decision of the United States Circuit Court of Appeals for the Third Circuit, in the case of *Heiner, Collector*, v. *Beatty, Executrix*, is published for the information of internal revenue officers and others concerned.

C. R. NASH,
Acting Commissioner of Internal Revenue.

Approved June 14, 1927.

A. W. MELLON,
Secretary of the Treasury.

UNITED STATES CIRCUIT COURT OF APPEALS, THIRD CIRCUIT.

Heiner, Collector, plaintiff, v. *Beatty, defendant.*

In error to the District Court of the United States for the Western District of Pennsylvania.

[February 23, 1927.]

WOOLLEY, Circuit Judge: The learned trial court so construed the will of Andrew Carnegie and so interpreted the applicable Revenue Act as to allow the executrix of John W. Beatty, one of the beneficiaries, to recover income taxes he paid on moneys he had annually received from the executor and trustee under the will. The collector appealed.

Referring to the opinion of the trial court, reported in 10 Fed. (2d), 390, for an extended statement of facts and discussions of the law, we shall do little more than give the opposing positions of the parties and recite what we regard to be the pertinent provisions of the will and the statute.

The plaintiff contended and the trial court held that the sums annually paid the "annuitant" (so named in the will) were gifts or bequests and were therefore exempt from income tax under the Revenue Act of 1918 (40 Stat., 1057, ch. 18, sec. 210-213; Comp. Stat., sec. 6336⅛ et seq.), which, though demanding a tax on net income reckoned from gross income "derived from any source whatever," did not include the value of property acquired by gift or bequest but did include the income therefrom. The position of the Government was that the money which annually came to the annuitant was not an annual gift or a gift annually distributed but was income within the sense of the Act and therefore taxable.

The first part of the Carnegie will with which we are concerned is the fifth article. It reads as follows:

"Fifth: I give to each of the persons hereinafter in this fifth article named an annuity of the annual amount in this fifth article set after his or her

name, to be paid semiannually during the annuitant's life, that is to say * * * Mr. Beatty Art-Dept. wife succeeding five thousand dollars."

If the will had stopped there, it is possible that the testator's provision for John W. Beatty would have been a bequest, payable in semiannual installments directly from the estate, and all payments made to him year by year would have been exempt from taxation under paragraph (3) of subdivision (b) of section 213 of the cited Act. However, the will did not stop there, but, going on, it provided in the very next article, by words whose significance we have emphasized by italics, as follows:

"Sixth: I direct my executor and *trustee* either to *set apart, hold in trust, invest and keep invested, in separate funds, one for each annuitant*, sufficient sums *to produce* by the clear net interest and *income* thereof respectively, the several annuities provided in the fifth article of this will, * * * and to pay the said several annuities *from the* interest and income of the *respective funds* in semiannual payments, *or* to purchase such annuities in life insurance companies * * *."

By the eighth article the testator authorized his executor and trustee (who is one corporate person), "in its discretion, to retain for investment of the principal of any of the *trusts*, herein provided for, any of the securities left by me." And, finally, by the same article he authorized the executor and trustee to sell any of the securities coming into its hands and reinvest the proceeds.

Recapitulating, these provisions created, somewhat inartificially, yet, we think, with no lack of certainty, out and out trusts. They provided a capital sum for each annuitant, directed that it be "set apart" and "held in trust" for him, and that from the interest and income therefrom accruing payment of a definite sum be made to him semiannually. Having all the earmarks of formal trusts, the executor and trustee, believing itself charged therewith, exercised the election given it to create capital trust funds by withdrawing from the body of the estate sufficient securities to produce the amounts to be paid annually to the more than 40 annuitants. For John W. Beatty it took, "set apart," and "held in trust" one $100,000 United States Steel Corporation registered 50-year 5 per cent gold bond and two $5,000 bonds of the same issue, and of the interest received therefrom it paid him $5,000 a year. This is what was done. But the testator directed, in the alternative and at the trustee's election, another way by which the trustee could provide for the payment of the annuities, namely, by taking a part of the principal of the estate and with it buy annuities. Thus in both ways the testator willed that parts of the corpus of his estate be appropriated as capital sums from which income in amounts sufficient to pay the annuities could be obtained. In neither way—indeed, nowhere in the will—did he provide for the payment of annuities from the principal of his estate. In other words, the testator, through alternative ways, specifically indicated and fully provided the sources of income to be paid the annuitants. What the will intended the annuitant here to receive and what actually he did receive was income derived from a source which we think is sufficiently definite to fall within the statute's denomination of "income derived from any source whatever." We are not unmindful that in construing a tax Act its words must be followed, and that the law gives no latitude in gathering from the statute a meaning which its words do not import. We are aware that there must be some ambiguity lurking in this and in like statutes because we find our views at variance with those of the learned judges who sat in the trial court. Moreover, the Supreme Court in construing a will, not unlike the one here in issue, in respect to liability for taxes, found its members not all of one mind; yet, we are constrained by the reasoning illustrations and inevitable inferences found in the opinion of that court, as well as by its judgment, in *Irwin* v. *Gavit* (268 U. S., 161, 165–169), to hold that the moneys which came in to John W. Beatty, being income produced from a capital sum created specifically to produce it, was income within the meaning of the Revenue Act of 1918, and that his payment of the tax thereon assessed, being proper, can not be recovered in this suit.

In this disposition of the case there is no occasion to decide the other question affecting the plaintiff's right to recover a tax voluntarily included in his return and paid without protest and not under duress.

The decree below is reversed.

ARTICLE 39: Sale of stock and rights. VI–3–3052
(Also Section 201, Article 1541; Section 202, Article 1561.) I. T. 2332

REVENUE ACT OF 1921.

I. T. 1545 (C. B. II–1, 54) is revoked in so far as inconsistent with General Counsel's Memorandum 916 (see page 135).

ARTICLE 42: Sale of personal property on installment plan.

REVENUE ACTS OF 1916, 1917, 1918, AND 1921.

Applicability of section 212(d) and section 1208 of the Revenue Act of 1926 to taxpayer selling real estate on the installment basis who reported the income therefrom on the accrual basis. (See G. C. M. 1123, page 37.)

ARTICLE 46: Deferred-payment sales of real estate not on installment plan. VI–1–3032
(Also Section 202, Article 1561; Section 214(a)10, Article 201.) G. C. M. 952

REVENUE ACT OF 1918.

Upon repossession of an oil and gas lease parted with under a contract to sell, title to which was retained by the vendor, income is realized to the extent of the difference between the total amount of payments received and retained under the contract and the sum of the gains previously reported as income in connection therewith and an amount representing a proper adjustment for depletion.

The property repossessed should be taken up on the taxpayer's books in the year of repossession upon the cost and discovery value bases prevailing as at the date of the contract to sell.

An opinion is requested as to the treatment for income tax purposes of the repossession of an oil and gas lease parted with under a contract to sell, title being retained by the vendor.

In April, 1919, the M Company, a Louisiana corporation, purchased for x dollars an oil and gas lease in Y Parish, Louisiana. The lease was for a term of 25 years and as much longer as oil or gas was produced from the property in paying quantities.

On July 1, 1919, the taxpayer discovered upon the property oil in paying quantities. A discovery value of $312x$ dollars was placed by it upon its rights and approved by the Income Tax Unit.

By a contract dated October 10, 1919, the taxpayer agreed to sell its leasehold to A for $1{,}872x$ dollars, the contract to sell and the assignment of the lease being deposited in escrow pending payment in full of the purchase price. The contract provided for a down payment of $312x$ dollars, for seven payments of $156x$ dollars each at 60-day intervals, and for a credit to the taxpayer of 40 per cent of the operator's seven-eighths of the oil produced until such credit should amount in the aggregate to $468x$ dollars. For the latter amount the taxpayer agreed to look solely to the oil to be produced under the lease. No personal liability therefor was to attach to the purchaser.

The purchaser went into possession as of October 1, 1919, and made the following payments under the contract:

	Dollars.	
1919.		
Cash payment	312x	
December 15 installment	156x	
Proceeds from oil	92x	
		560x
1920.		
February 15 installment	156x	
Proceeds from oil	20x	
		176x
		736x

On April 15, 1920, the purchaser defaulted in his payment then due. The taxpayer immediately declared the contract forfeited, repossessed itself of the property, and began operations on its own behalf.

The contract provided:

> Should second party fail or default in making the payment of any of said installments of 156x dollars upon the due date thereof, then and thereupon this contract shall immediately become ipso facto null and void and the payments previously made hereunder shall be immediately forfeited to first party as liquidated damages, and first party shall then and thereupon immediately take possession of said properties, free of any encumbrances on account of this contract.
>
> It is further agreed and understood that this is not an act of conveyance, but is merely a contract to sell and that the title to said property shall remain in the first party until each and all of the said installments hereinbefore described shall have been fully paid, at which time second party is to become the owner of said properties under the deeds and assignments hereinafter referred to * * *.

The specific questions presented are:

1. Upon repossession of the property (*a*) what income resulted to the taxpayer and (*b*) should the lease be carried by the taxpayer upon the basis of its original cost?

2. Should depletion after repossession be based upon cost or upon that portion of the discovery value which would have remained if the taxpayer's possession of the property had been uninterrupted?

The lease here agreed to be assigned was a personal contract creating rights strictly personal and giving to the lessee only the use of the property. (La. Civ. Code, art. 2669 (2639); *Hoffman* v. *Laurens*, 18 La., 70.) Any transactions with respect to the leasehold were governed by the rules of law applicable to other kinds of personal property. (I. T. 1362, C. B. I-1, 77.)

The taxpayer was not a regular dealer in personal property upon the installment plan within the meaning of the retroactive provisions of section 212(d) of the Revenue Act of 1926. Nor was there any warrant for returning the income from this casual transaction upon the installment basis. Payments made in 1919 pursuant to the terms of the contract aggregate 560x dollars, and that sum constituting the initial payment exceeded one-fourth of the 1,872x dollars purchase price stipulated. See section 212(d), Revenue Act of 1926.

On the other hand, the taxpayer's right under its contract to receive the balance of 1,312x dollars did not constitute an item of income taxable in 1919. The taxpayer was filing returns upon a cash receipts and disbursements basis. It received in 1919 nothing of value whatever as evidence of its contractual rights. No notes were exe-

cuted. No security was given. Personal liability even could never attach with respect to more than 35 per cent of the amount.

Neither the retroactive provisions of the Revenue Act of 1926 nor the regulations adopted thereunder provide expressly for the manner of determining income resulting from a casual sale of, or contract to sell, personal property when the initial payment exceeds one-fourth of the purchase price and when the deferred payments are not represented by obligations having a fair market value. This office is of the opinion that there should be applied to such a transaction by analogy the principle promulgated as part of article 46 of Regulations 69 with reference to real property.

Income resulting from the transaction here involved should be measured by the payments actually received by the taxpayer to the extent that such payments exceed the cost to the taxpayer of the property to be sold, and such income is returnable for the year in which such excess is received. (Art. 46, Reg. 69; O. D. 889, C. B. 4, 89.) Default by the purchaser and repossession of the property by the seller in such a case as this should be subjected to the same treatment as that prescribed by the regulations for use in the similar case of a contract to sell, default, and repossession of real property. Article 46, Regulations 69, provides in part as follows:

> If the vendor had retained title to the property and the purchaser defaults in any of his payments, and the vendor repossesses the property by agreement or process of law, the difference between (1) the entire amount of the payments actually received on the contract and retained by the vendor and (2) the sum of the profits previously returned as income in connection therewith and an amount representing proper adjustment for exhaustion, wear and tear, obsolescence, amortization and depletion of the property while in the hands of the purchaser, will constitute gain or loss, as the case may be, to the vendor for the year in which the property is repossessed, and the basis of the property in the hands of the vendor will be the original basis at the time of the sale. * * *

The ultimate purpose and effect of the contract here involved, and likewise of the rule embodied in the regulations, was to work a restoration, in so far as possible, of the former status of the parties, excepting alone the forfeiture of the payments. Upon default, the contract became null and void, the payments made were forfeited as liquidated damages, and the taxpayer repossessed itself of the property. No rights survived in favor of either party against the other. A change of property rights had been attempted, but the attempt had proven a failure.

The purchaser had been in possession, however, for a period of six months. During that period a large quantity of oil had been extracted. That was an extraction of the discovered wealth of the taxpayer by the party in possession and by virtue of the license and authority conferred upon him by his contract. Had the purchase of the leasehold been consummated, the purchaser would have been withdrawing his own oil. The purchase arrangements having fallen through short of consummation, however, the oil withdrawn was the property of the taxpayer-discoverer, and the payments made and forfeited on the contract were retained as liquidated damages and in part as compensation to the taxpayer for its oil withdrawn pursuant to its leave.

The taxpayer parted with its oil under a contract authorizing its extraction and has received payment therefor. In determining the amount of those payments which constitutes taxable income in the

year of repossession, the principle advanced by the regulations authorizes an offset measured by the sum of the profits previously returned as income in connection with the receipt of those payments plus an amount representing a proper adjustment for the depletion of its property while in the hands of the purchaser. The depletion adjustment in the instant case should be computed upon the basis of the taxpayer's discovery value for "the essence of these (depletion) provisions of the statute is that the owner of mineral deposits * * * shall * * * secure * * * the return of * * * the value of his property on the basic date. * * * The term 'basic date' indicates * * * the date of discovery, or within 30 days thereafter, in the case of discovery." (Art. 201, Reg. 45, Reg. 62, and Reg. 65.)

The records of the taxpayer should reflect the restoration of its property upon the bases prevailing as of October 10, 1919, for the purpose of depletion allowable in subsequent years and for the purpose of determining gain or loss resulting from a subsequent sale. The adjustment for exhaustion authorized by that part of article 46 of Regulations 69 quoted above will enter into the computation of later depletion allowances in accordance with article 203(a) of Regulations 45, 62, 65, and 69, and into the computation of gain or loss in accordance with article 1561, Regulations 45, 62, 65, and 69.

It is the opinion of this office, therefore, that there should be recognized as income to the taxpayer for the year of repossession the difference between the total amount of the payments received and retained under the contract of October 10, 1919, and the sum of the gains previously reported as income in connection therewith and an amount representing a proper adjustment for depletion based upon its discovery value; that the property repossessed should be taken up by the taxpayer in the year of repossession upon the cost and discovery value bases prevailing as of October 10, 1919; and that depletion subsequently allowable should be based upon the discovery value thus restored.

A. W. Gregg,
General Counsel, Bureau of Internal Revenue.

Article 46: Deferred-payment sales of real estate not on installment plan.

REVENUE ACTS OF 1916, 1917, 1918, AND 1921.

Treatment of the repossession of property, title to which the vendor transferred to the purchaser upon a deferred-payment sale other than on the installment plan. (See G. C. M. 880, page 45.)

Article 46: Deferred-payment sales of real estate not on installment plan.

REVENUE ACTS OF 1916, 1917, 1918, AND 1921.

Remission of unpaid interest by vendor on repossession of property. (See G. C. M. 888, page 46.)

ARTICLE 46: Deferred-payment sales of real estate not on installment plan. VI–11–3146 G. C. M. 1215

REVENUE ACT OF 1921.

Proper treatment, for income tax purposes, of a deferred-payment sale of real estate not on the installment plan and its subsequent repossession through foreclosure by the vendor's administrator.

An opinion is requested as to the proper treatment, for income tax purposes, of the sale and repossession of real estate under the circumstances set forth below.

It appears that the vendor sold a farm in the year 1920 for $32x$ dollars; that the purchaser paid $8x$ dollars in cash, assumed a first mortgage of $7x$ dollars, and gave the vendor a purchase money second mortgage obligation for the balance of $17x$ dollars; that the March 1, 1913, value of the farm sold was $16x$ dollars; that the second mortgage obligation did not have a fair market value; that no profit from the sale was returned as income by the vendor in 1920; that the vendor died in 1922, and that, as the interest on the mortgages was not paid, the administrator of the estate of the vendor foreclosed and repossessed the farm in the year 1923.

The solution of the issues involved depends largely on principles which may be classified into two groups: (1) The method provided for the handling of deferred-payment sales of real property not on the installment plan (and the sale involved in the instant case will be treated as such a sale in view of the fact that the vendor accorded that treatment to it) as set forth in article 46 of Regulations 69. (2) An administrator succeeds to the title of a decedent subject to the rights and liabilities which existed in respect thereof at the date of death. The character of such rights and liabilities is not changed by the transfer of title to the administrator, and it is his duty to proceed to settle the estate according to such rights and liabilities. The administrator is merely "the minister or dispenser of the goods" of the deceased. Schouler on Wills, Executors, and Administrators, volume 2, section 1242. So it was held in Solicitor's Memorandum 3256 (C. B. IV–1, 186) that interest and rent accrued prior to the date of the decedent's death constitute income to the estate upon the collection thereof by the administrator, where both the decedent and the estate report income on the cash receipts and disbursements basis. Thus the right which the decedent had to receive income was treated as continuing in the same character in the hands of the administrator. The fact that the value of such right to receive interest and rent, as of the date of death, was included in the decedent's gross estate for Federal estate tax purposes was held to be immaterial, inasmuch as the basis for the imposition of the Federal estate tax has no necessary relation to the basis of determining income for income tax purposes.

As the second mortgage obligation received by the vendor in 1920 did not have a fair market value, the $8x$ dollars cash received by him and the amount of the first mortgage assumed by the purchaser were properly applied to the reduction of the basis ($16x$ dollars) for determining gain or loss to him from the sale or disposition of the farm. Of the vendor's capital there was thus left unreturned to him x dollars, which amount represented his capital in the second mortgage obligation received from the purchaser.

The underlying principle of article 46 of Regulations 69 is that upon the repossession of property, title to which the vendor has actually transferred to the purchaser upon a deferred-payment sale other than on the installment plan, the repossession shall be treated as if there were an exchange by the vendor or his estate of the purchaser's obligations surrendered for the property repossessed, the gain or loss from the exchange being measured by the difference between the fair market value of the property repossessed and the basis in the hands of the vendor or his estate of the purchaser's obligations surrendered for the property.

In the usual case that basis will be the fair market value of the obligations at the time they were received by the vendor, and that is the case specifically covered by the language of the regulations. In other cases the only variation will be in the basis for determining gain or loss to the vendor of the purchaser's obligations, that basis being, in general, the amount of the vendor's capital represented by the obligations. In the instant case the basis of the purchaser's obligation surrendered by the vendor's estate to repossess the farm apparently was x dollars, the amount obtained by subtracting from the March 1, 1913, value ($16x$ dollars) of the farm the $8x$ dollars received by him in cash upon the sale and $7x$ dollars, the amount of the first mortgage assumed by the purchaser. When the vendor's estate repossessed the farm in 1922 it realized income measured by the excess of its fair market value (which, in the absence of clear and convincing proof to the contrary, must be presumed to be $17x$ dollars, the amount which it in effect offered for the property) over the basis to it (x dollars) of the purchaser's obligation surrendered for the property. Under this computation the profit derived by the vendor's estate upon the repossession of the farm in 1923 was $16x$ dollars. If the estate can satisfactorily prove that the fair market value of the farm at the time of its repossession was less than $17x$ dollars, the profit on the repossession will be correspondingly reduced. It will be noted that the basis of the purchaser's second mortgage obligation surrendered to obtain repossession of the farm is, in accordance with the principles above stated as to the status of the estate of a decedent, treated as having the same basis in the hands of the vendor's estate as in the hands of the vendor. In this connection see the case of *May McKinney et al., Executors of the Estate of Harry Nelson McKinney*, v. *United States*, decided May 3, 1926, certiorari denied by the Supreme Court October 26, 1926; also I. T. 2206 (C. B. IV–2, 63).

No consideration is given in the above opinion to the matter of unpaid interest, as the inquiry submitted does not indicate the facts as to unpaid interest except that it was a factor in the case. The treatment of claims for unpaid interest upon repossession of real property to be followed in cases such as the instant one is outlined in General Counsel's Memorandum 888 [see page 46].

A. W. GREGG,
General Counsel, Bureau of Internal Revenue.

SECTION 213(b).—GROSS INCOME DEFINED: EXCLUSIONS.

ARTICLE 73: Gifts and bequests.

REVENUE ACT OF 1913.

Appreciation realized by sale of stock received as a gift. (See T. D. 3974, page 182.)

ARTICLE 73: Gifts and bequests.

REVENUE ACTS OF 1913 AND 1916.

Amounts received under a will under the terms of which the residue was left in trust, the income to be paid to a designated person for life. (See T. D. 3975, page 185.)

ARTICLE 73: Gifts and bequests. VI–18–3216
(Also Section 204, Article 1601.) G. C. M. 1581

REVENUE ACT OF 1921.

A foreign corporation, at its own expense and pursuant to a contract with the taxpayer, erected on the latter's premises a demonstration plant and transferred it to the taxpayer in 1921 without cost.

Held, that the value of the plant acquired by the taxpayer did not constitute taxable income, and accordingly should not be added to the taxpayer's gross income in computing its net loss for 1921 under section 204 of the Revenue Act of 1921.

An opinion is requested on the following issue:

Whether or not the taxpayer's operating loss for 1921 should be reduced by the sum of 40x dollars representing the value of a manufacturing plant which a foreign corporation at its own expense and pursuant to a contract by its representative with the taxpayer dated February —, 1920, erected on the taxpayer's premises as a demonstration plant and thereafter transferred to the taxpayer in 1921 without cost.

On the ground that the value of the manufacturing plant constituted income to the taxpayer and that in the computation of a net loss under section 204 of the Revenue Act of 1921 all income must be taken into consideration, the Income Tax Unit proceeded to increase the taxpayer's 1921 gross income by 40x dollars (the value of the plant), thereby reducing by 40x dollars the net loss which the taxpayer could deduct from its net income for the succeeding taxable year, 1922. The taxpayer contends that it acquired the manufacturing plant as a gift and that the value thereof was not income to it (citing *Edwards* v. *Cuba Railroad Co.*, 268 U. S., 628, and appeal of Liberty Light & Power Co., 4 B. T. A., 155), and further that the value of gifts can not enter into a computation of net loss under section 204 of the Revenue Act of 1921.

This office is of the opinion that the taxpayer's contentions are sound, for the following reasons:

1. Section 204 of the Revenue Act of 1921, which by subdivision (b) authorizes a deduction from 1922 net income of the amount of a

1921 net loss sustained by a taxpayer, defines in subdivision (a) the term "net loss" to mean the excess of the deductions allowed by section 234 (business expenses, interest, taxes, etc.) over "the gross income of the taxpayer for the taxable year," plus certain other items which do not include the value of gifts and are not applicable in the present connection; and "gross income" for any taxable year is defined in section 213 of the 1921 Act as *not* including the "value of property acquired by gift," which item "shall be exempt from taxation."

From the foregoing it is apparent that the statute does not provide that the value of a gift shall be included in gross income in computing a net loss under section 204, but specifically excludes such item. Therefore, this point is resolved in favor of the taxpayer.

2. A copy of the contract dated February —, 1920, under which the taxpayer acquired the manufacturing plant in question, has been submitted, together with certain other data, in support of the contention of the taxpayer that it acquired the manufacturing plant as the result of a gift from the foreign corporation which erected the plant on the taxpayer's premises for demonstration purposes. If there was an advertising purpose as well, it was not mentioned in the contract and would not be sufficient under the circumstances of this case to change the character of the transaction.

The recital clauses of the contract in question show that in 1920 the foreign corporation (through its contractor as its respresentative) desired to introduce its plant into the United States and in connection therewith deemed it necessary—

> that there should be a demonstration or trial plant in the United States, to which prospective customers of the contractor or his assigns may be referred, in order to demonstrate to them practically the advantage of the system constructed by the contractor under conditions of actual industrial operation;

that it desired to construct such manufacturing plant at the plant of the taxpayer, and that "in order to induce the owner (taxpayer) to allow the use of its property and lend its cooperation for the purpose of such test and demonstration" it agreed to construct such plant "free of charge" to the owner (taxpayer).

The taxpayer permitted the construction of the manufacturing plant at its plant in accordance with the terms of the contract which provided that the plant should become the unincumbered property of the taxpayer (after test and acceptance) without the payment by the taxpayer of any money consideration, either principal or royalties. The taxpayer, however, was to provide the land, to furnish incidental equipment necessary for a test of the plant, to test the plant when completed, to accept the same (free of cost) if the test was satisfactory, and to permit the contractor or his assigns to refer prospective customers for plants of similar construction to the demonstration or trial plant in question, as contemplated by the clause quoted in the preceding paragraph.

The test was satisfactory, and the plant was accepted by the taxpayer under date of May —, 1921. The notice to this effect, a copy of which is attached to the copy of the contract, was signed by the taxpayer and the contractor. It acknowledged full and complete ownership of the taxpayer in, and conveyance by the contractor to

the taxpayer of, the plant, appurtenances, appliances, and right of operation—

subject only to the condition that the contractor shall in accordance with the terms of said agreement dated February —, 1920, have the right to resort to the same to demonstrate the advantage of such plant to other prospective customers of the contractor.

Article — of the contract provided that access should be granted by the owner to the contractor and prospective customers "at all reasonable times during the operation of said plant, including the test period," for the purpose of demonstrating the efficiency and satisfactory operation of the plant in every respect, and that "to that end the owner will afford them (the contractor and prospective customers) every reasonable facility free of charge," but the owner (taxpayer) was not specifically required by the contract to operate the plant after its test and acceptance. As a matter of accounting, the taxpayer charged "Plant account" $40x$ dollars and credited "Reserve for contingencies" $40x$ dollars.

That the acquisition of the plant under the foregoing circumstances constituted a gift is supported by the ruling of the United States Supreme Court in the case of *Edwards* v. *Cuba Railroad Co.*, supra, and the ruling of the United States Board of Tax Appeals in the appeal of the Liberty Light & Power Co., supra, acquiesced in by the Commissioner on November 30, 1926 [see page 4].

In the Cuba Railroad Co. case the Republic of Cuba granted the railroad company money and property subsidies, but as a condition thereto required it to agree to construct and operate a railroad system, to reduce fares, and to perform certain other services free of charge or at a reduced tariff. In the Liberty Light & Power Co. case certain prospective rural customers erected at their own expense through a contractor a transmission line for the purpose of transmitting electrical energy from the power plant of the company to their residences. Upon the completion of the line it became the property of the power company, but as a condition to the erection of the line the prospective consumers of electric current required the power company to agree to accept the line when completed, to make connection therewith, to afford continuous service, and to maintain the transmission line in proper condition without charge to the consumers. In each of the above cases, notwithstanding the conditions exacted by the grantors, the subsidies and the transmission line were held to be grants or capital to the grantees and not income within the meaning of the sixteenth amendment.

It is the opinion of this office that the property acquired in the instant case was as clearly a capital contribution or gift as was the property acquired in either of the cases cited, and therefore that the value of the property was not income to the taxpayer under the Revenue Act of 1921 and should not be added to the taxpayer's gross income for 1921 in computing its net loss for that year under section 204 of the Revenue Act of 1921.

A. W. Gregg,
General Counsel, Bureau of Internal Revenue.

ARTICLE 73: Gifts and bequests.

REVENUE ACT OF 1918.

Annuities received under a will under the terms of which parts of the corpus of the estate were apportioned as capital sums from which income in amounts sufficient to pay the annuities could be obtained. (See T. D. 4021, page 189.)

ARTICLE 88: Compensation of State officers and employees. VI-7-3095 T. D. 3969

INCOME TAX—REVENUE ACT OF 1917—DECISION OF COURT.

INCOME—SALARY—EXEMPTION—GOVERNMENTAL AGENCY.

The New York Society for Prevention of Cruelty to Children is not a State agency, but a private, philanthropic organization, and the salary of an officer is not exempt from taxation upon the ground that the society is a governmental agency of the State of New York or the salary is received by an officer or employee of the State.

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

To Collectors of Internal Revenue and Others Concerned:

The following decision of the United States District Court for the Southern District of New York in the case of *John D. Lindsay* v. *Bowers, Collector*, is published for the information of internal revenue officers and others concerned.

D. H. BLAIR,
Commissioner of Internal Revenue.

Approved February 4, 1927.

A. W. MELLON,
Secretary of the Treasury.

UNITED STATES DISTRICT COURT, SOUTHERN DISTRICT OF NEW YORK.

John D. Lindsay, plaintiff, v. *Frank K. Bowers, Collector of Internal Revenue, Second District of New York, defendant.*

[January 7, 1927.]

GODDARD, District Judge: This is a motion by defendant, the collector of internal revenue, for judgment upon the pleadings. The action was brought by the plaintiff to recover $1,041.09, composed of a tax of $743.60 with interest and penalty of $297.49, paid under protest for the year 1917 under the War Revenue Act of 1917 (Act October 3, 1917, chapter 63).

It appears that during the year 1917, the plaintiff, Mr. Lindsay, was the president of the New York Society for the Prevention of Cruelty to Children, and received as such president a salary of $5,000 per year; that this tax was imposed on his salary. The payment of the tax was protested on the ground that such salary was exempt income because received from a governmental agency of the State of New York, and therefore the salaries of its employees were exempt from Federal income taxation.

The New York Society for Prevention of Cruelty to Children was incorporated on April 26, 1875, under an act of the legislature of this State entitled "An act for the incorporation of societies for the prevention of cruelty to children," known as chapter 130 of the Laws of 1875, and its certificate of incor-

poration, after being approved, was duly filed with the secretary of state on April 27, 1875, since which time the society has carried on the business for which it was incorporated. The objects of the society, as stated in its certificate of incorporation, are as follows:

"The particular business and objects of this society are the prevention of cruelty to children and enforcement by all lawful means of the laws relating to or in any wise affecting children."

The society receives on commitment and subject to the order of the court children charged with the commission of crime in the county of New York, who otherwise would be sent to the city prison; children are also committed to it temporarily subject to the order of the court pending their commitment to some institution when, because of crime or other conditions, it is desirable to remove them from their homes. It maintains officers in various courts, who, upon order of the justice, investigate applications for the commitment of children and make written reports to the justices, and generally assist in the care of children and investigations of crimes and conditions in homes where children are involved. About one-half of the society's total income is contributed by the city of New York and the remainder by private donors. The president takes no oath of office; his salary, term, and duties are fixed by the directors of the society. In *People ex rel Board of Charities* v. *New York Soc. P. C. C.* (161 N. Y., 233) the court of appeals held that the society was a private philanthropic organization and not subject to visitation by the State board of charities. *In the matter of Moses* (138 A. D., 525), it was held that a bequest to a similar society, incorporated under the same act as was the New York Society for the Prevention of Cruelty to Children, was not exempt from the operation of the transfer tax law.

Mr. Lindsay's salary as president of the Society for Prevention of Cruelty to Children would be exempt income if he was an officer or employee of the State of New York, as the Revenue Act exempts the salary of such officer or employee. However, it must be and is conceded that Mr. Lindsay was not an officer or employee of the State of New York. (*United States* v. *Germaine*, 99 U. S., 508.) Mr. Lindsay's salary would also be exempt income if the society was a governmental instrumentality or agent of the State of New York and the taxation of his salary by the United States interfered with the exercise of sovereignty by the State of New York or impair the efficiency of such agency in a substantial manner. This, because the Constitution of the United States prohibits the Federal Government from imposing a tax upon the States or their agencies. (*Metcalf & Eddy* v. *Mitchell*, 269 U. S., 514 [T. D. 3824, C. B. V-1, 218].)

It seems to me that the Society for the Prevention of Cruelty to Children can not be regarded as a governmental agency or that a tax upon the salaries of its officers is an interference with the sovereignty of the State of New York to any appreciable or substantial manner. The character of the society is that of a private corporation, which, with the aid of funds from the city of New York and private donors, has devoted itself to the commendable task of assisting the State of New York in the enforcement of criminal laws relating to children and the care of them. The management of the affairs of the society is solely under the control of its directors; they alone had the power to employ Mr. Lindsay; to fix his term of office, duties, and salary. The society has rendered exceptional services to the community for many years by its efforts to have enforced laws for the prevention of cruelty to children and to further their welfare. Its ability to accomplish so much is due to the high character of its officers and members, and perhaps partly to the fact that it is an independent organization under the control of those who created it, or their successors, and who are devoted to its purposes. The State, appreciating the work carried on by the society, has given it certain powers and the city of New York has contributed toward its expenses. But it is not a State agency, and it is free from control by the State except in a general way.

It must be conceded that the salary of an officer of a private corporation, which performs service for the State by printing its laws and records and receiving an appropriation therefor, could not be held to be exempt income on the ground that such tax would be an interference with the exercise of sovereignty by the State or an impairment of the efficiency of such agency in a substantial manner, and it seems to me that there is little more reason to hold that the salary of an officer of this society is exempt income on that ground.

In *Metcalf & Eddy* v. *Mitchell*, supra, the Supreme Court held that the income received by consulting engineers, who were employed to advise States or subdivisions of States with reference to proposed water supply and sewage disposal systems, was taxable, and Mr. Justice Stone, in the opinion of the court, at page 524, stated:

"But here the tax is imposed on the income of one who is neither an officer nor an employee of government and whose only relation to it is that of contract under which there is an obligation to furnish service for practical purposes not unlike a contract to sell and deliver a commodity."

For the reasons stated above, the defendant's motion for judgment on the pleadings must be granted.

ARTICLE 88: Compensation of State officers and employees.

REVENUE ACTS OF 1918 AND 1921.

Compensation of bar pilots, San Francisco. (See G. C. M. 1706, page 54.)

ARTICLE 89: Additional exclusions from gross income under the Revenue Act of 1921.

REVENUE ACT OF 1921.

Amendment of article 89, Regulations 62, to include The Netherlands in the list of countries which satisfy the equivalent exemption requirement of section 213(b)8 of the Revenue Act of 1921. (See T. D. 4013, page 59.)

SECTION 214(a)1.—DEDUCTIONS ALLOWED: BUSINESS EXPENSES.

ARTICLE 101: Business expenses. (Also Section 215, Article 291.) VI–6–3084 T. D. 3964

INCOME TAX—REVENUE ACT OF 1918—DECISION OF COURT OF CLAIMS.

DEDUCTIONS—BUSINESS EXPENSE—LOSS—PERSONAL EXPENSE.

An amount paid for attorney's fees incurred in the defense of an action by a former partner for an accounting is not a business expense or loss within the meaning of section 214 of the Revenue Act of 1918 but is a personal expense within the meaning of section 215, and is therefore not deductible.

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

To Collectors of Internal Revenue and Others Concerned:

The following decision of the United States Court of Claims in the case of *Samuel J. Kornhauser* v. *The United States* is published for the information of internal revenue officers and others concerned.

D. H. BLAIR,
Commissioner of Internal Revenue.

Approved January 29, 1927.

A. W. MELLON,
Secretary of the Treasury.

COURT OF CLAIMS OF THE UNITED STATES.

Samuel J. Kornhauser v. *The United States.*

[November 16, 1926.]

Moss, Judge, rendered the opinion of the court.

It is alleged by plaintiff in his original petition that in his income-tax return for the calendar year 1918 he claimed as a deduction from his gross income for that year the sum of $10,000, being the amount paid by him for attorney's fees incurred in defending an action against himself for an accounting instituted by his former law partner, in which action it was charged that plaintiff had collected fees for professional services during the existence of the partnership in which his said law partner was entitled to share. The Commissioner of Internal Revenue refused to allow the deduction.

A demurrer was sustained to the original petition, and on plaintiff's motion the court vacated its judgment dismissing the petition and granted plaintiff leave to amend.

An amended petition was filed, which contains in addition to the matters alleged in the original petition the following language:

"1. * * * that the alleged fees in fact consisted of stock in the National Tool Co., which was acquired by this petitioner subsequent to the dissolution of said partnership and not in any manner in payment for legal services performed during the existence of said partnership."

The case is now submitted on demurrer to the amended petition and the question for determination is whether or not fees paid to an attorney for defending an action for an accounting instituted by a former law partner may be deducted by the taxpayer from his gross income in making his tax return.

Plaintiff contends that the expenditure is deductible, either as an ordinary and necessary expense in connection with his business under the provision of section 214(a) of the Revenue Act of 1918 (40 Stat., 1066), which allows deductions for "all ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business"; or else it is deductible as a loss under paragraph 4 of said section, which provides for deductions for "losses sustained during the taxable year and not compensated for by insurance or otherwise, if incurred in trade or business."

The expenditure in question is not an allowable deduction under either provision.

The payment of a fee for legal services under the conditions alleged in the original and the amended petitions is neither an ordinary nor necessary expense incurred in carrying on the trade or business, nor is it a loss sustained in trade or business in the meaning and intent of the statute.

It is a personal expense, and is controlled by section 215 of the same Act, which provides, "That in computing net income no deduction shall in any case be allowed in respect of—(*a*) Personal, living, or family expenses."

The amendment, which merely describes the character of the fee, does not in any manner affect the question of law as presented in the original petition.

The demurrer should be sustained and the petition and the amended petition should be dismissed. And it is so ordered.

ARTICLE 101: Business expenses. VI–15–3187
T. D. 4004

INCOME TAX—REVENUE ACTS OF 1916, 1917, AND 1918—DECISION OF COURT OF CLAIMS.

DEDUCTIONS—SALARIES.

Under section 12(a) of the Revenue Act of 1916 and section 234(a)1 of the Revenue Act of 1918, the Commissioner of Internal Revenue is charged with the duty to consider and determine the reasonableness of a deduction claimed for salaries.

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

To Collectors of Internal Revenue and Others Concerned:

The following decision of the United States Court of Claims in the case of *The Seinsheimer Paper Co.* v. *United States* is published for the information of internal revenue officers and others concerned.

C. R. NASH,
Acting Commissioner of Internal Revenue.

Approved March 29, 1927.

OGDEN L. MILLS,
Acting Secretary of the Treasury.

COURT OF CLAIMS OF THE UNITED STATES.

The Seinsheimer Paper Co. v. *The United States.*

[February 14, 1927.]

Moss, Judge, delivered the opinion of the court.

In its income-tax returns for the years 1917, 1918, and 1919 the plaintiff, the Seinsheimer Paper Co., deducted $75,000 for each of said years as total salaries paid to its three officers, $25,000 a year to each of them. The officers of plaintiff company consisted of the father and his two sons, who were the sole owners of the outstanding capital stock of the company and whose total salaries for the year 1916 and years prior thereto was $16,000.

The Commissioner of Internal Revenue in computing the net income of plaintiff disallowed as a deduction the sum of $75,000 per year as total salary, and allowed a total salary of $50,000 for each of the three years. As a result of the disallowance the Commissioner assessed additional income and profits taxes for the three years involved, amounting in the aggregate to $39,193.15, and this action is for the recovery of that sum.

Section 12(a), Act of 1916 (39 Stat., 756), provides as follows:

"In the case of a corporation * * * such net income shall be ascertained by deducting from the gross amount of its income received within the year from all sources—

"First. All the ordinary and necessary expenses paid within the year in the maintenance and operation of its business and properties * * *."

Under this statute, which is applicable to the 1917 taxes, salaries of officers were allowed as deductible items under proper Treasury regulations.

The Revenue Act of 1918, applicable to the taxes for 1918 and 1919, provides that in computing net income "all the ordinary and necessary expenses * * *, including a reasonable allowance for salaries, are deductible."

The ground upon which the Commissioner disallowed the deduction of $75,000 per year for salaries was that same was an unreasonable amount, and he allowed a deduction of $50,000 as being a reasonable sum for such salaries.

The sole question, therefore, is whether or not the $50,000 allowed as a deduction by the Commissioner constituted a reasonable salary.

The Commissioner of Internal Revenue under the law is charged with the duty of assessing the tax on net income, and in order to arrive at net income it is likewise his duty to consider and determine the question of proper allowable deductions.

It clearly appears from the record that in reaching his conclusion as to the reasonableness of the allowance made by him the Commissioner gave full consideration to all facts bearing upon the question; and in addition to the facts appearing in the record he considered also certain information contained in the files of his office concerning salaries allowed as deductions to officers of companies doing a similar business comparable in amount of invested capital and in volume of business.

The court is of the opinion that the evidence upon which the Commissioner determined that a total salary of $50,000 was reasonable was sufficient to justify such conclusion.

It is, therefore, the judgment of the court that plaintiff's petition should be and the same is hereby dismissed.

ARTICLE 105: Compensation for personal services. VI-4-3060
G. C. M. 941

REVENUE ACTS OF 1918 AND 1926.

Additional compensation reasonable in amount voted and paid by the taxpayer in its fiscal year 1918 to its president for services performed in 1917 and in prior years is deductible as an expense of the fiscal year 1918.

The ruling in Advisory Tax Board Memorandum 86 (C. B. 1, 106), that additional compensation voted and paid subsequent to close of the year in which the services were rendered is not deductible in any year, has been modified by the acquiescence of the Commissioner in decisions of the Board of Tax Appeals which hold contrary thereto.

The acquiescence of the Commissioner in a decision rendered by the Board of Tax Appeals is such a "final decision of another case by the Commissioner of Internal Revenue" as is referred to in Treasury Decision 3240 (C. B. 5, 313) and warrants the reopening of the claim for refund filed by the taxpayer, provided the facts upon which the claim is based are identical with the facts in the case decided by the Board.

An opinion is requested relative to the claim of the M Company that the amount of the additional compensation voted and paid in the fiscal year 1918 to its president for services rendered in prior years should be allowed as a deduction.

The company originally claimed the deduction in its return for the fiscal year ended June 30, 1917. The Unit, in a letter dated February —, 1924, disallowed the deduction for the year 1917, giving as authority Committee on Appeals and Review Recommendation 519 (C. B. 4, 134), quoting the digest of such ruling in Digest 19 (page 175), as follows:

The Committee recommends the disallowance of additional compensation claimed by a corporation as a deduction for 1917 where such additional compensation was not as a matter of fact authorized or paid until 1919 and that such additional compensation be allowed as a deduction under the heading of ordinary and necessary expenses in the taxpayer's return for the year 1919, in which year the payment was actually made.

The taxpayer construed the paragraph quoted from Committee on Appeals and Review Recommendation 519 to mean that the amount claimed in 1917 was deductible in 1918 and interpreted the action of the Unit in citing this ruling as an implied direction to claim the amount as a deduction in its return for the fiscal year 1918. Accordingly, the taxpayer revised its income for the fiscal year ended June 30, 1918, taking as a deduction the additional compensation of x dollars, and filed a claim for refund on March —, 1924, based on such revision. In a letter dated December —, 1924, the claim was rejected on authority of Advisory Tax Board Memorandum 86, the letter stating:

An examination in connection with the information at hand discloses that the salaries of x dollars for the fiscal year ended June 30, 1917, were voted on October 1, 1917, subsequent to the close of the fiscal year ended

June 30, 1917, and, in accordance with Advisory Tax Board Memorandum 86, are not an allowable deduction from gross income for the fiscal year ended June 30, 1918.

The taxpayer now requests that, under the provisions of I. T. 2110 (C. B. III–2, 287), the case be reopened and the claim considered on its merits, on the ground that it is materially affected by the final decisions rendered by the Board of Tax Appeals in the cases of C. H. Simonds Co. (1 B. T. A., 105) and Jamestown Worsted Mills (1 B. T. A., 659), the Commissioner having acquiesced in both of such decisions (C. B. IV–1, 2, 3).

The case is submitted to this office with the request that an opinion be rendered as to—

(1) Whether in view of the decisions of the Board cited the deduction claimed should be allowed;

(2) Whether the ruling laid down in Advisory Tax Board Memorandum 86 is to be considered modified to any extent by such Tax Board decisions and the acquiescence of the Commissioner;

(3) In case the item in question is considered an allowable deduction for the fiscal year 1918, in view of the decisions of the Board of Tax Appeals, whether the decisions of the Board of Tax Appeals are such final decisions as to warrant reopening the case for the allowance of the claim for refund under the ruling published as I. T. 2110.

Inasmuch as I. T. 2110, under which the taxpayer requests that its claim be reopened, repeats the regulations contained in Treasury Decision 3240 as to the reopening of cases finally closed, reference will be made to the Treasury decision instead of to I. T. 2110 in the following opinion.

Treasury Decision 3240 provides in part:

> Where any case in the Bureau of Internal Revenue has been finally closed * * *, the case will not be reopened except (1) where a showing is made of new and material facts, accompanied by an explanation, satisfactory to the Commissioner of Internal Revenue, of the failure to produce such facts prior to the closing of the case, or (2) *where the case is materially affected* by the change of regulations or *by the final decision of another case* either *by the Commissioner of Internal Revenue* or by a court of competent jurisdiction. [Italics supplied.]

It is the opinion of this office that the acquiescence of the Commissioner in a decision of the United States Board of Tax Appeals is such "a final decision of another case by the Commissioner of Internal Revenue" as is referred to in Treasury Decision 3240.

Before applying a precedent established by the acquiescence of the Commissioner in a decision rendered by the Board of Tax Appeals to other cases, it is necessary to determine whether the facts in the case under consideration are identical with the facts in the case decided by the Board. In the instant case the taxpayer cites the decisions rendered by the Board in the case of C. H. Simonds Co. and the Jamestown Worsted Mills, and contends that the latter case is almost exactly analogous to its case.

The material facts in the case of the Jamestown Worsted Mills are the authorization and payment in 1919 of additional salaries for prior years and the allowance of a deduction of the amount paid in the return for 1919. The material facts in the case under consideration are the authorization and payment in 1918 of compensation for 1917 and additional compensation for prior years and the contention

of the taxpayer that the amount is deductible in the return for 1918. The reasonableness of the amount is not in question in either case.

Other decisions of the Board of Tax Appeals involving the question have also held that additional salaries for services rendered in a prior year or years, voted and paid in the current year, are deductible expenses for the year in which voted and paid. Among such decisions are: Flint River Brick Co. (2 B. T. A., 31); Lihue Plantation Co. (2 B. T. A., 740 [this decision mentions T. B. M. 86]); Van de Kamps Holland Dutch Bakers (2 B. T. A., 1247); Arter Paint & Glass Co. (2 B. T. A., 1256); Washington Cadillac Co. (2 B. T. A., 844).

The Commissioner has acquiesced in all of these decisions. (C. B. IV–2, 2, and C. B. V–1, 4, 6, 1, 6.)

The facts in the Lihue Plantation Co. case, referred to above, in so far as they are pertinent to the question at issue, are that the board of directors on January 23, 1918, voted to set aside and pay a certain percentage of the profits of the company for 1917 to its employees as additional compensation for the year 1917, the date on which such additional compensation was to be paid being left to the discretion of the manager. Pursuant to this authorization, additional compensation was distributed in March, 1918, to the employees. This amount was included in the expenses of the corporation and claimed as a deduction in its 1918 income tax return. The Commissioner disallowed the item on the ground that bonus payments to employees based upon a percentage of net profits for 1917 but paid in 1918 are not allowable deductions in computing net income of the corporation for 1918 within the meaning of section 234(a)1 of the Revenue Act of 1918. The decision rendered contains the following statements:

> The position of the Commissioner apparently is, at least as respects the year here in question, that a bonus paid to employees who rendered services in a prior year, based upon profits and salaries of that year, is not "an ordinary and necessary expense" of a later year. The Commissioner in the deficiency letter states that his position is "fully covered in the Advisory Tax Board Memorandum 86, page 106 of Cumulative Bulletin No. 1." An examination of this memorandum of the Advisory Tax Board indicates that the case there presented was one in which the taxpayer was claiming the deduction for the year in which the services were rendered, or, applied to the instant case, the question was whether the compensation might be deducted not in the year 1918 but in the year 1917. The Advisory Tax Board held that this could not be done, upon the ground that the amounts were neither paid nor incurred during the earlier taxable year. At the conclusion of the memorandum the Advisory Tax Board also suggests that the amounts then in question might not be deductible in any year. This Board has held in appeal of C. H. Simonds Co. (1 B. T. A., 105) that so long as additional compensation paid within a year does not exceed a reasonable amount it may be deductible even though it is measured by services rendered and compensation received in prior years. That appeal appears to be on all fours with that of the instant taxpayer and fully sustains the deduction here in question for the year 1918. To the same effect are the appeal of Union Dry Goods Co. (1 B. T. A., 833) and appeal of Flint River Brick Co. (2 B. T. A., 31).

From the foregoing statements it is clear that the Board does not agree with that portion of Advisory Tax Board Memorandum 86 which holds that additional compensation voted and paid subsequent to the close of the year in which services were rendered is not deductible in any year. The Commissioner's acquiescence in the decision in Lihue Plantation Co. case should be interpreted as definitely

modifying Advisory Tax Board Memorandum 86, and that ruling should only be relied on as holding that additional compensation voted and paid subsequent to the close of the taxable year is not deductible in computing the net income of such taxable year.

Summarizing the foregoing conclusions and specifically answering the three inquiries submitted, it is the opinion of this office that—

(1) In view of the decisions of the Board of Tax Appeals cited by the taxpayer and of the other decisions of the Board involving the same question in which the Commissioner has acquiesced, the additional compensation voted and paid by the taxpayer in its fiscal year 1918 to its president for services performed in 1917 and in prior years is deductible as an expense of the fiscal year 1918;

(2) The ruling in Advisory Tax Board Memorandum 86 that additional compensation voted and paid subsequent to the close of the year in which the services were rendered is not deductible in any year has been modified by the acquiescence of the Commissioner in decisions of the Board of Tax Appeals which hold contrary thereto;

(3) The acquiescence of the Commissioner in a decision rendered by the Board of Tax Appeals is such a "final decision of another case by the Commissioner of Internal Revenue" as is referred to in Treasury Decision 3240 and warrants the reopening of the claim for refund filed by the taxpayer, provided the facts upon which the claim is based are identical with the facts in the case decided by the Board.

A. W. GREGG,
General Counsel, Bureau of Internal Revenue.

ARTICLE 111: When charges deductible. VI–24–3262
G. C. M. 1505

REVENUE ACT OF 1921.

Treatment of so-called "back royalties" paid to the Government pursuant to the terms of the relief provisions of the Leasing Act of 1920 (41 Stat., 437).

An opinion is requested as to the proper treatment of so-called "back royalties" paid to the Government pursuant to the terms of the so-called "relief provisions" of the Leasing Act of 1920 (41 Stat., 437).

The facts are as follows:

During the years 1910 to 1921 the M Company was operating certain oil properties, which properties were included within the scope of the Executive order of September 27, 1909, known as temporary petroleum withdrawal order No. 5. Suits to preserve the interest of the Government in the properties from exploitation were started at various dates from 1915 to 1919. Pending the outcome of the litigation a number of court orders were entered setting forth the methods under which the various properties were to be operated. Under the provisions of some of these orders the court appointed a commissioner to supervise operations, receive all oil or the proceeds of sales of oil, and in the event of receipt of proceeds from sales to deposit the same in a designated bank to the credit of the commissioner as trustee. In other instances the court refused to appoint a

commissioner, but instead ordered that the company should render statements to the Government, showing the amount of oil produced, to whom sold, the price received, cost of production, and other facts necessary to a complete accounting, should the Government eventually be successful in the litigation. In some instances the company and the Secretary of the Interior entered into agreements, under the terms of which the company was permitted to operate to a limited extent, but was required to place in escrow an amount equal to one-eighth of the current market value at the time of production of the oil and gas produced from such operations. These agreements further provided that should the company eventually be issued a patent to the lands in controversy the amounts deposited in escrow should be paid over to the company, but should the patent eventually be denied, the amounts so deposited should be paid over to the Treasurer of the United States, such payments to constitute full and complete payment, accord, and satisfaction of all claims of the United States against the company.

While this litigation was pending Congress passed the Leasing Act of 1920. This Act, among other things, permitted those claimants meeting certain qualifications to receive a lease upon the disputed lands, provided such claimants would file quitclaim deeds to the properties and there should be paid to the Government an amount equal to the value at the time of production of one-eighth of all the oil or gas already produced, except oil or gas used for production purposes on the claims or unavoidably lost. The taxpayer was able to meet the qualifications prescribed for applicants and accepted the terms of the leasing Act.

The amounts so paid to the Government in 1921 as a result of back production totaled $855x$ dollars. Of this sum, $406x$ dollars was paid in respect to production from the several properties during the period of litigation when income was impounded or otherwise required to be accounted for under various court orders. This sum is hereinafter referred to as the "impounded fund" and the period during which it was produced as the "impoundment period." The balance, $449x$ dollars, was paid in respect to production from the several properties from the commencement of operations to the beginning of the impoundment period. From the beginning of this period until 1918 the company reported all impounded funds as its income when earned, but beginning with 1918 it set up a suspense account to which this income was credited, and filed amended returns for prior years excluding from income the disputed funds. Income from the properties prior to the impoundment period was returned as income for the respective years in which it was received. In view of uncertainties with respect to proper adjustment of the matter the taxpayer has kept the case open by filing waivers for all years, beginning with the year 1909.

The exact procedure followed in disbursing the funds held by the trustee and in escrow upon the taxpayer's acceptance of the terms of the leasing Act does not appear. The leasing Act merely required a payment to the Government of a specified amount, based on back production. Where proceeds from back production with respect to certain leases were with the trustee or partly in escrow, satisfaction or part satisfaction of the obligation to the Government under

the terms of the leasing Act could undoubtedly have been made from these funds. Clearly, upon the company's acceptance of the terms of the leasing Act, the Government was not entitled to a part of the funds in the hands of the trustee and substantially all of the funds in escrow in addition to the amount specified in the leasing Act. The substance and effect of the transaction amounted to a release of the funds in the hands of the trustee and in escrow to the proper claimants, since this was one of the primary objects sought to be accomplished by the leasing Act.

Section 18 of the Leasing Act of 1920, under which the payment in question was made, provides:

> That upon relinquishment to the United States, filed in the General Land Office within six months after the approval of this Act, of all right, title, and interest claimed and possessed prior to July 3, 1910, and continuously since by the claimant or his predecessor in interest under the preexisting placer mining law to any oil or gas bearing land upon which there has been drilled one or more oil or gas wells to discovery embraced in the Executive order of withdrawal issued September 27, 1909, and not within any naval petroleum reserve, and upon payment as royalty to the United States of an amount equal to the value at the time of production of one-eighth of all the oil and gas already produced except oil or gas used for production purposes on the claim, or unavoidably lost, from such land, the claimant, or his successor, if in possession of such land, undisputed by any other claimant prior to July 1, 1919, shall be entitled to a lease thereon from the United States for a period of 20 years, at a royalty of not less than 12½ per centum of all the oil or gas produced except oil or gas used for production purposes on the claim, or unavoidable lost: * * *.
>
> All such leases shall be made and the amount of royalty to be paid for oil and gas produced, except oil or gas used for production purposes on the claim, or unavoidably lost, after the execution of such lease shall be fixed by the Secretary of the Interior under appropriate rules and regulations. * * * (41 Stat., 437, 443, 444.)

It will be observed that the Act provides that "upon payment *as royalty* to the United States of an amount equal to the value at the time of production of one-eighth of all the oil or gas already produced," etc., the claimant shall be entitled to a lease from the United States for a period of 20 years at "*a royalty*" of not less than 12½ per centum, the exact amount of the royalty to be determined by the Secretary of the Interior under appropriate regulations. "Royalty" as defined by Bouvier (Bouvier's Law Dictionary, 3d Revision) is "a payment reserved by the grantor of a patent, mining lease, etc., and payable proportionately to the use made of such right." The payment required by the section of the Act quoted was proportionate to the use made of the properties in past years and is declared by the Act to be made *as royalty*. Royalty is not ordinarily used to designate a bonus or a part of the purchase price of any transaction and in the absence of an intent clearly contrary to the express language used in the Act should not be given this meaning.

Section 18 was enacted to remedy a situation existing from the date of the withdrawal order of 1909, because of doubts as to the validity of such order, which were intensified by reason of the saving clauses of the Act of June 25, 1910 (36 Stat., 847). (See report of the Committee on Public Lands of the House of Representatives accompanying the bill enacted as the Leasing Act of 1920.) A great amount of litigation had arisen and the decisions of the courts were not harmonious. A history of that situation and the accompanying

litigation may be found in Law Opinion 1110 (C. B. II–1, 104), in which the following conclusion was reached:

> It will be noted from the excerpt from the committee report set forth above that section 18 was designed to settle the disputes between the Government and the oil claimants, and while in terms not a compromise measure, had many of the earmarks of one. The oil claimants desiring to come within this section of the Act were required to relinquish to the United States all the right title, and interest possessed by them under the preexisting placer mining laws to the lands in controversy and pay to the United States as royalty the amount named in the Act. The claimants were to receive a lease to the land and all the profits theretofore made by the operation of the properties, other than the one-eighth royalty, turned over to the Government. The substantial effect of this settlement was to treat the oil claimants as if they had been operating under a lease from the Government from the beginning.

This conclusion is considered equally applicable to the case now under consideration. There is not any suggestion in the law opinion that the back royalties paid to the Government upon acceptance of the terms of the leasing Act were in effect bonus payments by the claimants as consideration for future leases. As a result of the litigation, title to land and income therefrom was in dispute. The Leasing Act of 1920 provided a means whereby this income could be released partly to the Government and partly to the claimants. If the claimants had not seen fit to accept the provisions of the Act, they could have continued to prosecute their claims for patents to the lands and if successful would not have been required to pay future royalties. They also could have forfeited all their rights in the matter had they so desired. Where claimants did accept the provisions of the leasing Act, all uncertainties were, as stated in Law Opinion 1110, in effect compromised, and by the terms of compromise the claimants were treated as if they had been operating under a lease from the beginning.

Viewing the settlement in 1921 as a compromise, the cases of Brighton Mills (1 B. T. A., 392) and New Process Cork Co. (3 B. T. A., 1339) are considered applicable to the matter. These decisions held that a payment in compromise of liability does not relate back to the incidence of liability or commencement of litigation, but is deductible from taxable income in the year of payment or when liability therefor is actually admitted. Clearly in the present case there was no admission of liability for back royalties prior to acceptance in 1921 of the terms of the Leasing Act of 1920.

If the matter is considered from the other angle suggested in Law Opinion 1110, namely, that Congress treated the claimants as if they had been operating under a lease from the beginning, the same conclusion is reached as in the foregoing paragraph, but for other reasons. Under this view of the case, there was a payment in 1921 of royalties covering prior years' operations, and the question involved is whether such royalties should have been accrued and deducted in those years or whether they were a proper expense for the year 1921, in which year admission of liability and payment occurred.

Article 111, Regulations 62, so far as applicable, provides:

> Each year's return, so far as practicable, both as to gross income and deductions therefrom, should be complete in itself, and taxpayers are expected to make every reasonable effort to ascertain the facts necessary to make a correct return. * * * The expenses, liabilities, or deficit of one year can not be used to reduce the income of a subsequent year. * * * A taxpayer has the

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

This article of the regulations raises a further question of whether the royalties paid in 1921 were "authorized" deductions in prior years. The Bureau has never permitted the deduction of a liability in expectancy merely because it may materialize into an actual liability upon the happening of some contingency, but instead has held that before there can be an accrual and deduction the liability must be admitted, although in this connection it has been conceded that uncertainty as to amount of liability will not necessarily bar a deduction. (See A. R. R. 275, C. B. 3, 147.)

In the appeal of C. H. Simonds Co. (1 B. T. A., 105) and Jamestown Worsted Mills (1 B. T. A., 659), the issue involved was whether additional officers' salaries were deductible for the years in which authorized and paid, although the payments were intended to cover prior years' services. This concerned an interpretation of section 234(a)1 of the Revenue Act of 1918, which is identical with the same section of the Revenue Act of 1921 involved in the present case. The Board held that since there was no fixed obligation to pay the salaries in prior years, liability therefor did not arise until the years of authorization and payment, in which year the deduction should be taken. A digest of other decisions of the Board concerning the same principle may be found in General Counsel's Memorandum 941 [see page 205].

In the present case there was clearly no liability for payment of royalties on back production in the respective years of production, notwithstanding the fact that certain sums had then been impounded and others were required to be accounted for. The liability did not arise until acceptance of the terms of the Leasing Act of 1920, which occurred in the case of the taxpayer in 1921. Prior to that time the royalties were not "authorized" deductions under the foregoing rulings.

In view of the foregoing, this office has reached the following conclusions:

(1) Under the express language and apparent intent of the Leasing Act of 1920, the $855x$ dollars paid, or in part released, to the Government in 1921 was in satisfaction of a royalty for past production, by way of compromise, and was not a payment, or a release, in the nature of a bonus for a future lease, which should be capitalized. The interpretation of the meaning and intent of the Leasing Act of 1920, as found in Law Opinion 1110, supra, is considered controlling in this respect.

(2) The $855x$ dollars is divisible into two parts, namely, $406x$ dollars attributable to the impoundment period and $449x$ dollars attributable to the period prior to the impoundment period. The $406x$ dollars item is further divisible into three parts, namely, (*a*) that part held by the commissioner appointed by the court as trustee, (*b*) that part pertaining to properties which the court permitted the company to operate under the condition that the company would be required to account for proceeds of operations should the eventual result of the litigation make this necessary, and (*c*) that part per-

taining to properties operated under agreements with the Secretary of the Interior, which agreements required that one-eighth of the current market values of the oil or gas at the time of production be placed in escrow. The parts will be considered in the order named.

(*a*) Upon acceptance by the taxpayer in 1921 of the terms of the Leasing Act of 1920, the fund held by the commissioner as trustee was released partly to the company and partly to the Government. The company had no control over this fund, and could not have known until termination of the litigation by compromise or otherwise that it would receive any part thereof. It was not until acceptance of the terms of the leasing Act in 1921 that the company became entitled to a part of this fund. The company is accordingly taxable on the amount it received in that year. (See S. M. 1315, C. B. 2, 82.) The part released to the Government would not be taxable to the company in any year.

(*b*) This is practically the converse of the immediately preceding situation, where the funds were impounded by order of the court and never came into possession and use of the company until 1921. With respect to the present class of operations, the company was permitted to receive and use all of the proceeds derived from the sales of this particular oil or gas. The company may have been required later to pay over to the Government an amount equivalent to part or all of such proceeds, but in the meantime it enjoyed the use of the same. Proceeds derived from these operations are properly taxable in the respective years in which received. Liability for payment to the Government of an amount equal to approximately one-eighth of the value of the oil or gas at the time of production did not arise until 1921, when the terms of the leasing Act were accepted. Under the decisions of the Board of Tax Appeals, supra, the payment is properly deductible in 1921.

(*c*) With respect to the operation of the properties under agreements made with the Secretary of the Interior prior to the Leasing Act of 1920, it was known at the time of these agreements that the maximum liability of the company would not exceed the amount required to be deposited in escrow. The balance was clearly income to the company in the respective years in which received. The amount or approximate amount placed in escrow was eventually released to the Government in 1921. The amount so released to the Government would not be taxable to the company in any year. It is possible that the company may have received a small portion of the fund in escrow, due to slightly different requirements of the leases with the Secretary of the Interior made prior and subsequent to the Leasing Act of 1920. If the company received any part of the fund placed in escrow, it would be taxable on such part in the year in which received, for reasons previously stated under (*a*), supra.

The 449*x* dollars item attributable to the period prior to the impoundment period should be treated the same as item (*b*), supra. The company had the unrestricted use of this money and properly returned the same as income in the respective years in which received. It was never judicially determined, because of defective title to the land or otherwise, that this amount did not at all times properly

belong to the company. Upon acceptance of the terms of the leasing Act in 1921 the company was required to pay a royalty for the use of this property in prior years, but this liability did not arise until 1921. Under the Board's decisions, supra, the deduction properly belongs in 1921.

A. W. GREGG,
General Counsel, Bureau of Internal Revenue.

ARTICLE 111: When charges deductible. VI-24-3270
T. D. 4020

INCOME TAX—REVENUE ACT OF 1918—DECISION OF COURT.

1. DEDUCTIONS—ACCRUAL BASIS—JUDGMENTS.
The amount of a judgment for commissions entered against a taxpayer in 1919 was not a proper deduction from gross income for that year where the taxpayer's accounts were kept on the accrual basis and where an appeal was prosecuted and the judgment was affirmed by the appellate court in a later year.

2. DECISION DISTINGUISHED.
Becker Bros. v. *United States* (7 Fed. (2d), 3).

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

To Collectors of Internal Revenue and Others Concerned:

The following decision of the United States District Court for the Southern District of New York, in the case of *Consolidated Tea Co., Inc.*, v. *Bowers, Collector*, is published for the information of internal revenue officers and others concerned.

C. R. NASH,
Acting Commissioner of Internal Revenue.

Approved June 7, 1927.
A. W. MELLON,
Secretary of the Treasury.

UNITED STATES DISTRICT COURT, SOUTHERN DISTRICT OF NEW YORK.

Consolidated Tea Co., Inc., v. *Bowers, Collector.*

[January 25, 1927.]

GODDARD, District Judge: The plaintiff, the Consolidated Tea Co., Inc., has brought this action to recover the sum of $1,572.21 (with interest) alleged to have been wrongfully collected by Frank K. Bowers, collector of internal revenue, as taxes for the year 1919 and paid under protest by plaintiff. The case came on for trial before the court and a jury of one, and now, at the conclusion of the evidence, plaintiff and defendant respectively move for a direction of a verdict in their favor.

The facts, in so far as they are material, are as follows: On December 15, 1919, a suit which previously had been brought against the Consolidated Tea Co., Inc., to recover for commissions, was tried in the New York Supreme Court and a judgment of $10,012.57 entered against it. The Tea company appealed from this judgment, filing the usual bond on appeal. In January, 1921, the judgment was affirmed by the appellate court, and the plaintiff paid the judgment with interest and cost. The plaintiff, on December 31, 1919, set up

on its books a reserve for a judgment of $10.002 and a like debit to profit and loss account. When rendering its Federal income tax return for the year 1919, the Consolidated Tea Co., Inc., claimed as a deduction the amount of the judgment of $10,012.57 which had been entered against it during that year. The collector of internal revenue disallowed this item as a deduction in 1919, but allowed it as a deduction for the year 1921. Inasmuch as the tax rate for 1921 was less than that of 1919, plaintiff, the Tea company, was compelled to pay an additional amount of $1.572.21, which it seeks to get back with interest. Plaintiff contends that it kept its books on accrual basis, rendered its tax return accordingly, and was entitled to deduct the amount of the judgment in 1919. The collector of internal revenue urges that the Tea company kept its books and rendered its return on a cash basis, and bases its contention chiefly on the ground that question 17 of the return is as follows: "Is this return made on the basis of actual receipts and disbursements?" Which was answered "Yes," and which question is followed by—"If not, describe fully what other basis or method was used in computing that income." To this question or instruction plaintiff made no reply. But, with the exception of two minor items amounting to approximately $20 each for interest and insurance, it appears that the books were kept and the return rendered on an accrual basis, for its sales were set up by "accounts receivable" and its purchases by "accounts payable." The answers at the end of the return are merely informatory; they do not change the facts. At the most, they might be regarded as an intention by the one who prepared the report to have it on a cash basis. However, after hearing the witness and examining the books and returns, it is evident that such answers were made in error and I regard it as a clearly demonstrated fact that the plaintiff's books and income return were on an accrual basis. Moreover, it set up inventories both at the beginning and at the end of the year. And pursuant to due authority, the collector of internal revenue has promulgated Regulations No. 45, relating to the 1918 Revenue Act. Under the heading "Bases of computation," article 23 provided that—

"In any case in which it is necessary to use an inventory no accounting in regard to purchases and sales will correctly reflect income except an accrual method."

The question in this case is whether the judgment rendered against the Tea company in 1919 appealed and paid on affirmance in 1921 is deductible in 1919 where the Tea company has kept its books and filed its return on an accrual basis. The pertinent sections of the Revenue Act of 1918 (40 Stat., 1057) are:

"SEC. 232. That in the case of a corporation subject to the tax imposed by section 230 the term 'net income' means the gross income as defined in section 233, less the deductions allowed by section 234, and the net income shall be computed on the same basis as is provided in subdivision (b) of section 212 or in section 226.

* * * * * * *

"SEC. 213. (b) The net income shall be computed upon the basis of the taxpayer's annual accounting period (fiscal year or calendar year, as the case may be) in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; but if no such method of accounting has been so employed, or if the method employed does not clearly reflect the income, the computation shall be made upon such basis and in such manner as in the opinion of the Commissioner does clearly reflect the income. If the taxpayer's annual accounting period is other than a fiscal year as defined in section 200 or if the taxpayer has no annual accounting period or does not keep books, the net income shall be computed on the basis of the calendar year.

* * * * * * *

"SEC. 234. (a) That in computing the net income of a corporation subject to the tax imposed by section 230 there shall be allowed as deductions:

* * * * * * *

"(4) Losses sustained during the taxable year and not compensated for by insurance or otherwise;

* * * * * * *

"The term 'paid,' for the purpose of the deductions and credits under this title, means 'paid or accrued' or 'paid or incurred,' and the terms 'paid or incurred' and 'paid or accrued,' shall be construed according to the method of

accounting upon the basis of which the net income is computed under section 212."

In the case of *Malleable Iron Range Co.* v. *United States*—"No. D–510," decided June 14, 1926, by the Court of Claims of the United States [T. D. 3909, C. B. V–2, 166], and in the appeal of Lane Construction Co. (B. T. A. Decision No. 1705, 11 C. C. H. (1926), 3208), where similar questions were involved, it was held by the Court of Claims and Board of Tax Appeals, respectively, that a judgment which is appealed is a proper deduction for the year in which it is affirmed and paid. In *Becker Bros.* v. *United States* (7 Fed. (2nd), 3) the circuit court of appeals held that a judgment which had been rendered in 1914, affirmed and paid in 1916, should have been deducted from 1914 income, but Judge Rogers, writing for the court, apparently bases the decision upon the ground that "a deposit sufficiently large to pay the judgment had been deposited in escrow with a trust company in 1914 to await the result of the appeal. * * * That the defendant had in 1914 set aside that sum and parted with its control of that amount to pay the judgment rendered against it in that year."

In the case at bar, the Consolidated Tea Co., Inc., did not part with the control of the money in 1919; it had the use of it until 1921, when the judgment was affirmed and paid.

Since the suit is to recover a refund, the burden is upon the plaintiff to prove that the deduction it sought to make was a valid one and that the tax collected was invalid. (*United States* v. *Anderson, etc.*, 269 U. S., 422 [T. D. 3839, C. B. V–1, 179].) To entitle the plaintiff to deduct it must bring the loss within "losses sustained during the taxable year" section 234(4). Plaintiff has not shown that this was actually or constructively so.

It seems to me that the time of the mere rendering of a judgment is not the controlling factor in determining when a loss is sustained. It has no particular significance in this case. From all that appears in the record the services may have been rendered or the damage occurred upon which the judgment was founded prior to 1919; in fact, it was conceded upon the argument of the motion to dismiss that the action against the Tea company had been pending for some two years before it was reached for trial in 1919, and further it does not appear that the claim in the action against the Tea company was an unliquidated one.

From a tax income standpoint, both logical and practical reasons seem to me to support the conclusion that a loss should be deductible not in the year when the judgment was rendered but in the year when the claim was adjudicated to be final and definite, or possibly, under certain circumstances, in the year when the claim originated.

In its appeal from the judgment, the Tea company was denying that the claim against it was valid and that the judgment was anything more than a step toward the final determination of the claim, and that the company itself did not regard the claim as a fixed definite obligation until the judgment was affirmed by the appellate court.

The plaintiff, the Consolidated Tea Co., Inc., sues to recover a portion of the tax it was compelled to pay for the year 1919, and it bases this right to a refund on the ground that the amount of the judgment rendered against it in 1919 was a proper deduction for that year, and while it is not necessary in deciding this case, and is probably inadvisable with the present record to determine whether the loss in question may have been deductible at the time the services were rendered or the damage occurred upon which the judgment against the Tea company was founded, or was deductible when the judgment was affirmed and paid, I think it is clear that it was not deductible in 1919, and accordingly a verdict is directed in favor of the defendant.

ARTICLE 111: When charges deductible.

REVENUE ACT OF 1917.

Final judgment in 192– compelling accounting to another for profits earned in 1917. (See G. C. M. 1582, page 171.)

SECTION 214(a)4, 5, 6.—DEDUCTIONS ALLOWED: LOSSES.

ARTICLE 141: Losses. VI-7-3096
T. D. 3966

INCOME TAX—REVENUE ACT OF 1918—DECISION OF COURT.

DEDUCTIONS—LOSSES—SALE—RESIDENCE.

A loss sustained upon the sale of a residence is not deductible under section 214(a)5 of the Revenue Act of 1918, because it is not a transaction entered into for profit within the meaning of the statute.

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

To Collectors of Internal Revenue and Others Concerned:

The following decision of the United States District Court for the Western District of Pennsylvania in the case of *James R. Tindle and The Union Trust Co. of Pittsburgh, Coexecutors of the Last Will and Testament of Philander C. Knox, deceased,* v. *Heiner, Collector of Internal Revenue*, is published for the information of internal revenue officers and others concerned.

D. H. BLAIR,
Commissioner of Internal Revenue.

Approved February 4, 1927.

A. W. MELLON,
Secretary of the Treasury.

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DISTRICT COURT OF THE UNITED STATES FOR THE WESTERN DISTRICT OF PENNSYLVANIA.

James R. Tindle and the Union Trust Co. of Pittsburgh, Coexecutors of the Last Will and Testament of Philander C. Knox, deceased, plaintiffs, v. *D. B. Heiner, Collector of United States Internal Revenue for the Twenty-third District of Pennsylvania, defendant.*

[November, 1926.]

OPINION.

THOMSON, J.: This is an action brought by the executors of the will of Philander C. Knox, deceased, against the collector of internal revenue of this district to recover additional tax for the year 1920, the amount of which was assessed by the Government, and paid by the decedent under protest.

The facts in the case are briefly these:

Senator Knox, decedent, built in about the year 1887 a residence in the city of Pittsburgh, at a cost of approximately $172,000. The building was occupied by Mr. Knox as his residence from the time it was built until 1901, when he was elected to the United States Senate. At that time the Senator moved his residence to the Schenley Hotel, Pittsburgh, from which residence he voted until the time of his death in 1921. From 1901 until 1920 he leased the property to various tenants, and in 1920 sold it to one James H. Hammett for the sum of $73,706.79.

The plaintiffs contend that the property was worth in the neighborhood of $120,000 on March 1, 1913, and claim as a loss the difference between that sum and the amount for which it was sold in 1920, and seek to deduct that amount from the income of the taxpayer for the year 1920 under section

214(a)5 of the Revenue Act of 1918. This particular section of the law reads as follows:

"That in computing net income there shall be allowed as deductions:

"5. Losses sustained during the taxable year and not compensated for by insurance or otherwise, *if incurred in any transaction entered into for profit*, though not connected with the trade or business."

The defendant's contention is that the purchase of the property by a taxpayer for his residence is not a transaction entered into for profit under the Revenue Acts. He also contends that the property had the same value in 1913 that it had in 1920, at the time of its sale, and that hence no deductible loss in any case was sustained by the taxpayer.

The evidence justifies the finding which I now make, that the fair value of the property as of March 1, 1913, was $120,000, and if the loss in the sale is a deductible loss under the section of the Revenue Act above recited, the difference between that value and the price at which the property sold would represent that loss. We are, therefore, confronted with the question of the proper interpretation of the law in question under the facts as they are conceded to be. The provisions of section 5 are also contained in the Revenue Acts of 1921, 1924, and 1926. Regulations 45, as promulgated April 17, 1919, provided as follows:

"ART. 141. *Losses.*—* * * A loss in the sale of an individual's residence is not deductible."

This regulation was amended on January 28, 1921, to read as follows:

"ART. 141. *Losses.*—* * * A loss in the sale of residential property is not deductible unless the property was purchased or constructed by the taxpayer with a view to its subsequent sale for pecuniary profit."

This same provision is contained in Regulations 62, under the Revenue Act of 1921, and in Regulations 65, under the Revenue Act of 1924.

The question is, Is the purchase of property by a taxpayer for his residence a transaction entered into for profit? If not, where the taxpayer ceases to use the property as his residence and leases it to another as a residence, is the status changed, making the renting of the property a new transaction entered into for profit?

In the Solicitor's Law Opinion 780 (C. B. 1, 117) it is said:

"The expression 'transaction entered into for profit' clearly means a complete business venture from inception to conclusion. The deduction allowed is for losses sustained in any transaction '*entered into*' for profit. The intent to make a profit must have existed at the commencement of the enterprise or the right to deduct losses incurred is not within the contemplation of the statute. To construe the words 'transaction entered into for profit' as referring only to the conclusion of the venture—that is, the sale of the property—would result in a practical nullification of the statute. * * *

"Whether a loss incurred in the sale of residential property is deductible in arriving at net income must be determined by the object or intent of the individual in buying or constructing the property."

The provision of the law under which the plaintiff claims was not in any Revenue Act prior to 1918, but has been in all the Revenue Acts from 1918 to and including the Act of 1926. Except in one appeal before the Board of Tax Appeals no case is reported in the courts interpreting this provision. In the case of the appeal of John J. Madden (2 U. S. Board of Tax Appeals, page 702), decided on September 30, 1925, the Board held that the building of a house to meet the taxpayer's requirements for a home was not a transaction entered into for profit. In Office Decision 1148 (C. B. 5, 141) it is said:

"It is held that if a loss is deductible at all it is deductible under section 214(a)5 of the Revenue Act of 1918 as a loss sustained in a transaction entered into for profit. However, the mere renting of property purchased without the intention at the time of purchase of making a pecuniary profit thereon does not constitute a 'transaction entered into for profit' within the meaning of the statute, and as the taxpayer in the instant case purchased the property for a home, it was not his intention at the time to subsequently sell it for profit. It is therefore held that any loss sustained is not deductible for the purposes of the Revenue Act of 1918."

Ever since the Act of 1918 was passed the regulations have provided that a loss in the sale of property purchased by a taxpayer for his residence is not a loss in a transaction entered into for profit. The original Regulations 45 pro-

vided that a loss in the sale of an individual's residence is not deductible. The amendment of January 28, 1921, provided that a loss on the sale of the residential property is not deductible unless the property was purchased or constructed by the taxpayer with a view to its subsequent sale for pecuniary profit. The one is an amendment of the other and can scarcely be said to have effected any material change. Both relate to the beginning of the transaction, viz, the purchase or construction of the property in question.

The decisions of the Department have been uniform and all have held the loss in such cases not a deductible loss. The reenactment of the law year after year without change must be taken as an indication not only to continue in force the existing law but to adopt the practice of the Department in interpreting and applying it. It was said in *United States* v. *Anderson* (46 Sup. Ct., 131 [T. D. 3839, C. B. V–1, 179]):

"By thus adopting, without material change, the corresponding provisions of earlier Acts, Congress might have been deemed to have recognized and adopted the established practice of the Department interpreting and applying them. (*National Lead Co.* v. *United States*, 252 U. S., 140.)"

See also *Provost* v. *United States* (46 Sup. Ct., 152 [T. D. 3811, C. B. V–1, 417]).

The issuing of regulations by the Secretary of the Treasury is subsequently made his duty by the Revenue Act of 1918 and other Revenue Acts, and the Supreme Court has held that it is settled by the decisions of that court that a regulation by a department of Government, addressed to and reasonably adapted to the enforcement of an Act of Congress, the administration of which is confided to such department, has the force and effect of law if it be not in conflict with express statutory provision. *United States* v. *Grimaud* (220 U. S., 506) and many other cases.

It appears to me that the rulings of the Department are in harmony with the provisions of the law. The transaction in question is one which began with the purchase and ended with the sale. The transaction was the ownership of the property and was ended when the property was sold. It can not be fairly said that this was entered into for profit, but was entered into for the purpose of providing a home for the taxpayer. The transaction which was begun by the leasing of the property ended when the lease was ended, and it is not suggested that this was a loss. This is true of each succeeding lease. The transaction which was ended by the sale of the property seems clearly to have been the one which was begun by its purchase.

I am, therefore, compelled to hold that the plaintiffs' position that the loss claimed by the decedent as a deduction from taxable income under section 214(a) of the Revenue Act of 1918 can not be sustained. It appears, however, that in June, 1925, the plaintiffs filed with the defendant as collector of internal revenue a claim for refund of the amount of taxes which had been paid under protest, which claim was denied except as to the amount of $4,863.04, which sum was allowed, but has not in fact been paid by the Government. The allowance of this claim is conceded by the defendant in the affidavit of defense filed.

Plaintiff is, therefore, entitled to judgment in this action in the sum of $4,863.04, with interest from the date of payment thereof, to wit, from February 2, 1925.

Judgment may, therefore, be entered accordingly.

ARTICLE 141: Losses.

VI–24–3263
G. C. M. 1802

REVENUE ACT OF 1918.

The Circuit Court of Appeals, Second Circuit, in the case of *Shearer* v. *Anderson* (16 Fed. (2d) 995 [T. D. 3860, C. B. V–1, 239]), held that a loss resulting from damage to an automobile maintained for personal use while in the unauthorized possession of the taxpayer's chauffeur, and attributed to its overturning while being driven over an icy road and to the subsequent freezing of the motor, arose from a casualty which would be embraced within the term "other casualty" as used in section 214(a)6 of Revenue Act of 1918.

It is recommended that Office Decision 629 (C. B. 3, 158) and Office Decision 857 (C. B. 4, 160) be revoked in so far as inconsistent with the decision in the case above mentioned.

Office Decision 629 and the last sentence of Office Decision 857 are in conflict with the decision of the Circuit Court of Appeals, Second Circuit, rendered on January 10, 1927, in the case of *Shearer* v. *Anderson*, in which case the Solicitor General advises that no petition for a writ of certiorari will be filed. It therefore appears advisable that the Bureau acquiesce in the court's decision. The issue involved is the deductibility of a loss resulting from damage to an automobile maintained for personal use occasioned while in the unauthorized possession of the taxpayer's chauffeur. The cause of the damage is attributed to the overturning of the automobile while being driven over an icy road and to the subsequent freezing of the motor. It is stated in the opinion of the circuit court of appeals that the damage resulting to the automobile arose from a casualty which would be embraced within the term "other casualty" as used in that portion of section 214(a)6 of the Revenue Act of 1918, which permits the deduction in the computation of net income of losses sustained in the taxable year of property not connected with the trade or business, if arising from fires, storms, shipwreck, or other casualty, or from theft, and if not compensated for by insurance or otherwise.

The circuit court of appeals held that the loss sustained under the conditions mentioned above was an allowable deduction for the purpose of determining net income.

It is recommended, therefore, that the rulings published as Office Decision 629 and Office Decision 857 and all other Bureau rulings, in so far as they may be inconsistent with the decision of the circuit court of appeals in the case of *Shearer* v. *Anderson*, be revoked.

A. W. GREGG,
General Counsel, Bureau of Internal Revenue.

ARTICLE 141: Losses. VI–24–3264
I. T. 2363

REVENUE ACT OF 1918.

Office Decision 629 (C. B. 3, 158) and Office Decision 857 (C. B. 4, 160) are revoked, in view of General Counsel's Memorandum 1802, page 219, in so far as inconsistent with the decision of the Circuit Court of Appeals, Second Circuit, in the case of *Shearer* v. *Anderson* (16 Fed. (2d) 995 [T. D. 3860, C. B. V–1, 239]).

SECTION 214(a)7.—DEDUCTIONS ALLOWED: BAD DEBTS.

ARTICLE 151: Bad debts. VI–15–3188
T. D. 4003

INCOME AND EXCESS PROFITS TAXES—REVENUE ACT OF 1918—DECISION OF COURT OF CLAIMS.

DEDUCTIONS—BAD DEBTS.

Under section 234(a)5 of the Revenue Act of 1918, it is necessary in order to be entitled to claim a deduction for a bad debt that the debt be ascertained to be worthless and charged off within the taxable year.

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

To Collectors of Internal Revenue and Others Concerned:

The following decision of the United States Court of Claims in the case of *The Georgetown Grocery Co.* v. *United States* is published for the information of internal revenue officers and others concerned.

C. R. NASH,
Acting Commissioner of Internal Revenue.

Approved March 29, 1927.

OGDEN L. MILLS,
Acting Secretary of the Treasury.

COURT OF CLAIMS OF THE UNITED STATES.

The Georgetown Grocery Co. v. *The United States.*

[February 14, 1927.]

OPINION.

GRAHAM, Judge, delivered the opinion of the court.

The plaintiff, a corporation doing business in the city of Georgetown, S. C., filed on March 15, 1921, its income and excess-profits tax return for the calendar year 1920, which showed a net taxable income of $26,721.54, after a deduction of $1,010.72 for bad debts. At the time the return was made there was on the books of the plaintiff an account with the Sampit Contracting Co. which showed an indebtedness to plaintiff of $22,112.91. On September 15, 1921, plaintiff filed an amended income and excess-profits tax return for the calendar year 1920, claiming a deduction of $22,112.91 on account of the said debt of the Sampit Contracting Co. as a worthless debt. This return showed no taxable liability. At the same time plaintiff filed a claim for the abatement of remaining installments and the refund of $1,928.36 already paid as income tax. Both of these claims were rejected by the Commissioner of Internal Revenue, and the balance of the tax for 1920 in the sum of $1,985.76 was paid on September 25, 1924, on which date plaintiff filed a claim for refund of the entire amount of these two payments, namely, $3,914.12. The Commissioner of Internal Revenue having taken no action on the latter claim within six months, the plaintiff brought this action.

The applicable statute here is section 234(a)5 of the Revenue Act of 1918 (40 Stat., 1077, 1078), as follows:

"SEC. 234. (a) That in computing the net income of a corporation subject to the tax imposed by section 230 there shall be allowed as deductions:

* * * * * * *

"(5) Debts ascertained to be worthless and charged off within the taxable year;"

Under this statute, to entitle plaintiff to the deduction claimed, it is necessary that it should satisfactorily show that this debt, at the time of the filing of its tax return on March 15, 1921, had been "ascertained to be worthless and charged off within the taxable year," i. e., 1920.

The court has found that this debt had not been ascertained to be worthless at the time of the filing of plaintiff's tax return, March 15, 1921, and had not been charged off during said taxable year.

The plaintiff has failed to bring itself within the requirements of the statute above cited, and is not entitled to recover.

The petition should be dismissed, and it is so ordered.

ARTICLE 155: Reserve for bad debts. VI–11–3154
T. D. 3997

INCOME TAXES.

Amendment of article 155 of Regulations 62.

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

To Collectors of Internal Revenue and Others Concerned:

Article 155 of Regulations 62 is hereby amended to read as follows:

ART. 155. *Reserve for bad debts.*—Taxpayers for 1921 may elect the reserve method of treating bad debts, and for 1921 and subsequent years may deduct from gross income a reasonable addition to a reserve for bad debts in lieu of a deduction for specific bad-debt items.

What constitutes a reasonable addition to a reserve for bad debts must be determined in the light of the facts, and will vary as between classes of business and with conditions of business prosperity. A taxpayer using the reserve method should make a statement in his return showing the volume of his charge sales (or other business transactions) for the year and the percentage of the reserve to such amount, the total amount of notes and accounts receivable at the beginning and close of the taxable year, and the amount of the debts which have been ascertained to be wholly or partially worthless and charged against the reserve account during the taxable year.

D. H. BLAIR,
Commissioner of Internal Revenue.

Approved March 10, 1927.

A. W. MELLON,
Secretary of the Treasury.

ARTICLE 155: Reserve for bad debts.

REVENUE ACT OF 1921.

Method of treating bad debts for taxable years coming under the Revenue Act of 1921. (See Mim. 3527, page 68.)

SECTION 214(a)8.—DEDUCTIONS ALLOWED: DEPRECIATION.

ARTICLE 161: Depreciation. VI–7–3097
T. D. 3970

INCOME TAX—REVENUE ACT OF 1918—DECISION OF COURT.

1. DEDUCTION—DEPRECIATION—LESSEE.

A lessee of real estate and buildings, under a 99-year lease renewable forever, is not entitled to a deduction for depreciation under section 214(a)8 of the Revenue Act of 1918, on buildings erected by the lessor, the lessee having no capital investment therein.

2. DEPRECIATION.

Depreciation is an allowance made to a taxpayer to replace his capital investment, and capital invested is the cost of the property if acquired since March 1, 1913, and if acquired prior thereto, its value as of that date.

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

To Collectors of Internal Revenue and Others Concerned:

The following decision of the United States District Court for the Northern District of Ohio, Eastern Division, in the cases of *J. H. Wiener* v. *Weiss, Collector*, and *J. H. Wiener* v. *Routzahn, Collector*, is published for the information of internal revenue officers and others concerned.

D. H. BLAIR,
Commissioner of Internal Revenue.

Approved February 4, 1927.

A. W. MELLON,
Secretary of the Treasury.

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DISTRICT COURT OF THE UNITED STATES FOR THE NORTHERN DISTRICT OF OHIO, EASTERN DIVISION.

J. H. Wiener, plaintiff, v. *Harry H. Weiss, Collector, defendant.* At law 12414.

J. H. Wiener, plaintiff, v. *Carl F. Routzahn, Collector, defendant.* At law 12429.

[December 9, 1926.]

WESTENHAVER, District Judge: These actions are brought to recover income taxes for the years 1918, 1919, and 1920, paid under protest. The conditions precedent to the right to maintain them have been complied with. They have been heard and submitted upon an agreed statement of facts. As all material facts and questions of law are the same in both cases, they will be disposed of in one memorandum.

The question involved is the right of plaintiff, as lessee of real estate under 99-year leases renewable forever, to deduct depreciation on buildings in addition to a deduction of all sums paid as rent or for repairs and maintenance. This right is claimed under favor of the provisions of the Revenue Act of 1918, in force when the taxes were levied and assessed. Its pertinent provisions are as follows:

"SEC. 214. (a) That in computing net income there shall be allowed as deductions:

* * * * * * *

"(8) A reasonable allowance for the exhaustion, wear and tear of property used in the trade or business, including a reasonable allowance for obsolescence."

The foregoing is an old provision. It is found substantially in the same terms in the corporation excise tax law of 1909. It has been reenacted in precisely the same form in all subsequent Revenue Acts. It has been given a uniform departmental construction ever since it was so enacted, and that construction is the one adopted and applied in the present cases.

The object of the law, as well as its effect, is to get an accurate determination of the taxpayer's annual income. If he has capital invested in buildings and those buildings are used in his trade or business, it is necessary to allow and deduct a reasonable depreciation in order that his net income may be correctly ascertained. If he has no capital so invested, his net income will be correctly determined by deducting from his gross income all rent paid for the use of the buildings in which he carries on his trade or business. When the facts of the present case are stated and rightly understood, no different situation will be presented.

The plaintiff during the years 1918, 1919, and 1920 was the owner of 99-year leases renewable forever on 13 separate parcels of real estate. None of these leases were acquired prior to March 1, 1913, the date when the income tax amendment went into effect. On the contrary, nearly all were acquired during the

profiteering years 1918 and 1919. He paid no money by way of bonus or purchase price for any one of the leases, but agreed to pay, after having possession, an annual rent at stated intervals. He did not use or occupy any one of them in carrying on any trade or business, but merely sublet the same to tenants, and collected the rents. In ascertaining his net taxable income, he was permitted to deduct all sums paid by him for repairs, maintenance, and upkeep, as well as the full amount of all sums paid as rent. It is stipulated that he was also permitted to deduct depreciation upon all buildings which were erected or paid for by him. All the leases contain forfeiture clauses permitting the lessor, on 30 days' written notice, to avoid the same and enter into possession, both for failure to pay rent or to comply with any of the other covenants or provisions.

In my opinion, plaintiff's net income from these leases was correctly ascertained. He is not entitled to any other or additional deduction than was given him. Inasmuch as he had no capital investment in these leases, any allowance for depreciation on buildings would be a contribution to his capital account rather than a deduction in order to prevent an inclusion of some part of his capital as income. In substance and for all practical purposes, his annual payment of rent bought only a term for one year in the several leased premises. Hence, when he is permitted to deduct the full amount of the rent paid, together with repairs and maintenance, he is made whole with respect to his net income. Any further and additional allowance by way of depreciation of invested capital would be a mere contribution.

Even if it be true, as is urged, that under the law of Ohio, a 99-year lease renewable forever is not personalty but is a freehold estate in lands and has many of the attributes of an estate in fee, the situation for income tax purposes is not thereby changed. Nor is it material that the lessee is not exonerated from liability in the event a building may be destroyed, or that he is required to erect a new building within a given period, or that in the event of the destruction by fire or otherwise of any building, he is required to replace the same with another of equal or greater value, or that he is required to maintain the buildings at their present value or at any stated value. The several leases contain clauses imposing these obligations and impose forfeiture for failure to comply with them. But the important fact is that during the several years in question here the plaintiff did not make any such capital expenditures and has been permitted to deduct all sums paid for rent or for repair and maintenance and has been allowed proper depreciation on all buildings erected or paid for by him. It will be time enough to consider the question of allowing depreciation, under any of the conditions above stated, when the contingency shall have happened.

That such a contingency may never happen is evidenced by the history of the leases in question subsequent to the year 1920. It appears from the agreed statement of facts that leases D and K have been assigned to third persons with the consent of the lessor; that leases E, G, and I have been canceled and surrendered to the lessor; and the leases E and F have been assigned or released to the lessor. Thus, out of 13 leases, 7 have passed out of the picture without imposing on the plaintiff the obligation to invest any capital. If he had been permitted to retain some part of the net income under the guise of a capital depreciation, he would have merely pocketed an unearned increment.

The departmental construction adopted and applied to the plaintiff's tax returns is in accordance with old regulations. Depreciation has never been allowed except to replace capital investment. The capital invested has always been held to be the cost of the property in respect to which the allowance is made, if the property is acquired since March 1, 1913, and if acquired prior thereto, its value as of that date. Apparently these regulations have never [been] challenged. In numerous cases before the Board of Tax Appeals the law has been so construed and applied. The repeated reenactment by Congress of the same provisions after this Department construction was given thereto is the equivalent of an adoption and reenactment of that construction. If the meaning of the law were otherwise doubtful, as we think it is not, this departmental construction and congressional reenactment would be controlling, in accordance with familiar principles. *See Trumbull Steel Co.* v. *Routzahn* (292 Fed., 1009).

Judgment with costs will be rendered against plaintiff in defendant's favor. An exception may be noted.

ARTICLE 163: Depreciation of intangible property. VI–10–3131 T. D. 3980

INCOME AND EXCESS PROFITS TAXES—REVENUE ACT OF 1918—DECISION OF CIRCUIT COURT OF APPEALS.

1. DEDUCTIONS—OBSOLESCENCE—GOOD WILL.

No deduction can be taken for obsolescence of good will, an intangible asset, under section 234(a), subdivision (7), of the Revenue Act of 1918, which limits the allowance for obsolescence to such property as is susceptible to exhaustion, wear and tear by use in the business.

2. SUITS—CLAIM FOR REFUND.

The precise ground upon which the refund of taxes is demanded must be stated in the application to the Commissioner, and a suit in court to recover the tax can not be based upon an entirely different and distinct ground from that presented to the Commissioner.

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

To Collectors of Internal Revenue and Others Concerned:

The following decision of the United States Circuit Court of Appeals for the Eighth Circuit in the case of *Red Wing Malting Co.* v. *Willcuts, Collector of Internal Revenue*, is published for the information of internal revenue officers and others concerned.

D. H. BLAIR,
Commissioner of Internal Revenue.

Approved February 23, 1927.

A. W. MELLON,
Secretary of the Treasury.

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UNITED STATES CIRCUIT COURT OF APPEALS, EIGHTH CIRCUIT.

Red Wing Malting Co., plaintiff in error, v. *Levi M. Willcuts, Collector of Internal Revenue, etc., defendant in error.*

In error to the District Court of the United States for the District of Minnesota.

[November 5, 1926]

KENYON, Circuit Judge, delivered the opinion of the court.

This is an action brought by the Red Wing Malting Co., a corporation, plaintiff in error (designated for convenience as plaintiff), against Levi M. Willcuts, collector of internal revenue for the district of Minnesota, defendant in error (designated for convenience as defendant), for the recovery of $29,893.44 income and profits taxes alleged to have been erroneously assessed for the fiscal year ending August 31, 1918, and which were paid by plaintiff.

Plaintiff prior to the advent of prohibition was engaged in the business of manufacturing barley malt and selling the same to brewers engaged in the manufacture of fermented malt liquors. That was its sole business. Its market was destroyed as a result of the prohibition amendment and the Acts of Congress relating to the manufacture and sale of intoxicating liquors.

There is no dispute as to the facts. We set forth a number of the court's findings thereon, as follows:

"That on March 1, 1913, the plaintiff had built up a large and profitable business and had a good will of large value. That at said date, namely, March 1, 1913, the good will of the plaintiff's business was worth the sum of $153,618.75.

"11. That by reason of the Acts of Congress and the presidential proclamations thereunder, the business and trade of plaintiff, built up over a number of years, was totally destroyed, for although the plaintiff still had the right to manufacture its malt, its customers were, by said Acts of Congress and presidential proclamations thereunder, all put out of business and prohibited by law from using the products of this plaintiff. That as a result of this action the market for plaintiff's products was wholly destroyed and as a result plaintiff closed its plant and ceased all manufacturing operations in May, 1918. That in December, 1918, plaintiff sold its plant, including its real estate, machinery, and equipment, to the Fleischmann Yeast Co., under a contract, for $150,000.

"12. That as plaintiff was forced out of business by reason of the foregoing facts the good will of said business went with it and ceased to be."

For the fiscal year ending August 31, 1918, the Commissioner of Internal Revenue determined plaintiff's taxable net income to be $120,536.42. Plaintiff claims that in arriving at its taxable net income for said fiscal year a deduction for obsolescence of good will in the sum of $153,618.75, being the entire March 1, 1913, agreed value of its good will, should have been deducted. This would have left no taxable income for that year. Plaintiff seeks to recover the total income and profits taxes paid by it for said year.

The district court held against the contention of the plaintiff, and from that holding this writ of error is prosecuted. The issue presented is a narrow and precise one, viz, Is plaintiff in computing its taxable net income for the fiscal year ending August 31, 1918, entitled to a deduction on account of obsolescence or loss of good will?

The statute involved is the Revenue Act of 1918 (40 Stat. L., 1057, 1077). The particular portions thereof are parts of section 234(a), reading as follows:

"That in computing the net income of a corporation subject to the tax imposed by section 230 there shall be allowed as deductions:

* * * * * * *

"(4) Losses sustained during the taxable year and not compensated for by insurance or otherwise;

* * * * * * *

"(7) A reasonable allowance for the exhaustion, wear and tear of property used in the trade or business, including a reasonable allowance for obsolescence."

It is the theory of plaintiff that the phrase in subsection (7) of said statute, "including a reasonable allowance for obsolescence," created a new and additional tax deduction to the "exhaustion, wear and tear" clause of said subsection.

It is the contention of defendant that an allowance for obsolescence under the statute is merely supplementary to the allowance for "exhaustion, wear and tear," in those cases where by reason of economic circumstances the allowance for "exhaustion, wear and tear" based upon the estimated normal period of utility would be insufficient to restore to the taxpayer the cost of the capital investment. That the allowance for obsolescence applies only to property of a depreciable character. It will thus be seen that the matter presented raises legal questions of far-reaching importance.

Plaintiff contends that the Treasury Department has established an interpretation of the various Acts relating to depreciation for the purpose of arriving at taxable income through Office decisions, Treasury decisions, an Advisory Tax Board, the Committee on Appeals and Review, and that such construction has been that obsolescence of intangible property is permissible as a deduction in arriving at taxable income.

Article 163 of Regulations 45, promulgated by the Treasury Department construing the Revenue Act of 1918, is as follows:

"*Depreciation of intangible property.*—Intangibles, the use of which in the trade or business is definitely limited in duration, may be the subject of a depreciation allowance. Examples are patents and copyrights, licenses and franchises. Intangibles, the use of which in the business or trade is not so limited, will not usually be a proper subject of such an allowance. If, however, an intangible asset acquired through capital outlay is known from experience to be of value in the business for only a limited period, the length of which can be estimated from experience with reasonable certainty, such intangible asset may be the subject of a depreciation allowance, provided the

facts are fully shown in the return or prior thereto to the satisfaction of the Commissioner. There can be no such allowance in respect of good will, trade names, trade-marks, trade brands, secret formulæ, or processes."

This would seem to indicate the attitude of the Treasury Department at that time. It is true that after the promulgation of this regulation the Internal Revenue Bureau recognized for a time at least deductions for obsolescence of good will, the taxpayer having the burden of proving the beginning and end of the claimed obsolescence period. The deduction for good will was recognized only where it was assignable as distinguished from good will attached to the owning or carrying on of the business, or connected with the premises on which the business was conducted. No allowance for good will was recognized where it would be valuable in another business after the termination of the business in which the taxpayer was engaged.

The case of Rock Spring Distilling Co. (2 B. T. A., 207) was a case considering somewhat the question of obsolescence of good will, and the Board held there was no such thing under the Revenue Act of 1916. It does not decide that such deduction was permissible under the Act of 1918. We have been unable to find any decision of the Board of Tax Appeals passing directly upon the question of whether under the Act of 1918 a deduction could be allowed for obsolescence of good will.

In the decision on the appeal of the Brevoort Hotel Co. case before the Committee on Appeals and Review, and in its holdings as to hotels operating bars, there is language justifying the claim that a good will value may be established, for the loss of which an allowance for obsolescence may be made as distinct from the good will of the hotel. In the hotel cases may be noted the following language of the opinion:

"It is, therefore, held that hotels which can establish a good-will value which might have been assigned separate and distinct from the good will of the hotel, are entitled to obsolescence for the loss of their good will due to national prohibition legislation."

We have examined the references in the brief of plaintiff to the Cumulative Bulletins of the Treasury Department and the tax rulings contained therein bearing on this question, the holdings of the Committee on Appeals and Review, and the decisions of the Tax Appeals Board, and conclude that either side to this controversy may find some comfort therein.

Courts have respect for and give weight to departmental construction of a statute, although such construction is not controlling. (22 Cyc., 1606; *Baltzell* v. *Mitchell*, 3 F. (2d), 428.) Certainly, however, there has been no such consistent and uniform construction of the statute in question as to be persuasive with the court or of appreciable assistance. Nor do we see much force in the claim that Congress has reenacted in 1921, 1924, and 1926, the section under consideration substantially as in the Act of 1918, and thereby has acquiesced in the interpretation by the Treasury Department of the congressional intent as to obsolescence of good will as a tax deduction entity. There is no decision of the Treasury Department construing the Act of 1918 as authorizing a deduction for obsolescence of good will as a separate and distinct entity, nor is there any such definite and uniform construction of provisions in other statutes to warrant a conclusion that Congress was adopting any particular construction of the Treasury Department. The very claim here was denied by the Committee on Appeals and Review. It may as well be argued therefore that Congress in reenacting the section after such action of the Treasury Department has adopted its conclusion. Further, the Revenue Act of 1926, containing section 234(a)7 in substantially the same form as in the Revenue Act of 1918, was enacted after the decision of the lower court in the case at bar. Therefore, if there was a practice of the Treasury Department relied on in conflict with said decision, there would be no substance in the claim that Congress had ratified, by passing the Revenue Act of 1926, the practice of the Bureau. We content ourselves with saying that in the confusion of rulings of the Solicitors of the Treasury Department and the various boards created therein to pass on tax questions, or the decisions of the Board of Tax Appeals, no long-continued and uniform construction of the statute here involved can be found. Therefore we pretermit this phase of the matter, calling attention to the language of the Supreme Court of the United States in *Iselin* v. *United States* (270 U. S., 245, 251 [T. D. 3846, C. B. V-1, 365]):

"It suggests that these facts imply legislative recognition and approval of the executive construction of the statute. But the construction was neither

uniform, general, nor long continued; neither is the statute ambiguous. Such departmental construction can not be given the force and effect of law. Compare *United States* v. *Falk & Brother* (204 U. S., 143); *National Lead Co.* v. *United States* (252 U. S., 140, 146)."

The only case cited or that we have been able to find which bears directly on the question at issue is *Haberle Crystal Springs Brewing Co.* v. *Jesse W. Clarke, Collector of Internal Revenue.* A referee's opinion therein construes the statute as contended for by plaintiff. It is of note that the opinion of said referee has not as yet been adopted by the United States District Court of the Northern District of New York, where the case is pending. The case of *Kentucky Tobacco Products Co.* v. *Lucas, Collector of Internal Revenue* (5 Fed. (2d), 723), refers to the statute in question, but does not discuss the proposition here raised.

We are satisfied this case is one of first impression, and the question is squarely before this court as to the construction of subsection (7) of section 234(a) of the Revenue Act of 1918.

Some legal propositions argued are assumedly beyond controversy, e. g.,

(*a*) A statute should receive a natural and not a strained construction, and its plain, obvious and rational meaning should be adhered to. (*Lynch* v. *Alworth-Stephens Co.*, 294 Fed., 190.)

(*b*) Tax laws if doubtful are to be construed in favor of the taxpayer. (*Gould* v. *Gould*, 245 U. S., 151; *United States* v. *Merriam*, 263 U. S., 179.)

(*c*) The term property in the Act under consideration is not used in a restricted sense. (*Lynch, Executrix, etc.*, v. *Alworth-Stephens Co.*, 267 U. S., 364.)

(*d*) Good will is property of an intangible nature, and the term property includes good will. (28 Corpus Juris, 730; *Metropolitan Bank* v. *St. Louis Dispatch Co.*, 149 U. S., 436; *The Coca-Cola Bottling Co.* v. *The Coca-Cola Co.*, 269 Fed., 796; *Washburn* v. *National Wall-Paper Co. et al.*, 81 Fed., 17.)

(*e*) Good will has no existence except in connection with a continuing business. (*Kaufmann* v. *Kaufmann* (Pa.), 86 Atl., 634; *Metropolitan Nat. Bank* v. *St. Louis Dispatch Co. et al.*, 36 Fed., 722.)

(*f*) It may be bought and sold in connection therewith as an incident thereof. (*Camden* v. *Stuart*, 144 U. S., 104; *The Coca-Cola Bottling Co.* v. *The Coca-Cola Co.*, 269 Fed., 796, 805; *Commonwealth* v. *Kentucky Distilleries & Warehouse Co.* (Ky.), 116 S. W., 766; *Sawilowsky* v. *Brown*, 288 Fed., 533.)

With these general propositions in mind we proceed to a discussion of the statute in question. No difficulty arises as to the first part of subsection (7) of section 234(a), "a reasonable allowance for the exhaustion, wear and tear of property used in the business." That is clear enough as defining the deduction. The controversy is over the part of the subsection following these words, viz, "including a reasonable allowance for obsolescence." Does this provide for a new, distinct, deduction, or is it so attached and related to the previous phrase in subdivision (7) that it applies only to such property used in the business as is subject to exhaustion, wear and tear? The case relied on by plaintiff is *Haberle Crystal Springs Brewing Co.* v. *Clarke, Collector of Internal Revenue* (heretofore referred to), in the United States District Court, Northern District of New York, and the opinion of the referee in said case is attached as an appendix to plaintiff's brief. Plaintiff there claimed it was entitled under the 1918 statute to a reasonable allowance for the obsolescence of its good will, liquor licenses, and national plant, for which items no deductions were allowed in the computation of the tax which the plaintiff paid, and the referee there held that good will was property used in the business within the meaning of subsection (7) of section 234(a) of the Revenue Act of 1918, and that the purpose of the language of the statute as to allowance for obsolescence was to create a new and additional deduction. The position taken by the referee is presented with clearness and fortified by substantial reasoning, and states that theory of construction as well, we think, as it can be done.

We are, however, unable to reach the same conclusion. If it had been intended by the Congress to create a new and additional deduction not connected with property used in the business subject to "exhaustion, wear and tear," it would have been very easy for Congress, instead of using the word, "including," to have said, "a reasonable allowance for exhaustion, wear and tear and obsolescence of property used in the business." That would have made the matter clear.

The first part of the subsection provides for a deduction in arriving at tax income for the depreciation by exhaustion, wear and tear of property used in the business. Depreciation was the matter sought to be remedied in order

to restore to the owner the basis of original value. It is perfectly apparent that an allowance for depreciation due to exhaustion, wear and tear of property might not sufficiently provide for the restoration of capital over the period of useful life of an asset, and it might be entirely inadequate to effect restoration of the March 1, 1913, value thereof. The meaning of the word "including" as used in the statute is important. It evidently refers to the preceding part of the subsection, and must be recognized as occupying a significant and important place. It can not be brushed aside and ignored. This court should not attempt to write new language into the statute, nor ignore language there used, but must endeavor from the language of the statute itself to arrive at the meaning of the Congress. This word has received considerable discussion in opinions of the courts. It has been productive of much controversy. The word "include" is defined in the New Standard Dictionary as follows:

"(1) To comprise, comprehend, or embrace as a component part, item, or member; as, this volume *includes* all his works; the bill *includes* his last purchase;

"(2) To enclose within; contain; confine; as, an oyster shell sometimes *includes* a pearl."

It is defined by Webster as follows:

"To comprehend or comprise, as a genus of the species, the whole a part, an argument or reason the inference; to take or reckon in; to contain; embrace; as. this volume includes the essays; to and including the tenth."

The Century Dictionary defines "including," thus: "to comprise as a part."

Perhaps the most interesting discussion of the word "including" is found in *Montello Salt Co.* v. *State of Utah* (221 U. S., 452). There the court referred to and discussed some of the cases where the word "including" had been under consideration. For instance, the court pointed out in *Brainard* v. *Darling* (132 Mass., 218), "that a legacy of $100, 'including money trusteed at a certain bank,' could not be construed as meaning that the sum of $100 was in addition to the sum in bank." Also in *Henry's Executor* v. *Henry's Executor* (81 Kentucky, 342), "a bequest of $14,000, 'including certain notes,' was held to mean that the notes formed a part of the $14,000 and were not in addition thereto." Also the case of *Neher* v. *McCook County* (11 S. Dak., 422) (78 N. W., 998), where "it was held that a certain section of the laws of the State which provided that the sheriff's fees should be $16 for summoning a jury, 'including mileage,' did not entitle him to mileage in addition to the $16." And the Supreme Court after its reference to these cases says of the case before it, "The court also considered that the word 'including' was used as a word of enlargement, the learned court being of opinion that such was its ordinary sense. With this we can not concur. It is its exceptional sense, as the dictionaries and cases indicate. We may concede to 'and' the additive power attributed to it." We refer to a few other cases.

In *Sullivan Machinery Co.* v. *United States* (168 Fed., 561) the word "including" used in the Tariff Act was construed as a word of addition. In *Maben* v. *Rosser et al.* (Okla.) (103 Pac., 674, 676), the court discussing the meaning of the word "including" says:

"This word has also been defined as having an accumulative sense and as classing that which follows with that which has gone before."

In *Kennedy* v. *Industrial Accident Commission of California et al.* (Cal.) (195 Pac., 267, 271) the court says:

"'Including' is not a word of limitation. Rather it is a word of enlargement, and in ordinary signification implies that something else has been given beyond the general language that precedes it. * * * As here employed, the word 'including' is used to express the idea that the specific power to review, grant or regrant, diminish, increase, or terminate an award upon the ground that the disability has recurred, increased, diminished, or terminated—particular power specifically referred to in the section of the present act—is but a part of the larger and more comprehensive power conferred by the more general language of the immediately preceding clause of the section."

In *Dumas* v. *Boulin* (La.) (1 McGloin, 275, 278) it is pointed out that the word "include" has two shades of meaning. The court says, "'Include' has two shades of meaning. It may apply where that which is affected is the only thing included, and it is also used to express the idea that the thing in question constitutes a part only of the contents of some other thing. It is more commonly used in the latter sense."

That the word "includes" is a word of enlargement is held in *Fraser* v. *Bontel et al.* (Cal.) (119 Pac., 509); *Cooper* v. *Stinson* (5 Minn., 522); *Calhoun* v. *Memphis & P. R. Co.* (4 Fed. Cas., 1045).

Perhaps the most lucid statement the books afford on the subject is in *Blanck et al.* v. *Pioneer Mining Co. et al.* (Wash.) (159 Pac., 1077, 1079), namely, "the word 'including' is a term of enlargement and not a term of limitation, and necessarily implies that something is intended to be embraced in the permitted deductions beyond the general language which precedes it. But granting that the word 'including' is a term of enlargement, it is clear that it only performs that office by introducing the specific elements constituting the enlargement. It thus, and thus only, enlarges the otherwise more limited, preceding general language. * * * The word 'including' introduces an enlarging definition of the preceding general words, 'actual cost of the labor,' thus of necessity excluding the idea of a further enlargement than that furnished by the enlarging clause so introduced. When read in its immediate context, as on all authority it must be read, the word 'including' is obviously used in the sense of its synonyms 'comprising; comprehending; embracing.'"

It seems to us that the language "including a reasonable allowance for obsolescence" is but a part of and an enlargement of the previous phrase of the said subsection (7) relating to exhaustion, wear and tear, and that the first part of the sentence was intended to cover the subject-matter thereof. It does not add a new kind of deduction, but merely permits the inclusion of an additional element, namely, obsolescence of such property used in the business as is subject to exhaustion, wear and tear. The allowance for obsolescence was intended to be in connection with the allowance for exhaustion, wear and tear, that being at times insufficient to restore the proper basis of capital values.

The history leading up to the enactment of subsection (7) of section 234(a) of the 1918 Act is important. The Excise Tax Act of 1909 permitted deduction of "a reasonable allowance for depreciation of property, if any." Regulations of the Treasury Department provided that the deduction should be the loss "that arises from exhaustion, wear and tear, or obsolescence out of the uses to which the property is put." The United States District Court for the Northern District of California in *San Francisco & P. S. S. Co.* v. *Scott, Collector* (253 Fed., 854, 855), discussed depreciation as used in that statute, and said:

"It is intended to cover the estimated lessening in value of the original property, if any, due to wear and tear, decay, or gradual decline from natural causes, inadequacy, obsolescence, etc., which at some time in the future will require the abandonment or replacement of the property, in spite of ordinary current repairs."

The Revenue Act of 1913 had this provision, "a reasonable allowance for depreciation by use, wear and tear of property, if any."

The regulations under this Act recognized the interpretation put upon the word "depreciation" under the previous Act, and made an allowance for obsolescence "out of the uses to which the property is put."

The 1916 Act dropped the word "depreciation" and the deduction permitted was "a reasonable allowance for the exhaustion, wear and tear of property arising out of its use or employment in the trade or business." After that there was no basis for a deduction for obsolescence, as the depreciation deduction under the 1916 Act excluded obsolescence.

When the Revenue Act of 1918 was before the Congress the House wrote a provision the same as in the 1916 and 1917 Acts providing an allowance for "exhaustion, wear and tear," of property. The Senate adopted an amendment substituting the word "depreciation" for "exhaustion, wear and tear." In conference the word "depreciation" was stricken out, the words "exhaustion, wear and tear," restored, and the words "including a reasonable allowance for obsolescence" included. In this form the bill passed. It would seem quite apparent therefore that Congress was not intending to add a new and independent deduction. It was merely trying to provide the restoration of capital value of a depreciable asset over the period of its useful life by allowing something known as obsolescence as an additional element to exhaustion, wear and tear. This legislative history sustains, we think, the conclusion to which we are forced, that the phrase, "including a reasonable allowance for obsolescence" is one of specification and enlargement; that it is closely connected with and relates to the subject-matter of the other phrase of said subsection (7), and applies only to such property therein designated used in the business as is subject to exhaustion, wear and tear.

That leads to the query, Is good will such property?

Good will is property of an intangible nature. It differs from such intangibles as patents, copyrights, licenses and franchises, because while in a certain sense it inheres in and is used in the business, it is not subject to depreciation, as that term is commonly understood and commonly used in the statutes. The Supreme Court of the United States in *Metropolitan Bank* v. *St. Louis Dispatch Co.* (149 U. S., 436, 446), says:

"Undoubtedly, good will is in many cases a valuable thing, although there is difficulty in deciding accurately what is included under the term. It is tangible only as an incident, as connected with a going concern or business having locality or name, and is not susceptible of being disposed of independently. Mr. Justice Story defined good will to be 'the advantage or benefit, which is acquired by an establishment, beyond the mere value of the capital, stock, funds, or property employed therein, in consequence of the general public patronage and encouragement which it receives from constant or habitual customers, on account of its local position, or common celebrity, or reputation for skill or affluence, or punctuality, or from other accidental circumstances or necessity, or even from ancient partialities or prejudices.' Story Part. Sec. 99."

The opinion of the referee in the case hereinbefore referred to, relied upon by plaintiff, of *Haberle Crystal Springs Brewing Co.* v. *Jesse W. Clark, Collector of Internal Revenue*, so holds, because the referee says, "ordinarily it has an indefinite existence and value."

Opinions of expert accountants are not without value in considering the peculiar nature and status of good will in business. In Montgomery's "Auditing Theory and Practice," we find the following enlightening paragraph:

"This asset is in a class by itself. The question of depreciation certainly can not be applied to it as to other items. If earnings decline for any reason, the value of good will declines correspondingly, because by its very nature its value depends on earnings of a certain amount being maintained. Good will, however, always appears, or should appear, on the balance sheet as a separate item, and well-established practice permits it to appear at cost, irrespective of fluctuations which affect its value. As a matter of fact, its actual value changes from day to day, and there would be so much uncertainty in any attempt to adjust its book value that by common consent it is left alone, except in cases where earnings are unusually large, and it is considered advisable to write it off. In such cases the very fact of there being sufficient earnings to write it off would justify its retention, whereas earnings not up to expectations, and insufficient to enable a concern to write it off, would indicate that its book value is inflated. As good will does not suffer wear and tear, does not become obsolescent, is not used up in the operation of the business, depreciation, as such, can not be charged against it. * * *

"While good will does not depreciate, it is constantly liable to fluctuations. Good will is not usually written off, and the question of the amount at which it shall stand in the balance sheet was not formerly deemed to be within the scope of the auditor's work, but the present range of an auditor's duties compels him to give serious thought to this item."

In "Higher Accountancy Principles and Practice" (under supervision of William Arthur Chase), the following:

"The increased or decreased value of the good will does not show in any ordinary profit and loss account. Its growth can not be attributed to any particular year.

"In a private concern good will is only ascertainable by actually selling the business. In case of a public company the good will is known from day to day.

"The whole question of good will is a difficult one, because each case stands by itself."

From "Modern Accounting," by Henry Rand Hatfield:

"But in valuing good will for the inventory the limitation of its value to its cost must be most rigorously observed. It has been seen that the restriction of inventory value to cost price is of rather general application, but its force is much greater when the goods to be valued are immaterial. No one would object to the inclusion in the inventory of treasure trove even though it cost the finder nothing. But good will is rigorously excluded unless it has been secured at a cost. Hence it is recognized as legitimate for the purchaser of

good will to include it among his assets, but accounting practice prudently, though perhaps illogically, forbids the firm which created the good will to place in the balance sheet any value on the clientele which it has built up and which it could at any moment sell for a large sum."

We are satisfied there can be no wear or tear of good will, or exhaustion thereof by use, and even should we assume that good will separate and distinct from tangible property is property used in the business, section 234(a), subsection (7), of the 1918 Revenue Act limits the allowance for obsolescence to such property as is susceptible to exhaustion, wear and tear by use in the business, and good will is not such property.

We turn therefore to the question of whether the allowance claimed can be made under section 234(a), subsection (4). It is suggested in the reply brief of plaintiff that if defendant's argument be conceded to be correct as to the obsolescence feature of the statute, this court could decide the case under the loss section, section 234(a), subsection (4), hereinbefore set out, and it is claimed that under the pleadings the requested allowance could be granted under that subsection as a loss sustained in plaintiff's fiscal year ending August 31, 1918.

Defendant in its brief states:

"Plaintiff and defendant agree that unless a deduction for obsolescence of good will is authorized by section 234(a)7 of the Act plaintiff's claim must of necessity be denied."

Apparently this statement is incorrect. However, the case was tried and determined principally upon the question of the construction of section 234(a), subsection (7). We refer to this suggested proposition briefly.

We have heretofore pointed out that good will has no existence separate and apart from an established business. With the termination of that business it is ended. While a capital asset, it is not the subject of purchase, sale or assignment separate from the business itself. It is not an assignable asset distinct from the business. It is different in this respect from such intangibles as patents, contracts, or franchises which may be sold. When a business is disposed of its value and realized selling price may be enhanced by the existence of good will. If sold at a loss the loss of good will is reflected in the transaction. The claim is somewhat novel therefore and rather startling that loss of good will can be made the subject of an independent claim for a tax deduction separate and distinct from the business of which it is an incident.

When the property of the Red Wing Malting Co. was sold at a depreciated value by reason of prohibition the loss of good will was reflected in the general loss. This loss might possibly be a basis for a deduction under section 234(a), subsection (4) of the statute. We are not advised whether or not such allowance has been made. To hold that a claimant is entitled to segregate good will from the property and business to which it is attached as an incident and from which it is inseparable and permit a separate deduction for its loss might result in a double deduction and have far-reaching consequences. If the court is to open the door to claimants for tax deductions under the statute for the loss of good will apart from the tangible property with which it is connected, the right should clearly appear from the statute. We think it does not so appear. While we have indicated our view of the matter, we are not confident that this question is before us. It does not appear from the record that any claim under subsection (4) for refund covering the loss of good will as a sustained loss during the taxable year was presented to the Commissioner of Internal Revenue prior to bringing this action and a refund requested. The application for refund does not appear in the record. Such application is a condition precedent to the jurisdiction of this court in matters of this character. The precise ground upon which the refund is demanded must be stated in the application to the Commissioner, and we think if that is not done a party can not base a recovery in the court upon an entirely different and distinct ground from that presented to the Commissioner. We have reached the conclusion that the action of the trial court in dismissing plaintiff's petition and rendering judgment for defendant was correct, and the same is affirmed.

ARTICLE 164: Capital sum recoverable through depreciation allowances.

REVENUE ACT OF 1921 AND PRIOR ACTS.

Basis for depreciation with respect to property acquired by gift, bequest, devise, or inheritance both prior to and after March 1, 1913. (See I. T. 2337, page 144.)

SECTION 214(a)9.—DEDUCTIONS ALLOWED: AMORTIZATION.

ARTICLE 183: Property cost of which may be amortized. VI–18–3217 G. C. M. 266A

REVENUE ACT OF 1918.

The mere obligation to purchase facilities which had been used in the production of articles contributing to the prosecution of the war, after the cessation of the war or after the close of the amortization period, irrespective of how binding that obligation may be, does not bring a taxpayer within the terms of section 234(a)8 of the Revenue Act of 1918.

An opinion is requested relative to the claim for an amortization deduction made by the M Company. The question involved is as follows:

Was it the intention of the taxpayer to acquire the facilities in question for the production of articles contributing to the prosecution of the war, it being noted that the taxpayer was not to acquire the facilities until one year after the termination of the war?

The pertinent facts are briefly these:

On April 6, 1917, the taxpayer operated a shipyard at R, where both repair work and construction of small boats was carried on. A short distance away at S the taxpayer operated a repair yard where a small amount of construction was done.

On June —, 1918, the Navy Department placed an order with the taxpayer for *y* seagoing tugs to be built at the S Yard. As this yard was not equipped for this kind of work, a contract, dated June —, 1918, providing for the financing of the enlargement of the facilities necessary to construct the *y* tugs was entered into by and between the M Company, hereafter called the taxpayer, and the Navy Department of the United States, the material parts of which contract are as follows:

First. The contractor will make the necessary outlays in advance and will provide such plant and facilities as may be necessary, and will construct *y* seagoing tugs of approximately 1,000 tons, * * *.

Sixteenth. The contractor shall, as soon as possible, construct and equip additional building slips, extensions, and additions to its present buildings, plant, and other facilities, including the purchase and running of a system of motor busses for the transportation of workmen, for the special purpose of building the vessels herein contracted for. Such special facilities shall be as approved by the Department, and be made only to such extent as necessary to carry on with expedition the work herein contracted for, and their total actual cost (which shall not exceed $———) will be paid to the contractor by the Department as expenditures therefor are incurred. The title to all such buildings, building slips, plant, and other special facilities paid for by the Department shall vest in the United States. Said special facilities shall be left in the possession of

the contractor for the purpose of this contract and shall be operated for the exclusive purpose of building vessels and parts thereof for the Navy. The work of constructing and providing such special facilities shall be done at actual cost and no profit thereon shall be allowed the contractor. * * * At the conclusion of the work under this contract, disposal of all such special facilities shall be made as provided for in the twentieth clause of this contract.

Twentieth. At the expiration of one year after the termination of the present war, the compensation board shall appraise the then value to the contractor of the buildings, building slips, plant, and other facilities, the property of the United States and located in or upon the contractor's works. * * * The Department will furnish the contractor with copies of the appraisals upon completion. *The contractor hereby agrees to accept such appraisals and to repay to the Department the amount thereof in ten (10) annual installments*, without interest, beginning one year after the termination of the present war, but title to said buildings, building slips, plant, and other facilities shall not pass to the contractor until completion of the payments above provided for.

On February —, 1921, the limit to the total actual cost of the plant extensions was reduced from $—— as provided in paragraph 16 of the contract to $———. The plant extensions cost the taxpayer $——, or $3x$ dollars in excess of the reimbursement made by the Department. The latter amount of $3x$ dollars has been allowed as an ordinary and necessary expense deductible in the year in which incurred.

In accordance with the terms of the contract the compensation board in July, 1922, appraised the plant extensions which the Navy Department had paid for at $10x$ dollars. On October —, 1922, the taxpayer made its first payment of x dollars in cash, which amount was one-tenth of the total appraised value, and at the same time executed nine noninterest-bearing notes payable in nine annual installments as set forth in the contract of June —, 1918. It was held by the engineers who investigated this case that the date of cessation of operation of these facilities as war facilities was December 31, 1920.

The taxpayer maintains with respect to such plant extensions that their value in use as computed in accordance with article 184 of Regulations 45 and 62 was $3.3x$ dollars, and that it is entitled to an amortization allowance based upon a cost of $10x$ dollars, or an allowance of $6.7x$ dollars.

The taxpayer's contention is that it is entitled to this amortization deduction by reason of the fact that it was obligated on June —, 1918, to purchase these facilities from the Navy Department at a price to be agreed upon by the compensation board, that this agreed price is the cost to be borne by it within the terms of the provision of section 234(a)8 of the Revenue Act of 1918, and that under this theory the amortization deduction in the amount as contended for should be allowed.

The claim for the amortization deduction is based upon section 234(a)8 of the Revenue Act of 1918, the pertinent part of said Act being set out as follows:

> In the case of buildings, machinery, equipment, or other facilities, constructed, erected, installed, or acquired, on or after April 6, 1917, for the production of articles contributing to the prosecution of the present war, * * * there shall be allowed a reasonable deduction for the amortization of such part of the cost of such facilities or vessels as has been borne by the taxpayer, but not again including any amount otherwise allowed under this title or previous Acts of Congress as a deduction in computing net income.

The express terms of the contract clearly show that the Navy Department was to purchase these facilities, and no part of the cost

(except an amount in excess of the maximum allowed by the contract) was to be borne by the taxpayer. The title to said facilities was vested in the United States. (Paragraph 16 of the contract.) It was further provided that title to said building, slips, plant, and other facilities should not pass to the contractor until completion of the payments provided for in paragraph 20 of the contract. The Navy Department was to pay the total actual cost, not in excess of a certain amount. In computing net income the taxpayer has been allowed a deduction, as an ordinary and necessary business expense, for the amount it paid in excess of the maximum allowed by the Navy Department. Thus it clearly appears that the United States and not the taxpayer acquired these facilities for the production of articles contributing to the prosecution of the war.

The arbitrary price of $10x$ dollars was fixed by the compensation board as the entire purchase price to the taxpayer for these facilities. Upon payment of this price title was to vest in the taxpayer. On October —, 1922, the taxpayer made its first payment under the purchase contract. What it is now paying is not a certain proportion or part of the cost of facilities for the production of articles contributing to the prosecution of the war. The taxpayer is buying and paying for facilities which were used for the production of articles contributing to the prosecution of the war. The taxpayer has borne no part of the cost of facilities for the production of articles contributing to the prosecution of the war. It made no actual investment therein. The Navy Department actually bought and paid for such facilities. The Navy Department made the investment. The Navy Department bore the loss of the difference between the actual initial cost and the selling price fixed by the compensation board.

The date on which the taxpayer acquired the facilities, in the sense of the generally accepted meaning of the word "acquire" and in the sense used in this section of the law, was October —, 1922. On that date the taxpayer actually made a capital investment, but the investment at that time was not made in a facility for the production of articles contributing to the prosecution of the war, because at that time the amortization period was closed and the war was ended. The facilities certainly at that time had ceased to be war facilities. Therefore, the facilities must have been acquired for some purpose other than that of producing articles contributing to the prosecution of the war.

Although embodied in the same instrument, the agreement to purchase is a separate and distinct transaction from the agreement to construct the facilities for the production of articles contributing to the prosecution of the war. If this agreement to purchase the facilities had been made between the Navy Department and some other person not connected with the construction of the facilities or not connected with the building of vessels and tugs for the Navy Department, clearly such person would not have been entitled to the amortization deduction claimed herein by the taxpayer. And the fact that the taxpayer was connected with the contract in other capacities besides his obligation to purchase, in the absence of a conclusive showing that the price to be fixed by the compensation board was to be the part of the *cost to be borne by the taxpayer*, can not change or alter the circumstance.

The assertion that the facilities were constructed, installed, erected, or acquired on or after April 6, 1917, and that they were facilities constructed, installed, erected, or acquired for the production of articles contributing to the prosecution of the war is neither questioned nor denied, but it can not be said that such facilities were constructed, installed, erected, or acquired *by the taxpayer* for the production of articles contributing to the prosecution of the war or that the taxpayer has borne any cost of such facilities.

The section of the law dealing with amortization authorizes an allowance in the nature of an exemption, and as such must be strictly construed. It can not be extended by construction to cases not falling clearly within its terms. (*The Hampton & Langley Field Ry. Co.* v. *Noel*, 300 Fed., 438, published as T. D. 3619 [C. B. III–2, 134].) The mere obligation to purchase facilities which had been used in the production of articles contributing to the prosecution of the war, after the cessation of the war or after the close of the amortization period, irrespective of how binding that obligation may be, does not bring a taxpayer within the terms of section 234(a)8 of the Revenue Act of 1918.

It is therefore recommended that the claim for amortization made by the M Company be not allowed.

A. W. GREGG,
General Counsel, Bureau of Internal Revenue.

ARTICLE 184: Computation of amortization allowance.

VI–24–3265
G. C. M. 1792

REVENUE ACT OF 1921.

The M Company acquired after April 6, 1917, certain buildings, machinery, equipment, and other facilities for the production of articles contributing to the prosecution of the war. Thereafter its entire capital stock was acquired by the N Company and the two corporations thereupon became affiliated. The assets of the M Company were transferred in liquidation to the N Company on February —, 1923, and set up on its books at their book value on that date.

Held, that the deduction to be allowed to the M Company for the amortization of war facilities should be computed on the basis of the fair market value of the amortizable assets on the date of the transfer in liquidation.

An opinion is requested as to the proper method of computing the deduction to be allowed on account of the amortization of war facilities of the M Company.

The M Company acquired after April 6, 1917, certain buildings, machinery, equipment, and other facilities for the production of articles contributing to the prosecution of the war. Under date of October —, 1921, its majority stockholder contracted with the N Company to sell the entire capital stock of the taxpayer to the N Company for a consideration to be determined by an inventory and appraisal of all the assets as of December 31, 1921. Under this agreement all stock passed to the N Company on or before January 16, 1922, and the two corporations thereupon became affiliated. The purchase price of 240*x* dollars was determined on the basis of an appraisal, the final valuation being reported on January 27, 1922. The transaction was consummated on the basis, it is stated, of

"sound value of prewar plant and equipment and war facilities at postwar value." The provision of the contract of October —, 1921, contemplating that the fixed assets should be valued at cost less depreciation, was modified by subsequent agreement and they were appraised at their "utility value," or their "sale or salvage value," whichever was greater, but no asset was valued in excess of its original cost. Consolidated returns were filed for the affiliated companies for the period of 1922 and the taxable year 1923. Reserving a certain claim against the United States for refund of taxes and excepting certain land and buildings sold to A, all remaining assets of the taxpayer were transferred in liquidation to the N Company on February 28, 1923, and set up on its books at their book value on that date. This value was determined by the appraisal as of December 31, 1921, fixing the price of the capital stock, and, with operating adjustments to date of transfer, was $3x$ dollars more than the purchase price of the stock. War facilities costing $40x$ dollars out of a total of $60x$ dollars were transferred to the N Company at their appraised value of $20x$ dollars. The remainder, representing a cost of $10x$ dollars, was sold to third parties prior to the termination of the postwar period for a total of $2x$ dollars. From copies of the corporation records and instruments submitted, it is evident that the transfer of the assets by the taxpayer was made to take the form of a sale in consideration of the surrender for cancellation by the N Company of all shares of the capital stock of the M Company. For the purpose of continuing the corporate existence of the taxpayer, five qualifying shares were concurrently reissued.

It is represented that the prewar plant of the taxpayer would have been sufficient for its postwar business. The physical value in use of the war facilities to the taxpayer to the date of transfer to the N Company was much less than indicated by the appraised value at which they were transferred to the latter company. Production statistics indicate that the physical value in use of the amortizable assets, computed in terms of "labor dollars" and using the single year 1922 to determine postwar available production, was 31.14 per cent of their original cost. The appraised value, $20x$ dollars, as accepted by the parties to the transaction, was 55.94 per cent of original cost. While not contending that the use of the assets by the N Company after February 28, 1923, is controlling, the taxpayer urges that their subsequent physical value in use, shown by production statistics for the years 1923–1926 to have averaged but 26.09 per cent of original cost, is corroborative of the low value in use prior to the transfer. Subsequent to March 3, 1924, certain of the facilities were scrapped and sold at a loss of x dollars.

The question presented is which of two bases should be used in computing the deduction allowable to the taxpayer—(1) fair market value of the war facilities on the date of transfer or (2) value in use derived from production statistics of both transferor and transferee companies, in accordance with the principle of ignoring for purposes of taxation intercompany transactions, or in accordance with the principle of ignoring the separate corporate entities of members of an affiliated group, as applied in the appeal of G. M. Standifer Construction Corporation (4 B. T. A., 525).

The taxpayer contends in its main brief for the allowance of amortization on the basis of the "sale" price of the assets to the N

Company on February 28, 1923, but in its supplementary brief relies on the following factors as pertinent, stressing the importance of the third and fourth:

(1) The values at which such facilities were appraised in connection with the sale of its capital stock by its stockholders to the N Company.
(2) The fair sale or salvage values of such facilities, independent of any sale to the N Company, as appraised by independent appraisers, and as indicated by market conditions for the sale of such facilities.
(3) The sales of such facilities to the N Company and others.
(4) The postwar utility value of such facilities to the taxpayer.
(5) The utility value and sale or salvage value of such facilities to the N Company after such facilities were acquired by the N Company.

Article 184 of Regulations 62 provides in part:

Computaton of amortization allowance.—The total amount of the amortization allowance is the difference between the original cost of the property * * * and the value of the property on either of the bases indicated below:
(1) In the case of property which has been sold or permanently discarded, or which will be sold or permanently discarded before March 3, 1924, the value shall be the actual sale price or estimated fair market value as of the date when the property was or will be permanently discarded * * *.
(2) In the case of property not included in (1) above, the value shall be the estimated value to the taxpayer in terms of its actual use or employment in his going business, * * *.

The regulations thus divide war facilities, of which the cost is amortizable, into two classes—those sold or discarded prior to March 3, 1924, and those retained in use throughout the postwar period. Cases arise, however, which are difficult of classification. An intercompany transfer of assets, for example, may constitute strictly neither a sale or abandonment nor a retention in use by the taxpayer. Accordingly it has been recognized that amortizable assets which were thus "otherwise disposed of" before March 3, 1924, should be treated as falling within the first class.

In Solicitor's Memorandum 2321 (C. B. III–2, 146) amortizable facilities were transferred in July, 1919, from certain corporations to other corporations having respectively the same stockholders and making the same use of the facilities. The transferor corporations were thereupon dissolved. The plants were running at full capacity at the time of transfer and the facilities were worth the price originally paid for them. The transferor corporations contended for an allowance on the basis of value in use of the facilities, urging that the technical change of legal title be ignored. It was ruled that the transaction fell within the spirit of paragraph (1) of article 184 of Regulations 62, and that the amortization allowance should be computed on the basis of the fair market value of the facilities on the date of transfer.

In Solicitor's Memorandum 4911 (C. B. V–1, 250) the issue concerned the method of computing the deduction for amortizing the cost of war facilities transferred after the close of the amortization period and prior to the postwar period by one affiliated corporation to another in course of liquidation. The facts, for the purpose of the present opinion, may be taken to be as follows: The transferee corporation was formed in December, 1919, and acquired all the capital stock of three corporations owning war facilities. In January, 1920, all the assets were transferred in liquidation to the new company. On the date of transfer the war facilities had a fair market value equal to or in excess of their original cost. Certain

of the facilities remained in possession of the transferee during the entire postwar period, and their value in use declined to a point below their cost and their fair market value on the date of transfer. It was held that the allowance to the transferor corporations should be computed on the basis of the fair market value of the facilities on the date of transfer and not on the basis of their estimated value in terms of their actual employment in the going businesss of the transferee corporation during the postwar period.

In the appeal of G. M. Standifer Construction Corporation, supra, one member of a consolidated group of corporations constructed certain facilities for the use of another member or its employees. The latter member alone was engaged in the production of articles contributing to the prosecution of the war. The Board held that amortization was allowable for the benefit of the group based upon the cost of such facilities to the nonproducing subsidiary. That is the extent to which the decision goes. The issue here presented was in no way involved in that decision.

The appeal of Standard Refractories Co. (6 B. T. A., 24), however, presents a case which, on its facts, constitutes a precedent. The taxpayer had purchased amortizable facilities which were turned over in liquidation in 1922 to the General Refractories Co., a corporation which had recently become the sole stockholder of the taxpayer corporation. The effect of the decision was a dismissal of the appeal for want of evidence competent to prove the fair market value of the facilities at the time of distribution.

This office is of the opinion that the war facilities of the taxpayer transferred to the N Company should be considered, on the authority of Solicitor's Memoranda 2321 and 4911, as falling within class (1) of article 184. The deduction to be allowed should be computed on the basis of the fair market value of the amortizable assets on the date of the transfer in liquidation.

A. W. Gregg,
General Counsel, Bureau of Internal Revenue.

SECTION 214(a)10.—DEDUCTIONS ALLOWED: DEPLETION.

Article 201: Depletion of mines, oil and gas wells; depreciation of improvements.

REVENUE ACT OF 1918.

Repossession of oil and gas lease parted with under contract to sell, title to which was retained by the vender. (See G. C. M. 952, page 191.)

Article 201: Depletion of mines, oil and gas wells; depreciation of improvements.

REVENUE ACT OF 1921 AND PRIOR ACTS.

Basis for depletion (in absence of discovery) and depreciation with respect to property acquired by gift, bequest, devise, or inheritance both prior to and after March 1, 1913. (See I. T. 2337, page 144.)

ARTICLE 203: Amount returnable through depletion and depreciation deductions in the case of lessee. VI–16–3204 G. C. M. 1090

REVENUE ACT OF 1921.

The proper basis for computing depletion to the M Company on oil leases acquired by it in 1921 in an exchange of leasehold interests is the cost of the property traded, depleted to date of exchange, plus the cash consideration.

An opinion is requested as to the proper basis for depletion to the M Company on certain oil leases acquired by it on November —, 1921, in an exchange of leasehold interests.

On April —, 1921, the M Company purchased from A and B an approximately one-half undivided interest in several oil leases, plus equipment. The remaining one-half interest was owned by C.

On September —, 1921, the O Company bought the interest owned by C. The M and the O Companies then proceeded to operate the properties jointly.

The two companies thereafter decided to separate their interests so that each would be the absolute owner of approximately one-half of the leases and equipment. On November —, 1921, representatives of the companies met and divided the leases by alternate selections. It was at first decided that after the selections were completed, lots should be drawn to see which group of leases each company would receive. It was finally decided, however, that the M Company should retain its original selections and pay the O Company $37x$ dollars cash, which was done.

Subsequent to the acquisition of the one-half undivided interest by the M Company on April —, 1921, and prior to the acquisition of the one-half undivided interest by the O Company on September —, 1921, the M Company on June —, 1921, brought in in connection with one of the leases a discovery well having a discovery appreciation to the M Company of $66x$ dollars. The lease and well in question were assigned to the O Company on November —, 1921, on which date the adjusted discovery appreciation to the M Company was $56x$ dollars.

Under the Revenue Act of 1921, section 202(c)1, there was no taxable profit on the exchange of leasehold interests between the M and O Companies, since the transaction was essentially an exchange of property "for property of a like kind or use." The question is raised as to the basis which should be used for computing the depletion allowance to the M Company in respect to the leases acquired by exchange on November —, 1921.

Section 202(c)1 of the Revenue Act of 1921 and article 1566 of Regulations 62 thereunder provide that no taxable gain shall be recognized upon an exchange of property such as is involved in the instant case, and section 202(d)1 and article 1567 provide that the basis for gain or loss on future sale or disposition of the newly acquired property shall be the basis of the old property exchanged therefor. This would have left $272x$ dollars as such basis to the M Company were it not for an added element, to wit, the payment of $37x$ dollars in cash, in addition to the property exchanged. The cash was an added capital investment in the new leasehold rights, and

consequently the total basis for gain or loss to the M Company after the transfer is the sum of these two amounts, or $309x$ dollars.

This is the amount returnable by way of depletion allowances as prescribed by article 203 of Regulations 62. The same basic figure available for the determination of gain or loss on a subsequent sale is that to be used in determining depletion. Accordingly, the M Company may take depletion on the basis of $309x$ dollars.

As to the $56x$ dollars representing the M Company's discovery appreciation of $66x$ dollars as depleted to November —, 1921—when the lease of the tract affected by the discovery was transferred to the O Company, this discovery appreciation was, of course, lost as far as the O Company was concerned. Also, the M Company, which theretofore had been entitled to depletion on this appreciated value as discoverer, by transferring the property to the O Company, parted with any further right to depletion thereon.

A. W. GREGG,
General Counsel, Bureau of Internal Revenue.

ARTICLE 215: Depletion—Adjustments of accounts based on bonus or advanced royalty.

REVENUE ACTS OF 1918 AND 1921.

Treatment of royalties expected to be received in computing deductions for depletion and treatment of bonus received by lessor of unproven areas. (See I. T. 2361, page 73.)

ARTICLE 223: Charges to capital and to expense in the case of oil and gas wells. VI-5-3070 G. C. M. 932

REVENUE ACTS OF 1918 AND 1921.

An agreement was entered into between A, owner of an oil lease, and the M Company, as assignee, whereby the latter was to drill for oil, in consideration of which it was to own a one-half interest in the lease and the wells, and thereby to share equally with the assignor in the oil to be produced.

Held, the drilling costs represent capital expenditures and may be returned by way of depletion against production.

An opinion is requested on the following facts:

A owned an oil lease. In 1920 he assigned an undivided one-half interest in this lease to the taxpayer, the M Company, in consideration of an agreement by it to drill an oil well on the land covered by the lease, the well to extend to a depth sufficient to reach the usual productive sand in the oil field. This agreement provided that A and the taxpayer were to be equal owners of the completed well, and to share equally in oil runs. The cost of the lease to A was x dollars and the cost of the well to the taxpayer was $4x$ dollars. It is stated that it is customary for the taxpayer to charge development costs to expense.

The question presented on the foregoing state of facts is: In the case of drilling contracts as indicated above, should the drilling costs be construed as the cost of the lease and capitalized, or should they be considered as an allowable deduction, or should one half

of the drilling costs be capitalized as the cost of the lease and the other half considered as an allowable deduction?

When the well was completed, on which contingency the assignee-taxpayer's right depended, it then had not a half interest in a bare leasehold plus a half interest in an oil well, but an undivided one-half interest in a developed leasehold. This it in effect acquired by the expenditure of $4x$ dollars in developing the lease, and therefore that entire sum should be capitalized as the cost to it of its new interest in a producing leasehold. Drilling costs may well be ordinarily properly deducted as operating expenses by a taxpayer where the development is one of a previously perfected right, but here these very drilling costs constitute the consideration for the acquisition of the producing rights and can be nothing else but capital investment, returnable by way of depletion against production. Relative to the effect of the transaction in the case of the assignor, see Solicitor's Memorandum 3322 (C. B. IV–1, 112).

A. W. GREGG,
General Counsel, Bureau of Internal Revenue.

SECTION 214(a)11.—DEDUCTIONS ALLOWED: CHARITABLE CONTRIBUTIONS.

ARTICLE 251: Charitable contributions.

REVENUE ACT OF 1921 AND PRIOR ACTS.

Contributions to National Society of the Daughters of the American Revolution. (See I. T. 2334, page 82.)

SECTION 215.—ITEMS NOT DEDUCTIBLE.

ARTICLE 291: Personal and family expenses.

REVENUE ACT OF 1918.

Attorney's fees incurred in defense of an action by former partner for an accounting. (See T. D. 3964, page 202.)

SECTION 218.—PARTNERSHIPS AND PERSONAL SERVICE CORPORATIONS.

ARTICLE 331: Partnerships. VI–7–3104
T. D. 3977

INCOME TAX—REVENUE ACT OF 1917—DECISION OF CIRCUIT COURT OF APPEALS.

PARTNERSHIP—DEDUCTIONS—LOSS—GUARANTEE.

Where a partner guarantees to a partnership the payment of doubtful accounts and upon a loss occurring the amount is charged to the capital account of the partner, thereby reducing his distributive share of the partnership profits, the loss can not be deducted by the partnership but is the individual loss of the partner.

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

To Collectors of Internal Revenue and Others Concerned:

The following decision of the United States Circuit Court of Appeals for the Third Circuit in the case of *Grace N. Lederer, Executrix of Ephraim Lederer, Formerly Internal Revenue Collector, deceased,* v. *Morris L. Parrish, George R. McClellan, and Percival Parrish, Copartners, trading as Parrish & Co.*, is published for the information of internal revenue officers and other concerned.

D. H. BLAIR,
Commissioner of Internal Revenue.

Approved February 5, 1927.

A. W. MELLON,
Secretary of the Treasury.

CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT.

Grace N. Lederer, Executrix of Ephraim Lederer, Formerly Internal Revenue Collector, Deceased, defendant below, plaintiff in error, v. *Morris L. Parrish, George R. McClellan, and Percival Parrish, Copartners, trading as Parrish & Co., plaintiffs below, defendants in error.*

In error to the District Court of the United States for the Eastern District of Pennsylvania.

[January, 1927.]

BUFFINGTON, Circuit Judge: This is an income tax case. Three men were equal partners in a bond and brokerage business. Two of the partners, fearing a customer's account would eventually result in a loss to the firm, insisted on closing it. The third partner insisted on continuing the account, and agreed if its continuance resulted in a loss he would personally assume and pay it. The loss occurred and the third partner paid it. This he did by having the firm charge it against his capital share in the partnership and correspondingly reducing his capital in the firm. Thereafter the partner who had made up the loss claimed and was allowed for such loss in his personal income tax return. In its income tax return the firm also claimed the same loss as one made by it. The collector disallowed such claim and collected the firm's tax in full. Thereupon it brought this suit and recovered a verdict for the alleged overpayment. From a judgment entered thereon the collector took this appeal.

We are of opinion the collector was right. While the account of the firm's customer primarily fell on the firm, eventually the firm lost nothing, for, in pursuance of his antecedent agreement, the third partner assumed and paid the loss himself. This he did by sacrificing and lessening, by the amount of the loss, his share in the partnership. Of course, as regarded creditors, the firm's resources were lessened by the withdrawal of a part of its capital, but this involved no loss to the firm as such nor to its members. As to the firm and the other two partners, a corresponding benefit accrued to the firm by the extinguishment, pro tanto, of its capital account which was a liability and as to the two partners by giving them a correspondingly larger interest than their partner in the partnership assets and a correspondingly larger interest in the firm's profits. There was but one loss and we are unable to see how two losses can be made out of one.

So holding, the judgment below is reversed.

ARTICLE 332: Distributive shares of partners. VI–10–3132
T. D. 3982

INCOME TAX—REVENUE ACTS OF 1916, 1917, AND 1918—DECISION OF CIRCUIT COURT OF APPEALS.

INCOME—PARTNERSHIP—ASSIGNMENT OF INTEREST.

Under section 1204(1) of the Revenue Act of 1917, amending section 8(e) of the Revenue Act of 1916, and section 218(a) of the Revenue Act of 1918 the total profits on the interest of a firm partner are taxable as income to him irrespective of an agreement with his wife under which she was entitled to one-half of the partner's share of the profits and was liable for one-half of the losses, such an agreement not making the wife a member of the partnership.

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

To Collectors of Internal Revenue and Others Concerned:

The following decision of the United States Circuit Court of Appeals for the Second Circuit in the case of *Ormsby McKnight Mitchell* v. *Frank K. Bowers, Collector*, is published for the information of internal revenue officers and others concerned.

D. H. BLAIR,
Commissioner of Internal Revenue.

Approved February 24, 1927.

A. W. MELLON,
Secretary of the Treasury.

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CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

Ormsby McKnight Mitchell v. *Frank K. Bowers, Collector.*

On writ of error to a judgment of the United States District Court for the Southern District of New York dismissing upon the merits a complaint in an action at law.

The action was to recover from the collector part of the plaintiff's income tax paid under duress for the years 1917, 1918, and 1919. During this period he was assessed upon 51 per cent of the entire profits of the firm of Power, Son & Co., of which he and one Kneeland were the only partners. By the articles of copartnership the plaintiff received 51 per cent of the profits and Kneeland 49, a division which remained unchanged during the period in question. On January 1, 1916, the plaintiff entered into an agreement with his wife, which is the basis for his claim that he should have been assessed for only one-half of his share. This agreement stipulated that the wife should be "entitled to one-half of the profits which shall come to" the plaintiff "from said firm" and should be "liable to pay" him "one-half of the losses which he may sustain by reason of his partnership." Further it provided that "upon receiving the profits" the plaintiff "agrees to hold for and pay to" his wife "the share thereof to which she shall be entitled hereunder and upon the sustaining of the losses herein provided for" his wife agreed to pay the plaintiff "the share thereof for which she shall be liable hereunder." Settlements were to be made annually and the contract might be terminated at the option of either party "at any time."

The complaint alleged that the parties at once filed the contract with the firm, whom they directed "to credit and pay over" to her "as they accrued the profits to which, under the terms thereof" she "became entitled," the firm promised "so to do and since said time said firm did duly credit to the account" of the wife "as they accrued" one-half of the plaintiff's profits, "making the same forthwith, upon their accrual subject to her absolute disposition."

The sole question raised by the writ is whether, assuming the contract not to be a sham, the plaintiff remained taxable for his full share of the profits.

The defendant moved to dismiss the complaint on its face and the district court so ordered.

HAND, Circuit Judge: We start with the assumption agreed upon by both sides and well settled by the law of New York, where the agreement was made and the business of the firm was carried on, that the contract of January 1, 1916, did not make the plaintiff's wife a partner in the firm. (*Burnett* v. *Snyder*, 76 N. Y., 344; *Burnett* v. *Snyder*, 81 N. Y., 550.) The result is no different when the other partners in the firm know and assent to the arrangement. (*Rockafellow* v. *Miller*, 107 N. Y., 507.) It is only when the subpartner acquires some interest in the firm assets as such that he may sue the partners for an accounting. (*Nirdlinger* v. *Bernheimer*, 133 N. Y., 45.)

The question therefore is whether, his wife not being a partner, the plaintiff falls within section 1204(e) of the Revenue Act of 1916 and section 218(a) of the Act of 1918, to the extent of the half covered by the agreement. The first section provides that—

"Persons carrying on business in partnership shall be liable * * * only in their individual capacity, and the share of the profits of the partnership to which any taxable partner would be entitled if the same were divided, whether divided or otherwise, shall be returned for taxation."

The second is not in substance different, the important clause being:

"There shall be included in computing the net income of each partner his distributive share, whether distributed or not, of the net income of the partnership."

As a subpartner the wife through the agreement got no present interest, equitable or legal, in the firm assets; the assent of the other partners would have been as necessary for this as to constitute her a partner, for ownership follows the statute. Until by distribution the profits became the separate property of the plaintiff her rights were upon the contract, not in re. This does not run counter to *Nirdlinger* v. *Bernheimer* (133 N. Y., 45), which distinguished *Burnett* v. *Snyder* (81 N. Y., 550) for that reason. Therefore, the plaintiff was in any event obliged to include all undistributed profits in his return; the statute so directed, and the profits pro tanto were still his.

At most then his exemption was confined to such profits as were distributed, to such as "came to" him as his separate property. As to these it may be plausibly argued that since she could get nothing till the profits should "come to" him, and since he was to "hold for and pay to" her all that he got, the profits must be his before they became hers. On the other hand, since they became hers, at least in equity (*Barnes* v. *Alexander*, 232 U. S., 117), as soon as he got them, it must be admitted that there was no instant of time after their distribution at which she was not entitled to them. Whatever might be the dialectical escape from the dilemma so raised, it seems to us that in any view the provision which allowed him at his pleasure to denounce the agreement, put the absolute disposition of the profits always within his power. Whether the contract lacked consideration and was void, we need not decide. It seems to us enough that the plaintiff retained the power to resume his title to the profits when he chose. As to profits not yet distributed in which the wife had acquired no proprietary interest, we do not see that there can be a dispute. As to those distributed there may be some doubt, depending upon whether the contract had consideration, without which equity will not create an equitable assignment. But even if the wife's interest in these was unconditional, the plaintiff's inaction until their distribution was the exercise of an option to allow them to pass to her. The situation remained no different from the voluntary cession periodically to her of one-half of whatever was distributed. Throughout the period the right of disposition remained his, as it does in community property, and this was the ground of the decision in *U. S.* v. *Robbins* (269 U. S., 315). In substance the cases appear to us indistinguishable.

Moreover, taken more at large, the sections were in our judgment meant to read comprehensively. Their purpose was to reach all the firm income by taxing the partners individually. It would be a denial of that purpose to suppose that all the firm profits might not be taxable against the partners, but might have to be reached under other sections of the statute. Certainly it can not be argued that the wife could be taxed under these sections. Therefore, if the plaintiff be right, they allowed some part of the firm income to escape and left it to be caught elsewhere. This we think they pretty clearly forbid. Any

mediate arrangement by which a partner shared what he might get after he got it did not therefore put him outside the scope of such provisions, even if he reserve no power to terminate the contract.

Finally, we attach no significance to the action of the firm upon the contract. Nobody supposes that these made the wife a partner; they accomplished no more than to recognize formally and on the books obligations which the law would have imposed upon the firm in any case. Mere notice would have charged them at their peril with a respect for her rights.

Judgment affirmed.

ARTICLE 333: Credits allowed partners. VI-7-3098
T. D. 3971

INCOME AND EXCESS PROFITS TAX—REVENUE ACT OF 1917—DECISION OF CIRCUIT COURT OF APPEALS.

PARTNERSHIP—PARTNERS.

Under subsection 29 of section 1211 of the Revenue Act of 1917, a partner, in his individual income tax return for the year 1917, is entitled to a credit of his proportionate share of the excess profits taxes paid for the year 1917 by the partnerships to which he belonged.

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

To Collectors of Internal Revenue and Others Concerned:

The following decision of the United States Circuit Court of Appeals for the Second Circuit in the case of *William C. Reid* v. *Rafferty, Collector of Internal Revenue*, is published for the information of internal revenue officers and others concerned.

D. H. BLAIR,
Commissioner of Internal Revenue.

Approved February 4, 1927.

A. W. MELLON,
Secretary of the Treasury.

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

William C. Reid, plaintiff in error, v. *John T. Rafferty, Collector of Internal Revenue, defendant in error.*

Writ of error to the District Court for the Eastern District of New York.

[November 3, 1926.]

During the calendar year of 1917, Reid was a member of two copartnerships, each of which in the spring of 1918 filed a return of partnership excess profits and paid thereupon what is commonly known as the excess profits tax for 1917. Of the taxes so paid, Reid's proportionate share, according to his allotment of the partnership profits, amounted to upward of $25,000.

Reid also, during the same spring of 1918, filed his personal income tax return covering the calendar year 1917. He therein credited his net income with his proportionate share of the excess profits taxes paid by the partnerships to which he belonged for the year 1917.

Some years subsequently the Commissioner of Internal Revenue disallowed this credit and assessed an additional income tax against Reid in respect of the $25,000 credit so claimed by him in 1918.

He paid this tax under protest and brought this suit to recover the same. The collector moved for judgment on the pleadings, which was granted, whereupon this writ was brought.

The record before us consists of the pleadings. We are not assisted by any reports of committees in respect of the statute sections involved. Title 2 of the Act of October 3, 1917, created a "War excess profits tax." Section 201 laid the tax by saying:

"That in addition to the taxes under existing law and under this Act there shall be levied, assessed, collected and paid for each taxable year upon the income of every partnership * * * tax."

HOUGH, C. J.: That is to say the excess profits tax was laid upon the income of the partnership; it was due and payable by the partnership before any distribution could lawfully be made to the several partners, and while doubtless is attached like other partnerships' liabilities to the partners individually, the important point is that no partner could lawfully take as his income more than what was left to the partnership by the way of income after the payment of the excess profits tax.

Income tax on individuals for the year 1917 was provided for by the Act of September 8, 1916 (39 Stat., 756).

By section 2 the net income of a taxable individual included specifically—

"Gains, profits and income derived from * * * businesses * * * or the transaction of any business carried on for gain or profit."

Under section 8e (p. 762):

"Persons carrying on business in partnership shall be liable for income tax only in their individual capacity, and the share of the profits of the partnership to which any taxable partner would be entitled if the same were divided, whether divided or otherwise, shall be returned for taxation and the tax paid under the provisions of this title."

Then immediately follows a list of exclusions from income derived from partnership profits, thus: "From the net distributive interests on which the individual members shall be liable for tax" there shall be excluded "their proportionate shares" received from bonds of the several States or of the United States, and also their proportionate share of profits derived from dividends.

Thus the Act of 1916 specifically provided for certain deductions to be made from income derived from partnership profits before arriving at that net income upon which the individual partner must pay income tax.

When the Act of 1917, supra, created the war excess profits tax, the same statute by Title 12 (40 Stat., 329) introduced amendments into the income tax law of 1916, supra, and one of the amendments introduced (Part 3, general administrative provisions) was to add certain new sections (40 Stat., 336), one of which sections reads thus:

"That in assessing income tax, the net income embraced in the return shall also be credited with the amount of any excess profits tax imposed by Act of Congress and assessed for the same calendar or fiscal year upon the taxpayer, and in the case of a member of a partnership, with his proportionate share of such excess profits tax imposed upon the partnership."

Considering the sequence of events, viz, that in the fall of 1917 when Congress was providing for revenue to meet the expenses of the war there was already an income tax; that in the income which was to be taxed was included partnership profits, and that into this system of taxation the Act of 1917 introduced a new tax, that upon excess profits, which preceded and reduced all income lawfully derivable by partners from their partnership, it seems to us that the meaning of the statutes is too plain for discussion.

The contention of the Government's belief is that Reid "had the benefit of this credit (i. e., the benefit referred to in the statute last quoted) when the partnership income was credited with all excess profits taxes" in what is departmentally known as the "Information tax return" of the partnership itself.

It seems to us that this begs the whole question, which is what credits, deductions, or exemptions is Reid entitled to, and Reid the individual never had any reductions *quoad* his income is the excess profits tax; and all that the information tax return did say or could say was that the partnership income of Reid and his partners was so much, *after the payment of the excess profits tax*.

The point seems to be without precedent, but to us it is plain that under the Act of 1916 there were certain deductions or credits to which the individual

taxpayer was entitled in respect of income derived from a partnership before stating his taxable income. Then came the excess profits tax, which in effect diminished his partnership income and cotemporaneously with the laying of this burden the Congress permitted the partner to credit or deduct from his taxable income the excess profits tax. It is quite useless to speculate on legislative motives, but it may be permissible to observe that considering the size of the new tax of 1917, some reason appears for lessening the existing burden of the income tax. But it is enough for us that we are persuaded that the letter of the law is plainly in favor of plaintiff in error.

Judgment reversed with costs and new trial ordered.

SECTION 219.—ESTATES AND TRUSTS.

ARTICLE 343: Decedent's estate during administration. VI–15–3186 T. D. 4012

INCOME TAXES.

Amendment of article 343, Regulations 45 (1920 edition).

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

To Collectors of Internal Revenue and Others Concerned:

Article 343 of Regulations 45 (1920 edition) is hereby amended by changing the last sentence thereof and the reference directly following to read: "Where, however, the executor sells property of the estate for more than its cost or other basis to the decedent, as the case may be, the excess is income taxable to the estate. See article 1561." Article 343 of Regulations 45 (1920 edition) as amended reads as follows:

ART. 343. *Decedent's estate during administration.*—The "period of administration or settlement of the estate" is the period required by the executor or administrator to perform the ordinary duties pertaining to administration, in particular the collection of assets and the payment of debts and legacies. It is the time actually required for this purpose, whether longer or shorter than the period specified in the local statute for the settlement of estates. Where an executor, who is also named as trustee, fails to obtain his discharge as executor, the period of administration continues up to the time when the duties of administration are complete and he actually assumes his duties as trustee, whether pursuant to an order of the court or not. No taxable income is realized from the passage of property to the executor or administrator on the death of the decedent, even though it may have appreciated in value since the decedent acquired it. In the event of delivery of property in kind to a legatee or distributee, no income is realized. Where, however, the executor sells property of the estate for more than its cost or other basis to the decedent, as the case may be, the excess is income taxable to the estate. See article 1561.

D. H. BLAIR,
Commissioner of Internal Revenue.

Approved April 6, 1927.

OGDEN L. MILLS,
Acting Secretary of the Treasury.

ARTICLE 343: Decedent's estate during administration. VI–15–3196
T. D. 4010

INCOME TAXES.

Amendment of article 343, Regulations 62.

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

To Collectors of Internal Revenue and Others Concerned:

Article 343 of Regulations 62 is hereby amended by changing the last sentence thereof and the reference directly following to read: "Where, however, the executor sells property of the estate for more than its cost or other basis to the decedent, as the case may be, the excess is income, or may be capital gain, taxable to the estate. See article 1561." Article 343 of Regulations 62, as amended, reads as follows:

ART. 343. *Decedent's estate during administration.*—The "period of administration or settlement of the estate" is the period required by the executor or administrator to perform the ordinary duties pertaining to administration, in particular the collection of assets and the payment of debts and legacies. It is the time actually required for this purpose, whether longer or shorter than the period specified in the local statute for the settlement of estates. Where an executor, who is also named as trustee, fails to obtain his discharge as executor, the period of administration continues up to the time when the duties of administration are complete and he actually assumes his duties as trustee, whether pursuant to an order of the court or not. No taxable income is realized from the passage of property to the executor or administrator on the death of the decedent, even though it may have appreciated in value since the decedent acquired it. In the event of delivery of property in kind to a legatee or distributee, no income is realized. Where, however, the executor sells property of the estate for more than its cost or other basis to the decedent, as the case may be, the excess is income, or may be capital gain, taxable to the estate. See article 1561.

D. H. BLAIR,
Commissioner of Internal Revenue.

Approved April 6, 1927.
OGDEN L. MILLS,
Acting Secretary of the Treasury.

ARTICLE 345: Estates and trusts taxed to beneficiaries. VI–17–3210
G. C. M. 1535

REVENUE ACTS OF 1918 AND 1921.

The testator died in 1908, leaving one-half of his estate in trust to five sons to receive the income therefrom during their lives, the share of each son to go to his children upon the son's death. The sons were also named as trustees. During the years in question the trustees made "advances" of money out of the income of the estate to themselves as beneficiaries. Upon the death intestate of one of the sons, friendly suits were instituted, and the court ruled that the corpus of the deceased son's share of the trust estate vested in fee simple in his issue and that as to this share the trust terminated on his death.

Held, that the provisions of I. T. 1733 (C. B. II–2, 169) are not applicable to the trust created, and that the income from the trust property for 1918 and 1919 is taxable to the beneficiaries. For the years 1920 and 1921 the income from four-fifths of the property

is taxable to the four survivors as beneficiaries of the trust, and the income from the balance of the property should be taxed to the children of the deceased son for the year in which received by them.

An opinion is requested as to whether the income of the trust estate created under the will of A for the years 1918 to 1921 should be taxed to the estate or to the beneficiaries.

The facts are as follows:

A died in 1908, leaving a will whereby one-half of his estate was left in trust to pay the income therefrom to his five sons during their lives, the share of each son to go to his children upon his death. The five sons, life beneficiaries under the trust, were named executors and trustees in the will.

The issue is whether the income from the trust estate created by the will of A should be taxed to the trust or to the beneficiaries for the years 1918, 1919, 1920, and 1921. This depends upon whether the income was distributable in such a manner that the beneficiaries may be charged with the receipt thereof or whether it was tied up so that it was not available to them periodically and must be taxed to the trustees.

The will creating the trust provided:

The income of said one-half shall be divided equally among my said five sons as long as they shall respectively live.

Thus, under the terms of the will, the income was distributable to the beneficiaries currently and was taxable to them whether it was actually received or not. (Article 345, Regulations 45 and 62.) However, it has been recognized that where through some dispute, misconception of the law, ambiguity of a will, or otherwise, the income from a trust estate is in litigation or dispute so that the trustees withhold it and it is not available to the beneficiaries for the asking, the beneficiaries can not be charged with constructive receipt thereof and the income is taxable to the trust. (I. T. 1733, C. B. II–2, 169.)

In the instant case no formal distribution of the income was made by the trustees during the years in question, but so-called " advances " of money were made out of the net income of the estate by the trustees to themselves as beneficiaries throughout the respective years, totaling the sum of x dollars on December 31, 1921. This amount exceeded the total amount of income of the trust estate up to that date.

The executors, trustees, and life beneficiaries under the will being the same persons, no question arose until the death of B, one of the five sons, on February —, 1920. Upon his death, the question arose as to who was entitled to his share of the income and what should be done with the corpus of his share of the estate. In order to straighten out the affairs of the trust estate friendly suits were instituted in 1922. On March —, 1923, a decision was rendered by the trial court that "the corpus of the one-fifth interest in the trust estate created by and now held subject to the will of A, deceased, from which B, deceased, was entitled during his lifetime to receive the income vested upon the death intestate of said B, deceased, by virtue of the provisions of said will, by a title in fee simple absolute and in right of possession in the five children of said B, deceased." The court also ordered that the one-fifth interest of the heirs of B be segregated from the remainder of the trust estate. The decision of

the trial court was affirmed by the Supreme Court of Appeals of State of R, and a final decree segregating the one-fifth interest was entered on February —, 1926.

The question is raised whether the existence of this litigation brings the case within the decision in I. T. 1733, referred to above, and makes the entire income taxable to the trust estate during the years 1918 to 1921, inclusive. It is the opinion of this office that it does not. During those years there was no litigation nor was any question raised by anyone as to who was entitled to the income from the trust estate, the will providing that it should be equally divided among the five sons as long as they should live.

The question is next raised whether the fact that there were five trustees controlling the income of the trust estate was such as to prevent the beneficiaries from being charged with the receipt of the income, since it would require the assent of a majority of the trustees-beneficiaries to accomplish such a distribution. The provisions of the will being clear, it is not to be presumed that the trustees would violate their duty. Rather is it to be presumed that they would comply with the terms of the will, and, in the absence of a refusal on their part to so comply, that the income was available to the beneficiaries upon their request or upon the request of any one of them. To hold otherwise would be to say that in any case where the beneficiary under a trust indenture is not the person charged with the execution of the trust, the income is taxable to the trust estate and not to the beneficiary, because it is possible that those in charge of the trust will not accede to a request by a beneficiary for a distribution of the income, thus requiring the beneficiary to go into court to enforce his rights. Obviously, this is not true. Furthermore, in the instant case, the trustees not only did not refuse to distribute the income but instead actually treated it as distributable currently and made advances to themselves as beneficiaries, attempting in that way to distribute the income.

However, in 1920, the death of B raised a question as to the ownership of his one-fifth share of the estate. The will provided:

> The income of said one-half shall be divided equally among my said five sons as long as they shall respectively live and in the event of the death of any one of them unmarried and without issue and without will his share shall be divided among the remaining distributees; if, however, such deceased distributee have left issue, then to such child or children or grandchild or grandchildren of such distributee as he by last will or other instrument in the nature of a will may designate or appoint to receive his share and in default of any such appointment then as the law directs * * *.

The situation was such that it finally caused the matter to be taken into court in 1922 for a construction of the will. In 1923 the court ruled, as stated above, that the corpus of the one-fifth interest in the trust estate from which B was entitled during his lifetime to receive the income vested in fee simple upon his death in his five children and that as to his one-fifth interest the trust terminated on his death.

The question is thus raised as to the method of taxing the income from B's share of the estate during the period from his death on February —, 1920. The case does not come within the scope of I. T. 1733, because the trust created by the will of A terminated as to the one-fifth of the estate in question upon the death of B. In

the opinion of this office, the situation is analogous to that presented in I. T. 1212 (C. B. I–1, 90), where it was held that royalties from a lease of oil lands, which were being withheld by the lessee pending determination of certain litigation involving the title of the lessor, should be reported as income for the year in which the litigation in question was finally disposed of or the lessor's right to the royalties was established in some other way.

Accordingly, it is the opinion of this office:

1. For the years 1918 and 1919 the income of the trust estate should be taxed to the beneficiaries.

2. For the years 1920 and 1921 the income of the four-fifths of the trust estate to which the four surviving sons were entitled during their lives should be taxed to them as beneficiaries, and the income of the one-fifth of the estate to which B was entitled during his life should be taxed to the children of B in the year in which such income was actually received by them.

A. W. GREGG,
General Counsel, Bureau of Internal Revenue.

ARTICLE 347: Estates and trusts with income which is distributed periodically and other income. VI–21–3243 G. C. M. 1673

REVENUE ACT OF 1918.

Beneficiaries under a trust receiving income therefrom part of which consisted of rents and royalties derived from the leasing, use, or operation of mines, oil wells, and similar property are not entitled to depletion in proportion to their respective fractional interests in the trust.

The opinion of this office is requested on the following question:

Are all of the individuals or beneficiaries receiving royalty income through the A Family Trust entitled to depletion in proportion to their respective fractional interests in the trust?

The facts necessary to a determination of this question are briefly these:

A died, testate, ———, 190–, leaving an estate in the hands of three executors of his will, and the same three as trustees of the trust created thereby. After a certain specific devise, the residue was devised to said trustees on certain trusts set forth, providing among other things that the trustees should make payments to the children of the testator from rents, profits, and income of said trust estate, and money arising from the sale of said property, and that at the expiration of 10 years, or upon the death of two of the beneficiaries if before that time, the estate in the hands of the trustees should be divided into five equal shares, certain of the beneficiaries receiving a portion of the estate in fee, certain others only a life estate, and one beneficiary receiving only the income from a one-fifth interest in the estate.

On ———, 191—, the beneficiaries under the will of A, deceased, some acting individually and others by trustees and representatives, created a trust known as the A Family Trust. The interest of the respective beneficiaries was transferred to certain named trustees. The trustees were given full power to manage and control the trust

property, said powers being very broad and extensive. The trustees were to distribute the income to the beneficiaries in accordance with their proportionate interest in the trust property, said income to be distributed quarterly, or in any event not more infrequently than yearly. The term of said trust was 20 years from the 1st day of ———, 191—, provided two named beneficiaries should so long live. Provision was made for the transfer and distribution of the principal of said trust estate at the expiration of the term thereof to the beneficiaries in the proportionate interests they had transferred to the trustees, such interests being the same interests they owned in the estate of the said A, deceased.

A part of the income distributed to the beneficiaries consisted of rents and royalties derived from the leasing, use, or operation of mines, oil wells, and similar property. The beneficiaries are claiming depletion deductions in proportion to their respective fractional interests in the trust.

In the case of *Baltzell* v. *Mitchell* (3 Fed. (2d), 428, T. D. 3668, C. B. IV–1, 191) it was held that losses from the sale by a trustee of securities which formed a part of the corpus of a trust in which the beneficiaries held a life interest in the income were not deductible by the beneficiaries from the income paid to them, but were deductible by the trust in determining its net income. In that case one of the beneficiaries, Mrs. Baltzell, also held a vested equitable remainder in the fund itself. It was held that these losses were suffered by the corpus of the trust estate and did not affect the distributive share to be returned as income by the beneficiary. While that case arose under the Revenue Act of 1918, it is equally applicable to the corresponding provisions of the later Revenue Acts, and the reasoning applied therein is also equally applicable where a depletion deduction is claimed by life beneficiaries of a trust.

Section 219 of the Revenue Acts of 1918, 1921, 1924, and 1926, dealing with the taxation of estates and trusts, recognizes that the fiduciary and beneficiary are separate taxable persons. (*Merchants Loan & Trust Co.* v. *Smietanka*, 255 U. S., 509 [T. D. 3173, C. B. 4, 34].) The law provides that the estate or trust must compute its net income in the same manner as an individual and is entitled to the deductions allowed individuals under section 214 of the various Acts, one of which is depletion. Thus it appears that Congress intended the estate or trust, and not the beneficiary, to take this deduction for depletion. The law provides that the beneficiary must return as his net income the distributive share actually paid him unaffected by capital gains or losses which are sustained by the trust and must be ascribed to the corpus of the trust, in which the beneficiary has no immediate concern. The fact that a beneficiary is also the remainderman and ultimately does have a concern in the corpus of the trust can not alter the circumstance.

In the instant case the beneficiaries by their own acts created a new taxable entity, namely, the trust estate. Having chosen to take advantage, if any, of the creation of this new taxable entity, they should not be heard to complain because deductions for depletion are allowable to the trust instead of to them.

Under the trust herein the beneficiaries receive only such income as is available for distribution. If the expenses of administration

should consume all the income, the beneficiaries would take nothing. Where there is income of the trust to distribute and such income is distributed, the beneficiaries, under the law, must pay a tax on the amount actually received. The beneficiaries have no present right in the enjoyment of the corpus of the trust. Their right until the termination of the trust is in the income alone. They are, therefore, interested at this time as beneficiaries in the income, and not in the corpus. The trust instrument defines income in this manner:

> Wherever the term "income" is used with reference to the aforesaid "B Voluntary Trust" or the "A Family Trust," it is intended that said "income" shall include all rents and royalties and all sums derived from the leasing, use, or operation of any mines, oil wells, or other similar property, whether now or hereafter opened, *but shall not include increases in value of property.* [Italics supplied.]

From the last clause in the above-quoted paragraph it is apparent that the creators of the trust did not contemplate that they, as beneficiaries, would have any right to participate in the gain derived from the sale of the corpus of the trust estate. If the remaindermen were third persons, such remaindermen would have no right to the deduction for depletion. The fact that the beneficiaries and remaindermen are the same persons does not change the situation.

There is no more reason for ignoring the separate entity doctrine in the case at hand than there would be in a case where the beneficiary, the creator, and the remainderman were different individuals. The trustees in this case have title to the property; they have the possession and use thereof. The beneficiaries as beneficiaries are not immediately concerned with the deduction for depletion, inasmuch as depletion is a deduction designed to restore capital and does not affect the distributive share of the beneficiaries. Therefore, under the rule announced in the case of *Baltzell* v. *Mitchell*, supra, the trust and not the beneficiaries is entitled to the deduction for depletion.

In appeal of C. D. Woodard (2 B. T. A., 432) the taxpayer's entire income for the taxable year 1920 was derived from a legal one-third life interest in the estate of his deceased first wife. The income of the said estate was derived through royalties from oil and gas properties which it held. The Commissioner refused to allow the taxpayer a deduction of $15,254.07 for depletion of his alleged interest in the oil and gas properties. The taxpayer appealed, and the Board of Tax Appeals approved the determination of the Commissioner.

In two recent cases of the Board of Tax Appeals, styled *Arthur H. Fleming* v. *Commissioner of Internal Revenue*, and *Marjorie Fleming Floyd-Smith* v. *Commissioner of Internal Revenue*, consolidated and decided as one case in a well-considered opinion dated April 19, 1927, it was held that beneficiaries under certain trusts were not entitled to depletion on account of removal of iron ore from properties forming a part of the corpus of the trusts. The Board of Tax Appeals in denying depletion in those cases followed the principles laid down in the case of *Baltzell* v. *Mitchell*, supra. (See also Appeal of Steffanson, 1 B. T. A., 979; appeal of Henry Stoddard, 3 B. T. A., 79; appeal of Helene R. McConnell, 3 B. T. A., 260; appeal of Louise P. V. Whitcomb et al., 4 B. T. A., 80;

appeal of Elizabeth M. Abell et al., 4 B. T. A., 87; appeal of Sophia G. Coxe, 5 B. T. A., 261.)

In view of the foregoing, it is recommended that the beneficiaries under the A Family Trust be denied deduction for depletion.

A. W. GREGG,
General Counsel, Bureau of Internal Revenue.

ARTICLE 348: Stock bonus or profit-sharing trust.

REVENUE ACT OF 1921.

Status of dividends on stock held by trustees under a stock purchase plan when ultimately distributed to participating employees. (See I. T. 2333, page 78.)

PART III.—CORPORATIONS.

SECTION 231.—CONDITIONAL AND OTHER EXEMPTIONS OF CORPORATIONS.

ARTICLE 511: Proof of exemption.

REVENUE ACT OF 1921 AND PRIOR ACTS.

Procedure with respect to applications for exemption under section 231 of the Revenue Act of 1921 and corresponding provisions of prior Acts. (See Mim. 3537, page 81.)

ARTICLE 515: Building and loan associations and cooperative banks.

REVENUE ACT OF 1921.

Exemption of association whose sources of revenue are installment stock and a small number of savings accounts. (See G. C. M. 1231, page 82.)

ARTICLE 517: Religious, charitable, scientific, literary, and educational organizations and community chests.

REVENUE ACT OF 1921 AND PRIOR ACTS.

Exemption of the National Society of the Daughters of the American Revolution. (See I. T. 2334, page 82.)

ARTICLE 518: Business leagues.

REVENUE ACTS OF 1918 AND 1921.

Exemption of retail merchants' association. (See I. T. 2362, page 85.)

SECTION 236.—CREDITS ALLOWED CORPORATIONS.

ARTICLE 591: Credits allowed. VI–10–3133
T. D. 3981

INCOME TAX.

Section 29, Revenue Act of 1916, as amended; section 4, Revenue Act of 1917.

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

To Collectors of Internal Revenue and Others Concerned:

Section 29, Revenue Act of 1916, as amended by section 1211 of the Revenue Act of 1917, provides as follows:

That in assessing income tax the net income embraced in the return shall also be credited with the amount of any excess profits tax imposed by Act of Congress and assessed for the same calendar or fiscal year upon the taxpayer, and, in the case of a member of a partnership, with his proportionate share of such excess profits tax imposed upon the partnership.

Section 4, Revenue Act of 1917, provides in part as follows:

That in addition to the tax imposed by subdivision (a) of section 10 of such Act of September 8, 1916, as amended by this Act, there shall be levied, assessed, collected, and paid a like tax of 4 per centum upon the income received in the calendar year 1917 and every calendar year thereafter, by every corporation, joint-stock company or association, or insurance company, subject to the tax imposed by that subdivision of that section, except that if it has fixed its own fiscal year, the tax imposed by this section for the fiscal year ending during the calendar year 1917 shall be levied, assessed, collected, and paid only on that proportion of its income for such fiscal year which the period between January 1, 1917, and the end of such fiscal year bears to the whole of such fiscal year.

Pursuant to the above-quoted provisions, in the case of a corporation, joint-stock company or association, or insurance company returning income for a fiscal year ending during the calendar year 1917, the excess profits tax assessed upon the taxpayer under the Revenue Act of 1917 for the fiscal year 1917 should be credited against the net income apportioned to the part of the fiscal year falling within the calendar year 1917 in determining the amount of income subject to the 4 per cent tax imposed by section 4, supra.

All rulings and regulations inconsistent herewith are hereby revoked.

D. H. BLAIR,
Commissioner of Internal Revenue.

Approved February 23, 1927.

A. W. MELLON,
Secretary of the Treasury.

SECTION 239.—CORPORATION RETURNS.

ARTICLE 621: Corporation returns. VI–7–3099
G. C. M. 1122

REVENUE ACT OF 1921.

The M Company existed as an unincorporated association under the laws of Massachusetts from 1912 until February 28, 1923. On March 1, 1923, a charter was issued to the O Company, a Massachusetts corporation, which thereupon took over the business of

the M Company. The stockholders of both companies are identical and the net assets are practically of the same value. For 1923 the corporation filed a single return covering the entire calendar year.

Held, since an association in Massachusetts does not have the same rights and powers as a corporation and is governed by different laws, a return should be filed by the association for the period January 1–February 28, 1923, and a separate return filed by the corporation for the period March 1–December 31, 1923.

An opinion is requested relative to the filing of returns by the O Company for the year 1923.

It appears that the M Company existed as an unincorporated association under the laws of Massachusetts from 1912 until February 28, 1923. On March 1, 1923, a charter was issued to the O Company, a Massachusetts corporation, which thereupon took over the business of the M Company and has continued to operate the business since that time. The stockholders of both companies are identical and the net assets are practically of the same value. For the year 1923 the corporation filed a single return covering the entire calendar year. It now desires to be advised whether it would be required or permitted to file two separate returns for the year 1923, one for the period from January 1 to February 28, during which the business was operated by the M Company, and the other for the 10 months' period ending December 31, 1923, during which the business was conducted by the O Company.

Section 239(a) of the Revenue Act of 1921 provides in part as follows:

> That every corporation subject to taxation under this title * * * shall make a return, stating specifically the items of its gross income and the deductions and credits allowed by this title. * * *

Under the definition of the term "corporation" contained in section 2(2), the provisions of the Act relating to corporations are equally applicable to associations.

In the instant case, the association was essentially different from the corporation both with regard to its relations with the State, its stockholders, and the public. An association in Massachusetts does not have the same rights and powers as a corporation and is governed by different laws. One important difference is the personal liability of those who assume to act for the association. As said by the Supreme Court of Massachusetts:

> The object of it (the association) was to obtain for the associates most of the advantages belonging to corporations without the authority of any legislative act and with freedom from the restrictions and regulations imposed by law upon corporations. (*Hussey* v. *Arnold*, 185 Mass., 202.)

In view of the foregoing, it is the opinion of this office that a return should have been filed for the M Company for the period from January 1 to February 28, 1923, and for the O Company for the remaining 10 months ending December 31, 1923.

A. W. Gregg,
General Counsel, Bureau of Internal Revenue.

ARTICLE 621: Corporation returns.

REVENUE ACT OF 1921 AND PRIOR ACTS.

A union of national banks under Act of November 7, 1918 (40 Stat., 1043). (See G. C. M. 1880, page 92.)

SECTION 240.—CONSOLIDATED RETURNS OF CORPORATIONS.

ARTICLE 632: Consolidated returns. VI-19-3228
T. D. 4017

INCOME TAX.

Consolidated returns.—Article 632 of Regulations 62 amended.

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

To Collectors of Internal Revenue and Others Concerned:

Article 632 of Regulations 62 is hereby amended by the elimination of the third paragraph and the substitution for the paragraph eliminated of a paragraph reading as follows:

Personal service corporations, being exempt from income tax under section 231(14) of the statute for the period prior to January 1, 1922, can not, prior to that date, be affiliated with another corporation or corporations for the purpose of filing consolidated returns.

D. H. BLAIR,
Commissioner of Internal Revenue.

Approved April 30, 1927.

A. W. MELLON,
Secretary of the Treasury.

ARTICLE 634: Change in ownership during taxable year. VI-26-3285
T. D. 4022

INCOME TAX.

Consolidated returns of corporations.—Article 634 of Regulations 45 (1920 edition) amended.

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

To Collectors of Internal Revenue and Others Concerned:

Article 634 of Regulations 45 (1920 edition) is hereby amended to read as follows:

ART. 634. *Change in ownership during taxable year.*—(a) Where corporations are affiliated at the beginning of a taxable year but due to a change in stock ownership or control during the year the affiliated status is terminated, or (b) where corporations are not affiliated at the beginning of the taxable year but through change of stock ownership or control during the year become affiliated, a full disclosure of the circumstances of such changes of stock ownership or control shall be submitted to the Commissioner.

Ordinarily in such cases, where only two corporations are involved, the parent or principal corporation, under the conditions described in (a) above, should file a consolidated return including the income of such subsidiary or

subordinate corporation to the date of the change of stock ownership or control, and each should file a separate return from the date of such change in stock ownership or control to the end of the taxable period, and, under the conditions described in (b) above, each corporation should file a separate return from the beginning of the taxable period to the date of the change in stock ownership or control, and a consolidated return should be filed by the parent or principal corporation from the date of change of stock ownership or control to the end of the taxable year, including therein the income of the subsidiary or subordinate corporation for such period.

Where there are more than two corporations affiliated at the beginning of the taxable year, and due to a change in stock ownership or control the affiliated status of one or more is terminated, but there remain at least two corporations affiliated during the entire year, the parent or principal corporation should file a consolidated return for the entire year, excluding from its return the income of the corporations whose affiliated status is terminated from the date of the change in stock ownership or control; or where two or more corporations are affiliated at the beginning of the taxable year, and through change in stock ownership or control additional corporations become affiliated, the parent or principal corporation should file a consolidated return and include the income of such corporations from the date of change of stock ownership or control. In either case, the subsidiary or subordinate corporation whose status is changed during the taxable year should make a separate return for that part of the taxable year during which it was outside of the affiliated group.

D. H. Blair,
Commissioner of Internal Revenue.

Approved June 14, 1927.

A. W. Mellon,
Secretary of the Treasury.

Article 634: Change in ownership during taxable year. VI-26-3286 T. D. 4023

INCOME TAX.

Consolidated returns of corporations.—Article 634 of Regulations 62 amended.

Treasury Department,
Office of Commissioner of Internal Revenue,
Washington, D. C.

To Collectors of Internal Revenue and Others Concerned:

Article 634 of Regulations 62 is hereby amended by the elimination of the first paragraph and the substitution for the paragraph eliminated of the following paragraphs:

Art. 634. *Change in ownership during taxable year.*—(a) Where corporations are affiliated at the beginning of a taxable year but due to a change in stock ownership or control during the year the affiliated status is terminated, or (b) where corporations are not affiliated at the beginning of the taxable year but through change of stock ownership or control during the year become affiliated, a full disclosure of the circumstances of such changes of stock ownership or control shall be submitted to the Commissioner.

Ordinarily in such cases, where only two corporations are involved, the parent or principal corporation, under the conditions described in (a) above, should file a consolidated return including the income of such subsidiary or subordinate corporation to the date of the change of stock ownership or control, and each should file a separate return from the date of such change in stock ownership or control to the end of the taxable period, and, under the conditions described in (b) above, each corporation should file a separate return from the beginning of the taxable period to the date of the change in stock ownership or control, and a consolidated return should be filed by the parent or principal corporation from the date of change of stock ownership or control to the end of the taxable year, including therein the income of the subsidiary or subordinate corporation for such period.

Where there are more than two corporations affiliated at the beginning of the taxable year, and due to a change in stock ownership or control the affiliated status of one or more is terminated, but there remain at least two corporations affiliated during the entire year, the parent or principal corporation should file a consolidated return for the entire year, excluding from its return the income of the corporations whose affiliated status is terminated from the date of the change in stock ownership or control; or where two or more corporations are affiliated at the beginning of the taxable year, and through change in stock ownership or control additional corporations become affiliated, the parent or principal corporation should file a consolidated return and include the income of such corporations from the date of change of stock ownership or control. In either case, the subsidiary or subordinate corporation whose status is changed during the taxable year should make a separate return for that part of the taxable year during which it was outside of the affiliated group.

D. H. Blair,
Commissioner of Internal Revenue.

Approved June 14, 1927.

A. W. Mellon,
Secretary of the Treasury.

Article 636: Consolidated net income of affiliated corporations. VI–19–3223 G. C. M. 1501

REVENUE ACTS OF 1918 AND 1921.

The M Company, which obtained certain oil leases, etc., in exchange for its capital stock, and which subsequently became affiliated with the O Company, is not entitled to claim depletion, depreciation, and loss on abandonment, either before or after affiliation, on any basis other than the market value of the leases, etc., as of the date of their acquisition. Any operating loss sustained by the M Company after affiliation may be deducted from the combined net income of the affiliated group.

A subsequent transaction, whereby the M Company dissolved and its assets were transferred to the O Company in consideration of the assumption of its indebtedness and the forgiveness of its own obligations, was an intercompany transaction, and no gain or loss from such transaction can be recognized in computing the taxable income of the affiliated companies.

The basis of the transferred assets in the hands of the O Company for the purposes of depletion, depreciation, and gain or loss on future disposition will be the same as the basis in the hands of the M Company.

An opinion is requested on certain matters connected with the purchase by the O Company of the capital stock of the M Company and the subsequent liquidation of that company.

The M Company was incorporated on April —, 1919. On May —, 1919, the M Company acquired certain property and oil leases from A in exchange for its capital stock. At the time of this purchase only a small part of the acreage was proven for oil production, and the cash market value as of May —, 1919, of the leases has been set at x dollars, upon which basis depreciation, depletion, and loss on abandonment have been computed. Due to the discovery of deep sand in a certain field which the company was operating, the cash market value of certain of its leases rose to about $25x$ dollars in December, 1919, and January, 1920, but in February an abrupt decline of production set in and the value of the leases suffered proportionately. The company incurred operating losses during the entire period of its existence.

The O Company was incorporated on June —, 1919. Under contract dated December —, 1919, it acquired from A —— shares of the capital stock of the M Company, or 54.3 per cent of the —— shares then outstanding, for which it gave in consideration:

	Dollars.
Cash	$5\frac{1}{2}x$
— shares of capital stock of the O Company	9 x
Total	$14\frac{1}{2}x$

As of December —, 1920, the O Company purchased the remaining shares outstanding (45.7 per cent) for a cash consideration of $\frac{1}{2}x$ dollars. From July, 1920, to May, 1921, the O Company made unsecured cash advances to the M Company totaling $5x$ dollars. No dividends were ever received by the O Company from the M Company. For the period subsequent to December —, 1920, and including the calendar year 1923, the two corporations filed consolidated returns. On December 31, 1923, the M Company was dissolved and all its assets transferred to the O Company in consideration of the (1) assumption of all liabilities of the M Company, amounting to about x dollars, (2) forgiveness of its indebtedness of $5x$ dollars, and (3) surrender of all shares of the M Company for cancellation. The value of the assets transferred is put at between $1\frac{1}{4}x$ dollars and $1\frac{3}{4}x$ dollars, and it is claimed that they had no "readily realizable market value."

The taxpayer requests advice on the following propositions:

(1) Can the M Company before and after consolidation claim depletion, depreciation, and loss on abandonment on any basis other than the market value of its assets as of May —, 1919?

(2) How should the operating losses of the M Company be treated after affiliation?

(3) Can the O Company deduct an allowance for loss sustained on the transaction of December —, 1923?

(4) What is the basis of the assets acquired by the O Company from the M Company with respect to depletion, depreciation, and loss or gain on a subsequent disposition of the property?

As provided in section 214(a)10 of the Revenue Act of 1921, the basis for depletion and depreciation of the assets of the M Company should be taken to be the cost as of May —, 1919, represented by the fair market value of the leases and other property acquired on that day, plus the cost of development expended in its operations, if such cost has been capitalized and not deducted as an expense. The affiliation of the M Company with the O Company would not change the basis of the deduction allowable. Although it is stated that a large part of the acreage acquired under the leases as of May —, 1919, was "potential territory," no facts are submitted from which it could be determined that the M Company is entitled to claim discovery values for the leases in question.

With reference to the operating losses of the M Company, any such loss sustained by it after affiliation may be deducted from the combined net income of the affiliated group as provided in article 636 of Regulations 62.

The transaction of December 31, 1923, whereby the assets of the M Company were transferred to the O Company in consideration of the assumption of its indebtedness and the forgiveness of its own

obligations, was an intercompany transaction, and no gain or loss from such transaction can be recognized in computing the taxable income of the affiliated companies. The dissolution of the M Company followed the transfer of its assets to the O Company. The holding company received a liquidating dividend in kind from its affiliated subsidiary. The principles underlying such a liquidation have been thoroughly considered in Solicitor's Opinion 131 (C. B. I–1, 18). No gain or loss can be recognized on the transfer or sale of assets between affiliated companies. Rulings to this effect have been consistent under prior Revenue Acts. The nature of a liquidation of an affiliated subsidiary has been determined by the Board of Tax Appeals in a case arising under the Revenue Act of 1918. (See appeal of United States Trust Co., 1 B. T. A., 901.)

Section 204(a) of the Revenue Acts of 1924 and 1926 provides that the ordinary basis for determining gain or loss on property acquired after February 28, 1913, shall be the cost thereof. Subdivision (c) provides, so far as is here pertinent, that the basis for depletion and depreciation shall be the same as provided in subdivision (a) for the computation of gain or loss on subsequent disposition. Certain exceptions to these general rules are set forth in the same section. Among them is the following:

> (7) If the property (other than stock or securities in a corporation a party to the reorganization) was acquired after December 31, 1917, by a corporation in connection with a reorganization, and immediately after the transfer an interest or control in such property of 80 per centum or more remained in the same persons or any of them, then the basis shall be the same as it would be in the hands of the transferor, increased in the amount of gain or decreased in the amount of loss recognized to the transferor upon such transfer under the law applicable to the year in which the transfer was made.

The above paragraph is applicable to assets acquired by a corporation (1) on a reorganization (2) if immediately thereafter an interest or control of 80 per cent or more in such assets remains in the same persons, or any of them. The transfer of all the assets of the subsidiary to the parent corporation constitutes a reorganization within the meaning of section 203(h)1. Not only "substantially all" but all of the assets of the M Company were transferred to the O Company. Prior to the transfer the ultimate interest in and control of the property was vested in the stockholders of the O Company, and this interest and control was unaffected in any manner by the liquidation of the subsidiary.

It is accordingly the opinion of this office that the basis of the assets in the hands of the O Company for the purposes of depletion, depreciation, and gain or loss on future disposition should be the same as the basis in the hands of the M Company. This basis was their cost on May —, 1919, and can be neither increased nor decreased as a result of the intercompany transfer of December 31, 1923.

In computing the amount of gain or loss the basis of the property should be decreased by deductions previously allowable for depreciation and depletion and increased by prior capital expenditures, allowance for depletion being taken without reference to discovery values.

A. W. Gregg,
General Counsel, Bureau of Internal Revenue.

PART IV.—ADMINISTRATIVE PROVISIONS.

SECTION 250.—PAYMENT OF TAXES.

ARTICLE 1003: Nonpayment of tax—Interest and penalty.

REVENUE ACT OF 1921.

Collection from transferees of penalty and interest for failure of corporation to pay income tax within 10 days after notice and demand. (See G. C. M. 1126, page 117.)

ARTICLE 1008: Collection of tax by suit. VI-6-3085
T. D. 3963

INCOME TAX—REVENUE ACT OF 1921—DECISION OF CIRCUIT COURT OF APPEALS.

SUIT—LIMITATION.

In determining whether a suit by the United States is barred by section 250(d) of the Revenue Act of 1921, the suit is "begun," within the meaning of the statute, as soon as the writ, after issuance, has been lodged in the marshal's hands for service.

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

To Collectors of Internal Revenue and Others Concerned:

The following decision of the United States Circuit Court of Appeals for the Second Circuit in the case of *United States of America* v. *Northern Finance Corporation* is published for the information of internal revenue officers and others concerned.

D. H. BLAIR,
Commissioner of Internal Revenue.

Approved January 29, 1927.

A. W. MELLON,
Secretary of the Treasury.

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

United States of America, plaintiff in error, v. *Northern Finance Corporation, defendant in error.*

[January 10, 1927.]

Writ of error to a judgment of the District Court for the Southern District of New York dismissing a complaint in an action at law by the United States to recover an additional income tax for the year 1915.

The complaint alleged that the defendant had filed an income tax return for the year 1915 and paid the amount therein stated. That, for various reasons alleged, the defendant owed a larger sum, which became due on June 30, 1916. The answer denied none of the allegations of the complaint, but alleged that the action had not been begun within five years after the time when the tax became due, or before the passage of the Revenue Act of 1921.

The case was heard on agreed facts, as follows: The summons was issued on November 22, 1921, and on the same day lodged in the marshal's hands for service. It was served on November 29, 1921, and the complaint was filed on July 21, 1923.

The Revenue Act of 1921 was passed on November 23, 1921, of which section 250(d) provided that "no suit or proceeding for the collection of any such taxes * * * shall be begun after the expiration of five years after the date when such return was filed, but this shall not affect suits or proceedings begun at the time of the passage of this Act."

HAND, Circuit Judge: We have been unable to see the significance of the defendant's argument that the limitation in section 250(d) is upon the right and not upon the remedy, and that it "is jurisdictional in its character." That the section is a statute of limitations appears to us too plain for argument, and we are as much compelled to determine when the action is "begun," if the limitation be upon the right, as if it be upon the remedy. As a statute of limitations, it appears to us that it must be read as such statutes always have been, especially as we can see no difference in meaning between the word "begun" here chosen and the usual word, "commenced," or the phrase, "commenced and sued," of the statute of James I (1623).

It has been the general, if not the uniform, interpretation of statutes of limitation that the action is commenced at least as soon as the writ, after issuance, has been lodged in the sheriff's hand for service. (*Brown* v. *Babbington*, 2 Ld. Raymond, 880; *Harris* v. *Woolford*, 6 Term Rep., 617; *Parsons* v. *King*, 7 Term Rep., 6; *Bell* v. *Ohio, etc., Co.*, Fed. Cas., 1260; *Burdick* v. *Green*, 18 Johns, 14; *Jackson* v. *Brooks*, 14 Wend., 649; *Day* v. *Lamb*, 7 Vt., 426; *McCracken* v. *Richardson*, 46 N. J. L., 50; *Mason* v. *Cheney*, 47 N. H., 24; *Johnson* v. *Farwell*, 7 Mo., 370; Wood on Limitations, Vol. II, p. 570.) The question is now generally expressly covered by statute, as it is in New York (sec. 17 of the Civil Practice Act). Indeed, the best modern instances are those of suits in equity which accept the statute of limitation by analogy from actions at law. Here it is the usual rule that the issuance of subpoena, after bill filed, and the lodgment of it for service in the sheriff's hands tolls the statute. (*Linn & Lane Timber Co.* v. *U. S.*, 236 U. S., 574; *U. S.* v. *American Lumber Co.*, 85 Fed. Rep., 827 (C. C. A. 9); *U. S.* v. *Miller*, 164 Fed. Rep., 444; *International Paper Co.* v. *Commonwealth*, 232 Mass., 7.) The mere filing of the bill is at times enough (*Armstrong Cork Co.* v. *Merchants Refrigerating Co.*, 184 Fed. Rep., 199 (C. C. A. 8)), following the Missouri statute. Why a different rule should apply to this statute we can not see. This result is quite independent of section 17 of the New York practice act, which does no more than codify the prevailing construction of statutes of limitation which had preceded it.

Strictly, the case does not involve the question whether the section should have a uniform meaning, wherever the action is brought, or whether the time when it is "begun" is to be determined by the local law. In either case, the statute was tolled in the case at bar, though, so far as we can see, *Goldenberg* v. *Murphy* (108 U. S., 162) is flat for the second view, and rules. The defendant by way of distinction suggests that that was a removed suit, and that the court overlooked the jurisdictional point. But the limitation of the statute there at bar applied equally in whatever court the suit was brought, and, as we have just said, the supposed jurisdictional question had nothing to do with its meaning.

Judgment reversed, and cause remanded with instructions to enter judgment for the plaintiff on the agreed facts.

ARTICLE 1008: Collection of tax by suit. VI-7-3100
T. D. 3972

INCOME AND EXCESS PROFITS TAXES—REVENUE ACTS OF 1918 AND 1921—DECISION OF CIRCUIT COURT OF APPEALS.

1. DISSOLVED CORPORATION—STOCKHOLDER—LIABILITY.

A stockholder of a dissolved or expired corporation is liable for its debts to the extent of the value of the assets acquired by virtue of his relation as stockholder. The liability for an unpaid tax due from the dissolved corporation may be enforced by the United States by a suit in equity against former stockholders.

2. SUITS—LIMITATIONS.

Section 250(d) of the Revenue Act of 1921 extended the time for suit to five years from the date the return was filed and superseded section 250(d) of the Revenue Act of 1918.

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

To Collectors of Internal Revenue and Others Concerned:

The following decision of the United States Circuit Court of Appeals for the Fifth Circuit in the case of *Capps Manufacturing Co.* v. *United States* is published for the information of internal revenue officers and others concerned.

D. H. BLAIR,
Commissioner of Internal Revenue.

Approved February 4, 1927.

A. W. MELLON,
Secretary of the Treasury.

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UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT.

Capps Manufacturing Co., appellant, v. *United States of America, appellee.*

Appeal from the District Court of the United States for the Northern District of Georgia.

[October 19, 1926.]

WALKER, Circuit Judge: This suit, which was brought by the appellee, the United States, on March 22, 1924, asserted the claim that the appellant, Capps Manufacturing Co., was liable for the alleged amount of income and excess profits taxes assessed against the Capps Cotton Mill (Inc.) for the period from January 1, 1918, to June 17, 1918. The bill contained the following allegation:

"That the defendant, the Capps Manufacturing Co., was the sole stockholder of the Capps Cotton Mill (Inc.), and that when said Capps Cotton Mill (Inc.) ceased doing business and abandoned its charter, which has since expired, and was finally liquidated, the Capps Manufacturing Co., without bill of sale, deed or other formality, took over all assets of the Capps Cotton Mill (Inc.)."

The just quoted allegation was put in issue. Evidence adduced was to the following effect: The appellant was organized pursuant to an agreement entered into by the stockholders and depositors of the First National Bank of Toccoa, Ga., after the assets of that bank had been placed in the hands of a receiver appointed by the Comptroller of the Currency in a proceeding to wind up the affairs of the bank. That agreement, after reciting that said bank then was in the hands of said receiver, that its assets included claims against Capps Cotton Mill, Toccoa Banking Co., Toccoa Falls Light & Power Co., Toccoa Realty Co., and Georgia Furniture Co., and considerable stock of each of said companies, provided as follows:

"That said new company will undertake the purchase of the assets belonging to the First National Bank to be sold by said W. L. Wilson, receiver, and will undertake to purchase all the property of Capps Cotton Mill, Toccoa Banking Co., Toccoa Falls Light & Power Co., Georgia Furniture Co., and Toccoa Realty Co., so that said new company will have every asset, real, personal, and mixed, including notes, accounts, choses in action, judgments, mortgages, bonds, and everything, obtainable from said companies, and said receiver, all of said assets to belong solely to the new company after the payment of such indebtedness as may exist, not having been paid up to the time of said several companies, including the bonds due T. A. Capps which are secured by mortgages on the property of said Capps Cotton Mill."

The appellant acquired the assets of said bank under a sale thereof pursuant to a decree of court. Among those assets was all of the capital stock of Capps Cotton Mill except 15 shares. That decree ordered the sale only of the assets of the bank, which included the shares of the capital stock of Capps Cotton Mill held by the bank, but did not include the properties of Capps Cotton Mill. The 15 shares of that stock not owned by the bank were acquired by the appellant from the owner thereof. During the period from January 1, 1912, to June 17, 1918, Capps Cotton Mill was operated in its own name by the owner of all its capital stock, who acquired the same as trustee under the above-mentioned agreement. Capps Cotton Mill took no corporate action for the disposition of its property, and that property was not sold to or purchased by the appellant, which took possession of and operated that property as the owner of all the stock of the corporation which owned it. The properties of Capps Cotton Mill so taken possession of by the appellant exceeded in value the amount of its debts and liabilities, including its tax liability asserted by this suit. The charter of the Capps Cotton Mill expired in 1920. On June 11, 1919, appellant filed a consolidated corporation income and profits tax return for the calendar year 1918, purporting to be a true and correct statement of the gains, profits, and income from all sources received by or accrued to appellant and Capps Cotton Mill during the calendar year ending December 31, 1918. That return did not correctly show the taxable net income of Capps Cotton Mill, subject to income and excess profits taxes, for the period from January 1, 1918, to June 17, 1918. On August 15, 1923, an additional income and excess profits tax in the amount of $5,556.61 for the above-mentioned period was duly assessed against Capps Cotton Mill. The court found that the amount so assessed was correct, and by its decree adjudged that appellant pay, out of the assets of Capps Cotton Mill taken over by appellant, that amount with interest thereon at 1 per cent per month from the 14th day of September, 1923.

The claim asserted was resisted on the ground that it was barred by limitation. The applicable limitation is prescribed in section 250(d) of the Revenue Act of 1921 (42 Stat., 264), which provides that "no suit or proceeding for the collection of any such taxes due under this Act or under prior income, excess-profits, or war-profits tax Acts, * * * shall be begun after the expiration of five years after the date when such return was filed, but this shall not affect suits or proceedings begun at the time of the passage of this Act." The suit was in time, as it was brought within five years from the date of the filing of the above mentioned return made by the Capps Manufacturing Co.

To the extent of the value of the assets of a dissolved or expired corporation acquired by a stockholder thereof by virtue of his relation as stockholder to the corporation he is liable for the debts owing by the corporation. Capps Cotton Mill, by the expiration of its charter, having ceased to exist, the appellant, which used its position as sole stockholder to take over for its own use all the assets of that corporation, which were worth more than its debts, thereby made itself subject to be sued in equity for the enforcement of the tax liability asserted by the suit. (*Curran* v. *Arkansas*, 15 How., 304; *Benton* v. *American National Bank of Macon*, 276 Fed., 368; *McWilliams* v. *Excelsior Coal Co.*, 298 Fed., 884.) Under the evidence there is no merit in the contention that the appellant was the purchaser in good faith of the assets of Capps Cotton Mill. There was no semblance of a sale of such assets to the appellant. After it became sole owner of the capital stock the appellant took over the assets of that corporation, without any sale or transfer thereof by that corporation, and thereafter used and dealt with such assets as its own property. The fact that the above mentioned agreement shows that a purchase by the appellant of all the property of Capps Cotton Mill was contemplated is not evidence that such a purchase was made.

The decree appealed from was not erroneous on any ground which was suggested. That decree is affirmed.

ARTICLE 1008: Collection of tax by suit. VI–15–3194
T. D. 4008

INCOME AND EXCESS PROFITS TAXES—REVENUE ACTS OF 1918 AND 1921—DECISION OF COURT.

DISSOLVED CORPORATION—STOCKHOLDERS' LIABILITY—SUIT—JUDGMENT.

It is not necessary to obtain a judgment against a dissolved corporation for unpaid Federal taxes as a condition precedent to a suit in equity against stockholders to enforce their liability as transferees where it is either impossible to obtain a judgment against the corporation, or obtaining a judgment is manifestly useless and an idle formality.

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

To Collectors of Internal Revenue and Others Concerned:

The following decision of the United States District Court for the Southern District of New York in the case of *United States* v. *William H. Fairall et al.* is published for the information of internal revenue officers and others concerned.

D. H. BLAIR,
Commissioner of Internal Revenue.

Approved April 4, 1927.
OGDEN L. MILLS,
Acting Secretary of the Treasury.

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UNITED STATES DISTRICT COURT, SOUTHERN DISTRICT OF NEW YORK.

United States of America, plaintiff, v. *William H. Fairall; Charles P. Howland; August Klipstein, jr.; George C. Van Tuyl, jr.; Samuel O. Vander Poel; Charles Pausner; Frank Jefferson; John N. Willys; William P. Joyce; Edward S. Maddock; Howard L. Wynegar, defendants.*

[December 6, 1926.]

Suit in equity by United States against stockholders of a dissolved corporation to recover income and excess profits taxes. *Sur* motion by defendant Joyce to dismiss complaint.

HAND, C. J.: If it is proper to treat the distributed assets of a dissolved corporation as a trust fund for creditors, plainly there can be no need of getting judgment against the corporation as a condition precedent to a suit like this. Where there is a trust the creditor may follow the res without more. (*Case* v. *Beauregard*, 101 U. S., 688.) That was the theory on which *Updike* v. *U. S.* (8 Fed. (2d), 913 (C. C. A. 8)) proceeded, and so far as the doctrine of the trust fund is valid, the result is inescapable. In spite of the impressive authority back of that doctrine, I somewhat hesitate to say that to-day it is accepted law, and in any case, since it is not necessary to the disposition of this case, I prefer to put my decision upon another ground.

The rule that you must get judgment and issue execution against a debtor as a condition precedent to following his assets into the hands of transferees is not absolute. If it is impossible to get judgment, or if, when you get it, it is manifestly useless, equity does not insist upon such an idle formality. (*Bank of Commerce & Trusts* v. *McArthur*, 256 Fed. Rep., 84 (C. C. A. 5), *Murray* v. *Sioux Alaska Mining Co.*, 239 Fed. Rep., 818 (C. C. A. 9), *Williams* v. *Adler-Goldman Commission Co.*, 227 Fed. Rep., 374 (C. C. A. 8), *National Tradesmen's Bank* v. *Wetmore*, 124 N. Y., 241.) The condition is imposed in accordance with the general equitable principle that equity gives its remedy only when the law fails, and it may be apparent that the law has failed without insisting upon an idle gesture.

In the case at bar, section 105 of the New York stock corporation law would indeed allow a judgment to be got against the corporation, which is continued for that purpose. But the judgment, once had, would be useless, unless the directors could be held liable for distributing the assets. As this liability arose after the distribution was made, it can scarcely be possible that any court would hold them liable for failing to divine the future action of the Treasury officials of the United States. Yet that would be the only remedy open to the plaintiff here except that which it is now pursuing. It is plain, therefore, that procuring a judgment and issuing execution would be a mere waste of effort and ought not to be required.

Motion denied.

ARTICLE 1009: Collection of tax by distraint. VI–15–3195
T. D. 4009

INCOME AND EXCESS PROFITS TAXES—REVENUE ACTS OF 1917 AND 1921—DECISION OF SUPREME COURT.

STATUTE OF LIMITATIONS—COLLECTION—DISTRAINT—PROCEEDING.

"Distraint" is a "proceeding" within the meaning of section 250(d) of the Revenue Act of 1921, and under that section collection by distraint is barred after five years from the date the return was filed.

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

To Collectors of Internal Revenue and Others Concerned:

The following decision of the United States Supreme Court in the cases of *Bowers, Collector*, v. *New York & Albany Lighterage Co.; Bowers, Collector*, v. *Lloyd W. Seaman;* and *Bowers, Collector*, v. *Thomas Staples Fuller* is published for the information of internal revenue officers and others concerned.

D. H. BLAIR,
Commissioner of Internal Revenue.

Approved April 4, 1927,
OGDEN L. MILLS,
Acting Secretary of the Treasury.

SUPREME COURT OF THE UNITED STATES.

366. *Frank K. Bowers, Individually and as Collector of Internal Revenue, petitioner*, v. *New York & Albany Lighterage Co.*

367. *Frank K. Bowers, Individually and as Collector of Internal Revenue, petitioner*, v. *Lloyd W. Seaman.*

368. *Frank K. Bowers, Individually and as Collector of Internal Revenue, petitioner*, v. *Thomas Staples Fuller.*

On writs of certiorari to the United States Circuit Court of Appeals for the Second Circuit.

[February 21, 1927.]

Mr. Justice BUTLER delivered the opinion of the court.

In No. 366, respondent, March 26, 1918, filed its return of income and excess-profits taxes for 1917 and paid the amount shown due. Shortly before the expiration of five years after the return the Commissioner assessed and the collector demanded payment of additional income and excess-profits taxes. Respondent refused to pay. More than five years after the return the collector distrained and sold personal property of the respondent to pay the amount claimed.

In No. 367, respondent, February 28, 1917, filed his return of income taxes for 1916 and paid the amount shown due. Later an additional tax was assessed; and, more than five years after the return, the collector sought to enforce payment by distraint. Respondent brought suit to restrain the collection on the ground that it was barred by the limit fixed by section 250(d), Revenue Act of 1921 (ch. 136, 42 Stat., 227, 265), and that respondent had no adequate remedy at law. The district court denied relief, and its decree was affirmed by the Circuit Court of Appeals. (297 Fed., 371.) The latter expressed the view that distraint was barred, and held that respondent had an adequate remedy at law. Later the collector enforced payment by distraint.

In No. 368, respondent, February 27, 1917, filed his income tax return for 1916 and paid the amount shown due. The Commissioner, February 27, 1922, assessed an additional income tax. In 1924 the collector enforced payment by distraint.

Each respondent sued in the southern district of New York to recover the amount so collected. Judgments for respondents were affirmed in the Circuit Court of Appeals. (10 F. (2d), 1017.) Writs of certiorari were granted. (271 U. S., 658, 659.)

The question for decision is this: Where, under the tax laws enacted prior to the Revenue Act of 1921, income and excess-profits taxes were assessed within five years after filing return, does section 250(d) of that Act bar collection by distraint proceedings begun after the expiration of the five-year period?

The part of the subdivision that has a bearing is printed in the margin.[1] The clause in controversy is: "no suit or proceeding for the collection of any such taxes * * * shall be begun, after the expiration of five years after the date when such return was filed." Petitioner insists that the word "proceeding" refers only to a proceeding in court and means the same as "suit," and that the Act prescribes no limitation against the collection of such taxes by distraint.

There are two methods to compel payment. One is suit, a judicial proceeding; the other is distraint, an executive proceeding. The word "proceeding" is aptly and commonly used to comprehend steps taken in pursuit of either. There is nothing in the language or context that indicates an intention to restrict its meaning, or to use "suit" and "proceeding" synonymously.

The purpose of the enactment was to fix a time beyond which steps to enforce collection might not be initiated. The repose intended would not be attained if suits only were barred, leaving the collector free at any time to proceed by distraint. In fact, distraint is much more frequently resorted to than is suit for the collection of taxes. The mischiefs to be remedied by setting a time limit against distraint are the same as those eliminated by bar against suit. Under petitioner's construction taxpayers having no property within reach of the collector would be protected against stale demands, while others would be liable to have their property distrained and sold to pay like claims. The result tends strongly to discredit petitioner's contention.

He maintains that any ambiguity in the clause under consideration must be resolved in his favor. Undoubtedly the United States will not be held barred by a general statute of limitation unless, upon a strict construction in its favor, the United States and the claim sought to be enforced fairly may be held to be within the terms and purpose of the statute. (*Dupont De Nemours & Co.* v. *Davis*, 264 U. S., 456, 462.) That rule rests upon the general principle of policy applicable to all governments that the public interest should not be prejudiced by the default or negligence of public officers. (*United States* v. *St. Paul, M. & M. Ry. Co.*, 247 U. S., 310, 314.) The limitation applies to petitioner and to the claims. It applies to suit; the only question is whether it also bars distraint. The provision is a part of a taxing statute; and such laws are to be interpreted liberally in favor of the taxpayers. (*Eidman* v. *Martinez*, 184 U. S., 578, 583; *Shwab* v. *Doyle*, 258 U. S., 529, 536.) There has been suggested no principle of public policy or other consideration that furnishes any reasonable support for the setting of a limitation against only one of the two authorized methods of enforcing collection.

The provision is to be applied in harmony with the intention reasonably to be inferred from its terms and the circumstances of its enactment. (Cf. *United States* v. *Oregon Lumber Co.*, 260 U. S., 290, 299.) Prior to the Revenue Act of 1918 there was no limitation against suit to collect income taxes. Section 250(d) of that Act (40 Stat., 1083) required assessment within five years after

[1] Not printed in Bulletin.

return, and prohibited the commencement of suit or proceeding to collect such taxes after that period. This bar was held to apply only in respect of taxes for 1918 and later years. Then section 250(d) of the Act of 1921 made the limitation apply against collection of taxes under all the earlier Acts; and, in pursuance of a legislative purpose to require more prompt action upon the part of the Commissioner and collectors, prescribed the five-year period for determination and assessment of taxes under earlier Acts but allowed only four years as to those for 1921 and succeeding years. The same purpose is shown by the requirement that the Commissioner, within one year after request by their personal representatives, shall make assessments on income received by deceased persons. These stricter limitations applicable to taxes for the later period make against the petitioner's contention that the Act sets no bar against collection by distraint. A reasonable view of the matter is that it was the intention of Congress by the clause here in question to protect taxpayers against any proceeding whatsoever for the collection of tax claims not made and pressed within five years.

Petitioner's construction of the limitation is inconsistent with the provision immediately preceding it. "The amount of any such taxes due under any return * * * shall be determined and assessed within five years after the return was filed, unless both the Commissioner and the taxpayer consent in writing to a later determination, assessment, and *collection* of the tax." If collection by distraint were not barred by section 250(d) it would not be necessary to have this general consent of taxpayers that collection, as well as determination and assessment, might be made after the lapse of the prescribed period.

Later legislation assumes that the limitation under consideration applies to distraints as well as to suits. See section 278 (d) and (e), Revenue Act of 1924 (ch. 234, 43 Stat., 253, 300). Section 278(d) provides that, where assessment is made within the prescribed time, the tax may be collected by distraint or by a proceeding in court within six years after the assessment. And section 278(e) provides:

"This section shall not (1) authorize the assessment of a tax or the collection thereof by *distraint* or by a proceeding in court if at the time of the enactment of this Act such assessment, *distraint*, or proceeding was barred by the period of limitation then in existence."

This plainly implies that distraint might be barred. And the limitation prescribed by section 250(d) is the only one that could have that effect. See also section 278 (d) and (e), Revenue Act of 1926 (ch. 27, 44 Stat., 9, 59).

The word "proceedings" is rightly used as descriptive of steps taken for the distraint and sale of property to enforce payment of taxes. See *Parker* v. *Rule's Lessee* (9 Cranch, 64, 70); *Murray's Lessee* v. *Hoboken Land & Improvement Co.* (18 How., 272); *Sheridan* v. *Allen* (153 Fed., 568). (*Cf. Scottish Union & Nat. Ins. Co.* v. *Bowland*, 196 U. S., 611, 632, 633; *Hale* v. *Henkel*, 201 U. S., 43, 66.) In a later part, subdivision (g), of section 250, "proceedings" is used broadly in reference to steps for the collection of taxes. Obviously its meaning it not there limited to collection by suit. And in other parts of the internal revenue laws, enacted before this controversy arose, that word is used as descriptive of steps taken to distrain and sell personal property and to seize and sell real estate for the collection of taxes. See Revised Statutes, sections 3194, 3199, 3200, 3203; sidenotes to sections 3190 and 3197. Section 250(d) of the Act of 1921 and these sections of the Revised Statutes relate to the same subject and are to be construed together.

It is clear that the meaning of "proceeding" as used in the clause of limitation in section 250(d), Revenue Act of 1921, can not be restricted to steps taken in a suit; it includes as well steps taken for the collection of taxes by distraint.

Judgments affirmed.

ARTICLE 1010: Liens and enforcement of tax liens by bill in equity. VI–12–3159 G. C. M. 1402

REVENUE ACT OF 1918.

A lien for income and profits taxes, notice of which has been filed in accordance with the provisions of section 3186, Revised Statutes, as amended, can not be released prior to the satisfaction of the tax, even though to support a claim in abatement the taxpayer has filed an indemnity bond with the collector.

An opinion is requested as to whether or not a lien for income and profits taxes may be released prior to the payment of the tax upon the submission of an indemnity bond by the taxpayer.

An additional assessment of x dollars was made against the M Company for the year 1918 on the March, 1924, income tax list. At the time of this assessment the corporate taxpayer was in the process of dissolution and liquidation. Another corporation of the same name disclaimed any liability for the additional tax assessed, so the collector filed the notice of tax lien authorized by section 3186, Revised Statutes, as amended, and this notice is still unreleased.

Subsequent to the filing of the notice of lien the taxpayer filed a claim in abatement and has supported such claim by a bond equal to twice the amount of the indebtedness. This claim is still pending.

The pertinent portion of section 3186, Revised Statutes, as amended, bearing upon the question at issue, is as follows:

> 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 from the time when the assessment list was received by the collector, except when otherwise provided, until paid, with the interest, penalties, and costs that may accrue in addition thereto upon all property and rights to property belonging to such person: * * *.

In section 3186, as originally enacted, it was provided that the lien therein created took effect at the due date of the tax. In the second session of the Forty-fifth Congress a bill to amend the internal revenue laws was passed by the House of Representatives. In this bill that portion of section 3186 relating to the time when the lien took effect was struck out and in lieu thereof the words "when the assessment list was received by the collector, except when otherwise specially provided," were inserted. When the bill (H. R. 4414) came before the Senate in the third session of the Forty-fifth Congress, the only change made by the Senate in the amended section 3186 was to strike out the word "specially" in the clause "except when otherwise specially provided."

Neither in the debates in the House nor in the Senate was there any discussion of just what was intended by the qualifying phrase "except when otherwise specially provided." The section, as amended by the Senate, was agreed to in conference and the conferees' report was adopted by both Houses of Congress. The bill referred to became the Act of March 1, 1879 (20 Stat., 327).

The qualifying clause "except when otherwise provided" has never been judicially construed, so far as known. However, it is believed that the clause has no effect whatever in so far as income and profits taxes are concerned.

In determining the congressional intent in enacting this particular clause, it may be said that by section 3253 of the Revised Statutes the Commissioner of Internal Revenue is required to make assessments upon the distiller of distilled spirits moved from the place of distillation and not deposited in bonded warehouses as required by law. It will be noted that in the case just referred to the *assessment* by the Commissioner is necessary, which assessment, under the terms of the statute, is to be—

> returned to the collector who shall immediately demand payment of such tax, and, upon the neglect or refusal of payment by the distiller, shall proceed to collect the same by distraint.

Under the provisions of section 3251, as amended by the Act of March 3, 1875 (a statute in force when the amendment to section 3186 was adopted on March 1, 1879)—

every proprietor or possessor of, and every person in any manner interested in the use of, any still, distillery, or distilling apparatus, shall be jointly and severally liable for the taxes imposed by law on the distilled spirits produced therefrom, and the tax shall be a first lien on the spirits distilled, the distillery used for distilling the same, the stills, vessels, fixtures, and tools therein, the tract of land whereon the said distillery is situated, and on any building thereon, *from the time said spirits are in existence as such until the tax is paid.* [Italics supplied.]

Clearly as to distilled spirits on which an assessment by the Commissioner was made necessary under the provisions of section 3253, Revised Statutes, the lien arose not at the date the assessment list was received by the collector but immediately on the completion of the manufacture or distillation of the spirits subject to the tax. Moreover, the liability was not limited to the taxpayer, as is the case under 3186, Revised Statutes, but extended to "every proprietor or possessor of, and every person in any manner interested in the use of, any still, distillery, or distilling apparatus," utilized in the manufacture of the particular distilled spirits covered by this section.

Other examples might be given but the one cited is sufficient to show that Congress, in the use of the qualifying phrase "except when otherwise provided" in section 3186, Revised Statutes, as amended, intended that the rule laid down in said section 3186, as amended, was to apply generally in all cases other than the limited number wherein the lien for taxes was made to commence from a period anterior to the receipt of the assessment list by the collector, and those cases where assessment lists were unnecessary and the tax devolved upon a taxpayer without the formality of an assessment.

Under section 3218, Revised Statutes, every collector is charged with the whole amount of taxes appearing on the lists transmitted to him by the Commissioner of Internal Revenue or by other collectors, or delivered to him by his predecessor in office, together with such additions as may be made thereto in the way of interest, penalties, etc., and it is his duty to use the utmost diligence to collect the taxes with which he is charged.

In article 1032, Regulations 45, it is provided—

The filing of a claim for abatement does not necessarily operate as a suspension of the collection of the tax or make it any less the duty of the collector to exercise due diligence to prevent the collection of the tax being jeopardized. He should, if he considers it necessary, collect the tax and leave the taxpayer to his remedy by a claim for refund.

Of the same tenor is article 1032, Regulations 62, and undoubtedly the same language substantially would have been used in subsequent regulations (65 and 69) had not the Revenue Acts of 1924 and 1926, by reason of the creation of the Board of Tax Appeals, completely revolutionized the practice relating to matters formerly covered by abatement claims. In the instant case, however, it is well to remember that the assessment of additional tax occurred prior to the passage of the Revenue Act of 1924, and notice of the lien was filed shortly after notice and demand for the payment of the additional tax had been made by the collector, which was before the enactment of the Revenue Act of 1924.

From what has been said it is a fair conclusion that the collector, being the person primarily responsible for the collection of internal revenue taxes, is not inhibited from filing a notice of tax lien, even though the taxpayer may have presented, before the filing of the notice of lien, a claim in abatement supported by a bond. Indeed, in many cases the filing of the notice of lien is the best procedure to protect the interest of the Government. The lien for taxes covers all property or rights to property of a delinquent taxpayer, and, when the statutory provisions have been complied with by the collector, the lien is valid against all subsequent mortgagees, purchasers, or judgment creditors. Even without the notice the lien is valid against all other classes of claimants. Moreover, the lien, by the terms of the statute, is "in favor of the United States," while the bond customarily given to support a claim in abatement is in favor of the collector.

Under the old practice—that is, the practice in vogue with respect to claims in abatement filed by taxpayers in cases arising prior to the enactment of the Revenue Act of 1924—it was optional with the collector to require a bond to support the claim. Theoretically, if not indeed actually, the collector's bond protected the Government's interest in all outstanding assessments standing on that officer's books. The provisions of section 3186, Revised Statutes, as amended, gave then, as it now gives, the collector the authority to make the collection of delinquent taxes more certain by the filing of the notice of the Government's lien for taxes. It was also within the collector's discretion, when a claim in abatement was filed, whether he would require a bond further to protect him in the event of the disallowance of the abatement claim.

It very often happens that the amount sought to be abated does not equal that of the assessment. Certainly, in such a case, it could not be said that the collector ought not to file a notice of lien because the abatement claim is supported by a bond. In doubtful cases of this character it is the duty of the collector fully to protect the interests of the United States (and of himself as well) by filing the notice of the Government's lien for taxes, which being general in all its terms would apply to all the property or rights to property belonging to the delinquent taxpayer irrespective of any bond given to secure the payment of a part of the liability.

The lien for taxes due the Government, once attaching, must remain under the mandatory terms of the statute "until paid." There is no provision of law authorizing the release of a lien once it has come into being. True it is that (1) if the outstanding liability be compromised in full, or (2) if under the provisions of section 3207, Revised Statutes, as amended by section 1127 of the Revenue Act of 1926, the tax lien of the Government upon realty subject to other liens or interest is determined to be of no value by reason of other superior liens, then the property or rights to property covered or supposed to be covered by the lien for taxes are released therefrom and it is the duty of the collector to file his notice of release; in the first instance, by a general release; second, by a release covering the particular realty involved. Otherwise the collector can not release a lien once placed until the outstanding tax, together with the interest, penalties, and costs that may accrue in addition thereto, have been satisfied.

The premises considered, it is held that a lien for income and profits taxes, notice of which has been filed in accordance with the provisions of section 3186, Revised Statutes, as amended, can not be released prior to the satisfaction of the tax, even though to support a claim in abatement the taxpayer has filed an indemnity bond with the collector.

A. W. GREGG,
General Counsel, Bureau of Internal Revenue.

ARTICLE 1011: Compromise of tax cases. VI–10–3134
T. D. 3984

INCOME AND EXCESS PROFITS TAXES—REVENUE ACTS OF 1916 AND 1917—DECISION OF CIRCUIT COURT OF APPEALS.

TAXES—COMPROMISE—SUIT.

Where a taxpayer pursuant to section 3229 of the Revised Statutes offers a certain sum in compromise of taxes, penalties, civil and criminal liability, which offer is duly accepted by the authorized officers of the Government, an action at law can not thereafter be maintained to recover back a part of the taxes alleged to have been illegally assessed and collected.

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

To Collectors of Internal Revenue and Others Concerned:

The following decision of the United States Circuit Court of Appeals for the Fifth Circuit in the case of *Alexander S. Walker, Formerly Collector of Internal Revenue*, v. *Alamo Foods Co.* is published for the information of internal revenue officers and others concerned.

D. H. BLAIR,
Commissioner of Internal Revenue.

Approved February 24, 1927.

A. W. MELLON,
Secretary of the Treasury.

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT.

Alexander S. Walker, formerly Collector of Internal Revenue, plaintiff in error, v. *Alamo Foods Co., defendant in error.*

Error to the District Court of the United States for the Western District of Texas.

[January 4, 1927.]

WALKER, Circuit Judge: This was an action by the defendant in error, the successor of the San Antonio Brewing Association (herein called the plaintiff), against the plaintiff in error, former collector of internal revenue (herein called the collector), for the recovery of the sum of $237,128.53 with interest thereon. By stipulation of the parties a jury was waived, and the court made findings of facts and conclusions of law, and thereon judgment for the amount sued for was rendered. The following statement indicates the circumstances of the payment of the principal amount sought to be recovered: In July, 1918, two criminal indictments were returned by the Federal grand jury at Austin, Tex., charging C. T. Priest, plaintiff's vice president and general manager, with knowingly participating in filing false and fraudulent tax returns on behalf of

the plaintiff for the year 1917. Prior to August 14, 1919, the Commissioner of Internal Revenue made an assessment against plaintiff in the sum of $370,184.53, for additional income taxes for the year 1916, for income and profits taxes for 1917, and for penalties. On the last-mentioned date the collector caused to be served on plaintiff notice demanding payment within 10 days of the amount of that assessment. Thereupon the plaintiff applied to the collector for an extension of time for payment to enable it to file claims for abatement and to secure hearings thereon before the Commissioner of Internal Revenue. Upon the collector refusing to grant such extensions unless plaintiff executed a conveyance of all its property to a trustee, conditioned to pay the assessed taxes and penalties if the request for abatement was not granted, plaintiff executed such conveyance. Thereupon plaintiff filed claims for abatement of the taxes and penalties assessed. On November 13, 1919, the Commissioner notified plaintiff that the sum of $27,486.78 was abated, and that the amount of the assessment was reduced to $342,697.75. Thereupon the collector demanded payment of the just stated amount. When this occurred the plaintiff requested the collector to postpone enforcement of the trust deed to enable plaintiff to communicate further with the Commissioner with a view to the latter reconsidering the controversy. The collector complied with this request. During the period of several months thereafter representatives of the plaintiff had numerous conferences with the officials at Washington in the effort to bring about a reduction of the assessment. Even before that assessment was made a representative of the plaintiff notified the Department that the plaintiff would prepare and submit a proposition to settle and compromise the matters in question, both criminal and civil. In November, 1919, after it was disclosed that plaintiff could not obtain a reduction of the assessment, at a conference in Washington between officials and the representative of the plaintiff who had knowledge of all the pertinent facts, it was agreed that plaintiff would make an offer of compromise and settlement on terms stated, which included a 50 per cent reduction in the penalties assessed and a dismissal of the above-mentioned indictments. Pursuant to that understanding the plaintiff, in December, 1919, and January, 1920, made deposits, the aggregate of which made up the amount proposed to be paid by plaintiff, and the plaintiff submitted the following written offer, dated February 1, 1920:

"COLLECTOR OF INTERNAL REVENUE,
Austin, Tex.:

"The undersigned, The San Antonio Brewing Association, seeking the benefits of section 3229, United States Revised Statutes, hereby tenders the sum of $318,039.70 in payment of all income and excess profits taxes, and in compromise of all penalties and other civil and criminal liabilities of said association and its officers growing out of internal revenue taxes due for the years 1916 and 1917.

"SAN ANTONIO BREWING ASSOCIATION,
[Signed] "By C. T. PRIEST, *Vice President.*"

That offer was received in the office of the Solicitor of Internal Revenue in May, 1920. After the acceptance of this offer had been recommended by the Commissioner of Internal Revenue and that recommendation had been approved by the Secretary of the Treasury and by the Attorney General, the Solicitor of Internal Revenue, on August 23, 1920, by the following written communication, advised the plaintiff of its acceptance:

"SAN ANTONIO BREWING ASSOCIATION,
San Antonio, Tex.

"SIRS: The Commissioner of Internal Revenue has considered the proposition submitted by you on May 14, 1920, through the collector of internal revenue at Austin, Tex., as a compromise of liabilities on account of filing false and fraudulent income and excess-profits tax returns for the years 1916 and 1917, and has decided, with the advice and consent of the Secretary of the Treasury and the concurrence of the Attorney General, to close the case by the acceptance of the following terms:

"$318,039.70 in payment of all income and excess-profits taxes and in compromise of all penalties and all civil and criminal liabilities of the San Antonio Brewing Association and its officers growing out of internal revenue taxes due for the years 1916 and 1917.

"Respectfully,

[Signed] "WAYNE JOHNSON,
"*Solicitor of Internal Revenue.*"

Thereupon the above-mentioned indictments were dismissed. In August, 1923, claims for the refund of the additional taxes and penalties involved in the above-mentioned compromise and settlement were filed. In December, 1923, those claims for refund were rejected for the reason that the controversy as to the subject of them had been settled. This suit was brought on June 10, 1924, the principal amount sued for being the amount paid as above stated less the part thereof which was admitted by plaintiff to have been properly paid. The court's conclusions of law included one to the effect that said payments by plaintiff and said attempted compromise were made under duress, and that, because of such duress neither the payments nor the compromise are binding on the plaintiff. It is disclosed that the only finding of fact upon which the just mentioned conclusion was based was the following:

"That the proposal of compromise hereinbefore found, was not made voluntarily and that the taxes and penalties paid in pursuance thereof were not paid voluntarily, but that such proposal and the payment of such taxes and penalties were made only by reason of the threat made by the collector to distrain the property of the association if the taxes and penalties were not paid within ten (10) days after the notice by the collector demanding such payment, and because of the threat of the collector to make sale of the association's property under the deed of trust or mortgage given by the association to secure the payment of such taxes and penalties if not promptly paid, and because of the pendency of the indictments against C. T. Priest and the threat to prosecute the same."

The facts of this case do not call for the application of the rule that money paid to prevent the enforcement of process for the collection of taxes not legally due or owing may be recovered if the making of such payment was accompanied with notice that the party making it did not do so voluntarily. (*Ward* v. *Board of County Commissioners of Love County*, 253 U. S., 17; *Gaar, Scott & Co.* v. *Shannon*, 223 U. S., 468; *United States* v. *New York & Cuba Mail S. S. Co.*, 200 U. S., 488; *Railroad Co.* v. *Commissioners*, 98 U. S., 541.) There is a material difference between a payment so made and a payment made pursuant to an agreement of compromise of the matters in dispute. A party against whom taxes have been assessed is at liberty to make or accept or to refrain from making or accepting an offer of compromise. The making of an offer of compromise is a voluntary act, and the contract resulting from its acceptance is binding on a party unless his consent to the contract was illegally obtained. (*Ostrum* v. *City of San Antonio*, 71 S. W., 304; *Palomares Land Co.* v. *Los Angeles County*, 146 Calif., 530; *Lee* v. *Inhabitants of Templeton*, 13 Gray, 476.) The opinion in the case of *Swift Co.* v. *United States* (111 U. S., 22), which was invoked by counsel for the plaintiff, and the opinion in the same case on a previous appeal (105 U. S., 691), recognize the distinction between a coerced payment and a payment made pursuant to a contract or agreement. It clearly appears from those opinions that the plaintiff in that case would not have been entitled to recover if an agreed settlement of the matters in controversy had been proved. Furthermore, a material difference between that case and the instant one is indicated by the following statement made in the opinion rendered on the second appeal.

"No formal protest, made at the time, is, by statute, a condition to the present right of action, as in cases of action against the collector to recover back taxes illegally exacted."

The payments now in question were made, not in compliance with any official demand or statutory requirement, but in pursuance of an agreement to which the plaintiff was a party, and without protest or notice that in making or complying with that agreement the plaintiff acted otherwise than voluntarily. The making of that agreement was authorized by the statute providing for the compromise of any civil or criminal case arising under the internal revenue laws. (R. S. 3229, Comp. Stat., sec. 5952.) A compromise by which the authorized representatives of the Government agreed to take, and the plaintiff agreed to pay, a less sum than had been assessed against the latter had the effect of extinguishing the controversy between the parties to the contract. (*Little* v. *Bowers*, 134 U. S., 547, 556.) The matters which were in controversy between the parties to the compromise before it was made are not subject to be reopened if the compromise was binding on the parties, and the question whether it was binding is determined by rules applicable to contracts generally. A payment made pursuant to a contract can not be recovered back without annuling or canceling the contract, and that can not be done unless the payer's consent to the contract was illegally obtained, or without his taking prompt action to

annul or avoid the contract and restoring the status which existed before the payment was made. The party seeking to get back what he has paid can not retain the benefits of the contract and escape its burdens. (*McLean* v. *Clapp*, 141 U. S., 429; *Grymes* v. *Sanders*, 93 U. S., 55; *Multnomah County* v. *Title Guarantee & Trust Co.*, 46 Oregon, 523.) The indictment mentioned having been dismissed pursuant to the compromise agreement, it is obvious that it was impossible to restore the status which existed before that agreement was made. In the situation which existed between the date of the making of the demand that plaintiff pay the amount of the assessment finally made and the date of the compliance with the compromise agreement it was open to the plaintiff either to pay under protest the amount assessed and sue for the whole or any part thereof claimed to have been erroneously or illegally assessed or collected. (Comp. Stat., sec. 5949), or to avail itself of an opportunity to settle by compromise the matters in controversy. It chose the last-mentioned alternative. By this suit it claims that it was as free to attack the assessment as it would have been if it had chosen the other alternative. No finding made indicates that in making the compromise the plaintiff acted without full knowledge of all the circumstances, or that it was influenced by any constraint except such as resulted from the facts that when the agreement was made the above-mentioned indictments against one of its officers was pending and the collector had means of promptly enforcing collection of the assessment made. It well may be inferred that when the statute authorizing the compromise of any civil or criminal case arising under the internal revenue laws was enacted it was contemplated by the lawmakers that it would frequently happen that at the time of the making and acceptance of an offer of compromise an assessment of taxes claimed to be due would be presently enforceable and there would be pending a charge of criminal misconduct with reference to such taxes against the party claimed to be liable therefor or a representative of such party. Officials rarely would be justified in exercising the power to compromise criminal cases if the pendency of a duly made criminal charge sought to be included in a proposed compromise has the effect of enabling the party seeking the compromise to repudiate the compromise or treat it as a nullity except as to its result in getting rid of the criminal charge. Certainly a compromise agreement to pay a stated sum is not kept from being binding on the party agreeing to make such payment by the fact that that party knew that the payment by him of a greater sum could and would have been coerced if he had not so agreed. (*Savage, Executrix*, v. *United States*, 92 U. S., 382.)

The court's ruling was to the effect that the plaintiff was entitled to treat the compromise agreement as a nullity and to maintain an action to recover back the amount wrongfully assessed, because at the time that agreement was made plaintiff was subject to be coerced to pay a larger sum than the one it agreed to pay and its representative was subject to be tried under the indictments against him, though the plaintiff did not promptly take action to avoid or annul the compromise agreement and could not restore the status which existed before that agreement was made and complied with. We are of opinion that the ruling was erroneous, and that on the state of facts found plaintiff was not entitled to recover back the whole or any part of the sum it paid in pursuance of the compromise agreement. The just stated conclusion makes it unnecessary to consider other grounds on which the judgment under review was challenged.

The judgment is reversed, and a judgment will be here rendered dismissing the suit, with costs against the defendant in error.

Reversed and remanded.

SECTION 252.—REFUNDS.

ARTICLE 1037: Special relief where invested capital reduced by Commissioner.

REVENUE ACT OF 1921.

Refund or credit of overpayment for prior years where there is no profits tax liability for current taxable year. (See G. C. M. 1254, page 126.)

PART V.—INVESTED CAPITAL.

SECTION 326.—INVESTED CAPITAL.

ARTICLE 831: Meaning of invested capital. VI–6–3086
T. D. 3959

EXCESS PROFITS TAX—REVENUE ACT OF 1917—DECISION OF SUPREME COURT.

INVESTED CAPITAL—INSURANCE COMPANIES—LEGAL RESERVE.

In computing the excess profits tax of a mutual life insurance company having no capital stock, the legal reserve should be included as "invested capital" of the company under the definition of section 207 of the Revenue Act of 1917.

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

To Collectors of Internal Revenue and Others Concerned:

The following decision of the United States Supreme Court in the case of *Charles V. Duffy, Former Collector of Internal Revenue*, v. *The Mutual Benefit Life Insurance Co.* is published for the information of internal revenue officers and others concerned.

D. H. BLAIR,
Commissioner of Internal Revenue.

Approved January 29, 1927.

A. W. MELLON,
Secretary of the Treasury.

SUPREME COURT OF THE UNITED STATES. No. 108.—OCTOBER TERM, 1926.

Charles V. Duffy, Former Collector of Internal Revenue, petitioner, v. *The Mutual Benefit Life Insurance Co.*

On writ of certiorari to the United States Circuit Court of Appeals for the Third Circuit.

[November 29, 1926.]

Mr. Justice SUTHERLAND delivered the opinion of the court.

This case arises under the Revenue Act of 1917 (ch. 63, 40 Stat., 300, 302–306), imposing upon every corporation, partnership, and individual a war excess profits tax. The pertinent provisions of the Act are as follows:

"SEC. 201. That in addition to the taxes under existing law and under this Act there shall be levied, assessed, collected, and paid for each taxable year upon the income of every corporation, partnership, or individual, a tax (hereinafter in this title referred to as the tax) equal to the following percentages of the net income:

"Twenty per centum of the amount of the net income in excess of the deduction (determined as hereinafter provided) and not in excess of 15 per centum of the invested capital for the taxable year; * * *

"SEC. 203. That for the purposes of this title the deduction shall be as follows, except as otherwise in this title provided—

"(a) In the case of a domestic corporation, the sum of (1) an amount equal to the same percentage of the invested capital for the taxable year which the average amount of the annual net income of the trade or business during the prewar period was of the invested capital for the prewar period (but not less than 7 or more than 9 per centum of the invested capital for the taxable year), and (2) $3,000; * * *

"SEC. 207. That as used in this title, the term 'invested capital' for any year means the average invested capital for the year, as defined and limited in this title, averaged monthly.

"As used in this title 'invested capital' does not include stocks, bonds (other than obligations of the United States), or other assets, the income from which is not subject to the tax imposed by this title, nor money or other property borrowed, and means, subject to the above limitations:

"(a) In the case of a corporation or partnership: (1) Actual cash paid in, (2) the actual cash value of tangible property paid in other than cash, for stock or shares in such corporation or partnership, at the time of such payment (but in case such tangible property was paid in prior to January 1, 1914, the actual cash value of such property as of January 1, 1914, but in no case to exceed the par value of the original stock or shares specifically issued therefor), and (3) paid in or earned surplus and undivided profits used or employed in the business, exclusive of undivided profits earned during the taxable year: * * *"

By section 200 it is provided that the term "corporation" includes joint-stock companies or associations and insurance companies, and we assume that this includes nonstock mutual insurance companies as well as those having capital stock.

Respondent is a mutual company having no capital stock, and its policyholders constitute its members. Its business has always been conducted upon the "level premium plan," under which the estimated annual cost of the insurance is averaged and the maximum annual contribution of each member is uniform throughout the life of the policy. The annual contributions during the early years of the policy are in excess of the natural premiums, and such excess premiums, augmented by interest thereon, are held as a reserve to maintain the insurance in the later years. These contributions (or premiums), together with the increment derived from their investment, constitute the sole assets of the company. A more complete statement of the plan will be found in the opinion of the district court in this case (295 Fed., 881), and cases cited in that opinion, at page 883.

The company is required by State laws, as a condition of continuing business, to maintain its assets at a sum not less than the amount of the "legal reserve" required by such laws. For the year 1917 the legal reserve amounted to something over $186,000,000. In addition to the legal reserve, the company maintained a second or "contingent reserve" as a margin of safety to meet contingencies. The two reserves are not segregated in any way or separately identified or invested. The funds therein, constituting the company's entire assets, are invested in its office building and in Government bonds and other securities. The income resulting from the investments is returned for Federal taxation and is taxed. For the year 1917 the sum of the two reserves was returned by the company as invested capital for that taxable year. The net income shown for the year was $1,808,339.33, upon which the company paid an income tax of $108,500.36, but no excess profits tax. The Commissioner of Internal Revenue amended the returns and, thereupon, levied an additional assessment against the company amounting to $83,779.70. This was accomplished, so far as necessary to be now considered, by deducting from the amount of invested capital as returned the sum of $186,258,796, being the exact amount of the legal reserve, and reducing the company's invested capital for the year to the sum of $14,719,043.76. It is agreed that if, instead of this latter sum, the company's invested capital had been computed at any sum in excess of $25,500,000, no war excess profits tax would have been due.

The company paid the amount of the additional assessment under protest and brought this action to recover it. The collector moved to strike out the complaint as insufficient in law. It was stipulated that the decision on the motion should be a final disposition of the controversy. The district court denied the motion and rendered judgment, for the full amount, with interest. (295 Fed., 881.) This judgment was affirmed by the circuit court of appeals (3 F. (2d), 1020).

The question for determination is whether the funds constituting the legal reserve, or sufficient thereof to make up as much as $25,500,000 when added to the amount allowed by the Commissioner, is invested capital within the meaning of section 207(a) of the Revenue Act. The contention of the collector is that under subdivisions (1) and (2), section 207(a), invested capital must be either cash or tangible property paid in for stock or shares of the

corporation, and inasmuch as the company has no capital represented by stock or shares, its legal reserve is not invested capital within the meaning of those subdivisions; that the legal reserve is not surplus or undivided profits within the meaning of subdivision (3), because it is no more than the equivalent of the obligations of the company at the time under its policies of insurance. It is contended that the legal reserve represents a present existing liability; and stress is put upon the fact that it is carried by the company on the liability side of its ledger.

It appears from the complaint that the company has been in business since the year 1845. During that time the amount of its assets has increased, year by year, from about $20,000 in 1846 to over $200,000,000 in 1917, divided between the legal reserve and the contingent reserve, as already stated. The legal reserve includes $70,000,000 premiums theretofore paid and $116,000,000 earnings upon investments. The legal reserve, therefore, constitutes assets of a very permanent character. Originally consisting of the contributions of members only, the earnings now make up considerably more than one-half of the whole. The contributions were made for, and have been used to serve, the double purpose of protection and of investment. These assets, thus constituted, have never represented indebtedness any more than the capital of a stock corporation subscribed by its stockholders represents indebtedness. Until the maturity of a policy, the policyholder is simply a member of the corporation, with no present enforceable right against the assets. Upon the maturity of the policy he becomes a creditor with an enforceable right. Then for the first time there is an indebtedness. See *Mayer* v. *Attorney General* (32 N. J. Eq., 815, 820–822). In the meantime, each member bears a relation to the mutual company analogous to that which a stockholder bears to the joint-stock company in which he holds stock. In either case, the title to the assets is in the corporation and not in the members or stockholders.

True, the amount of the reserve is carried on the books as a liability, but only as the capital stock of a stock corporation is carried on its books as a liability. In both instances, it is a form of bookkeeping to balance assets, which in the one case is contributed by the members and in the other by the stockholders. If section 207(a) subdivisions (1) and (2) had defined invested capital as "actual cash paid in," without more, it probably would not be doubted that the part of the legal reserve derived from premiums would be included. The doubt results from the use of the additional words "for stock or shares in such corporation or partnership." The collector says these words qualify the phrase "(1) actual cash paid in" as well as the phrase which they immediately follow, "(2) the actual cash value of tangible property paid in." For present purposes we shall assume this to be so—although there is a plausible argument on the other side to the contrary—and consider the case accordingly. The mutual company is not a stock company, and the word "stock" may be put aside as having no application to it. It is clear that since the word "stock" does not describe interests in partnership, included expressly along with corporations in the same paragraph, the word "shares" must be held to do so. And if that word is broad enough to include partnership interests, it is broad enough to include the interests held by members in nonstock corporations.

To hold the contrary would be to so limit the application of subdivisions (1) and (2) of section 207(a) as altogether to exclude therefrom those corporations which have no capital stock. We can not suppose that Congress intended such a result, but must conclude that it used the word "stock" as appropriate in the case of stock corporations and the word "shares" as appropriate in the case of partnerships and nonstock corporations. Such an interpretation does no violence to the ordinary meaning of the word, for while it is entirely proper to speak of "stock" as "shares," it is equally proper to designate the several interests in a common fund as "shares." To the extent of $70,000,000 the legal reserve consisted of "actual cash paid in" by the members. These payments were intended for investment, and were invested, to increase the resources of the company and thereby reduce the cost of the insurance; and it requires no stretch of the realities to say that, within the meaning of subdivisions (1) and (2), section 207(a), the fund which they created is invested capital. This is enough to relieve the company from the payment of any war excess profits tax, and it is unnecessary to inquire whether the remaining $116,000,000 is to be regarded as earned surplus under subdivision (3).

Judgment affirmed.

ARTICLE 836: Tangible property paid in: value in excess of par value of stock. VI-10-3135 T. D. 3985

INCOME AND EXCESS PROFITS TAX—REVENUE ACT OF 1917—DECISION OF COURT.

1. INVESTED CAPITAL—CAPITALIZATION—MINE SLOPES.

In determining invested capital in the case of mines, development costs may be capitalized until the mine reaches a stage of production, namely, when the output is such as to allow the payment of a dividend or shows a profit on the capital invested, after which further capitalization should not be allowed.

2. INVESTED CAPITAL—CAPITALIZATION—BUILDINGS.

In capitalizing the cost of buildings, actual cost as shown by the books and records of the taxpayer should be taken rather than a value determined by a retrospective appraisal, supported by oral testimony, fixing an estimated average cost of the structures.

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

To Collectors of Internal Revenue and Others Concerned:

The following decision of the United States District Court for the Northern District of Alabama, Southern Division, in the case of *Little Cahaba Coal Co. and Blockton Cahaba Coal Co.* v. *United States* is published for the information of internal revenue officers and others concerned.

D. H. BLAIR,
Commissioner of Internal Revenue.

Approved February 24, 1927.

A. W. MELLON,
Secretary of the Treasury.

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DISTRICT COURT OF THE UNITED STATES FOR THE NORTHERN DISTRICT OF ALABAMA, SOUTHERN DIVISION, AT BIRMINGHAM.

Little Cahaba Coal Co. and Blockton Cahaba Coal Co., Alabama Corporations, plaintiffs, v. *The United States of America, defendant.*

[November 8, 1926.]

OPINION.

CLAYTON, District Judge: The above-stated suits were brought under paragraph 20, section 24 of the Judicial Code as amended (Supp. 1925 Comp. Stats., ch. 2, sec. 991, (20a)), and are for the recovery of income and profit taxes alleged to have been erroneously collected by the defendant from the plaintiff corporations for the tax year 1917. The taxes were assessed under the Revenue Act of that year. John D. McNeel was the collector of internal revenue who assessed and collected the taxes, and W. E. Snead at the time of the entry of the suits was his successor.

The cases were consolidated without objection and tried together. The stock ownership of each corporation, and the law and the material facts in each are practically the same. After the amended complaints were filed the demurrers to the originals were withdrawn and the defendant pleaded in each case in short by consent, the general issue. So that as a matter of law arising from the pleadings, it is conceded that the suits are well brought, and the cause is now upon the merits.

The questions are, (1) the amount at which the plaintiffs should be allowed to capitalize their three separate mining slopes, (2) the cost price at which

they should be allowed to capitalize their tenant houses, and (3) whether plaintiffs' exemption rate should be 9 per cent, the maximum allowed by the statute, or 7 per cent, the minimum.

The plaintiff corporations filed, as required by law, their respective Federal income and profit tax returns for the year 1917, within the time prescribed by statute. The consolidated items in such returns are:

Total income and profits tax, 1917	$25,018.89
Income, 1917	145,209.54
Invested capital, 1917	848,384.30

The corporations voluntarily paid the tax as calculated by them in this original return, $25,618.89, to McNeel, collector of internal revenue, on March 28, 1918. Notation is stamped across the face of the original return of the parent corporation. "Closed no tax due, Consolidated Returns Audit Division, Little Cahaba Coal Company parent or principal company." It may be inferred that this stamp was placed upon the return by one of the defendant's auditors at Washington after the cases had been consolidated and after the returns had been filed, for a photostatic copy of the original return had from the Washington bureau and a part of the evidence here, carries that stamp. It at least tends to show that at first the defendant found no tax due upon an audit of the taxpayer's return at Washington after the consolidation of the two cases there. It is not controverted that the original returns as prepared by the taxpayer are in accord with the taxpayer's books. Therefore, it was necessary, before the Government could collect the additional tax, the subject matter of this controversy, for it to adjust and make changes in the taxpayer's original books and figures and values.

Accordingly, the defendant, by its agents Mobley and Perry, made a field audit and report upon the taxpayer corporations. On April 22, 1921, following the report of such revenue agents, defendant published a letter giving the following figures divergent from those of the taxpayer's books as shown by the original return, as its true income, capital and taxes for the year 1917. These are the figures as given by the taxpayer, as found by the defendant, and the difference:

	Taxpayer's figures.	Revenue agents' figures.	Difference.
Total tax	$25,018.89	$56,526.21	$31,507.92
Invested capital	848,384.30	586,531.68	261,852.62
Income	145,209.54	197,522.20	52,312.66

The additional tax as shown above, $31,507.92, results of course from the changes made by the defendant's agents in the taxpayer's book figures and their original returns. This additional tax was assessed, and was on July 15, 1921, paid to McNeel, then the collector of internal revenue. The consolidated suit is to recover of the United States the sums of $13,894.35 in behalf of the Little Cahaba Coal Co. and $5,391.08 in behalf of the Blockton Cahaba Coal Co., aggregating $19,295.43, alleged to have been wrongfully exacted, with interest thereon at the statutory rate of 6 per cent from July 15, 1921, the date of payment.

The subject matter of this suit involves the application of the provisions by which the deduction from income for the purpose of tax is measured by the "invested capital" of the taxpayer; and the provisions of the Act of October 3, 1917, relating to deductions are:

"SEC. 203. That for the purposes of this title the deduction shall be as follows, except as otherwise in this title provided—

"(a) In the case of a domestic corporation, the sum of (1) an amount equal to the same percentage of the invested capital for the taxable year which the average amount of the annual net income of the trade or business during the prewar period was of the invested capital for the prewar period (but not less than 7 or more than 9 per centum of the invested capital for the taxable year), and (2) $3,000; * * *."

The provisions of the Act relating to invested capital are:

"SEC. 207. That as used in this title, the term 'invested capital' for any year means the average invested capital for the year, as defined and limited in this title, averaged monthly. * * *

"(a) In the case of a corporation or partnership: (1) Actual cash paid in, (2) the actual cash value of tangible property paid in other than cash, for stock or shares in such corporation or partnership, at the time of such payment (but in case such tangible property was paid in prior to January 1 1914, the actual cash value of such property as of January 1, 1914, but in no case to exceed the par value of the original stock or shares specifically issued therefor), and (3) paid in or earned surplus and undivided profits used or employed in the business, exclusive of undivided profits earned during the taxable year: * * *."

Accordingly, Regulations 33 and 41 were adopted under the Acts of 19 and it follows that under such regulations made in pursuance of the Act this controversy must be tried.

Section 207 of the Revenue Act of 1917, subdivision (a), quoted above, defines invested capital under three numbered headings, only two of which need be here discussed—"(1) Actual cash paid in," and, "(3) Paid in or earned surplus and undivided profits used or employed in the business, exclusive of undivided profits earned during the taxable year: * * *." The meaning of clause (1) is simple. Articles 62 and 64 of Treasury Department Regulations 41, define clause (3) as follows:

"*Scope of phrase 'Surplus and undivided profits.*'—Clause (3) of subdivision (a) of section 207 authorizes the inclusion in invested capital of earned surplus and undivided profits used or employed in the business. Inasmuch as section 201 provides that all the income of a corporation or partnership shall be deemed to be received from its trade or business, all the surplus and undivided profits of a corporation or partnership (exclusive of undivided profits earned during the year), from whatever source derived, will, unless invested in stocks, bonds (other than obligations of the United States), or other assets, the income from which is not subject to the excess profits tax, be deemed to be used or employed in the business and may be included in the invested capital.

"*Reconstruction of surplus and undivided profits accounts.*—Where through failure to provide for depletion, depreciation, obsolescence, or other expenses or losses, or where for any other cause or reason the books of account of the taxpayer do not show the true paid-in or earned surplus and undivided profits, in the computation of invested capital such adjustments shall be made as are necessary to arrive at a statement of the correct amount.

"Where a taxpayer claims additions to the capital account, the books of account will be presumed to show the true facts and the burden of proof will rest upon the taxpayer. Such additions will be accepted only to the extent and under the conditions stated below:

"(1) Amounts which have been expended in the past for the acquisition of plant, equipment, tools, patterns, furniture, fixtures, or like tangible property, having a useful life extending substantially beyond the year in which the expenditure was made, and which have been charged as current expense, may (less proper reduction for depreciation or obsolescence) be added to the surplus account in computing invested capital when such assets are still owned and in active use by the taxpayer during the taxable year. * * *

"(4) The taxpayer shall in his return to the Commissioner of Internal Revenue make a statement of the proposed additions, specifying the kinds and amounts of property involved, the years in which the expenditures were made, and the method followed in distinguishing between capital outlays and current expenses.

"(5) The taxpayer shall also show that adequate provision has been made for the depletion, depreciation, or obsolescence of such of the assets so acquired as are, under the rulings of the department, subject to recognized depreciation."

Under the sanction of the Secretary of the Treasury, the Commissioner of Internal Revenue published Regulations 45 in pursuance of the Revenue Act of 1918. On the trial, counsel for the respective parties admitted that article 222 of Regulations 45 was more explicit than preceding regulations in regard to determining allowable additions to capital. Article 222 provides:

"*Allowable capital additions in case of mines.*—(a) All expenditures for development, rent, and royalty in excess of receipts from minerals sold, shall be charged to capital account recoverable through depletion, while the mine is in

the development stage. Thereafter any development which adds value to the mineral deposit beyond the current year shall be carried as a deferred charge and apportioned and deducted as operating expense in the years to which it is applicable.

"(b) All expenditures for plant and equipment shall be charged to capital account recoverable through depreciation, while the mine is in the development stage. Thereafter the cost of major items of plant and equipment shall be capitalized but the cost of minor items of equipment and plant, necessary to maintain the normal output, and the cost of replacement may be charged to current expense of operation."

The Supreme Court, construing section 207 of the Revenue Act of October 3, 1917, has said:

"The Revenue Act of October 3, 1917, passed after we had become engaged in the war, took the place of the Act of March 3, and embodied a 'war excess profits tax' with higher percentages imposed upon the income in excess of deductions and a more particular definition of terms. A scrutiny of the particular provisions of section 207 shows that it was the dominant purpose of Congress to place the peculiar burden of this tax upon the income of trades and businesses exceeding what was deemed a normally reasonable return upon the capital actually embarked. But if such capital were to be computed according to appreciated market values based upon the estimates of interested parties (on whose returns perforce the Government must in great part rely), exaggerations would be at a premium, corrections difficult, and the tax easily evaded. Section 207 shows that Congress was fully alive to this and designedly adopted a term—'invested capital'—and a definition of it, that would measurably guard against inflated valuation. The word 'invested' in itself imports a restrictive qualification. When speaking of the capital of a business corporation or partnership, such as the Act deals with, 'to invest' imports a laying out of money, or money's worth, either by an individual in acquiring an interest in the concern with a view to obtaining income or profit from the conduct of its business, or by the concern itself in acquiring something of permanent use in the business; in either case involving a conversion of wealth from one form into another suitable for employment in the making of the hoped-for gains. See Webster's New Internat. Dict., 'invest,' 8; * * *."

(*La Belle Iron Works* v. *U. S.*, 256 U. S., 377, l. c., 387 [T. D. 3181, C. B. 4, 373].)

The questions before this court with reference to invested capital are, whether the plaintiffs have established by the evidence that they are entitled to include for invested capital purposes a greater amount for cost of development of mine slopes than was allowed by the Commissioner of Internal Revenue; and whether plaintiffs have established by the evidence that they are entitled for invested capital purposes to a greater amount for tenant houses than was allowed by the Commissioner of Internal Revenue.

In writing the income tax law it was recognized that the taxpayer should be entitled to certain deductions for depreciation on buildings, machinery, equipment, etc., and a certain amount for depletion in case of mines, oil and gas wells and timber properties. For the purpose of computing depreciation and depletion it was necessary to fix a basic date. Accordingly, March 1, 1913, value was fixed for depreciation and depletion purposes in case of properties acquired prior to that date.

Paragraphs 7 and 8 of section 5(a) and paragraph 2 of section 12(a) of the Revenue Act of 1916 authorized individuals and corporations to deduct from their gross income "a reasonable allowance for the exhaustion, wear and tear of property * * *" and "(b) in the case of mines a reasonable allowance for depletion thereof not to exceed the market value in the mine of the product thereof which has been mined and sold during the year for which the return and computation are made, * * *." It was provided that when the sum of annual allowances for depletion equaled the capital originally invested, or, in case of purchase prior to March 1, 1913, the fair market value as of that date, "no further allowance shall be made."

It is evident that under the Revenue Act of 1917 it is of benefit to the taxpayer to fix the invested capital at the highest allowable figure, for its exemption for income and profit purposes is based upon a percentage of its invested capital.

The Committee on Appeals and Review was the final board of appeals up to the time the Board of Tax Appeals was established in the place of the Committee. The Committee consisted of lawyers and tax experts especially selected

by the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury. And its duty was to hear appeals from rulings of the Income Tax Unit. This committee was composed of some 15 members and sat in sections. Later, under the Revenue Act of 1924, Congress established the Board of Tax Appeals. The jurisdiction of this Board has been construed to be limited to authority to hear matters involving additional assessments of Federal income taxes before payment on assessments made after the Board was created. The Board has no jurisdiction or authority to hear and determine the matter involved in this controversy, which is solely a question of a refund of taxes already paid upon an additional assessment made before the Board was created. For this reason the taxpayer had no opportunity to have the merits of its case determined by any authority in the Treasury Department on the question of valuation, except by a single person, namely, Mr. du Rell, Government valuation engineer. Plaintiff had no remedy except to bring this suit to review his decision. The Committee had authority under the law to hear and determine controversies relating both to refunds and to additional assessments in income tax cases.

The taxpayer here in endeavoring to get relief claimed, employed a mining engineer, Mr. Cowin, to make an appraisal. And this retrospective appraisal was made pursuant to a general and express holding made by the Committee, as follows:

"The Committee has made an exhaustive study of appraisals and their relation to invested capital of corporations. It has also considered appraisals in connection with establishing March 1 values for purposes of depreciation and depletion and for purposes of establishing certain values in connection with amortization claims, and has reached the conclusion that retrospective appraisals may properly be accepted as a basis for the allowance of a paid-in surplus. In making such an appraisal, care should be exercised in order to value the assets in question at cost, and to eliminate any appreciation written upon the books of the corporation since the date of acquisition. It will be necessary to inventory at cost as of the basic date (for invested capital purposes, the date of acquisition) the date of renewal, and the cost, of additions made subsequent to the date the property was paid in. Adjustment should be made for property scrapped or discarded and for depreciation. The books of account, if available, should be considered the best evidence as to the date of acquisition and actual cost. The assets accounts may be incomplete for many reasons, and may include property still on the books that has been discarded. The tangible property actually in existence and in use should be considered as the basic evidence of the invested capital in existence, and should be used as a basis for the proper correction of the accounts to reflect the actual investment in the depreciable properties in existence during the taxable years. The burden of proof is upon the taxpayer when a claim for paid-in surplus is made. A retrospective appraisal is in substance the opinion of experts based upon the facts presented to them, and as such is admissible as evidence of a paid-in surplus, but its value as proof of a paid-in surplus must depend upon the truth of the facts upon which it is based. In order, therefore, for the Bureau to accept as conclusive a retrospective appraisal, it must be satisfied that the facts upon which the appraisal is based are true. The Bureau should accept such proof of the facts as is ordinarily accepted in business transactions, and must receive and consider such appraisals with a sound and intelligent discretion, without being able to prove their accuracy, as mathematicians judge accuracy, if they convince the mind of their correctness to that moral certainty upon which practical men of affairs act. It has been the policy of the Bureau to construe strictly the requirements of article 63 of Regulations 41 and article 836 of Regulations 45, and numerous retroactive or retrospective appraisals have been rejected as a result of such construction. This practice should be discontinued." (Comm. Rec. 747, C. B. I–1, 353.)

It is established that the decisions of the Commissioner of Internal Revenue in the assessment of Federal estate taxes are not conclusive on courts, but the district court has jurisdiction to try de novo suits for recovery of excess payments of Federal estate tax, after the taxpayer has taken necessary steps before appealing to the court. (*Fidelity & Columbia Tr. Co.* v. *Lucas*, 7 F (2d), 146.)

The plaintiffs cite section 177 of the Judicial Code, as amended by section 1324 of the Revenue Act of 1921, and reenacted without change in section 1020 of the Revenue Act of 1924, which provides that, "interest may be allowed in any judgment of any court rendered after the passage of the Revenue Act of 1921 against the United States for any internal-revenue tax erroneously or

illegally assessed or collected, or for any penalty collected without authority or any sum which was excessive or in any manner wrongfully collected, under the internal-revenue laws." But in my view of this case it is not necessary to consider the matter of interest.

When defendant's agents originally audited plaintiffs' books no allowance was made for capitalization of plaintiffs' three mine slopes. Afterwards plaintiffs made claim for a refund of a portion of the excess profits tax paid, basing this claim partly upon the cost of sinking their mine slopes. However, the parties have previously agreed upon a basic rate for the capitalization of the cost of each of the three slopes, the figures agreed upon being approximately as follows:

	Per linear yard.
Slope No. 1. Little Cahaba	$68.00
Slope No. 2. Little Cahaba	103.00
Slope No. 3. Blockton Cahaba	87.00

Plaintiffs contend that the slopes should be capitalized to the respective depths they had been sunk as of March 1, 1913, and that the mines did not pass from the development stage to the stage of production until that time. They introduced several witnesses experienced in mine construction and operation, including the vice president and manager of the mines involved in this case, and the president of the Roden Coal Co., which owns mines near those of plaintiffs. The testimony of these witnesses differed materially as to when a mine passed out of the stage of development, where they were allowed to capitalize the expense of constructing the mine slopes, and entered a stage of production, where the cost of further development should be charged to expense. Each testified that in his opinion these mines did not pass out of the development stage before March 1, 1913. Two of the witnesses testified that the mines should be allowed to capitalize the construction of the mine slopes through to the boundary of the property, or until a point is reached where all the coal available to a slope can be reached from it. One witness testified the construction of the slopes should be capitalized until the mines had reached their maximum production; while another testified the mines should not only reach their maximum production, but the slopes should be pushed far enough in advance for that maximum production to be maintained before the slopes should cease to be capitalized.

These opinions of the expert witnesses have been given respectful consideration. But no adjudicated case or specific ruling has been furnished or found to sustain such views. And I think that public policy back of the income tax law, and the law itself, are in conflict with such opinion-conclusions.

Defendant contends, and I approve the contention as a reasonable interpretation of the law, that the mines reached a stage of production at the time when in their operation the output of coal was such as to allow the mines to pay a dividend or profit on the capital invested.

If plaintiffs' theory were accepted, it might be possible for a mine to operate until its property should be entirely exhausted and charge the whole cost of extending mine slopes to development, and avoid the tax by reason of the fact that the output of the mine had not reached the maximum for which the slopes were designed to produce, although it might be returning a profit each year.

It developed in the testimony in this case that two of the three mine slopes in question entered on the outcrop, and, therefore, produced coal from the very beginning of operations, though, necessarily, they could not produce enough coal to pay the cost of the development until they had advanced far enough for headings and rooms to be opened up, allowing a larger number of miners to work and substantially increasing the production.

Plaintiffs insist they should be allowed to capitalize the cost of the slopes as follows:

	Feet.
Slope No. 1. Little Cahaba	6,000
Slope No. 2. Little Cahaba	4,000
Slope No. 3. Blockton Cahaba	3,800

These figures represent the depths to which the respective slopes had been carried March 1, 1913. Defendant refused to allow capitalization to those depths, but did allow approximately the following:

	Feet.
Slope No. 1. Little Cahaba	2,000
Slope No. 2. Little Cahaba	1,600
Slope No. 3. Blockton Cahaba	1,500

The figures allowed by the defendant for slopes 1 and 2 represent approximately the depths to which they had been carried in 1906. In that year the Little Cahaba Coal Co. declared a dividend of $60,000, which defendant insists indicates that it had then reached a stage of production, and beyond which it should not be permitted to capitalize its mine slopes. Blockton Cahaba Coal Co. was purchased by Little Cahaba in 1908. The slope of that mine is the No. 3 slope involved here. Defendant contends that this mine reached a productive stage prior to its purchase by Little Cahaba. It was shown to have earned, in 1910, $10,465.15, and had a surplus at the end of the year, after paying $10,000 dividends, of $88,660.31.

I am of opinion from all the evidence that these mines did reach a stage of production when the output of coal from them was such as to allow a profit on the money invested in them. The evidence shows that they were making a profit at the point where defendant ceased to allow the slopes to be capitalized, and, therefore, defendant was right in disallowing their further capitalization.

Plaintiffs contend they should be allowed to capitalize the cost of their tenant houses as follows:

Little Cahaba	$205,240.88
Blockton Cahaba	78,400.00

To support these values they introduced in evidence a so-called retrospective appraisal by one Cowin, a mining engineer, as well as the oral testimony of Mr. Cowin and other witnesses.

Defendant allowed capitalization of the houses as follows:

Little Cahaba	$90,864.53
Blockton Cahaba	34,693.74

These figures represent the actual cost of the buildings to plaintiffs as shown by their books.

There might have been items charged to expense which should have been charged to the house accounts during the years prior to 1917, but no effort was made by the plaintiffs to segregate such items or show such cost. Their witness Lemon stated that such costs could be obtained from the taxpayers' records, but that it had not been done. The sole evidence as to such costs was the Cowin appraisal and oral testimony tending to support the costs given by Cowin in his appraisal. However, as a witness, Cowin admitted that all the items of the cost of the houses had not been taken from the taxpayers' records, but that from the books as well as other available facts his appraisal was the estimated average cost of the structures involved. So that I feel constrained to use the figures shown by the books and allowed by defendant.

Coming now to the last question, as to whether plaintiffs are entitled to a profits tax exemption of 9 per cent or only 7 per cent. I think it is unnecessary for me to determine this point in view of my findings in the other two and main issues in this case.

Decree will be entered in harmony with this opinion.

TITLE XIII.—GENERAL ADMINISTRATIVE PROVISIONS.

SECTIONS 1318, 1319, AND 1320.—LIMITATIONS UPON SUITS AND PROSECUTIONS.

ARTICLE 1050: Suits for recovery of taxes erroneously collected. VI–7–3101 T. D. 3973

REVENUE ACT OF 1918—INCOME TAX—DECISION OF CIRCUIT COURT OF APPEALS.

SUITS—CLAIM FOR REFUND.

A suit to recover internal revenue taxes can only be maintained upon the same grounds and only such as are presented to the Commissioner of Internal Revenue in the claim for refund filed as a necessary prerequisite to suit.

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

To Collectors of Internal Revenue and Others Concerned:

The following decision of the United States Circuit Court of Appeals for the Eighth Circuit in the case of *W. C. Tucker* v. *Acel C. Alexander, Collector of Internal Revenue*, is published for the information of internal revenue officers and others concerned.

D. H. BLAIR,
Commissioner of Internal Revenue.

Approved February 4, 1927.

A. W. MELLON,
Secretary of the Treasury.

UNITED STATES CIRCUIT COURT OF APPEALS, EIGHTH CIRCUIT.

W. C. Tucker, plaintiff in error, v. *Acel C. Alexander, Collector of Internal Revenue, defendant in error.*

In error to the District Court of the United States for the Western District of Oklahoma.

[October 27, 1926.]

STONE, Circuit Judge, delivered the opinion of the court.

This is an action for refund of a portion of a tax, paid under protest, on the income of plaintiff in error (plaintiff below) for the year 1920. Plaintiff made a tax return for that year and paid upon the basis thereof. An investigation by an agent of the Department thereafter resulted in an additional assessment, which was paid under protest. In due time after this last payment, plaintiff filed his claim for refund. After waiting 17 months, in vain, for some action thereon by the Department, this action was brought. About 6 months after this action was begun and before trial thereof, the Department made an allowance of $216.26 (a small part of the claim) and rejected the balance of the claim. From a judgment favoring defendant, but without prejudice to acceptance by plaintiff of the allowance of $216.26, this writ of error is sued out.

In the view which we take of the issues which must determine this case, an extended statement of fact is unnecessary.

Prior to 1913 plaintiff was half owner of the stock of a corporation which had for some years been engaged in a general merchandise business at Pawhuska, Okla. In 1920 the corporation was voluntarily dissolved and the assets distributed in kind to plaintiff and his brother (who owned the other half of the capital stock, the two men assuming the existing indebtedness of the corporation. As half owners, the brothers continued the business as a copartnership. The income upon which the additional tax (refund of which is now sought) was collected was the increased value of the corporate stock from March 1, 1913, to the date of liquidation in 1920.

There are two main contentions here. One is of minor importance, concerning costs herein.

The important contention is in respect to collection of an income tax assessed upon the liquidation of the Osage Mercantile Co., of which Tucker was a stockholder. The main grounds for recovery thereof, as stated in the petition, are:

"That the assessment and collection of said additional income tax was erroneous and illegal in that it is based upon alleged income accruing to the plaintiff from the liquidating dividend upon the dissolution of the Osage Mercantile Co., a corporation, in which he was a stockholder; that this corporation was chartered and organized in the year 1902 with a capital stock of $15,000 divided into 150 shares of the par value of $100 each; that thereafter in the year 1906 the capital stock of said corporation was increased to $30,000 divided into 300 shares of the par value of $100 each; that on March 1, 1913,

the plaintiff was the owner and holder of 112 shares of the capital stock in said corporation and the same was of the fair market value of $500 a share on said date; that on July 22, 1920, said corporation was liquidated and dissolved and its assets were transferred and distributed in specie to its stockholders by a liquidating dividend; that the net actual and fair market value of the assets so distributed was $88,408.97 on that date; that the share of such assets received by the plaintiff was less in value by the sum of $5,491.84 than the fair market value on March 1, 1913, of the stock he then owned plus the cost of the stock he subsequently acquired and he, therefore, sustained an actual loss in said amount on the liquidation of said corporation; that in ascertaining the gain or loss to the plaintiff upon the liquidation of said corporation the Commissioner of Internal Revenue erroneously, wrongfully, and illegally assumed and took $356.86 per share, instead of the correct sum of $500 per share, as the fair market value of the plaintiff's stock on March 1, 1913, and $97,292.71, instead of the correct sum of $88,408.97, as the net actual and fair market value of the assets of said corporation distributed at the time of liquidation in excess of all its liabilities then outstanding and assumed by its stockholders."

The collector contends that the plaintiff can not recover upon such grounds, because they are different from those asserted in his claim of refund. The claim of refund is general in terms and is to the effect that there was a loss instead of a profit, but it is made specific through an incorporation, by reference, of a letter from the deputy commissioner which sets forth the grounds of protest actually urged to payment of the tax. Those grounds were as follows:

"The taxpayer says that said revenue agent's report is erroneous (1) in that he used the book value of the taxpayer's stock in the Osage Mercantile Co. on March 1, 1923, instead of the fair market value thereof as a basis for determining the gain derived therefrom at liquidation, and (2) in that he did not deduct from the capital and surplus of said company at date of liquidation the full amount of its outstanding liability, and (3) in that he did not take into account the reduction of the value of the assets of said company at liquidation, its certain outstanding obligation to W. T. Mosier which the stockholders assumed upon liquidation. In all other respects the taxpayer accepts the revenue agent's report."

It appears, therefore, that the grounds relied upon in the petition for refund are entirely different from those contained in the claim for refund. Hence, the above point raised by the collector must be determined. We think the collector is right, for the reasons following:

This is a suit against the Government in connection with the imposition and collection of the general revenue, which is a prime governmental function; such character of actions can be maintained only when permitted by the sovereign and only upon the conditions imposed by the sovereign. Such character of action is permitted by the statute but certain conditions are required as a condition precedent thereto. One of these conditions is that a claim for refund shall first be made to the Commissioner of Internal Revenue and a period of six months allowed for his determination thereof. The evident purposes and objects of this condition are to afford the Commissioner an opportunity to correct errors made by his office and to spare the parties and the courts the burden of litigation in respect thereto. Unless the claimant were required to present to the Commissioner all of the grounds upon which he relies for refund, the above purposes and objects would be partially or entirely defeated. The resort to the courts is allowed only because the Commissioner will not correct the wrong claimed to have been done. The purposes of requiring the claim and the object of the resort to the courts would be in part or wholly defeated unless the claim contained all of the grounds relied upon by the claimant. Therefore, we think it is a required precedent or limitation that the action shall be upon the same grounds and only such as are presented in the claim. As no ground in this petition is stated in the claim for refund, we think this petition has no standing under the issues tendered by the petition and that the determination of the court as to this major claim was correct.

The minor claim affects only costs and arises out of the fact that the Commissioner allowed a refund of $216. The tax was paid, under protest, on October 30, 1923; the claim for refund was filed early in November, 1923; this action was filed October 7, 1924; the ruling and above refund on the claim was made by the Commissioner April 24, 1925. The Commissioner had, under

the statute, six months after the claim was filed within which to determine the claim and within which time plaintiff could not bring suit. As the Commissioner did not act within that period, the plaintiff was within his rights in bringing suit. If he had based his suit upon any ground contained in the claim and the above refund had been all or a part of the sum claimed under such ground, we think the plaintiff would have been entitled to his costs herein. But no refund of the above sum could have been secured under this petition; it was not secured because of the suit nor would the early announcement of such refund have obviated necessity for the suit nor have prevented it being brought. Under these conditions, we think the plaintiff has no right to his costs herein.

The judgment should be and is affirmed.

ARTICLE 1050: Suits for recovery of taxes erroneously collected.

REVENUE ACT OF 1917.

Formal written claim for refund as a prerequisite to suit. (See T. D. 4007, page 128.)

SALES TAX RULINGS.

TITLE V.—TAX ON ADMISSIONS AND DUES. (1926)

TAX ON DUES.

REGULATIONS 43–II, ARTICLE 10: Initiation fees. VI–1–3036
T. D. 3950

TAX ON INITIATION FEES: REFUND OF TAX.

Articles 10 and 15 of Regulations 43, Part 2, relating to the tax on dues and initiation fees (section 501, Revenue Act of 1926), amended.

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

To Collectors of Internal Revenue and Others Concerned:

Article 10 of Regulations 43, Part 2, relating to the tax on dues and initiation fees under the Revenue Act of 1926, is hereby amended by the elimination of the fourth and fifth paragraphs and example 3 of that article and the substitution for the paragraphs eliminated of a paragraph reading as follows:

The term "initiation fees" as used in the statute means the payment of an amount for the purpose of becoming a member of a club and enjoying its privileges and which, when paid, is not intended to be returned to the person paying it. The term "initiation fees" does not include amounts required to be paid by new members for stock, bonds, promissory notes, or certificates representing an interest in the property and assets of the club.

CREDITS AND REFUNDS.

REGULATIONS 43–II, ARTICLE 15: Refund of overpayment. VI–1–3037
T. D. 3950

To Collectors of Internal Revenue and Others Concerned:

Article 15 [of Regulations 43–II, revised May, 1926] is hereby amended to read as follows:

ART. 15. *Refunds.*—Where any club or individual member of a club has paid to a collector of internal revenue as a tax on dues or initiation fees any amount subsequently determined to have been erroneously or illegally assessed or collected, or any amount in excess of the amount of tax actually imposed for the month covered by that payment, or an amount as a penalty for the collection of which there was no authority, a refund of the amount so paid may be obtained by filing with the office of the collector to whom such payment was made a properly prepared claim on Form 843. (See secs. 3220 and 3228, R. S., as amended.)

In any case where a club seeks a refund of an amount collected by it from its members and paid to the collector of internal revenue, a claim on Form 843 must be accompanied by a list of the members who paid such tax, showing the amount of tax claimed on behalf of each member and the date on which the amounts claimed were paid to the collector. There should also accompany the claim for refund a sworn statement of an authorized officer of the club

to the effect that no prior claim for refund of any amount involved in such claim has been filed with the Bureau by or on behalf of any member, and that in the event a claim is filed by an individual member subsequent to the presentation of the claim filed by the club, the club will assume the liability and satisfy the claim of the individual member to the amount refunded to the club on his behalf.

In any case where an amount was assessed by the Commissioner against the individual member and by him paid direct to the collector, a claim must be filed on Form 843 by such individual member for a refund of the amount alleged to have been erroneously assessed and paid, accompanied by proper evidence of such payment.

D. H. BLAIR,
Commissioner of Internal Revenue.

Approved December 28, 1926.

GARRARD B. WINSTON,
Acting Secretary of the Treasury.

TITLE V.—TAX ON ADMISSIONS AND DUES. (1924)

TAX ON DUES.

REGULATIONS 43–II, ARTICLE 10: Initiation fees. VI–5–3071
T. D. 3954

DUES TAX—REVENUE ACT OF 1924—DECISION OF COURT.

1. CLUBS—INITIATION FEES—PROPRIETARY CERTIFICATES.

An amount paid for a certificate of proprietary interest in a club, required to be purchased as a prerequisite to membership, is not taxable under section 501 of the Revenue Act of 1924 as an initiation fee.

2. DEFINITION—INITIATION FEE.

An initiation fee under section 501 is an amount paid to a club for the purpose of enjoying its privileges and which once paid will not be returned.

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

To Collectors of Internal Revenue and Others Concerned:

The following decision of the United States Court of Claims in the case of *Lukens* v. *The United States* is published for the information of internal revenue officers and others concerned.

D. H. BLAIR,
Commissioner of Internal Revenue.

Approved January 21, 1927.

A. W. MELLON,
Secretary of the Treasury.

COURT OF CLAIMS OF THE UNITED STATES.

Charles K. Lukens v. *The United States.*

[November 15, 1926.]

HAY, Judge, delivered the opinion of the court.

This is a suit to recover the sum of $50, representing a tax of 10 per cent on the sum of $500, paid by the plaintiff for his proprietary certificate of stock

purchased from the Manufacturers' Country Club. The plaintiff by purchasing this share of stock became eligible to membership in said club, but in order to enjoy the privileges of the club was required by its by-laws to pay an entrance or initiation fee of $100 in addition to the $500 paid by him for a share of the stock. The stock aforesaid was sold for the purpose of acquiring the necessary real estate upon which to build the club house and to construct a golf course. The certificates were known as proprietary certificates and had a par value of $500. The owners of these certificates were in fact the owners of the property of the club. These certificates can be sold and transferred without regard to membership, and the property rights of the holders continue after membership may have ceased by resignation, expulsion, or death. The owner of one of these certificates in order to become a member of the club must be elected and must pay to the club an initiation fee of $100 and dues of $100 per year. A person who is not the owner of one of these shares of stock may be elected to membership in the club, and may enjoy its privileges by paying the initiation fee and annual dues fixed by the directors of the club.

Proprietary members—that is, members who own shares of stock and are the owners of the club property—have all voting rights. Those members who do not own shares of stock have only the privileges of the club.

The plaintiff paid his tax of 10 per cent on $100, his initiation fee, and 10 per cent on $100, his annual dues.

The Government contends that he is liable to pay and has collected from him 10 per cent on $500, paid for his proprietary certificate, upon the theory that the said $500 is a part of the initiation fee, and this it claims under the provisions of the Revenue Act of 1924 (43 Stat., 253), which reads as follows:

"SEC. 501. On and after the date this title takes effect there shall be levied, assessed, collected, and paid, in lieu of the taxes imposed by section 801 of the Revenue Act of 1921, a tax equivalent to 10 per centum of any amount paid on or after such date, for any period after such date, (*a*) as dues or membership fees (where the dues or fees of an active resident annual member are in excess of $10 per year) to any social, athletic, or sporting club or organization; or (*b*) as initiation fees to such a club or organization, if such fees amount to more than $10, or if the dues or membership fees (not including initiation fees) of an active resident annual member are in excess of $10 per year; such taxes to be paid by the person paying such dues or fees: * * *."

The proviso in this section has no bearing on the instant case.

It is the contention of the Government that any money or property of value paid by a prospective member of a club as a prerequisite to membership therein is an initiation fee, and that in this case the plaintiff, besides paying the tax on his $100 initiation fee, is liable to be taxed on his proprietary stock, the theory being that his stock is a part of his initiation fee. From the facts in this case it is evident that the plaintiff is one of the owners of the property and franchises of the club and that his proprietary share of stock makes him so. He, together with the other owners of the club, elected a board of directors, which proceeded to enact by-laws for the government of the club. Among these by-laws was one fixing the initiation fee of the proprietary members of the club, which fee was fixed at the sum of $100. It is not perceived how the purchase and ownership of the stock can be construed into being an initiation fee; it has none of the earmarks of such a fee. There is no definition in the statute, nor any words therein, which lend themselves to such a construction. The words "initiation fees" used in the statute must be given their common and ordinary meaning, which is the payment of a sum of money that will enable the person paying it to enjoy the privileges of the club, and which once paid will never be returned to the person paying it. In this case the share of stock or its value can be in certain contingencies repaid to the party paying, or to his estate. We can not so construe the statute to enlarge its meaning and to impose a tax not therein contemplated nor intended. The meaning of the words of the Act can not be enlarged to include what has been omitted by the Congress. (*Iselin* v. *United States*, 270 U. S., 245 [T. D. 3846, C. B. V–1, 365].)

A judgment will be entered in favor of the plaintiff for the sum claimed, with interest.

TITLE V.—TAX ON TRANSPORTATION AND OTHER FACILITIES, AND ON INSURANCE. (1918)

SECTION 500(e).—TRANSPORTATION OF OIL BY PIPE LINE.

REGULATIONS 49, ARTICLE 92: Miscellaneous provisions. VI–7–3106 T. D. 3965

TRANSPORTATION TAX—REVENUE ACT OF 1918—DECISION OF CIRCUIT COURT OF APPEALS.

1. EXCISE TAX—CONSTITUTIONALITY—TRANSPORTATION OF OIL.

The transportation tax imposed by section 500(e) of the Revenue Act of 1918 is not a direct tax upon property but is an excise tax upon the privilege of using property and is therefore constitutional.

2. TRANSPORTATION OF OIL—COMMON CARRIER—PRIVATE CARRIER—HIRE.

Under section 501(d) the tax applies to all transportation of oil by pipe line whether by common or private carrier and is not confined to oil transported for hire.

3. RATES—TARIFFS—COMMISSIONER.

Section 501(d) imposes an administrative duty upon the Commissioner of Internal Revenue in cases where no charge for transportation is made and where there are no actual bona fide rates or tariffs. This duty was properly exercised by computing the tax from the published tariff of a pipe line company operating in the same general territory.

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

To Collectors of Internal Revenue and Others Concerned:

The following decision of the United States Circuit Court of Appeals for the Eighth Circuit in the case of *H. H. Motter, Collector of Internal Revenue*, v. *The Derby Oil Co.* is published for the information of internal revenue officers and others concerned.

D. H. BLAIR,
Commissioner of Internal Revenue.

Approved February 4, 1927.

A. W. MELLON,
Secretary of the Treasury.

UNITED STATES CIRCUIT COURT OF APPEALS, EIGHTH CIRCUIT.

H. H. Motter, Collector of Internal Revenue for the District of Kansas, plaintiff in error, v. *The Derby Oil Co., a Corporation, defendant in error.*

In error to the District Court of the United States for the District of Kansas.

[December 13, 1926.]

VAN VALKENBURGH, Circuit Judge, delivered the opinion of the court.

The Derby Oil Co., a corporation, brought suit, in the District Court for the District of Kansas, against the collector of internal revenue, for that revenue district, to recover back the sum of $6,590.18, collected, under protest, as excise taxes on the transportation of oil by pipe line during the period from June 1, 1920, to December 31, 1921. Trial was to the court upon an agreed statement of facts, and judgment resulted for defendant in error, plaintiff below. As

stated in the agreed statement of facts, defendant in error owned, operated, and controlled an oil refinery located at Wichita, Kans., and owned, operated, and controlled oil producing properties in Butler County, and other counties in the State of Kansas, and owned, operated, and controlled 2 and 3 inch pipe lines connecting the greater part of its production with its refinery at Wichita, Kans., through which pipe lines it pumped the crude oil produced by it, and the crude oil purchased by it, to its refinery at Wichita, Kans.

The material parts of the Revenue Act of 1918 (40 Stat. L., 1057, 1101, 1102) under which the tax complained of was levied and collected are as follows:

"SEC. 500. That from and after April 1, 1919, there shall be levied, assessed, collected, and paid, in lieu of the taxes imposed by section 500 of the Revenue Act of 1917—

* * * * * * *

"(e) A tax equivalent to 8 per centum of the amount paid for the transportation on or after such date of oil by pipe line.

* * * * * * *

"SEC. 501. (a) That the taxes imposed by section 500 shall be paid by the person paying for the services or facilities rendered.

* * * * * * *

"(c) The taxes imposed by section 500 shall apply to all services or facilities specified in such section when rendered for hire, whether or not the agency rendering them is a common carrier. In case a carrier (other than a pipe line) principally engaged in rendering transportation services or facilities for hire does not, because of its ownership of the goods transported, or for any other reason, receive the amount which as a carrier it would otherwise charge, such carrier shall pay a tax equivalent to the tax which would be imposed upon the transportation of such goods if the carrier received payment for such transportation, such tax, if it can not be computed from actual rates or tariffs of the carrier, to be computed on the basis of the rates or tariffs of other carriers for like services, as determined by the Commissioner. In the case of any carrier (other than a pipe line) the principal business of which is to transport goods belonging to it on its own account and which only incidentally renders services for hire, the tax shall apply to such services or facilities only as are actually rendered by it for hire. Nothing in this or the preceding section shall be construed as imposing a tax (1) upon the transportation of any commodity which is necessary for the use of the carrier in the conduct of its business as such and is intended to be so used or has been so used; or (2) upon the tranportation of company material transported by one carrier which constitutes a part of a railroad system for another carrier which is also a part of the same system.

"(d) The tax imposed by subdivision (e) of section 500 shall apply to all transportation of oil by pipe line. In case no charge for transportation is made, by reason of ownership of the commodity transported, or for any other reason, the person transporting by pipe line shall pay a tax equivalent to the tax which would be imposed if such person received payment for such transportation, and if the tax can not be computed from actual bona fide rates or tariffs, it shall be computed (1) on the basis of the rates or tariffs of other pipe lines for like services as determined by the Commissioner, or (2) if no such rates or tariffs exist, on the basis of a reasonable charge for such transportation, as determined by the Commissioner."

Practically the sole issue presented is whether subdivisions (e) and (d) of the foregoing sections impose a valid tax on the transportation of oil produced or purchased, and owned by the plaintiff, through pipe lines owned by the plaintiff, to a refinery owned and operated by the plaintiff.

The main contentions of defendant in error to which attention need be directed are:

1. That Congress, throughout these Acts, including subdivision (d), aforesaid, had in mind solely and exclusively the oil pipe line common carriers, made such by the Act of June 29, 1906, commonly known as the Hepburn Act (C. 3591-34 Stat., 584). In construing this Act the Supreme Court in the Pipe Line Cases (234 U. S., 548) held that it was valid in so far as it applied to the great interstate oil pipe line companies as natural monopolies of oil transportation. It was held that said companies were common carriers, although they did not carry oil for others, but transported only their own commodities, through their own lines.

2. That if subdivision (d) is made to apply to private activities in the use of property, as the Government contends, then it is claimed that this subdivision is unconstitutional as authorizing the levy of a direct tax without apportionment according to population among the several States.

The language of the applicable sections of the Acts quoted, on its face, includes the use of pipe-line facilities for the transportation of oil by defendant in error, as disclosed by the agreed facts. The term "person transporting by pipe line" includes common carriers, of course, but it is not limited to such. The classification made by the Hepburn Act, as construed by the Supreme Court, can have no application here. That was a regulatory statute, while the Act of 1918 is a taxing statute. There is no necessary relationship between regulation and taxation, nor is there anything in the Act of 1918 to indicate that Congress had exclusively in mind the pipe lines designated as common carriers. The contrary rather expressly appears from the comprehensive and inclusive terms employed. The operations conducted by defendant in error are, in miniature, precisely the same as those of the great interstate carriers to which defendant in error concedes the Act applies. It has wells of its own, and it has what may be called a trunk line between its wells and its refinery. Branching from this are at least two gathering lines leading to the wells of other producers from whom it purchases oil. The oil from its own wells, and from those of other producers, is conducted through these gathering lines to tanks along its main trunk line, and is pumped to its refinery by relay pumping stations. This is exactly what the greater carriers do. The difference is in degree and volume only. It is conceded that the so-called common carriers carry their own oil. While they carry the product of others to market, they compel such outsiders to sell it to them before taking it into their pipes. (The Pipe Line Cases, supra, l. c. 561.)

Subdivision (d) of section 501 provides that the tax imposed by subdivision (e) of section 500 shall apply to *all* transportation of oil by pipe line. No exception is made. The subdivision makes it clear that the transportation by pipe line is not confined to oil transported for hire. That the Act in its application is not confined to the common carrier pipe lines contemplated by the Hepburn Act is further made evident by the provision that if the pipe line has no established tariffs by which the tax can be computed, the rates of other pipe lines for like services may be employed. As is well known, the interstate common carrier pipe lines, under the Hepburn Act, not only are required to file, but do file, such rates. This provision shows that others, than such, were in the mind of Congress. Defendant in error is not taxed as a common carrier, but as one who transports oil by pipe line. The tax is levied upon the privilege of such transportation. In other words, it is not laid on the general business of the corporation, nor on the doing of business, as was the case in *United States* v. *Emery, Bird, Thayer Realty Co.* (237 U. S., 28) [T. D. 2188], but on the right to employ pipe-line facilities. All those who employ pipe lines for transportation purposes, whether common carriers or not, are placed in the same class and upon the same footing.

This tax is laid as an excise. Defendant in error contends that it is tantamount to a direct tax—in effect, assessed upon the commodity or business, and, as an incident to the latter contention, it is claimed that the tax was intended to be levied upon the business of transportation as such; that the business of defendant in error is not that of transportation, but that transportation is a mere incident of its production and refining of oil; that so viewed this tax is, in effect, a direct tax upon the business, and likewise upon the oil itself; that this offends against the constitutional provision demanding apportionment according to census. This was the view taken by the trial court, whose opinion was also bottomed upon the consideration, in effect, that the imposition of this tax was an unwarranted invasion of private rights. The trial court was also of opinion that, if defendant in error be deemed to be engaged in the business of transportation, then the material transported was its own, for use in its own business, and was exempted from taxation by the exception in the Act. But that exception not only is made not to apply to pipe lines, but, even if so applicable, the transportation in question is not of the nature covered by the exception which applies only to articles and material used as an incident to the transportation itself, such as, in the case of railroads, ties and rails for roadbed, rolling stock, and supplies of that nature. Railroads are not exempt from the tax upon other commodities not inhering in the business of transportation even though the property of the road itself.

We conclude that this tax, as laid, is an excise tax. It is not for this court to determine whether Congress should have passed this Act. It is sufficient that Congress has authority to impose excises, and that this is an excise. It is not a tax on property, but upon the privilege of using property. The classification made is one of transaction. As an excise tax on the employment of pipe line facilities for the transportation of oil it is clearly within the power of Congress to impose. That power, in cases far more debatable than this, has frequently been exercised, and its exercise has as frequently been upheld, as witness the array of cases collated by counsel for plaintiff in error upon this point: License Tax cases (5 Wall., 462–471); *Pollock* v. *Farmers' Loan & Trust Co.* (157 U. S., 429–491–558); *Patton* v. *Brady, Executrix* (184 U. S., 608–617); *Meischke-Smith et al.* v. *Wardell* (286 Fed., 785); *Hylton* v. *United States* (3 Dall., 171); *Pacific Ins. Co.* v. *Soule* (7 Wall., 433–443) [T. D. 3461, C. B. II–1, 256]; *Veazie Bank* v. *Fenno* (8 Wall., 533); *Scholey* v. *Rew* (23 Wall., 331); *Railroad Co.* v. *Collector* (100 U. S., 595); *Knowlton* v. *Moore* (178 U. S., 41–81) [T. D. 129]; *Nicol* v. *Ames* (173 U. S., 509) [T. D. 20984]; *Treat* v. *White* (181 U. S., 264–269) [T. D. 338]; *Cornell* v. *Coyne* (192 U. S., 418) [T. D. 757]; *Spreckels Sugar Refining Co.* v. *McClain* (192 U. S., 397) [T. D. 462]; *Thomas* v. *United States* (192 U. S., 363) [T. D. 758]; *McCray* v. *United States* (195 U. S., 27, 61–62); *Flint* v. *Stone-Tracy Co.* (220 U. S., 107) [T. D. 1816]; *Billings* v. *United States* (232 U. S., 261, 280, 282–283); *Bowman* v. *Continental Oil Co.* (256 U. S., 642–648); *Magoun* v. *Illinois Trust & Savings Bank* (170 U. S., 283–296); *American Sugar Refining Co.* v. *Louisiana* (179 U. S., 89–92).

It is further urged that the duties and powers assumed by the Commissioner under the provisions of subdivision (d), as construed by the Department, prescribing the basis upon which the tax is computed in case no charge for transportation is made and the person transporting has established no actual bona fide rates or tariffs, result in an illegal delegation of both legislative and judicial power. The tax in this case was computed from the published tariff of the Empire Pipe Line Co. filed with the Interstate Commerce Commission—a pipe-line company operating in the same general territory, and from which a portion of the oil transported by defendant in error was purchased. This was an administrative duty authorized by the Act. Whether in the absence of such rates or tariffs the Commissioner might make an independent determination of the reasonable charge for such transportation need not be decided, because no such power was exercised. It follows that the judgment must be reversed and the case remanded for further proceedings in accordance with the views herein expressed.

TITLE VI.—EXCISE TAXES. (1926 AND 1924)

SALES BY THE MANUFACTURER.

REGULATIONS 47, ARTICLE 3: Basis of tax. VI–7–3105
T. D. 3968

MANUFACTURER'S EXCISE TAXES: BASIS OF TAX.

Article 3 of Regulations 47, relating to the excise taxes on sales by the manufacturer (sections 600 and 903 of the Revenue Act of 1926) amended.

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

To Collectors of Internal Revenue and Others Concerned:

Article 3 of Regulations 47 (revised March, 1926), relating to the excise taxes on sales by the manufacturer, as imposed under the provisions of sections 600 and 903 of the Revenue Act of 1926, is hereby amended to read as follows:

ART. 3. *Basis of tax.*—The tax is imposed on the sale by the manufacturer and should be returned and paid by him whether the sales price is actually

collected or not. It is measured by the price for which the article is sold by the manufacturer and not by the list price where that differs from the actual sales price.

Where goods are ordered direct from the manufacturer with no agreement as to price, the tax is based on the amount billed or invoiced to the purchaser as the selling price.

Where a lump sum is specified as the price of a taxable article or articles, and other articles not taxable and not a component part of the taxable articles are included in the price, the tax attaches to the entire amount unless the selling prices of the taxable and nontaxable articles are segregated. In such case the tax will be measured by the price specified as the selling price of the taxable article or articles. For example, if an automobile manufacturer sells an automobile for a lump sum price of $1,100, he will be required to pay tax computed at 3 per cent of this price, that is, a tax of $33, even though such price may have been determined by including the cost of the tax, gas, oil and insurance. On the other hand, if he wishes to collect the tax from his customer as a specific item and also to avoid paying tax on gas, oil, and insurance, he can do this provided he quotes or indicates the price of each item separately as, one automobile, $1,000; 3 per cent tax, $30; gas and oil, $5; insurance $65; total, $1,100.

D. H. Blair,
Commissioner of Internal Revenue.

Approved February 4, 1927.

A. W. Mellon,
Secretary of the Treasury.

Regulations 47, Article 4: Discounts and expenses. VI–15–3189
T. D. 4005

MANUFACTURERS' EXCISE TAXES—DISCOUNTS AND EXPENSES.

Article 4 of Regulations 47, relating to the excise taxes on sales by the manufacturer (secs. 600 and 903, Revenue Act of 1926), amended.

Treasury Department,
Office of Commissioner of Internal Revenue,
Washington, D. C.

To Collectors of Internal Revenue and Others Concerned:

Article 4 of Regulations 47 (revised March, 1926), relating to the excise taxes on sales by the manufacturer, as imposed under the provisions of sections 600 and 903 of the Revenue Act of 1926, is hereby amended to read as follows:

Art. 4. *Discounts and expenses.*—A discount not provided for at the time of sale but made subsequently thereto can not be deducted in determining the price upon which the tax is to be computed.

An adjustment in price, where articles are sold over a period of time, under an agreement for a quantity rebate, or an agreement for a so-called wholesale bonus, i. e., a rebate on goods resold by a distributor or dealer to so-called subdealers, is held not to be a discount made subsequently to the sale, and the tax, if originally computed on the gross price, may be adjusted in the return for the month in which the price is finally determined. If in such cases the tax assumed to be due on the original selling price has been billed to the dealer and by him to the purchaser as a separate item, and collected from the purchaser, the overcollection of tax arising from the adjustment of the sale price under the contract between the manufacturer and the dealer must be refunded to the purchaser.

Where articles are sold under an agreement for a rebate on goods remaining unsold in the hands of the dealer, and which were purchased by such dealer within a definitely specified period, in case of a decline in the market, a reduction in price made in accordance with such agreement is not considered a dis-

count made subsequently to the sale, and if the manufacturer refunds to the dealer a portion of the original or tentative price, together with the amount for which he was reimbursed to cover the tax thereon, he may take credit on his return for the month in which such adjustment in price is made for the amount of overpayment on the original sale, resulting from the price adjustment.

Commissions to agents and other expenses of sale are not deductible from the price.

Freight and delivery charges are not a part of the sales price, subject to tax, when the goods are sold and actually become the property of the purchaser at the factory or are sold f. o. b. cars at place of manufacture and the transportation charges are paid by the purchaser.

Actual freight and delivery charges paid by the manufacturer are not a part of the sales price subject to tax. Charges represented by the manufacturer as freight or delivery charges when such charges, whether or not billed as a separate item, do not represent the actual transportation charges, are to be included in the amount upon which the tax is to be computed.

C. R. NASH,
Acting Commissioner of Internal Revenue.

Approved April 1, 1927.

OGDEN L. MILLS,
Acting Secretary of the Treasury.

REGULATIONS 47(1924), ARTICLE 30: Credits and refunds. VI-17-3213 T. D. 4015

MANUFACTURERS' EXCISE TAX.

Requirements to be observed by manufacturers of parts and accessories for automobiles, motorcycles, automobile trucks, and automobile wagons in making claims for refund of tax.

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

To Collectors of Internal Revenue and Others Concerned:

The Act of Congress approved February 28, 1927 (Public, No. 660—69th Congress), making deficiency appropriations for various purposes, contains the following provisions, viz:

Refunding taxes illegally collected: For refunding taxes illegally collected under the provisions of sections 3220 and 3689, Revised Statutes, as amended by the Revenue Acts of 1918, 1921, 1924, and 1926, including the payment of claims for the fiscal year 1928 and prior years, $175,000,000, to remain available until June 30, 1928: * * * *Provided further*, That no part of this appropriation shall be available to refund any amount paid by or collected from any manufacturer, producer, or importer in respect of the tax imposed by subdivision (3) of section 600 of the Revenue Act of 1924, or subdivision (3) of section 900 of the Revenue Act of 1921 or of the Revenue Act of 1918, unless the Commissioner of Internal Revenue certifies to the proper disbursing officer that such manufacturer, producer, or importer has filed with the Commissioner under regulations prescribed by the Commissioner with the approval of the Secretary of the Treasury, a bond in such sum and with such sureties as the Commissioner deems necessary, conditioned upon the immediate repayment to the United States of such portion of the amount refunded as is not distributed by such manufacturer, producer, or importer, within six months after the date of the payment of the refund, to the persons who purchased for purposes of consumption (whether from such manufacturer, producer, importer, or from any other person) the articles in respect of which the refund is made, as evidenced by the affidavits (in such form and containing such statements as the Commissioner may prescribe) of such purchasers, and that such bond, in the case of a claim allowed after the passage of this Act, was filed before the allowance of the claim by the Commissioner.

The procedure with respect to claims affected by the foregoing provisions of law, now on file or filed hereafter, will be as follows:

The claimant's attention will be called to the terms of the Act and he will be requested to advise the Bureau whether, in view of the conditions imposed by the law, he intends to prosecute the claim and comply with the terms imposed. If he declares his intention not to prosecute the claim, it will be rejected, without further action, and the claimant so advised.

If the claimant decides to prosecute the claim and agrees to furnish the bond and proof of distribution required by the law, the claim for refund will then be developed by the Bureau to the point where the amount refundable is determined. The manufacturer, producer, or importer will be advised of this determination and requested to file a bond in an amount equal to one and one-half times the sum determined to be refundable. The bond must be in the form and with a surety or sureties approved by the Secretary of the Treasury under the provisions of existing law, and conditioned upon the immediate repayment to the United States of such portion of the amount refunded (interest included) as is not distributed by such manufacturer, producer, or importer within six months after the date of the payment of the refund, to the persons who purchased for purposes of consumption (whether from such manufacturer, producer, importer, or from any other person) the articles in respect of which the refund is made, as evidenced by the affidavits of such purchasers. A corporate surety company, duly licensed by the Secretary of the Treasury under the provisions of existing law, is preferred as surety on the bond. The face of the bond must show the effective date and the date executed, the full name and address of principal and surety, and the rate and total amount of the premium charged. All erasures or interlineations must be noted above the signature of the witnesses as having been made before execution of the bond. A corporate surety must affix its corporate seal. When furnished, the bond will be forwarded to the Commissioner of Internal Revenue for the attention of the Miscellaneous Tax Unit, and no warrant for any amount allowable shall be issued unless and until a satisfactory bond is filed.

Upon receipt of the bond it will be carefully examined and if found to be in proper form and made in accordance with the terms of the Act of February 28, 1927, the claim will be allowed in the amount determined to be due. The Commissioner will then make the certificate required by the law to the proper disbursing officer.

A manufacturer, producer, or importer will be furnished with the Treasury warrant in the full amount for which his claim has been allowed. Within six months after the date of payment the manufacturer, producer, or importer must distribute the proper proportion thereof to the persons who purchased the nontaxable articles for consumption. If the refund allowance includes interest, the distribution to the purchasers shall also include the proper share of interest due in each case.

The manufacturer, producer, or importer must procure from each consumer to whom distribution is made an affidavit, for transmission to the Commissioner of Internal Revenue, in substantially the following form, viz:

CONSUMER'S AFFIDAVIT.

The undersigned, being duly sworn, declares that during the period from ----------, 19--, to ----------, 19--, he purchased from ----------
(Name of seller.)
for purposes of consumption, articles manufactured, produced, or imported by ----------
(Name.)
and with respect to which, according to information and belief, taxes were paid as being subject to the provisions of subdivision (3) of section 600 of the Revenue Act of 1924, or subdivision (3) of section 900 of the Revenue Act of 1921 or of the Revenue Act of 1918.

The undersigned also declares that the said manufacturer, producer, or importer paid to him on ----------
(Date.)
taxes collected under one or more of those laws, in the sum of $------, together with interest in the sum of $------, the receipt of which is hereby acknowledged.

(Signature.)

(Address.)

Subscribed and sworn to before me this ------ day of ----------, 19--.

[SEAL.]

(Signature and title of officer administering oath.)

On or before the expiration of six months after the date of payment of the refund, the manufacturer, producer, or importer must deliver to the collector of internal revenue, to whom the tax was originally paid, (1) the original affidavits furnished by purchasers as evidence of receipt of taxes and interest, (2) a certified check, drawn in favor of the collector, for the balance of the amount refunded to him and interest allowed, not distributed to purchasers, and (3) a suitable letter of explanation. The collector will forward the affidavits and letter of explanation to the Commissioner of Internal Revenue with an appropriate report.

The Commissioner shall not release the manufacturer, producer, or importer from liability under his bond unless and until the Bureau is in receipt of evidence establishing that the entire amount refunded, including interest, has been properly accounted for as having been distributed to the purchasers or as having been repaid to the collector.

C. R. NASH,
Acting Commissioner of Internal Revenue.

Approved April 19, 1927.

A. W. MELLON,
Secretary of the Treasury.

TITLE VI.—TAX ON BEVERAGES. (1918)

SECTION 628.—TAX ON SOFT DRINKS AND OTHER BEVERAGES SOLD IN BOTTLES OR OTHER CLOSED CONTAINERS.

REGULATIONS 52(1919), ARTICLE 8: Basis of tax: Sale price. VI-7-3107 T. D. 3967

TAX ON BEVERAGES: BASIS FOR TAX.

Article 8 of Regulations 52, relating to the tax on soft drinks and other beverages sold in bottles or other closed containers (section 628 of the Revenue Act of 1918), amended.

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

To Collectors of Internal Revenue and Others Concerned:

Article 8 of Regulations 52, relating to the tax imposed under the provisions of the Revenue Act of 1918 on soft drinks and other beverages sold in bottles or other closed containers, is hereby amended to read as follows:

ART. 8. *Basis for tax: sale price.*—The tax is on the sale by the manufacturer of the beverage. It is measured by the price for which the beverage is sold. It is on the actual sales price of the beverage sold and not on the list price where that differs from the sales price. The tax is payable in respect to a sale made whether or not the purchase price is actually collected.

D. H. BLAIR,
Commissioner of Internal Revenue.

Approved February 4, 1927.

A. W. MELLON,
Secretary of the Treasury.

TITLE VIII.—TAX ON ADMISSIONS AND DUES. (1918 AND 1921)

TAX ON DUES.

REGULATIONS 43–II, ARTICLE 10: Initiation fees. VI–5–3072
T. D. 3955

DUES TAX—REVENUE ACTS OF 1918 AND 1921—DECISION OF COURT.

1. CLUBS—INITIATION FEES—STOCK SUBSCRIPTION.

An amount paid for a share of the capital stock of a social club, required to be purchased as a prerequisite to membership, is not taxable under sections 801 of the Revenue Acts of 1918 and 1921 as an initiation fee.

2. DEFINITION—INITIATION FEE.

An initiation fee, under sections 801 of the Revenue Acts of 1918 and 1921, is an amount paid for the purpose of becoming a member of a club, the amount so paid being parted with absolutely by the person paying it.

3. ACTIONS—PARTIES.

Under section 802 of the Revenue Acts of 1918 and 1921 a club may maintain an action for recovery of taxes imposed upon its members by sections 801 of such Acts.

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

To Collectors of Internal Revenue and Others Concerned:

The following decision of the United States Court of Claims in the case of *Alliance Country Club* v. *The United States* is published for the information of internal revenue officers and others concerned.

D. H. BLAIR,
Commissioner of Internal Revenue.

Approved January 21, 1927.

A. W. MELLON,
Secretary of the Treasury.

COURT OF CLAIMS OF THE UNITED STATES.

Alliance Country Club v. *The United States.*

[November 15, 1926.]

OPINION.

HAY, Judge, delivered the opinion of the court.

The plaintiff, Alliance Country Club, was incorporated under the laws of the State of Nebraska, March 14, 1921. The Act of November 23, 1921 (42 Stat., 227, 291), reads as follows:

"SEC. 801. That from and after January 1, 1922, there shall be levied, assessed, collected, and paid, in lieu of the taxes imposed by section 801 of the Revenue Act of 1918, a tax equivalent to 10 per centum of any amount paid on or after such date, for any period after such date, (*a*) as dues or membership fees (where the dues or fees of an active resident annual member are in excess of $10 per year) to any social, athletic, or sporting club or organization; or (*b*) as initiation fees to such a club or organization, if such fees amount to more than $10, or if the dues or membership fees (not including initiation fees) of an active resident annual member are in excess of $10 per year; such taxes to be paid by the person paying such dues or fees; * * *.

"SEC. 802. That every person receiving any payments for such admission, dues, or fees, shall collect the amount of the tax imposed by section 800 or 801 from the person making such payments. * * * In all the above cases returns and payments of the amount so collected shall be made at the same time and in the same manner and subject to the same penalties and interest as provided in section 502.

"SEC. 502. (a) That each person receiving any payments referred to in section 500 shall collect the amount of the tax, if any, imposed by such section from the person making such payments, and shall make monthly returns under oath, in duplicate, and pay the taxes so collected to the collector of the district in which the principal office or place of business is located.

* * * * * * *

"(c) The returns required under this section shall contain such information, and be made at such times and in such manner, as the Commissioner, with the approval of the Secretary, may by regulation prescribe.

* * * * * * *

"SEC. 1303. That the Commissioner, with the approval of the Secretary, is hereby authorized to make all needful rules and regulations for the enforcement of the provisions of this Act. * * *"

The Revenue Act of 1918, section 801, is in the same language as is the Act of November 23, 1921. Under the provisions of this Act the plaintiff paid under protest to the collector of internal revenue the sum of $1,756. The plaintiff applied to the Commissioner of Internal Revenue for a refund of the above amount; this application was denied, and the plaintiff brought its suit in this court.

The defendant contends that the plaintiff is not the proper party to bring suit, and that its petition must therefore be dismissed. But section 802 of the Act provides for the collection of the amount of the tax by the person receiving any payment for initiation fees, and further provides that payments of the amounts so collected shall be made at the same time and in the same manner and subject to the same penalties and interest as provided in section 502; and section 502(a) reads as follows:

"That each person receiving any payments referred to in section 500 shall collect the amount of the tax, if any, imposed by such section from the person making such payments, and shall make monthly returns under oath, in duplicate, and pay the taxes so collected to the collector of the district in which the principal office or place of business is located."

The Commissioner of Internal Revenue issued on March 28, 1919, the following regulation:

"*Refund of overpayment.*—Any club, organization, corporation, partnership, or individual that has paid to the collector of internal revenue, as a tax, under section 801 of the Revenue Act of 1918, any amount erroneously or illegally assessed, or any amount in excess of the amount of the tax actually imposed

by that section for the month covered by that payment, or any amount as a penalty for the collection of which there was no authority, may secure a refund of the amount so overpaid by filing with the collector to whom such payment was made a properly prepared claim on Form 46 (revised). When a club or organization seeks to secure a refund to it of an amount collected by it from its members and then paid over by it to the collector of internal revenue, the claim on Form 46 (revised) must be accompanied by a list of the members who paid such amount and by a sworn statement of a club officer that no claim for refund of any such amount has been filed with the collector or commissioner on behalf of any of such members."

And this regulation has not been changed and was in force and effect when the plaintiff paid the tax in controversy and when it applied for a refund and when this suit was brought. So it seems that the Treasury Department recognizes and treats the club as the taxpayer, both as the proper party to pay the tax and also as entitled to recover the tax if the same has been illegally or erroneously paid. We are of the same opinion, and therefore think there is nothing in the contention of the Government that the plaintiff is not the proper party to bring this action.

It is contended by the Government that the payments of $150 each made by members of the Alliance Country Club to the club for one share of stock, the ownership of which said share of stock was a prerequisite to membership, were payments of initiation fees and as such were subject to the tax imposed by the statute. The words "initiation fees" used in the statute must in the construction of the Act be given their plain and ordinary meaning. The court in construing the meaning of a statute, and especially one imposing a tax, will not enlarge the meaning of the words used so as to include within its scope what has been omitted by the legislature. (*Iselin* v. *United States*, 270 U. S., 245 [T. D. 3846, C. B. V–1, 365].) Only those things can be taxed which are within the plain import of the language used. The words "initiation fees" as used in the statute mean the payment of an amount for the purpose of becoming a member of a club and the parting absolutely with the amount so paid. These words can not be construed to mean an investment in stock purchased from the club, which may be repaid to the purchaser upon certain contingencies.

In the case at bar, if the owner of the stock resigned or was expelled, the club was to repay the value of the stock to the member, or in case of death to his personal representative. So that the purchase of the stock was not in the ordinary meaning of the words an initiation fee; and if it was not an initiation fee, then it was not subject to be taxed as such, and the plaintiff is entitled to recover. If there is any doubt about the question, it must be resolved in favor of the taxpayer. This principle is too well established to need elaboration and has been repeatedly announced to be the law by the Supreme Court of the United States.

Judgment will be entered against the Government in favor of the plaintiff for the amount erroneously paid, with interest.

REGULATIONS 43–II(1920), ARTICLE 13: Initiation fees. VI–5–3073 T. D. 3956

DUES TAX—REVENUE ACT OF 1918—DECISION OF COURT.

1. CLUBS—INITIATION FEES—STOCK SUBSCRIPTION.

An amount paid for a share of the capital stock of a club entitling the owner upon election by the board of directors to membership in the club is not taxable under section 801 of the Revenue Act of 1918 as an initiation fee.

2. DEFINITION—INITIATION FEE.

An initiation fee, under section 801, is a payment, without the expectation of being refunded, made by a person who wishes to become a member of a social or fraternal club already established, and is not a payment by a person who, with others, founds and establishes a club.

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

To Collectors of Internal Revenue and Others Concerned:

The following decision of the United States Court of Claims in the case of *John H. Page* v. *The United States* is published for the information of internal revenue officers and others concerned.

D. H. BLAIR,
Commissioner of Internal Revenue.

Approved January 21, 1927.

A. W. MELLON,
Secretary of the Treasury.

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COURT OF CLAIMS OF THE UNITED STATES.

John H. Page v. *The United States.*

[November 15, 1926.]

OPINION.

HAY, Judge, delivered the opinion of the court.

The plaintiff was, in December, 1919, a resident member of the Phoenix Country Club. He became a resident member of said club by complying with the by-laws of said club, which provided that resident members should be required to be the owner of at least one share of the capital stock of the corporation.

On July 25, 1922, the collector of internal revenue for the district of Arizona demanded a tax of $25 from the plaintiff as a tax on "initiation fees" under section 801 of the Revenue Act of 1918. The tax was assessed on the payment by the plaintiff of $250 for one share of the capital stock in the Phoenix Country Club, and upon the theory that his subscription and payment for one share of said stock was an initiation fee paid by him for membership in said club. On August 8, 1922, the plaintiff paid the tax to the collector under protest. On March 21, 1923, the plaintiff filed a claim for refund of the tax so paid. The claim for refund was adjusted by the Commissioner of Internal Revenue on September 5, 1923, and was allowed in the sum of $5 and rejected in the sum of $20. This adjustment the plaintiff refused to abide by, and has brought suit in this court for the amount so paid by him. Section 801 of the Revenue Act of 1918 reads as follows:

"SEC. 801. That from and after April 1, 1919, there shall be levied, assessed, collected, and paid, in lieu of the taxes imposed by section 701 of the Revenue Act of 1917, a tax equivalent to 10 per centum of any amount paid on or after such date, for any period after such date, (*a*) as dues or membership fees (where the dues or fees of an active resident annual member are in excess of $10 per year) to any social, athletic, or sporting club or organization; or (*b*) as initiation fees to such a club or organization, if such fees amount to more than $10, or if the dues or membership fees (not including initiation fees) of an active resident annual member are in excess of $10 per year; such taxes to be paid by the person paying such dues or fees: *Provided*, That there shall be exempted from the provisions of this section all amounts paid as dues or fees to a fraternal society, order, or association, operating under the lodge system. In the case of life memberships a life member shall pay annually, at the time for the payment of dues by active resident annual members, a tax equivalent to the tax upon the amount paid by such a member, but shall pay no tax upon the amount paid for life membership."

The regulation of the Treasury Department with respect to initiation fees is to be found in article 13 of Regulations No. 43 (revised December, 1920), and reads as follows:

"ART. 13. *Initiation fees.*—The Revenue Act of 1918 imposes a tax of 10 per cent on any amount paid as initiation fees to any club which is within the

terms of the Act (see arts. 1–7, above): *Provided*, That either (*a*) such initiation fees amount to more than $10, or (*b*) the regular dues or membership fees (not including extraordinary dues or assessments, or penalties incurred by failure to pay promptly) of 'an active resident annual member' of such club are in excess of $10 per year. (See art. 12 and the analysis just before art. 11, above.) The term 'initiation fee' includes any payment to the club required for becoming a member, whether evidenced by a certificate of membership or a share of stock in the club or not."

Is the payment made by the plaintiff within the terms of the statute? The statute provides for the payment of a "tax equivalent to 10 per centum of any amount paid * * * as initiation fees to such a club or organization, if such fees amount to more than $10." In this case the amount paid by the plaintiff was the sum of $250 for one share, par value $250, of the capital stock of the Phoenix Country Club. By subscribing to and paying for this share of stock the plaintiff was entitled to become a member of the club if he was elected to membership by the board of directors of said club. He might have purchased the stock and still might not have become a member of the club. In this case the plaintiff was one of a certain number of persons who founded and established the club. His purchase of a share of the stock was not the payment of an initiation fee in the ordinary meaning and common acceptance of those words. An initiation fee is a payment made by a person who wishes to become a member of a social or fraternal club already established, and not the payment by a person who with others founds and establishes a club.

When an initiation fee is paid there is no expectation that the person so paying it will have it refunded. It is a payment which goes to the club for its uses and does not hold out any hope of being returned. In this case under certain contingencies mentioned in the by-laws the share of stock purchased by the plaintiff will be returned to him or to his personal representatives. Thus the subscription to and payment for the share have not the characteristics of "initiation fees," the words used in the statute.

Congress in enacting laws does not use words different in meaning from the common and well-understood meaning of the words used. If there is any doubt about their meaning it must be resolved in favor of the taxpayer. We are asked by the Government not to construe the statute but to enlarge it, so that all payments to clubs, whether in money or by purchase stock, may be included in the words "initiation fees." See *Iselin* v. *United States* (270 U. S., 245) [T. D. 3846, C. B. V–1, 365], decided March 1, 1926, by the Supreme Court of the United States.

We are of opinion that the plaintiff was not liable for the tax which was collected from him and judgment will be entered against the United States.

TITLE IX.—EXCISE TAXES. (1918)

SECTION 903.—RETURN AND PAYMENT OF TAX.

REGULATIONS 47(1921), ARTICLE 37: Return and payment of tax. VI–10–3138 T. D. 3989

EXCISE TAX—REVENUE ACT OF 1918—DECISION OF CIRCUIT COURT OF APPEALS.

1. INJUNCTION—DISTRAINT—SECTION 3224 R. S.

Under the provisions of section 3224, Revised Statutes, injunction will not lie to restrain the collection by distraint of a Federal tax.

2. CASE FOLLOWED.

The case of *Peacock* v. *Reinecke* (3 Fed. (2d), 583, T. D. 3672 [C. B. IV–1, 285]) followed.

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

To Collectors of Internal Revenue and Others Concerned:

The following decision of the United States Circuit Court of Appeals for the Seventh Circuit in the case of *Reinecke, Collector*, v. *O. D. Jennings & Co.* is published for the information of internal revenue officers and others concerned.

D. H. BLAIR,
Commissioner of Internal Revenue.

Approved February 26, 1927.

A. W. MELLON,
Secretary of the Treasury.

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

Mabel G. Reinecke, as Collector of Internal Revenue at Chicago, appellant, v. O. D. Jennings & Co., appellee.

Appeal from the District Court of the United States for the Northern District of Illinois, Eastern Division.

[January 25, 1927.]

PAGE, Cir. J.: This is an appeal from an order restraining appellant, collector of internal revenue at Chicago, from collecting from appellee a sum of money that the appellee avers was wrongfully demanded as a tax under paragraph 5, section 900 of the Revenue Act of 1918, on certain of appellee's manufactures, alleged to be "slot machines of the exclusively gambling type," known as "operator's bells" and "traders."

One of appellee's contentions is that "the exaction demanded was not a tax," but it admits that if it was a tax the court was, by reason of section 3224 of the Revised Statutes, without jurisdiction.

Its main reliance, it says, is upon *Lipke* v. *Lederer* (259 U. S., 557), which was followed by this court in *Jakovich* v. *Mager* (283 Fed., 980). The question in the Lipke case arose under section 35 of the National Prohibition Act. Section 35 and paragraph 5, section 900, supra, are so different in language and purpose that we are of opinion that in the light of the Lipke case it clearly appears that any exaction under the latter section must be for a tax and not for a penalty. In fact, appellee makes no argument to show that any exactions leviable under paragraph 5, section 900, are not taxes but seems to concede that fact. It contends that slot machines alleged to be "of the exclusively gambling type" do not come within the language of that paragraph and section, or within any other section of the Revenue Act of 1918, and the whole argument seems to be intended to support appellee's urge that if an exaction is not authorized by some statute, even though the taxing authorities believe it to be so, its collection may be enjoined in equity. We held to the contrary in *Peacock* v. *Reinecke* (3 Fed. (2d), 583, 584).

The decree should be and is reversed, with directions to the district court to vacate the injunction and dismiss the bill.

ESTATE TAX RULINGS.

TITLE IX.—BOARD OF TAX APPEALS. (1924)

ANNOUNCEMENT RELATING TO DECISIONS OF THE UNITED STATES BOARD OF TAX APPEALS.

[1] VI–26–3287

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

Taxpayer.	Docket No.	Board of Tax Appeals.	
		Volume.	Page.
C.			
Caplis, Mary, deceased, estate of	6720	4	983
D.			
DeLisser, Horace, estate of	2459	2	102
DeLisser, Ione, executrix	2459	2	102
F.			
Frankel, Osmond K., executor	3182	3	1207
H.			
Harris, Charles L., administrator estate of William L. Harris, deceased	4426	5	41
Harris, William L., deceased, estate of	4426	5	41
Hausmann, Louis, executor	5931	5	199
Hausmann, Theresa R., estate of	5931	5	199
Hortenstine, J. L., coadministrator	3633	3	697
K.			
Kaufman, Samuel R., estate of	4698	5	31
Kaufman, Una Libby, executrix	4698	5	31
Kennedy et al., Annie S., executors	5244	4	330
Kennedy, D. J., deceased, estate of	5244	4	330
Kessler, George A., estate of	3182	3	1207
M.			
McDonald, Mary E., executrix	3042	2	1295
McDonald, Patrick J., estate of	3042	2	1295

[1] Ruling No. 3287 includes rulings Nos. 3053, 3061, 3108, 3160, 3224, 3235, 3244, 3251, 3266, and 3276. These ruling published in the weekly Bulletins during the semiannual period January 1 to June 30, 1927, have been combined and the decisions arranged in alphabetical order.

Taxpayer.	Docket No.	Board of Tax Appeals.	
		Volume.	Page.
O.			
O'Neill, John, estate of	5185	4	78
O'Neill, John J., jr., et al., executors	5185	4	78
P.			
Prouty, Anson V., et al., executors	2951	5	107
Prouty, C. C., estate of	2951	5	107
R.			
Rosser, Luther Z., estate of	2161	3	809
S.			
Schroth, Joseph, estate of	3914	5	326
Schroth, Julia [illegible]nna, executrix	3914	5	326
Schwing, Samuel P., estate of	3633	3	697
Security Trust Co., executor	6720	4	983
Shelton, Charles B., et al., executors	2161	3	809
Starck, Philip A., estate of	4051	3	514
Starck, Philip P., executor estate of Philip A. Starck	4051	3	514
Stern, Samuel E. A., executor	2459	2	102
U.			
United States Mortgage & Trust Co., executor	2459	2	102
W.			
Walter, George L., estate of	1782	4	870
Walter, Howard K., et al., executors estate of George L. Walter, deceased	1782	4	870
Wilson, Charles Scotto, estate of	4909	5	615
Wilson, Fannie L., executrix	4909	5	615

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

Taxpayer.	Docket No.	Board of Tax Appeals.	
		Volume.	Page.
Blair, J. W., administrator	2440	4	959
Blair, W. A., estate of	2440	4	959
Jackson, Minnie L., estate of	4219	3	832
Root, Henry L., estate of	2825	5	696
Root, Susie M., executrix	2825	5	696

TITLE III. PART II.—GIFT TAX. (1924)

REGULATIONS 67, ARTICLE 1: Transfers reached. VI–11–3149
T. D. 3993

GIFT TAX—REVENUE ACT OF 1924—DECISION OF CIRCUIT COURT OF APPEALS.

GIFT TAX—CONSTITUTIONALITY.

The gift tax imposed by the Revenue Act of 1924 is constitutional as an excise, although it imposes a retroactive tax on gifts completed prior to the passage of the Act.

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

To Collectors of Internal Revenue and Others Concerned:

The following decision of the United States Circuit Court of Appeals for the Second Circuit in the case of *Anderson, Collector*, v. *George McNeir* is published for the information of internal revenue officers and others concerned.

C. R. NASH,
Acting Commissioner of Internal Revenue.

Approved March 5, 1927.

A. W. MELLON,
Secretary of the Treasury.

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

Charles W. Anderson, Collector of Internal Revenue for the Third District of New York, plaintiff in error (defendant below), v. George McNeir, defendant in error (plaintiff below).

Writ of error to the District Court for the Southern District of New York. Suit by George McNeir, plaintiff, against the collector of internal revenue for the third district of New York, to recover a tax assessed against him and paid under the Revenue Act of 1924. Decree for plaintiff; defendant appeals. Reversed.

MANTON, Circuit Judge: During the calendar year of 1924, and prior to the passage of the Revenue Act of that year, the defendant in error made an irrevocable deed of trust to the Farmers Loan & Trust Co., giving a large gift of securities for the benefit of his wife, children, and grandchildren. The income from the *corpus* of this trust was to be paid to his wife and two children during the term of their lives. Trusts were created for grandchildren of the donor in the event that the wife and the children of the donor should predecease him without leaving issue. A further provision of the trust was that, in the event of the wife and children so dying and the donor being not then living, one half of the principal should go to Georgetown University and the other half pass under the intestate laws of the State of New York. An additional gift of $4,300 was made by the donor after the passage of the Act.

Because of the requirements of sections 319–324 of the Revenue Act of 1924, in January, 1925, the defendant in error filed a gift tax return reporting these gifts made by him during the year 1924. The plaintiff in error assessed a tax and collected it, under protest, pursuant to this Act. In this action, the defendant in error has succeeded in its recovery.

The Act (43 Stat. L., 253, 313–316, sec. 319) requires that for the calendar year of 1924, and each calendar year thereafter, a tax (referred to in a schedule unnecessary to mention here) is imposed upon the transfer by a resident by gift during such calendar year of any property wherever situate, whether

made directly or indirectly, and upon the transfer by a nonresident by gift during such calendar year of any property situated within the United States. Section 320 makes provision for a tax in the event that the gift be made in property so that the tax be paid on the fair market value. Section 321 provides for deductions, in the case of a resident, an exemption of $50,000; also gifts to charity, all gifts the aggregate amount of which to any one person do not exceed $500, are exempt. A further provision of exemption is made for property transferred by gift which has been received by the donor within five years prior to the time of his making such gift, either from another person by gift or by a decedent by gift, devise, or inheritance. Section 322 provides that where a tax is imposed under section 319 upon any gift and thereafter upon the death of the donor the amount thereof is required by any provision of Part I of this title to be included in the gross estate of the decedent, then there shall be credited against and applied in reduction of the estate tax an amount equal to the tax paid with respect to such gift. Section 323 provides that any person who, within the calendar year of 1924 or any calendar year thereafter makes any gift or gifts in excess of the deductions allowed by section 321 shall, on or before the 15th day of March, file with the collector a return under oath, listing and setting forth therein all gifts and contributions made by him during such calendar year. Section 324 provides how the tax shall be assessed and collected.

This gift tax is attacked by the defendant in error as repugnant to the Constitution, and he invokes Article I. section 2, clause 3, which requires that direct taxes shall be apportioned among the several States according to their respective numbers, and Article I, section 9, clause 4, which provides that no capitation or other direct tax shall be laid unless in proportion to the census or enumeration hereinbefore directed to be taken, and Article I. section 8, clause 1, that Congress shall have power to lay and collect taxes, duties, imposts and excises, but all duties, imposts and excises shall be uniform throughout the United States; and Article I, section 9, clause 5, that no tax or duty shall be laid on articles exported from any State.

The questions presented by this writ are (1) whether the gift tax provided for by this enactment is a direct tax as contended by the defendant in error or an excise or indirect tax as claimed by the Government; (2) is it unconstitutional in so far as it imposes a tax upon transfers by gift made in the calendar year 1924 but consummated before June 2, 1924, when the Act became effective. It is also claimed that if the tax be an excise and not a direct tax, it is repugnant to the fifth amendment of the Constitution as unreasonable and of capricious classification.

The power of taxation by the National Government was delegated to Congress but within the restraints of the Constitution. The power to lay and collect taxes, duties, imposts, and excises is exhaustive and embraces every conceivable power of taxation. (*Brushaber* v. *Union Pacific R. R. Co.*, 240 U. S., 1.) It embraces all the attributes which appertain to sovereignty in the fullest sense. (*United States* v. *Bennett*, 232 U. S., 299.) As said in *Nicol* v. *Ames* (173 U. S., 509, 514):

"The presumption, as has frequently been said, is in favor of the validity of the Act, and it is only when the question is free from any reasonable doubt that the court should hold an Act of the lawmaking power of the Nation to be in violation of that fundamental instrument upon which all the powers of the Government rest. This is particularly true of a Revenue Act of Congress. The provisions of such an Act should not be lightly or unadvisedly set aside, although if they be plainly antagonistic to the Constitution it is the duty of the court to so declare."

There is not to be found in the cases a clear definition of precisely what is meant by a direct tax or, indeed, an excise tax. It has become a rule of application to each particular tax. The nature of the tax is to be determined from the standpoint of the Constitution. It may not be answered by the theories of political economists. (*Pollock* v. *Farmers' Loan & Trust Co.*, 157 U. S., 429; *Knowlton* v. *Moore*, 178 U. S., 41.) Prior to the Pollock case, it was thought that the direct tax referred to in the Constitution comprised only a capitation or poll tax and a tax on land. The Supreme Court in *Hylton* v. *United States* (1796) (3 Dall., 171) overruled a challenge to a tax, as unapportioned, imposed on carriages for the convenience of persons who shall keep them for their own use or to be let out for hire or conveying of passengers. This was held

to be an excise tax. In *Pacific Insurance Co.* v. *Soule* (7 Wall., 433), a tax imposed upon premium receipts, dividends, and income of insurance companies was upheld as a proper exercise of constitutional power to levy excise taxes. A tax levied upon the amount of notes of State banks or banking associations, paid out by any National or State banking association, was also held to be an excise tax. (*Veazie Bank* v. *Fenno*, 8 Wall., 533.) The succession tax upon the devolution of title to real estate was held to be an indirect tax and constitutional. (*Scholey* v. *Rew*, 23 Wall., 331.) In *Pollock* v. *Farmers' Loan & Trust Co.*, supra, an income tax was held to be unconstitutional and was said to be the legal equivalent of a direct levy upon the property from which the income was derived and therefore required apportionment. Later, in 1898, the Supreme Court held a tax levy upon the sale of commodities on boards of trade and exchanges was a valid excise. (*Nichol* v. *Ames*, supra.) A tax on gifts by will was held to be an excise and not a direct tax. (*Knowlton* v. *Moore*, 178 U. S., 41.) So also the stamp tax levied on calls or agreements to sell stock. (*Treat* v. *White*, 181 U. S., 264.) And the tax on manufactured tobacco intended for sale was held to be an excise tax in *Patton* v. *Brady* (184 U. S., 608), as was a stamp tax on a memorandum or contract of sale of stocks in *Thomas* v. *United States* (192 U. S., 363). A corporation excise tax was held valid in *Flint* v. *Stone Tracy Co.* (220 U. S., 107). This tax was said not to be upon the corporate franchises irrespective of their use or upon the property of the corporation but upon the doing of the corporate business and with respect to the carrying on thereafter. In *Billings* v. *United States* (232 U. S., 261) the tax was imposed under the Tariff Act upon the use of foreign built yachts not used or intended to be used for trade. It was sustained as an excise tax. In that case, the court pointed out that it was to be observed that the provision dealt with ownership, and distinguished between ownership and use, since it based the tax not upon the former but upon the use, and stated that it followed that it was not the ownership but the election, during the taxing period, of the owner to take advantage of one of the elements which were involved in ownership; that is, the right to use was subject under the statute to the excise duty. And the court said:

"In this view the fact of use, not its extent or its frequency, becomes the test, as distinguished from mere ownership, for that in the statutory sense could exist without use having taken place. * * * use in the statutory sense, although it arises from ownership, is active (objective); that is, it is the outward and distinct exercise of a right which ownership confers but which would not necessarily be exerted by the mere fact of ownership."

The general estate tax enacted in 1916 (Revenue Act) was held constitutional as an indirect tax in *New York Trust Co.* v. *Eisner* (256 U. S., 345), where it was attacked as a direct tax and said to be void for want of apportionment. The argument was held unsound and it was said to be a duty or excise because of the particular occasion which gave rise to its levy.

Below, the learned district judge thought the tax imposed was a direct tax for the reason that it was imposed by reason of ownership of the property. The tax is novel in this country and perhaps has no historical background, but the same may be said of many of the instances of taxation referred to here. This gift tax is not imposed because of general ownership of the property but because of the happening of an event. The transfer of the property by gift gives rise to its levy. The burden of taxation is born by the donor and not by the donee. The tax does not affect any vested right. When the tax is paid by the donor, the donee is divested of no part of the gift and suffers no diminution thereof. All excises upon any use of property affect some inherent incidents of the right of property. In the lawful excise taxes referred to in the cases cited, they are levied upon the owner in the exercise of some interest each had in the property, which might well be termed a right of property. But the cases are clear that where it is impossible to use property at all without incurring the tax, this is a direct tax upon property and unconstitutional. (*Pollock* v. *Farmers Loan & Trust Co.*, supra; *Dawson* v. *Kentucky Distilleries*, 255 U. S., 288.) It can not be successfully contended that the right to give away property exhausts those interests which together constitute the rights of property so as to amount to the taking of the property. The succession tax was sustained largely because of the historical background; it was a part of what was understood as excises. This gift tax does not encumber all the interests one has in property any more than does the tax imposed upon

the right of succession. Congress has no power to regulate succession to property on death, but this did not avoid the legacy tax in *Knowlton* v. *Moore*, supra, or the Federal estate tax in *New York Trust Co.* v. *Eisner*, supra. The court in *Knowlton* v. *Moore*, supra, said:

"The thing forming the universal subject of taxation upon which inheritance and legacy taxes rest is the transmission or receipt, and not the right existing to regulate * * *."

The right to dispose of property *inter vivos* is no more a natural right than is the right to dispose of one's property by sale. The distinction is illustrated in *Dawson* v. *Kentucky Distilleries*, supra, where a Kentucky statute imposed a tax upon persons engaged in the business of owning and storing whisky in bonded warehouses. The court held the tax to be one upon property levied solely by reason of ownership, and said:

"The whole value of the whisky depends upon the owner's right to get it from the place where the law has compelled him to put it, and to tax the right is to tax the value. To levy a tax by reason of ownership of property is to tax the property * * *. It can not be made an occupation or license tax by calling it so."

The excise imposed here is like the act of using property (*Billings* v. *United States*, supra) or selling property (*Thomas* v. *United States*, 192 U. S., 363; *Bowman* v. *Continental Oil Co.*, 256 U. S., 642), and the single use of property—the gift of it—which is a use the owner may make, may furnish the occasion for laying a valid excise. There are so many other uses which the owner of property may take advantage of that it can hardly be said that a tax imposed for the act of making a gift of it makes it impossible to use it at all without incurring the tax.

Nor is the Act unconstitutional because it is retroactive. By the terms of the statute the taxpayer must pay the tax for any gift made during the calendar year of 1924, which begins January 1, and in this instance involves a gift made prior to the effective date of the law. (*Billings* v. *United States*, supra.) Statutes are presumed to operate prospectively; where the intention is clearly expressed, the statute may operate retrospectively. Congress has the power to enact retroactive tax legislation. (*Brushaber* v. *Union Pacific R. R. Co.*, 240 U. S., 1; *Billings* v. *United States*, 232 U. S., 261; *Stockdale* v. *Insurance Co.*, 20 Wall., 323; *Flint* v. *Stone Tracy Co.*, 220 U. S., 107.) In view of the clear language of the statute and its positive direction, there can be no doubt that a gift made any time after January 1, 1924, is taxable under the statute.

A further objection to this tax is that it is void under the fifth amendment of the Constitution because the classification is unreasonable and capricious, even assuming it to be an excise tax. The tax operates uniformly throughout the United States. The authorities are in full accord in announcing that the due process clause of the fifth amendment does not constitute a limitation upon the taxing power of the Federal Government. (*Brushaber* v. *Union Pacific*, 240 U. S., 1; *Billings* v. *United States*, 232 U. S., 261; *McCray* v. *United States*, 195 U. S., 27.) This rule obtains unless the taxing power is so exercised as to imply the conclusion that it was not the exertion of taxation, but a confiscation of property. (*Barclay* v. *Edwards*, 267 U. S., 442; *Lewellyn* v. *Frick*, 268 U. S., 238.) This tax is a revenue-raising measure, and while it may be aimed at reducing the possibility of avoidance of income and State taxation by persons possessing large fortunes, Congress did not overstep its constitutional limitation in this enactment and taxation.

Judgment reversed with costs.

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

Charles W. Anderson, etc., v. *George McNeir.*

HAND, Circuit Judge (concurring): In view of the fact that the question at bar is already before the Supreme Court on a certificate from the sixth circuit, I should have preferred to certify this case as well. However, as my brothers think otherwise, I have considered it on its merits.

The best argument against the tax seems to me to be that stated in the opinion of the learned district judge, and it is this: Succession taxes must rest upon a historical basis; inherently they are taxes on property, because they

so far invade the interests which the law collectively protects as property as to leave too little unincumbered by the tax. A gift tax has no historical justification, because it was unknown in 1789.

Even so, and I do not mean that the reasoning is inexorable, it does not seem to me that we need so straitly circumscribe the powers of Congress to what had been done in the eighteenth century. It is unlikely, had the practice then arisen to avoid estate taxes either by settlements, dependent upon the death of the settlor, or by outright gifts, that anybody would have felt it more than a step in the same path to include them with testamentary dispositions, properly speaking.

Considering the amendments of 1916 and 1918, which covered settlements with remainders on the settlor's death, and this amendment of 1924, which covers outright gifts of over $50,000, we must assume, I think, that Congress supposed these to be in pari materia and progressively in execution of the main design. This is not to use the power of taxation for an ulterior purpose, as in the Child Labor Cases (259 U. S., 20) and the like. The statute may be read as ancillary to collecting sources of revenue made available under *Knowlton* v. *Moore* (178 U. S., 41) and *New York Trust Co.* v. *Eisner* (256 U. S., 345). New occasions call out new means, and if the purpose be lawful, it does not seem to me an insuperable difficulty that it is realized by strange instruments. Whatever was accepted procedure when the Constitution was enacted is constitutional (*Murray* v. *Hoboken Land Co.*, 18 How., 272), but the converse is not true.

TITLE IV.—ESTATE TAX. (1921)

SECTION 402.—GROSS ESTATE.

REGULATIONS 37, ARTICLE 27; REGULATIONS 63, ARTICLE 23: Property held jointly or as tenants by the entirety. VI-1-3038 T. D. 3951

ESTATE TAX.

Property held as joint tenants and as tenants by the entirety.—Article 27, Regulations No. 37 (revised January, 1921), and article 23, Regulations No. 63, amended.

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

To Collectors of Internal Revenue and Others Concerned:

Article 27 of Regulations No. 37 (revised January, 1921), and article 23, Regulations No. 63, are hereby amended to read as follows:

Property held jointly or as tenants by the entirety.—The statute provides for the inclusion in the gross estate of interests held jointly by the decedent and any other person or persons and of estates by the entirety. This provision applies only to a joint tenancy, or a tenancy by the entirety, created subsequent to the passage of the Revenue Act in force and effect at the time of the decedent's death. This class of property includes all interests, whether in real or personal property, where the survivor takes the entire property by right of survivorship, and consequently the decedent's interest therein forms no part of his estate for purpose of administration. It does not include interests held as tenants in common where the interest of each tenant passes free from any right of survivorship.

The following are examples of this class: Real estate held by joint tenants; real estate held by husband and wife (known as an estate by the entirety); money deposited in a bank or trust company in the joint names of the decedent and another and payable to either or the survivor; and, in general, all securities and other personal property, where the title thereto was vested in the decedent and one or more other persons, subject to the right of survivorship.

These amendments apply only to the estates of decedents who died prior to the effective date of the Revenue Act of 1924.

D. H. BLAIR,
Commissioner of Internal Revenue.

Approved December 29, 1926.

A. W. MELLON,
Secretary of the Treasury.

TITLE IV.—ESTATE TAX. (1918)

GROSS ESTATE—TRANSFERS BY DECEDENT IN HIS LIFETIME.

REGULATIONS 37, ARTICLE 22: Nature and time of transfer. VI–8–3118 G. C. M. 1164

The proceeds of insurance policies carried on the life of a decedent dying after the effective date of Title IV of the Revenue Act of 1918 may not be included in the gross estate of such decedent under section 402(c) of said Act, or under similar provisions of subsequent Acts, even though a policy, amounting to more than $40,000, may have been assigned, or the beneficiary named, in contemplation of or intended to take effect in possession or enjoyment at or after death.

All rulings of this office to the contrary are expressly revoked.

An opinion is requested as to whether the estate of A is entitled to the $40,000 exemption, provided by section 402(f) of the Revenue Act of 1918, where insurance, payable to beneficiaries other than the estate as such, is included in the gross estate under the provisions of section 402(c) of said Act in accordance with certain rulings.

Recently article 27, Regulations 70, has been amended by Treasury Decision 3945 [C. B. V–2, 228] which entirely changes the rule previously in effect.

The decedent, A, died in September, 1921. At the time of his death, he carried considerable life insurance, and a question has now been raised as to whether certain policies are subject to inclusion in the gross estate in view of the decision of the Supreme Court in the case of *Lewellyn* v. *Frick* (45 Sup. Ct. Rep., 487) [T. D. 3715, C. B. IV–1, 322].

Some of these policies, those either issued or in which the beneficiary was changed subsequent to the enactment of the Revenue Act of 1918, fall clearly within the purview of section 402(f) of the Act and are not affected by the decision in the Frick case, supra.

In each of the remaining policies carried on the decedent's life the beneficiary receiving the proceeds was named prior to the effective date of Title IV of the Revenue Act of 1918 and, under the decision in the Frick case, supra, and article 27 of Regulations 70, as amended by the said Treasury decision, would not be subject to inclusion in the gross estate of this decedent under section 402(f) of said Act. There is, of course, the question of whether the proceeds of any part or all of these policies may be included in the gross estate under section 402(c) of the Revenue Act of 1918.

The provisions of section 402(c) of the Revenue Act of 1918 may be regarded as general rather than special provisions of the Act

in that said section deals generally with transfers inter vivos, regardless of the character of interest constituting the gift. Section 402(f), however, deals specifically with the inclusion in the gross estate of insurance, such insurance being specifically divided into two classes, i. e., (1) insurance receivable by the executor and (2) insurance in excess of $40,000 receivable by all other beneficiaries.

It is a well-established rule that all parts of an Act are to be given effect. The rule is stated in 25 R. C. L. as follows:

SEC. 246. The maxim ut res magis valeat, quam pereat, requires not merely that a statute shall be given effect as a whole, but that effect shall be given to each of its express provisions. It is a cardinal rule of statutory construction that significance and effect shall, if possible, be accorded to every section, clause, word or part of the act. In applying the rule it frequently occurs that a particular construction of a provision which the court is urged to adopt can not be sanctioned, because, according to the view suggested, certain other provisions would thereby be rendered unnecessary, and it should not be presumed that any provision is redundant or useless. * * *

SEC. 247. Obviously, in order that effect may be given to every part of an act in accordance with the legislative intent, all the language of the act must be considered and brought into accord. It is not safe to base a construction upon a particular word or phrase, for the language of legislative enactments is not always precise and accurate, and, besides, one portion may frequently be designed to extend, qualify or limit another, that the meaning of one portion of a statute may depend upon the effect of another. Hence, it is an established rule in the exposition of statutes that the intention of the lawgiver is to be deduced from a view of the whole, and of every part of a statute taken and compared together. The several provisions of the statute should be construed together in the light of the general purpose and object of the act and so as to give effect to the main intent and purpose of the legislature as therein expressed. If possible, a statute should be so construed as to render it a consistent and harmonious whole; if different portions seem to conflict, they should, if practicable, be harmonized, that construction being favored which will render every word operative rather than one which makes some words idle and nugatory. In other words, a statute must receive such construction as will make all its parts harmonize with each other, and render them consistent with its general scope and object. The various provisions of an act should be read so that all may, if possible, have their due and conjoint effect without repugnance or inconsistency. * * *

SEC. 248. The construction of a statute can ordinarily be in no wise affected by the fact that it is subdivided into sections or titles. A statute is composed as a whole and not in parts or sections and is animated by one general purpose or intent. Consequently, the several parts or sections of an act are to be construed in connection with every other part or section and all are to be construed as parts of a connected whole and harmonized, if possible, so as to aid in giving effect to the intention of the lawmakers. * * *

It is well settled that where there are in one act, or several contemporaneously passed, specific provisions relating to a particular subject, they will govern in respect to that subject as against general provisions contained in the same acts. (Section 275, Second Edition of Lewis' Sutherland Statutory Construction, citing *Felt* v. *Felt* (19 Wis., 193), *State* v. *Goetz* (22 Wis., 363), and *Crane* v. *Reeder* (22 Mich., 322).) In section 351 of the same work it is stated that "The general intent will be controlled by the particular intent subsequently expressed," citing *Ihmsen* v. *Monongahela Navigation Co.* (32 Pa. St., 152), *State* v. *Goetz*, supra, and *Minis* v. *United States* (15 Pet., 445). The rule is also given in 25 R. C. L., as follows:

SEC. 251. * * * When one section of a statute treats specially and solely of a matter, that section prevails in reference to the matter over other sections in which only incidental reference is made thereto; not because one section has more force as a legislative enactment than another, but because the legislative

mind, having been in the one section directed to the particular matter, must be presumed to have there expressed its intention thereon rather than in other sections where its attention was turned to other things. * * *

In *Felt* v. *Felt*, supra, the Supreme Court of Wisconsin said:

But it is a well-settled rule of construction, that specific provisions relating to a particular subject must govern in respect to that subject, as against general provisions in other parts of the law, which might otherwise be broad enough to include it. And by this rule, the provisions of section 6, relating specifically to actions on notes given for more than $100, must govern the case.

If proceeds of insurance may be said to fall within the purview of section 402(c) of the Revenue Act of 1918, and similar provisions of subsequent Federal estate tax laws, then, at least to this extent, the specific provisions of such Acts relating to insurance are entirely unnecessary. If it be contended that section 402(c) of the Revenue Act of 1918 applies to insurance transferred in contemplation of or intended to take effect in possession or enjoyment at or after death, the question immediately arises as to whether all of such insurance goes into the gross estate, or only the excess over $40,000. Section 402(c) of the said Act requires the inclusion in the gross estate of transferred property upon the basis of its value as of the date of decedent's death, whereas the subdivision relating to insurance (section 402(f)) provides that only the excess over $40,000 shall be so included. To this extent, then, there is a conflict in these two provisions, and, if this be true, the cardinal rules of construction herein previously cited require such a construction as will not only harmonize all provisions but also give effect to the whole Act. Such a construction is possible only if subdivision (f) of section 402 of the Revenue Act of 1918 is recognized as being the only rule under which insurance may be brought into the gross estate.

Section 402(f) clearly indicates an intention to exempt from the provisions of the Act at least $40,000 of insurance receivable by beneficiaries other than the estate, so that by including insurance in the gross estate under section 402(c) the said exemption of $40,000 would, nevertheless, have to be recognized.

If, in applying section 402(c) of the Revenue Act of 1918, and similar provisions of subsequent Acts, the insurance provisions are recognized to the extent of allowing the $40,000 exemption, it of necessity follows that the remaining portion of the said insurance provisions apply. The inclusion of proceeds of life insurance policies in the gross estate under section 402(c) of the Revenue Act of 1918, and similar sections of subsequent Acts, would not effect a change in the character of the items so included. The insurance in question would still fall within the classification of subdivision (f) as being receivable by beneficiaries other than the estate and, being insurance so receivable, would also be includable in the gross estate under the insurance provisions of the Acts, thus resulting in double taxation, a result not possible of accomplishment unless the Act expressly requires it. The question of double taxation was touched upon by the Supreme Court in its decision in the case of *United States* v. *Supplee-Biddle Hardware Co.* (265 U. S., 189) [T. D. 3604, C. B. III–1, 112], in which Chief Justice Taft, who delivered the opinion of the court, said:

This view is strengthened by the fact that under section 402, page 1097, of the same revenue law of 1918 (Comp. St. Ann. Supp. 1919, S. 6336–3/4 c), a

decedent's estate tax is levied, with rates ranging from 1 per centum to 25 per centum on the net estate which is made to include (paragraph f) "the amount receivable by the executor as insurance under policies taken out by the decedent upon his own life; and to the extent of the excess over $40,000 of the amount receivable by all other beneficiaries as insurance under policies taken out by the decedent upon his own life." The result of the construction put by the Government upon sections 233, 230, and 213 would be to impose a double tax on the proceeds of the two policies in this case over and above $40,000; i. e., an income tax and an estate tax. Such a duplication, even in an exigent war tax measure, is to be avoided, unless required by express words.

In view of the foregoing, it is held that the proceeds of insurance policies carried on the life of a decedent dying after the effective date of Title IV of the Revenue Act of 1918 may not be included in the gross estate of such decedent under section 402(c) of said Act, or under similar provisions of subsequent Acts, even though a policy, amounting to more than $40,000, may have been assigned, or the beneficiary named, in contemplation of or intended to take effect in possession or enjoyment at or after death.

All rulings of this office to the contrary are hereby expressly revoked.

A. W. GREGG,
General Counsel, Bureau of Internal Revenue.

REGULATIONS 37 (1921), ARTICLE 25: Power of revocation or control. VI-10-3139 T. D. 3988

ESTATE TAX—REVENUE ACT OF 1918—DECISION OF COURT.

1. GROSS ESTATE—TRANSFERS—TRUST INTENDED TO TAKE EFFECT IN POSSESSION OR ENJOYMENT.

A trust in which the founder reserves the right to revoke the trust with the consent of the trustee and the right to change the trustee, the corpus to be distributed at death, is intended to take effect in possession or enjoyment at or after death within the meaning of section 402(c) of the Revenue Act of 1918, and the value of the corpus at the date of death should be included in the gross estate.

2. SAME—CONSTITUTIONALITY.

Section 402(c) of the Revenue Act of 1918 is constitutional when construed to include a trust created prior to September 8, 1916, terminating at death, in which the founder reserves a right to revoke the trust with the consent of the trustee and the right to change the trustee.

3. ESTATE TAX—COLLECTION—LIABILITY OF TRANSFEREES.

Section 409 of the Revenue Act of 1918 has no application to a case in which the trust instrument provides that all taxes shall be paid out of the trust funds.

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

To Collectors of Internal Revenue and Others Concerned:

The following decision of the United States District Court for the Southern District of New York in the case of *The Farmers' Loan & Trust Co., as Trustee under a Deed of Trust made by Wil-*

liam Waldorf Astor (now deceased) dated May 25, 1916, v. *Bowers, Collector*, is published for the information of internal revenue officers and others concerned.

D. H. BLAIR,
Commissioner of Internal Revenue.

Approved February 26, 1927.

A. W. MELLON,
Secretary of the Treasury.

UNITED STATES DISTRICT COURT, SOUTHERN DISTRICT OF NEW YORK.

The Farmers' Loan & Trust Co. (a Corporation), as Trustee under a Deed of Trust made by William Waldorf Astor (now deceased), dated May 25, 1916, plaintiff, v. *Frank K. Bowers, United States Collector of Internal Revenue for the Second District of New York, defendant.*

[September 20, 1926.]

KNOX, D. J.: This suit is before the court upon defendant's motion to dismiss plaintiff's complaint, it being contended that the pleading fails to state a good cause of action.

Plaintiff's statement of the facts, as contained in its brief, may be accepted, on the whole, as accurate, and it will, with a few eliminations and amendments, be incorporated herein as the basis of decision.

William Waldorf Astor, on May 25, 1916, transferred to the Farmers' Loan & Trust Co., a New York corporation, as trustee, stocks, bonds, and cash, which stocks, bonds, and cash were to be held, invested, and reinvested by the said trustee, and the income therefrom (after paying from such income the taxes and other incidental expenses chargeable thereto), *was to be distributed to one or more of the issue of William Waldorf Astor, or the wife or husband of such issue, or to any charity or charities, as the said William Waldorf Astor should, by an instrument under his hand, and delivered to the said trustee, instruct and direct*, and in the absence of such direction it was provided that the trustee should pay or apply such income to such charities in existence in the State of New York as the said trustee, in its absolute discretion, might think proper. It was also provided in the indenture that upon the death of William Waldorf Astor, the trustee should distribute the principal then in its hands as trustee to and among the issue of William Waldorf Astor, in such shares or in such manner, permitted by the laws of New York, as William Waldorf Astor might, by his will or codicil specifically referring to such power appoint, and in default of any such appointment, then to and among his issue then surviving, in equal shares. *It also was provided in the said trust indenture that said William Waldorf Astor, with the written consent of the trustee, which consent the trustee had the absolute discretion to grant or withhold without in any case incurring any liability in that behalf, might modify or revoke the said instrument and the trust thereby created, either in whole or in part.* The plaintiff accepted the trust and has continued to act under and is now acting as trustee.

Subsequently to the creation of this trust, and on or about July 7, 1916, the said Astor executed and delivered to the said trustee, an instrument under his hand and seal, by which instrument he directed and instructed the trustee, in respect of the application of the income of the trust fund and provided one half of the said income be applied to the use of the three sons then living of Waldorf Astor (a son of the grantor) and the other half be paid to John Jacob Astor (a son of the grantor) subject to the payment of $30,000, or 6,000 pounds sterling, annually, to Violet Mary Mercer Nairne, in case the intended marriage of the son, John Jacob Astor, and Violet Mary Mercer Nairne was consummated. There were other provisions in the case of the death of any of the grandsons of the grantor or his son before the death of the grantor, which are more specifically set out in Exhibit C of the complaint. These provisions covering income were never changed.

On or about September 8, 1916, the Federal Congress enacted, and the President approved, the Revenue Act known as the Revenue Act of 1916, which Revenue Act carried with it, for the first time, a tax upon the transfer of estates of decedents

Subsequently thereto, and on or about December 26, 1916, the said William Waldorf Astor, duly executed and delivered to the said trustee, another instrument under his hand and seal, in and by which he, with the consent in writing of the said trustee, as required by said indenture, modified the said trust indenture, so as to provide (but only to that extent) for the payment out of the said trust fund of all taxes, if any, payable on or by reason of the death of the said William Waldorf Astor, upon or in respect of the said trust fund or any part thereof, and such English death duties as might be imposed upon his estate.

Subsequently thereto and on or about August 15, 1919, the said William Waldorf Astor duly executed and delivered to the said trustee a further instrument under his hand and seal by which he, with the consent, in writing of the said trustee, as required by said indenture of trust, modified the said indenture of trust, by providing, upon the termination of the trust, that the trustee should distribute the capital of the trust fund then in its hands to and among the issue of the grantor, in such shares, or in such manner, as permitted by the laws of the State of New York, as the grantor should by will or codicil specifically referring to that power appoint, and in default of such an appointment by will or codicil, the trustee should divide the capital of the trust fund into two portions of equal value, provided the grantor during his lifetime should have paid to the trustee or trustees of the English indenture of covenant and settlement made on the marriage of his younger son, John Jacob Astor, with Violet Mary Astor (formerly Violet Mary Mercer Nairne) the sum of £800,000 or $4,000,000, covenanted in the English indenture of covenant and settlement, to be paid by the grantor to said John Jacob Astor, and if such sum had not been paid, then one, or the first portion of the capital of the trust fund, should be less than the net value at the time of the death of the grantor of the second or other portion, by so much of the principal sum of £800,000 or $4,000,000, as should not have been so paid by the grantor during his life; and should distribute that portion of the said trust fund to all or any of the sons of his elder son, Waldorf Astor, living at the death of the grantor, if more than one, in equal shares; in default of any such son, living at that time, then to the person or persons more specifically set out in Exhibit "E" attached to the complaint and made a part thereof. The other, or second of the said portions of the capital of the said trust was to be distributed to John Jacob Astor, a son of the grantor, unless he should predecease the grantor, then as more specifically provided for in the said Exhibit "E" attached to the complaint.

William Waldorf Astor died on October 18, 1919, without having altered or amended the said indenture of trust, except as hereinbefore set out, and died leaving an American will, which did not exercise the power of appointment. He also left an English will and an Italian will. There were left upon the death of William Waldorf Astor, surviving him, his two sons, Waldorf Astor and John Jacob Astor, and four sons of the said Waldorf Astor.

The said William Waldorf Astor was a subject of the Kingdom of Great Britain. He died leaving certain property physically situated and located, or having a situs, within the United States of the value of $1,323,706.69, which was disposed of by his American will. The total amount of his debts and administration expenses amounted to $1,119,997.80, of which sum under and by virtue of the Revenue Act of 1918, there was deductible from the gross estate (for purposes of the Federal estate tax) within the United States the sum of $132,370.67, which left a net estate subject to the Federal estate tax of $1,191,336.02.

The Farmers' Loan & Trust Co. qualified as executor of the American will of decedent, and in accordance with the law duly prepared the return on Form 706 for the Commissioner of Internal Revenue and the defendant, and upon assessment paid the tax indicated as payable thereunder of $70,633.60. Thereafter, the Commissioner of Internal Revenue and the defendant audited the return of the executor and placed a value upon the property composing this trust fund, which was not included in that return, though reference was made and full information given in respect thereof, of $19,788.938.73, and thereupon assessed an additional tax not only against the Farmers' Loan & Trust Co., as trustee, under a certain deed of trust made by William Waldorf Astor, dated May 25, 1916, and as trustee under other trusts, of $15,961,321.34, of which tax $4,947,234.68 was computed by including as a part of the estate of William Waldorf Astor, the value of this trust fund as determined by the Commissioner of Internal Revenue and the defendant, which value as stated amounted to $19,788,938.73. The tax assessed was paid by the trustee (the plaintiff herein),

because, for one reason, the executor, that is, the estate of William Waldorf Astor, did not have assets with which to pay the tax, inasmuch as the total gross estate amounted only to $1,323,706.69. Another was that the trust deed provided that all taxes should be paid from the trust funds. The total amount of the tax paid upon the additional assessment against the plaintiff, and against the executor, and against the Farmers' Loan & Trust Co., as trustee under other deeds of trust, as assessed by the assessment of the 11th day of July, 1922, was $15,769,069.86. Subsequently, the said plaintiff was called upon to pay, and, under protest and duress, did pay on September 17, 1923, an additional tax assessed against the said executor and against the said plaintiff and against the Farmers' Loan & Trust Co., as trustee of other trusts, of $13,348.74, which additional tax was due to the increase in the value of the assets composing this trust fund by the sum of $221,896.95, and which made the full value of this trust, as determined by the Commissioner of Internal Revenue and the defendant, $20,010,833.68.

Subsequently, the said plaintiff, acting in its own behalf and jointly with the executor, and jointly with the Farmers' Loan & Trust Co., as trustee of other trusts, filed with the Commissioner of Internal Revenue, through the said defendant, a claim for refund of the said money and petitioned for the refund of the said tax. This claim for refund which is applicable to both assessments of additional taxes, the Commissioner of Internal Revenue and the defendant rejected, and refused to refund and repay the said tax. Thereupon, the plaintiff instituted this action for the recovery of the sums so paid, which were chargeable against and paid under duress and protest by this plaintiff in the sum of $4,971,560.61, together with interest.

It is also alleged in the complaint that William Waldorf Astor died a nonresident alien of the United States, and that the beneficiaries under the trust instrument were all nonresident aliens, and that none of them was engaged in business within the United States at the time of the death of William Waldorf Astor, and that, therefore, under the Victory, Liberty Loan Act (ch. 100, Stat. L., vol. 40, No. 1, 65th Cong., p. 1311), the amount of Liberty and Victory bonds of the United States of America, composing a part of the said trust fund, were not subject to the tax.

The authority under which the defendant assumed to collect the tax sought to be recovered is to be found in the following sections of the Revenue Act of 1919, effective February 24, 1919:

"SEC. 401. That (in lieu of the tax imposed by Title II of the Revenue Act of 1916, as amended, and in lieu of the tax imposed by Title IX of the Revenue Act of 1917) a tax equal to the sum of the following percentages of the value of the net estate (determined as provided in sec. 403) is hereby imposed upon the transfer of the net estate of every decedent dying after the passage of this Act, whether a resident or nonresident of the United States: * * * (Here follow the applicable rates.)

"SEC. 402. That the value of the gross estate of the decedent shall be determined by including the value at the time of his death of all property, real or personal, tangible or intangible, wherever situated * * *.

"(c) To the extent of any interest therein of which the decedent has at any time made a transfer, or with respect to which he has at any time created a trust, in contemplation of or intended to take effect in possession or enjoyment at or after his death (whether such transfer or trust is made or created before or after the passage of this Act), except in case of a bona fide sale for a fair consideration in money or money's worth. Any transfer of a material part of his property in the nature of a final disposition or distribution thereof, made by the decedent within two years prior to his death without such a consideration, shall, unless shown to the contrary, be deemed to have been made in contemplation of death within the meaning of this title."

The large sum of money dependent upon the final outcome of this suit, and the uncertainty of the questions that are presented would, under ordinary circumstances, justify a more extended discussion of the case than I shall give it. But the matters of general law that are here involved have already received attention by a number of courts. The result has been far from uniform, and anything that I may say will not make it so. Until the Supreme Court speaks, the law is, and will remain, in a state of splendid confusion. Therefore, I shall not undertake to analyze the prior decisions.

In the first place, the beneficiaries of the remainders created by the trusts set up by Mr. Astor, whatever their technical status, had, until the occurrence of his death, nothing more than an expectancy of the possession and enjoy-

ment of his bounty. The reason was that the founder, subject only to the possibility, probably more apparent than real, that the trustee, might not assent to such change in the trusts, or a revocation thereof, as he might wish to make, retained complete power over the disposition of the property and its usufruct. In suggesting that the likelihood of the trustee withholding its consent to a proposed change or revocation of the trust was more apparent than real, there is no intention to asperse or criticize the plaintiff. But it is so hard to conceive of any reason that would have impelled the trustee to withhold consent had it been requested that I regard the provision which predicated a right of change or revocation of the trusts upon the exercise of the trustee's discretion as of no present legal effect. It is noteworthy that the trustee did give its consent to changes in the trusts whenever and as often as they were suggested. And there was no good cause why it should not do so then and at any time. Aside from acting faithfully in its stewardship so long as the same should continue for the benefit of particular persons and institutions, the trustee owed no duty to those beneficiaries to see to it that they should remain in Mr. Astor's favor. And, granting full performance by the trustee of any obligations that might from time to time be dischargeable, its chief concern was to satisfy and meet the wishes of the men who had intrusted it with the management of securities of large value. Had it failed to do so, there is slight doubt that Mr. Astor would have had recourse to the fifth paragraph of the indenture of May 25, 1916, wherein he reserved the right at any time to *remove* the trustee therein named, and to appoint a successor which presumably would be amenable to his suggestions and directions. This right of removal, it will be observed, was not contingent upon the consent and willingness of plaintiff to be removed. It was absolute and complete. Thereby, a consent to a change or revocation of the trusts upon the part of the trustee, if refused, might, very effectively, be compelled. Consequently, it may be concluded that Mr. Astor, from every reasonable and practical standpoint, was in position, at all times prior to his death, to direct and control the disposition to be made of the trust property.

From the care exercised by the settler to retain this control until the end of his life, and from the fact that at no time, prior to Mr. Astor's death, did the remainderman have any right to the possession or enjoyment to the property, I have slight hesitancy in holding, not only that the trusts actually took effect in possession and enjoyment as of the settler's death, but that it was his intention that they should not do so until that event. And as Judge Brewster said in *Coolidge* v. *Nichols* (4 Fed. (2d), 112, 115):

"If a transfer is one to take effect in possession and enjoyment after death, it may be reached under a statute imposing an estate tax. Granting, as we must, that Congress has power to levy a tax upon the net estate of a decedent, it may adopt any reasonable measure of that tax. Admittedly, it is entirely reasonable to measure the tax by the value of the property transmitted by will or by intestate laws, and I do not think it can be said to be unreasonable to measure the tax also by the value of property of which a decedent during his lifetime has made a disposition which partakes of the nature of a testamentary disposition. * * * Whether the transmission be by will, by intestate laws, or by transfers to take effect on or after or in contemplation of death, the transmission bears in each case a reasonable relation to the event of death."

While that decision held that a tax was not applicable to the transfer made by Mrs. Coolidge to her sons, the basis of the ruling was that, prior to the enactment of the statute, she had parted with all *control over* or interest in the property which was sought to be included in the tax computation. Such too was the holding in *Frew* v. *Bowers* (12 Fed. (2d), 625).

In the case at bar, as has been seen, Mr. Astor retained until the day of his death, complete *power* to control the disposition of the trust estate. That the power of control was real is evidenced by the fact that "in exercise of the power for this purpose reserved to him by clause eighth of the (original) settlement" he modified the original agreement, as modified by the agreement of December 26, 1916.

Now, when the founder of a trust reserves such power and control over a subject matter such as is here present, I think it proper to hold that the trusts were, so far as their remainders are concerned, so ambulatory as to render them testamentary in character, and includable within the tax liability of the estate of the decedent whose death gave them the "fullness of finality." (Matter of Schmidlapp, 236 N. Y., 278; *McCaughn* v. *Girard Trust Co.*, 11 Fed. (2d), 520, C. C. A. 3d Circuit; *Cleveland Trust Co.* v. *Routzahn*, 7 Fed.

(2d), 483; and *Stark* v. *United States*, decided May 28, 1926, in the Southern District of Ohio, Western Division. 14 Fed. (2d), 616). See also concurring opinion of Judge Learned Hand in *Frew* v. *Bowers*, supra.

There is no question, I believe, but that the retroactive feature of the statute is lawful. (*Billings* v. *United States*, 232 U. S., 261; *United States* v. *Bennett*, 232 U. S., 299; *Flint* v. *Stone Tracy Co.*, 220 U. S., 107; and *Brushaber* v. *Union Pacific Railroad Co.*, 240 U. S., 1.) And, in my opinion, its application to the facts of the present case was proper. As I have heretofore endeavored to point out, Mr. Astor's trusts, although they were set up in an instrument executed and delivered prior to the enactment of the statute, did not and were not intended to become finalities until his death, which occurred after the statute became law.

The cessation of the donor's power of control of the trust properties, which occurred after the statute became law, was sufficient to support the imposition of the tax.

Plaintiff's contention that at least $4,000,000 or 800,000 pounds sterling of the corpus of the trust was transferred as a debt or surety, and as consideration in money or money's worth, for a marriage settlement, can not prevail. This provision of the trust agreement, like the others, was wholly ambulatory and can not be regarded as having been a fixed irrevocable charge upon the corpus of the trust.

Due to the fact that the trustee paid the tax assessed not only against it, but also against the estate of the decedent, and inasmuch as the agreement of December 26, 1916, provided that the trustee should raise and pay out of the capital of the trust fund, "All taxes and duties whatsoever payable on or by reason of the death of the grantor or in respect of the said trust fund or any part thereof * * * payable in or under the laws of the State of New York or England or any other country, * * * and whether or not the same shall be primarily payable by any person or persons other than the trustee," it is not necessary to consider what the situation might have been had the executor of the decedent's estate been unable to pay the taxes from the funds which came into its possession as executor.

In view of what has been said, I feel required to dismiss the complaint, and without the discussion of the other points of law that have been raised, it will be done.

PROPERTY PASSING UNDER POWER OF APPOINTMENT.

REGULATIONS 37 (1921), ARTICLE 30: General rules. VI-6-3087
T. D. 3960

ESTATE TAX—REVENUE ACT OF 1918—DECISION OF COURT.

GROSS ESTATE—POWER OF APPOINTMENT.

A power of appointment, although it can be exercised only by will, is a general power of appointment within the meaning of section 402(e) of the Revenue Act of 1918, there being no limitation as to the persons or estates which may be appointed.

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

To Collectors of Internal Revenue and Others Concerned:

The following decision of the United States District Court for the Eastern District of Pennsylvania in the case of *Elise Whitlock-Rose, Executrix of Henry C. Whitlock, deceased*, v. *McCaughn, Collector*, is published for the information of internal revenue officers and others concerned.

D. H. BLAIR,
Commissioner of Internal Revenue.

Approved January 29, 1927.

A. W. MELLON,
Secretary of the Treasury.

DISTRICT COURT OF THE UNITED STATES FOR THE EASTERN DISTRICT OF PENNSYLVANIA.

Elise Whitlock-Rose, Executrix of Henry C. Whitlock, deceased, v. *Blakeley D. McCaughn, Collector.*

[November 1, 1926.]

SUR STATUTORY DEMURRER.

DICKINSON, J.: The question raised is solely one of the lawfulness of a tax exaction. If payment of the tax was unlawfully exacted, the plaintiff should have judgment; otherwise judgment should go in favor of defendant. The general principles involved have been so frequently and so fully discussed that little, if anything, of value can be now contributed. The question is a narrow one in itself. It may be formulated as that of whether the power of appointment here in question is a general power within the meaning of the statute which imposes the tax.

Counsel for plaintiff plants himself upon the fact feature that this power was one which could be exercised by will only, and because thus restricted in the mode of its exercise was not a general power, and for the legal conclusion that the property which passed was not properly to be included in the admeasurement of the tax payable, he cites the case of *Fidelity Trust Co. et al., Exr.*, v. *McCaughn* (1 Fed. (2d), 987). Incidentally, we understand this to be the case meant by both counsel for plaintiff and defendant, although cited by the plaintiff as reported in another volume of the Federal Reports and by defendant as "not yet reported."

The stress of the argument for defendant is laid upon the proposition that by the use of the words "general power of appointment" Congress meant whatever the courts found to be a general power and emphatically as the will of the donor of the power here is a New Jersey will, the phrase has the meaning which the courts of New Jersey give to it.

We may premise the statement of the conclusion we have reached with one or two general observations. Speaking for our view, we have already expressed the opinion that the words of Congress are to be given that meaning which expresses the declared will of Congress with respect to how the tax is to be measured. In construing any legislative enactment aid may be sought from the situation unaffected by the legislation; the need which was felt for a change and the change sought to be effected. This is the time-honored phrase of "the old law; the mischief and the remedy." So far as this leads us to delve into the legislative mind we have found that the motive for the adoption of the phrase in question was to bring about as nearly as it could be reached a uniformity throughout the United States in the admeasurement of the tax. If it was measured "by the estate passing," there was no such uniformity, for the reason that what constituted the estate of a decedent received a different answer in different States. There was the additional motive of making property taxable if in practical effect it formed part of the decedent's estate.

In choosing a phrase Congress encountered the difficulty which usually confronts those who introduce what are called reform measures. It is an easy thing to find a word or a phrase which will give the right concept of a general thought intended to be conveyed, but when we descend from the general and abstract to the concrete and particular and seek to express a specific meaning which can be applied to a practical situation, the task is not easy of accomplishment.

It has been authoritatively ruled for this circuit that this statute was framed to meet the practical situation of the enjoyment of possession passing by succession at death, whether what passed formed part of the estate of the decedent (as that phrase is interpreted in different jurisdictions) or not, if the practical effect and substantial result was the same as if that to the enjoyment of which the beneficiary succeeded had formed a part in every sense of such estate. (*McCaughn* v. *Girard Trust Co., Exr.*, 11 Fed. Rep. (2d), 520.)

As before observed, enjoyment of possession in a real sense may pass in several ways by succession upon a death. It may so pass because it was in what may be called the ownership of the decedent at the time of his death; it may pass through the operation of a power exercised by the will of a testator, or an equivalent exercise of a like power, or in practical effect it may pass,

in the sense of the enjoyment of the succeeding beneficiary beginning immediately upon the death of a decedent, through the ending of a life estate or otherwise. A power, even one to be exercised by will only, it must be conceded, is property in a very real sense, although the argument to be drawn from this, which has been urged upon us, has, we think, been pressed too far. Powers are distinguished in many ways. There is, for illustration, a naked power and a power coupled with an interest. Again, there is frequently given a power as broad and general as it can be made, coupled with a provision that if it should not be exercised the property with which the power is concerned takes a prescribed course of succession. In such case, the donee of the power may, again in a very real sense, dictate and control the course of succession in either of two ways. He can direct the succession through and by the affirmative exercise of the power or he can actually direct the succession by a refusal to exercise the power. The one mode of succession is really as much the creature of his volition as the other. Congress has sought to give us as definite a measure of this tax as can be adopted. It is measured by the value of the estate of the decedent, to which is to be added the value of "any property passing under a general power of appointment exercised by the decedent by will or by deed," etc. In the instant case, to uphold this tax the power must be found to be a general one. As before stated, it is urged upon us by the plaintiff that the power is not a general one because it is restricted in the mode of its exercise to the one method of a will. We have been referred to no case (except the one before mentioned and next discussed) as so deciding. A number of authorities have been brought to the support of the contrary doctrine. Without going into these, it seems clear that the word "general" is not defined by the mode or manner of the exercise of the power but by the absence of limitations of the power when exercised in the prescribed manner. If this were not so the expression would, in the cases of a large number of powers to which it has been applied, be without any meaning, because in almost every instance of the creation of a power the mode of its exercise is restricted, as by a writing (will or deed) executed in the presence of a prescribed number of witnesses or otherwise. Nor could the phrase ever apply when the property was the subject of a spendthrift trust. Moreover, Congress was concerning itself only with what are in real effect testamentary exercises of such powers. It mentions only powers exercised by will or by deeds which are in reality of a testamentary nature. Had, therefore, Congress had in mind to exclude powers limited to testamentary exercise, it is difficult to believe that the language used would have been adopted.

We do not read the cited case of *Fidelity Trust Co. et al., Exr.*, v. *McCaughn* (1 Fed. Rep. (2d), 987) in such way as to sustain the position of the plaintiff. The language of an opinion must be read in the light of the fact situation to which it applies. A power which can not be exercised by the donee in favor of a surviving spouse or his or her own children can not be said to be in any real sense a general power. The language employed may not be clear, but reference was made to the fact that the power there could be exercised only by will because such was the fact but chiefly for the purpose of making emphatic the other fact that the donee could not have exercised the power in favor of her surviving husband or her own children. This was the feature which induced the ruling that the power was not a general one.

We are not unmindful but have given due weight to the argument ably and forcibly urged upon us by counsel for the plaintiff that a power limited to its testamentary exercise is far from being the practical equivalent of that conferred by ownership. The answer, we think, is that Congress was viewing it from the standpoint of succession at death. When so viewed, whether considered as the privilege of directing the succession or the right of enjoying it, a testamentary power, otherwise than in the mode of its exercise, does not differ in practical results from that which flows from dominion.

In the instant case, the conclusion reached is that the tax in question was lawfully levied, and as the point of law raised goes to the whole of the case for the plaintiff, judgment may be formally entered in favor of the defendant and against the plaintiff, with costs.

TITLE IV.—ESTATE TAX. (1916)

SECTION 203.—THE NET ESTATE.

REGULATIONS 37 (1917), ARTICLE XXI. VI–6–3088
T. D. 3962

ESTATE TAX—REVENUE ACT OF 1916—DECISION OF COURT.

1. GROSS ESTATE—DEDUCTIONS—TAXES.

The Federal estate tax can not be deducted from the gross estate of a decedent under section 203(a)1 of the Revenue Act of 1916 as a charge against the estate allowed by the laws of the jurisdiction under which the estate is being administered.

2. ESTATE TAX—COMPUTATION.

The estate tax is imposed upon each estate as a unit and the method of computing the tax provided by article 8 of Regulations 37 (revised [1921]) is correct.

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

To Collectors of Internal Revenue and Others Concerned:

The following decision of the United States District Court for the District of Massachusetts in the case of *Old Colony Trust Co. et al., Executors*, v. *Malley, Collector*, is published for the information of internal revenue officers and others concerned.

D. H. BLAIR,
Commissioner of Internal Revenue.

Approved January 29, 1927.

A. W. MELLON,
Secretary of the Treasury.

DISTRICT COURT OF THE UNITED STATES, DISTRICT OF MASSACHUSETTS.

Old Colony Trust Co., et al., Executors, v. *John F. Malley, Collector, et al.*

[October 13, 1926.]

OPINION.

MORTON, J.: This is an action at law to recover back a tax alleged to have been illegally exacted. There is no dispute about the facts; they are settled by stipulation and are substantially as stated in the declaration.

The tax in question was an inheritance tax levied under the Act of September 8, 1916 (U. S. Compiled Stats., sec. 6336½b), on the estate of Sidney W. Winslow, deceased. This statute (sec. 201) imposed "a tax * * * equal to the following percentages of the value of the net estate to be determined as provided in section 203." Then follows a schedule. Section 203 provides that "for the purposes of the tax the value of the net estate shall be determined * * * by deducting" from the gross estate certain specifically enumerated items. These deductions include, inter alia, "claims against the estate," and "such other charges against the estate, as are allowed by the laws of the jurisdiction * * * under which the estate is being administered."

The net value of this estate as determined by the Commissioner is $4,837,860. The Commissioner computed the tax by taking the first bracket in the statute schedule—after deducting the exemption—and figuring the tax on that; then proceeding to the second bracket and figuring the tax on that; then proceeding to the third bracket and figuring the tax on that; and so on. The tax which he assessed is the total of the taxes under the various brackets. It is a method in familiar use in connection with income surtaxes.

The plaintiff contends, first, that the tax was a proper deduction under section 203; and, second, that if the tax was not deductible, the Commissioner's method of computation was wrong—that the tax should have been computed by figuring the amount in the first bracket, then deducting the amount of that tax from the residue of the estate, then proceeding to the second bracket and deducting the amount of the tax under it from the residue of the estate, and so on. The difference between the two methods is considerable, amounting to about $58,000. The method followed by the Commissioner results, as the plaintiff contends, in taxing as part of the estate in the highest bracket, all the taxes which have been assessed under the lower brackets; in other words, that the amount taken by the Commissioner for the highest bracket is pro tanto fictitious and unreal.

Congress undoubtedly had power to levy taxes on inheritances to an extent not surpassed—if indeed it be approached—by the statute in question as the Commissioner has construed it. The case turns on whether his construction is right. What is taxed is the "net estate": i. e., the gross estate less specified expenses, debts, and charges. Ordinarily it would approach absurdity to say that in determining a net amount in order to compute a charge against it the amount of the charge to be imposed should be deducted. No case so holding is referred to in the elaborate briefs which have been submitted on behalf of the plaintiff. The only substantial argument for such a result is based on the language of section 203, "such other charges * * * as are allowed by the laws of the jurisdiction * * * under which the estate is being settled." Under the law of Massachusetts, the Federal tax, being against the estate itself, is deductible in arriving at the amount which is subject to State taxation. It is, therefore, as the plaintiff contends, deductible against the United States. There is no gainsaying the literal sufficiency of the argument. But I do not think that it can have been intended that, because the Federal estate tax, after it has been assessed, is an allowable charge in arriving at the net estate for the purpose of State taxation, the amount of the Federal tax should be deducted from the net estate for the purpose of Federal assessment. The observation of Judge Hand in *Edwards* v. *Slocum*, quoted at 287 Fed., 655 [T. D. 3584, C. B. III–1, 479], that by long established practice and usage the incidence of a tax is never regarded in the levying of it, is sound and pertinent.

As to the method of computation: If it be the intention of the Act to impose a unit tax on each estate, computed according to the directions in the schedules, the Commissioner's assessment was correct. If, on the other hand, the intention of the Act is that successive taxes on the different brackets shall be imposed, the aggregate of which shall constitute the entire tax against the estate, the plaintiff is right.

The question involved is not entirely free from doubt and is of sufficient general importance to warrant decision by a court of last resort. It is therefore unnecessary for me to undertake an elaborate discussion of the authorities; I content myself with saying that in my opinion the net estate is the taxable entity, and the schedule specifies how the tax on any given estate is to be computed.

The plaintiff suggests that there is an inconsistency in the Commissioner's methods of assessment between the estate tax and the gift tax. If there be such inconsistency—which is far from clear—I do not see that it affords much light on the present question.

Judgment for defendant.

REGULATIONS 37 (1917), ARTICLE XXI. VI-6-3089
T. D. 3961

ESTATE TAX—REVENUE ACT OF 1916—DECISION OF COURT OF CLAIMS.

1. GROSS ESTATE—DEDUCTIONS—TAXES.

The Federal estate tax can not be deducted from the gross estate of a decedent under section 203(a)1 of the Revenue Act of 1916 as a charge against the estate allowed by the laws of the jurisdiction under which the estate is being administered.

2. DECISION FOLLOWED.

The decision in *Edwards* v. *Slocum* (264 U. S., 61; T. D. 3584 [C. B. III-1, 479]) followed.

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

To Collectors of Internal Revenue and Others Concerned:

The following decision of the United States Court of Claims in the case of *Irving Bank-Columbia Trust Co., as executor of Herman Sielcken, deceased*, v. *United States* is published for the information of internal revenue officers and others concerned.

D. H. BLAIR,
Commissioner of Internal Revenue.

Approved January 29, 1927.

A. W. MELLON,
Secretary of the Treasury.

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COURT OF CLAIMS OF THE UNITED STATES.

Irving Bank-Columbia Trust Co., as executor of Herman Sielcken, deceased, v. *The United States.*

[November 8, 1926.]

OPINION.

Moss, Judge, delivered the opinion of the court.

This action is brought to recover an alleged excess payment of Federal estate tax.

In order to determine the question involved it is necessary for the court to consider the Revenue Act of 1916, section 203 (39 Stat., 778), the applicable portions of which are as follows:

"SEC. 203. That for the purpose of the tax the value of the net estate shall be determined—

"(a) In the case of a resident, by deducting from the value of the gross estate—

"(1) Such amounts for funeral expenses, administration expenses, claims against the estate, unpaid mortgages, losses incurred during the settlement of the estate arising from fires, storms, shipwreck, or other casualty, and from theft, when such losses are not compensated for by insurance or otherwise, support during the settlement of the estate of those dependent upon the decedent, and such other charges against the estate, as are allowed by the laws of the jurisdiction, whether within or without the United States, under which the estate is being administered;"

Plaintiff contends that the Commissioner of Internal Revenue should have deducted from the gross estate the amount of the estate tax itself in arriving at the value of the net estate, upon the theory that the estate tax is a charge against the estate in the meaning of the statute.

The court is unable to accept plaintiff's theory.

The Federal estate tax is imposed upon the transfer of the net estate; and the net estate is the difference between the total value of the gross estate and the total of the authorized deductions.

Section 203, above referred to, definitely authorizes the deduction of certain expenses and charges, and then states, "and such other charges against the estate, as are allowed by the laws of the jurisdiction, whether within or without the United States, under which the estate is being administered."

It is not to be assumed that the Congress, in attempting to promulgate a rule by which the net estate is to be determined, would describe in precise terms items which are to be deducted, some of which might or might not exist in certain cases, and yet leave unmentioned a highly important item which must surely apply in all cases.

Under the structure of the Federal Estate Tax Act the tax is not a charge against the estate in the meaning of section 203.

The case of *Edwards* v. *Slocum* (264 U. S., 61), while dealing with a different issue from that involved in the instant case, determined the principle which controls the question here in the following language:

"It (the estate tax Act) levies a sum equal to a certain percentage of the value of the net estate, and provides the criteria by which the net estate shall be ascertained. It thus manifestly assumes that the net estate will be ascertained before the tax is computed."

The petition should be dismissed. And it is so ordered.

MISCELLANEOUS TAX RULINGS.

TITLE VIII.—STAMP TAXES. (1926)

REGULATIONS 71, ARTICLE 80: Stamps. VI–7–3109
T. D. 3976

SALE OF ADHESIVE STAMPS.

Article 80 of Regulations 71, relating to the distribution and sale of adhesive stamps, amended.

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

To Collectors of Internal Revenue and Others Concerned:

Article 80 of Regulations 71 is hereby amended by changing the designation of paragraphs (a) (b) and (c) to (c) (d) and (e), respectively, and by adding two paragraphs (a) and (b) reading as follows:

(a) No person other than a collector of internal revenue or duly authorized deputy collector of internal revenue, or designated United States depositary shall sell or expose for sale, give away, traffic in, trade, barter, lend, borrow, or exchange any stock transfer or future delivery stamps issued pursuant to these regulations: *Provided*, That any person or corporation which has been duly appointed and constituted and is acting agent of any State for the sale of stock transfer stamps of such State may, upon approval by the Commissioner and upon giving a bond satisfactory to the collector, sell United States stamps issued pursuant to these regulations: *Provided further*, That a bond shall not be required when such person or corporation uniformly purchases such stamps from the collector for cash.

(b) No person shall buy, receive, or have in his possession, or under his control, any stock transfer or future delivery stamps issued pursuant to these regulations, unless such stamps have been purchased directly from the collector of internal revenue, or duly authorized deputy collector of internal revenue, United States designated depositary, or a designated agent for the sale of State stock transfer stamps, authorized by the Commissioner, in the district in which the stamps are to be used.

D. H. BLAIR,
Commissioner of Internal Revenue.

Approved February 5, 1927.

A. W. MELLON,
Secretary of the Treasury.

SCHEDULE A–5. PASSAGE TICKETS.

REGULATIONS 71: Exemption from stamp tax. VI–16–3197
T. D. 4014

EXEMPTION FROM STAMP TAX ON PASSAGE TICKETS.

Regulations relating to exemption provided by the Act of February 24, 1927, from the stamp tax on passage tickets imposed by Schedule A–5, Title VIII, of the Revenue Act of 1926.

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

To Collectors of Internal Revenue and Others Concerned:

The Act of February 24, 1927, provides as follows:

That under regulations prescribed by the Commissioner of Internal Revenue with the approval of the Secretary of the Treasury, the provisions of Title VIII of the Revenue Act of 1926 imposing a tax on passage tickets shall not apply to any round-trip passage ticket issued to any individual if—

(1) Such individual is certified, by such national officer or officers of the American Legion and in such form and manner as the Commissioner of Internal Revenue may by regulations prescribe, as authorized to participate in the 1927 national convention of the American Legion or of the American Legion Auxiliary, to be held at Paris, France; and

(2) The eastbound portion of the passage covered by the ticket is upon a vessel certified, by such national officer or officers of the American Legion and in such form and manner as the Commissioner of Internal Revenue may by regulations prescribe, as having been designated by the American Legion France convention committee as an official ship, and such vessel is scheduled to sail on or after June 1, 1927, and not later than September 15, 1927.

In pursuance of these provisions the following regulations are promulgated:

No stamp tax shall apply to any round-trip passage ticket issued to an individual who has been certified by the American Legion as authorized to participate in the 1927 national convention of the American Legion or of the American Legion Auxiliary to be held at Paris, France, provided the eastbound portion of the passage ticket is upon a vessel certified as having been designated by the American Legion France convention committee as an official ship and such vessel is scheduled to sail on or after June 1, 1927, and not later than September 15, 1927.

An official certificate of identification, serially numbered, bearing the facsimile signature of the national commander, the national adjutant, the national chairman, and the national travel director, shall be issued to each individual with steamship ticket of identical serial number, such steamship ticket to be impressed with the seal of the American Legion and stamped with the indorsement of the national travel director.

The national travel director shall designate an American Legion representative on every eastbound official ship to certify on the passenger manifest which passengers are authorized to participate in the 1927 national convention of the American Legion or American Legion Auxiliary, to be held at Paris, France. In all cases so certified no tax shall be collected. If any passenger or passengers whose names appear on the manifest are not so certified, the tax on passage tickets held by them shall be collected and paid to the steamship company and a documentary stamp in evidence of payment, properly canceled, shall be affixed to the copy of the passenger manifest retained at the principal office of the steamship company in this country.

D. H. BLAIR,
Commissioner of Internal Revenue.

Approved April 11, 1927.

OGDEN L. MILLS,
Acting Secretary of the Treasury.

[Amended by T. D. 4030, Internal Revenue Bulletin VI–28, 15.]

TITLE XI.—STAMP TAXES. (1918 AND 1921)

CAPITAL STOCK, SALES OR TRANSFERS.

REGULATIONS 40, ARTICLE 11: Computation of tax. VI–11–3150 T. D. 3992

STAMP TAXES—REVENUE ACTS OF 1918 AND 1921—DECISION OF SUPREME COURT.

STAMP TAX—PAR VALUE—FACE VALUE.

Where, pursuant to a plan of reorganization, the par value of $100 of capital stock is reduced to $1 a share, without the issuance of new certificates, which remained outstanding with the old face value of $100, the stamp tax should be computed on the actual par value of $1 a share, as shown by the amended charter.

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

To Collectors of Internal Revenue and Others Concerned:

The following decision of the United States Supreme Court in the case of *The Goodyear Tire & Rubber Co.* v. *United States* is published for the information of internal revenue officers and others concerned.

C. R. NASH,
Acting Commissioner of Internal Revenue.

Approved March 5, 1927.

A. W. MELLON,
Secretary of the Treasury.

SUPREME COURT OF THE UNITED STATES.

The Goodyear Tire & Rubber Co., appellant, v. *United States.*

Appeal from the Court of Claims.

[January 3, 1927.]

Mr. Justice STONE delivered the opinion of the court.

Prior to April 11, 1921, the par value of the outstanding capital stock of appellant, an Ohio corporation, was $100 per share. On that date this par value was reduced to $1 a share by appellant's filing a proper certificate of reduction with the secretary of state, pursuant to the laws of Ohio. No new certificates of stock were issued in place of the old which remained outstanding and stated on their face that they were of the par value of $100. After the reduction of the par value of the stock, the holders of 534,849 shares, evidenced by the old certificates, transferred them to voting trustees in order to carry out a plan of reorganization. The Commissioner of Internal Revenue demanded a stamp tax on the transfer computed upon the apparent par value of $100 as indicated on the face of the certificates and not on the actual reduced value of $1 per share, which appellant contended was the proper tax base. Appellant paid the tax at the higher rate under protest and brought suit in the Court of Claims to recover the excess. From a judgment in favor of the Government, the case comes here on appeal. Judicial Code, section 242, prior to the amendment of February 13, 1925.

The sole question presented is whether the tax assessed is to be measured by the actual par value of the stock as disclosed by the amended charter of the corporation at the time of the transfer or by the value printed on the certificates themselves. The applicable revenue statutes are the Acts of 1918 and 1921, as some of the transfers here involved were made while the Act of 1918 was in force and others after the Act of 1921 had taken effect. Section 1100 and Schedule A of Title XI of the Revenue Act of 1918 (Feb. 24, 1919, ch.

18, 40 Stat., 1133, 1135), which, so far as material here, are identical with section 1100 and Schedule A of Title XI of the Revenue Act of 1921 (Nov. 23, 1921, ch. 136, 42 Stat., 301, 304), impose a stamp tax of 2 cents per "$100 of face value or fraction thereof," "On all sales, or agreements to sell, or memoranda of sales, or deliveries of, or transfers of legal title to shares or certificates of stock." The pertinent provisions of this section are printed in the margin.[1]

The tax is not a tax on certificates of stock but upon the transfer of legal title of shares or certificates of stock. Compare *Provost* v. *United States* (269 U. S., 443). The payment of the tax must be evidenced by stamps to be affixed either to the delivered certificate or other document manifesting the transfer. The Treasury Department has consistently ruled that the tax applies to transfers even though no certificates be issued. (40 Treas. Regulations, art. 12 (b).)

The statutory measure of the tax is the "face value" of the stock transferred. It was conceded by the Government, both here and below, that the phrase face value in the statute is synonymous with par value. It is used in contradistinction to the actual value which is made the measure of the tax when applied to nonpar value stock which the statute describes as "without par or face value." To say that the term face value is intended to apply to a fictitious statement of value on the face of the certificates, having no relation to the actual par value, would be to give the statute a strained construction and open the way for evasion. Obviously the face or par value of the stock transferred is to be determined by an inspection of the instrument which alone fixes par value, namely, the corporate charter. The statements in the certificate of incorporation as amended and not those appearing on the face of the stock certificates control. It follows that the measure of the tax here was the actual par value of the stock transferred and that a recovery of the excess tax paid should have been allowed.

This conclusion is not inconsistent with the decision in *United States* v. *Isham* (17 Wall., 496), urged in support of the assessment as made. There, in applying a documentary tax, the form and terms of the instrument controlled in determining whether the instrument was subject to the tax. Compare *Malley* v. *Bowditch* (259 Fed., 809); *Danville Building Ass'n.* v. *Pickering* (294 Fed., 117); *Haverty Furniture Co.* v. *United States* (286 Fed., 985); *Merchants' Warehouse Co.* v. *McClain* (112 Fed., 787); *Granby Mercantile Co.* v. *Webster* (98 Fed., 604). But here the tax was levied on the transfer rather than on any particular document and applies to transfers not evidenced by a writing. It is measured by evidence extrinsic to any document to which the stamp is affixed, found only in the corporate charter.

Judgment reversed.

OLEOMARGARINE.

REGULATIONS 9, SECTION 40: Substances taxable as oleomargarine. VI–15–3190 T. D. 4006

Regulations 9 (revised August, 1925), relative to oleomargarine, etc., amended with respect to certain substances known or styled as cooking compounds.

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

To Collectors of Internal Revenue and Others Concerned:

Paragraph (b) of section 40, Regulations 9 (revised August, 1925), relative to the tax on oleomargarine and other substances, is hereby amended to read as follows:

(b) Cooking compounds: Cooking compounds which are placed on the market in good faith as such, and which do not resemble butter in flavor, texture, or appearance, are exempt from the tax imposed upon oleomargarine.

All animal fats or oils, vegetable oils, and all compounds and mixtures of such animal fats or oils, or vegetable oils, with or without the addition of color-

[1] Not printed in the Bulletin.

ing matter, which have been churned in milk or cream with the effect of causing the resultant product to assume a flavor, texture, and appearance resembling that of butter, are properly taxable under the law as oleomargarine.

All vegetable or animal oils or combinations thereof, churned, emulsified, or however mixed, colored to look like butter, crystalized, salted (or unsalted), and worked, will be deemed to possess a sufficient similarity to butter in flavor, texture, and appearance to bring the resultant product within the classification of oleomargarine.

All compounds referred to above as being taxable as oleomargarine which are found on the market on and after the effective date of this Treasury decision will be held subject to the tax.

The provisions of this Treasury decision will take effect six months after the date of approval and all rulings inconsistent therewith are hereby revoked as of that date.

D. H. BLAIR,
Commissioner of Internal Revenue.

Approved April 1, 1927.

OGDEN L. MILLS,
Acting Secretary of the Treasury.

[Amended by T. D. 4085, Internal Revenue Bulletin VI-37, 41.]

VI-2-3044
MS. 62

Schedule of oleomargarine produced and materials used during the month of November, 1926, as compared with November, 1925.

	November, 1926.	November, 1925.
	Pounds.	*Pounds.*
Total production uncolored oleomargarine	22,111,722	23,130,761
Ingredient schedule for uncolored oleomargarine:		
Butter	196,024	175,637
Cocoanut oil	9,457,322	10,275,040
Corn oil	19,425	
Cottonseed oil	1,943,334	2,156,728
Edible tallow	2,600	7,986
Milk	6,366,732	6,664,294
Mustard oil	4,628	2,370
Neutral lard	2,005,976	2,184,213
Oleo oil	3,947,791	3,815,069
Oleo stearine	423,252	373,663
Oleo stock	217,329	240,650
Palm oil	49,581	102,200
Palm-kernel oil	4,300	159,500
Peanut oil	487,399	478,228
Salt	1,834,793	1,889,402
Sesame oil	1,203	
Soda	6,402	6,366
Soya-bean oil	300	8
Vanila extract	22	28
Total	26,968,413	28,531,382
Total production colored oleomargarine	1,316,388	1,144,642
Ingredient schedule for colored oleomargarine:		
Butter	1,407	
Cocoanut oil	392,408	337,211
Color	1,253	5,641
Cottonseed oil	214,644	162,822
Milk	524,230	412,697
Neutral lard	174,973	140,368
Oleo oil	355,906	309,505
Oleo stearine	25,474	11,550
Oleo stock	35,869	141,788
Palm oil	13,010	102
Palm-kernel oil	200	4,000
Peanut oil	25,035	24,577
Salt	107,796	96,585
Sesame oil	2,484	
Soda	139	60
Total	1,874,828	1,646,906

VI–7–3110
MS. 63

Schedule of oleomargarine produced and materials used during the month of December, 1926, as compared with December, 1925.

	December, 1926.	December, 1925.
	Pounds.	*Pounds.*
Total production uncolored oleomargarine	23,369,846	22,912,572
Ingredient schedule for uncolored oleomargarine:		
Butter	190,860	183,009
Cocoanut oil	10,181,724	9,586,977
Corn oil	5,850	
Cottonseed oil	1,857,210	2,464,739
Edible tallow	2,035	5,500
Milk	6,798,305	6,611,276
Mustard oil	5,130	3,635
Neutral lard	2,360,850	2,401,267
Oleo oil	4,044,762	3,969,643
Oleo stearine	403,100	443,184
Oleo stock	188,354	246,888
Palm oil	49,376	93,610
Palm-kernel oil	3,000	1,026
Peanut oil	560,653	502,124
Salt	1,940,026	1,953,486
Sesame oil	2,040	
Soda	7,100	5,460
Vanilla extract	24	29
Total	28,600,399	28,471,853
Total production colored oleomargarine	1,428,573	1,304,583
Ingredient schedule for colored oleomargarine:		
Butter	1,220	
Cocoanut oil	423,931	421,278
Color	1,551	2,611
Cottonseed oil	150,705	224,703
Edible tallow	7,048	
Milk	464,188	522,145
Neutral lard	149,855	176,001
Oleo oil	382,219	341,774
Oleo stearine	5,565	15,100
Oleo stock	27,428	17,288
Palm oil	13,422	13,939
Peanut oil	29,337	30,006
Salt	108,069	111,677
Sesame oil	4,320	
Soda	184	56
Total	1,774,042	1,876,578

VI–11–3151
MS. 64

Schedule of oleomargarine produced and materials used during the month of January, 1927, as compared with January, 1926.

	January, 1927.	January, 1926.
	Pounds.	*Pounds.*
Total production uncolored oleomargarine	21,508,222	21,397,722
Ingredient schedule for uncolored oleomargarine:		
Butter	195,681	151,776
Cocoanut oil	9,450,970	8,952,961
Corn oil	6,425	
Cottonseed oil	1,878,451	2,209,964
Edible tallow	21,009	5,663
Milk	5,886,134	6,149,629
Mustard oil	5,740	3,660
Neutral lard	1,967,627	2,204,777
Oleo oil	3,750,743	3,710,059
Oleo stearine	385,839	393,079
Oleo stock	168,155	194,479
Palm oil	49,002	63,594
Palm-kernel oil	3,000	20,370
Peanut oil	475,504	551,899
Salt	1,800,546	1,777,975
Sesame oil	1,650	15
Soda	6,495	5,017
Vanilla extract	23	27
Total	26,052,994	26,394,944
Total production colored oleomargarine	1,241,821	1,187,143
Ingredient schedule for colored oleomargarine:		
Butter	300	
Cocoanut oil	386,213	373,830
Color	2,303	3,316
Corn oil	500	
Cottonseed oil	134,461	197,515
Edible tallow	22,696	
Milk	401,294	466,356
Neutral lard	134,591	153,765
Oleo oil	295,854	306,613
Oleo stearine	5,675	12,850
Oleo stock	24,443	13,988
Palm oil	4,839	13,103
Palm-kernel oil		40
Peanut oil	27,001	26,331
Salt	104,281	102,849
Soda	100	61
Total	1,544,551	1,670,617

VI–14–3179
MS. 65

Schedule of oleomargarine produced and materials used during the month of February, 1927, as compared with February, 1926.

	February, 1927.	February, 1926.
	Pounds.	*Pounds.*
Total production uncolored oleomargarine	21,051,401	19,525,951
Ingredient schedule for uncolored oleomargarine:		
Butter	183,129	134,983
Cocoanut oil	9,261,971	7,774,050
Corn oil	21,638	
Cottonseed oil	1,878,268	2,510,750
Edible tallow	24,693	3,855
Milk	5,834,402	5,539,413
Mustard oil	5,700	2,795
Neutral lard	2,060,281	1,988,834
Oleo oil	3,584,916	3,376,426
Oleo stearine	382,262	344,938
Oleo stock	164,968	109,161
Palm oil	45,900	54,222
Palm-kernel oil	2,400	24,598
Peanut oil	406,232	391,408
Salt	1,788,596	1,644,892
Sesame oil	2,483	
Soda	6,818	4,350
Soya-bean oil		15
Vanilla extract	21	22
Total	25,654,678	23,904,712
Total production colored oleomargarine	1,293,057	1,194,741
Ingredient schedule for colored oleomargarine:		
Butter	1,643	45
Cocoanut oil	417,663	358,445
Color	1,513	6,786
Corn oil	1,437	
Cottonseed oil	127,457	194,220
Edible tallow	19,654	
Milk	427,928	432,359
Neutral lard	135,546	138,012
Oleo oil	303,970	312,765
Oleo stearine	6,785	14,100
Oleo stock	30,681	11,230
Palm oil	5,059	12,517
Peanut oil	22,912	24,937
Salt	106,152	99,213
Soda	1,043	145
Total	1,609,443	1,604,774

VI–20–3236
MS. 66

Schedule of oleomargarine produced and materials used during the month of March, 1927, as compared with March, 1926.

	March, 1927.	March, 1926.
	Pounds.	*Pounds.*
Total production uncolored oleomargarine	23,975,151	21,141,436
Ingredient schedule for uncolored oleomargarine:		
Butter	210,503	147,103
Cocoanut oil	10,703,010	8,516,826
Corn oil	7,325	19,009
Cottonseed oil	2,325,450	2,146,727
Edible tallow	18,982	4,060
Milk	6,555,358	6,021,472
Mustard oil	5,464	3,090
Neutral lard	2,245,654	2,091,449
Oleo oil	4,120,540	3,844,573
Oleo stearine	456,644	444,067
Oleo stock	163,023	177,912
Palm oil	16,859	54,857
Palm-kernel oil	2,700	36,590
Peanut oil	368,646	479,225
Salt	2,043,868	1,752,473
Sesame oil	4,050	26,740
Soda	7,073	4,456
Soya-bean oil		15
Vanilla extract	21	26
Total	29,255,170	25,770,661
Total production colored oleomargarine	1,508,672	1,272,175
Ingredient schedule for colored oleomargarine:		
Butter	2,445	2,178
Cocoanut oil	466,343	408,176
Color	1,863	1,761
Cottonseed oil	161,960	200,377
Edible tallow	41,353	
Milk	486,215	590,930
Mustard oil	150	
Neutral lard	167,428	171,626
Oleo oil	352,018	332,928
Oleo stearine	10,423	18,880
Oleo stock	17,308	15,621
Palm oil	12,669	19,617
Peanut oil	25,635	33,770
Salt	123,491	108,057
Sesame oil		3,253
Soda	157	106
Total	1,869,458	1,817,280

VI–24–3267
MS. 67

Schedule of oleomargarine produced and materials used during the month of April, 1927, as compared with April, 1926.

	April, 1927.	April, 1926.
	Pounds.	*Pounds.*
Total production uncolored oleomargarine	22,261,431	18,644,693
Ingredient schedule for uncolored oleomargarine:		
Butter	195,572	347,865
Cocoanut oil	9,886,422	7,612,561
Corn oil	1,260	52,400
Cottonseed oil	2,044,395	1,764,533
Edible tallow	6,949	2,823
Milk	6,064,174	5,253,272
Mustard oil	5,193	3,120
Neutral lard	2,099,124	1,768,453
Oleo oil	3,887,141	3,432,708
Oleo stearine	421,754	442,766
Oleo stock	153,829	175,650
Palm oil	2,955	50,982
Palm-kernel oil	2,266	14,466
Peanut oil	310,301	383,930
Salt	1,870,185	1,575,481
Sesame oil	3,459	43,995
Soda	6,891	4,433
Soya-bean oil		8
Vanilla extract	22	24
Total	26,961,823	22,929,470
Total production colored oleomargarine	1,307,691	1,148,498
Ingredient schedule for colored oleomargarine:		
Butter	1,660	1,553
Cocoanut oil	392,650	383,931
Color	1,538	1,790
Cottonseed oil	128,819	133,727
Edible tallow	22,301	
Milk	453,439	436,462
Mustard oil	60	
Neutral lard	156,246	159,136
Oleo oil	364,501	310,933
Oleo stearine	30,755	16,625
Oleo stock	16,648	15,728
Palm oil	5,700	10,904
Peanut oil	20,995	29,310
Salt	108,368	100,373
Sesame oil		6,655
Soda	99	45
Total	1,703,779	1,607,172

PROHIBITION RULINGS.

PERMITS TO PURCHASE.

REGULATIONS 60, ARTICLE IV, SECTION 406. VI–8–3119
T. D. 3978

Prohibition.—Requirement for confirmation of permits to purchase, Form 1410–D, rescinded.—Treasury Decision 3958 [see page 341] amended.

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

To Prohibition Administrators and others Concerned:

Treasury Decision 3958, approved January 26, 1927, is hereby amended in the second paragraph to include wine.

The requirement that permits to purchase liquor, issued in pursuance of the provisions of the National Prohibition Act, shall be authenticated by letter of confirmation, Form 1410–D, is hereby rescinded, and in all cases the vendor's copy of permit to purchase shall be used in lieu of letter of confirmation, Form 1410–D, and shall be subject to all the requirements of section 432 and all other provisions of existing regulations relating to confirmation of permits to purchase.

Section 406, Regulations 60, is hereby accordingly amended to read as follows:

The vendee's copy in all cases will at once be mailed to the vendee. Where the permit to purchase covers not to exceed 10 wine gallons of alcohol or wine, or the preparations mentioned in section 810, or not exceeding 6 quarts of intoxicating liquors to be administered by physicians to their patients in emergency cases as provided by section 1430, all copies other than the vendee's copy will at once be mailed to the vendor. In all other cases the original permits and copies of permits will be retained in the office of the administrator until request is received from the vendor for the vendor's copy and other copies relating thereto. In case the places of business of the vendor and vendee are within the same administrative district, the administrator will, within 48 hours after receipt of such request, mail to the vendor the original and all remaining copies of the permit to purchase. If the vendor and vendee are located in different administrative districts, such copies, upon request, will be forwarded as provided in section 1533. The vendor under no circumstances will ship or deliver the liquor covered by the permit until the vendor's copy and accompanying copies are received from the administrator and the vendee's copy from the vendee. The vendee's copy, when received by the vendor, must correspond in every particular with the original and copies received from the administrator.

All regulations inconsistent herewith are repealed to the extent of such inconsistency only.

D. H. BLAIR,
Commissioner of Internal Revenue.

Approved February 9, 1927.

A. W. MELLON,
Secretary of the Treasury.

REGULATIONS 60, ARTICLE IV, SECTION 406. VI–12–3162
T. D. 3998

Prohibition.—Permits to purchase—Request for vendor's copy not required to be made by registered mail.

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

To Prohibition Administrators and Others Concerned:

Request for the vendor's copy of the permit to purchase, Form 1410–A, in accordance with Treasury Decision 3978 [see page 340] will not hereafter be required to be sent to the administrator by registered mail. The communication must, however, be on the letterhead of the vendor, must be signed by him, must show the name, address, and basic permit number of the vendee wishing to secure the liquor, the date and number of the vendee's permit to purchase covering the proposed shipment, and the kind and quantity of liquor covered by the vendee's copy of permit to purchase.

D. H. BLAIR,
Commissioner of Internal Revenue.

Approved March 16, 1927.

A. W. MELLON,
Secretary of the Treasury.

REGULATIONS 60, ARTICLE IV, SECTION 406. VI–5–3077
T. D. 3958

PROHIBITION.

Revoking requirement for confirmation of permits to purchase by use of Form 1410–D.

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

To Prohibition Administrators and Others Concerned:

The requirements that permits to purchase liquor issued in pursuance to the provisions of the National Prohibition Act shall be authenticated by letter of confirmation, Form 1410–D, is hereby revoked. In all cases the vendor's copy of permit to purchase shall be used in lieu of letter of confirmation, Form 1410–D, and shall be subject to all requirements of section 432 and all other provisions of existing regulations relating to letters confirming permit to purchase.

Section 406, Regulations 60, is hereby amended to read as follows:

The vendee's copy in all cases will at once be mailed to the vendee. Where the permit to purchase covers not to exceed 10 wine gallons of alcohol exclusively, or the preparations mentioned in section 810, or not exceeding 6 quarts of intoxicating liquor to be administered by physicians to their patients in emergency cases as provided by section 1430, all copies other than the vendee's copy will at once be mailed to the vendor. In all other cases the original permits and copies of permits will be retained in the office of the administrator until request is received from the vendor for the vendor's copy and other copies relating thereto. In case the places of business of the vendor and vendee are within the same administrative district, within 48 hours after receipt of such request, the administrator will mail to the vendor the original and all remaining copies of the permit to purchase. If the vendor and vendee are

located in different administrative districts, such copies, upon request, will be forwarded as provided in section 1533. The vendor under no circumstances will ship or deliver the liquor covered by the permit until the vendor's copy and accompanying copies are received from the administrator and the vendee's copy from the vendee. The vendee's copy, when received by the vendor, must correspond in every particular with the original and copies received from the administrator.

All sections or parts of sections of existing regulations not consistent with the foregoing are hereby rescinded to the extent only of such inconsistency.

D. H. BLAIR,
Commissioner of Internal Revenue.

Approved January 26, 1927.

A. W. MELLON,
Secretary of the Treasury.

[Amended by T. D. 3978, p. 340.]

REGULATIONS 60, ARTICLE VI, SECTION 680: Vinegar. VI–13–3170
T. D. 4000

Prohibition.—Treasury Decision 3942 [C. B. V–2, 264] amended.—Procurement of tax-paid wine for use in the manufacture of vinegar.

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

To Prohibition Administrators, Collectors of Internal Revenue, and Others Concerned:

Treasury Decision 3942, approved November 29, 1926, is hereby amended to read as follows:

Hereafter, before tax-paid wine is shipped or delivered from a bonded winery, bonded storeroom, or manufacturer's agency to the holder of a basic permit to manufacture vinegar, pursuant to permit to purchase, Form 1410–A, the wine will be converted into vinegar stock, as defined in section 600(d) of Regulations 60, revised.

Conversion will be effected under the supervision of an officer detailed to such duty by the prohibition administrator of the district by the addition of not less than 1½ gallons of glacial acetic acid, U. S. P. (United States Pharmacopoeia), or the equivalent thereof of acetic acid, U. S. P. (approximately 4½ gallons), or of wine vinegar, to each 100 gallons of wine. Where glacial acetic acid, U. S. P., or acetic acid, U. S. P., is used, the same need not be tested (except when the administrator shall so direct), provided the material is delivered to the officer in a sealed package, bearing seal and label descriptive of its contents, placed thereon by a reputable manufacturer.

In all cases where it is desired to use wine vinegar, or glacial acetic acid, U. S. P., or acetic acid, U. S. P., not contained in a sealed package, bearing seal and label descriptive of its contents, placed thereon by a reputable manufacturer, the officer will take a 1-pint sample from each container of the material to be used, and will submit the same to the district chemist for analysis. After the samples are taken, the containers will be sealed by the officer.

The chemist will make a report of his analysis to the administrator of the district, and will state the quantity, in wine gallons, of the material required to raise the acetic acid content of 100 gallons of wine to not less than 1½ per cent by volume. The officer supervising the conversion will satisfy himself that the material has not been tampered with since the samples were taken, and will see that the required quantity is added to the wine.

Where the wine is procured from a bonded winery or bonded storeroom the tax will be paid on the wine before conversion by surrender to the collector

of the district of uncanceled wine stamps in a value equal to the tax. The collector will forward such stamps uncanceled to the Commissioner by registered mail.

Where glacial acetic acid, U. S. P., or acetic acid, U. S. P., is used to effect conversion, the containers in which the vinegar stock is shipped will be marked "Acetic acid and wine vinegar stock." Where wine vinegar is used to effect conversion, the containers will be marked "Wine vinegar stock." All containers will also be marked with the name, permit number, and district of the winery, storeroom, or agency from which shipped. Report of shipment will be made in Statement VI of Form 702 when shipment is from a winery or storeroom and on Form 52–B when shipment is from an agency.

Wine makers may not retain acetic acid on the winery or storeroom premises. Where tax-paid wine is to be converted into vinegar stock in accordance with the foregoing, the material required for such conversion must be brought into the winery or storeroom at the time of conversion, and any residue not used must be immediately removed from the winery or storeroom. Tax-paid wine converted into vinegar stock must be kept separate and apart from other wines in the winery or storeroom during the period necessary for conversion and shipment. The vinegar stock must be removed from the winery or storeroom immediately after conversion. The officer supervising the conversion will see that these requirements are complied with.

C. R. NASH,
Acting Commissioner of Internal Revenue.

Approved March 19, 1927.

A. W. MELLON,
Secretary of the Treasury.

REGULATIONS 60, ARTICLE VII: Cereal beverages, dealcoholizing plants, etc. VI–5–3076 T. D. 3957

PROHIBITION.

Treasury decision covering submission of Form 1413, revised December, 1926.

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

To Prohibition Administrators and Others Concerned:

Monthly statements of transactions at plants producing cereal beverages will be made upon the new Form 1413, revised as of December, 1926, beginning with statements covering transactions for the month of February, 1927. All old Forms 1413 will be destroyed February 1, 1927.

The procedure in the submission and handling of the new Form 1413 will be same as that prescribed for the old, except that the new form will be taken by the permittee to the office of the nearest collector or deputy collector of internal revenue, where a deputy collector will administer the oath and a second deputy collector will witness the oath and signature in places indicated upon the new form.

D. H. BLAIR,
Commissioner of Internal Revenue.

Approved January 26, 1927.

A. W. MELLON,
Secretary of the Treasury.

[Rescinded by T. D. 3991, page 344.]

REGULATIONS 60, ARTICLE VII: Cereal beverages, dealcoholizing plants, etc. VI-10-3142 T.D. 3991

Prohibition.—Manufacturers of cereal beverage to make sworn returns on Form 1413.—Treasury Decision 3957 [see page 343] rescinded.

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

To Prohibition Administrators and Others Concerned:

Treasury Decision 3957, approved January 26, 1927, is hereby rescinded, and the following regulation is substituted therefor:

Monthly returns of the operations at cereal beverage plants will be made on Form 1413, Revised, not later than the 10th day of each month for the next preceding month; and such returns shall be sworn to (or affirmed) before a collector, deputy collector, clerk of court, deputy clerk of court, notary public, justice of the peace, or other officer, authorized to administer oaths, and having a seal.

All regulations inconsistent herewith are hereby rescinded to the extent of such inconsistency.

D. H. BLAIR, *Commissioner.*

Approved March 2, 1927.
A. W. MELLON,
Secretary of the Treasury.

REGULATIONS 60, ARTICLE XIX, SECTION 1915: Revocation of permits. VI-1-3033 T.D. 3948

Prohibition.—Report of hearings in revocation cases.—Section 1915 of Regulations 60 amended.

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

To Prohibition Administrators and Others Concerned:

Section 1915 of Regulations 60, revised March 14, 1924, is hereby amended to read as follows:

A reporter shall be designated and sworn to take down, transcribe, and deliver to the hearing officer an accurate report of the proceedings in the case: *Provided*, That the representatives of the Government and the representatives of the permittee may agree, in writing, upon a summary narrative of the testimony in lieu of a detailed report thereof, and such summary narrative, thus agreed to, shall have all the force and effect of such testimony when reported in detail: *Provided further*, That in minor cases, such as retail druggist, physicians, and hospital permits, where the testimony is brief, and where no stenographer is available, the hearer may, at his option, regardless of any stipulation by the representatives of the parties, make a narrative summary of the testimony, being careful to give accurately and impartially the substance of the facts on both sides, and such narrative testimony, when so taken, shall have like force and effect as if it had been recorded verbatim.

All regulations inconsistent herewith are hereby rescinded to the extent of such inconsistency.

C. R. NASH,
Acting Commissioner.

Approved December 24, 1926,
GARRARD B. WINSTON,
Acting Secretary of the Treasury.

REGULATIONS 61, ARTICLE 104: Sale and use of completely denatured alcohol. VI–1–3034 T. D. 3949

Prohibition.—Regulations No. 61.—Report required of rescinded or modified formulae of completely denatured alcohol on hand.

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

To Prohibition Administrators and Others Concerned:

All persons owning, storing, or possessing 20 barrels or drums (1,000 wine gallons) or more of completely denatured alcohol formulae 2, 3, 4, 6, and 7, or any completely denatured alcohol formula 5 compounded prior to January 1, 1927, must report within ten (10) days from date hereof to the prohibition administrator of the district the quantity in gallons and number of packages of each formula so owned, stored, or possessed at the time such report is made.

The administrator will at once acknowledge receipt of these notices, and no further sales of the stock thus owned, stored, or possessed, in quantities exceeding one barrel or drum, may be made after the date of receipt of the administrator's acknowledgment by the owner, storer, or possessor except as authorized by the temporary permit issued by the administrator.

D. H. BLAIR,
Commissioner of Internal Revenue.

Approved December 27, 1926.

GARRARD B. WINSTON,
Acting Secretary of the Treasury.

[Modified by T. D. 3987, below.]

REGULATIONS 61, ARTICLE 104: Sale and use of completely denatured alcohol. VI–10–3140 T. D. 3987

Prohibition.—Stocks of completely denatured alcohol, denatured under withdrawn formulas 2, 3, 4, 6, and 7, to be reported.—Treasury Decision 3949 [above] modified.

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

To Prohibition Administrators and Others Concerned:

Treasury Decision 3949, approved December 27, 1926, is hereby rescinded and the following substituted therefor:

All persons owning, storing, or possessing completely denatured alcohol in quantities of 20 barrels, or drums, or more, denatured under formulas 2, 3, 4, 6, and 7, which formulas have now been withdrawn, shall make report of such alcohol to the prohibition administrator of the district in which it is located, giving the name and address of the owner, storer, or possessor, the quantity on hand, the number of packages, the serial number of each package, and the number of the formula under which the alcohol so owned, stored, or possessed was denatured.

Administrators will, on receipt of such report, at once issue to the owner, storer, or possessor of the alcohol a special permit for the sale or other disposition thereof, and no sale or other disposition of such alcohol in quantities of 1

barrel, or drum, or more may be made by the owner, storer, or possessor, except as authorized by the said special permit.

All completely denatured alcohol denatured under the foregoing withdrawn formulas, together with the containers thereof, when owned, used, stored, possessed, sold, or otherwise disposed of in any manner other than as herein provided, is liable to seizure and forfeiture under the law.

All regulations inconsistent herewith are rescinded to the extent of such inconsistency.

D. H. BLAIR, *Commissioner.*

Approved February 26, 1927.

A. W. MELLON,
Secretary of the Treasury.

REGULATIONS 61, ARTICLE 109: Dealers' records and reports. VI–5–3074 T. D. 3952

Prohibition.—Regulations No. 61 amended.—Additional copy of memorandum slip, Form 1473, required to be made by bonded dealers in specially denatured alcohol.

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

To Prohibition Administrators and Others Concerned:

The second paragraph of article 109, Regulations No. 61, is hereby amended to read as follows:

Memorandum slips, Form 1473, covering each delivery or shipment shall also be made out by the dealer at the time of making the delivery or shipment. These memorandum slips must be prepared by the dealer in duplicate where the consignee and consignor are located in the same administrator's district, and in triplicate where located in different administrators' districts. At the close of the day such dealer will forward one copy of each slip prepared to the administrator of the district in which the dealer is located, one copy to the administrator of the district in which the consignee is located, if in another district, and the other copy directly to the Commissioner: *Provided, however,* that in cases where a prohibition agent or representative is regularly stationed on the premises of the bonded dealer, such dealer will prepare an additional copy of the memorandum slip, Form 1473, which additional copy must be submitted to the agent on duty at the premises at the time of or prior to making the shipment or delivery covered thereby.

D. H. BLAIR,
Commissioner of Internal Revenue.

Approved January 21, 1927.

A. W. MELLON,
Secretary of the Treasury.

VI–12–3163
T. D. 3999

BUREAU OF PROHIBITION.

TREASURY DEPARTMENT,
OFFICE OF THE SECRETARY,
Washington, D. C., March 18, 1927.

To Commissioner of Prohibition, Commissioner of Internal Revenue, Prohibition Officials, and Other Officials and Employees of the Treasury Department Concerned:

Pursuant to the provisions of the Act of Congress approved March 3, 1927 (Public, No. 751), and in the exercise of authority conferred

upon me by that law, there is promulgated hereinafter, for the information and guidance of all concerned, the following, to wit:

1. Effective April 1, 1927, there is hereby created in the Department of the Treasury a bureau to be known as the Bureau of Prohibition.

2. An official to be known as the Commissioner of Prohibition shall be at the head of the Bureau of Prohibition.

3. The Bureau of Prohibition shall also have one assistant commissioner, two deputy commissioners, one chief clerk, and such attorneys and other officers and employees as may be necessary. Appointments under this subdivision shall be subject to the provisions of the civil service laws, and the salaries shall be fixed in accordance with the Classification Act of 1923.

PERSONNEL.

The Commissioner of Prohibition shall, under the supervision of the Secretary of the Treasury, have control of the officers, agents, inspectors, clerks, and other employees now attached to the Prohibition Unit in the Bureau of Internal Revenue, and of the prohibition agents and other field officers, of whatever grade, now employed in said service, subject to reappointment by him, with the approval of the Secretary of the Treasury, such reappointments to be in accordance with the requirements as to civil service qualifications provided by the Act.

The Commissioner of Internal Revenue shall transfer to the Commissioner of Prohibition all deputy collectors, gaugers, storekeepers, storekeeper-gaugers, auditors, accountants, clerks, chemists, and other employees now occupied in the performance of work in the administration and enforcement of the prohibition laws and amendments thereto, revised statutes relating to intoxicating liquors, and the Harrison Narcotic Act, whether such employees be now located in the Bureau of Internal Revenue at Washington, D. C., in the offices of collectors of internal revenue, or elsewhere.

An amount equivalent to the salaries and expenses of the employees so transferred to the Bureau of Prohibition shall also be transferred from the appropriation "Collecting the internal revenue," to be placed under the control of the Commissioner of Prohibition. This sum will be decreased by such amounts as may be necessary to continue the functions transferred to the Commissioner of Internal Revenue, heretofore performed in the Prohibition Unit, Bureau of Internal Revenue.

The Commissioner of Internal Revenue shall also, on the date named, turn over to the said Commissioner of Prohibition all the unused balances in the appropriations for the enforcement of prohibition and narcotic laws for the fiscal years 1925, 1926, 1927, and the entire appropriation for the fiscal year 1928; provided, however, that such amounts as may be necessary to complete the investigation and prosecution of cases involving violations of the National Prohibition Act now being conducted by the Intelligence Unit of the Bureau of Internal Revenue shall continue to be available for that purpose, under the supervision of the Commissioner of Internal Revenue, until said cases are completed.

The amount of $15,000 shall be transferred from the appropriation "Collecting the internal revenue" for the fiscal year 1927, and an additional amount of $25,000 from the appropriation "Collecting the internal revenue" for the fiscal year 1928, for the purpose of paying informers' fees in administering the Harrison Narcotic Act. In the event Congress makes provision for the payment of such fees, any unexpended balance shall be returned to the Commissioner of Internal Revenue.

All obligations incurred by the Prohibition Unit prior to April 1, 1927, shall be transferred to and settled by the Commissioner of Prohibition.

DISTILLED SPIRITS, ALCOHOL, WINES, AND OTHER LIQUORS.

The Commissioner of Prohibition shall have custody and supervision of all stocks of distilled spirits, alcohol, wines, and other liquors, and of all distilleries, industrial alcohol plants, bonded warehouses, denaturing plants, wineries, bonded wine storerooms, breweries, dealcoholizing plants, and all other places at which such spirits or liquors are produced or stored and which have heretofore been under the custody and supervision of the Commissioner of Internal Revenue. The Commissioner of Prohibition shall at all times have supervision over the production, storage, safeguarding, disposition, and accounting for all such spirits and liquors. The Commissioner of Internal Revenue shall turn over to the said Commissioner of Prohibition the control and custody of all such places where said distilled spirits, alcohol, wines, and other liquors are produced or stored, as well as all books, records, files, forms, blanks, and other articles pertaining thereto. Records and reports pertaining to narcotic registrants shall be retained in the offices of the collectors of internal revenue.

MANUFACTURE, WITHDRAWAL, AND DISTRIBUTION OF INTOXICATING LIQUORS AND CEREAL BEVERAGES.

The Commissioner of Prohibition shall have the power to grant permits for the manufacture, sale, purchase, transportation, use, rectification, importation, exportation, prescription, and other privileges provided by law in relation to intoxicating liquors and cereal beverages. The Commissioner of Prohibition shall have the power to issue citations, hold hearings, and render final judgment in all cases where there are grounds for action against such permits, and the judgment rendered therein by the said Commissioner of Prohibition shall be final unless modified or disapproved by the Secretary of the Treasury, save as to review thereof in a court of equity, as provided by section 5, Title II, of the National Prohibition Act.

TAXES, TAX PENALTIES, COMPROMISES, AND SUITS FOR THE RECOVERY OF TAX LIABILITIES.

The function of assessing, collecting, abating, refunding, and compromising internal revenue taxes, that is, taxes arising under the internal revenue and prohibition laws when there is no violation of the prohibition laws, shall devolve upon the Commissioner of Internal Revenue, and all negotiations in compromise of such liabili-

ties shall be made with the collector of internal revenue for the district wherein the liability arose.

In cases of taxes and tax penalties which arise from violations of the various provisions of the prohibition law, wherein increased tax rates are imposed and penalties provided, whether such settlement is to be effected by a compromise tendered through the collector of internal revenue or by an action brought therefor in the courts, the proceedings shall be conducted by the Commissioner of Prohibition, until an agreement by compromise is reached; or, upon failure of agreement by compromise, a court action for the recovery of such taxes and penalties is prosecuted to a judgment. When an agreement by compromise is reached, the Commissioner of Prohibition shall make report and recommendation to the Commissioner of Internal Revenue as to the amount agreed upon in the compromise settlement. The Commissioner of Internal Revenue shall effect such compromise, with the approval of the Secretary of the Treasury, under the provisions of section 35, Title II, of the National Prohibition Act.

When a court action involving such taxes and tax penalties results in a judgment favorable to the Government, all moneys arising therefrom shall be covered into the Treasury through the collector of internal revenue for the district wherein the liability arose.

NARCOTIC DRUGS.

All assessments of taxes under the Harrison Narcotic Act or its amendments shall be made, collected, abated, refunded, or compromised by the Commissioner of Internal Revenue.

All compromise proceedings for criminal liability under the Harrison Narcotic Act and its amendments shall be conducted by the Commissioner of Prohibition.

When an agreement by compromise is reached, the Commissioner of Prohibition shall make appropriate report and recommendation to the Commissioner of Internal Revenue as to the amount agreed upon in the compromise settlement. The Commissioner of Internal Revenue shall effect such compromise, with the approval of the Secretary of the Treasury, under the provisions of section 3229, Revised Statutes.

INTERNAL REVENUE STAMPS.

The Commissioner of Internal Revenue will issue to the various collectors of internal revenue all internal revenue stamps of every class pertaining to spirits, wines, malt liquors, and narcotics, including narcotic order forms, and the collectors of internal revenue will account to the Commissioner of Internal Revenue for the same. The authority to redeem stamps shall rest with the Commissioner of Internal Revenue.

INVESTIGATIONS.

The Commissioner of Prohibition shall cause inquiries and investigations to be made by the appropriate officers under his jurisdiction with a view to requiring returns to be made to the appropriate collectors of internal revenue of all occupational and commodity taxes

and penalties accruing on distilled spirits, alcohol, wine, and other intoxicating liquors and narcotics as imposed or may hereafter be imposed by law. Upon receipt of such returns it shall be the duty of the collector of internal revenue in whose district such cases arise to collect the internal revenue taxes and penalties and to cover the proceeds into the Treasury as provided by law.

SEIZURE AND SALE.

The seizure and sale of property as provided by law in connection with violations of the above-mentioned Acts, with the exception of seizures made by collectors under authority of warrant for distraint, shall be a function of the Commissioner of Prohibition.

CHEMICAL ANALYSES.

The Commissioner of Prohibition shall perform such necessary analyses in connection with miscellaneous taxes relating to adulterated and renovated butter, oleomargarine, filled cheese, mixed flour, and phosphorus matches as may be required by the Commissioner of Internal Revenue.

DISPOSITION OF RECORDS.

The Commissioner of Internal Revenue shall retain all assessment lists, claims, offers in compromise, documents, and records pertaining to assessed taxes.

There shall be transferred to the Commissioner of Prohibition all documents and records relating to appropriations and personnel and any other records, equipment, space, property, etc., now in the possession of the Commissioner of Internal Revenue, that relate to the functions of the Commissioner of Prohibition.

A. W. MELLON,
Secretary of the Treasury.

[Revoked by T. D. (Pro.) 1, below.]

VI–17–3211
T. D. (Pro.) 1

BUREAU OF PROHIBITION.

Order of the Secretary of the Treasury prescribing the duties and powers of the commissioner and other officers and employees of the Bureau of Prohibition, including the field service of the Bureau of Prohibition, providing for the designation of the Acting Commissioner of Prohibition, and transferring certain personnel, records, and property of the Office of the Commissioner of Internal Revenue to the Bureau of Prohibition.

TREASURY DEPARTMENT,
OFFICE OF THE SECRETARY,
Washington, D. C., April 1, 1927.

To Commissioner of Prohibition, Commissioner of Internal Revenue, Prohibition Officials, and Other Officials and Employees of the Treasury Department Concerned:

The Act entitled "An Act to create a Bureau of Customs and a Bureau of Prohibition in the Department of the Treasury," approved March 3, 1927 (Pub. No. 751, 69th Congress), provides as follows:

H. R. 10729. PUBLIC—NO. 751, SIXTY-NINTH CONGRESS.

An Act to create a Bureau of Customs and a Bureau of Prohibition in the Department of the Treasury.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That there shall be in the Department of the Treasury a bureau to be known as the Bureau of Customs, a bureau to be known as the Bureau of Prohibition, a Commissioner of Customs, and a Commissioner of Prohibition. The Commissioner of Customs shall be at the head of the Bureau of Customs, and the Commissioner of Prohibition shall be at the head of the Bureau of Prohibition. The Commissioner of Customs and the Commissioner of Prohibition shall be appointed by the Secretary of the Treasury, without regard to the civil-service laws, and each shall receive a salary at the rate of $8,000 per annum.

SEC. 2. (*a*) The Secretary of the Treasury is authorized to appoint, in each of the bureaus established by section 1, one assistant commissioner, two deputy commissioners, one chief clerk, and such attorneys and other officers and employees as he may deem necessary. One of the deputy commissioners of the Bureau of Customs shall have charge of investigations. Appointments under this subdivision shall be subject to the provisions of the civil service laws, and the salaries shall be fixed in accordance with the Classification Act of 1923.

(*b*) The Secretary of the Treasury is authorized to designate an officer of the Bureau of Customs to act as Commissioner of Customs, during the absence or disability of the Commissioner of Customs, or in the event that there is no Commissioner of Customs; and to designate an officer of the Bureau of Prohibition to act as Commissioner of Prohibition during the absence or disability of the Commissioner of Prohibiton, or in the event that there is no Commissioner of Prohibition.

(*c*) The personnel of the Bureau of Prohibition shall perform such duties as the Secretary of the Treasury or the Commissioner of Prohibition may prescribe, and the personnel of the Bureau of Customs shall perform such duties (other than duties in connection with the administration of the National Prohibition Act, as amended, or any other law relating to the enforcement of the eighteenth amendment), as the Secretary of the Treasury or the Commissioner of Customs may prescribe.

SEC. 3. (*a*) The Secretary of the Treasury is authorized to confer or impose upon the Commissioner of Customs or any of the officers of the Bureau of Customs any of the rights, privileges, powers, or duties, in respect of the importation or entry of merchandise into, or exportation of merchandise from, the United States, vested in or imposed upon the Secretary of the Treasury by the Tariff Act of 1922, or any other law.

(*b*) The records, property (including office equipment), and personnel of the Division of Customs are hereby transferred to the Bureau of Customs.

(*c*) The Division of Customs and the offices of director of customs, assistant directors of customs, and director and assistant directors, Special Agency Service of the Customs, are hereby abolished.

SEC. 4. (*a*) The rights, privileges, powers, and duties conferred or imposed upon the Commissioner of Internal Revenue and his assistants, agents, and inspectors, by any law in respect of the taxation, importation, exportation, transportation, manufacture, production, compounding, sale, exchange, dispensing, giving away, possession, or use of beverages, intoxicating liquors, or narcotic drugs, or by the National Prohibition Act, as amended, or any other law relating to the enforcement of the eighteenth amendment, are hereby transferred to, and conferred and imposed upon, the Secretary of the Treasury.

(*b*) The Secretary of the Treasury is authorized to confer or impose any of such rights, privileges, powers, and duties upon the Commissioner of Prohibition, or any of the officers or employees of the Bureau of Prohibition, and to confer or impose upon the Commissioner of Internal Revenue, or any of the officers or employees of the Bureau of Internal Revenue, any of such rights, privileges, powers, and duties which, in the opinion of the Secretary, may be necessary in connection with internal revenue taxes.

SEC. 5. (*a*) The Secretary of the Treasury is authorized to transfer to the Bureau of Prohibition such records, property (including office equipment), and personnel of the Office of the Commissioner of Internal Revenue as may be necessary for the exercise by the Bureau of Prohibition of the functions vested in it.

(*b*) The Commissioner of Prohibition, with the approval of the Secretary of the Treasury, is authorized to appoint in the Bureau of Prohibition such employees in the field service as he may deem necessary, but all appointments of such employees shall be made subject to the provisions of the civil service laws, notwithstanding the provisions of section 38 of the National Prohibition Act, as amended. The term of office of any person who is transferred, under this section, to the Bureau of Prohibition, and who was not appointed subject to the provisions of the civil service laws, shall expire upon the expiration of six months from the effective date of this Act.

SEC. 6. Any action or decision of the Secretary of the Treasury under the National Prohibition Act, as amended, or of any officer upon whom the power to take such action or make such decision is conferred, shall be subject to the same review by a court of equity as the action or decision of the Commissioner of Internal Revenue under such Act, as amended, prior to the effective date of this Act.

SEC. 7. This Act shall take effect on April 1, 1927.

Approved, March 3, 1927.

In pursuance of the authority conferred upon the Secretary of the Treasury by the above Act, it is hereby ordered as follows:

I.

DESIGNATION OF ACTING COMMISSIONER OF PROHIBITION.

The Assistant Commissioner of the Bureau of Prohibition shall act as the Commissioner of Prohibition during the absence or disability of the Commissioner of Prohibition, or in the event there is no Commissioner of Prohibition. In case of the absence or disability of the Assistant Commissioner, or in the event there is no Assistant Commissioner, an officer of the Bureau of Prohibition will be designated by the Secretary at the time to act as Commissioner of Prohibition during the absence or disability of the Commissioner of Prohibition, or in the event that there is no Commissioner of Prohibition.

II.

TRANSFER OF PERSONNEL.

There is hereby transferred to the Bureau of Prohibition at their present grades and salaries, and in their present status, the following personnel:

All officers, attorneys, assistants, agents, inspectors, deputy collectors, gaugers, storekeepers, storekeeper-gaugers, auditors, accountants, clerks, chemists, and other employees of the Internal Revenue Service, whether located in the Bureau of Internal Revenue at Washington, D. C., or in the offices of collectors of internal revenue, or elsewhere, now engaged in the performance of functions conferred or imposed by this order upon the officers and employees of the Bureau of Prohibition, including the field service of the Bureau of Prohibition.

III.

TRANSFER OF RECORDS AND PROPERTY.

There are hereby transferred from the Office of the Commissioner of Internal Revenue to the Bureau of Prohibition all documents, files, forms, blanks, and other records, and all property (including office equipment) and space, necessary for the performance of functions conferred or imposed by this order upon the Commissioner of Prohibition or upon the officers and employees of the Bureau of Prohibition, including the field service of the Bureau of Prohibition, as determined by the Commissioner of Internal Revenue and the Commissioner of Prohibition.

IV.

RIGHTS, PRIVILEGES, POWERS, AND DUTIES CONFERRED OR IMPOSED UPON THE COMMISSIONER OF PROHIBITION RELATING TO PROHIBITION.

(1) There are hereby conferred and imposed upon the Commissioner of Prohibition, subject to the general supervision and direction of the Secretary of the Treasury, all the rights, privileges, powers, and duties conferred or

imposed upon the Commissioner of Internal Revenue (and which are transferred to and conferred and imposed upon the Secretary of the Treasury by subdivision (a) of section 4 of the above Act of March 3, 1927), by the National Prohibition Act as amended, or by the Act entitled "An Act supplemental to the National Prohibition Act," approved November 23, 1921, and the power conferred upon the Commissioner of Internal Revenue to remove distilled spirits from any internal-revenue bonded warehouse to any other such warehouse, for the purpose of concentration, and to prescribe the form and penal sum of bonds covering distilled spirits in any such warehouse and in transit between such warehouses, except that all moneys shall be received and accounted for by the collectors of internal revenue, under the direction of the Commissioner of Internal Revenue;

(2) There are also hereby conferred and imposed upon the Commissioner of Prohibition, subject to the general supervision and direction of the Secretary of the Treasury, all the rights, privileges, powers, and duties conferred or imposed upon the Commissioner of Internal Revenue (and which are transferred to and conferred and imposed upon the Secretary of the Treasury by subdivision (a) of section 4 of the above Act of March 3, 1927) by any law, in so far as such rights, privileges, powers, and duties relate to—

(*a*) The production, custody, and supervision of distilled spirits, alcohol, wines, fermented liquors, cereal beverages, denatured alcohol, and other such liquors and liquids;

(*b*) The establishment, construction, operation, custody, and supervision of distilleries, industrial alcohol plants, bonded warehouses, denaturing plants, wineries, bonded wine storerooms, breweries, rectifying houses, dealcoholizing plants, cereal beverage plants, and other places at which such spirits, liquors, or liquids are produced or stored;

(*c*) The determination, assertion, and compromise of liability for, and the institution and compromise of suits for the recovery of, internal-revenue taxes and penalties, but only in case a violation of law relating to the enforcement of the eighteenth amendment is involved, except that all moneys shall be received and accounted for by the collectors of internal revenue, under the direction of the Commissioner of Internal Revenue;

(*d*) Inquiries and investigations relating to the filing of returns for occupational and commodity taxes and penalties in respect of intoxicating liquors, cereal beverages, and denatured alcohol;

(*e*) The seizure, for violation of the internal-revenue laws relating to intoxicating liquors, cereal beverages, and denatured alcohol, of property, whether real or personal (except seizure under distraint warrant), and the custody, control, sale, and disposition of property so seized;

(*f*) The discharge of liens, under section 902 of the Revenue Act of 1926.

(3) All regulations shall be prescribed by the Commissioner of Prohibition, with the approval of the Secretary of the Treasury.

V.

RIGHTS, PRIVILEGES, POWERS, AND DUTIES CONFERRED AND IMPOSED UPON THE OFFICERS AND EMPLOYEES OF THE BUREAU OF PROHIBITION, INCLUDING THE FIELD SERVICE OF THE BUREAU OF PROHIBITION, RELATING TO PROHIBITION.

There are hereby conferred and imposed upon the officers and employees of the Bureau of Prohibition, including agents, inspectors, and other employees in the field service of the Bureau of Prohibition, all the rights, privileges, powers, and duties conferred or imposed upon the assistants, agents, and inspectors of the Commissioner of Internal Revenue (and which are transferred to and conferred and imposed upon the Secretary of the Treasury by subdivision (*a*) of section 4 of the above Act of March 3, 1927), (1) by any law in so far as such rights, privileges, powers, and duties relate to any of the matters referred to in paragraph (2) of Section IV of this order, or (2) by any law referred to in paragraph (1) of Section IV of this order.

VI.

RIGHTS, PRIVILEGES, POWERS, AND DUTIES CONFERRED AND IMPOSED ON THE COMMISSIONER OF PROHIBITION RELATING TO NARCOTIC DRUGS.

(1) There are hereby conferred and imposed upon the Commissioner of Prohibition, subject to the general supervision and direction of the Secretary of the Treasury, all the rights, privileges, powers, and duties conferred or imposed

upon the Commissioner of Internal Revenue (and which are transferred to and conferred and imposed upon the Secretary of the Treasury by subdivision (*a*) of section 4 of the above Act of March 3, 1927) by the Harrison Narcotic Act, as amended, or by the Act entitled "An Act regulating the manufacture of smoking opium within the United States and for other purposes," approved January 17, 1914, in so far as such rights, privileges, powers, and duties relate to—

(*a*) The investigation and the detection and punishment of violations of either of the above laws, or any regulations issued thereunder;

(*b*) Exemptions from any of the provisions of the above laws;

(*c*) The books, records, and returns required to be kept or rendered under any of the above laws;

(*d*) The prescribing of forms and order forms under any of the above Acts;

(*e*) The manner in which the record of sales, exchanges, and gifts of tax-exempt preparations and remedies containing narcotic drugs shall be kept;

(*f*) The manner in which application shall be made for confiscated narcotic drugs;

(*g*) The appointment of a committee for the certification and disposition of confiscated narcotic drugs;

(*h*) The compromise of any civil or criminal case under either of the above laws in accordance with section 3229 of the Revised Statutes, except that all moneys shall be received and accounted for by the collectors of internal revenue, under the direction of the Commissioner of Internal Revenue;

(*i*) Seizures, for violation of either of the above laws, of property, whether real or personal (except under distraint warrant), and the custody, control, sale, and disposition of property so seized;

(*j*) The appointment of such officers and employees as may be necessary for the execution of the functions imposed upon the Bureau of Prohibition relating to narcotic drugs.

(2) Power is hereby conferred upon the Commissioner of Prohibition to prescribe such regulations as he may deem necessary for the execution of the functions imposed upon him or upon the officers or employees of the Bureau of Prohibition, relating to narcotic drugs, but all regulations and changes in regulations shall be subject to the approval of the Secretary of the Treasury.

VII.

RIGHTS, PRIVILEGES, POWERS, AND DUTIES CONFERRED AND IMPOSED UPON THE OFFICERS AND EMPLOYEES OF THE BUREAU OF PROHIBITION, INCLUDING THE FIELD SERVICE OF THE BUREAU OF PROHIBITION, RELATING TO NARCOTIC DRUGS.

There are hereby conferred and imposed upon the officers and employees of the Bureau of Prohibition, including the agents, inspectors, and other employees in the field service of the Bureau of Prohibition, all the rights, privileges, powers, and duties conferred or imposed upon the assistants, agents, and inspectors of the Commissioner of Internal Revenue (and which are transferred to and conferred and imposed upon the Secretary of the Treasury by subdivision (*a*) of section 4 of the above Act of March 3, 1927) by either of the laws referred to in Section VI of this order, in so far as such rights, privileges, powers, and duties relate to any of the matters referred to in paragraphs (*a*) to (*j*), inclusive, of such section. All such officers and employees of the Bureau of Prohibition, including the agents, inspectors, and other employees in the field service of the Bureau of Prohibition, shall have, in the performance of their functions under the narcotic drug laws, all the rights, privileges, and powers of internal-revenue officers.

VIII.

RIGHTS, PRIVILEGES, POWERS, AND DUTIES CONFERRED AND IMPOSED UPON THE COMMISSIONER OF INTERNAL REVENUE.

There are hereby conferred and imposed upon the Commissioner of Internal Revenue all the rights, privileges, powers, and duties conferred or imposed upon such officer (and which are transferred to and conferred and imposed upon the Secretary of the Treasury by subdivision (*a*) of section 4 of the above Act of March 3, 1927) by any law, except the rights, privileges, powers, and duties conferred or imposed upon any other person by Section IV, V, VI,

or VII of this order, but not excepting rights, privileges, powers, and duties relating to internal-revenue taxes where no violation of a law relating to the enforcement of the eighteenth amendment is involved. All regulations and changes in regulations shall be subject to the approval of the Secretary of the Treasury.

IX.

RIGHTS, PRIVILEGES, POWERS, AND DUTIES CONFERRED AND IMPOSED UPON THE OFFICERS AND EMPLOYEES OF THE BUREAU OF INTERNAL REVENUE.

There are hereby conferred and imposed upon the assistants, agents, and inspectors of the Commissioner of Internal Revenue all the rights, privileges, powers, and duties conferred or imposed upon such assistants, agents, and inspectors (and which are transferred to and conferred and imposed upon the Secretary of the Treasury by subdivision (*a*) of section 4 of the above Act of March 3, 1927) by any law, except the rights, privileges, powers, and duties conferred or imposed upon any other person by Section IV, V, VI, or VII of this order, but not excepting rights. privileges, powers, and duties relating to internal-revenue taxes where no violation of a law relating to the enforcement of the eighteenth amendment is involved.

X.

GENERAL PROVISIONS.

Any proceeding pending on the effective date of this order may be maintained, prosecuted, or defended by the officer or employee on whom this order confers or imposes the function of maintaining, prosecuting, or defending a similar proceeding begun after the effective date of this order. Nothing in this order shall be construed to affect the validity of any act done, power exercised, or order, decision, or finding made, or to relieve any person from any liability incurred, before the effective date of this order.

Advances to be made by special disbursing agents heretofore authorized by the Commissioner of Internal Revenue and approved by the Secretary of the Treasury may be made after the effective date of this order upon such authority, and the Commissioner of Prohibition with the approval of the Secretary of the Treasury may, after the effective date of this order. authorize advances to be made by special disbursing agents, in accordance with the law.

The order of March 18, 1927 (T. D. 3999 [see page 346], is hereby revoked.

XI.

EFFECTIVE DATE OF ORDER.

This order shall take effect 12.01 a. m. April 1, 1927. The right to amend or supplement this order or any provisions thereof, from time to time, or to revoke this order or any provision thereof at any time, is hereby reserved.

OGDEN L. MILLS,
Acting Secretary of the Treasury.

MISCELLANEOUS.

WAR RISK LIFE INSURANCE.

VI–6–3090

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

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

The following proclamation of the President of the United States, issued under date of January 11, 1927, relative to the reinstatement of policies of war risk insurance issued by the Government, is published for the information of internal revenue officers and others concerned.

D. H. BLAIR, *Commissioner.*

BY THE PRESIDENT OF THE UNITED STATES OF AMERICA

A PROCLAMATION.

During the World War the United States Government insured, at an exceedingly low premium rate, nearly 5,000,000 members of the armed forces of the country against death or total permanent disability. The insurance thus granted was for the greater protection of the insured and their dependents than was afforded in the compensation, independently of insurance and unconnected therewith, which was provided for death or disability resulting from personal injury or disease contracted in the military service.

Statutory provision was made for the continuance of this war risk insurance after the termination of the war, and its conversion within a limited time into such form or forms of insurance, usually issued by life insurance companies, as the insured might request. Many veterans do not seem to have had knowledge of this continuing privilege, and for one reason or another have permitted their war risk insurance to lapse. Under the terms provided for the reestablishment of lapsed insurance, normal health conditions will permit reinstatement upon the payment of two monthly premiums; and for those whose service disabilities render them otherwise not insurable, and who are not permanently and totally disabled, provision is made for reinstatement upon the payment of premiums and interest for the period of lapse. Even these payments may be temporarily waived for those whose resources do not permit immediate compliance.

The law provides that no reinstatement of war risk life insurance which has lapsed shall be made after July 2, 1927. After that date, such war risk term insurance can not be reinstated. On or prior to that date, therefore, such insurance must be reinstated and converted, at the election of the applicant, into one or more of the seven standard forms of life insurance provided by the Government. If such insurance is now in force, the insured must convert it into one of the forms above mentioned on or before the above date.

The potential protective value of the insurance thus provided is apparent, as affecting the future economic and domestic welfare of veterans and their dependents. Provision is made for extended insurance, paid-up values, loan values, cash surrender values, and dividend participation. No premium is charged during total permanent disability. Thousands of our national defenders are passing on each year. All veterans of the World War should be

generally and fully informed of their right to procure the safe and certain protection for themselves and their dependents of the insurance afforded by the Government.

Detailed information with reference to such insurance may be obtained from the central office of the United States Veterans Bureau, Washington, D. C., or from its regional offices located throughout the country.

Wherefore, I, Calvin Coolidge, President of the United States, do hereby designate the period January 31 to February 7, 1927, as a time during which special effort should be made to inform all veterans of the World War of the right they have to reinstate lapsed war risk life insurance, and to convert it into United States Government life insurance; and, that all such veterans may, in some manner, be properly informed, I urge all citizens, particularly employers, the press, labor organizations, women's associations, professional groups, and civic and patriotic bodies, to secure full information and use such means of informing the veterans as may be most effective.

IN WITNESS WHEREOF, I have hereunto set my hand and caused the seal of the United States to be affixed.

Done at the city of Washington, this 11th day of January, in the year of our Lord one thousand nine hundred and twenty-seven, and of the Independence of the United States the one hundred and fifty-first.

CALVIN COOLIDGE.

By the President:
FRANK B. KELLOGG,
Secretary of State.

MISCELLANEOUS.

[1] VI–26–3288

Disbarments and suspensions from practice before Treasury Department of attorneys and agents.[2]

DISBARMENTS.

The Secretary of the Treasury, after due notice and opportunity for hearing, and upon the recommendation of the Committee on Enrollment and Disbarment, has approved the disbarment from further practice before the Treasury Department of the following-named attorneys and agents:

Name.	Address.	Date of disbarment.	Cause.
Bienemann, Walter J.	Baltimore, Md.	Mar. 22, 1927	Charged with embezzling a confidential report, the property of the United States, while employed as an accountant by the Department of Justice, and defaulted for failure to file answer to such charges, as required by the rules, and charges found proven by the committee by reason of such default.
Clifford, James J.	Washington, D. C.	Mar. 19, 1927	Charged with having entered into a conspiracy to defraud a taxpayer and defaulted for failure to file answer to such charge, as required by the rules, and charges found proven by committee.
Epstein, Hyman M.	New York, N. Y.	Oct. 9, 1926	Charged with having been indicted and convicted for grand larceny in the Court of General Sessions of the Peace of the County of New York and State of New York, and charges found proven.
Goldman, Ralph Harrie.	Cincinnati, Ohio.	Nov. 9, 1926	Charged with having been arrested on warrant charging respondent with embezzling $2,391.50 as receiver of Common Pleas Court of Hamilton County, Ohio, and that said respondent is a fugitive from justice, and charges found proven by committee.
Hall, Samuel Prescott.	Washington, D. C.	Jan. 11, 1926	Charged with unethical solicitation by mail of tax business from taxpayers whose affairs in one case were handled by a business associate when employed in the Bureau of Internal Revenue, and in another case the respondent held out his own former employment in said Bureau as an inducement to taxpayer to make contract with him, and charges found proven by committee.
Hayes, George B.	New York, N. Y.	Oct. 25, 1926	Charged with failing to file income tax returns for himself for the years 1917, 1918, 1919, and 1920, with the intent and purpose of evading the payment of $233,527.40 due the United States as income taxes for said years from said respondent, and charges found proven by committee.
Hill, Charles S.	Washington, D. C.	Mar. 22, 1927	Charged with having been disbarred as an attorney by the Supreme Court of the District of Columbia and defaulted for failure to file answer to such charge, as required by the rules, and charges found proven by committee.
Isquith, Louis I.	New York, N. Y.	Mar. 17, 1926	Charged with having been convicted on charge of larceny in second degree in the Court of General Sessions of the Peace in the County of New York, State of New York, and defaulted for failure to file answer to such charge, as required by the rules, and charges found proven by committee.

[1] This ruling (No. 3288) includes also rulings Nos. 3035, 3045, 3054, 3062, 3075, 3083, 3111, 3120, 3126, 3141, 3152, 3161, 3171, 3180, 3191, 3198, 3212, 3218, 3225, 3237, 3245, 3252, 3258, 3268, and 3277. These rulings have been thus consolidated because publication of each one separately herein would be mere duplication.

[2] This list includes all agents and attorneys disbarred from practice during the 12-month period July 1, 1926–June 30, 1927, inclusive, and all suspensions in effect during the 6-month period January 1–June 30, 1927, inclusive. It does not include those barred from practice by reason of disapproval of their applications for enrollment.

Name.	Address.	Date of disbarment.	Cause.
Laskey, Ellis A.	Brooklyn, N. Y.	Apr. 27, 1927	Charged with entering into an agreement with an auditor in the Internal Revenue Bureau which provided that such auditor was to inform said respondent of the names of taxpayers entitled to refunds, and that such auditor was to receive 10 per cent of the fees received by said respondent in such cases. Charges found proven by the committee.
Lindsey, Thomas A.	Little River, Fla.	Nov. 8, 1926	Charged with habitual intoxication, neglect of taxpayers' interests, and misrepresentation to his clients of status of such cases in which respondent had been employed; failure to return data and papers to taxpayers in tax cases neglected and abandoned by respondent; and charges found proven by committee.
Moore, E. Linwood	San Antonio, Tex. (formerly El Dorado, Ark., and Detroit, Mich.).	Nov. 8, 1926	Charged with practicing for and on behalf of an accounting corporation and with soliciting employment in tax matters of taxpayers with whom said respondent had no previous association, and charges found proven by committee.
Rembold, A. A.	Salt Lake City, Utah.	Aug. 13, 1926	Charged with accepting employment from a taxpayer to prepare and file claim for refund of income taxes when a claim for refund for such taxes was barred by statute of limitations, and that respondent did not prepare nor file a claim for such refund, and that respondent collected a fee of $300 in said matter, and charges found proven by committee.
Shanahan, Frank	Chicago, Ill.	Apr. 13, 1926	Charged with advertising the fact that he was formerly employed in the Internal Revenue Bureau as assistant field deputy; and that respondent held himself out as an attorney and fraudulently procured $200 to defend and procure a dismissal of a prohibition case against a woman, and charges found proven by committee.
Tromley, Samuel E.	San Diego, Calif.	Mar. 18, 1926	Charged with receiving fees from clients in tax matters and failing to render any service; obtaining money under false pretenses; passing worthless checks; defrauding hotels; and fraudulently selling worthless oil stocks; and charges found proven by committee.
Weinshenk, Maurice T.	Chicago, Ill.	Mar. 26, 1927	Charged with preparing false income tax returns for taxpayers, and charges found proven by committee.
Wing, L. L.	Wheeling, W. Va. (formerly Ottumwa, Iowa, and Washington, D. C.).	June 30, 1926	Charged with solicitation of tax case through employee who illegally obtained information of pendency of case in Bureau, and agreeing to divide fees with representatives of taxpayer, and charges found proven by committee.

SUSPENSIONS.

The Secretary of the Treasury, after due notice and opportunity for hearing, and upon the recommendation of the Committee on Enrollment and Disbarment, has approved the suspension from practice before the Treasury Department for the period stated in each case of the following-named attorneys and agents:

Name.	Address.	Period of suspension.	Cause.
Amick, James H.	Detroit, Mich.	30 days, from Mar. 31, 1927.	Charged with soliciting employment in Federal tax matters before the Treasury Department by employed solicitors, and charges found proven by committee.
Spicer, Joseph H.	do	do	Do.

INDEX.

	Ruling No.	Page.
A.		
Abatement:		
Claims for. (*See* Claims.)		
Deficiency, deferred payment sale changed to installment basis	3113	38
Accounting methods:		
Accrual basis—		
Cash discount reserve	3168 3169	177 178
Judgment affirmed in later year, deduction	3270	214
Sales of real estate on installment plan, amended returns	3067	37
Single sale on unusual credit terms reported on installment plan	3057	22
Change in, requirements, article 23, Regulations 69, amended	3172	26
Accounting period, returns on different basis, amendment for 1918 and later years	3158	178
Adhesive stamps, sale of	3109	330
Affiliated corporations. (*See* Corporations.)		
Agents. (*See* Attorneys and agents.)		
Alcohol, completely denatured, on hand; report required	3034	345
Aliens, nonresident, foreign corporation, bank acceptances purchased at discount, taxable income	3049	76
Amendments:		
Regulations 9, section 40	3190	333
Regulations 37, article 27	3038	314
Regulations 43–II (1926)—		
Article 10	3036	291
Article 15	3037	291
Regulations 45, article 343	3186	248
Regulations 45 (1920 edition)—		
Article 634	3285	258
Article 1524	3227	161
Regulations 47 (1926)—		
Article 3	3105	297
Article 4	3189	298
Regulations 52 (1919), article 8	3107	301
Regulations 60—		
Article IV, section 406	3077 3119 3162	341 340 341
Article VI, section 680	3170	342
Article XIX, section 1915	3033	344
Regulations 61, article 109	3074	346
Regulations 62—		
Article 89	3200	59
Article 155	3154	222
Article 343	3196	249
Article 632	3228	258
Article 634	3286	259
Article 1524	3227	161
Regulations 63, article 23	3038	314
Regulations 65—		
Article 89	3200	59
Article 155	3153	143
Article 343	3185	77
Article 634	3283	148

	Ruling No.	Page.
Amendments—Continued.		
Regulations 69—		
Article 23	3172	26
Article 89	3200	59
Article 219	3136	74
Article 343	3185	77
Article 601	3269	90
Article 621	3068	91
Article 632	3290	99
Article 1304	3173	121
Regulations 71, article 80	3109	330
Amortization:		
Assets transferred in postwar reorganization	3265	236
Facilities purchased by Government, acquired by contractor after war period	3217	233
Annuities, payments, real estate conveyance, taxability	3047	12
Appeals and hearings, Board of Tax Appeals. (*See* United States Board of Tax Appeals.)		
Appropriations supplying deficiencies, 1927 and prior years	3178	131
Arizona, community property and income, income from separate estate and community, how reported	3122	26
Assessment of taxes. (*See* Taxes.)		
Assets, transferred:		
Penalty and interest against dissolved corporation, transferees' liability	3081	117
Tax liability terminated before 1926 Act, assessment limitation	3042	115
Associations, Massachusetts, subsequently incorporated, separate returns	3099	256
Attorney fees. (*See* Fees.)		
Attorneys and agents:		
Agents, waiver filed under general power of attorney	3080	104
Disbarments and suspensions	3288	358
Automobiles:		
Business trucks and passenger cars traded in purchase of new machines, losses	3242	168
Damaged by unauthorized use, losses	3263 3264	219 220
Parts and accessories, refund claim requirements by manufacturers	3213	299
B.		
"Back royalties" payment to Government under leasing Act, deduction	3262	208
Bad debts:		
Change from reserve method, 1926 and subsequent years, procedure	3207	67
Requirements under section 234(a)5, 1918 Act	3188	220
Reserves—		
Article 155, Regulations 62 and 65, amended	3153 3154	143 222
Method of treatment under Revenue Acts of 1921, 1924, and 1926	3192	68
Personal property on installment plan, deduction	3281	69
Bankruptcy, discharge of tax lien, authority for filing	3041	103
Banks:		
Liberty bonds exchanged for Treasury notes, loss deduction	3184	87
National, amalgamation, "merger," and "consolidation" distinguished, returns	3273	92
Bar pilots, compensation, San Francisco	3272	54
Bequests, income from trust fund	3278	189
Beverages sold in closed containers: Basis of tax	3107	301

	Ruling No.	Page.
Bonds:		
Abatement claim, suit to recover on, tax validity as defense	3147	149
Conversion into stock, discount, amortization treatment	3202	86
Exchange of. (*See* Exchanges.)		
Interest, foreign corporations' income, withholding, Regulations 69, amended	3269	90
Liberty. (*See* Liberty bonds.)		
Municipal, convertible certificates of ownership, interest, exemption	3206	29
Tax-free covenant clause, example	3093	80
Bonus, oil and gas property, lessor of unproven areas, depletion	3256	73
Building and loan associations. (*See* Exempt corporations.)		
Bureau of Prohibition, effective date April 1, 1927, legislation and procedure	3163 3211	346 350
Business expenses:		
Additional compensation, services rendered in prior years	3060	205
Attorney's fees, defense of accounting action by former partner	3084	202
"Back royalties" payment to Government under leasing Act	3262	208
Contributions, chamber of commerce, revision of freight rates	3231 3232	59 62
Dividends on stock in trust, corporate officer's additional compensation	3249	90
Dues, protective service against fraudulent practices	3255	63
Judgments—		
Affirmed in later year, deduction	3270	214
Payment to another of prior earned profits, when deductible	3284	171
Oil and gas wells, incidental expenses, 1925 election	3079 3289	74 75
C.		
California, community property and income, earnings of spouses and minor child, separate property by parol agreement	3230	32
Capital expenditures:		
Buildings, use of retrospective appraisal	3135	281
Mines, development costs	3135	281
Oil and gas wells—		
Drilling costs, assignee of lease interest	3070	241
Incidental expenses, 1925 election	3079 3289	74 75
Capital gains, cash in excess of basis of old stock under reorganization	3094	168
Capital losses, computation methods, section 208, 1924 Act	3167	140
Capital net loss. (*See* Capital losses.)		
Cereal beverages:		
Regulations governing statement of production	3076	343
Amended	3142	344
Chamber of commerce, contributions for revision of freight rates	3231 3232	59 62
Choctaw Tribe member, refund of erroneous tax payment, limitation	3030	123
Cigars, tax on, refund under 1926 Act, gross income	3201	66
Claims:		
Abatement, bond in support of, condition breached, tax validity as defense	3147	149
Credit or refund. (*See* Credit or refund.)		
Refund of taxes. (*See* Credit or refund.)		
Transferred assets, assessment where transferor's liability terminated before 1926 Act	3042	115
Collection of taxes. (*See* Taxes: Collection.)		

	Ruling No.	Page.
Community property and income:		
Earnings of spouses and minor child, separate property by parol agreement, California	3230	32
Income from separate estate and community, Washington or Arizona, how reported	3122	26
Texas, profits from sale of husband's separate personal property	3215	187
Compensation:		
Additional—		
Dividends on stock in trust, business expense	3249	90
Services rendered in prior years	3060	205
Officers' salary deduction, reasonableness	3187	203
State officers and employees. (*See* State: Officers and employees.)		
Compromise, taxes and penalties, subsequent suit to recover	3134	274
Computation:		
Capital net loss, section 208, 1924 Act	3167	140
Surtax, sale of mine	3130	176
Confirmation of permits to purchase liquor:		
Regulations governing amended	3077	341
Request for vendor's copy	3162	341
Treasury Decision 3958 amended	3119	340
Consolidated returns. (*See* Returns.)		
Contributions:		
Chamber of commerce, revision of freight rates	3231 3232	59 62
National Society of the Daughters of the American Revolution	3059	82
Corporations:		
Affiliation—		
Consolidated returns. (*See* Returns.)		
Intercompany transactions attending subsidiary's dissolution, gain or loss	3223	260
Amortization, assets transferred in postwar reorganization	3265	236
Dissolved—		
Penalty and interest, transferees' liability	3081	117
Stockholders' tax liability	3100 3194	264 267
Distributions—		
Pending operating deficit, taxability	3220	10
Premium on capital stock, dividend	3092	9
Dividends on stock in trust, officer's additional compensation, deduction	3249	168
Exemption. (*See* Exempt corporations.)		
Foreign—		
Bank acceptances purchased at discount, taxable income	3049	76
Withholding, Regulations 69, amended	3269	90
Massachusetts, formerly association, separate returns	3099	256
Personal service—		
Article 1524, Regulations 45 and 62, amended	3227	161
Commission business, substantial capital employed	3117	154
Consolidated returns, Regulations 62, amended	3228	258
Returns. (*See* Returns.)		
Waiver by agent, general power of attorney	3080	104
Court decisions:		
Alliance Country Club v. *United States*	3072	302
Anderson, collector, v. *McNeir*	3149	310
Bowers, collector, v. *Fuller*	3195	268
Bowers, collector, v. *New York & Albany Lighterage Co*	3195	268
Bowers, collector, v. *Seaman*	3195	268
Capps Manufacturing Co. v. *United States*	3100	264
Chapman v. *United States*	3291	164
Chattanooga Savings Bank, administrator, v. *Brewer, collector*	3137	161
Consolidated Tea Co., Inc., v. *Bowers, collector*	3270	214

	Ruling No.	Page.
Court decisions—Continued.		
Duffy, former collector, v. *Mutual Benefit Life Insurance Co*	3086	278
Farmers Loan & Trust Co., trustee, v. *Bowers, collector*	3139	318
Fowler et al. v. *United States*	3130	176
Georgetown Grocery Co. v. *United States*	3188	220
Goodyear Tire & Rubber Co. v. *United States*	3150	332
Gray Motor Co. et al. v. *United States*	3147	149
Heiner, collector, v. *Beatty, executrix*	3278	189
Irving Bank-Columbia Trust Co. v. *United States*	3089	328
Kirby v. *United States*	3148	163
Kornhauser v. *United States*	3084	202
Lane & Co. v. *United States*	3117	154
Lederer, executrix, v. *Parrish & Co*	3104	242
Lindsay v. *Bowers*	3095	200
Little Cahaba Coal Co. v. *United States*	3135	281
Lukens v. *United States*	3071	292
Mitchell, Ormsby McKnight, v. *Bowers, collector*	3132	244
Motter v. *Derby Oil Co*	3106	294
Old Colony Trust Co. et al., executors, v. *Malley, collector*	3088	326
Page v. *United States*	3073	304
Red Wing Malting Co. v. *Willcuts, collector*	3131	225
Reid v. *Rafferty*	3098	246
Reinecke v. *Jennings & Co*	3138	306
Rice v. *Eisner*	3102	182
Ritter v. *United States*	3193	128
Seinsheimer Paper Co. v. *United States*	3187	203
Tindle v. *Heiner*	3096	217
Tucker v. *Alexander*	3101	287
United States v. *Fairall et al*	3194	267
United States v. *Northern Finance Corporation*	3085	263
Verner, executor, v. *United States*	3103	185
Walker, former collector, v. *Alamo Foods Co*	3134	274
Whitlock-Rose, executor, v. *McCaughn, collector*	3087	323
Wiener v. *Routzahn*	3097	222
Wiener v. *Weiss*	3097	222
Credit or refund:		
Appropriations supplying deficiencies, 1927 and prior years	3178	131
Choctaw Tribe member, erroneous tax payment, limitation	3030	123
Claims—		
Basis of subsequent suit, prerequisities	3101 3131	287 225
Correspondence as basis, sufficiency	3274	122
Exemption certificates not filed prior to February 1, limitation	3275	145
Formal written, basis of suit, prerequisite	3193	128
Generalities as basis, sufficiency	3043	119
Reopening on acquiescence of Tax Board ruling	3060	205
Requirements by manufacturers of automobile parts and accessories	3213	99
Taxes, interest, and penalties, article 1304, Regulations 69, amended	3173	121
Initiation fees	3037	291
Invested capital decrease, no profits tax liability, limitation	3116	126
Taxes, cigars, refund under 1926 Act, gross income	3201	66
Waivers, executor, New York, ratification by court, validity	3233	151
Credits:		
Earned income—		
Extension by withholding agents	3065	20
Interest and dividend on securities	3029	21
$20,000 limitation, application to section 213(b)14, 1926 Act	3166	58

	Ruling No.	Page.
Credits—Continued.		
Excess profits tax—		
Fiscal year ended in 1917	3133	256
Partner's share in individual return	3098	246
Personal exemption, father supporting minor son in mother's custody	3239	75
D.		
Deeedents, estates. (*See* Estates and trusts.)		
Deferred-payment sales, personal property. (*See* Sales: Personal property.)		
Deficiencies, taxes. (*See* Taxes.)		
Definitions:		
"Initiation fees"	3071 3072 3073	292 302 304
"Other casualty," section 214(6), Act of 1918	3263 3264	219 220
"Reorganizing," section 203, Act of 1924	3257	138
Depletion:		
Computation under section 204(c)2, article 219, Regulations 69, amended	3136	74
Oil and gas wells—		
Allowance under 1926 Act, charging off books	3221	20
Capital charges and deductions, 1925 election	3079 3289	74 75
Drilling costs, assignee of lease interest	3070	241
Income from sale of royalty interest	3056	19
Interest acquired in exchange for leasehold, computation	3204	240
Leases—		
Exchanged for stock, allowance before and after affiliation	3223	260
Repossession under sale contract, vendor retaining title	3032	191
Royalties, expected, and lessor's bonus received on unproven areas, treatment	3256	73
Section 204(c)2, 1926 Act	3028	18
Trust beneficiaries receiving royalty income	3243	252
Property acquired by gift, bequest, etc., before or after March 1, 1913, basis	3069	144
Depreciation:		
Leases exchanged for stock, allowance before and after affiliation	3223	260
Lessee, 99-year lease renewable forever, buildings erected by lessor	3097	222
Life beneficiary and remainderman, real estate trust	3183	69
Property acquired by gift, bequest, etc., before or after March 1, 1913, basis	3069	144
Trust property sale, life beneficiary's and remainderman's apportionment	3248	71
Development expenses, mines, capitalization	3135	281
Disbarments. (*See* Attorneys and agents: Disbarments and suspensions.)		
Discharge of tax lien, filing after discharge in bankruptcy, authority	3041	103
Discount:		
Bonds converted into stock, amortization treatment	3202	86
Cash, reserves, accounts on accrual basis	3168 3169	177 178
Distraint, collection of taxes. (*See* Taxes: Collection.)		

	Ruling No.	Page.
Distributions:		
Dividends, earnings available, entire year as a unit	3156	10
Operating deficit, no surplus, taxability	3220	10
Premium on capital stock	3092	9
Presumption as to earnings from which paid	3148	163
Stock, treatment under several reorganizations	3165	15
Withdrawals, unauthorized, declared as dividends in subsequent year	3137	161
Dividends:		
Earnings available, entire year as a unit	3156	10
Officer's additional compensation, business expenses	3249	90
Operating deficit, distribution treated as return of capital	3220	10
Payment to trustees under stock purchase plan	3058	78
Premium on capital stock	3092	9
Presumption as to earnings from which paid	3148	163
Securities, dealer in, earned income credit	3029	21
Stock received as, sale of	3291	164
Stock subscription rights	3050	135
	3052	191
	3082	133
Withdrawals, unauthorized, formal declaration in subsequent year	3137	161
Dues and initiation fees:		
Claims for refund by club	3072	302
Initiation fee and payment for stock	3071	292
	3072	302
	3073	304
Initiation fee defined	3071	292
	3072	302
	3073	304
Initiation fees, Regulations 43–II amended	3036	291
Protective service against fraudulent practices, business expenses	3255	63
Refunds, Regulations 43–II amended	3037	291
E.		
Earned income credits. (*See* Credits.)		
Equivalent exemption, Netherlands, earnings of documented ships, regulations amended	3200	59
Estate tax:		
Insurance taxable	3118	315
Net estate—		
Computation of	3088	326
Inclusive of Federal estate tax	3088	326
	3089	328
Power of appointment, property passing under	3087	323
Property held jointly or as tenants by the entirety	3038	314
Transfers by decedent in his lifetime	3118	315
	3139	318
Estates and trusts (*see also* Trusts):		
Decedent's estate during administration, amendment of regulations	3185	77
	3186	248
	3196	249
Decedent's real estate, Idaho, sale during administration, executor's liability	3208	78
Executors, waiver of limitation period. (*See* Limitation period: Waiver by administrators or executors.)		
Real estate, life beneficiary's and remainderman's depreciation allowance	3183	69
Trust beneficiaries receiving royalty income, depletion	3243	252

	Ruling No.	Page.
Estates and trusts—Continued.		
Trust income, friendly suit by trustee-beneficiaries, by whom returned	3210	249
Trust sale, life beneficiary's and remainderman's depreciation apportionment	3248	71
Excess profits taxes. (*See* Taxes: Excess profits.)		
Exchange rates (*see also* Foreign exchange):		
Foreign, December 31, 1926	3066	21
Exchanges:		
Assets for stock, reorganization, gain or loss	3257	138
Bonds for municipal and nonindustrial bonds, gain or loss	3234	166
Business trucks and passenger cars traded in purchase of new machines, losses	3242	168
Real estate conveyance for annuity contract, gain or loss	3047	12
Second Liberty loan bonds for Treasury notes, gain or loss	3254	51
Stock, reorganization	3064 3094 3280	18 168 13
Exempt corporations:		
Building and loan associations, loans to members conditioned upon subscription to installment stock	3144	82
Final determination and assessment, agreement request	3031	127
Funds administered for benefit of regular contributors	3145	83
National Society of the Daughters of the American Revolution	3059	82
Procedure respecting application for exemption, section 231, 1926 and prior Acts	3226	81
Retail merchants' association	3261	85
Exemption:		
Corporations. (*See* Exempt corporations.)		
Income, State officers and employees. (*See* State: Officers and employees.)		
F.		
Fees, attorneys', defense of accounting action by former partner, deduction	3084	202
Fiscal year, ended in 1917, excess profits tax credit	3133	256
Foreign:		
Corporations. (*See* Corporations.)		
Exchange, rates prevailing December 31, 1926	3066	21
G.		
Gain or loss:		
Exchange of property. (*See* Exchanges.)		
Intercompany transactions attending subsidiary's dissolution	3223	260
Oil and gas lease, repossession under sale contract, vendor retaining title	3032	191
Repossession of real property by surrender of purchaser's obligations	3040	45
Sales. (*See* Sales.)		
Stock distribution under several reorganizations	3165	15
Gifts:		
Demonstration plant acquired without cost	3216	197
Bequest of income from trust fund	3278	189
Gift tax, constitutional	3149	310
Good will, obsolescence	3131	225
Gross income:		
Annuity payments for conveyance of real estate	3047	12
Bequest of income from trust fund	3278	189
Community income. (*See* Community property and income.)		

	Ruling No.	Page.
Gross income—Continued.		
Compensation—		
Bar pilots, San Francisco	3272	54
State officers and employees. (*See* State: Officers and employees.)		
Demonstration plant acquired without cost	3216	197
Income from separate estate and community, Washington or Arizona, how reported	3122	26
Interest—		
Convertible certificates of ownership in municipal bonds	3206	29
Duplicate, second Liberty loan bonds exchanged for Treasury notes	3254	51
Unpaid, remission by vendor on repossession of property	3048 3051	46 142
Officers and employees, medical director of county public hospital	3247	52
Oil and gas lease, repossession under sale contract, vendor retaining title	3032	191
Partner's interest assigned to wife, how reported	3132	244
Profits from sale of husband's personal property, Texas	3215	187
Repossession—		
Real estate sold on deferred-payment basis	3146	195
Real property by surrender of purchaser's obligations	3040	45
H.		
Husband and wife:		
Assignment of partnership interest to spouse	3132	244
Community property and income. (*See* Community property and income.)		
I.		
Idaho, decedent's real estate, sale by executor, estate's liability	3208	78
Income from sources within United States, aliens, nonresident, bank acceptances purchased by foreign corporation at discount	3049	76
Income from sources without United States, earned income, application of $20,000 limitation	3166	58
Informal claim for refund, correspondence as basis, sufficiency	3274	122
Injunction against collection vacated	3138	306
Installment sales. (*See* Sales.)		
Insurance companies:		
Affiliated member's lower tax rate, applicability to group	3240	98
Mutual life, reserved, invested capital, inclusion	3086	278
Insurance, war risk life, reinstatement of policies by veterans of World War	3090	356
Interest:		
Bonds, foreign corporation, withholding, Regulations 69, amended	3269	90
Convertible certificates of ownership in municipal bonds, exemption	3206	29
Deficiency in payment of tax. (*See* Interest: Taxes.)		
Second Liberty loan bonds exchanged for Treasury notes, duplicate interest exemption	3254	51
Securities, dealer in, earned income credit	3029	21
Taxes, dissolved corporation, transferees' liability	3081	117
Unpaid, remission upon repossession of real property	3048 3051	46 142
Inventories, copper ore, mining and selling companies	3284	171
Invested capital:		
Decrease, insufficient deductions, no profits tax liability, refund limitation	3116	126
Mines, development costs, limitation	3135	281
Reserves, insurance companies, mutual life, without capital stock	3086	278

	Ruling No.	Page.
J.		
Judgments:		
Accounting for earlier year profits, when deductible	3284	171
Appeal, affirmed later year, accrual basis, deduction	3270	214
L.		
Leases:		
Depreciation. (*See* Depreciation.)		
Oil and gas—		
Assignee's drilling costs, consideration for part interest, depletion	3070	241
Interest acquired in exchange, depletion computation	3204	240
Repossession under sale contract, vendor retaining title, gain or loss	3032	191
Liberty bonds:		
Exchange by banks for Treasury notes, loss deduction	3184	87
Exchange for Treasury notes, duplicate interest, exemption	3254	51
Liens:		
Discharge (Form 669) filed after discharge in bankruptcy, authority	3041	103
Federal taxes, filing of notices—		
Montana	3177	104
West Virginia	3282	104
Release upon filing indemnity bond with abatement claim	3159	270
Limitation period:		
Assessment—		
Appeal filed with Board prior to enactment of 1926 Act, suspension	3203	107
Transferor's liability terminated before 1926 Act	3042	115
Claims for credit or refund—		
Choctaw Tribe member, erroneous tax payment	3030	123
Exemption certificates not filed prior to February 1	3275	145
Invested capital decrease, no profits tax liability	3116	126
Collection of taxes—		
Distraint after expiration of 5-year period	3195	268
Distraint or suit where 5-year period expired prior to 1924 Act	3209	109
Suit, commencement, writ service	3085	263
Credit or refund. (*See* Limitation period: Claims for credit or refund.)		
Instituted last day of 5-year period	3147	149
Suits to collect taxes, extension under 1921 Act	3100	264
Waiver by administrators or executors, New York, ratification by court, validity	3233	151
Waivers—		
Absence of corporate seal and Commissioner's signature, validity	3250	110
Agent, general power of attorney, profits tax not specified	3080	104
Losses:		
Attorney's fees, defense of accounting action by former partner	3084	202
Automobile damaged by unauthorized use	3263 3264	219 220
Business trucks and passenger cars traded in purchase of new machines	3242	168
Liberty bonds exchanged by banks for Treasury notes	3184	87
Partnership, guarantee by individual member, deduction	3104	242
Residential property, sale of	3096	217

	Ruling No.	Page.
M.		
Manufacturer's excise:		
Automobile parts and accessories, refund claim requirements	3213	299
Basis of tax	3105	297
Discounts and expenses	3189	298
Injunction against collection vacated	3138	306
Massachusetts, association subsequently incorporated, separate returns	3099	256
Medical director of county public hospital, compensation, gross income	3247	52
Mines:		
Development costs, capitalization, limitation	3135	281
Sale of, surtax computation	3130	176
Minnesota, taxes, real property, effective date of accrual	3124	63
Montana, Federal tax lien, filing of notices	3177	104
Municipal bonds. (*See* Bonds.)		
Mutual insurance companies. (*See* Insurance companies.)		
N.		
National Society of the Daughters of the American Revolution, exemption	3059	82
Netherlands, equivalent exemption, earnings of documented ships, regulations amended	3200	59
Net losses, computation, exclusion from gross income of gift value	3216	197
New York:		
Society for Prevention of Cruelty to Children, officer's salary, exemption	3095	200
Waivers—		
Absence of corporate seal and Commissioner's signature, validity	3250	110
Executor filing, ratification by court, validity	3233	151
O.		
Obsolescence, good will	3131	225
Oil and gas wells:		
Capital charges or deductions, 1925 election	3079 3289	74 75
Depletion. (*See* Depletion.)		
Drilling costs, assignee of lease interest, depletion	3070	241
Leases, repossession under sale contract, vendor retaining title, gain or loss	3032	191
Royalties, payments to Government under leasing Act	3262	208
Oleomargarine:		
Certain substances known or styled as cooking compounds	3190	333
Statistics of production and materials used—		
November, 1926 and 1925	3044	334
December, 1926 and 1925	3110	335
January, 1927 and 1926	3151	336
February, 1927 and 1926	3179	337
March, 1927 and 1926	3236	338
April, 1927 and 1926	3267	339
Oregon, estate by the entirety, collection of tax by distraint	3125	101
"Other casualty," statutory construction	3263 3264	219 220
P.		
Partnerships:		
Assignment of member's interest to wife	3132	244
Excess profits tax credit, member's individual return	3098	246
Losses guaranteed by individual member, deduction	3104	242
Penalties. (*See* Taxes: Penalties.)		
Personal exemption. (*See* Credits.)		

	Ruling No.	Page.
Personal expenses, attorney's fees, defense of accounting action by former partner	3084	202
Personal property:		
Installment sales. (*See* Sales: Installment.)		
Sales. (*See* Sales: Personal property.)		
Personal service corporations. (*See* Corporations.)		
Procedure:		
Applications for exemption, section 231 of 1926 Act and prior Acts	3226	81
Bad debt deduction, change from reserve basis, 1926 and subsequent years	3207	67
Bureau of Prohibition legislation, effective date	3163 3211	346 350
Proclamation by President of United States relative reinstatement of war risk life insurance policies by veterans of World War	3090	356
Prohibition:		
Alcohol completely denatured on hand, report required	3034 3140	345 345
Cereal beverages—		
Regulations governing statements of production	3076	343
Amended	3142	344
Dealers' records and reports, Regulations 61 amended	3074	346
Permits to purchase liquor—		
Confirmation requirements revoked	3077 3119	341 340
Request for vendor's copy	3162	341
Treasury Decision 3958 amended	3119	340
Procurement of tax-paid wine for use in manufacture of vinegar; regulations amended	3170	342
Regulations promulgating separate bureau, effective date April 1, 1927, procedure	3163 3211	346 350
Revocations—		
Permits	3033	344
Treasury Decision 3999 [page 346]	3211	350
R.		
Real estate:		
Installment sales. (*See* Sales: Installment.)		
Repossession, remission of unpaid interest	3048 3051	46 142
Sale of. (*See* Sales.)		
Real estate taxes, effective date of accrual, Minnesota	3124	63
Records, copies, charges for furnishing	3115	100
Refunds. (*See* Credit or refund.)		
Regulations:		
Amendments. (*See* Amendments: Regulations.)		
Creating separate Prohibition Bureau, effective date, April 1, 1927	3163 3211	346 350
Governing monthly statements of production of cereal beverages	3076	343
Retroactivity—		
Article 39, Regulations 69	3529	36
Reorganization:		
Assets exchanged for stock, gain or loss	3257	138
Consolidation, exchange of stock and sale of assets, gain or loss	3280	13
Stock—		
Distributions, gain or loss	3165	15
Exchanges—		
Similar stock and "other property," valuations	3064	18
Stock and cash consideration, capital gain	3094	168
Repossession of real estate sold on deferred-payment basis	3146	195

	Ruling No.	Page.
Reserves:		
Bad debts—		
Article 155, Regulations 62 and 65, amended	3153 3154	143 222
Change to specific deduction method, 1926 and subsequent years, procedure	3207	67
Method of treatment under Revenue Acts of 1921, 1924, and 1926	3192	68
Personal property on installment plan, deduction	3281	69
Cash discount, accounts on accrual basis	3168 3169	177 178
Insurance companies, mutual life, invested capital	3086	278
Residential property, sale of, loss deduction	3096	217
Retail merchants' association, exemption	3261	85
Returns:		
Amended—		
Accounting period and returns on different basis, requirements	3158	178
Installment basis prior to 1926, requirements in subsequent years	3175	41
Consolidated—		
Affiliated corporations—		
Member entitled to insurance company's lower rate, computation for group	3240	98
Right of election, taxable year 1925	3157	96
Right of election, taxable year 1925, Regulations 69 amended	3290	99
Stock ownership, change in, article 634, Regulations 45, 62, and 65, amended	3283 3285 3286	148 258 259
Article 632, Regulations 62, amended	3228	258
Copies, charges for furnishing	3115	100
Corporations—		
Article 621, Regulations 69, amended	3068	91
Banks, national, amalgamation of, "merger" and "consolidation" distinguished	3273	92
Massachusetts, formerly association, filing requirements	3099	256
Husband and wife, earnings as separate property by parol agreement, California	3230	32
Revenue Act of 1918:		
Bad debts, requirements under section 234(a)5	3188	220
Procedure respecting application for exemption under section 231	3226	81
Revenue Act of 1921:		
Procedure respecting application for exemption under section 231	3226	81
Reserves for bad debts, method of treatment	3192	68
Revenue Act of 1924:		
Procedure respecting application for exemption under section 231	3226	81
Reserves for bad debts, method of treatment	3192	68
Section 208, capital net loss computation methods	3167	140
Revenue Act of 1926:		
Claims against transferred assets, limitation period	3042	115
Earned income limitation, application to section 213(b)14	3166	58
Final determination under section 1106(b), qualification of parties to agreement	3031	127
Interest on deficiencies, assessment under prior Acts	3241	105
Procedure respecting application for exemption under section 231	3226	81
Reserves for bad debts, method of treatment	3192	68
Royalties, oil and gas property:		
"Expected to be received," depletion	3256	73
Income from sale, depletion	3056	19
Payments to Government under leasing Act	3262	208

	Ruling No.	Page.
S.		
Salaries. (*See* Compensation.)		
Sales:		
Installment—		
Personal property—		
Amended returns prior to 1926, requirements in subsequent years	3175	41
Bad debt reserves, deduction	3281	69
Single transaction on unusual credit terms, taxpayer's accounts on accrual basis	3057	22
Tax originally computed on deferred-payment basis, deficiency abatement	3113	38
Real estate—		
Accounts kept on accrual basis, amended return	3067	37
Deferred-payment plan, foreclosure and repossession	3146	195
Proceeds from sale of purchaser's obligations, "initial payment"	3123	42
Requirements for computing income for prior years	3114	40
Mines, surtax computation	3130	176
Personal property—		
Deferred-payment, no evidence of indebtedness covering balance, profit computation	3176	48
Husband's separate estate, Texas, taxable status of profits	3215	187
Real estate—		
Decedent's, Idaho, profits reported as estate income	3208	78
Deferred payment. (*See* Sales: Installment.)		
Installment plan. (*See* Sales: Installment.)		
Mortgage securing loan canceled in initial payment	3222	43
Repossession by surrender of purchaser's obligations, gain or loss	3040	45
Selling and incidental expenses, treatment	3128	43
Residential property, loss deduction	3096	217
Rights to subscribe to stock of another corporation	3050 3052 3082	135 191 133
Royalty interests in oil and gas properties, income from, depletion	3056	19
Stock—		
Common and dividend, gain or loss computation	3291	164
Dividends. (*See* Dividends: Stock.)		
Received as dividends, income resulting from, treatment	3291	164
Subscription rights. (*See* Sales: Rights to subscribe.)		
Stock rights—		
Date of issuance, determination of	3182	35
Retroactive application, article 39, Regulations 69	3259	36
Trust property, life beneficiary's and remainderman's depreciation apportionment	3248	71
San Francisco, bar pilots, compensation	3272	54
Securities, dealer in, interest and dividends, earned income credit	3029	21
Stamp tax:		
Passage tickets, exemption for American Legion	3197	330
Sale of adhesive stamps; regulations amended	3109	330
Stock transfers, par value shown by charter	3150	332
State:		
Officers and employees, compensation—		
Bar pilots, San Francisco	3272	54
Medical director of county public hospital	3247	52
New York Society for Prevention of Cruelty to Children	3095	200
Taxes, income and property, accrual	3129	65
Stock:		
Distribution under several reorganizations, gain or loss	3165	15
Exchange of. (*See* Exchanges.)		

	Ruling No.	Page.
Stock—Continued.		
Rights to subscribe to, sale of. (*See* Sales: Stock.)		
Transfers, par value shown by charter	3150	332
Stock purchase plan, dividend payment to trustees for employees, status	3058	78
Stockholders liability for dissolved corporation's taxes, judgment	3100	264
conditions precedent to suit	3194	267
Subscription rights, sale of. (*See* Sales: Rights to subscribe to stock.)		
Suits:		
Collection of taxes—		
Bond supporting abatement claim, tax validity as defense, limitation period	3147	149
Dissolved corporation, stockholders' liability	3100	264
	3194	267
5-year period expired prior to 1924 Act	3209	109
Writ service, commencement of suit, limitation	3085	263
Recovery of amount offered in compromise	3134	274
Recovery of taxes—		
Claim for refund, formal, prerequisite	3193	128
Grounds presented in refund claim, prerequisite	3101	287
	3131	225
Surtaxes. (*See* Taxes.)		
Suspensions. (*See* Attorneys and agents: Disbarments and suspensions.)		
T.		
Taxes:		
Abatement, excess from changing prior year sale to installment basis	3113	38
Assessment—		
Distraint, estate by the entirety, Oregon	3125	101
Final determination, exempt corporation	3031	127
Limitation period. (*See* Limitation period.)		
Cigars, refund under 1926 Act, gross income	3201	66
Collection—		
Distraint, limitation period expired	3195	268
	3209	109
Suits. (*See* Suits.)		
Compromise, subsequent suit to recover	3134	174
Credits for. (*See* Credits.)		
Deficiencies, assessment, waiver by agent with general power of attorney	3080	104
Estate. (*See* Estate tax.)		
Excess profits. (*See* Taxes: War-profits and excess-profits.)		
Federal, liens. (*See* Liens: Federal taxes.)		
Final determination and assessment, exempt corporation	3031	127
Income, State, accrual basis, when deductible	3129	65
Liens for Federal taxes. (*See* Liens: Federal taxes.)		
Payment, liens for. (*See* Liens: Federal taxes.)		
Penalties, dissolved corporation, transferees' liability	3081	117
Property, State, accrual	3129	65
Real property, effective date of accrual, Minnesota	3124	63
Refund or credit. (*See* Credit or refund.)		
Stamp. (*See* Stamp taxes.)		
Surtax, mines, sale of, computation	3130	176
Waiver of statute of limitation. (*See* Limitation period.)		
War-profits and excess-profits—		
Excess-profits—		
Credits, fiscal year ended in 1917	3133	256
Waiver, agent's general power of attorney in income tax matters	3080	104
Tax-free covenant clause, example	3093	80

	Ruling No.	Page.
Texas, husband's separate personal property, profits from sale, taxable status	3215	187
Transferees:		
Assessment where transferor's liability terminated before 1926 Act	3042	115
Penalty and interest against dissolved corporation, liability	3081	117
Transportation of oil by pipe line	3106	294
Trust fund, bequest of income from, taxability	3278	189
Trusts (*see also* Estates and trusts):		
Beneficiaries receiving royalty income, depletion	3243	252
Dividend payment under stock purchase plan to employees, status	3058	78
Real estate, life beneficiary's and remainderman's depreciation allowance	3183	69
Sale of real estate, life beneficiary's and remainderman's depreciation apportionment	3248	71
U.		
United States Board of Tax Appeals:		
Appeals filed prior to enactment of 1926 Act, limitation suspension	3203	107
Decisions, list of acquiescences and nonacquiescences	3279 3287	1 308
Ruling acquiescence grounds for reopening refund claim	3060	205
V.		
Vinegar, procurement of tax-paid wine for use in manufacture of, regulations [T. D. 3942, C. B. V–2, 264] amended	3170	342
W.		
Waivers of statute of limitations. (*See* Limitation period: Waivers.)		
War risk life insurance policies, reinstatement of, by veterans of World War	3090	356
Washington, community property and income, income from separate estate and community, how reported	3122	26
West Virginia, Federal tax lien, filing of notices	3282	104
Withdrawals, unauthorized, declared as dividends in subsequent year	3137	161
Withholding at source:		
Earned income credit extended by withholding agent	3065	20
Exemption certificates not filed prior to February 1, credit or refund, limitation	3275	145
Foreign corporation's income, Regulations 69, amended	3269	90
Tax-free covenant clause, example	3093	80
Writs, commencement of suits to collect taxes, limitation	3085	263

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